ICRC

INDEPENDENT COMPETITION AND REGULATORY COMMISSION

FINAL REPORT

Inquiry into Motor Vehicle Fuel Prices

September 2001

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Public information about the Commission's activities

A range of information about the role and current activities of the Commission, including copies of latest reports, can be found on the Commission's web site at <www.icrc.act.gov.au>.

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PREAMBLE

This is the final report of the Commission's inquiry into motor vehicle fuel prices. The inquiry was conducted in response to a reference dated 14 April 2001 from the Treasurer responding to a motion of the Legislative Assembly.

As required by the terms of the reference, the Commission has examined the efficiency of fuel prices in the ACT, the cost of fuel in the ACT compared with Queanbeyan and Sydney, the level of competition and tied arrangements in the petroleum wholesaling and retailing industry segments, retail price fluctuations and fuel price regulations that are being considered or introduced in other jurisdictions. In line with the Commission's objectives, social and environmental considerations have also been examined.

In May 2001, the Commission published an issues paper and invited submissions on it. Twenty-five written submissions were received from the industry, community groups and members of the public. In addition, numerous telephone calls were received and face-to-face meetings were held with a number of stakeholders. The views presented to the Commission through this process have been thoroughly considered as part of the final preparation of this report.

Fuel prices have been investigated a number of times in recent years, not only in the ACT but also in other States and Territories and the Commonwealth. At the same time as this report is being submitted, a number of other inquiries are being conducted in other jurisdictions into aspects of the industry. That there are several reviews being undertaken reflects the importance placed upon the absolute price and variability in price for petrol, diesel and liquefied petroleum gas by the Australian public.

This report seeks to inform decision-makers and the community about the motor vehicle fuel market and makes a number of recommendations designed to improve community understanding of this complex and contentious issue. The Commission's recommendations have been framed in the context of the particular circumstances that apply in the ACT and in recognition of the national inquiries being undertaken by the Australian Competition and Consumer Commission and the Trebeck Committee. The Commission believes that the recommendations it has made provide practical options which can be acted upon by the ACT Government. They will contribute towards not only a better understanding of the factors which cause changes in fuel prices but also a continuing competitive environment for motor vehicle fuels in the ACT.

The Commission commends its findings and recommendations to the Legislative Assembly for its consideration.

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LIST OF ABBREVIATIONS

Term	Definition
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AIP	Australian Institute of Petroleum
ALP	Australian Labor Party
APADA	Australian Petroleum Agents and Distributors Association
ATO	Australian Taxation Office
GPOC	Government Prices Oversight Commission (Tasmania)
GST	goods and services tax
ICRC	Independent Competition and Regulatory Commission
IPI	import parity indicator
LPG	liquefied petroleum gas, sometimes known as autogas
LRP	lead replacement petrol
MWP	maximum wholesale price
NSW	New South Wales
NT	Northern Territory
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of Petroleum Exporting Countries
PULP	premium unleaded petrol
SA	South Australia
TGP	terminal gate price
ULP	unleaded petrol
WA	Western Australia

EXECUTIVE SUMMARY

This inquiry was established against the background of fuel prices in the ACT reaching record high levels, with petrol and diesel peaking over $1 per litre. Concern amongst consumers led to the ACT Legislative Assembly recommending that the ACT Government issue a reference to the Independent Competition and Regulatory Commission (the Commission) for an investigation into the motor vehicle fuel industry and fuel prices. The Government issued the reference on 14 April 2001.

The Commission is required to report to the Government on the terms of the reference and to recommend possible courses of action. As the petroleum industry is not a regulated industry under the *Independent Competition and Regulatory Commission Act 1997*, it is not the Commission's role to impose price controls or introduce a new regulatory framework.

The Commission has concluded that the retail motor vehicle fuel market in the ACT is competitive despite the extensive involvement of the four major oil companies (the majors): Caltex, BP, Shell and Mobil. This competition *inter alia* comes from the presence of a number of independent wholesalers and retailers in the ACT market. At the refinery level, the major oil companies face competition from imports. Demand for fuel is often considered to be inelastic (i.e. demand is relatively unaffected by price) because there is no readily available substitute product. However, despite attempts to create brand loyalty consumers are sensitive to price changes and will respond to differences in price at different retail outlets.

Fuel prices are made up of three components: taxation, international refined fuel prices, and a domestic marketing and retailing component. Taxation and international refined fuel prices are the largest component. In the ACT, the domestic industry marketing and retailing component is typically less than 10% and includes all transport, retailing, wholesaling and marketing costs. Fuel taxation and international refined fuel prices are outside the scope of the inquiry and have not been investigated in depth.

Fuel prices are subject to two types of fluctuations: long-term cyclical movements generally driven by international refined fuel prices which include the cost of crude oil; and short-term fluctuations which are largely generated in the domestic industry component of prices.

Excluding taxation and international issues, there is no evidence that petrol and diesel price levels are inefficient. International comparisons show that Australian tax-exclusive petrol and diesel prices are amongst the lowest in the Organisation for Economic Cooperation and Development (OECD) countries and domestic competition is high. Domestic fuel market profitability is low for the majors, independents and other industry participants. High unleaded petrol (ULP) prices experienced in the first half of 2001 were largely caused by international factors, namely the coincidence of a low Australian dollar and high gasoline prices in the Singapore spot market.

A comparison of prices in the ACT with those in other areas does not show large, unexplained differentials, suggesting the ACT market is efficient:

- For ULP, the differential in prices between the ACT and Queanbeyan is fully explained by the Commonwealth's 1 cent/L Fuel Sales Grant Scheme subsidy on fuel sales in regional areas. This is available in Queanbeyan but not in the ACT.
- For ULP and diesel, the differential in prices between the ACT and Sydney is fully explained by transport costs.

- For LPG, the differential in prices between the ACT and Sydney is mostly explained by transport costs.

Short-term fluctuations in price appear to occur in reasonably regular cycles of around a week in length. These cycles are a direct result of heightened levels of competition in the ACT market and attempts by retailers to attract customers or to respond to price reductions initiated by others. Rapid price rises usually occur on a Wednesday and are often associated with public service paydays. There is mixed evidence on whether rises also tend to occur before public holidays. However, evidence analysed by the Commission suggests that these cycles are not attempts by industry participants to gain monopoly profits, but instead are caused by regular competitive price-discounting cycles. At the bottom of the cycle, fuel is being sold at or below breakeven cost recovery levels. The correlation of the upward movement in the cycle with public service paydays is most likely caused by retailers being unwilling to sell fuel at a loss over high demand periods and thus the payday acts as a trigger for discounting to end.

The Commission received some complaints that the oil majors are effectively setting the retail prices of the independents and franchisees they supply. This would be illegal if proven. Evidence provided to the Commission suggests that, while the oil majors do have a strong influence over the retail prices of their franchisees and branded independents, they are not fixing them in a legal sense. Further, the Commission has no evidence that the majors set retail prices across the market as a whole and no evidence of collusion was uncovered.

The evidence available to the Commission indicates that there are sophisticated processes of 'price watch' operated by all participants in the market. This allows almost instantaneous response to movements in prices so that if one player leads with a price reduction, others can follow quickly. Similarly if one market participant leads with a price rise, the reaction of the market can be readily assessed. It is not unusual to find one participant trying to lead prices up, but because others do not follow, dropping prices again after a few hours.

The Commission notes that some other jurisdictions are also either conducting inquiries into this industry or introducing fuel price regulations:

- The Federal Government is conducting an inquiry into fuel taxation which is due to be completed in early 2002.
- The Australian Competition and Consumer Commission (ACCC) is conducting an inquiry into methods of reducing fuel-price fluctuations. A discussion paper has been released and a final report is due later this year.
- The WA Government has introduced a range of controls including a 24-hour price rule and a maximum wholesale price (MWP) scheme, and will consider a retail price cap in future.
- The SA Parliament is holding an inquiry into options for fuel industry regulation.
- Victoria has recently mandated terminal gate prices (TGPs).

NSW, Queensland, Tasmania and the NT are not currently undertaking any inquiries or proposing new regulatory measures for the industry.

Conclusion

The Commission has concluded that the domestic industry component of the fuel price is efficient. Thus, the Commission believes there is little scope for prices to be reduced

significantly in the ACT by regulatory action. Artificial removal of the short-term price fluctuations caused by competitive price discounting cycles risks reducing competition and thus raising average prices for all consumers. At this stage it is too early to tell whether the reforms being introduced in other jurisdictions will benefit consumers in the long run. Also, there is a grave risk that unilateral action taken only in the ACT could conflict with decisions taken at a national level as a result of, for example, the current ACCC inquiry into fuel price fluctuations.

Thus, the Commission concludes that the ACT Government should support further regulation of the industry only where it can be shown that such action would contribute to the long-term competitive pricing of fuel in the ACT and would be instituted and operated in a way that is consistent across all jurisdictions. However, the Commission considers that a public information strategy providing consumers with fuel market structural and pricing information could allow them to manage their fuel costs by taking advantage of price discounting cycles. A cross-jurisdictional effort to improve wholesale fuel price transparency without setting fuel prices may also be beneficial and deserves consideration in consultation with other jurisdictions.

Detailed recommendations are set out below.

RECOMMENDATIONS

Recommendation 1: That the ACT Government make representations to the Commonwealth to ensure all service stations in the ACT region are treated equitably in their ability to access the Fuel Sales Grant Scheme.

Recommendation 2: That the ACT Government consider reducing the requirement for a person who purchases a service station as a going concern to operate it as a service station for five years.

Recommendation 3: That the ACT Government request the Commission to monitor ACT/Sydney and ACT/Queanbeyan fuel price differentials.

Recommendation 4: That the ACT Government support the introduction of a national temperature correction regime and, following the introduction of such a regime, ensure that ACT legislation is harmonised with the national approach.

Recommendation 5: That the ACT Government not introduce any new fuel pricing regulation before the conclusion of the current ACCC inquiry into price variability. Following the ACCC inquiry, the ACT should take a regulatory approach that is consistent with any national regulatory action. In particular, fuel regulatory policies that differ from those in surrounding NSW should be avoided.

Recommendation 6: That the ACT Government implement a public information strategy that informs the public about the discounting cycle and regularly provides information on the movement of fuel prices.

Recommendation 7: That the ACT Government work with other jurisdictions on improving the transparency of wholesale pricing of fuel, for example through the introduction of an initiative to release terminal gate pricing information that includes the terminals that supply the ACT.

Recommendation 8: That the ACT Legislative Assembly repeal the fuel price setting provisions of the ACT *Fair Trading (Fuel Prices) Act 1993* as these have been superseded by the powers contained in the legislation establishing the Commission.

1. INTRODUCTION

1.1. Background to the Inquiry

There is a considerable body of popular opinion in the ACT and nationally that motor vehicle fuel prices are too high. This concern has been led by comments in the media and the political arena, and was exacerbated by prices exceeding $1 per litre in a number of major centres around Australia, including the ACT.

The volatility of fuel prices and the rapidity with which they change are also major concerns. Public frustration was particularly strongly expressed following large increases in fuel prices (over 10 cents/L in a day at some service stations) just before Easter and Anzac Day.

These concerns among ACT consumers led to the Legislative Assembly passing a motion (Appendix 1) recommending "that the Government issue to the Independent Competition and Regulatory Commission a reference to investigate and advise the Assembly on matters relating to motor vehicle fuel, including petroleum, diesel and gas prices in the ACT". The Government responded by issuing the reference to the Commission shown in Appendix 2.

1.1.1. Role of the Commission

The Commission is established under the ACT *Independent Competition and Regulatory Commission Act 1997*. Its objectives are to promote effective competition in the interests of consumers, facilitate an appropriate balance between efficiency and environmental and social considerations, and to ensure non-discriminatory access to monopoly and near-monopoly infrastructure. It does this for regulated industries by providing price directions, recommendations about price regulations and advice on, registration of, and arbitration for access to, monopoly infrastructure. For non-regulated industries (such as petroleum) its role is to investigate competitive neutrality complaints, government-regulated activities and matters referred by the Minister or other referring authorities.

The Commission's role in this inquiry is to report to the Government on each of the issues covered in the terms of reference and to recommend possible courses of action. As the petroleum industry is not a regulated industry under the Act, it is not the Commission's role to impose price controls or to introduce a new regulatory framework for the petroleum industry. Rather it is to research the issues and consult widely with the community, industry and Government, and develop advice for the ACT Government on the competitiveness and efficiency of the market in the ACT and what controls might be introduced to ensure prices are efficient and consumers' interests are protected.

1.1.2. Scope of the inquiry

In the terms of reference, the Commission was asked to investigate petrol, diesel and automotive liquefied petroleum gas (LPG). Whilst the Commission has attempted to deal with each of these fuels equally, the data availability for fuels other than ULP is limited. In particular, LPG, premium unleaded petrol (PULP) and lead replacement petrol (LRP) have proved a problem. Because PULP and LRP are generally priced in a fixed relationship to ULP, they are, in effect, covered in the analysis of ULP. Where lack of data has restricted analysis of diesel and LPG pricing, this is noted in the text of the report.

1.2. The Motor Vehicle Fuel Industry

1.2.1. Industry structure

1.2.1.1. National

The petroleum industry in Australia is dominated by three vertically integrated multinational petroleum companies (BP, Shell and Mobil) and a fourth company (Caltex) which is owned by a combination of a vertically integrated multinational petroleum company and local shareholders. Caltex Australia is a listed public company in Australia and differs from the other three majors in that it is not a crude oil producer.[1]

These four companies own all of Australia's refinery capacity, with refineries being located in Queensland (2), New South Wales (2), Victoria (2), South Australia (1) and Western Australia (1).[2] These refineries are old and small by international standards, particularly compared with competing refineries in the Asia–Pacific region. Despite this, fuel supplied in the market is dominated by fuel refined in Australia from local or imported crude, and local refineries have enough capacity to supply the whole Australian market.[3]

However, of the total fuel supplied in Australia, a significant proportion is imported refined fuel.[4] In some places and at some times, market conditions stimulate import of refined fuel as a substitute for locally available fuel. Importing refined fuel rather than purchasing locally refined fuel is a strategy frequently used by the larger independent wholesalers and retailers.

In addition to their domination of refining, the major oil companies dominate the wholesale market segment, although there are independent wholesalers in most States. These include Gull in WA and Trafigura in NSW/ACT and Victoria.

Again at the retail level, the majors have a strong role. The sector is made up of the following categories of retailer:

- independent chains (for example, Woolworths and Gull);
- independent operators who use their own site, equipment and brand name;
- independent operators who use their own site and equipment but are in a branding agreement with a major oil company;
- single-site franchisees who rent a major-owned site and operate it under a franchise agreement which legally allows them to determine their own prices;

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[1] Caltex Australia, *An Introduction – Caltex Australia*, 2001 (accessed 24 July 2001), <http://www.caltex.com.au/about/index.html>.

[2] Industry Commission, *Petroleum Products* (Report No. 40), Australian Government Publishing Service, Melbourne, 5 July 1994, p7.

[3] Frank Topham, Peter Morris & Chris Hefford, Caltex Australia Limited, pers. comm., 16 May 2001.

[4] Commonwealth Department of Industry, Science and Resources, *Australian Petroleum Statistics* (Issue No 57, April 2001), Department of Industry, Science and Resources Canberra, 2001. Automotive gasoline imports were reported as 1271.4 megalitres for the year to April 2001, while sales over that period were 18193.2 megalitres. For diesel, imports were reported as 1144.6 megalitres for the year to April 2001, while sales over that period were 12902.8 megalitres. Imports of both fuels have been growing rapidly, up from 482.8 and 769.5 megalitres for gasoline and diesel, respectively, in the 1997–98 financial year.

- multi-site franchisees who rent a number of major-owned sites and operate them under one or many franchise agreements which legally allow them to determine their own prices;
- commission agents who manage a major-owned site for a commission based on sales and typically cannot set prices themselves;
- distributor-owned sites that are run by a local fuel distributor (which may or may not be owned by an oil major); and
- sites owned directly by an oil major and operated by company staff.

At the national level, most metropolitan sites are operated by franchisees (single and multi-site) or independents (major-branded, own brand and chain). In rural areas, the majority of service stations are independents supplied through distributors (less than half of which are partly owned by the oil majors).[5] These retailers are independent in that legally they can set their own prices.

1.2.1.2. ACT

The ACT is in many ways part of a Sydney-based structure that also supplies most of the rest of NSW. There is no refinery in the ACT, and most of the fuel sold through service stations in the ACT is supplied by road directly from Sydney terminals. The local depots at Fyshwick and Queanbeyan are owned by either local distributors or oil majors, but typically do not on-sell to service stations. Instead they supply industrial and other smaller users who are unable to receive or store large consignments of fuel.[6]

At the retail level in the ACT, the breakdown of sites by type is quite complicated. This is because the definition of types varies from company to company and relationships between individual service stations and majors are constantly changing. In the best estimate of the Commission, the ACT market differs from the national market in that there are fewer independents of all types and also fewer single site franchisees. As a result, a higher proportion of sites have their prices directly controlled by the majors than in the national market. Appendix 3 discusses this issue in more depth and attempts a breakdown of the number of various types of site in the ACT.

1.2.2. Market characteristics

1.2.2.1. Demand inelasticity

An often observed characteristic of consumer behaviour is that as the price of a product rises, consumers will purchase less of it. For many products, this effect is very high because consumers can easily substitute different products for those that they have been buying. With motor vehicle fuel, however, there is no readily available substitute. Thus, any reductions in demand must come from changing consumer behaviour. Changes such as driving a smaller car, using public transport and car pooling are much more inconvenient for consumers than, for example, a change from broccoli to cauliflower when broccoli prices rise. This means

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[5] Australian Institute of Petroleum, *Service Stations*, 2001 (accessed 27 July 2001), <http://www.aip.com.au/info/statistics/servicest.html>.

[6] Garth Symington, Australian Petroleum Agents and Distributors Association, pers. comm., 18 June 2001.

that, in comparison to many other products, a large motor vehicle fuel price rise is required for a small reduction in demand.

1.2.2.2. Prices

Fuel prices in the major cities often fluctuate rapidly from day to day, and even more than once on the same day. These fluctuations can amount to over 10%. While such large short-term volatility is uncommon in other commodities, it is not unknown; it can be seen regularly in markets such as wholesale fruit, vegetable and fish markets, as well as stock markets.

Prices also tend to fluctuate in longer cycles and may rise or fall by 30% over a period of six months to two years. This type of fluctuation is also seen in a number of other markets such as:

- commodity markets like wheat, coal and metals;
- financial securities such as shares and bonds; and
- travel-related services such as accommodation and airfares.

Fluctuations in fuel prices are discussed at Chapter 4 while the make-up of the price of fuel is discussed at 2.1.

1.2.3. Government regulation

There is currently no price regulatory activity in the Australian petroleum industry that affects the ACT. In terms of regulation of the structure of the industry, the Commonwealth *Petroleum Retail Marketing Sites Act 1980* controls the proportion of sites that are allowed to be directly owned and operated by the four major oil companies, and the Commonwealth *Petroleum Retail Marketing Franchise Act 1980* controls aspects of the franchise agreements between the majors and their franchisees. There is also a high level of taxation on petrol and diesel. This is discussed in section 2.1.1 below. Regulatory activity is discussed in depth in section 6 below.

1.3. ACT Government's Powers

1.3.1. Existing powers

The ACT *Fair Trading (Fuel Prices) Act 1993* allows the ACT Minister for Fair Trading to determine caps on the wholesale price, retail price and retail margin following a recommendation from the Director of Consumer Affairs. These price capping provisions have never been used.[7]

This Act also deals with temperature correction of fuel. As the temperature of motor vehicle fuel increases, it expands. This expansion means that at higher temperatures each litre of fuel purchased weighs less and contains less chemical energy. While this change is not very great in percentage terms, for large volume transactions the quantity change can be significant. For this reason, many fuel transactions, such as purchases on international oil markets and excise tax collection, include an adjustment so that the transaction occurs as if the fuel was at 15°C.

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[7] Tony Brown, Director, ACT Fair Trading, pers. comm., 8 May 2001.

The ACT *Fair Trading (Fuel Prices) Act 1993* contains provisions which ensure that large volume fuel sales in the ACT are temperature corrected in this way. This is discussed in depth in section 5.4 below.

Other powers affecting the petroleum industry exist under non-industry-specific legislation such as health and safety, and environmental laws. As discussed above, the petroleum industry is not declared under the *Independent Competition and Regulatory Commission Act 1997*, and thus is not subject to regulation by the Commission.

1.3.2. Limitations on the ACT Government

The ACT is part of a global oil and gas market and is neither geographically nor economically isolated from other parts of that market. These factors impose constraints on the actions that the ACT might take to modify wholesale and retail fuel prices. For example:

- Australian fuel prices are highly susceptible to fluctuations in international crude oil prices and the value of the Australian dollar, neither of which is under ACT control;
- the petroleum refining industry is a national issue over which the Commonwealth Government has regulatory control; and
- overall market structure issues such as vertical integration between refiners and distributors is a matter for consideration by the Commonwealth and is outside the Territory's influence.

Further, if the Territory wishes to take any regulatory action, it needs to ensure that action is consistent with national policies and those of other States, particularly NSW. Failure to act consistently in the national context may harm the ACT economy. This could occur through flight of investment to other jurisdictions and higher fuel costs in the ACT leading to migration of businesses to NSW.

1.4. Reports into the Motor Vehicle Fuel Industry

1.4.1. Previous inquiries

Inquiries into aspects of the petroleum industry are not a new occurrence. The industry has been investigated on many occasions over many years and reports have been written at the Territory and national levels by many different bodies. The findings of the most relevant of these reports are summarised below.

1.4.1.1. ACT Government Working Group on Petrol Prices (November 1992)[8]

The working group was made up of public servants from a range of ACT government agencies. Its report looked into competition in the ACT market, whether there were higher costs of supply in the ACT, and the structure of the retail and wholesale petroleum industries in the Territory.

[8] ACT Government Working Group on Petrol Prices, *Report of the ACT Government Working Group on Petrol Prices*, Canberra, November 1992.

The report's major recommendations included the following:

- Planning and other Government policies relating to service stations should be rationalised and have an overall objective of promoting competition in the ACT petrol market. This includes expanding the land-use zones available for service stations.
- The ACT should take up with the Commonwealth several aspects of the Prices Surveillance Authority's regulation of the market, including allocation of transport costs, which were felt to be unfairly increasing prices in the ACT.
- The ACT Government should access commercial price data sources for the purpose of price monitoring.
- Measures should be taken to increase the number and proportion of independent operators in the ACT.
- The amount of allowable non-petrol retail space should remain at 50 m^2 in stations at local shopping centres, but elsewhere be lifted to 150 m^2.
- There should be increased signage of the location of service stations on main roads.
- Investigation of whether there are any higher construction costs in the ACT should be continued.

