United Petroleum Pty Ltd
ACN 085 779 225

Friday, July 27, 2007

Mr Graeme Samuel
Chairman
Petrol price inquiry
Australian Competition and Consumer Commission
GPO Box 520
Melbourne
Victoria 3001

Dear Mr Samuel,

Re: Inquiry into the price of unleaded petrol

We hereby make our submission to your inquiry into the price of unleaded petrol.

Background

United Petroleum Pty Ltd (United) is Australia's largest independent petrol retailer and operates nationally. United purchases its petrol supplies from Shell and Mobil and resells it to the public, through a network of 189 United Branded locations. United is an independent fuel discounter and has introduced petrol discounting in numerous country markets.

Independent Fuels Australia Pty Ltd (IFA), Andrews Oil Pty Ltd, and Norvac Pty Ltd, which are companies associated with United supply approximately another 300 independent service stations.

United is very concerned about the state of competition in the downstream oil industry. We believe that substantial divergence between movements in domestic petrol prices and movements in the international benchmark price for refined petrol that the ACCC detected, is a symptom of an industry out of balance with falling levels of retail competition.

Importance of the participation of Independents

Independents in the Australian retail petrol industry have historically driven competition in the market and were always considered to be the drivers of the retail petrol price cycle. In this regard regulators introduced measures such as the Sites Act in order to ensure that the Oil Majors were unable to vertically integrate and control the market. Recently this legislation was abolished and replaced with Oil Code which provides no such protection.

Following the introduction of the Shopper Dockets by Coles and Woolworths the numbers of independents have been decimated in all metropolitan markets in Australia. It has also "clipped the wings" of the remaining independents and drastically reduced their ability to compete. Independents do not any longer drive the price cycle and are now in many cases just "market followers".

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Without strong independent participation in the market and where there are barriers to entry for new independent competitors, there will be reduced competition and higher prices for consumers.

Shopper dockets and are not in the public interest

<u>Shopper dockets have decreased competition</u>

The introduction of the Shopper Docket has had the effect of channeling volume from other market participants to the Supermarket operators Coles and Woolworths. This third line forcing mechanism has particularly affected the independents in the market and stripped them of between 15% to 30% of their base volume. The customers that they have lost are the very price conscious shoppers who now have become Shopper Docket converts. The independent operator has been unable even with increased board discounting to claw back this lost ground. Due to the fact that much of the independent's costs are fixed then the gross margin in cents per litre required has increased, and therefore the independent operator must post a price with a higher margin to survive. Therefore most independents have altered their pricing strategies in order to live with lower volumes and higher margins.

- Higher prices for consumers – the retail margins of the Supermarkets and Oil Majors have grown.
- Supermarkets have gained huge volume increases through sites fuelled by the shopper dockets.
- The combination of higher board margins, higher supermarket grocery margins and increased volumes through sites has funded the docket discount.
- The price cycle is no longer driven by the independents and thus the whole price cycle (peak and trough) has moved up relative to the Singapore price.
- Price elasticity of demand has flattened therefore a price board which is lower than a competitor by say 0.2 cpl or 0.5 cpl – delivers a lesser volume benefit. Thus discounting of petrol as a business strategy for market participants is far less attractive and beneficial to the business. Market participants have increasingly put their efforts into new shop offers and other schemes to drive customers through their sites. Evidence of this flatter demand curve includes;
    - Independents and other market participants have not been able to claw back volume from the Supermarkets even in the face of vigorous discounting.
    - Many supermarket customers will still redeem their dockets even when the price board difference is less than 4 cpl. On days where the price cycle moves up, customers will at times redeem dockets and pay more for fuel at a Supermarket site even though independents are cheaper.
    - Many consumers report that they no longer take note of the board price as they simply rely on their docket => Many customers are locked into the supermarkets for fuel.
    - BP has bundled fuel with a Mastercard offer to try to attract more volume. Again price discounting clearly has not been working for this market participant.
    - Mobil have introduced a 4 cent per litre discount if the consumer buys $5.00 of convenience items in the store. This

measure has not been all that successful but is a way of capturing the customers that may not have ready access to a docket.

