CHAPTER 4

Competition or Collusion?

Introduction

4.1 The Committee found that although the drivers of competition have changed over the last 15 years or so as a result of events overseas and in Australia, the domestic market continues to operate in a way that benefits the majority of consumers.

4.2 This chapter explores competition issues in the domestic petrol markets by firstly considering the major competitive influences on and the industry structure of the market. It then turns to the evidence of anti-competitive behaviour in the market. Finally it considers the role of the supermarket chains.

Changes in the drivers of competition

4.3 The structure of the Australian petroleum industry has altered significantly over the last 15 years or so. During the mid-1990s independent operators were able to compete effectively with the major oil companies. They could do this because of surplus supplies both in the Asian region as well as from a number of the Australian refineries. Their entry increased the level of price competition in the marketplace and they were able to discount retail prices in competition with the refiner/marketers.

4.4 Since 2003, economic growth increased demand for fuel in the Asian market and absorbed surplus supplies. In July 2003 the Mobil refinery at Port Stanvac closed and this restricted refinery capacity in Australia, which was also experiencing strong economic growth, increasing domestic demand for fuel. Furthermore, the introduction of Australian fuel quality standards made sourcing fuel from overseas for the Australian market more difficult. Independent importers were restricted in their ability to purchase product in the spot market and their capacity to provide competitively priced imported fuel declined.

4.5 However, by 1996 Woolworths had entered the retail petrol market, and was joined in 2003 by the other supermarket chain, Coles. This had the effect of increasing concentration in the industry and the market dominance of Caltex and Shell. Nevertheless, the supermarkets have competed fiercely and successfully for market share and have taken over from the independent operators as the significant driver of competition in the retail markets in which they operate.

Industry concentration and vertical integration

4.6 The Australian oil industry is dominated by the Australian offshoots of four major international oil companies: BP Australia, Mobil Oil Australia, Caltex Australia and Shell Australia.[1] Although Australia has no formal barriers to entry, the significant investment in capital equipment required to refine oil represents a major barrier to establishing new refineries in this country. Accordingly it constrains greater competition at the wholesale level of the market.

4.7 However, the size and location of the Australian market also determines refining capacity. Since the 1980s the number of refiner/marketers in Australia has decreased from nine to the current four due to industry rationalisation. The domestic market for fuel is quite small by world standards and our geographical location is removed from the larger markets of Asia which makes it a less attractive location for new refineries. From the mid-1990s to 2000, Australia and Asia enjoyed excess refinery capacity which, while it constrained prices, led to poor margins for refiners.

4.8 Many submissions suggested that the concentration of the fuel industry at the wholesale level and the vertical integration of the major oil companies were, at face value, evidence of a lack of competition leading, to higher prices:

> …Australia's oil industry is dominated by a small number of large integrated players and…there are significant barriers to entry. These and other factors have resulted in a weakening of the competitive process and higher retail prices for consumers.[2]

4.9 However, not all submissions consider that vertical integration is detrimental to consumers. The Royal Automobile Club of Victoria (RACV) stated:

> The oil industry in Australia has been traditionally vertically integrated, with refining, distribution and wholesale, and retail elements each under the control of one or other of a small number of oil majors. RACV's view is that vertical integration of the industry can produce efficiencies and cost savings, and therefore we do not have any objection in principle to this structure, bearing in mind that the Australian market is quite small in international terms.
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> However, at the wholesale and retail levels, the field is open to players other than the oil majors, and Australia has long had an independent fuel wholesaling and retailing sector. We believe that this has added competition, particularly in the metropolitan areas and major regional centres.[3]

4.10 Caltex suggested that the petroleum industry is not highly vertically integrated and there are few sites directly operated by major oil companies.[4] It provided the

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1 The ACCC provides a useful outline of the industry structure in its submission no. 31, pp 20 – 27.

2 NRMA, *Submission 33*, p. 25.

3 RACV, *Submission 30*, p. 5.

4 Caltex Australia, *Submission 55*, p. 30.

following breakdown of the Australian service station structure in its submission, as shown in Figure 4.1.