Since the completion of this report:

- planning and leasing policies have been overhauled to make more sites available for the construction of service stations;
- the Prices Surveillance Authority's regulation of the market was at first modified, then finally abolished, ceasing in 1998;
- commercial fuel price data are now much more readily available;
- measures were taken to increase the number and proportion of independent operators, resulting in the establishment of first Burmah, then Gull and Woolworths+Petrol, in the ACT;
- the amount of allowable non-petrol retail space was lifted to 150 m^2 in many locations; and
- signage of the location of some service stations was installed on main roads.

1.4.1.2. Industry Commission (July 1994)[9]

This report looked in depth at the structure and functioning of the petroleum industry nationally, as well as controls on the location of service stations in the ACT. Recommendations relevant to the ACT included the following:

- The Commonwealth should cease regulating petroleum prices.
- States and Territories should refrain from regulating petroleum product prices.
- The Commonwealth should withdraw the *Petroleum Retail Marketing Sites Act 1980*.
- The Commonwealth should withdraw the *Petroleum Retail Marketing Franchise Act 1980* and replace it with a strengthened industry code of conduct (the "Oilcode").
- Restrictions on trading hours, the range of goods sold and permissible retail areas of service stations should not be used to protect other businesses.

[9] Industry Commission, *Petroleum Products*, Australian Government Publishing Service, Melbourne, 5 July 1994.

Since this report:

- the Commonwealth ceased regulation of petroleum prices in 1998, although Western Australia began regulating prices in 2001; and
- in the ACT, restrictions on the retail area of service stations remain.

The Commonwealth *Petroleum Retail Marketing Sites Act 1980* and *Petroleum Retail Marketing Franchise Act 1980* remain in force and the Oilcode has not been finalised.

1.4.1.3. ACT Legislative Assembly Standing Committee on Public Accounts (September 1994)[10]

The Committee inquired into the impact on the ACT Government's finances of the Government's arrangements to encourage independent retailers to establish in the ACT. The recommendations largely attacked the Government's policy of introducing independents, but also called for:

- an investigation of national fuel supply regulation with a view to persuading the Commonwealth to change any aspects that disadvantage the ACT;
- an investigation of the effects on local shopping centres of the closure of local service stations; and
- implementation of the planning and signage recommendations of the November 1992 report discussed in 1.4.1.1.

Since that report:

- the Commonwealth has abandoned fuel price regulation, but the *Petroleum Retail Marketing Sites Act 1980* and *Petroleum Retail Marketing Franchise Act 1980* remain in force; and
- planning and leasing policies have been overhauled to make more land available for the construction of service stations.

1.4.1.4. Australian Competition and Consumer Commission (August 1996)[11]

The Australian Competition and Consumer Commission's (ACCC) report primarily investigated the system of wholesale price capping which was then in existence at the Commonwealth level. It recommended, among other things:

- a conditional lifting of the capping system;
- the Commonwealth repeal the *Petroleum Retail Marketing Sites Act 1980*;
- the Commonwealth repeal the *Petroleum Retail Marketing Franchise Act 1980* and replace it with a strengthened industry code of conduct (the Oilcode) and recommendations arising from work undertaken by the Commonwealth Department of Industry, Science and Tourism to simplify franchise agreements;
- State and Territory Government consideration of mandating price sign boards at service stations; and
- State and Territory Government consideration of uniform fuel taxation to eliminate border distortions.

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[10] Australian Capital Territory Legislative Assembly, *Review of Petrol Supply Arrangements* (Report no. 13 of the Standing Committee on Public Accounts), Canberra, September 1994.

[11] Australian Competition and Consumer Commission, *Inquiry into the Petroleum Products Declaration*, Australian Government Publishing Service, Canberra, August 1996.

Since that report:

- the Commonwealth has abandoned fuel price regulation, but the *Petroleum Retail Marketing Sites Act 1980* and *Petroleum Retail Marketing Franchise Act 1980* remain in force and the Oilcode was never finalised;
- some jurisdictions have mandated price sign boards, and though the ACT is not one of them, price sign boards are generally used in the ACT; and
- State and Territory governments have not introduced uniform fuel taxation, though NSW and the ACT have the same levels.

1.4.1.5. ACT Legislative Assembly Select Committee on Petrol Pricing (September 1997)[12]

The Committee investigated ways to reduce petrol prices in the ACT to a level similar to those in other cities, with a focus on Sydney. Its recommendations included that:

- the ACT Government seeks action from the Commonwealth Government on strengthening the bargaining power of franchisees and distributors in their relationships with oil majors;
- a review of land and planning controls should be conducted with a view to freeing up the constraints on service station development and exit from the market;
- the retail space restrictions on service stations be eased; and
- the ACT *Fair Trading (Petroleum Retail Marketing) Act 1995*, which gave the ACT Government the power to restrict oil major operation of sites and multi-site franchising, should not be repealed.

Since that report:

- planning and leasing policies have been overhauled to make more land available for the construction of service stations;
- retail space restrictions remain at 50 m^2 for local centres and 150 m^2 in other locations; and
- the ACT *Fair Trading (Petroleum Retail Marketing) Act 1995* was repealed despite the recommendation against this.

1.4.1.6. Senate Rural and Regional Affairs and Transport Legislation Committee (June 1999)[13]

The Committee investigated the repeal of the Commonwealth *Petroleum Retail Marketing Sites Act* and *Petroleum Retail Marketing Franchise Act* in response to a Federal Government repeal bill. As such, its investigations focused mainly on the retail market segment. A recommendation of relevance to our inquiry was that the repeal bill should be passed by the Senate following amendments to ensure that a strengthened Oilcode was in place before repeal occurred. Transitional arrangements were also recommended to ensure existing contracts were not affected.

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[12] Australian Capital Territory Legislative Assembly, *Report of the Select Committee on Petrol Pricing*, Canberra, September 1997.

[13] Senate Rural and Regional Affairs and Transport Legislation Committee, *Report on the Provisions of the Petroleum Retail Legislation Repeal Bill 1998*, Parliament of the Commonwealth of Australia, Canberra, June 1999.

The repeal bill was not subsequently passed by the Senate, largely because the Opposition and minor parties opposed the repeal and the industry could not agree to a strengthened Oilcode.

1.4.1.7. Senate Economic References Committee (March 2001)[14]

This inquiry investigated a private member's bill entitled the "Fair Prices and Better Access For All (Petroleum) Bill 1999" and multi-site franchising by the oil majors. The Bill sought to allow franchisees who currently operate under arrangements which force them to purchase fuel from their major, to purchase up to 50% of their fuel from other suppliers. The inquiry recommended that:

- the Government negotiate with local governments to allow independents better access to country areas;
- the Bill be amended to deal with a number of issues raised in the inquiry and then be reintroduced to Parliament; and
- the *Petroleum Retail Marketing Sites Act 1980* be amended so that no more than 10 sites can be controlled by any one operator.

The Bill has recently been reintroduced to Parliament, this time in the Senate, and is discussed in depth in section 6.1.2 below. It should be noted that the Bill has never been supported by the Federal Government, and that Government Senators disagreed with the recommendations of the report.

1.4.2. Other changes since previous inquiries

This inquiry's terms of reference require the Commission to "focus the Inquiry to those changes that have occurred since previous Inquiries into the ACT motor vehicle fuel, including petroleum, diesel and gas, market". The most recent of these was the ACT Legislative Assembly Select Committee on Petrol Pricing report of September 1997 and changes since this are discussed below.

1.4.2.1. Increase in price levels and variability

Price levels have increased from 70 to 80 cents/L to 90 to 100 cents/L, with a brief peak of over 105 cents/L at some service stations. Variability in prices has also increased. These issues are discussed in sections 2 and 4 below.

1.4.2.2. Reduction in single-site franchisees

There has been a continued reduction of the number of single-site franchisees in the ACT retail market, to the point where there are now very few left. Sites that were previously operated by single-site franchisees have either closed or have been transferred to a multi-site franchisee, distributor, commission agent or direct oil major operations.

1.4.2.3. Pattern of service station locations

The trend in closures of service stations in small, local shopping centres has continued. There has also been development of new, large and diversified service stations at group centres and in busy locations such as on highways and major roads. This has led to an uneven distribution

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[14] Senate Economics References Committee, *Inquiry into the Provisions of the Fair Prices and Better Access for all (Petroleum) Bill 1999 and the Practice of Multi-site Franchising by Oil Companies*, Parliament of the Commonwealth of Australia, Canberra, March 2001.

of service stations with there being far fewer in newer areas such as Tuggeranong than in older areas such as Belconnen. Overall, there appears to be a continuing reduction in the number of service stations. The present locations of service stations in the ACT are shown at Appendix 4.

According to industry and ACT Planning and Land Management, this rationalisation is part of a wider trend towards a lower number of large, high turnover sites. This trend extends across Australia and is occurring in many other industries, not just petroleum.[15,16]

1.4.3. Other current inquiries

At the Commonwealth level, there are currently two inquiries under way. The first, being conducted by the ACCC, is an inquiry into fuel price variability. The second is an inquiry into fuel taxation being conducted by a Committee based in the Commonwealth Department of the Treasury. These inquiries are discussed further in sections 6.1.3 and 6.1.4 below respectively.

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[15] Frank Topham, Peter Morris & Chris Hefford, Caltex Australia Limited, pers. comm., 16 May 2001. Peter Harris & Ian McKenzie, Shell Australia, pers. comm., 2 May 2001.

[16] David Snell, ACT Planning and Land Management, pers. comm., 25 June 2001.

2. EFFICIENCY OF THE PETROLEUM MARKET AND PRICES

This section of the report examines efficiency issues in the fuel market, including the efficiency of fuel prices. The overall make-up of fuel prices is investigated, followed by an examination of a range of indicators of efficiency. The main focus in this section is on the national market, with local circumstances considered more directly in section 3.

2.1. Composition of Fuel Prices

Broadly speaking, fuel prices in Australia are made up three components. These are, in order of size: government taxation, refined fuel costs which are set in the international market, and domestic industry costs.

2.1.1. Government taxation

Government taxation represents a large component of fuel prices, generally around 50% of the total. This portion is made up of two components: a fixed excise of 38.143 cents/L and goods and services tax (GST) of 10% of the retail price. The GST is levied after the addition of excise, so the GST in effect includes a tax on a tax. While the revenue from these taxes is split between the States, Territories and the Commonwealth, for Constitutional reasons the revenue is collected by the Commonwealth, then redistributed.

A tax which can represent up to 50% of the final price can have a significant impact on consumers' final purchasing decisions. However, fuel taxation also represents a major source of government revenue, and without it other taxes would need to increase or spending be cut. Notwithstanding the importance of fuel taxes for revenue-raising purposes, tax rebates do exist for some fuel purchases. These rebates reflect the Federal Government's policy objectives as they relate to remote area use of fuel and the use of diesel for transport, mining and agriculture.

It is not the Commission's role to comment on what the correct level and mix of fuel taxation is. This issue is currently being investigated by a Commonwealth inquiry, as discussed in section 6.1.4 below.

2.1.1.1. LPG

LPG is not subject to excise but is subject to the GST. Thus, over 38 cents/L of the price difference between LPG and other fuels is not due to any higher efficiency or inherent cheapness of the fuel. Rather, it is a product of taxation.

2.1.2. International component

After taxation, the next largest component of the cost of fuel is international refined fuel costs. As shown in Figure 1, these costs are highly variable over time, particularly in the medium and long terms. There are many reasons for this, including the impact on world production levels of decisions by Organisation of Petroleum Exporting Countries (OPEC) supplying countries, the refinery capacity arrangements in South-East Asia from where Australia's imported refined fuel supply originates and demand fluctuations due to weather and economic conditions (for example, the recent high demand for petrol on the USA West Coast and subsequent slump in demand resulting in lower import prices for Australia).

2.1.2.1. Why use international prices?

Most of the crude oil refined in Australia is produced in Australia, and most of the fuel (including diesel and LPG) used in Australia is refined here. The question is often asked: why should international prices affect Australian fuel prices?

The answer is that Australia is part of a global petroleum product market and over time has become increasingly integrated into that market. This being the case, if Australian prices were above those elsewhere in the world, Australian retailers would simply stop buying locally refined fuel and buy imported fuel. Such imports already occur on a small scale.[17] If Australian prices were below those elsewhere in the world, Australian refineries would sell their product overseas, thus cutting off supplies to Australian consumers and driving local prices up. Indeed, there is already a significant LPG export market, and other fuels have also been exported in the past.[18,19] For this reason, Australian tax-exclusive fuel prices, like those of many other products, are inextricably linked to global prices.

2.1.2.2. Refined product prices versus crude oil prices

There is a general misconception in the community and the petroleum industry that the benchmark for Australian fuel prices is the global crude oil price commonly quoted in media financial reports. However, this is not entirely true. Because refined fuels are regularly imported into Australia, local refineries are, in effect, competing with refineries in the source countries of those imports, typically Singapore and other South-East Asian countries. The Singapore product price has also typically been used for setting wholesale price controls. For these reasons, Australian fuel prices are more closely aligned to Singapore refined fuel prices than to crude oil prices (after adjustment into Australian dollars).

While there is a strong relationship between Singapore refined fuel prices and crude oil prices, the two do not always move together. Thus, watching only the crude oil price and the Australian dollar exchange rate can give an observer the impression that fuel prices in Australia are going up while world oil prices are coming down, and thus that consumers are being exploited. In fact, the Singapore product price may be rising despite the fall in crude prices. This situation occurred in April and May 2001, as can be seen in Figure 1.

2.1.2.3. Use of current Singapore prices

A further complication is that prices do not move in response to the actual Singapore cost of the fuel being sold but rather vary around a measure based on current Singapore prices. If prices were based on the cost of producing the fuel being sold, the relevant Singapore price would be that of some time ago, this gap being the time it takes for imported product to arrive in Australia, be transported to the service station and then sold. Instead, the measure typically used by industry in determining the cost is the current Singapore price. This appears to be a hangover from the days of the ACCC's regulated wholesale price cap, as the formula used for setting the price cap included current Singapore prices.[20]

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[17] Craig Stewart, Trafigura Fuels, pers. comm., 18 June 2001.

[18] Phillip Westlake, Australian Liquefied Petroleum Gas Association, pers. comm., 18 June 2001.

[19] Industry Commission, *Petroleum Products*, Australian Government Publishing Service, Melbourne, 5 July 1994, p xvii.

[20] Gary Dobinson, ACCC (Melbourne office), pers. comm., 30 April 2001.

Figure 1. Comparison of Singapore gasoline and West Texas crude oil prices

Sources: US Energy Information Administration; Reserve Bank of Australia

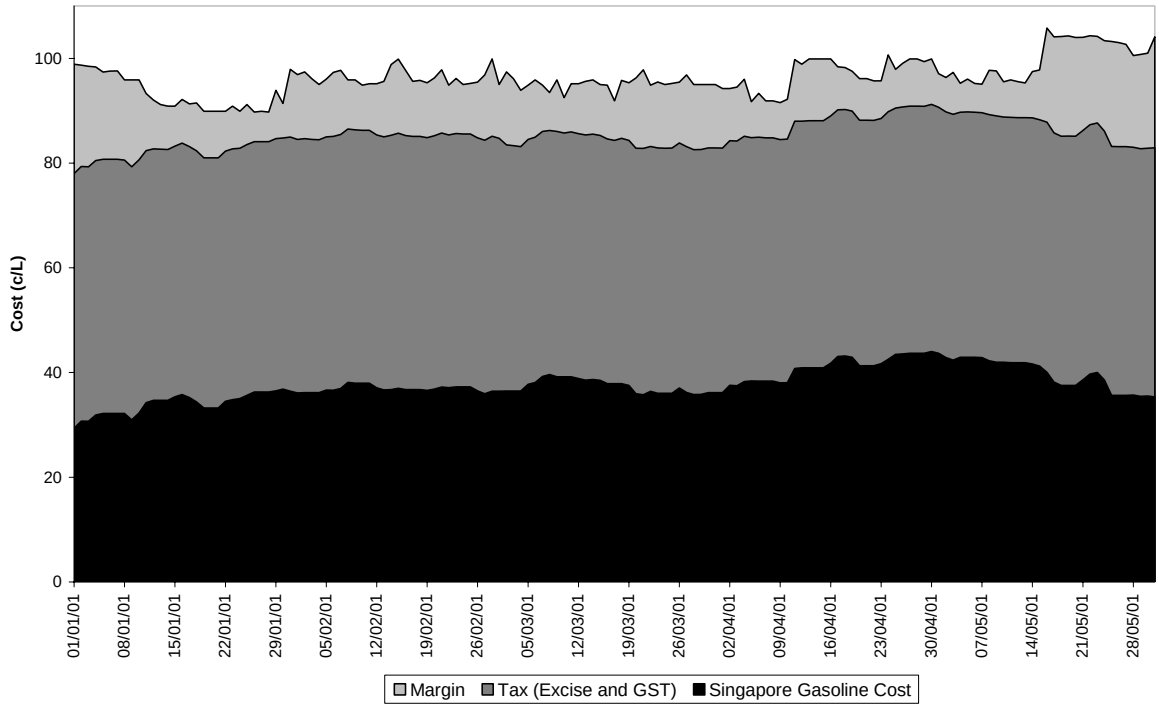
2.1.3. Domestic component

With the possible exception of LPG, the smallest component of fuel prices is the domestic industry margin. This includes modifying the fuel to fit Australian and brand standards, transport from Singapore to Sydney by sea, insurance, wharfage, terminal costs, transport from Sydney to the ACT by road, service station costs and profit. The margin varies a great deal in the short-term. This component is considered in more depth below.

2.1.4. Overall make-up of prices

To give an overall indication of how these components make up a final price, Figure 2 shows the ACT average daily retail ULP price with its various components. The margin of 5 to 22 cents/L is the domestic component discussed above. It is clear from the figure that taxation and Singapore gasoline costs are by far the largest components of the retail price. Notably, in the short-term, there is only a weak correlation between cost and prices. Retail prices regularly dip towards the tax and product costs, despite the fact that the margin has to cover the wide range of costs outlined above.

Figure 2. Composition of the ACT retail price of unleaded petrol



Sources: FUELtrac; US Energy Information Administration; Reserve Bank of Australia

2.1.4.1. Import parity indicator

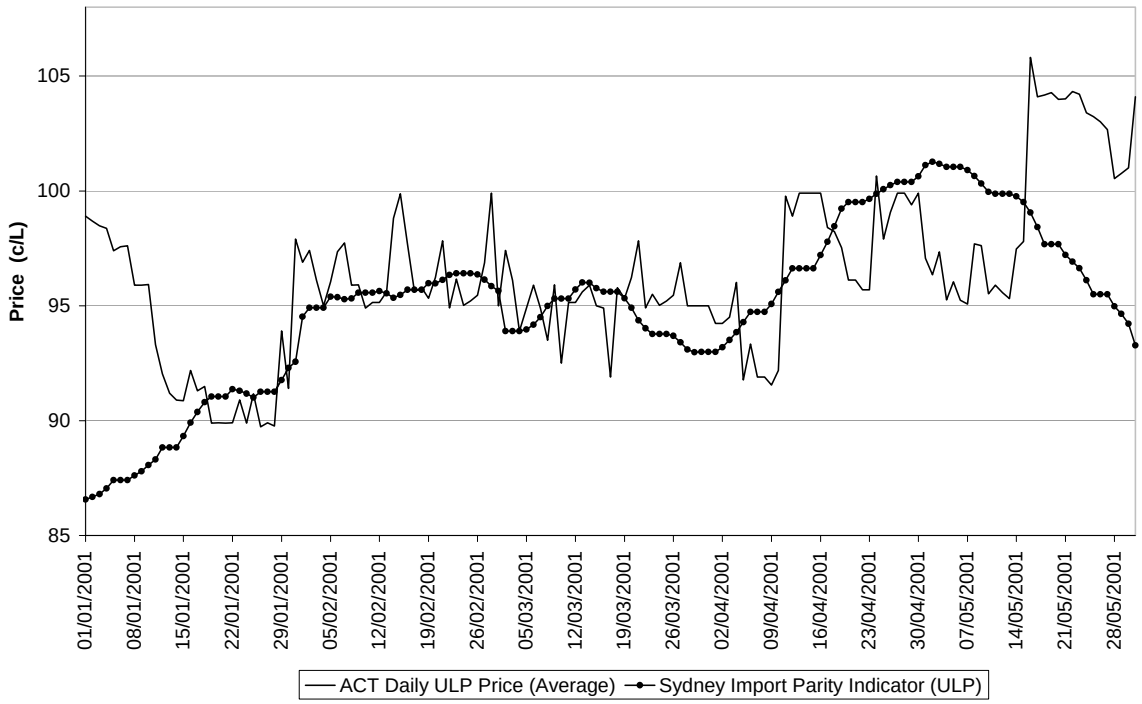
Figure 3 examines whether the margin does cover the costs of buying fuel in Singapore and retailing it in the ACT. The import parity indicator (IPI) shown is a measure of the cost of wholesaling petrol in Sydney, and is calculated using a formula used by the ACCC to set the maximum wholesale price under the regulation regime in force until 1998. (No IPI was calculated for the ACT, with the ACT cap being based on the Sydney IPI.) It includes excise and the cost of importing fuel from Singapore, but not the cost of transporting fuel to the ACT. The IPI should be seen as only an indicator of cost, because the formula used has not been revised for some time.

Even allowing for flaws in the IPI measure of costs, it is clear that for much of the five months from 1 January 2001 to 31 May 2001, the wholesale and retail sectors of the petroleum industry were on extremely low margins, and almost certainly making a loss on several occasions, such as in early May 2001.

2.1.4.2. Price fluctuations

Fuel prices are observed to have two types of fluctuations: long-term movements of up to 30% over periods of months to years, and short-term fluctuations of up to 10% over days and weeks. Short-term fluctuations are largely generated in the domestic industry component of prices, as can be seen in Figure 2. This is discussed in more depth in section 4 below.

Figure 3. Comparison of ACT retail unleaded petrol prices and the import parity indicator



Sources: FUELtrac; NUS Consulting

Long-term fluctuations are driven by international refined fuel prices as mentioned in section 2.1.2 above. High fuel prices in April to June 2001 appear to have resulted from such international factors; namely, high prices for refined fuel product in Singapore in conjunction with the low Australian dollar. As these factors are outside of the control of the ACT Government, they are not considered further in this report.

2.2. Efficiency of the Domestic Industry

Given that government taxation on fuel is outside the scope of this inquiry and the ACT Government can have no influence on international petroleum product prices, this inquiry focuses on the efficiency of the domestic industry component of the pump price.

2.2.1. Cost efficiency

To examine efficiency, it is desirable to investigate the components of the margin. However, data on which to base such an analysis are scarce. Typically, the industry does not separate costs into those associated with selling fuel at an individual service station and those associated with other activities at the service station, such as running a convenience store. This means that data relating solely to the fuel side of the business are not available.

