Public Competition Assessment

25 July 2018

Caltex Australia Petroleum Pty Ltd – proposed acquisition of certain assets of Milemaker Petroleum Pty Ltd

The ACCC's decision

1. On 4 May 2017 the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition by Caltex Australia Petroleum Pty Ltd (**Caltex**) of certain assets of Milemaker Petroleum Pty Ltd (**Milemaker**). Caltex proposed to acquire retail fuel business assets associated with 46 retail service stations (the **proposed acquisition**).

2. The ACCC considered that the proposed acquisition would be unlikely to contravene section 50 of the *Competition and Consumer Act 2010* (the **Act**).

3. Section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.

4. The ACCC considered the competitive effects of the proposed acquisition in markets for:

   - the retail supply of petrol in the Melbourne metropolitan area

   - the retail supply of petrol in the local areas in the vicinity of each Milemaker site.

5. The ACCC found that Milemaker is a vigorous and effective price competitor in fuel retailing and as a result exerts competitive pressure on fuel prices in Melbourne. The ACCC also formed the view that post-acquisition, Caltex is likely to change the way the Milemaker sites are operated and as a result the proposed acquisition is likely to remove a vigorous price competitor from fuel retailing in Melbourne.

6. The ACCC noted that there are a number of other vigorous and effective price competitors in fuel retailing in Melbourne who are larger than Milemaker and who compete more directly with Caltex on a local site basis. As a result, the ACCC formed the view that sufficient competitive pressure would remain in fuel retailing in Melbourne to prevent the proposed acquisition from having the effect or likely effect of substantially lessening competition in the relevant markets.

7. This Public Competition Assessment outlines reasons for the decision by the ACCC not to oppose the proposed acquisition.

8. Please note that this and other public competition assessments are subject to the following qualifications:

- the ACCC considers each transaction on a case-by-case basis and so the analysis and decision outlined in one assessment will not necessarily reflect the ACCC's view of another transaction, even where that other transaction may involve the same or a related market

- as assessments are brief and do not refer to confidential information provided by the parties or other market participants, assessments do not set out all of the issues and information considered by the ACCC, nor all of the analysis and reasons of the ACCC.

The parties and the transaction

The transaction

9. Caltex proposed to acquire most of Milemaker's retail fuel business assets in Victoria for $95 million. The transaction involved Caltex acquiring the business assets and taking over operation of 46 retail service station sites from Milemaker (the **target sites**). Milemaker intended to grant Caltex long-term leases to operate the fuel businesses at the target sites. The transaction was completed in mid-2017.

The acquirer: Caltex

10. Caltex Australia Group's business operations include the refining, wholesaling and retailing of transport fuels.

11. Caltex's business operations include the retail supply of fuel through its Caltex owned and operated service stations.

12. Caltex or its agents operate 59 sites in the Melbourne metropolitan area, and sets the retail price of fuel at those sites (**Caltex sites**). There are approximately a further 40 Caltex-branded sites in the Melbourne metropolitan area which Caltex and its agents do not operate, including 34 Milemaker sites (33 of which Caltex will acquire). Caltex does not set the retail price of fuel at these sites except for diesel sold at certain sites under an agency arrangement.

The target: Milemaker

13. Milemaker is a family run business, which has been operating for over 30 years.

14. Across Victoria, Milemaker owns or operates 47 retail service stations, 46 of which Caltex proposes to acquire. Milemaker operates 34 sites in the Melbourne metropolitan area and two sites in Geelong. Milemaker operates one site in the Melbourne metropolitan area which is not part of the proposed acquisition.

15. Milemaker's sites carry Caltex branding, sell Caltex fuels and accept Caltex payment cards. To most consumers, they are not obviously distinguishable from Caltex's company sites.

16. Milemaker sets the retail fuel prices at its sites, with the exception of a small number of sites where Caltex sets the retail price of diesel.

Review timeline

17. The following table outlines the timeline of key events for the ACCC in this matter.

Date	Event
17 November 2016	ACCC commenced review under the Merger Process Guidelines
15 December 2016	Closing date for submissions from interested parties
16 March 2017	ACCC published a statement of issues
4 May 2017	ACCC decision not to oppose the proposed acquisition

18. The total elapsed time from start to finish was approximately four and a half months. However, the total period net of time taken by the parties to submit information or documents and extensions requested by the parties was 42 business days.