Figure 4.1—Australian service station structure[5]

Controlling entity	Number of sites controlled*
Major oil companies**	238
Supermarkets (includes Caltex Woolworths and Coles Shell sites)	1040
Franchisees – major oil company brands	800
Independent sites – major oil company brands	3900
Other brands (eg 7-Eleven, United, IFS, Neumann)	600
	6600[6]

* Company-controlled sites reported under Sites Act to DITR, end-Oct 2004, supermarkets at May 2005, other data adapted from AIP June 2004 survey
** Caltex, BP, Mobil, Shell

4.11 Nevertheless, the Motor Trades Association of Australia (MTAA) argued that while the oil majors may not directly control the setting of prices at many sites, the majority of retail sites are tied to a particular oil major for their fuel supplies. Therefore the oil companies can wield a significant degree of influence over the prices at the retail level through their control of wholesale prices and the inability of many retailers to source fuel supplies from an alternative supplier.[7] The Committee further notes that by providing price support, the major oil companies can influence the discounting cycles.[8]

4.12 The MTAA asserted that that the repeal of the Sites and Franchise Acts is likely to further increase the influence of the major oil companies over the retail market by removing the final constraints on vertical integration in the industry:

> MTAA considers that increased vertical integration and market concentration are not in the best interests of Australian consumers in the longer term as it will allow the larger market participants to exert a greater degree of influence over the product supply chain and to potentially manipulate the price of petrol. It will also threaten the level of competition

5 Caltex Australia, *Submission 55*, p. 30.

6 The figures for franchisees, independents and other brands are rounded figures. Consequently the total number of sites is rounded to the nearest hundred.

7 MTAA, *Submission 28*, p. 12.

8 ACCC, *Submission 31*, p. 21.

> in the industry and create barriers to entry which may preclude other more efficient competitors from entering the market in the future.[9]

4.13 Some submissions cited the current profits that the oil companies are making as evidence of a lack of competition in the industry. For example, the NRMA argued that if Australia's petroleum industry were characterised by robust competition, higher input prices (such as higher crude oil prices) would lead to lower profits or no profit growth.[10] Mr Warwick Richards, Director, Economic and Energy Analysis, told the Committee that the current market is one in which margins have almost certainly exceeded the long-run requirements in the short term.[11]

4.14 Claims of 'price gouging' and 'profiteering' have been raised in the context of the high refiner margin in recent times. The Committee understands that the refiner margin is highly variable over time. Additionally, changes in it are due to movements in the international prices of crude oil and refined petrol, which reflect underlying demand and supply factors.

4.15 In order to assess profit levels in general, an appropriate period over which to make the assessment needs to be determined.[12] For example, there will be a difference in profitability measured over a short period, such as the months covering an upswing in prices, or a longer term, such as over a year or more. Furthermore, to make claims of 'price gouging' and 'profiteering' requires a notion of the appropriate level of prices and profits and an assessment that current prices and profits are significantly above that appropriate level.

4.16 The Committee notes that it is not unusual in any business for there to be periods of both unprofitability and profitability. Supply and demand factors are such that oil refineries are currently enjoying a period of profitability – indeed, that is the natural effect of the operation of competitive markets. Mr Russell Caplan, Chairman, Shell Company of Australia, described for the Committee the cyclical nature of the refiner margin:

> First, refiner margins vary, and it is unarguable that refiner margins in recent times have been high. I am sure that the committee has had a lot of evidence as to why they are high, but it principally relates to demand outstripping supply, exacerbated by some natural phenomena in the United States and some apprehension about affairs in the Middle East.…
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> …[S]econd…it is too simple to compare average Australian margins with average Singapore margins, because you need to take into account the

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9 MTAA, *Submission 28*, p. 15.

10 NRMA, *Submission 33*, p. 27.

11 Mr Warwick Richards, Director, Energy Analysis, *Committee Hansard*, 26 September 2006, p. 49.

12 ACCC *Submission 31*, p. 102.

> different configuration of every refinery and the different product qualities that we have in Australia.
>
> There are all sorts of refineries in Singapore. There are quite complex refineries in Australia. Without going into details…six or eight refineries are currently under construction in this part of the world, totalling about two million barrels, and there are 70 or so projects at varying stages of detail for further refinery construction. You have probably heard that the refining business is a cyclic business. It has happened often in the past that the high margins have brought additional capacity, which has destroyed the margins. You would think that people would learn but, in fact, we are in the process of seeing that happen again. Shell's expectation is that refinery margins will come off out of refineries that are currently under construction…[13]

4.17 At the retail level, the price cycles result in high volatility of prices where at times they will move down very low and maybe even move to points at which those in the supply chain are losing money. Then there will be times when prices will move up again, and they will move to points where those in the supply chain are making profits, and then they will move down.[14]

4.18 Despite only four refiner/marketers operating in Australia a number of factors have increased the competitive forces at work between them at the wholesale level. First, Australian refineries must price their output to be competitive with imports and Australian prices are determined by prices in the Asia-Pacific region where there is significant competition between refineries. Secondly, in 2002 the oil companies ended refinery exchange (where refiners exchanged product in different capitals on a tonne per tonne basis) and replaced it with full buy/sell arrangements.[15] Thirdly, a number of independent chains established terminals so they could import fuel. Finally, the entry of Coles into the petrol market to compete with Woolworths necessarily encourages competition between the supermarket chains and the rest of the market.