Data supplied by the Australian Institute of Petroleum (AIP) give a profit and loss statement broken down into refining and marketing (post-refinery gate) market segments, but go no

further and are available for 1999 only.[21] This does not allow a separation of the costs of fuel sales from those of non-fuel activity. Information associated with Caltex's annual financial results gives a figure for operating expenses of 4.5 cents/L, but again it is impossible to determine exactly what this comprises.[22] The best approximation that the Commission can make from confidential information provided by oil companies is that post-refinery costs are 4 to 6 cents/L, although this is difficult to verify.

Because of this lack of information, it is not possible to make a direct assessment of the efficiency of the costs being added by the local industry. In view of this, the Commission has investigated indicators of efficiency in the sections below. It should be noted, however, that given that these costs seem to be a small per litre add-on, any inherent cost inefficiencies must be a small part of the total cost per litre of fuel. For example, even if half of the domestic industry add-on comes from profiteering and/or production inefficiency as opposed to legitimate costs of production, that would still increase the price consumers pay for fuel by only 2 to 3 cents/L.

2.2.2. Industry profitability

If the oil industry is profiteering, as is often claimed, these profits should show up in the oil majors' financial results. This section examines industry profitability to investigate this issue.

In an efficient market, companies will not be making excessive profits. Instead they will make a reasonable return on the equity they have invested. Note, however, that the important measure here is the rate of return, not the size of the profit. This is the same principle that ordinary investors use when choosing a term deposit account, for example. It is the interest rate that is considered important because the amount of interest received is as much a function of the amount invested as it is of the relative worth of the term deposit.

2.2.2.1. Retail

In the retail sector, all of the franchisees and independent retailers that spoke to the Commission reported that they were receiving very low per-litre margins and that this was causing them financial difficulty. The Motor Trades Association (ACT) reported in its submission to the inquiry that such retailers were being forced out of the market, and this is backed by the number of such service stations that have either closed or been combined into larger retailing operations such as multi-site franchises. Confidential documentation provided to the Commission which allows calculation of retailers margins also supports these claims.

The oil majors also indicated during discussions with the Commission that retail outlets do not make much profit from selling fuel and indeed often make a loss.[23] Lack of profitability was reported by Trafigura, an independent wholesaler, as the reason that it was not interested in owning retail outlets in Australia, while Woolworths made it clear that its reason for

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[21] Ernst and Young, *Downstream Oil Industry Financial Survey January 1995 to December 1999*, Australian Institute of Petroleum, Canberra, 2000, p11.

[22] Caltex Australia, *Caltex Australia Limited Announces Reduced Full Year Profit* (media release), 23 February 2001.

[23] Frank Topham, Peter Morris & Chris Hefford, Caltex Australia Limited, pers. comm., 16 May 2001. Peter Harris & Ian McKenzie, Shell Australia, pers. comm., 2 May 2001. Mike McGuinness & Greg Foot-Connolly, BP Australia, pers. comm., 15 June 2001.

establishing service stations was not to make a profit but to attract customers to its supermarkets.[24,25] Losses on petrol sales are partly recouped by sales of convenience store products (the chips and coke side of a service station) but clearly the additional revenue is not enough to make the fuel retailing business attractive.

2.2.2.2. Wholesale

The wholesale segment of the industry includes all operations between the refinery and the service station. These include storage of fuel, distribution to service stations and overheads such as each company's corporate head office.

Again in this segment, both oil majors and independents reported very low margins and a lack of profitability. Trafigura, the owner of the former Burmah wholesale business, stated that the oil majors often sell at a loss, which makes business difficult for them.[26] The Australian Petroleum Agents and Distributors Association (APADA), the organisation representing fuel distributors, reported that many of its members were losing money and being forced to take equity from the oil majors or close. Around 50% are now partly oil major owned. There was also a general rationalisation of facilities such as depots to cope with the tightening of margins.[27]

2.2.2.3. Refining

The refining business in Australia consists of a large number of small and old refineries and it also faces strong import competition. All of the oil majors reported losses in their refining businesses to the Commission and this view was supported by the AIP. One oil major reported they would soon close a refinery because of continuing unprofitability.

2.2.2.4. Overall profitability

Several indicators of overall profitability in the industry are available in the Ernst and Young Downstream Oil Industry Survey.[28] This shows that, in 1999, return on equity amongst the oil majors in the Australian downstream industry was 17.3%. This compares favourably with companies in other industries in that year, such as Qantas (13.8%), National Australia Bank (15.2%), Woolworths (17.3%) and Brambles (18.6%).[29] However, most of this return is the result of an increase in the value of crude oil and fuel stocks held by the majors. This occurred because world petroleum prices doubled over 1999. After adjusting for inventory value gains associated with this, underlying return on equity was 5.7%, well below returns being delivered by other companies. This is not a one-off case. The report shows that profit has been consistently low since the survey began in 1995. Figures for profit per litre of fuel sold are also provided, and this has been below 1 cent/L since 1995. Note, however, that this figure includes non-fuel revenue and expenditure, and is thus unlikely to accurately reflect the profit per litre that the majors are making on fuel sales.

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[24] Craig Stewart, Trafigura Fuels, pers. comm., 18 June 2001.

[25] Hans Sidler, General Manager Petrol, Woolworths Limited, pers. comm., 16 May 2001.

[26] Craig Stewart, Trafigura Fuels, pers. comm., 18 June 2001.

[27] Garth Symington, Australian Petroleum Agents and Distributors Association, pers. comm., 18 June 2001.

[28] Ernst and Young, *Downstream Oil Industry Financial Survey January 1995 to December 1999*, Australian Institute of Petroleum, Canberra, 2000.

[29] Returns were calculated by the Commission based on information extracted from the companies Annual Reports for 1999.

Throughout the downstream petroleum industry (refining, wholesaling and retailing), profits and rates of return are low, to the point that companies are being driven out of the market. This suggests that the industry is not making excessive profits; indeed, it is more likely to be making returns lower than those typically expected by financial markets.

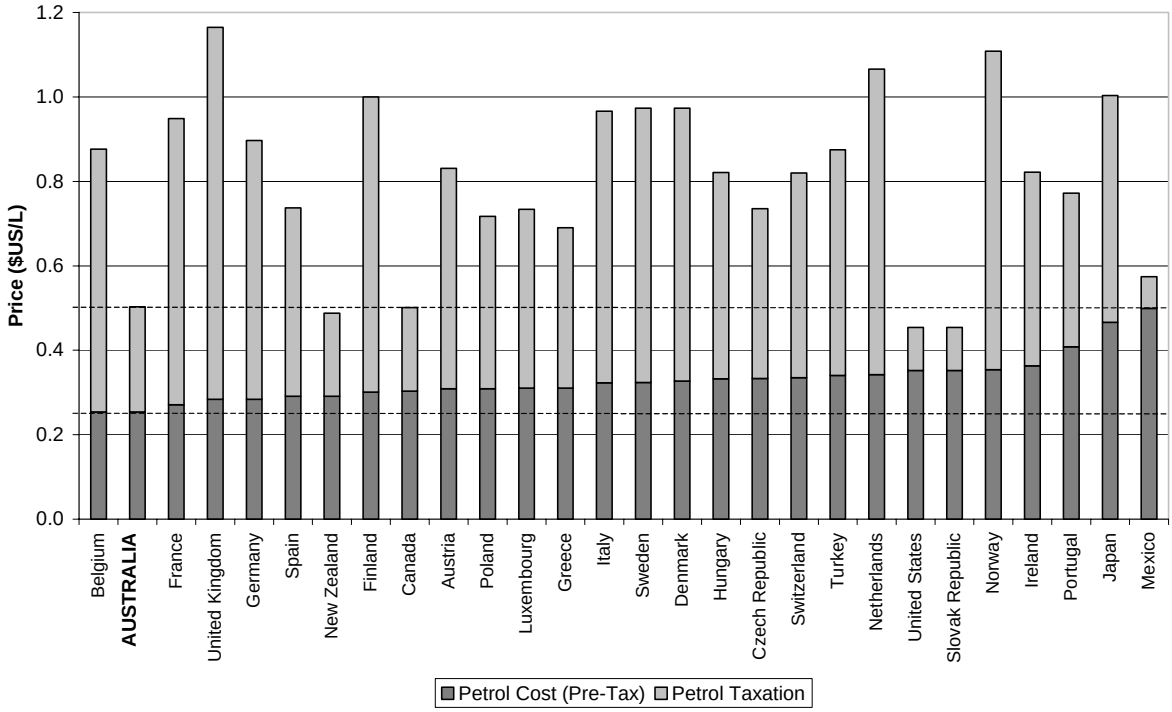
It is important to note that this analysis only partly applies to LPG, as most of the automotive LPG sold in Australia is not produced by the oil majors. However, the majors do have a greater role in LPG in the retail sector as much of it is sold through major-owned or branded service stations.[30]

2.2.3. Comparison with international prices

In a global market such as that for petroleum products, domestic retail fuel prices should be the same as, or very close to, international retail fuel prices. However, in the petroleum industry worldwide, retail prices are dominated by taxation, as discussed above. Because of this, tax-exclusive prices must be examined to make an international comparison of the efficiency of the underlying industry.

Figure 4 compares the Australian ex-tax petrol price with prices in other OECD countries. Figure 5 provides the same comparison for diesel. There are no data for LPG.

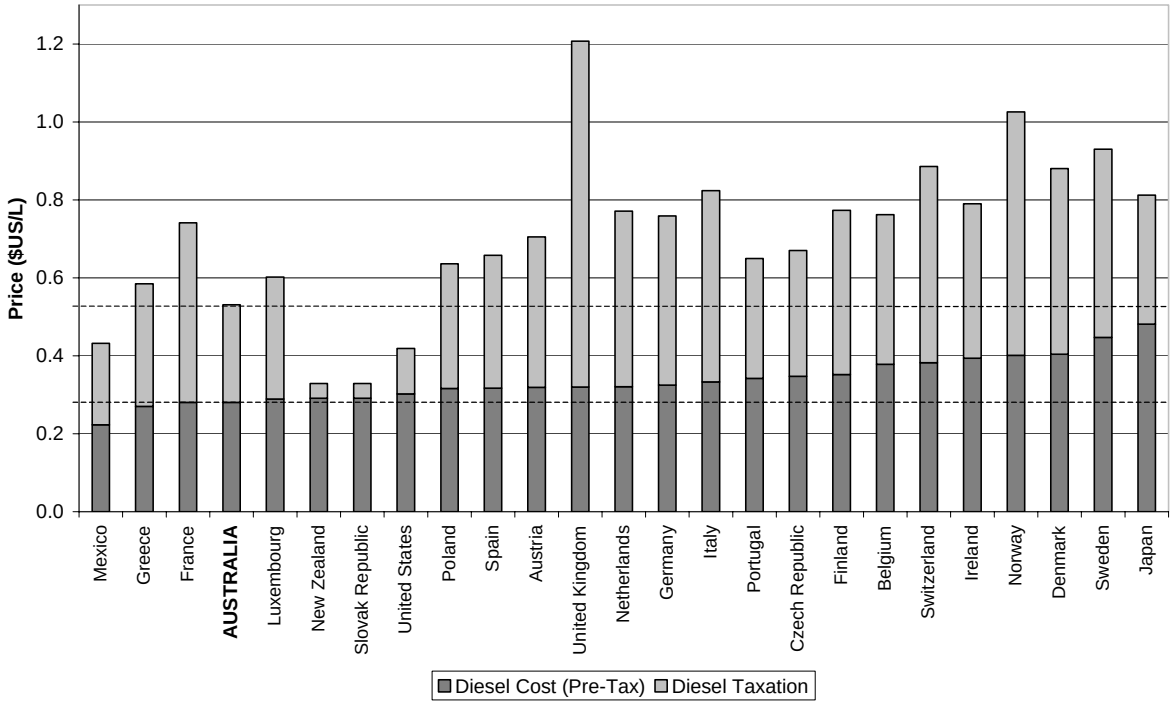
Figure 4. Comparison of petrol costs across OECD countries, 1st quarter 2001



Source: International Energy Agency

[30] Phillip Westlake, Australian Liquefied Petroleum Gas Association, pers. comm., 18 June 2001.

Figure 5. Comparison of diesel costs across OECD countries, 1st quarter 2001



Source: International Energy Agency

As can be seen, Australian tax-exclusive petrol prices are the equal lowest in the OECD, and remain comparatively low after tax has been included. In the case of diesel, Australian tax exclusive prices are equal third lowest of 25 countries and fifth lowest after tax is included. To confirm whether this comparative cheapness of fuel is significant or just part of an overall pattern of low prices for goods and services in Australia, the Commission engaged the Centre for International Economics to investigate international purchasing parity. Their report suggests that, at the exchange rates Australia has experienced since at least 1996, goods and services are generally cheaper in Australia than in most other OECD countries, though Australia is not the cheapest country in the OECD.[31]

This result suggests that part of the relative cheapness of petrol and diesel in Australia is not specific to the petroleum industry, but rather reflects an overall pattern of goods and services being cheaper in Australia than in most other OECD countries. However, this does not entirely explain the relative cheapness of fuel in Australia, particularly for petrol. It is likely that the comparative cheapness of fuel in Australia is also indicative of comparatively efficient pre-tax price levels.

[31] Centre for International Economics, 'International prices comparison', report for the Independent Competition and Regulatory Commission, Centre for International Economics, Sydney, 29 June 2001.

2.2.4. Competition

This section examines competition in the petroleum industry. Lack of competition is often associated with inefficiency and excessive profit-taking because it allows companies to operate without pressure continually to improve their performance.

2.2.4.1. Findings of ACCC discussion paper

The discussion paper prepared by the ACCC for its inquiry into reducing fluctuations in fuel prices included an examination of average daily retail prices and the IPI for Sydney and Melbourne. This showed that prices in Melbourne were typically below the IPI on most days and that there were strong, regular fluctuations in retail prices in both 1998 and 2001.

In Sydney, retail prices have fallen compared with the IPI since the cessation of wholesale price capping in 1998. Whereas retail prices previously were typically below the IPI only on some days, they are now below the IPI on most days. This indicates that wholesale and retail margins have fallen since 1998 and it was suggested that this was because the Sydney market had become more competitive. The regular retail price cycles had also strengthened.

Graphs provided with this analysis also showed that, if the influence of regular weekly to fortnightly cycles is removed, there is a strong correlation between the IPI and retail prices. This suggests that, in Sydney and Melbourne at least, prices reflect costs.[32]

2.2.4.2. Number and strength of competitors

At the retail level, control of outlets by majors has been increasing in the ACT over recent years through changes such as multi-site franchising, increasing commission agent operation of oil-major-owned sites and distributor ownership of sites where that distributor is partly or entirely owned by a major. As this is reducing the number of outlets that can price independently of the oil majors, it could potentially reduce competition. On the other hand, Woolworths and Gull, two strong independent chains, have entered the market. Woolworths in particular has the network size and financial strength to be a strong competitor to the majors.

The wholesale sector is dominated by the four major oil companies, though there is an independent wholesaler (Trafigura) and several brand-carrying but otherwise independent distributors. At the refinery level, strong competition comes from imports of refined product. The import threat appears to be real as fuel imports occur regularly.

It should be noted that ownership in the oil industry is far less concentrated than in other industries, such as supermarkets and domestic aviation, and there are enough competitors at each level for strong competition to occur.

2.2.4.3. Price indicators

Another indicator of competition is that prices change relatively regularly. In a competitive market, one competitor will cut prices in an attempt to gain market share from another. Others will tend to follow suit to ensure they retain market share. Prices will remain down (or

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[32] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001, pp 11 – 14.

continue falling) until enough companies, because of financial suffering, raise their prices again. At this point, any companies that remain cheap can increase their prices without risking their market share, and will raise their prices towards the original level. Other markets which typically see this type of discounting cycle are wholesale fish, fruit and vegetables.

In a non-competitive market, such discounting cycles are unlikely because companies are not actively trying to win market share from each other. Companies tend to prefer a stable price to fluctuating prices because stability decreases their risk and allows them to calculate a price which maximises their profit. Fuel prices away from the major cities and highways often exhibit this type of stability.[33] This issue is discussed in more depth in section at 4 below.

2.2.4.4. Entry and exit

In markets where entry and exit of competitors is relatively easy, competition tends to be stronger. If market players are earning excessive profit and start-up costs are not prohibitive, companies outside the market will see it as a profit opportunity and will enter. High exit costs can also retard entry of new players as they increase the risk of being trapped in an unprofitable market. Entry to the service station market seems to be fairly easy. The rapid spread of Woolworths+Petrol and the number of single-site independent retailers indicates that the set-up costs of entering the industry are not prohibitive.

Exit from the industry is more problematic, partly because of the costs of environmental repair of sites and partly because of a potential lack of alternative uses of some sites. This is made more difficult by ACT Government policy, as discussed in section 3.3.3.3 below.

2.2.4.5. Collusion

The ACCC regularly receives and investigates a wide range of complaints from consumers and industry players about perceived collusion, price fixing and other such illegal practices. It has been unable to substantiate and/or prosecute these claims on any occasion in recent years. This indicates that either there are no *Trade Practices Act* infringements occurring or that infringements are occurring but are not being prosecuted.[34]

A major area of complaint from members of the public is that prices at all outlets rise at the same time, or stay at the same level. The feeling is that this is a sign of collusion. This issue is discussed in section 4.2.2 below, but this kind of activity can actually be as much a sign of competitive behaviour as much as a sign of collusion or price fixing.

2.2.4.6. Arrangements between retailers and distributors

In the case of franchisees and branded independents, there are arrangements which do restrict competition. An example of this is the tied arrangements that force franchisees and branded independents to purchase their fuel solely from their franchisor or brand-owner. The question is: do such arrangements hinder or facilitate the market?

For example, branding arrangements with independents allow the oil majors to extend their wholesale sales, thus giving them greater market share. However, it also introduces to the

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[33] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001, p 5.

[34] Michael Kiley, ACCC (Canberra office), pers. comm., 1 June 2001.

market an additional competitive group (the independent service station owners) who might not have been able to participate in the market without the branding arrangement that gives them access to a corporate image that attracts customers. Thus, the tied-branding arrangements may actually increase competition in the market.

Opinions differ on whether such tied arrangements operating within the ACT are hindering or facilitating the market. Most of the market players believe that, in theory, the arrangements are good for competition, but many retailers argue that the way that the arrangements currently work, they are used to restrict competition.

2.2.4.7. The price-support mechanism

Price support is an example of a tied arrangement. Often when retail prices fall in a short-term cycle, wholesale prices charged to franchisees do not change. Franchisees are thus caught between falling retail prices and a fixed wholesale price. Given the slim margins most franchisees are working on, this very rapidly causes financial hardship. In most cases when this occurs, the franchisee's major offers price support through a post-sale payment per litre of fuel sold intended to allow the franchisee to reduce prices to stay competitive.

Price support is clearly effective in reducing the cost of fuel to franchisees so that they can compete in the market during short-term price reduction cycles. However, it achieves this in such a way that franchisees lose a degree of independence in their ability to set prices. If they set their price above or below the price suggested by their major, their price support can be cut or withdrawn. The price support mechanism of delivering reduced costs to franchisees can thus be used to reduce price competition.

To overcome this, it may benefit competition to find a way to cease price support while still allowing a mechanism for franchisees' costs to be reduced during short-term price declines. One way would be to regulate that any support provided be through the mechanism of reducing wholesale prices. Nevertheless, it is important not to cause a significant rise in the average price of fuel while trying to remove this problem. For example, a change could not only remove from the market anti-competitive price support but also far greater competitive forces by leading to a cessation of short-term price declines altogether. Thus, any such change should be subject to industry consultation before its introduction.

There is only a small number of locally-based franchisees remaining in the ACT market. Thus, any change to the price-support mechanism will have a relatively minor effect. Furthermore, to make changes in this area and have them apply only in the ACT could add significantly to industry costs through requiring the implementation of new information systems. Thus, any such action should be taken only in conjunction with other jurisdictions.

2.2.5. Balanced supply and demand

In an efficient market, supply and demand are balanced. If prices are too low, producers will be unwilling to supply and stocks will quickly run out at some outlets, leading to queuing at others. Consumers will be willing to pay more for fuel to avoid the queuing and retailers will be able to raise prices without losing sales. Both factors will drive prices up.

If prices are too high, consumers will tend to reduce their use. They will drive less, catch public transport and share vehicles where possible. This will lead to a fall in sales. Some retailers will then cut their prices to attempt to increase their sales and the rest of the market

will be forced to follow suit. These two forces will be in balance only when the price is at a level where supply and demand are equal.

In motor vehicle fuels markets, there are no signs of under or oversupply such as queuing.

2.3. Submissions and Public Opinion

Nearly all submissions and telephone calls to the Commission commented on price levels, efficiency or related issues. However, the viewpoints expressed varied greatly, depending on the submitter's relationship to the industry.

Members of the public typically felt that prices were too high. Most felt that this was due to "profiteering" by the major oil companies and believed that they were colluding to raise prices. A large number called for Government intervention to reduce prices, either by stopping the price fixing or regulating to reduce prices.

Retailers such as franchisees and independents also felt that the majors were charging too much for fuel at the wholesale level and wanted transparency in the wholesale price. They claimed they were being financially squeezed by the majors who used their market power to reduce the gap between wholesale and retail prices. They also felt that they were being unfairly targeted for criticism by the public when in reality they were suffering financially, not profit-taking. These views were supported by the Motor Trades Association (ACT) and the Motor Trades Association Australia.

The oil majors and the AIP felt that prices were high because of taxation and high international oil and refined fuel costs, not because of any local industry factors. They felt unfairly blamed and pointed to their low profitability as evidence that they were not price fixing to make extraordinary profits. They argued that, in fact, prices were probably unsustainably low on average.

APADA, independent wholesalers and retail chains felt that margins were extremely tight throughout the industry and that if anything, prices were too low to be sustainable. Prices should thus be higher, and probably will be in the longer term. Some blamed the majors for this situation.

2.4. Data Update

Data for June 2001 show that the daily average ULP price for the ACT declined from around 100 cents/L to around 92 cents/L. By the beginning of August, price observations suggested that ULP prices were around 83 cents/L. These rapid declines in ULP prices appear to have been driven by falls in Singapore refined gasoline prices.

During June 2001, Sydney prices fell faster than ACT prices and, despite their 8 cents/L fall, ACT prices were well above the import parity indicator. This gap began to shrink again as ACT prices continued to fall in July 2001. By early August, ACT and Sydney were again close. This may indicate that downward competitive pressures were less strong in the ACT than Sydney, though by no means absent.

The price decline between late May and early August 2001 was much lower for diesel, around 2.5 cents/L. Indeed, in June 2001 the monthly average price for the ACT rose from

97.3 cents/L to over 100 cents/L and remained unchanged at 97.7 cents/L in Sydney. In early August, price observations showed diesel prices had fallen back to around 95 cents/L. Again, these changes were most likely caused by international cost factors.