Market inquiries

19. The ACCC conducted market inquiries with industry participants, including competitors, representatives of customers, fuel suppliers, industry bodies and other interested parties. The ACCC received limited responses to its market inquiries, which is in part explained by the fact that consumers and some competing retailers could not differentiate Milemaker from Caltex. Submissions were sought in relation to the substantive competition issues.

Statement of Issues

20. On 16 March 2017 the ACCC published a Statement of Issues on the proposed acquisition identifying a number of competition issues. In the Statement of Issues the ACCC stated its preliminary view that the proposed acquisition may substantially lessen competition in the markets for the retail supply of petrol to consumers by removing a vigorous and effective competitor. This would have an effect on the competitive process in both:

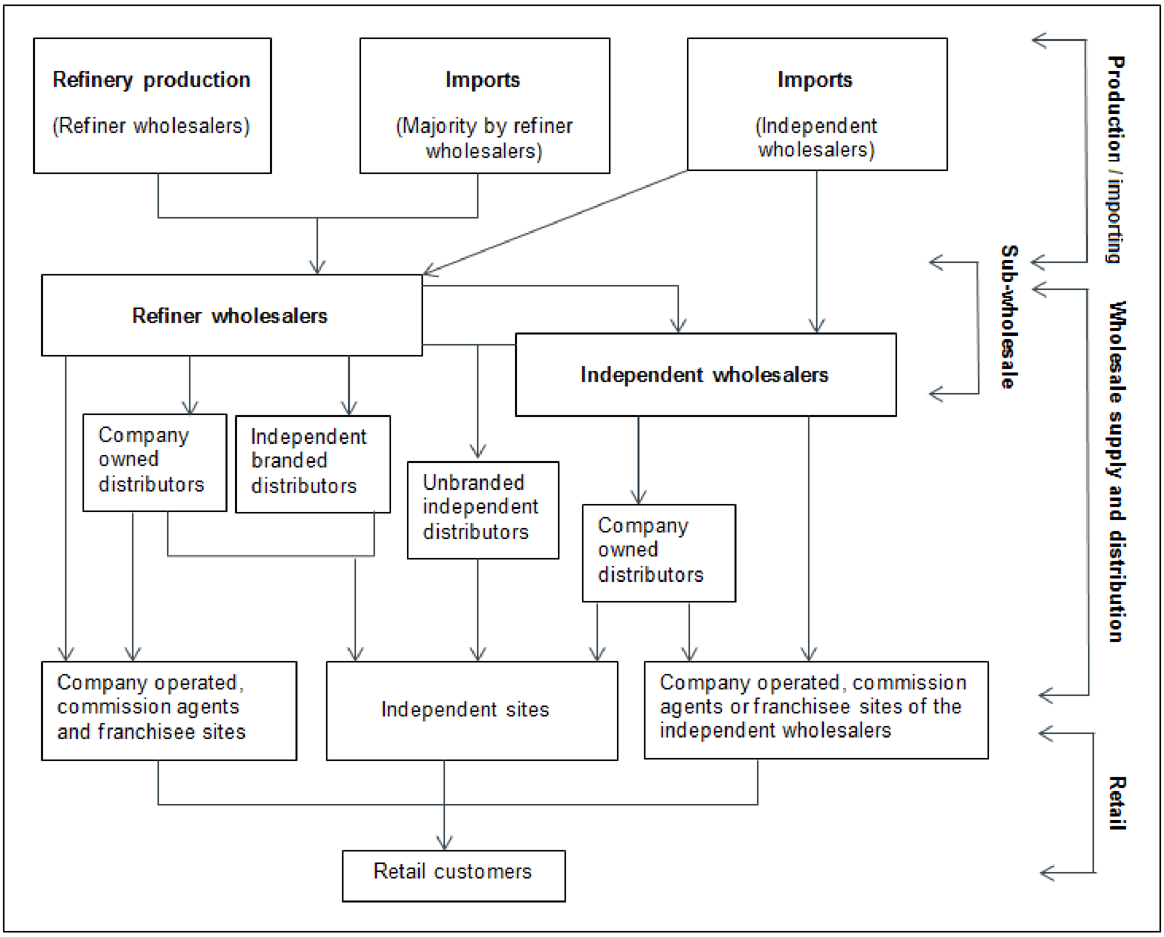
- each local geographic market in parts of Melbourne and regional Victoria where there is currently a Milemaker site
- a broader Melbourne metropolitan market.

