EXECUTIVE SUMMARY

Background

This inquiry concerns the adequacy of competition at the wholesale level in the petroleum industry and the effect that competition in the industry has on petrol prices.

In 1975 the Trade Practices Commission (TPC), the forerunner of the Australian Competition and Consumer Commission (ACCC), expressed concern that the franchise arrangements between the oil majors and their franchisees who retailed petrol to the public, inhibited competition. The TPC's attempt to remedy this situation was frustrated by problems relating to infringing the major oil companies' property rights, petrol retailers' belief that any attempt to alter the status quo would result in retaliation from the oil majors, and the cost of introducing competition.[1] These issues are explored in depth later in this report.

Attempts on the part of both Victoria and Western Australia to legislate to alter current franchise arrangements, in order to boost competition in the retailing of petrol, were also not successful, partly because the legislation enacted failed to express the intent of the policy makers.

The bill which is the subject of this report, is a further attempt to enact legislation to achieve the aims first set out by the TPC in 1975.

The impetus for this report therefore arose before the current debate regarding taxation revenue and petrol prices and is unconnected with that debate.

The Bill

It is an article of economic faith that competition moderates prices by providing the leverage needed to actively encourage industry players to compete for market share. In the case of the petrol industry, this is seen as producing a desirable outcome for consumers who would otherwise have to buy fuel at whatever price the major oil companies thought the market would bear.

Country consumers, especially those in rural and remote areas, are particularly vulnerable to the effects of high fuel prices. Lacking the alternative transport options widely available to people living in metropolitan areas, they are largely dependant on private vehicles for transport, moreover, the distances they must travel are often much greater than those travelled by city dwellers.

The bill therefore seeks to provide a mechanism to encourage oil companies to compete against each other for the right to supply service station operators. The

1 Evidence, p. E194.

underlying idea is that increased competition will lead to lower petrol prices in both city and country areas.

The premise of the bill is that the contractual relationships between the major oil companies and service station operators inhibit competition. This is because an oil company requires service station operators contracted to trade under its logo, to enter into exclusive supply contracts, colloquially known as tied supply arrangements. These contracts require the service station operators to purchase their fuel exclusively from the company under whose logo they operate.

Exclusive supply arrangements give the major oil companies dominance in the marketplace. Specifically, while a major oil company must offer fuel to its service station operators at a price that allows them to maintain market share, there is no pressure on the oil company to supply wholesale fuel at a competitive price because contractual arrangements prevent service station operators from buying their fuel elsewhere. The oil company, following fundamental economic principles, is able to extract the maximum feasible price from the service station operator.

Service station operators complain that the oil companies exploit their dominance by charging a wholesale price that is, in their view, uncompetitive. They cite two key sources of evidence in support of their case. Firstly, they claim that the companies sell fuel to the service station operators' competitors at a lesser price than they charge them. Second, they note that in metropolitan markets at least, service station operators are forced to operate on company provided price support for very long periods of time, because the wholesale price the companies charge is higher than the prevailing retail price.

The current bill attempts to change this by giving service station operators who are bound to the oil companies under particular franchise arrangements the right to seek up to 50 per cent of their fuel supplies from sources other than their franchisor. The theory is that in order to maintain market share and keep the service station operators' custom, the oil companies will sell fuel to the service stations at a more competitive price.

The oil companies are opposed to the bill on a number of grounds. They maintain that there is already strong competition in retailing petrol and that the prices they charge franchisees are fair and reasonable. The companies also oppose the bill claiming that it fundamentally misunderstands the nature of franchising, unconstitutionally impinges on their property rights, and makes it impossible for them to continue to guarantee the quality of fuel.

The report addresses:

- the historical context of the bill,
- the nature of franchise arrangements,
- the economic paradigms of the industry,

- competition and pricing in the petrol retailing industry,
- constitutional and legal issues,
- multi-site franchising, and
- conclusions and recommendation as to how to proceed.