The price decline between late May and early August 2001 was also lower for LPG, around 4.5 cents/L. For the ACT, the monthly average price fell from 49.4 cents/L to 47.8 cents/L between May and June 2001. Price observations in early August 2001 showed prices in the ACT of around 44.9 cents/L.

2.5. Conclusion

Excluding taxation and international issues, there is very little evidence that petrol and diesel price levels are inefficient at a national level. Indeed, Australian petrol and diesel prices, both tax exclusive and inclusive, are amongst the lowest among OECD countries. Competition in the Australian downstream petroleum business seems to be high, to the point that margins and profitability are low, possibly unsustainably so. This is causing ongoing rationalisation in the industry. The proportion of petrol and diesel pump prices attributable to the local industry is very small, so even if there is any inefficiency in the industry at a national level, it can be causing only a small rise in retail prices.

High fuel prices in April to June 2001 appear to have resulted from high prices for refined fuel product in Singapore in conjunction with the low Australian dollar. The ACCC shows in the discussion paper for its current inquiry into fuel price fluctuations that, aside from weekly cycles, prices follow these factors very closely.[35]

Looking at LPG, less work has been done previously and there are fewer data available. This makes a firm conclusion more difficult, but many of the same factors are relevant, suggesting a similar situation.

[35] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001, pp 11 – 14.

3. ARE FUEL COSTS HIGHER IN THE ACT?

This section narrows the examination of market efficiency to the ACT by looking at price differentials between the ACT, Sydney and Queanbeyan. It is based on the view developed in Chapter 2 that broad national prices are efficient.

3.1. Analysis Method

The Sydney market has a number of regions where prices are much lower than in other regions. This was explained to the Commission by the oil companies as being a result of some areas having a far more competitive market than others. This competition can be driven by independent retailers with old and poorly-maintained service stations (and thus lower costs) or independent chains who can purchase large, cheap loads of fuel from a refinery during periods of oversupply. Equally, other areas such as the north shore and eastern Sydney have a number of service stations off major roads that maintain prices well above the rest of the market, and cater to price insensitive consumers.[36] To avoid any ACT/Sydney comparison being skewed by such sites, the measure used for price comparisons in this report is a monthly average price. This will tend to reduce the effects of these extreme cases.

3.2. Are There Price Differentials?

3.2.1. Petrol

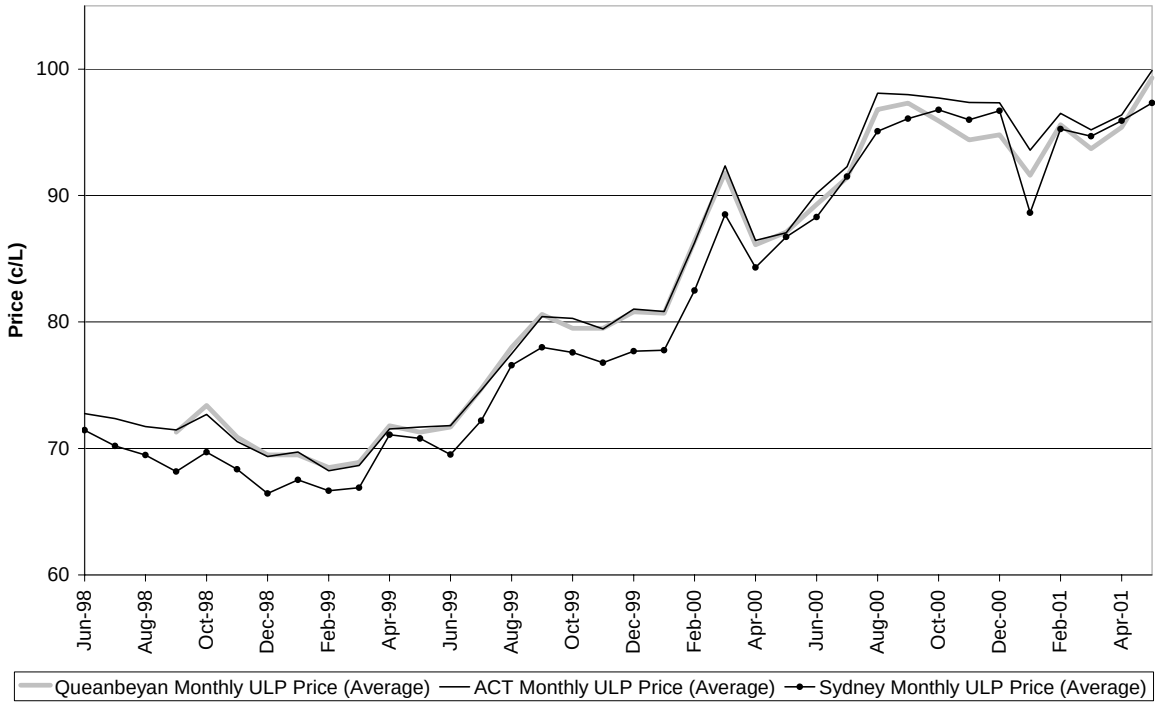
Figure 6 shows monthly average ULP prices for the ACT, Sydney and Queanbeyan from June 1998 to May 2001. The clear pattern is that, until early 2000, all three markets moved very much in concert. As you would expect, the ACT and Queanbeyan are very similar during this time, and Sydney is significantly and constantly cheaper. After early 2000, the relationships become much less clear and regular. In particular after June 2000, the ACT and Queanbeyan averages separate, with Queanbeyan being permanently lower. Sydney prices also converge, until in some months (for example September to December 2000), Queanbeyan is cheaper on average than Sydney.

3.2.1.1. Sydney

To analyse the differential between the ACT and Sydney, Figure 7 shows the difference in average prices over the same period, with numbers above zero indicating the ACT is more expensive. Before May 2000, the difference appears to be cyclical, with the two peaks around 18 months apart. As illustrated, the average differential during that period is 2.3 cents/L. After May 2000, the difference is much less regular, with major spikes in August 2000, January 2001 and May 2001. On average though, the differential between the ACT and Sydney narrowed to 1.6 cents/L.

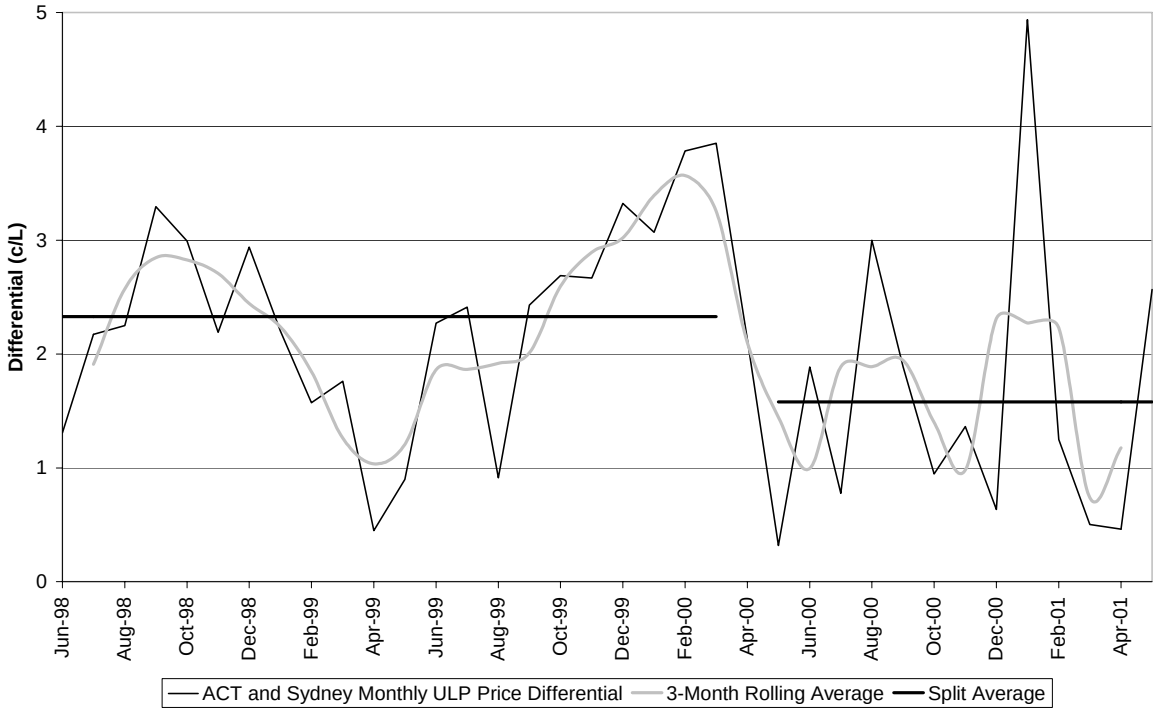
[36] Frank Topham, Peter Morris & Chris Hefford, Caltex Australia Limited, pers. comm., 16 May 2001.

Figure 6. Comparison of monthly unleaded petrol prices (ACT, Queanbeyan and Sydney)



Source: FUELtrac

Figure 7. Differential between ACT and Sydney unleaded petrol prices

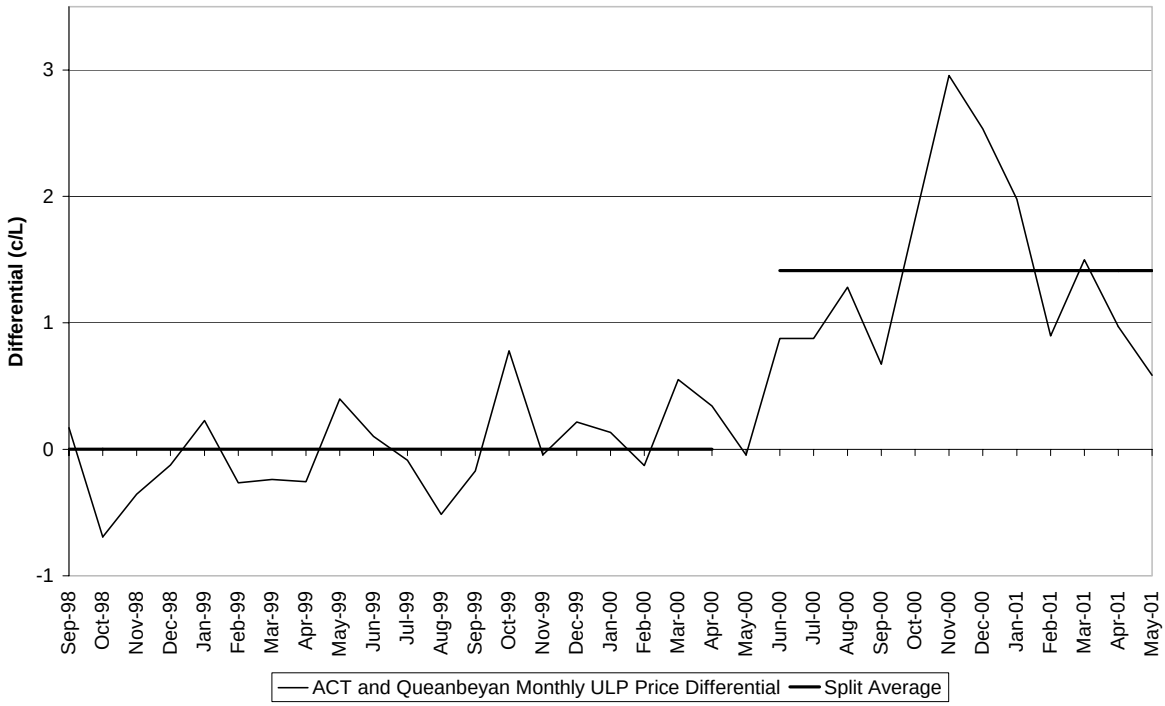


Source: FUELtrac

3.2.1.2. Queanbeyan

Figure 8 shows the difference in average prices between the ACT and Queanbeyan from September 1998 to May 2001. Again numbers above zero indicate that the ACT is more expensive. Before June 2000, on average there is no differential: ACT prices and Queanbeyan prices are roughly the same. After June 2000, there is a noticeable jump, with average prices in the ACT 3 cents/L higher in November. The average difference after June 2000 is 1.4 cents/L.

Figure 8. Differential between ACT and Queanbeyan unleaded petrol prices



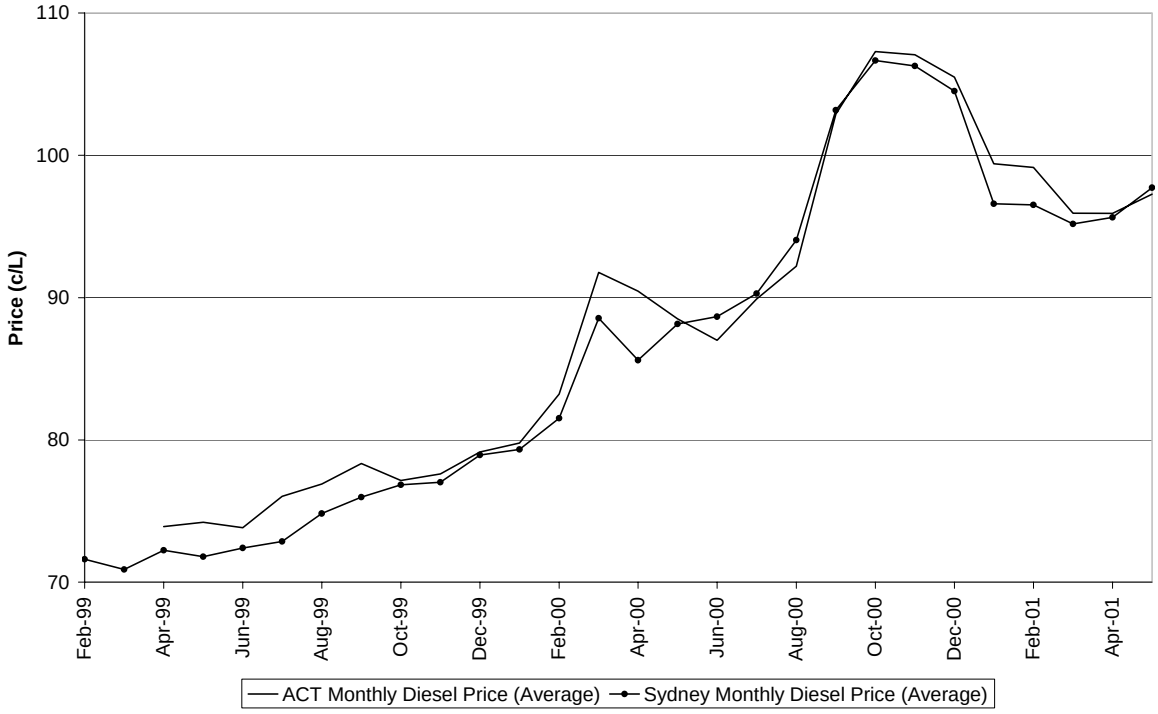
Source: FUELtrac

3.2.2. Diesel

Figure 9 shows monthly average diesel prices for the ACT and Sydney from February 1999 to May 2001. No statistically robust data for Queanbeyan are available. Until May 2000, the average Sydney price was below that in the ACT, usually by a significant amount. From May 2000, average Sydney prices were much closer to the ACT average, and sometimes even above it.

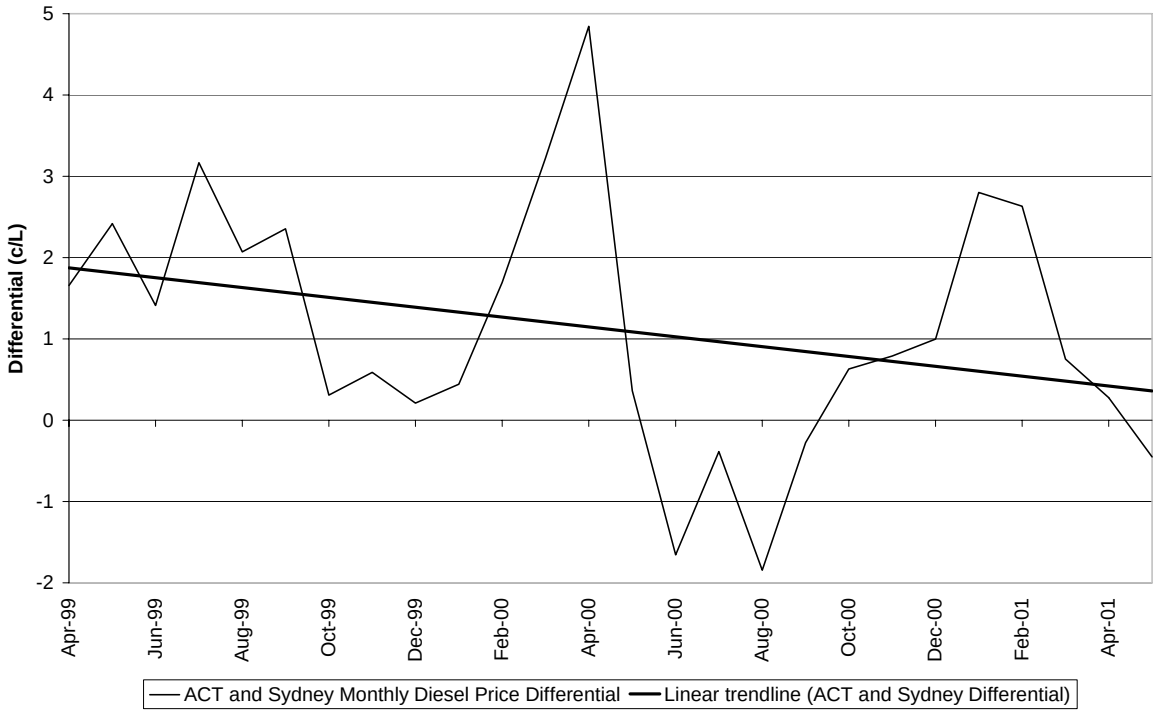
Figure 10 shows the difference between the monthly average ACT and Sydney prices. Numbers above zero indicate that, on average, the ACT was more expensive. The most prominent feature is a nine-monthly cycle. However, adding a linear trend-line shows that underlying these cycles, the differential between the ACT and Sydney is falling from just under 2 cents/L to around 0.5 cents/L.

Figure 9. Comparison of average monthly diesel prices (ACT and Sydney)



Source: FUELtrac

Figure 10. Differential between ACT and Sydney diesel prices

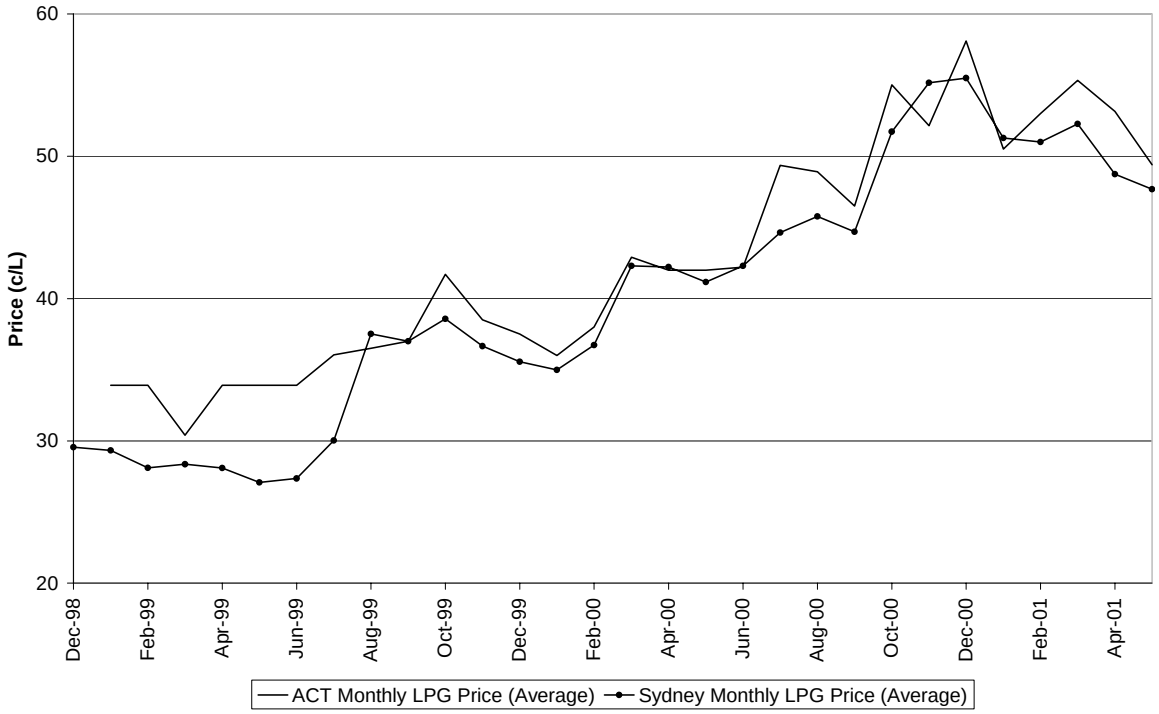


Source: FUELtrac

3.2.3. LPG

Figure 11 shows monthly average LPG prices for the ACT and Sydney from February 1999 to May 2001. No statistically robust data for Queanbeyan are available. It is clear that, the short-term correlation between the average ACT price and the average Sydney price is less strong for LPG than for petrol and diesel. This means that the difference between the two varies widely, as can be seen in Figure 12, which shows the difference between the monthly average ACT price and the monthly average Sydney price. Numbers above zero indicate that, on average, the ACT was more expensive. The trend-line shows that underlying the fluctuations there is an initial differential of around 5 cents/L. This drops to around 1 cent/L in May 2000, before rising back towards 2.5 cents/L in May 2001.