- The price board has become less important to the customer as an indicator of value and the Docket or loyalty scheme has grown in importance.
    - Price boards display the price after the application of a docket discount, despite the fact that less than half the potential customers redeem the docket. This has meant that the price is less transparent to the consumer.
    - Consumers regularly will redeem dockets and purchase fuel from Supermarket sites when the discounted price they pay is higher than board price for all customers at a competing site. Consumers increasingly concentrate on the value of the docket discount rather than considering the board price.
    - Independents and other market participants following suit with cross promotional offers of their own, again reducing price transparency to the consumer. These promotions are really no match for the Shopper Docket and are really quite ineffective.
- Different sites are closing - prior to the introduction of shopper dockets there were a number of small independents investing in new sites and rebuilds. Uneconomic sites including Shell and Caltex sites were closing and were being replaced with less newer larger independent and oil company sites. Since that time, the number of Coles and Woolworths sites have increased at the expense of independent sites. At the same time Mobil has accelerated its retail site closure program, and while in the past many of these outlets would have fallen into the hands of independents and re-opened, these are now also considered to be uneconomic by independents. This is leading to site number concentration in the hands of Supermarket market participants.
- Small Independents have left or are leaving the market;
    - Many small independents are closing their sites and leaving the industry. The sites where there is potential have been taken over by other market participants. This effect has been most marked in the metropolitan areas.
    - Medium sized independents are now seriously considering their futures in the industry, and planning their exits.

Consumers are now forced to collect dockets and now pay more for their fuel. The observations made in a Paper written by Joshua S. Gans and Stephen P. King ((16th July,2004) Supermarkets and Shopper Dockets: The Australian Experience) are being played out. They warn that, "….the spread of shopper docket schemes can lead to a reduction of competition in groceries and the petrol industry due to the exit of incumbent players and increased barriers to entry."[1]

<u>Shopper dockets link two unrelated products reducing competition in both markets</u>

The bundling of essentially unrelated products in two increasingly oligopolistic markets is a recipe for decreasing levels of competition in both markets. It is clear that Coles and Woolworths now dominate in the market for groceries and liquor, and increasingly the retail petrol market. These markets are all dominated by a small number of very large participants, and "both the retail grocery sector and petrol industry in Australia are relatively concentrated by international standards…….as this practice spreads such bundling may result in considerable loss of consumer welfare and long-term erosion of competitive pressures in the relevant industries."[2]

In December 2006 Coles launched a 12 cent per litre Shopper Docket promotion which Woolworths quickly matched. Clearly given the dominance of Coles and Woolworths in both the Grocery market and Retail Petrol market, Coles would have expected Woolworths to immediately follow. Given their respective shares of the grocery market one would have to question the intentions of this lengthy and expensive promotion as the discounted petrol price was well below cost price. This promotional behavior can seem like a boon for consumers and welcomed by consumers but damages competition in the market. In a Paper written by Joshua S. Gans and Stephen P. King ((16th July,2004) Supermarkets and Shopper Dockets: The Australian Experience) they note that, "….a firm may find bundling profitable because of its anti-competitive effects. Bundling may involve practices that are similar to predatory pricing…………The firm may use the bundled products to undermine competition in the potentially competitive sector, for example by effectively selling the tied product below cost."[3]

Supermarket dominance is a barrier to entry

- Bundling these effectively unrelated goods – groceries and fuel causes issues in both markets. Given the Oligopoly position of Coles and Safeway they can "lock' their customers into a grocery and fuel offer whereby the customer becomes less concerned with the price of either groceries (if the fuel offer is attractive enough) or the board price of fuel. It creates barriers in both markets and distorts the consumer's buying decisions.
- Independent supermarkets have for the most part also joined the "bandwagon"[4] and introduced their own Shopper Docket schemes and reverse docket schemes. These have been less successful but have been very necessary for them to be able to compete with Coles and Woolworths. It is today a reality that any new entrant into the grocery and liquor market will have to have a petrol offer. This need for a petrol offer has created a barrier to entry for new supermarket operators.
- Likewise any new entrant considering an entry into the retail petrol industry would need to consider whether they have an offer that can compete with the Shopper Docket offered by Coles and Woolworths. In a Paper written by Joshua S. Gans and Stephen P. King ((16th July,2004) Supermarkets and Shopper Dockets: The Australian Experience) they note that, "Bundling can also be used to raise barriers to entry in an industry. By bundling two products, an incumbent can make entry more difficult. If an entrant just comes in with one of the bundled products then it may only be able to access a small part of the potential market."[5]

Increasing levels of supermarket dominance by creeping acquisition

Woolworths introduced the Shopper Docket to Australia around 10 years ago with the explanation that it would be restricted to their supermarket car parks, therefore the bundled offer was essentially on the same premises and thus less of a third line forcing issue. Over time Woolworths expanded its participation by building outside of those car parks, leasing the Liberty Oil chain of sites (thus removing an independent competitor), taking over all the Caltex franchise sites, and buying out other small independents. Over the years Woolworths has built a very large market share and are continuing to open sites.