Discounting petrol prices—competition or collusion?

4.19 The Treasury states that competition maximises welfare and increases productivity which benefits consumers through lower prices and greater choice.[16] Although Australia and the world have recently experienced large rises in the price of fuel, Australians continue to enjoy some of the lowest petrol prices of the OECD nations. This is due to the relatively low government imposts on fuel in this country, and, at least in metropolitan areas, competition-driven fuel price discounting.

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13 Mr Russell Caplan, Chairman, Shell Australia, *Committee Hansard*, 28 September 2006, p. 55.

14 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission (ACCC), *Committee Hansard*, 3 August 2006, p. 9.

15 ACCC, *Submission 31*, p. 19.

16 Australian Treasury, *Submission 68*, p. 19.

4.20 Mr Nathan Dickens from the Australian Institute of Petroleum (AIP) told the Committee that the real price of petrol has actually fallen as a consequence of competition:

> …the competitive nature of the market at the retail level has meant that petrol, as a general commodity, has decreased in real terms over the last couple of decades. In real terms, we are very much paying now for fuel what we were in 1980. They are the outcomes of the price cycle from our view. It is very much an indicator of a highly competitive market where aggressive price discounting occurs in order to attract incremental volume. The outcome of that is that we have very low prices by international standards. We have a cycle that is denominated by most fuel being sold below the average point of the cycle. In fact we have such high levels of competition that despite price increases in petrol over time we are basically paying the same now for petrol that we were in the 1980s.[17]

4.21 The Committee received evidence about the importance of competition in the market by reference to prices in the diesel market in which the oil companies do not compete at the retail level.[18] The consequence for the price of diesel is that it is not discounted to the same extent as petrol. Therefore its price stays higher and sometimes significantly so, and does not go through significant price cycles.

4.22 The provision of price support by a major oil company to its franchisees contributes to price discounting in the retail market. It also allows certain retailers to compete when prices are low when they would otherwise be making losses on their petrol sales.

4.23 The competition provisions of the *Trade Practices Act 1974* (the TPA) govern the market for petrol. The Australian Competition and Consumer Commission (ACCC) administer this Act. It is often criticised for not prosecuting 'clear' cases of collusion, 'price gouging' and 'predatory pricing' by petrol companies. The following section examines the evidence about such matters.

Parallel pricing[19]

4.24 Contracts, arrangements or understandings which have the purpose or likely effect of substantially lessening competition in a market are prohibited under section 45 of the TPA.[20] Section 45A of the TPA makes contracts, arrangements and understandings a *per se* breach of the TPA.

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17 Mr Nathan Dickens, AIP, *Committee Hansard*, 27 September 2006, p. 39.

18 Mr Nathan Dickens and Dr John Tilley, AIP, *Committee Hansard*, 27 September 2006, pp 35–36.

19 ACCC, *Submission 31*, p. 101.

20 Australian Treasury, *Submission 68*, p. 20.

4.25 Some submissions claimed that similar movements in petrol prices over a short period of time stem from price fixing or collusion between industry participants.

4.26 A feature of petrol prices is that they tend to reflect a high incidence of price matching or 'parallelism'. This relates to the fact that petrol (particularly regular unleaded petrol) is generally a very similar product with minimal brand loyalty, which means that competition is based primarily on price. Retailers therefore cannot afford to set prices that are higher than prevailing market prices for too long or they risk losing market share.

4.27 Furthermore, in the automotive fuel industry, it is not difficult for retailers to be aware of each other's prices. They are prominently displayed on roadside price boards and made available in comprehensive up-to-date surveys of retail prices in major cities. Caltex told the Committee that pricing information is available electronically to the oil companies in real time, so companies can react very quickly on price:

> There is such a transparency of information on petrol prices in this country—probably more so than any other country, both electronically to the oil companies and to the ACCC—that everybody knows what everybody is doing in a very short period of time, which enables people very quickly to follow once somebody leads.[21]

4.28 Therefore, it is not surprising that retail petrol prices cluster around an average. As long as prices are determined individually without collusion, there is no breach of the TPA. The courts have held that the similarity or even uniformity in price of similar products is not, of itself, sufficient evidence to suggest a breach of the TPA.