Figure 11. Comparison of monthly liquefied petroleum gas prices (ACT and Sydney)

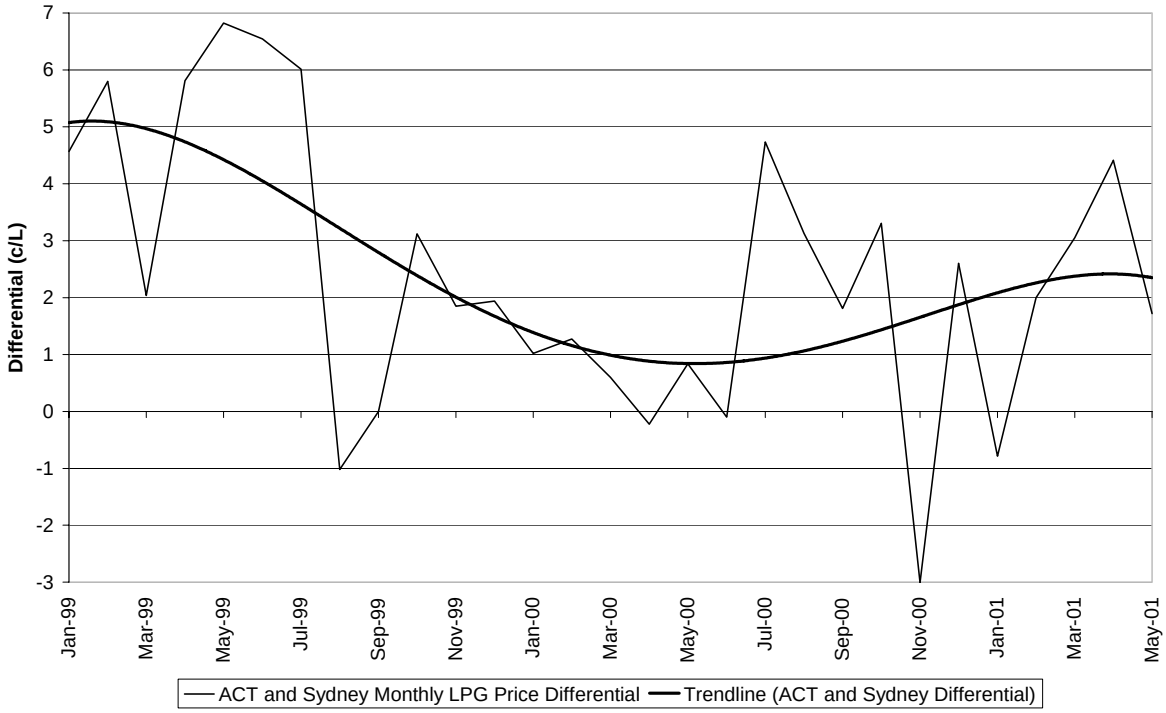


Source: FUELtrac

3.3. Should There be a Difference?

According to the oil industry, the ACT, Sydney and Queanbeyan all function as separate markets, with different demand, supply and competition pressures. As a result, short-term differences in price are to be expected. However, in all cases a long-term differential between average prices is visible. This section examines possible reasons for this differential.

Figure 12. Differential between ACT and Sydney liquefied petroleum gas prices



Source: FUELtrac

3.3.1. Fuel Sales Grant Scheme

As part of the introduction of the new tax system in July 2000, the Federal Government introduced a Fuel Sales Grant Scheme for petrol and diesel (but not LPG). This was designed to offset the fact that the introduction of the GST caused a percentage increase in fuel prices, whereas excise reductions caused a fixed-sum reduction. These were approximately balanced in most urban areas at that time, but in areas where prices were significantly higher, such as rural areas, the percentage increase was larger and the fuel price rose overall. Grant amounts are 1 cent/L in non-metropolitan areas and 2 cents/L in remote areas, with area boundaries being determined by an index of remoteness called ARIA.[37]

Mapping by the Australian Taxation Office (ATO) shows that service stations in Queanbeyan are eligible to receive the non-metropolitan level of grant while most of those in the ACT are not.[38] This factor explains up to 1 cent/L of the difference between ACT prices and those in Queanbeyan. Figure 13 shows the difference between ACT and Queanbeyan average ULP prices, with average Queanbeyan prices adjusted up by 1 cent/L from July 2000 to remove the effect of the subsidy. Apart from a brief but large spike in December and January 2001, there

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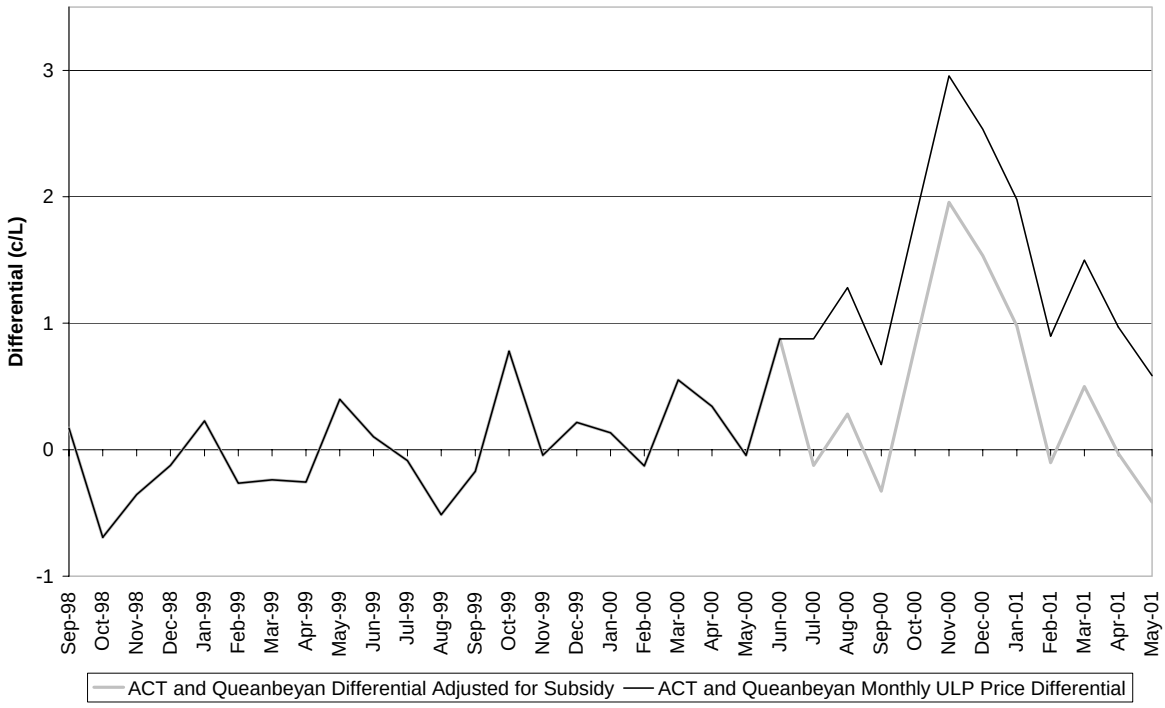
[37] David Crawford, Indirect Tax Division, Commonwealth Department of the Treasury, pers. comm., 28 June 2001.

[38] Australian Taxation Office, *Fuel Sales Grant Scheme – Australian Remote/Regional Boundary Maps*, 2000 & 2001 (accessed 28 June 2001), <http://www.taxreform.ato.gov.au/general/fuel_sales/rural_remote.htm>, <http://www.taxreform.ato.gov.au/general/fuel_sales/act/act_map2.pdf> & <http://www.taxreform.ato.gov.au/general/fuel_sales/act/act_map1.pdf>.

is no long-term differential between ACT and Queanbeyan average prices once the subsidy has been removed. Thus, with the exception of a brief spike in December and January 2001, the ACT/Queanbeyan differential is completely attributable to the operation of the Commonwealth Fuel Sales Grant Scheme.

Figure 13. Differential between ACT and Queanbeyan unleaded petrol prices excluding the effect of the Fuel Sales Grant Scheme



Source: FUELtrac

3.3.1.1. ACT anomalies

According to the ATO, most of the ACT is classified as metropolitan and is ineligible for the grant. However, there appear to be a number of anomalies:

1. There are areas that are eligible for the 1 cent/L grant because they are classified as non-metropolitan but are effectively metropolitan. These, include Hume and Canberra Airport, both of which have service stations.
2. Yet-to-be-developed areas of Gungahlin are classified as non-metropolitan but will become metropolitan as Canberra grows. These do not have service stations yet but are likely to as the area is developed. There are no plans for their status to be changed to metropolitan when development occurs.
3. The Oaks Estate is classified as metropolitan, despite being isolated from the rest of Canberra. It also directly borders Queanbeyan, which is classified as non-metropolitan. Oaks Estate does not have a service station at present.

There also appear to be anomalies between the status of Canberra and other large centres. Wollongong, for example, which is highly urbanised and in many ways part of Sydney, is included as a regional area and qualifies for the subsidy. On the other hand, Newcastle, like Canberra, is defined as a metropolitan area.[39]

While 1 cent/L does not sound very significant, in a market where margins are very low, service stations that receive the grant will have a significant competitive advantage over those that do not. In the short-term, passing motorists are more likely to stop at service stations selling lower-priced fuel, particularly where they are in a visible location close to a major road. In the longer term, they are likely to develop a reputation for having cheaper fuel, which will further increase their sales. The resulting increase in profitability will be enhanced by increased shop sales.

Given the highly urbanised nature of the Territory, prices being fairly even throughout and the lack of transport cost differences across the ACT, there is little justification for some parts of the ACT receiving the grant and others not, with the exception of true non-metropolitan locations such as Williamsdale.

Note that for "privacy reasons", the ATO will only confirm that there are service stations in the ACT that receive the grant and not which service stations are included. Thus, the Commission cannot be certain whether all service stations in the ACT in areas shown as non-metropolitan are receiving the grant.[40]

Recommendation 1: That the ACT Government make representations to the Commonwealth to ensure all service stations in the ACT region are treated equitably in their ability to access the Fuel Sales Grant Scheme.

3.3.2. Transport costs

As discussed above, fuel sold in the ACT and Queanbeyan is typically delivered from terminals in Sydney. Thus, the cost of retailing fuel in the ACT and Queanbeyan must be higher than in Sydney, and in an efficient market, it would be expected that prices would be higher by the amount of the transport costs (plus the additional GST caused by that differential). Various industry representatives have quoted a range of figures for transport costs, varying between wholesaler and also on whether the individual service station can receive B-double trucks or not. However, in all cases, the transport differential between Sydney and the ACT has been reported as being at least 1.6 cents/L for diesel and petrol, and slightly higher again for LPG. Transport cost differentials between Sydney and Queanbeyan are identical to those between Sydney and the ACT.

For petrol, transport costs explain the entire differential between Sydney and the ACT after the change in market behaviour in May 2000. For diesel, the analysis of the price differential with Sydney shows that average ACT prices are typically less than 1 cent/L higher than

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[39] Australian Taxation Office, *Fuel Sales Grant Scheme – NSW*, 2001 (accessed 24 July 2001), <http://www.taxreform.ato.gov.au/general/fuel_sales/nsw_map.htm>.

[40] Michael Harms, Australian Taxation Office, pers. comm., 28 June 2001.

Sydney prices. When transport costs of 1.6 cent/L or higher are taken into account, Canberra diesel consumers are on average getting a better deal than those in Sydney.

For LPG, the picture is less clear. The trend line in Figure 12 shows that the average LPG cost differential between Sydney and the ACT trended down to less than 1 cent/L in May 2000, but has since risen to around 2.5 cent/L. While transport costs are higher for LPG than for petrol and diesel this may not explain the entire 2.5 cents/L.

3.3.3. Factors considered in previous reports

The current situation is very different to that described in the ACT Legislative Assembly's report of September 1997. In that and previous reports, petrol prices were 2 to 3 cents/L higher in Canberra even after taking transport costs into account.[41,42] In those reports, the following factors were considered to be the probable causes of the price differential.

3.3.3.1. Competition in the ACT market

In the past it was argued that the ACT market was less competitive than the Sydney market, which led to the ACT missing out on heavily discounted fuel which is sometimes available in Sydney. This was seen to be forcing up average prices in the ACT by comparison. Discount cycles have appeared in the ACT market in recent years, as discussed in section 4 below. These are likely to have reduced the importance of this factor. This could, however, explain the remaining differential in the LPG market, as LPG is available at fewer outlets and its price is less frequently displayed on price sign boards than are prices for petrol or diesel.

3.3.3.2. Lease costs

The oil companies have consistently argued in previous reports that high lease costs are the cause of the differential and that these high lease costs have been caused by local ACT planning policies.

In the 1980s, planning policy in the ACT was to earmark sites suitable for service station development and auction them on that basis. Because of the limited number of sites released and the locations of these sites (in local centres away from passing traffic) this policy distorted the fuel market.

Sites in local centres had a geographical monopoly; customers in a suburb often did not have ready access to any other service stations. This gave them the ability to raise prices to levels above those that they would otherwise have been able to achieve. Further, they typically had small populations to sell to, with little hope of attracting customers from other locations. As such, they had low sales volumes to spread their costs across.

Sites in more lucrative locations such as town centres and near major roads had far better access to customers, and were more crucial to the oil majors' networks. With this in mind, they were often leased by developers who then extracted high rents from the major chains.

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[41] Australian Capital Territory Legislative Assembly, *Report of the Select Committee on Petrol Pricing*, Canberra, September 1997, pp 2 – 3.

[42] ACT Government Working Group on Petrol Prices, *Report of the ACT Government Working Group on Petrol Prices*, Canberra, November 1992, pp 19 – 22.

For example, the Commission was provided with confidential information that showed that the rent on at least one site was nearly $1 million per year. In response, the industry had to increase fuel prices to cover these costs.[43,44,45]

During the 1990s planning policies changed, with land available for service station development increasing greatly. For example, Woolworths indicated that they had little difficulty in obtaining sites for their service stations in the ACT, indeed far less than in many other places.[46] Further, sites in local suburbs have become increasingly non-viable and as a result many have closed down.

These trends have led to lease costs being negotiated downwards over several years, and evidence presented by one oil major suggested that they are now much closer to those in Queanbeyan and Sydney. Further, with the relationship between price and costs seeming weak over the short-term the companies' ability to raise their margin to cover high lease costs may be impaired.

3.3.3.3. Ability to exit from the market

In the ACT, market exit is made more difficult by the ACT Government's policy on service station sites.[47] The policy requires lessees seeking to convert the site to another use to first advertise the site as a going concern and to accept any offer deemed reasonable by the Government. Failing any reasonable offers being made, an application to vary the lease to allow a use other than as a service station can be lodged. Any purchaser of a site as a going concern is unable to vary the lease to another use within 5 years.

Of particular concern from a competition viewpoint is the five-year delay before a new owner can seek to vary the lease. If there was no delay, a purchaser could buy the service station simply to develop it. It could be immediately closed, or operated in a way that leads to a decline in the infrastructure of the site. However, a delay increases the business risk of taking over an existing site, particularly where a site is marginal. This is because it ties the purchaser into running a potentially loss-making outlet. Thus, the requirement is likely to act as a significant deterrent to any company considering taking over an existing service station site, and as such is likely to restrict entry to the market. It also seems to run counter to the policy's intention of stopping service station sites being converted to other uses. By discouraging new entrants it is likely to reduce the number of potential purchasers for existing sites and thus hasten the closure of smaller service stations.

Another difficulty when exiting the market is that, because of previous planning policies, a number of service stations are sited on land zoned for extremely restrictive uses or are surrounded by land zoned for an alternative purpose which makes other uses of the service

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43 ACT Government Working Group on Petrol Prices, *Report of the ACT Government Working Group on Petrol Prices*, Canberra, November 1992, pp 39 - 57.

44 Australian Capital Territory Legislative Assembly, *Report of the Select Committee on Petrol Pricing*, Canberra, September 1997, pp 16 - 21.

45 Australian Institute of Petroleum, Submission to the inquiry P18/01, 24 May 2001.

46 Hans Sidler, General Manager, Petrol, Woolworths Limited, pers. comm., 16 May 2001.

47 Australian Capital Territory Department of Urban Services, *ACT Government Policy on Service Station Sites - 17 July 1998*, 2001 (accessed 25 June 2001), <http://www.palm.act.gov.au/planning%5Fand%5Fdevelopment/policy/servstat.htm>.

station site difficult. For example, a service station may be on land surrounded by an ACT Government car park and be so small that any allowable alternative use would need a block significantly larger than the service station site. This can make finding a buyer for the site extremely difficult if not impossible.

Where possible, the ACT Government should ensure that these types of planning restrictions do not occur, so that service stations can be redeveloped when they become non-viable. If this is not done, service stations may be run down, leading to loss of visual amenity, or be closed and become subject to vandalism. It is understood that work is currently being undertaken by ACT Planning and Land Management to resolve a number of such issues in relation to service stations on land zoned for residential use.[48]

Recommendation 2: That the ACT Government consider reducing the requirement for a person who purchases a service station as a going concern to operate it as a service station for five years.

3.3.3.4. Retail space constraints

One oil company mentioned that the amount of non-fuel retail space allowable in an ACT service station is limited in a way not done in other jurisdictions.[49] While this is true, Queanbeyan service stations do not, in general, make use of their legal ability to have larger shops; in fact most are smaller. Anecdotally, this is also true in many parts of Sydney. Thus, shop size cannot legitimately be claimed as a reason for present price differentials, particularly when such differentials are largely attributable to transport costs.

3.4. Submissions and Public Opinion

Very few submissions or telephone calls to the Commission were concerned with price differentials between the ACT and elsewhere. One caller commented that prices in Canberra were typically higher than at Marulan, and another that prices were often higher than those at Albury. A number of callers commented that prices in Canberra had been higher than those elsewhere occasionally, but not in general. Some callers commented that the ACT was cheaper than surrounding rural areas.

3.5. Data Update

Data for July 2001 shows that the average daily ULP price for the ACT declined from around 100 cents/L to around 92 cents/L. In Sydney, prices fell faster than in the ACT, leading to a high differential between Sydney and the ACT in June. However, by early August, the differential appeared to have fallen back to more usual levels of 1 to 2 cents/L.

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[48] Australian Capital Territory Department of Urban Services, *DVP125 Residential Land Use Polcices* (sic), 2001 (accessed 24 July 2001), <http://www.palm.act.gov.au/tplan/VARIATIO/DV125/DV125.HTM>.

[49] Frank Topham, Peter Morris & Chris Hefford, Caltex Australia Limited, pers. comm., 16 May 2001.

Prices in Queanbeyan fell more slowly than in the ACT in June, leading to the monthly average price being higher in Queanbeyan for the first time since February 2000. Again by early August 2001, prices appeared to have reverted to their usual pattern of being slightly cheaper than in the ACT.

For diesel, the monthly average price for the ACT rose from 97.3 cents/L to over 100 cents/L in June 2001 and remained unchanged at 97.7 cents/L in Sydney. In early August, price observations showed diesel prices had fallen back to around 95 cents/L. The situation in Sydney and Queanbeyan was similar. Overall, the differentials do not appear to have been outside the normal range shown for previous months.

For LPG, the ACT monthly average price fell from 49.4 cents/L to 47.8 cents/L between May and June 2001. Price observations in early August 2001 showed prices in the ACT of around 44.9 cents/L. For Sydney, the monthly average price had fallen from 47.7 cents/L to 44.7 cents/L between May and June 2001. Price observations in early August 2001 showed prices in Sydney of between 39.9 and 43.9 cents/L. Overall, the differentials do not appear to have been outside the normal range shown for previous months.

3.6. Conclusion

Price differentials between the ACT and Sydney are currently much lower than at the time of previous reports. These differentials are fully attributable to transport costs for petrol and diesel, and mostly attributable to transport costs for LPG. The price differential between the ACT and Queanbeyan for ULP was fully attributable to the Commonwealth Fuel Sales Grant Scheme, which treats most of the ACT as a metropolitan area but treats Queanbeyan as a non-metropolitan area, with a resulting 1 cent/L subsidy.

The reduction in differentials since previous reports suggests that changes since the reports were written, such as changed planning rules and the introduction of independent chains, have been effective in making the ACT market more efficient and competitive. However, one of the more striking features of the differentials is the rate at which they change over time. With LPG for example, the differential between the ACT and Sydney fell from 5 cents/L to 1 cent/L in little more than a year leading up to May 2000. With changes happening so rapidly, it is worth considering ongoing price monitoring to ensure that the ACT community remains informed about fuel pricing issues.

Recommendation 3: That the ACT Government request the Commission to monitor ACT/Sydney and ACT/Queanbeyan fuel price differentials.

4. PRICE FLUCTUATIONS

This section looks at the timing of, and reasons for, short-term fluctuations in retail petrol prices. The longer-term rises and falls that occur over months and years are not examined as they were identified in section 2.1 as arising from international pricing factors. These are outside of the influence of the ACT Government and thus were not examined in depth by the inquiry.

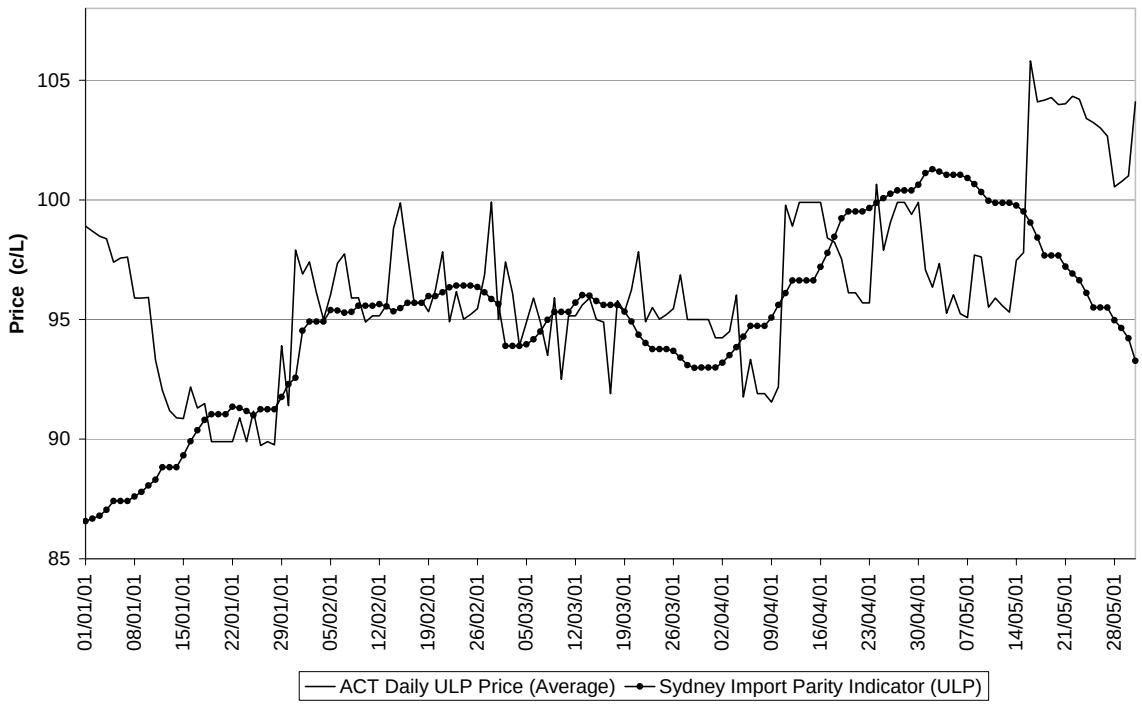
Note that the ACCC is currently also conducting an inquiry into fuel price fluctuations. At this stage, a discussion paper has been released and submissions taken. The discussion paper and information on the inquiry can be obtained from the ACCC on (03) 9290 1884.

4.1. The Pattern of Cycles

Figure 14 shows daily average ACT ULP prices. No statistically robust daily data are available for the ACT for diesel and LPG. There are weak cycles evident in the data, made up of short-term peaks and troughs. Almost all rises are rapid, followed immediately by a decline, either rapid or gradual. Peaks are typically around a week apart, although not in all cases.

Notably, the relationship between the average price and wholesale costs indicated by the IPI for Sydney is weak. Further, over most of the period, the difference between retail price and wholesale cost is either small or negative, indicating that wholesalers and retailers are likely to be making losses.