Coles entered the market by taking over the very large Shell retail network. Utilizing the Shopper Docket scheme has now built a very large and growing market share. Recently Coles have set up an acquisition program and are acquiring sites from Independents in order to increase the rate of growth of its market share.

Together the Supermarkets dominate the Retail petrol market and by creeping acquisition are slowly but surely removing more and more independents from the market.

Further, the third line forcing conduct that started at essentially the same location has now distorted consumers behaviour to such a degree that , independents on highway sites are affected by having to compete with Supermarket petrol sites where there are no actual Supermarkets in close proximity.

Supermarket dominance has reduced competition in wholesale fuels

Supermarket dominance in the Retail petrol market has exacerbated the tightness in supply in Australia following the closure of the Port Stanvac refinery and the introduction of the new Australian fuel standards.

Caltex formally was a very large wholesale supplier to independents. They have had to very significantly reduce supply to independents, due to the success of Woolworths and its demand for fuel. Therefore many former Caltex customers have had to take supply from other majors typically Mobil and BP, or from fuel distributors. The remaining independent customers have faced arrangements upon less favorable terms as Caltex seeks to grow its profitability.

The success of Coles and its growing fuel demands have also lead Shell down the path of reducing its reliance on selling fuel to the smaller independents and also winding back the terms to the remaining customers.

Prior to the launch of the Coles / Shell alliance the four majors were all quite interested in supplying the small independent petrol market, upon much more flexible arrangements. Today a small independent realistically faces a choice between supply from BP (on a branded basis), or from fuel distributors. If the independent takes supply from either BP or from fuel distributors the arrangements are likely to be very tight and inflexible.

We expect this tightness in the market to continue and it has increased the pressure on smaller independents and has further discouraged them to continue in the industry. This reduction in the choices of supply may lead ultimately to set up supply as the new barrier to entry for new market participants.

Solutions to increase competition

United Petroleum believes that the substantial divergence between movements in domestic petrol prices and movements in the international benchmark price for refined petrol that the ACCC detected, is a symptom of an industry out of balance with falling levels of retail competition. One of the main reasons the industry is out of balance is the uneven playing field that the Shopper Docket has created. This has lead to the Supermarkets absolutely dominating the retail petrol market and lead to ever increasing market shares of the Supermarkets.

In order to restore strong competition in the retail petrol market the ACCC must take steps to even up the "playing field". We propose the following measures;

Remove or restrict the impact of the Shopper Docket

- ACCC to determine that the Shopper Docket is no longer in the public interest and remove its support of the scheme and commence the enforcement of third line force provisions of the Trade Practices Act.

Or

- Restrict the discount to such a level that it cannot be used as a predatory pricing tool. For example put a cap on the discount to 4 cpl or 2 cpl in total including other non price board discounts

And / or

- Restrict the acceptance of the Shopper Docket to a 1 km zone from the issuing supermarket store.

Increase transparency of the petrol price to consumers

- Regulate standards for price boards such that the price boards only display the price applicable to all customers. The current practice of displaying a discounted price can be confusing and at times misleading to consumers.

Restrict the site numbers or market share of the supermarkets

- Restrict the ability of the Supermarket competitors to continue to increase their stranglehold on the retail petrol market by creeping acquisition. This could be achieved by setting a maximum market share percentage or maximum site number allowed by Supermarket market participants.

Open up the liquor market to allow sales through retail petrol sites

- Encourage the various Liquor licencing agencies to open up the sale of liquor through convenience stores. Clearly the sale of Liquor through service station convenience stores is a more controlled environment than Drive-through Bottle Shops and special age checking procedures could be put in place.

  This initiative would increase the scope of the other Retail Petrol market participants to compete with the Supermarkets, and assist independents and others become less reliant on petrol volumes. It will also open the liquor market up to increased competition at the same time.

Yours faithfully,

David Szymczak
General Manager
United Petroleum Pty Ltd.

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[1] Joshua S. Gans and Stephen P. King (16th July,2004) Supermarkets and Shopper Dockets: The Australian Experience, *Melbourne Business School, University of Melbourne*. Page 11

[2] Ibid. Page 2

[3] Ibid. Page 6

[4] Ibid. Page 10

[5] Ibid. Page 6