Industry background

Overview of Australia's downstream petroleum industry

21. Australia's downstream petroleum industry consists of three broad levels – production/importing, wholesale supply and retail supply. This structure is depicted in the figure below.

Figure 1: Australia's downstream petroleum industry



Production/ importing

22. Petrol sold in Australia is either refined from crude oil at local refineries or imported as a finished product from overseas refineries.

23. There are four refineries currently operating in Australia (down from eight refineries in 2003). They are owned and operated as follows:

- Corio, Geelong (Viva Energy)
- Kwinana, Perth (BP)
- Lytton, Brisbane (Caltex)
- Altona, Melbourne (Mobil).

24. These four owners also operate in wholesale markets and are known as “refiner-wholesalers”.

25. In 2016-17 around 38 per cent of petrol sold in Australia was imported. Around 95 per cent of petrol imports came from South Korea, Singapore, India and Malaysia.

26. The four refiner-wholesalers account for most fuel imports into Australia. Other importers include United and Puma Energy.

Wholesale supply

27. Wholesale supply is dominated by the four refiner-wholesalers and other importers. The refiner-wholesalers supply wholesale petrol to their own outlets as well as supermarkets, independent distributors and retailers.

28. In 2013-14 (the latest data available), the four refiner-wholesalers supplied over 90 per cent of wholesale petrol volumes in Australia.

Retail supply

29. At the retail level, service stations supply fuel to retail customers. Service stations can be:

- supermarket operated sites (Woolworths or Coles Express)
- refiner-wholesaler company owned and operated sites (**COCO**), where the refiner-wholesaler sets retail prices
- refiner-wholesaler commission agent sites, where the refiner-wholesaler typically sets retail prices
- refiner-wholesaler franchisee sites, where typically the franchisee sets retail prices, but this may be influenced by price support from the refiner-wholesaler
- refiner-wholesaler branded but independently operated sites, where typically the independent operator sets retail prices
- independently owned and/or operated sites which range from large independent chains to single-site operations (these may be operated on a COCO, commission agent or franchisee basis).

30. A given site may fit more than one of these categories.

31. Since the early 2000s, supermarket operated sites have gained market share of sales volumes at the expense of refiner-wholesalers. The share of large independent chains has grown marginally, apart from a sharp increase in 2010-11 when 7-Eleven and Peregrine acquired Mobil’s company owned sites.

Other industry participants

BP

32. BP's business operations include the retail supply of fuel through its BP owned and operated service stations. BP also refines and supplies wholesale fuel to a number of independent retailers that own and operate service stations, including those that do so under the BP brand. The largest BP-branded independent retail chain in Melbourne is BP AA (discussed below).

33. The ACCC understands that there are approximately 145 BP-branded sites in the Melbourne metropolitan area.

Woolworths

34. Woolworths entered fuel retailing during the late 1990s, establishing service stations that offer fuel discounts to those purchasing groceries at its stores.

35. In August 2003, Woolworths entered into an alliance with Caltex to operate dual-branded service stations. These dual-branded sites are operated by Woolworths and obtain all fuels from Caltex.

36. The ACCC understands that there are approximately 95 Caltex/Woolworths dual-branded sites in the Melbourne metropolitan area.

37. On 28 December 2016, BP announced that it had agreed to acquire Woolworths' network of retail service station sites. The ACCC commenced a public review of that proposed transaction on 15 March 2017, following the receipt of submissions from BP and Woolworths. The ACCC announced it would oppose the proposed acquisition on 14 December 2017.