Figure 14. Comparison of ACT retail unleaded petrol prices and the import parity indicator



Sources: FUELtrac; NUS Consulting

4.1.1. Weekly pattern

To examine the weekly pattern, large rises and falls were analysed for the period 1 January to 31 May 2001. Large rises and falls were considered to be a change of 3 cents/L and over between one day and the next. The breakdown is as follows:

Day	Mon	Tue	Wed	Thu	Fri	Sat	Sun
Large increases	1	1	5	1	-	-	1
Large decreases	-	-	-	2	-	2	-

As can be seen, there are far more increases of 3 cents/L than similar falls, 9 compared with 4. By far the majority of such increases occur on a Wednesday.

4.1.2. Public holidays and paydays

There are often claims that petrol prices go up before public holidays and public service paydays. During the data period (1 January 2001 to 31 May 2001) there were four public holiday periods. Two of these, Easter and Anzac Day, were associated with paydays and also with sharp rises. The Wednesday before Easter (11 April) saw a rise in average prices of 7.6 cents/L, the second largest one-day jump in the period. The Wednesday before Anzac Day (24 April) saw a rise in average prices of 5 cents/L, the fourth largest one-day jump. The Canberra Day holiday saw a rise of less than 3 cents/L on both the preceding Friday and Sunday, but a fall of 3.4 cents/L on the preceding Saturday. The net effect was a small rise. There was no price rise associated with Australia Day.

Looking at paydays, of the eleven highest increases, six were on the Tuesday or Wednesday before a payday, well above what would be expected if there was no correlation between price and paydays. In all there were eleven paydays during the period. Notably, however, one payday (1 March 2001) was associated with the largest one-day fall in the period (4.9 cents/L) and the highest increase (8 cents/L) was on 16 May 2001, which was not related to either a public holiday or a payday.

4.1.3. Summary

For the period examined, there appeared to be rough cycles in petrol prices, typically around a week long, with peaks around Wednesday. There also appeared to be an association between such peaks and public service paydays, as most of the largest one-day increases were associated with such paydays. There were, however, a number of exceptions when large price increases occurred away from paydays or paydays were not associated with rises in prices.

With public holidays, the picture was less clear. Two holidays were associated with large price rises, Easter and Anzac Day. However, these were also associated with a payday. The two other public holidays in the period, Australia Day and Canberra Day, were not associated with large rises.

For most of the period analysed, there is only a low correlation between cost and price. The difference between the retail price and the IPI is low, with the result that wholesalers and retailers are highly likely to be making very a low profit or a loss on petrol sales.

4.2. Why Do Cycles Occur?

Two main arguments on why cycles occur were presented to the Commission. The oil majors and the AIP suggested they were caused by price discounting. Price discounting occurs when, to gain or maintain market share, one or more retail outlets reduce their price. Other retailers then follow suit to maintain their market share. This pattern continues until companies can no longer afford to keep prices down. At this point, some companies will 'lead' upward with prices and others will follow until prices return to original levels. Some companies accepted that prices tend to rise before holidays and paydays and suggested that this was because the industry was unwilling to continue large losses during these high demand times. Thus, an impending holiday or payday is a trigger for prices to return to pre-discount levels.[50]

The second argument, mostly from members of the public and politicians, is that the cycles are used by oil companies as a tool to increase profit. This argument assumes that prices at the bottom of the cycle are the "correct" price that should be charged for fuel, and prices higher than that are making oil suppliers a higher profit than is warranted. Prices therefore rise before paydays and holidays because these are high demand periods when oil companies can "profiteer" from that high demand.[51]

For the discounting argument to be correct, evidence of a fall in prices before each sudden rise would be expected. There would be signs of some companies leading prices upward ahead of the market, and the bottoms of the discounting cycles would also be at or below cost. Evidence for the second argument could include oil suppliers making excessive profits and bottoms of cycles being prices that produce reasonable profits.

4.2.1.1. Discounting before rises

Figure 15 shows average prices and costs in the weeks before Anzac Day 2001. There is evidence of a long, slow decline in prices for most of the month before Easter. In the week before Easter in particular, prices are low and well below cost, as demonstrated by the IPI. The rise is, however, far more than the preceding decrease, possibly because of the rise in cost in the week before Easter shown by the IPI. Following the rise for Easter, again there is a slow decline until Anzac Day. This time, the rise is equal to the decline despite another increase in costs. This pattern of decrease before sudden rise supports the discounting argument.

4.2.1.2. Price levels and profitability

As discussed in sections 2 and 3, profitability in the downstream oil industry is typically very low. This does not support the profiteering argument. Figure 14 examined the relationship between costs and retail prices. This showed that for most of the period from 1 January 2001 to 31 May 2001, retail prices were close to or below the IPI indicator of wholesale costs in Sydney. This is particularly true of prices just before a sudden rise. This also supports the discounting argument.

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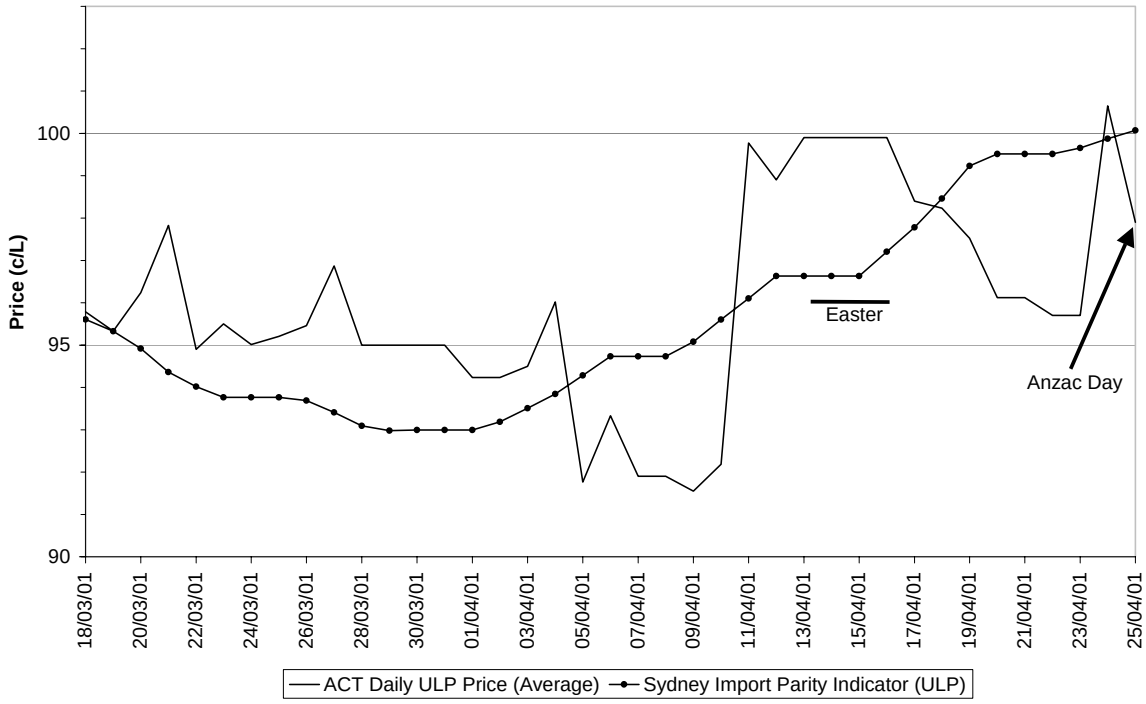
[50] This view was expressed in submissions to the inquiry by the AIP (P18/01), BP Australia (P28/01) and Caltex Australia (P30/01) as well as in meetings with Peter Harris & Ian McKenzie of Shell on 2 May 2001 and Frank Topham, Peter Morris & Chris Hefford of Caltex on 16 May 2001.

[51] This view was expressed in many telephone calls to the Commission and a number of submissions from members of the public.

Figure 15. Behaviour of ACT unleaded petrol prices prior to Anzac Day 2001



Sources: FUELtrac; NUS Consulting

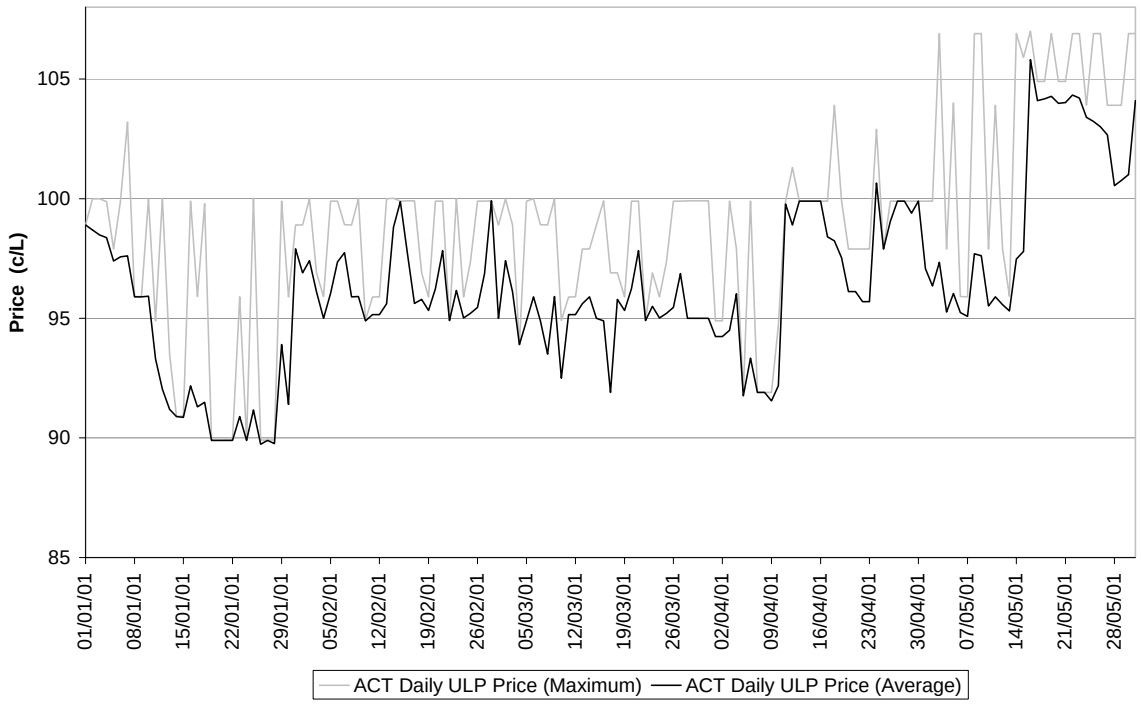
4.2.1.3. Is there price leading?

Figure 16 shows the daily average retail price and the daily maximum retail price for the ACT. It is immediately apparent that there are a very many days where some fuel was sold at significantly above market average prices. These are interspersed with days when the maximum sale price has collapsed back towards the market average. This pattern suggests that some retail sites were attempting to lead prices upwards, usually unsuccessfully, and thus supports the discounting argument.

The ACCC, in the discussion paper for its inquiry into reducing fluctuations in fuel prices, concludes that fluctuations may be a reflection of competition in fuel markets through the discounting cycle mechanism. This is because in Sydney the cycles have become more pronounced since the end of price regulation in 1998, and corresponding with this has been a fall in prices compared with the IPI, suggesting a more efficient market. Melbourne, considered the most competitive market in Australia, also has the strongest cycles. However, the paper only examines the Sydney and Melbourne markets.

The ACCC paper also finds that cycle lengths for both of those markets are around 5.5 working days, slightly longer than seems to be the case in the ACT. The cycles in Sydney and Melbourne also appear to be more regular and more pronounced than in the ACT.

Figure 16. Comparison of average and maximum unleaded petrol retail prices in the ACT



Source: FUELtrac

4.2.2. ACCC view

The ACCC's paper also examines what aspects of the petroleum market cause it to compete in this cyclical fashion. The following factors are considered, but there is no firm conclusion:

- Fuels are relatively homogenous, meaning that competition occurs through prices more than product differentiation.
- The price of petrol is highly visible through price sign boards.
- Customers may be particularly sensitive to changes in fuel prices.
- Petrol may be sold at a loss by some companies in an attempt to increase shop sales.
- Excess refinery capacity and/or short-term oversupply may lead to dumping of oversupply into the market.
- The price support mechanism used by majors to support franchisees may be driving the market down in a way that reducing wholesale prices would not.[52]

4.2.3. Do sudden price rises mean collusion?

An argument repeatedly put to the Commission was that sudden price rises across all retailers indicate that there must be collusion.[53] While this may have been true in the past, because of

[52] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001, pp 1, 5–7.

advances in marketing and technology it is not so now. For example, where the staff at one service station can see the price signs of another, they can match that station's price immediately. Through the computerised and networked registers now installed in most service stations, the competitor's price change can also be instantly relayed to the company's headquarters. If head office decides to change its wholesale price or increase price support in response, that information can also be fed back to retailers instantly through their cash registers, with the whole process taking only minutes.

Pricing information is also available from credit and fuel card transactions. The oil majors each have their own fuel card that can be used at most branded outlets. Each sale on these cards provides company headquarters with the price at the particular service station within minutes of the sale. This allows the companies to track what prices their franchisees and branded independents are setting. Where required, information on sale prices can also be purchased based on credit card transactions, although this would typically have a longer delay.

In addition, service station managers, agents or franchisees are often required to survey and notify company headquarters the prices displayed at a number of rival service stations several times a day. If this proves to be inadequate, oil companies can hire third parties to monitor prices at various service stations, and several companies provide these services to oil companies and other interested parties on a regular basis.

All of these factors allow the chains to rapidly know and match their competitors pricing.

4.3. Submissions and Public Opinion

There was an extremely wide range of opinion on fluctuations in the market. The AIP and oil majors argued that fluctuations were caused by discounting. However, they disagreed on whether or not rises coincided with paydays and public holidays.

Other industry participants such as the Motor Trades Association (ACT) suggested that price fluctuations did tend to occur around public service paydays and public holidays.

The views expressed in submissions and telephone calls to the Commission from the public tended to fall into two categories. Many felt that the fact that prices are often so similar across the whole market and that all retailers tend to change at once means that there must be collusion. A smaller number complained that their local service station always charged a higher price than other service stations.

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[53] This view was expressed in many telephone calls to the Commission and a number of submissions from members of the public.

4.4. Data Update

Short-term ULP price fluctuations continued to be seen in average daily prices during June 2001. These were, however, much less pronounced than in previous months, possibly because of a masking effect from the overall price decline. There was only one movement of more than 3 cents/L in one day; a decline of 3.2 cents/L on 1 June 2001. Prices appeared to be largely unaffected by the two public service paydays and the Queen's Birthday long weekend.

4.5. Conclusion

The price fluctuations in the market appear to occur in fairly regular cycles that are around a week long. Rapid rises usually occur on Wednesdays and are often associated with public service paydays. There is mixed evidence on whether rises also tend to occur before public holidays.

Evidence suggests that these cycles are not caused by an attempt by oil companies to gain monopoly profits, but rather are caused by price discounting cycles as companies try to gain market share. Evidence for this is the low profitability of the industry and the fact that the troughs of the cycle often see fuel sold at or below wholesale cost. Further support for this view comes from the ACCC, which concludes in the discussion paper for its inquiry into fuel price volatility that discounting cycles are a likely cause of short-term price fluctuations in the Sydney and Melbourne markets.[54]

Theoretically, cycles caused by discounting benefit consumers as they are able to take advantage of low prices at the bottom of the cycle. On average, they will pay a lower price than if there were no cycles. On the other hand, if customers are strongly averse to risk, the benefits of a lower average price may be outweighed by their dislike of risk. Up-to-date information on retail margins may help customers decide when to buy to avoid peaks, leading to a reduction in consumer anxiety.

[54] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001.

5. RELATIONSHIP BETWEEN OIL MAJORS AND OTHER RETAILERS

This section looks briefly at the relationship between the oil majors and the retailers they do not control: independents who buy from majors, branded independents, and franchisees. While most of the issues in this area are the realm of the ACCC, they are a useful background to many of the complaints from the industry and groups such as the Motor Trades Association (ACT).

5.1. Low Fuel Sales Margins

The major area of concern the Commission heard from franchise and independent retailers was that the oil majors were driving the market in such a way that sales margins were unsustainably low for such retailers. Material was provided to the Commission that demonstrated that margins were indeed unsustainably low.

The oil majors' response was typically that they were also experiencing unsustainably low margins and that they also could do nothing about this. Evidence discussed in section 2 above supports this claim. However, it appears that the majors are doing a very poor job of communicating this message to retailers, which is adding to political pressure for regulatory action to be taken against them.

From an ACT Government perspective, it is important to recognise the financial strain that the industry is under and to take account of this in its industry policies. Failure to do so may result in the rationalisation of service stations being hastened and the loss of some of the independent competition in the market.

5.2. Do the Majors Control Their Retailers' Prices?

Legally, the majors are not able to set retail prices for the independents and franchisees they supply. However, there has been an ongoing stream of media coverage and comments from such retailers that their prices are, in effect, being set by the oil majors they buy from. With one exception, the oil majors argued that franchisees and major-supplied independents set prices completely independently. The other oil major agreed that the majors have a very strong influence over their retailers' prices, but do not set them in a legal sense.

5.2.1. Franchisees

Evidence provided by franchisees suggests to the Commission that the oil majors do have a strong influence over the retail prices the franchisees set, because franchisees are essentially price takers. Thus, the market sets the maximum price they can charge without a significant loss of business. Because they are on very low margins and they must also accept the wholesale price offered by their major, they are also largely unable to reduce their retail price below that recommended by their major. As discussed in section 2.2.4.7 above, the ability to of franchisees to respond in the market is strengthened when they are being provided with price support by their major. Their ability to vary from these prices, however, is further limited as price support can be withdrawn if they deviate from the recommended price.

5.2.2. Major-supplied independents

Major-supplied independents appear to be better able to set retail prices. Like franchisees, however, their ability to move is limited by prevailing market conditions and, for smaller and branded independents, by having to accept the wholesale price offered. Unbranded independents have the ability to choose which wholesaler to buy from, and as such are not constrained in this way.

Note that despite the majors' ability to strongly influence the retail prices of their franchisees, the Commission has come across no evidence that they set retail prices across the market as a whole. If they did, it seems unlikely that they would choose to set prices so low that they regularly make losses on fuel sales.

5.3. Wholesale Price Transparency

A major complaint of both franchisees and major-supplied independents is that the wholesale prices provided are not transparent. They feel that they are not sure what makes up the price they pay and they are unable to understand why it moves in the way it does. There have also been complaints that, because of this lack of clarity, various individual or groups of retailers can be easily discriminated against in terms of the price they are offered. Particularly for tied retailers such as franchisees and branded independents who cannot chose a supplier, any such discrimination would have the potential to destroy the retailer's ability to compete in the market.

Increasing transparency in wholesale prices may also benefit consumers. If information on wholesale prices is readily available, they will easily be able to determine the margin between wholesale and retail prices. This will give them more information with which to predict when a rise in prices is likely, and thus improve their ability to choose the best time to buy. The availability of more information is also likely to assist in educating the community on the facts of the petroleum industry.

Examples of government action to increase wholesale price transparency in other jurisdictions are discussed in section 6 below.

5.4. Temperature Correction

The volume of liquid fuel changes with the temperature of the fuel: higher temperatures cause the fuel to expand, so that for the same mass (and chemical energy content) the volume is higher. This is an issue only because fuel is sold by volume. Because of this, fuel that is sold at a high temperature provides less chemical energy per litre than fuel that is sold at a lower temperature.

A long-standing complaint by franchisees is that when they are sold fuel, it is often hot because it was recently refined or stored in above-ground tanks. They then place the fuel into their below-ground tanks, where it cools down and shrinks. As they then have a smaller volume to sell to motorists, they suffer a financial loss as a result of an effective loss of stock.

In 1999, the ACT *Fair Trading (Fuel Prices) Act* was amended in an attempt to ensure that "the volume of a fuel in a regulated transfer must be measured or calculated as if the fuel were at the temperature of 15°C".[55] After a lag period while compliance systems were introduced, oil companies began providing fuel at a notional 15°C. For example, Caltex adjusts the price per litre of wholesale fuel to ACT clients so that, while invoices state that the fuel is adjusted to 15°C and show the 15°C volume, the overall cost is the same as if the fuel had been sold at ambient temperature.[56] Some companies also added to wholesale prices a per litre charge to recover the cost of implementing the temperature correction changes.[57] A further amendment to the Act in June 2001 outlawed such charges.

Victoria is currently moving to have temperature correction introduced nationally. This is discussed in section 6.3.2.2 below.

5.5. Other Complaints by Tied Retailers

In addition to the above complaints, a number of *Trade Practices Act* and related issues were raised with the Commission. These concerns included:

- franchisees being forced to work within price-support agreements whose documentation they do not have and cannot get;
- manipulation of the trading conditions of a particular retailer to ensure they are unprofitable; and
- third-line forcing of low-profit automatic teller machines on retailers who had received offers of far more profitable automatic teller machines from a third party.[58]

These issues are outside the control of the Commission, but rather are within the jurisdiction of the ACCC. The Commission encourages retailers with these types of concerns to report them directly to the ACCC by phoning 1300 302 502.

5.6. Conclusion

Relationships between the oil majors and the retailers they supply are typically very poor. This is the source of much of the media comment that comes from the industry and, as such, is a major cause of public and political concern. In turn, this can be a driver for demands for regulatory action against the oil majors.

The question the Commission must ask is: will new regulatory action have the effect of improving competitive behaviour and pricing outcomes? Inappropriate action driven by industry in-fighting might, on the contrary, result in a reduction in competition and in adverse pricing outcomes.

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[55] 15°C is an international standard for many transactions involving liquid volumes.
[56] Frank Topham, Government Affairs Manager, Caltex Australia Limited, pers. comm., 26 June 2001.
[57] John Riding-Hill, Executive Director, Motor Trades Association (ACT), pers. comm., 23 May 2001.
[58] Third line forcing is the term used when a business sells goods or services on the condition that the customer also buys other goods or services from another business (which may be a related company).
Australian Competition and Consumer Commission, *Does your advertisement raise any issues of third line forcing?*, Undated (accessed 22 August 2001), < http://www.accc.gov.au/docs/news/interne7.htm>.

6. ACTION BY OTHER JURISDICTIONS

This section examines the action currently being taken by other Australian jurisdictions and, in doing so, outlines the major regulatory options for petrol pricing.

6.1. Commonwealth

As with most other jurisdictions, responsibility is split between industry structure issues, for which the Department of Industry, Science and Resources is responsible, and consumer affairs and trade practices issues for which the Treasury portfolio (which includes the ACCC) is responsible. The Parliament has also shown interest in the issue.

