# Response to ACT Motor Vehicle Fuel Prices

**From**

### BP Australia

BP Australia welcomes the opportunity to offer comment on the Commission’s Issues Paper of April 2001, Inquiry into Motor Vehicle Fuel Prices. BP has long supported an open and transparent pricing system to help both the public and private sectors understand how the pricing of petrol and motor fuels is established. While not necessarily popular, it is our belief that the more people know about how these fuels are priced, the improved understanding will help to remove some of the angst and frustration from peoples’ lives.

Our submission is made with the hope that it will explain some of the intricacies of this industry. As the Commission’s own Paper states, “The issue of fuel prices is complex and not easily understood”. We would attempt to shed some light or understanding into this process.

**EFFICIENT RETAIL PRICES IN THE ACT**

In Australia, BP has all the components of a major integrated oil company. We produce both crude oil and natural gas as a partner in the North West Shelf project. We also own and operate two of Australia’s refineries. Our Bulwer refinery at Brisbane refines 80,000 B/D and the Kwinana refinery near Perth produces some 120,000 B/D of refined products. In addition to these operations, BP has some 1300 branded outlets throughout the country. In the ACT, BP currently has 10 BP Branded sites, operating under three different forms of agreement between BP and the site operators.

5 Sites are operated under a Multi Site Franchise Agreement. These sites are owned by BP and the fuel is sold via an Agency agreement. The fuel is owned by BP and therefore is priced by BP according to market conditions.

3 sites are operated as Single Site Franchisee Agreements under the Petroleum Retail Marketing Franchise Act 1980. These sites are either operated under Crown Leases in the name of BP Australia or Head Lease arrangements with a third party. These sites purchase fuel from BP at the daily Wholesale Price, which is set by BP according to the recommended PSA pricing formula. Under the Trade Practices Act they must set their own selling price for the fuel. BP does offer Temporary Price Assistance to enable these sites to be competitive in the market.

2 Sites are operated under a Privately Owned Service Station Agreement. This is where an independent business owns the site and purchases their fuel from BP under a Terminal Gate Pricing arrangement. (we attach a brochure explaining how we calculate Terminal Gate Pricing and would welcome the opportunity to explain further) Under the Trade Practices Act they must set their own selling price for the fuel.

 In general, BP believes that this is a very competitive industry segment. If it were not, the profits for this segment of the industry would be substantially greater. Instead, many companies experience losses in the refining segment and marketing is not a lot better, as reflected by recent earnings reports. It is fair to say of late that Oil Co Profits as a total may be seen as large however this masks the fact that the majority of these profits are generated from upstream activities such as exploration for oil and gas. Our downstream activities, such as refining, and ownership of retail assets along with the wholesaling of retail fuel is highly competitive and hence profitability is extremely tight. A recent Ernst & Young study showed that for 1999, this industry produced a profit of just A $221 million on assets worth A$5.8 billion. The refining segment reported a loss of A $61 million. The overall performance was a return on assets of just 2% and a profit of just 0.4 Acpl. Year 2000 was no better and the return in retail marketing was far below an acceptable level

In considering efficiencies in the petrol marketplace, the Commission needs to keep in mind that there are already restrictions in place, which limit certain competitive forces. The National Government has already imposed legislation, which supports the existence of independent retailers. While this policy may seem to stimulate competition, in fact, the passage of The Sites Act removed one of the more competitive segments of petrol marketing by limiting the number of company operated outlets. The most efficient was curtailed to protect the less efficient for a variety of purposes.

While not wishing to enter this debate since it is not likely to be changed, it should be pointed out that operating costs spread over a larger number of outlets as opposed to having to recover all expenses from one site is not going to be as efficient. Thus retail prices reflect this inefficiency

We believe in a very competitive situation allowing all to compete where the more effective competitor should be allowed to win out. It is not in the best interest of the consumer to “protect” the inefficient competitor. That produces greater distortions in the marketplace that in the long run hurt the consumer because of subsidization of the weakest competitors.

If the ACT chooses to interfere in this marketplace, it is likely to create additional costs as inefficiencies will be created which ultimately hurt the group which the Commission wishes to help, the consumer.

It is not our place to determine if the excise tax policy of the Government is fair or inequitable. Each Commission member recognizes the excise tax burden placed on each liter of petrol or diesel. It is well known that this burden is borne by the consumer at the bowser. If the government believes this burden is justified, is within the range of the public to pay and if the general public tolerates these rates then it is not for BP to say if this is right or wrong. That is a matter of public policy to be decided between office holder and electorate.

## PRICE COMPARISONS WITH QUEANBEYAN AND OTHER CAPITALS

BP has provided the attached pricing data, for the past three months, to show where the ACT stands in regard to surrounding areas, and this clearly shows that, over this period of time, quite similar competitive patterns were occurring. i.e. Periods of discounting

Fig. 1 – Shows the average pump prices for Sydney, ACT and Queanbeyan as well as the Maximum Wholesale Price (GST Inclusive) applicable for the period

It should be remembered that, at least for BP, all fuel for retail sales is trucked here from out Sydney terminal, some 300 kilometers. This equates to an extra cost of approximately 1.5 Acpl for the transportation cost. While this may not seem the most efficient, in reality it is because the much larger complex can store and have a larger quantity of fuels available than BP’s small depot here in Canberra. This is an efficiency, which means a lower overall price for the consumer. It is simply not economical to either expand the current facility or build a new and larger one for this area. Such an expense would certainly drive costs higher.