Coles Express

38. Coles has been retailing fuel since mid-2003, under a commercial alliance with Shell Australia (now owned by Viva Energy Australia Ltd). Coles sets the price at dual-branded Coles Express-Shell service stations Australia-wide.

39. The ACCC understands that there are approximately 159 Coles Express-Shell branded sites in the Melbourne metropolitan area.

7-Eleven

40. 7-Eleven Stores has been retailing fuel since the late 1970s.

41. In 2010, 7-Eleven Stores purchased a large number of retail service stations from ExxonMobil, which significantly lifted its presence in fuel retailing.

42. The ACCC understands that there are approximately 150 7-Eleven branded sites in the Melbourne metropolitan area.

United

43. United is an independent fuel wholesaler and retailer.

44. United's control of terminal facilities allows it to import fuels from overseas.

45. The ACCC understands that there are approximately 96 United branded sites in the Melbourne metropolitan area.

BP AA

46. BP AA is a family run business with approximately 50 sites in Melbourne, operating service stations as a BP franchisee.

47. BP AA sites carry BP branding, sell BP fuels and accept BP payment cards.

Other participants

48. There are a range of other participants. The ACCC understands that collectively, these other participants have around 130 sites in the Melbourne metropolitan area.

Retail petrol price cycles

49. Price cycles are a prominent feature of retail petrol prices in Australia's largest cities. Price cycles have at least two distinct phases:

    a) a substantial increase in prices that generally occurs across a metropolitan area (the **price increase phase**). In 2016 in Melbourne:

        i. the average increase in daily average petrol prices from the trough to the peak of the cycle was about 21.6 cents per litre

        ii. the average length of time from the trough to the peak of the cycle was about five days

    b) a more prolonged phase of decreasing prices (the **discounting phase**). In 2016 in Melbourne, the average duration of the discounting phase was about 33 days.

Price increase phase

50. The price increase phase is generally initiated by one or two of the major retailers increasing prices substantially at a number of retail sites in a metropolitan area. If other retailers respond to this move with similar increases, then the increased price usually spreads across the retail networks within a metropolitan area.

51. Some retailers follow shortly after the leader (or 'first mover') raises prices; others take longer to follow price increases (they 'lag' price increases). This is because there is a (short-term) incentive for individual retailers to delay their price response during the price increase phase of the price cycle, thereby potentially gaining a temporary increase in sales and a reputation for low prices. The risk for retailers who delay is that the first mover (or those that follow quickly) may abandon their attempt to increase prices, and return their prices to the previous, lower level. The longer other retailers delay in following an attempted price increase, the greater the potential that the first mover or early followers will abandon their price increase.

52. Generally during the price increase phase, retailers increase prices to the same or a similar price point across different local areas within a metropolitan area. However, in recent times in Melbourne, the ACCC has observed some retailers increasing prices to a level below what was initially set by the first mover.

Discounting phase

53. In contrast, the discounting phase involves a slower process of retailers undercutting and matching each other's prices on a local basis in small decrements.

54. During the discounting phase, the rate at which retailers reduce their prices from the cyclical peak tends to vary on a site-by-site basis depending on factors that include the prices of nearby sites. As a result, during the discounting phase, there will often be a degree of price variability between a retailer's sites across a city, although the market as a whole tends to shift downwards within a price band.

Relevant markets

55. Market definition establishes the relevant field of inquiry for merger analysis. The ACCC's starting point for delineating relevant markets, to assess the competitive effects of the proposed acquisition, involves identifying the products and geographic regions actually or potentially supplied by the parties to the transaction. The ACCC then focuses on areas of activity where competitive harm could occur as a result of the proposed acquisition. These are discussed below.

Product dimension

56. Three types of fuel products are commonly sold at retail service stations in Victoria: petrol (including regular unleaded, premium unleaded and ethanol blends), diesel and automotive liquefied petroleum gas (**LPG**).

57. In this matter, the ACCC did not consider it necessary to assess the proposed acquisition in separate markets for petrol, diesel and LPG. All these fuel types are supplied at most or all sites, and it is unlikely that the separate consideration of each fuel type would have affected the ACCC's analysis.