6.1.1. Industry deregulation

Following a number of reports into regulation in the industry, including one by the ACCC in 1996, the Federal Government decided to deregulate the petroleum industry.[59] This was to include:

- the removal of wholesale price controls;
- the repeal of the *Petroleum Retail Marketing Sites Act 1980*, which limits direct control of retail fuel outlets by the major oil companies;
- the repeal of the *Petroleum Retail Marketing Franchise Act 1980*, which controls aspects of franchise agreements between franchisees and oil companies as well as protecting franchisees once they are in agreements; and
- the introduction of an enforceable code of conduct, the Oilcode, agreed between representatives of the various sectors of the oil industry and the Government to protect franchisees, commission agents and distributors.

Because of the failure of the industry to agree on the Oilcode and resistance to the repeal of the *Petroleum Retail Marketing Sites Act* in the Senate, the only part of the package to succeed was the lifting of wholesale price controls.

6.1.2. The Fitzgibbon Bill

In August 1999, Mr J Fitzgibbon MP (Member for Hunter, ALP) introduced the Fair Prices And Better Access For All (Petroleum) Bill 1999 to Commonwealth Parliament. The Bill was intended to introduce a “50/50 supply rule” arrangement nationally. Such a rule seeks to allow tied retailers such as franchisees (and, potentially, branded independents, though they were not covered in this Bill) to purchase up to 50% of their fuel from a different wholesaler.

The Bill was not supported by the Government and thus did not become law. However, it has recently been reintroduced into the Senate, again by the Opposition. WA is also seeking to introduce a 50/50 supply rule as part of its regulatory package discussed in section 6.2 below.

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[59] Australian Competition and Consumer Commission, *Inquiry into the Petroleum Products Declaration*, Australian Government Publishing Service, Canberra, August 1996.

6.1.2.1. Potential benefits

Proponents of 50/50 legislation argue that it will increase competition at the wholesale level. Because many retailers are tied to one supplier, they argue that there is not a strong or transparent wholesale fuel market. If franchisees and branded independents can also purchase fuel on the wholesale market, that will strengthen the market.

A second argument is that it will increase competition in the retail market. Franchisees and branded independents will not be so dependent on the wholesale prices "set" by their majors, and will thus have more freedom when setting retail prices. They will also be able to run their businesses more independently, making them less open to being made unprofitable by their majors and thus being driven out of business.

6.1.2.2. Potential problems

Opponents of a 50/50 rule argue that it would be unfair to franchisors and also point to numerous difficulties in effectively implementing such a scheme.

Under a franchise agreement, oil companies own the site and all the equipment on it. The franchisee owns the fuel and operates the site on the oil company's behalf. The majors argue that to force them to allow another company's fuel to be sold through the site is a breach of their fundamental right to decide what happens on their property.

Secondly, it is argued that the rule would interfere with existing contracts in a way that could cause serious financial losses to oil majors. This is because franchise contracts are often negotiated with a low entry price, much lower than the cost of leasing the property. Return on assets is then generated partly through profit on sales of fuel. If up to half of the fuel sold was to come from another wholesaler (from which the franchisor would obviously make no wholesale profit), they would suffer a loss of return on assets.

Thirdly, a 50/50 rule would harm the image of the oil majors as they could no longer guarantee the quality of fuel sold. A franchisee could purchase poor quality or doctored fuel and consumers purchasing that fuel would blame the major when it was found to be inferior. Further, a consumer who was choosing to go to that service station specifically to purchase a certain brand of fuel would be being misled. The Fitzgibbon Bill attempts to avoid these issues by requiring franchisees to show a notice on any pump selling fuel other than that of the brand shown on the pump.

As a result of these potential problems, it is likely that any 50/50 legislation would become bogged down in legal action if it were introduced. It would also likely see at least a slow-down, if not an outright cessation, of franchising.

6.1.2.3. Additional problems for implementation in the ACT

A large part of the ACT retail market may not be affected by such a rule because it is not made up of local franchisees or branded independents. Thus, any benefit from such a rule being introduced into the ACT would be reduced. However, if the Fitzgibbon Bill or one like it is successful at the Commonwealth level, the ACT will almost certainly be covered.

6.1.3. Fuel price fluctuation inquiry

In early March 2001, the Commonwealth Government asked the ACCC to examine the feasibility of limiting fluctuations of retail petrol and diesel prices nationally, with a report to be provided to the Minister for Financial Services and Regulation as soon as possible.

After discussions with stakeholders, the ACCC released a discussion paper in mid-June that outlines the options for reducing fuel price variability.[60] These options are discussed briefly below.

The closing date for submissions to the ACCC inquiry was 13 July 2001. The inquiry is expected to be completed by late 2001.

6.1.3.1. Inform consumers about the price cycle

This approach involves informing consumers about how the price cycle works and increasing their knowledge of the market's mechanics in general. The aim is to increase consumers' ability to take advantage of the peaks and troughs in prices and thus reduce their overall fuel costs. It would also tend to change the discounting cycle by reducing demand at what were formerly peak periods and increasing demand at previously low-demand times.

The major advantage of this approach is that it requires no interference in the market. This is important because in a market that is already delivering low-cost fuel, interference is more likely to increase prices than reduce them.

The major disadvantage is that the irregularity in the market may lead to consumers becoming frustrated when the price does not move as expected. For this reason, it would be important to emphasise how the market functions, rather than attempting to predict price movements. It could also be costly to Government, requiring an information campaign and ongoing staffing for information provision. In comparison, many forms of intervention in the market are cheap for governments because most of the costs are passed to consumers through higher average prices.

6.1.3.2. Constraining price movements – 24-hour rule

The ACCC discussion paper focused on the WA model of a 24-hour rule. This is discussed in section 6.2.1 below.

6.1.3.3. Constraining price movements – maximum movement rule

This option involves limiting the daily maximum price rise to, for example, three cents a day. This would remove the large one-day rises in price.

This option would provide consumers with a little more certainty in prices. It is also much less restrictive than some other options, and as such is less likely to drive up average prices. It could still, however, restrict the industry's willingness to discount prices, as they would fear being trapped at a loss-making price level. Further, while it would slow the increase in prices

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[60] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001.

at the end of a discount cycle, it would not stop it. The price increase would be split over two or three days instead of one.

Another potential problem is the regulatory cost to government and the industry. It would be necessary to either enforce notification of prices after every price change, employ a team of inspectors, or both. With notification, retailers would have the cost of notifying each move to government. As prices can move many times a day, this cost could be significant and may be passed on to consumers through higher average prices.

6.1.3.4. Retail price regulation

The ACCC discussion paper focused on the WA model of retail-price regulation. This is discussed in section 6.2.4 below.

6.1.3.5. Wholesale price regulation

This option is basically a return to the wholesale price-capping regime that was in place until 1998. The aim is to ensure that wholesale fuel prices are not raised above a level government deems to be "correct".

As with all price caps, the real difficulty is in setting its level. If the price cap is set too high, it will either be useless, as prices will be below the cap anyway, or it will provide a "benchmark" for companies to aim at, and prices may rise to the cap. Given that the local industry component of fuel costs is already efficient, setting a price cap below the market price will lead to the cessation of supply or falling profitability. Falling profitability will lead to further restructuring in the industry and in the long run to a run-down in investment. Eventually, this may lead to a poor safety record, environmental damage, higher wholesale costs and eventually a withdrawal of players from the market.

Several reports that investigated the regulatory regime that was in place nationally until 1998 ,showed that it was not very effective. Apart from having no visible effect on prices, it had several flaws, such as allowing oil majors to escape the cap by selling through their local, unregulated distributors, and it was used for political purposes to the possible detriment of the ACT. [61,62] Transport costs to some coastal areas of Australia were cross-subsidised by transport costs to other areas, possibly including the ACT.[63]

WA has also recently introduced a maximum wholesale price cap. This is discussed in section 6.2.2 below.

6.1.3.6. Terminal gate pricing

The ACCC discussion paper covered the WA model of terminal gate pricing associated with a wholesale price cap. This is discussed in section 6.2.2 below. Victoria is also introducing terminal gate pricing, but without a wholesale price cap, as discussed in section 6.3.2.1 below.

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[61] Industry Commission, *Petroleum Products*, Australian Government Publishing Service, Melbourne, 5 July 1994.

[62] Australian Competition and Consumer Commission, *Inquiry into the Petroleum Products Declaration*, Australian Government Publishing Service, Canberra, August 1996.

[63] ACT Government Working Group on Petrol Prices, *Report of the ACT Government Working Group on Petrol Prices*, Canberra, November 1992.

6.1.4. Fuel taxation inquiry

On 1 March 2001, the Federal Government announced that it would conduct an inquiry into petroleum taxation. Some $4 million was included in the 2001–2002 Federal Budget to fund a secretariat for the inquiry, and details of the make-up of the committee of inquiry and their terms of reference were released on 8 July 2001. At this stage, it appears that the inquiry will focus on fuel taxation and associated subsidies and rebates. A report is not expected until March 2002.[64,65]

6.2. Western Australia

In late 2000, the then WA Government proposed a series of regulatory controls aimed at reducing petrol prices, particularly in country areas. The incoming Government has continued with the introduction of the package.

6.2.1. 24-hour price rule

24-hour price setting was introduced on 2 January 2001. The theory behind 24-hour price setting is that consumers want certainty in prices. They prefer to be able to plan ahead for their fuel purchases so they can find the cheapest retailer and to do this they need to be certain that the price will not change unexpectedly.

The legislation requires retailers to report the intended price for the next day to the Department of Consumer and Employment Protection each afternoon. They must then sell at that notified price for the whole of the next day. Thus, the only time that retail prices can change is at midnight each day, which gives consumers price certainty.[66]

In WA, this legislation is supported by a "FuelWatch" service provided by the Department of Consumer and Employment Protection. This involves a web site at <http://www.fuelwatch.wa.gov.au> and a 1300 telephone number which consumers can use to find out the cheapest fuel prices in their area.

While a FuelWatch-type information scheme is, in theory, viable separated from a 24-hour rule, in practice it requires the 24-hour rule to function. If prices are not fixed, consumers using the FuelWatch service will often find that prices have changed by the time they reach a service station. This will severely limit the benefit to consumers of the scheme. To minimise this, service stations could be required to notify every price change. However, this would massively increase the cost of notification to both service stations and the Government, and some consumers will still find that prices change between their use of FuelWatch and their arrival at a service station.

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[64] Australia, Commonwealth of, *Budget Paper No. 2 – Budget Measures*, 2001 (accessed 29 June 2001), <http://www.budget.gov.au/papers/bp2/html/4_expense.htm#P4_0>.

[65] Australia, Commonwealth of, *Fuel Taxation Inquiry* (media alert), 8 July 2001.

[66] Graeme Cantelo, West Australian Department of Consumer and Employment Protection, pers. comm., 11 May 2001, 22 & 26 June 2001.

6.2.1.1. Benefits

The FuelWatch service has been heavily utilised by consumers, with the web site receiving around 20,000 hits per day. Feedback to the Department of Consumer and Employment Protection suggests that both FuelWatch and the 24-hour price rule have been very popular with consumers.[67] This further suggests that consumers are averse to risk and benefit when that risk is removed.

6.2.1.2. Problems

A major criticism of 24-hour price setting is that it has had a greater negative impact on independent retailers. Many independent retailers, particularly chains such as Gull and Woolworths+Petrol, use being the cheapest in the market to gain a reputation for being cheap, which increases their market share by persuading customers to go out of the way to buy from them. To do this, they have to regularly adjust their prices to match or undercut their cheapest competitor. The 24-hour price rule stops them from making this adjustment and thus on days where their prediction of their competitors' prices is wrong, they will not be the cheapest in the market. Over time this will cost them their reputation as cheap retailer and may drive them out of the market.[68,69] If independents are driven out of the market, it is likely to lead to higher prices in the long-term as competition decreases.

Another potential negative impact is the possibility of average prices increasing. Because of their inability to rapidly move prices back up from a loss-making position, and uncertainty as to what price competitors are going to choose, retailers could be reluctant to reduce their prices.

Price setting in this fashion also increases a retailer's risk. If they notify a price that is lower than the rest of the market, their sales will increase massively. This can lead to being understaffed, running out of fuel and, where prices are below break-even, a very large loss. If they notify too high a price, they will have very few customers, resulting in few shop sales and a loss of profit. Previously they could change their price if they found themselves in any of these situations, whereas now they are stuck at the notified price and forced to wear any losses incurred. This increases the risk of operating, and retailers may over time seek increased margins to pay for this risk. A potential balancing factor is that competition will increase as a result of the improved public information arising from FuelWatch.

There is some evidence that the 24-hour price rule has led to a rise in average prices. For example, the discussion paper for the current ACCC inquiry identifies that such an increase in prices has probably occurred.[70] However, at the end of June 2001, prices in Perth were particularly low and it was felt by the Department of Consumer and Employment Protection that this may be an outcome the 24-hour price rule.[71]

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[67] Graeme Cantelo, pers. comm., 26 June 2001.

[68] Hans Sidler, General Manager, Petrol, Woolworths Limited, pers. comm., 16 May 2001.

[69] Graham Pember, Executive Manager, Gull Petroleum, pers. comm., 4 May 2001.

[70] Australian Competition and Consumer Commission, *Reducing Fuel Price Variability* (discussion paper), Melbourne, June 2001, pp 36 – 45.

[71] Graeme Cantelo, pers. comm., 26 June 2001.

The original 24-hour price rule legislation also has a loophole that allows retailers to stay at the price they set the day before and not move to their notified price. This is being rectified by legislation currently before the WA Parliament.

6.2.1.3. Additional problems for implementation in the ACT

Because Queanbeyan is so close, any ACT FuelWatch-type system would face extra costs from NSW customers seeking price information for the ACT. NSW service stations may also use the fact that their ACT competitors cannot change prices to ensure that they are slightly cheaper.

6.2.2. Maximum wholesale price

The maximum wholesale price (MWP) as applied in WA aims to allow spot (non-contract) sales of fuel to occur at a "reasonable" price that does not include additional charges such as brand licensing and the provision of credit. The MWP is calculated daily for each terminal using a formula set by the WA Government. The aim is to increase competition by allowing non-contract or above-contract fuel purchasers to buy at a transparent and competitive price.

While the scheme has been in place since 12 April 2001, it is understood that few if any spot sales of fuel have yet occurred.

6.2.2.1. Benefits

As no spot sales have occurred, there are no obvious benefits to the scheme at this stage. However, its proponents argue that, in the long run, the capped wholesale price will become the benchmark for new contracts. This will lead to a fall in fuel prices as the capped price is below the previous wholesale prices, particularly in regional areas. It will also be the base for any future retail price capping, as discussed below.

6.2.2.2. Problems

The oil wholesalers (the four majors plus Gull) argue that the formula used to calculate the MWP is flawed and thus sets prices that are too low. For this reason, no prices were provided at first. More recently, prices have been provided, but the wholesalers have not supplied fuel at the prices nominated. They have done this by not making spot sales of fuel from their terminals, on the basis that there is no fuel available for spot sales as their stock is only for supplies under existing contracts.

While there are moves to adjust the formula to ensure it sets an adequate price, this problem highlights the theoretical failings of wholesale price caps in a competitive market. If the cap is set too low, there will either be no sales, or investment in the industry will be limited. This could take the form of rationalisation and closure of terminals, redundancies, the cancellation of investment programs and possibly the withdrawal of players from the market, leading to a reduction in competition. If the cap is set too high, it will either be ineffective or will cause prices to rise to the cap level, rather than staying competitive. The only price level that will not have negative side effects is the price level that would be reached by the market anyway!

6.2.2.3. Additional problems for implementation in the ACT

Because of the industry structure in the ACT, setting an MWP would likely be less effective than in WA. Sites run as commission agencies, direct oil major or distributor operations and independent chains do not pay wholesale prices for fuel in the ACT and they are a larger part of the ACT market. Further, spot sales may be shifted out of the ACT to avoid an ACT-only MWP.

6.2.3. 50/50 supply rule

The WA regulatory package includes a 50/50 supply rule similar to that proposed under the Fitzgibbon Bill at the Federal level, discussed in section 6.1.2 above. The legislation containing the required provisions has yet to come into force however, so again the costs and benefits are entirely theoretical at this stage.

6.2.4. Retail price caps

Regulation to allow the WA Government to cap retail fuel prices has yet to come into force but is expected to shortly. However, it is unlikely to be used in the short-term as it is seen very much as a last resort to force down prices in some regional areas. The first step to capping retail prices is to ensure that the wholesale price capping is working.

6.2.4.1. Potential benefits

When a retail price cap is set below normal market prices, it will benefit consumers at the cost of discouraging sellers. As discussed later, for all price caps, any benefit derived by consumers in these circumstances may be offset by time spent queuing and finding a service station that is selling if shortages occur.

6.2.4.2. Potential problems

Apart from the general problems with price caps discussed above, a retail price cap has several specific problems. Because many fuel retailers, such as independents and franchisees are small businesses, they are less able to withstand short-term losses, particularly when overall profitability is as low as it is at present. Thus, setting a price that is too low would rapidly drive a number of service stations out of business. The result would be a market supplied solely by the majors.

Retail price caps are also likely to lead to shortages of supply from time to time. If prices are too low for too long, retailers will be better off shutting than continuing to sell at a loss and some will close until the price improves. Given the importance of motor vehicle fuels to the ACT economy, any shortage of supply would be devastating. While this scenario may sound far-fetched, it is important to remember that wholesale spot-sales of fuel have ceased in WA as a result of the MWP arrangement. Further, fuel shortages are common in less developed countries around the world where price caps are in place. Given that governments cannot ever perfectly understand markets, it is likely that from time to time the cap would be set too low. For this reason, it would be essential to also cap wholesale prices to ensure that a reasonable retail margin is retained.

6.2.4.3. Additional problems for implementation in the ACT

If the retail cap were set too low and thus cheap fuel became available in the ACT, NSW consumers would travel to the ACT to buy fuel. This would be likely to increase the financial pressure faced by ACT businesses and worsen shortages.

6.2.5. Compulsory price sign boards

Price sign boards outside service stations are generally felt to increase competition between service stations, as potential consumers can see what prices are being offered without driving into the service station. The WA Department of Consumer and Employment Protection is intending to make sign boards compulsory in some areas where they are not usually displayed and prices are high.

6.2.5.1. Benefits
Competition between service stations may increase, driving prices down.

6.2.5.2. Problems
In some places, there have been conflicts between having price sign boards and local planning regulations which, for reasons of visual amenity, discourage signage.

6.2.5.3. Issues for local implementation
Most if not all service stations in the ACT already display their prices; certainly there were no public comments about service stations lacking price sign boards. One caller stated that, on one occasion, he had stopped at the service station and the price displayed was incorrect. Given this, there would seem to be very little benefit in regulating to mandate sign boards.

6.2.6. Cost to the WA Government

Anecdotal evidence suggests that government costs in WA are quite high as it is believed that up to twenty staff are working on the regulatory package, particularly in running the telephone and Internet service associated with FuelWatch. In addition, there are the costs of infrastructure required to run the telephone and Internet services.

6.3. Other States and Territories

6.3.1. New South Wales

New South Wales is not currently considering any action on motor vehicle fuel pricing. In the recent past, however, it has undertaken three main actions. Firstly, in 1999 it established a telephone hotline for the public to report pricing practices that are possibly illegal and uncompetitive. Following the closure of the hotline, 23 allegations of suspected illegal and anti-competitive behaviour were forwarded to the ACCC for investigation. No prosecutions arose from these allegations.

Secondly, from 24 March 2000, all service station operators were required to have a price sign board which displays the price per litre for unleaded petrol. Thirdly, in late 2000 and early 2001, the Government commissioned two reports into the possibility of the community using fuel cooperatives to access discount motor vehicle fuel.[72]

6.3.2. Victoria

Consumer and Business Affairs Victoria is working on two initiatives at present.

6.3.2.1. Terminal gate pricing
The Victorian *Petroleum Products (Terminal Gate Pricing) Act 2000* came into effect on 1 August 2001. This introduced mandatory terminal gate pricing to Victoria.

Terminal gate pricing simply means that a fuel terminal posts a wholesale price for fuel sales "from the terminal gate". This allows retailers (and other bulk fuel purchasers) to purchase

[72] Dominic Wong, New South Wales Department of Fair Trading, pers. comm., 19 June 2001.

fuel from the terminal immediately post-import or refining, and potentially allows for a stronger, more transparent wholesale fuel market. Three oil majors previously made a terminal gate price (TGP) available publicly.

The difficulty with TGPs has typically been that they do not apply to most purchasers. For example, the independent chains have often been able to negotiate a bulk-purchase discount, while the wholesale price offered to franchisees contains a range of add-on costs that can include freight, return on assets for the service station infrastructure and other franchise fees and rebates. Even BP, which operated under a particularly transparent terminal gate pricing scheme before the legislation, did not offer its TGP to franchisees.

The Victorian legislation tries to force more transparency in the wholesale market by requiring:

- declared suppliers to publicly advertise a TGP for declared products, and to provide product at that price;
- contracts to identify the TGP plus the price of additional services such as freight, less discounts and rebates; and
- invoices to also identify the TGP plus the price of additional services such as freight, less discounts and rebates.

To ensure clarity, the TGP advertised must be calculated according to a particular methodology, which is a build-up of landed international product price, plus excise, terminal operating margin and GST. Note that unlike wholesale price caps, terminal gate pricing does not specify a formula or particular price level and allows for the add-on of other costs such as freight and branding.

A number of industry participants commented that the consultative approach taken to the development of the Victorian terminal gate pricing policy is preferable to the Western Australian approach, which is seen as poorer policy because of lack of consultation.

The major benefit of mandating terminal gate pricing in this manner is that it improves pricing transparency and provides far more information to the purchaser than has previously been provided. This should improve competition in the wholesale fuel market. It also appears to do so in a way that does not seriously interfere with price levels. However, the results are unlikely to be a dramatic reduction in price or market fluctuations and, as such, consumers are unlikely to see terminal gate pricing as beneficial to them. Terminal gate pricing would also be difficult to implement in the ACT as it does not have any fuel terminals. Instead fuel is typically delivered from terminals in Sydney.

6.3.2.2. Temperature correction

Victoria is planning to take a proposal for fuel temperature correction to the national Ministerial Council on Consumer Affairs, which is made up of the Ministers responsible for Consumer Affairs in each State and Territory, and the Commonwealth. This, if successful, will lead to the introduction of temperature-correction legislation nationwide. The Victorian

approach is apparently similar to the current ACT legislation,.[73] Temperature correction legislation was discussed in section 5.4 above.

The Commission views temperature correction as a trade measurement issue. In general, ensuring a trading standard helps to facilitate markets and thus such measures are desirable. However, the costs such mechanisms impose on industry also need to be taken into account. As the ACT's legislation has already imposed these costs on the wholesale industry that supplies the ACT, it seems likely that a nationwide extension involving largely the same wholesalers would have a considerably lower cost, and will spread the cost already imposed across a greater volume of fuel.

Recommendation 4: That the ACT Government support the introduction of a national temperature correction regime and, following the introduction of such a regime, ensure that ACT legislation is harmonised with the national approach.