Some years ago, the ACT Government sought to control petrol retail sites in the Territory. This eventually proved to be a mistake as the growth and competition patterns changed too quickly or too subtlety for the government to fully master. Thus the ACT government withdrew from this practice. That is the kind of interference, which benefits no one in the marketplace or as a part of the consuming public. Marketplace forces will best determine both the best site as well as the best competitive prices to emerge.

FLUCTUATIONS IN PRICES SUCH AS THOSE BEFORE LONG WEEKENDS

The Commission addresses herein the most frustrating of all issues in petrol marketing. Our experience tells us that consumers show more dislike of this occurrence than any other, including higher prices. They cannot understand this fluctuation in volatility and hence their ire is acerbated.

Fuel prices will change with market conditions. As the preamble of this Paper states, there are many factors, which influence these prices. The price of crude, the value of the dollar, world political conditions, and disruptions in supply either locally or in world markets – all of these and many other factors influence what happens daily in the market. Prices for Australia are basically set by the Singapore trading market. As goes Singapore, so goes the Australian market except for local competitive conditions.

As the Paper also points out there is little that can be done to influence any of these factors.

But what of local conditions, those within the ACT? What if anything can be done there?

BP believes certain steps can be taken which do not interfere with the freedom of the marketplace but may reduce some of the volatility seen by consumers. This is why BP instituted a TGP or Terminal Gate Price. We have had this for about three years now. It is the price at which we will sell to contracted customers who meet financial and safety standards. It is not a posted price from which discounts are then offered thus clouding the actual price. This is it. Purchase if you wish, that is our price. We believe this offers a good deal of transparency without interfering with the functioning of the marketplace.

Mention and consideration is being given to occurrences in WA. We will address those in the next section of reference. However, one step, which we supported, is the 24-hour rule that allows only one price for a 24-hour period. While it requires some adjustment, BP believes that this step can reduce some of the volatility seen in street prices. It can remove some of the volatility during the course of a day which motorists find irritating but permits competition to continue around the one daily price change. It is interference in the marketplace but one, which our Company believes, can be tolerated.

It is difficult to single out each and every circumstance that causes change in retail prices. They do occur often, sometimes several times within a day. They seem to occur randomly or in sequence with some event or holiday. All of these influences have some impact into petrol pricing.

However, investigation after investigation has shown no collusion, no price fixing among competitors, and no illegal activity. Market forces will move a company to do one thing or another. Other companies will see this and react accordingly. Contrary to the belief that there is some sort of conspiracy it is actually the sensitivity to competition that moves companies to react so often or so quickly. If we did not we would soon be out of step with our competition and lose in the marketplace.

This is not a unique event for petroleum retailers. Many retail marketers react to what their competitor does. Perhaps our situation is so different because we are so visible. No other retail competition is so visible to the public. No other competitor displays his selling price so boldly on the street than does a petrol retailer. It is there for all to see and compare. No other industry is under such competitive scrutiny EVERY DAY. But for some reason this is seen as a negative. We post our price not inside the store where the customer must enter first to see what the price is. That price is right out front, on a large sign for the consumer to judge whether or not he/she wants to patronize this location.

While the public may not like that price it is right there for him/her to see and make the ultimate choice. There is no other competitor or industry that undergoes such public scrutiny daily.

Do prices change on certain days? Yes they do. Do they go up sometimes on or just before certain holidays? Probably, in many cases. This is response to market conditions. It is perhaps ironic that as someone is leaving for a holiday at the beach, complaints are heard about the increase in petrol price to drive there but little or nothing is said about the increase in room rates at the resort. Is the room any different from the week or month before? No. Has there been any alteration of the facility for this period or holiday? No. The resort is responding to market conditions. As demand changes so do prices, in almost every consumer product or market. The only difference is that our industry takes that price to the street in full view of our customer.

Have these recent prices or events been “unjustified”? Even one of our harshest critics, Dr. Allan Fels, Chairman of the ACCC recently stated that there was no evidence of illegal wrongdoing. “The facts at the moment are that the underlying level of prices is high because the exchange rate has fallen so sharply and, to some extent, international petrol prices have risen – so the fundamentals for petrol are not good at present.” (30 April 2001) Fels admitted that the low dollar and soaring world crude oil prices – not profiteering – were the principal causes of the recent retail price increases.

**WESTERN AUSTRALIAN REFORMS**

We have already commented on one of the WA “reforms”, the 24-hour rule, which we support.

While we do so with some reservation, we believe that a Maximum Wholesale Price can also work. However, the formula and operation of the plan implemented in WA will not. BP as well as a number of other oil companies has met extensively with the WA Government on this issue. While we do not know what other companies told the Ministry of Fair Trade, we at BP do know what we told them.