58. For simplicity, the ACCC focused on the effect of the proposed acquisition on competition in the retail supply of petrol.

59. The ACCC did not identify any major issues that are likely to arise from the proposed acquisition that would affect competition for the retail supply of diesel or LPG, but do not affect competition in the retail supply of petrol.[1]

60. In considering future acquisitions of retail service stations the ACCC may consider it appropriate to specifically consider markets for the supply of any or all of petrol, diesel and LPG.

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1 In the case of diesel, Caltex already set the retail price at several Milemaker sites before the proposed acquisition.

Geographic dimension

Local markets

61. The ACCC considers that competition in local markets is an important determinant of retailers’ pricing decisions, particularly in the discounting phase of the price cycle.

62. The ACCC understands that location is an important factor in consumers’ fuel purchasing decisions. Consumers usually have a preference for purchasing fuel within a limited geographic area, normally around their home, work, or along their usual commute. Consumers may have a limited willingness to travel more than a few minutes’ drive from their usual commute in order to purchase fuel from another fuel retailer.

63. Major retail petrol chains generally set fuel prices at each of their sites centrally (rather than being determined by individual site managers). When setting prices at a site, these retailers often monitor the prices at a number of other competing sites in the same local area. These are commonly known as ‘marker sites’. Marker sites are frequently located close to the site at which the price is being set, hence local competition is important.

Metropolitan Melbourne

64. While there are areas of close local competition between fuel retailers, it is also relevant to consider the competitive dynamics in petrol retailing across broader geographic markets.

65. In metropolitan areas where retail petrol prices follow cycles, price outcomes can depend on behaviours of retailers across the city. Cyclical price increases typically occur across the city as a whole. As noted above, in the price increase phase, retailers generally increase prices to the same or a similar point across the city, regardless of differences in local area competition. If a price increase fails to ‘stick’, it is most likely because one or more major retailers decide not to follow the increase on a city-wide basis. These factors suggest the relevant competitive constraints in these circumstances may be city-wide in addition to local.

66. Therefore, in cases such as this one, where the parties to the transaction have a large number of sites across a city, the ACCC will consider city-wide effects in addition to local effects.

Conclusion – geographic dimension

67. The ACCC assessed the likely competitive effects of the proposed acquisition on competition in the:

    - retail supply of petrol in the Melbourne metropolitan area
    - retail supply of petrol in the local areas in the vicinity of each Milemaker site.

Competition analysis

Overview of the ACCC’s concerns

68. The ACCC considered whether the proposed acquisition would be likely to substantially lessen competition in the markets for the supply of retail petrol to consumers by removing a vigorous and effective competitor from the relevant markets.

69. To this end, the ACCC examined:

    a. whether Milemaker is a vigorous and effective competitor in petrol retailing

    b. Caltex’s approach to petrol retailing, and the likely effect on prices at the target sites if Caltex acquired them

    c. the competitive discipline imposed by other petrol retailers in the relevant markets.

Is Milemaker a vigorous and effective competitor?

70. The ACCC analysed price data and marker site data for petrol retailers in Melbourne (the **price data**). In respect of Milemaker’s pricing behaviour, the ACCC concluded that in Melbourne:

    - Milemaker’s average prices were below most other retailers

    - Milemaker often led discounting at a number of its sites (i.e. it lowered prices when none of its marker sites had prices below it), or quickly followed the discounting of other local retailers

    - other retailers appeared to follow Milemaker’s lead in the discounting phase (that is, they would lower prices at a site when a nearby Milemaker site was cheaper)

    - Milemaker was often slow to follow the price increases of others in the price increase phase, and did not initiate price increase phases.

71. Accordingly, the price data suggested that Milemaker is a vigorous and effective price competitor. The ACCC also analysed information including documents held by the parties and others. This information was consistent with our findings from analysis of the price data.

Caltex’s approach to pricing, and the likely effect on the target sites

72. The ACCC's analysis of the price data concluded that in Melbourne:

    - retail petrol prices at Caltex sites are on average higher than those of Milemaker, and several other retailers

    - Caltex was unlikely to lead price discounting on a site basis and usually only lowered prices in response to lower prices of a marker site

- Caltex typically either instigated or quickly followed price increases in the price increase phase of the price cycle.