6.3.3. Queensland

The Queensland Government has established an 1800 telephone service to take information and complaints on motor vehicle fuel price issues from concerned consumers. This information is being forwarded to the Premier's Department. At this stage, the Government has not decided if it will take further action.

6.3.4. South Australia

The South Australian Parliament has set up a Select Committee on Petrol, Diesel and LPG Pricing. It is investigating "all aspects of petrol, diesel and LPG auto gas pricing in South Australia" but particularly issues such as wholesale prices, oil company discounting and rebating practices, and control of retail outlets.[74] The Committee was due to report on 25 July 2001 but this deadline has been extended. No conclusions have been reached at this stage.[75]

6.3.5. Tasmania

The Government Prices Oversight Commission (GPOC) began monitoring fuel prices in Tasmania in mid-1999. GPOC has been producing monthly price reports since August 1999. No other action is being taken at present.[76]

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[73] Del Stitz, Project Manager – Fuel, Consumer and Business Affairs Victoria, pers. comm., 19 June 2001.

[74] South Australia, Parliament, *Select Committee on Petrol, Diesel and LPG Pricin*g, 2001 (accessed 6 June 2001), <www.parliament.sa.gov.au/committee/select09.shtm>.

[75] Rick Crump, Parliament of South Australia, pers. comm., 18 June 2001.

[76] Raymond Chan, Tasmanian Government Prices Oversight Commission, pers. comm., 30 May 2001.

6.3.6. Northern Territory

The Northern Territory Government is currently not planning or undertaking any regulatory activity related to motor vehicle fuel prices.[77]

6.4. Submissions and Public Opinion

Most of the opinion provided to the Commission was strongly critical of most aspects of the WA regulatory package. The oil majors (with one exception) and the AIP felt that the package was anti-competitive and would lead to higher costs and thus higher prices. The dissenting oil major felt that some aspects were workable if modified, but overall the package was anti-competitive and bad for consumers. It was generally felt that the package was bad policy implemented for political reasons and with inadequate consultation.

Independent retailers felt that the 24-hour rule particularly disadvantaged them because they were no longer able to adjust their prices to be the lowest in the market. It was felt that in the long run this would harm their position in the market, and could either limit their growth or drive them out of the market. The Motor Trades Association (ACT) and the Service Station Association were also strongly critical of the package.

The Motor Trades Association of Australia and the Western Australian Department of Consumer and Employment Protection were supportive of the regulatory package. A small number of submissions and telephone calls to the Commission from members of the public supported the idea of the Western Australian regulatory package and in particular the FuelWatch information service. No submissions or telephone calls from members of the public were against the changes.

Apart from the oil majors, which supported the Victorian approach over the WA approach, and the Motor Trades Association of Australia which supported the Fitzgibbon Bill, there were no submissions about the activities of jurisdictions other than WA.

6.5. Conclusion

Each State and Territory is currently undertaking its own action on fuel pricing issues independently from any national approach. This approach has the potential to lead to a situation where each jurisdiction takes a different action. Such a situation will lead to increased compliance costs for industry. This, in turn, is highly likely to lead to increased fuel costs for consumers.

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[77] Janine Stoner, Northern Territory Department of Industries and Business, pers. comm., 23 June 2001.

7. SOCIAL AND ENVIRONMENTAL IMPACTS

While social and environmental impacts are not mentioned in the inquiry's terms of reference, the *Independent Competition and Regulatory Commission Act 1997* includes environmental and social considerations in the objectives of the Commission. For this reason, the Commission has briefly considered environmental and social aspects of motor vehicle fuel pricing.

7.1. Environmental Issues

Petroleum products have a number of impacts on the environment when used to power motor vehicles. These include the release of greenhouse gases and gaseous pollutants such as carbon monoxide, nitrogen oxides and particulates.

7.1.1. Impact of high fuel prices

Increases in motor vehicle fuel prices in theory should decrease demand for motor vehicle fuel. In reality, it is often hard in the short-term for consumers to reduce fuel consumption because their vehicle's consumption rate is relatively fixed and their journeys are crucial to employment, education and social activities. Nevertheless, in 2000 the national petrol market contracted as a result of increasing prices.[78] In the long run, history shows that higher prices lead to a large decline in use, presumably as users convert their vehicles to new fuels and adopt lower-energy-use practices. Through this mechanism, unless consumers are substituting to more environmentally damaging fuels (which seems unlikely in the case of motor vehicle fuels), higher fuel prices will lead to a reduced environmental impact of transportation.

7.1.2. Price differentials between fuels

LPG is generally considered a less environmentally damaging fuel than petrol. LPG is also considerably cheaper than petrol, largely because no excise is levied on it. This relative cheapness is a major motivation for users to convert their vehicles to LPG, a change which, incidentally, will benefit the environment.

Changes in the price of LPG and petrol also change the relative cheapness of LPG, which presumably affects the motivation to move to LPG. In early 2000, LPG prices were around 45% of those of petrol, while in early 2001, they had risen to around 60% before falling back towards 50% in May 2001. Clearly, this may influence those considering converting to LPG.

7.1.3. Alternative fuels

It is possible that government action to support the use of alternative fuels and fuel extenders such as ethanol, "biodiesel" and compressed natural gas could have the added benefit of reducing the ACT economy's exposure to changes in petroleum product prices. However, as

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[78] Caltex Australia, *Caltex Australia Limited Announces Reduced Full Year Profit* (media release), 23 February 2001.

this issue lies outside the scope of the inquiry's terms of reference, it has not been examined by the Commission.

7.2. Social Issues

Like any other cost of living, motor vehicle fuel costs can have differing impacts on different sections of the community. This section briefly examines these issues.

7.2.1. Impact of high fuel prices

According to the ACT Council of Social Service, people living in poverty in the ACT spend a higher proportion of their income on transport costs than those who do not live in poverty, and these costs are a significant proportion of their income.[79] Because of this, they are likely to be disproportionately affected by increasing motor vehicle fuel prices. They may also be more likely to be forced to use other methods of transport, such as public transport, because they are unable to pay increased fuel costs.

7.2.2. Impact of price fluctuations

Price fluctuations could possibly affect people living in poverty in two ways. Firstly, being more cost sensitive, they may be able to reduce their overall fuel costs by purchasing fuel during discounting cycles.[80] Secondly, their financial constraints and poor access to information could stop them from taking advantage of low points in cycles, leading to higher overall fuel costs. Overall impact is uncertain as this issue has not been examined in depth during the inquiry.

7.3. Fuel Prices as a Policy Tool

Changing fuel prices for social or environmental policy purposes is a very blunt policy tool. Petroleum-based fuels are crucial inputs to many industries, ranging from transport related such as taxis to transport dependent industries such as retailing, tourism and manufacturing. Thus, the side effects of changing fuel prices are likely to be large and potentially outweigh any beneficial outcomes of the change.

An example is a policy to increase motor vehicle fuel prices for environmental reasons through increased fuel taxation. Such a policy would hurt the poor disproportionately, because of their higher proportionate transport costs. Industry could well be damaged through increased costs of doing business, costing jobs and harming the ACT economy. Further, there could be cross-border effects, with ACT motorists travelling to NSW to buy cheaper fuel.

As a result of these issues, the ACT's social and environmental problems are best addressed not through changing the fuel price but through targeted social or environmental policies.

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[79] ACT Council of Social Service, Submission to the inquiry P13/01, 24 May 2001, p2.

[80] Chamber of Commerce and Industry Western Australia, Issues and Policies in Respect of Vehicle Fuel Price Regulation in Western Australia, 2001, p. 8.

7.4. Submissions and Public Opinion

A small number of submissions to the inquiry from members of the public discussed environmental issues. These were primarily concerned with the increasing price of LPG and thus its decreasing attractiveness as an alternative fuel. One telephone call was about the limited availability of compressed natural gas in the ACT. There were no submissions identified as being from environmental groups.

In addition to the ACT Council of Social Service submission, which dealt with the effects of high petrol prices on people on low incomes and disadvantaged groups, a number of submissions and telephone calls from members of the public stated that high petrol prices were causing them financial difficulty.

Several submissions commented on Commonwealth excise on LRP. The excise on leaded petrol was increased above that on unleaded petrol in the early 1990s as a measure to reduce lead emissions into the environment. However, following the removal of lead from petrol, this differential has been maintained and several submissions commented that the excise differential should be removed.[81] The current differential is, in fact, not the result of excise. The excise on LRP, is the same as that levied on unleaded fuel. Instead, the differential is attributed to higher costs of production of lead replacement fuel.[82]

7.5. Conclusion

Changes in motor vehicle fuel prices can have environmental and social impacts. Thus, there may be a need for policy activity. However, because of the importance of fuel as an input to production of other goods and services, manipulating fuel prices as a policy tool could have a widespread deleterious impact on other industries. The Commission therefore suggests that the ACT Government does not seek to set fuel prices independently of other States as an environmental or social policy tool. From an individual Territory perspective, targeted social or environmental policies are more appropriate.

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[81] ACT Council of Social Service, Submission to the inquiry P13/01, 24 May 2001, p3.

[82] David Crawford, Indirect Tax Division, Commonwealth Department of the Treasury, pers. comm., 28 June 2001.

8. CONCLUSION

8.1. Current Situation

Overall, the inquiry has found that the major drivers of both absolute price levels and medium and long-term price fluctuations have been taxation and international factors such as supply restrictions by the OPEC nations and refinery margin increases in Singapore.

In contrast to this, the domestic fuel retailing and distribution industry appears to be competitive and low-cost. It constitutes only a small proportion of overall fuel prices, and tax exclusive prices are low by world standards. Profitability is low at all levels of the industry and there is no evidence of a lack of competition. Low profitability is leading to rationalisation of depots and service stations nationally. The domestic industry component of prices does appear to be responsible for the short-term weekly or fortnightly cycles in petrol price movements. Evidence on these cycles points to them being driven by competition in fuel markets, not profiteering by the oil majors.

Focusing on local factors, the price differentials between Sydney and the ACT are much lower than they were at the time of previous inquiries into the industry. With the exception of LPG, they now appear to be solely made up of the freight cost between Sydney and Canberra. For LPG, although the picture is less clear, again, most of the differential is likely to be attributable to freight costs. The price differential between the ACT and Queanbeyan is entirely made up of the 1 cent/L fuel sales subsidy available to Queanbeyan service stations under the Commonwealth Fuel Sales Grant Scheme. As a result, there is no evidence that the ACT market is less efficient than that in Sydney or neighbouring Queanbeyan.

In terms of regulatory action, a number of States have brought in, or are in the process of establishing, regulatory regimes to reduce the price of fuel or rectify other perceived deficiencies in fuel markets. There are also two fuel inquiries at the Commonwealth level. The ACCC is in the information-gathering phase of an inquiry into reducing fluctuations in fuel prices that is due to report later this year. A separate inquiry into fuel taxation has been established and is due to report in March 2002.

8.2. Possible Regulatory Action

Other States have introduced, and the ACCC is examining, a range of regulatory actions impacting on the fuel industry. However, at this stage it is difficult to see how any of these new regulatory actions, if introduced only in the ACT, could have long-term net benefits for ACT consumers.

In terms of potential benefits, as the fuel market appears to be efficient in its domestic industry component and there are no large unexplained differentials between prices in the ACT and other places, there appears to be little scope for prices to be reduced by regulatory action within the ACT. It may be possible to remove or reduce short-term price fluctuations, but as they are most likely a product of competition, their removal or reduction would be at the risk of reducing competition and thus raising average prices in the long-term. Further, at this stage, it is too early to tell whether the reforms being introduced in other jurisdictions are benefiting local consumers.

Looking at the potential costs of introducing new regulations solely within the ACT, there is a grave risk that such action could be contrary to decisions taken at a national level as a result of the current ACCC inquiry. This would almost certainly result in high compliance costs for the ACT fuel industry, which are likely to be passed on to ACT consumers as higher prices.

A second risk is that regulatory action of the type being seen in some other States is likely to have greater adverse effects on independent participants in the market than on the oil majors. Thus, given the current low profitability in the industry, it may drive out the small businesses and independents in the market. In the long-term, the result would be a market even more dominated by the majors, with a potential lessening of competition and thus higher prices.

There is also a risk of institutionalising poor policy if regulatory intervention is made. Once a regulatory scheme is introduced, there can be a high level of political pressure to retain it, even if it is blatantly failing. The abolition of a scheme is likely to be seen as giving in to the industry and thus be politically unpopular. Evidence of this can be seen in the operation of the previous Commonwealth wholesale price capping scheme which continued until 1998 although numerous reports had questioned its effectiveness since as early as 1994.[83]

These findings and conclusions draw the Commission to the view that the best approach that can be adopted by the ACT Government at this time is a continuing pro-competition stance to the fuel industry. It should support further regulation of the industry only where it can be shown that it will contribute to the long-term competitive pricing of fuel in the ACT and will be implemented and operated in a way that is consistent across all jurisdictions.

Recommendation 5: That the ACT Government not introduce any new fuel pricing regulation before the conclusion of the current ACCC inquiry into price variability. Following the ACCC inquiry, the ACT should take a regulatory approach that is consistent with any national regulatory action. In particular, fuel regulatory policies that differ from those in surrounding NSW should be avoided.

8.3. Solutions

The desirability of adopting a nationally consistent approach to fuel price and supply regulation does not mean that the ACT Government should take no action. Rather, the Commission believes that there is an opportunity for the ACT Government to take a proactive approach in ensuring the ACT community is informed of the range of fuel prices available and the make-up of these prices, and to do this in a way which will not reduce competitive pressures in the ACT market.

8.3.1. Public information

It is clear from the submissions and telephone calls from the public that the Commission received that there is little public understanding of the way that the fuel market works. The result is that consumers are unlikely to be able to take full advantage of the competitive price

[83] Industry Commission, *Petroleum Products*, Australian Government Publishing Service, Melbourne, 5 July 1994.

cycles to purchase fuel when it is cheap. If consumers are informed about the discounting cycles in the market and how they work, as well as provided with information on changes to the wholesale cost of fuel, they will be able to make more informed purchasing decisions. As a result, they will pay less on average for their fuel.

There are several potential models for a public information strategy that may be adopted. For example, the Government could on a daily basis provide the media with information about where prices are in the current cycle, and let the media pass this information on as it sees fit. Alternatively, a partnership between industry, the Government and the media could be developed to publish information on the components of the daily pump price, such as is currently displayed on the Shell web site.[84]

Recommendation 6: That the ACT Government implement a public information strategy that informs the public about the discounting cycle and regularly provides information on the movement of fuel prices.

8.3.2. Improving wholesale transparency

There may also be advantages in improving the transparency of wholesale pricing of fuel through an initiative such as the Victorian terminal gate pricing legislation. By providing more information to purchasers of wholesale fuel, transparency is likely to improve the functioning of the market.

The main difficulty is that the ACT does not have any terminals, and thus this approach is not feasible on an ACT-only basis. However, the ACT Government could work with other jurisdictions to have a scheme introduced at the terminals that supply the ACT.

Recommendation 7: That the ACT Government work with other jurisdictions on improving the transparency of wholesale pricing of fuel, for example through the introduction of an initiative to release terminal gate pricing information that includes the terminals that supply the ACT.

8.3.3. ACT *Fair Trading (Fuel Prices) Act 1993*

The ACT *Fair Trading (Fuel Prices) Act 1993* allows the Minister for Fair Trading to determine caps on the maximum wholesale price, retail price and retail margin following a recommendation from the Director of Consumer Affairs, as discussed in section 1.3.1 above. This Act also contains the temperature correction provisions discussed fully in section 5.4 above.

The fuel-price-setting provisions of the Act have never been used but could be in the future. However, as discussed in sections 6.2.4 and 6.1.3.5 above, price caps have real dangers. In an

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[84] Shell Australia, *Petrol Pricing*, 2000 (updated 16 July 2001, accessed 16 July 2001), <http://www.shell.com.au/petrolpricing/>.

efficient market, they will either be ineffective, lead to the closure of fuel businesses such as service stations or even possibly cause supply shortages.

A further issue is that the *Independent Competition and Regulatory Commission Act 1997* already gives price control powers to the Commission for declared industries. Declared industries currently include buses, taxis and utilities. The motor vehicle fuels industry is not a declared industry but could easily be made so. As such, the fuel price settings of this Act are an unnecessary duplication of existing powers and should be removed.

Recommendation 8: That the ACT Legislative Assembly repeal the fuel price setting provisions of the ACT *Fair Trading (Fuel Prices) Act 1993* as these have been superseded by the powers contained in the legislation establishing the Commission.

9. LIST OF WRITTEN SUBMISSIONS

Submitter	Date Received
John Riding-Hill, Motor Trades Association (ACT)	21/5/01
G Lynes	23/5/01
Michael Delaney, Motor Trades Association of Australia	23/5/01
Mr Robin J Foster	23/5/01
Mr R P Harris	23/5/01
K Sture	23/5/01
Mr Girts Ozols	23/5/01
Ms Marianne Vreugdenhil, ACT Council of Social Service	24/5/01
Mr Neal Hardy	24/5/01
Mr Neil Abraham	24/5/01
Ashley Callinan	24/5/01
Karyn Gentleman	25/5/01
Australian Institute of Petroleum	25/5/01
Terry Crabb	25/5/01
Sally Donaldson	25/5/01
Paul Gardener	25/5/01
Neil Ferguson	25/5/01
Gull	25/5/01
Len Goodman	25/5/01
Mobil	28/5/01
Bethany Smith	29/5/01
D V Huntley	29/5/01
BP Australia	29/5/01
Frank J Kelly	30/5/01
Caltex Australia	8/6/01

APPENDIX 1. ACT LEGISLATIVE ASSEMBLY MOTION FOR INQUIRY

Motion moved by Mr Rugendyke:

"That the Legislative Assembly recommends that the Government issue to the Independent Competition and Regulatory Commission a reference to investigate and advise the Assembly on matters relating to motor vehicle fuel, including petroleum, diesel and gas prices in the ACT. The reference should require the Independent Competition and Regulatory Commission to have regard to the following in its advice:

(1) whether an efficient retail price for petroleum is being delivered in the ACT;
(2) whether there is a higher average cost of fuel in the ACT compared to other capital cities and neighbour Queanbeyan;
(3) whether there is efficient competition in the ACT distribution and retail sectors in the ACT;
(4) whether the fluctuation of ACT fuel prices, particularly prior to public service pay days and peak holiday periods, is indicative of a failure in the retail market that disadvantages consumers;
(5) the efficacy of the *Petroleum Products Pricing Amendment Act 2000* passed in Western Australia and whether similar reforms would provide a net benefit to the community as a whole in the ACT;
(6) whether there are tied arrangements between retailers and distributors in the ACT fuel market that have the effect of restricting competition;
(7) any other related matter."

APPENDIX 2. INQUIRY TERMS OF REFERENCE

AUSTRALIAN CAPITAL TERRITORY

INDEPENDENT COMPETITION AND REGULATORY COMMISSION ACT 1997

REFERENCE FOR INVESTIGATION UNDER SECTION 15
AND
SPECIFIED REQUIREMENTS IN RELATION TO INVESTIGATION UNDER SECTION 16

INSTRUMENT NO. 69 OF 2001

Reference for Investigation Under Section 15

Pursuant to subsection 15(1) of the Act, I refer to the Independent Competition and Regulatory Commission (the "Commission") the matter of an investigation into motor vehicle fuel, including petroleum, diesel and gas, prices in the ACT.

Specified Requirements in Relation to Investigation Under Section 16

Pursuant to subsection 16(1) of the Act, 1 specify the following requirements in relation to the conduct of the investigation:

The Commission is to have regard to the following in its report on the Inquiry:

(1) whether an efficient retail price for petroleum is being delivered in the ACT;
(2) whether there is a higher average cost of fuel in the ACT compared to other capital cities and neighbour Queanbeyan;
(3) whether there is efficient competition in the ACT distribution and retail sectors in the ACT;
(4) whether the fluctuation of ACT fuel prices, particularly prior to public service pay days and peak holiday periods, is indicative of a failure in the retail market that disadvantages consumers;
(5) the efficacy of the Petroleum Products Pricing Amendment Act 2000 passed in Western Australia and whether similar reforms would provide a net benefit to the community as a whole in the ACT;
(6) whether there are tied arrangements between retailers and distributors in the ACT fuel market that have the effect of restricting competition; and
(7) any other related matter.

In undertaking the Inquiry, the Commission is to:

(i) conclude the Inquiry by 30 June 2001 and report as soon as practicable thereafter;

(ii) note the ACCC Inquiry and restrain (sic) from unnecessarily inquiring into those issues under reference to the ACCC;

(iii) focus the Inquiry to those changes that have occurred since previous Inquiries into the ACT motor vehicle fuel, including petroleum, diesel and gas, market;

(iv) have regard to the Government's view that the reasonable costs of the Inquiry ought not exceed $60,000; and

(v) have regard to the Inquiry report being advice to the Legislative Assembly.

Dated this 14th day of April 2001

GARY HUMPHRIES
TREASURER

APPENDIX 3. TYPES OF SERVICE STATION OPERATORS IN THE ACT

Calculating the number of service stations of each ownership and type of operation in the ACT is made complex by changes to the status of sites and the different definitions each data source uses in reporting. For example, some consider a multi-site franchise to be one company which runs a number of sites under a series of franchise agreements, whereas others will include service stations that are run by the multi-site franchisee acting as a commission agent. This is a significant difference, as the oil companies can directly set prices at a commission agency site but not at a franchise site.

In light of this lack of clarity, when analysing this issue the Commission has relied on data available from the AIP on the basis that they are recent, detailed and break down the data in a useful way. These data provide the following view of service stations in the ACT at the end of 2000.

Ownership and Operation of Service Station	Number
Oil major – Direct operation	5
Oil major – Commission agency	4
Oil major – Franchisee	43
Branded independent	4
Independent chain	7
Owned by distributor with oil major equity	6
Other supplied by distributor with oil major equity and carrying oil major branding	6
Total	**75** [85]

Overall, the AIP data indicate that, in the ACT, 77% of service stations are linked directly to an oil major whereas nationally this figure is lower.

It is noteworthy, however, that neither these figures, nor any others the Commission accessed, match with information provided by the oil companies during the course of the inquiry. Instead they suggest that, at the end of 2000, at least 26 sites in the ACT were being operated through a commission agency agreement, whether by a company that was a franchisee of other sites or otherwise.[86]

[85] Australian Institute of Petroleum, *Service Stations*, 2001 (accessed 27 July 2001), <http:/www.aip.com.au/info/statistics/servicest.html>.

[86] Information was provided by Ian McKenzie, Retail Strategy and Development Manager of Shell on 27 June 2001 and in submissions to the inquiry by BP Australia (P28/01), Caltex Australia (P30/01) and Mobil Oil Australia (P25/01).

APPENDIX 4. LOCATIONS OF SERVICE STATIONS IN THE ACT