Our basic message was, is and will be that any formula must be equitable to ALL parties. Just as your Paper points out there must be a reasonable profit margin to recognize the risk taken just to be in business. The WA formula does not and is doomed to failure if not corrected. We believe the MWP would require every company to sell very near, at or even below cost. No entrepreneur, regardless of the product can sustain a business under these circumstances. The risk reward balance is just not there.

We have repeatedly points out that many of the numbers in the “formula” do not work and do not reflect true market conditions. Freight is but one example. Another is the differential in price allowed for rural areas. It does not reflect the fact that marketing conditions in the bush are different than those in central Perth. They will never be the same. But thus far all of these suggestions, requests, warnings have gone unheeded. The WA market cannot sustain itself under these conditions. Given the nature of the population in the ACT, such a plan is even less likely to work.

The last “reform” to be introduced is the so-called 5050, which allows a retailer to purchase up to 50% of his fuel from another supplier other than his prime supplier. This is proposed under the guise of offering the consumer a choice when he/she pulls into the forecourt of a service station.

In reality the individual most hurt in 5050 is that very consumer. When that same consumer pulls unto the forecourt, he/she will not know if the brand desired will even be there. Is it BP fuel or some substitute? If the customer did not want BP fuel he/she would have gone elsewhere in the first place.

That same consumer looking for a particular grade of BP fuel can go elsewhere if that retailer has chosen to go 5050 and offer a substitute. Who benefited and who was inconvenienced? Certainly not the consumer. And how will the consumer know if the next retailer hasn’t done the same thing thus denying him/her the opportunity once again to buy the preferred petrol? How is this consumer benefited?

The legislation as proposed does not address the critical question of quality. We currently guarantee our fuels. We would not do so at a location operated under 5050. Will the retailer who now offers some substitute? If there is a problem who will "make it right” for the consumer? If the fuel is not contaminated but just doesn’t run well, who is responsible to satisfy this customer? If the customer isn’t satisfied, he/she leaves, angry, and BP, the retailer in question and probably every other BP retailer in the area loses a customer. How is the market helped? How does this serve the consumer?

Most critical as well is where is the guarantee that if the retailer finds a “better deal” on petrol that he is going to share it with the consumer. It is assumed that this will happen. There is nothing that can even begin to substantiate that assumption.

The concept of 5050 is not new. In the largest petrol market in the world, with more competitors and more suppliers anywhere, the US, this concept has been around for 25 years or more. Yet it has been rejected by every political entity at every level that has considered it. If it were such a good idea one would think that at least one jurisdiction would have tried it. Not one has.

In this regard, BP is concerned that the WA Government in its haste to respond to public pressure is considering this ill-conceived measure with little or no investigation. For this reason we commissioned Dr. Ed Shann, well known economist here in the ACT and throughout Australia to look at the concept. We attach his conclusions for your consideration and review. We believe Dr. Shann’s credentials are beyond question and his work bears out what we have felt from the beginning. 5050 does not benefit the consumer and will probably cost him/her money in the long run.

5050 is also likely to destroy the market franchise, which both the company and the retailer have worked so hard to establish. The retailer is able to use a company’s site, the pumps, the tanks the logo out in front of the station to sell another’s product. This is not only expropriation of property; it is a fundamental denial of the right of the franchiser to expect his product to be sold in his location. This is the same thing as a McDonald’s franchisee being allowed to sell Hungry Jack hamburgers in the McDonald’s site.

It is fundamentally wrong and the biggest loser will be the consumer as he/she tries in vain to sort out who is selling what fuel, when and where, and who has a fuel he/she can depend on for quality and dependability. This legislation is a fraud on the motoring public.

## OTHER REFORMS

Much has been talked about the Western Australian experience, however we would like to highlight to the Commission that the Victorian Government has also initiated reforms, The Petroleum Products (Terminal Gate Pricing) Act 2000. Whilst we would never be one to advocate regulation of the Oil Industry we do believe that the Victorian model is far superior to the Western Australian model in its desire to be consultative with all stakeholders and its framework sets out a template under which all parties must adhere (given government checks and balances) rather than the prescriptive nature of the Western Australian reforms (MWP / 50/50).

## CONCLUSION

It is BP’s contention that the motoring public in the ACT has been served well by the petroleum-marketing segment of our industry. While that public may not be happy with current prices at retail, there is no proof, no evidence that any illegal activity has occurred.

We believe that this is a highly competitive industry subject to a great many variables, which cause volatility and frustrate companies as well as our customers. BP stands ready to work with the ACT Commission and Parliament to try to find equitable solutions to some of these concerns without destroying the free market or an efficient distribution, supply and marketing system for the sake of “punishing” some entity. That serves no constructive end. Likewise hasty and ill-considered steps should be avoided for the sake of political expediency. Reasonable approaches by reasonable people can reach a far better resolution to some of these issues.

We would urge the Commission to carefully and fully investigate both problem and solution before taking any action. There are many which may seem beneficial on the surface but which in reality have more far-reaching harm than benefit.