73. In this and previous investigations, the ACCC has observed persistent differences in pricing strategy between different petrol retailers. These differences do not appear to be driven by particular features of the sites they operate. For example, there does not appear to be a general difference in the features of Milemaker and Caltex sites which would explain the difference in pricing strategy the ACCC observed between those two retail chains. Therefore, when sites change hands between competitors with different pricing strategies, the pricing strategy for those sites can also be expected to change.

74. The ACCC was concerned that, following the proposed acquisition, Caltex would implement its own pricing strategies at the target sites. This would be likely to lead to higher prices at the target sites, and less aggressive discounting. Those sites would also become more likely to lead or quickly follow cyclical price increases.

75. This would remove the contribution that Milemaker's pricing strategy makes to competition in both the local markets where Milemaker currently operates and the Melbourne metropolitan market more broadly.

Competitive discipline of other fuel retailers in Melbourne

76. Notwithstanding the finding that Milemaker's pricing strategy indicated that it is a vigorous and effective competitor, the ACCC determined that Milemaker's strategy is not unique. Some other petrol retailers in Melbourne actively lead prices down during the discounting phase of the price cycle and/or delay following other retailers in the price increase phase. Moreover, these retailers have a much larger presence in Melbourne than Milemaker: United (96 sites in metropolitan Melbourne), Woolworths (95 sites) and 7-Eleven (150 sites).

77. The ACCC considers that the competitive process and outcomes in retail petrol markets are influenced by the presence of numerous retailers who regularly attempt to win customers from their rivals by initiating discounting or lagging price increases. Without such behaviour, the competitive process can stagnate, leading to higher prices, higher net retail margins, and inferior outcomes for consumers[2]. Any acquisition which removes such a competitor has potential to raise competition concerns, and in this case the ACCC considered competition was likely to be reduced. However, the small size of Milemaker and limited direct competitive overlap with Caltex led the ACCC to conclude that the effect on competition is not likely to be substantial. The ACCC will continue to assess future acquisitions on a case by case basis.

The retail supply of petrol in the local areas in the vicinity of each Milemaker site

78. The ACCC considered whether the proposed acquisition would be likely to result in a substantial lessening of competition in any local area where Caltex and Milemaker sites were both present. Competition concerns would be most likely to arise where Caltex and Milemaker appear to be close competitors (given their

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[2] See for example the findings of the ACCC's *Report on the Darwin Petrol Market*; November 2015; the ACCC's *Report on the Launceston Petrol Market*; July 2016; and the ACCC's *Report on the Armidale Petrol Market*; November 2016.

proximity and other relevant factors), and there are few other competitors remaining in the area.

79. Because Milemaker sites are Caltex branded, they tend to be positioned in local areas where there is not an existing Caltex site. As a result, Caltex and Milemaker's site networks are largely geographically complementary, and there are few local areas in which both Caltex and Milemaker overlap.

80. In those local areas where both Caltex and Milemaker overlapped, the proposed acquisition would reduce competition. However, the ACCC considered that there would remain a sufficient number of effective competitors, such that no substantial lessening of competition would be likely to occur in any local area as a result of the proposed acquisition.

Conclusion

81. The acquisition will remove Milemaker as an independent retail competitor in Melbourne. The ACCC considered that Caltex is likely to replace Milemaker's pricing strategy at the target sites with its own, and that the acquisition is likely to lessen competition by reducing the competitive pressure faced by Caltex and other retailers in metropolitan Melbourne.

82. However, the ACCC did not consider this would reach the threshold of a substantial lessening of competition because of a combination of the following factors:

- Milemaker controls a relatively small number of sites in metropolitan Melbourne, and the combined market share of the parties is relatively low
- there are a number of other retailers in Melbourne that lead or quickly follow price discounting, and delay price increases
- those retailers are larger than Milemaker
- there are few areas of local overlap between Milemaker and Caltex sites.

83. Based on the above analysis, the ACCC concluded that the proposed acquisition would not be likely to have the effect of substantially lessening competition in any relevant market.