4.29 Mr Graeme Samuel, Chairman, ACCC, said that collusion requires the parties to gather together and to agree that they will follow certain price patterns and certain price arrangements between them.[22] The Committee notes that price following and parallel pricing are not the same as collusion:

> The simple increase of a price on a board is not, of itself, evidence of a breach of the act. There is no law in this land—in relation to competitive commodities, in any event—that says that suppliers of the commodity cannot charge whatever price they want to charge, and the fact that the price moves from one figure to another figure, even in a matter of two hours, may reflect nothing more than that the party that has set the price has decided to increase the price in order to increase the profit margin, or whatever might be the case; it is not necessarily evidence of anticompetitive conduct.[23]

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21 Mr Desmond King, Managing Director and Chief Executive Officer, Caltex Australia, *Committee Hansard*, 13 October 2006, p. 7.

22 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 3 August 2006, p. 10.

23 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 3 August 2006, p. 9.

ACCC investigations

4.30 In the past, the ACCC has brought actions under Part IV of the TPA against petroleum distributors and retailers for price-fixing. For example, it successfully brought actions under section 45 against petrol price-fixing arrangements in Brisbane and Ballarat. In March 2005 financial penalties totalling $23.3 million were ordered by the Federal Court.[24] The total penalty was later reduced by $3.2 million after a successful appeal by two respondents.

4.31 In June 2005, the Federal Court made declarations based on admissions of price fixing conduct involving two service stations in the Brisbane area. The Federal Court imposed penalties totalling $470,000 in November 2005.

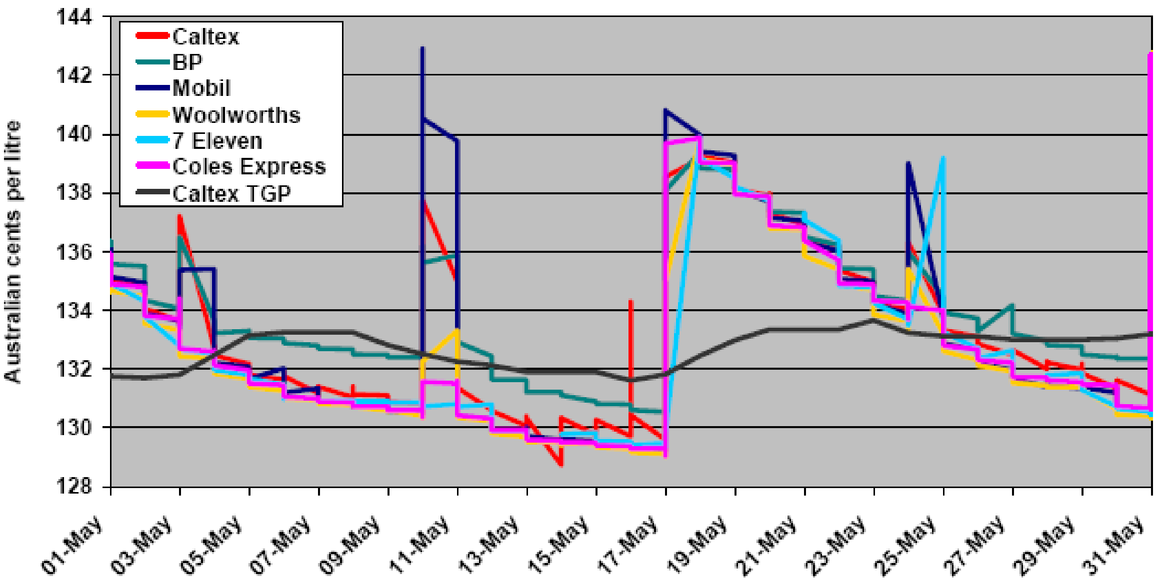
4.32 There is a further case currently before the courts concerning alleged price-fixing in the Geelong area of Victoria.

4.33 These proceedings indicate to the Committee that price collusion may exist in local markets between individual retailers, but there is no evidence it exists at an industry level.

Evidence of price movements

4.34 Many of the charts of petrol price movements submitted to the inquiry showed a pattern of retail prices moving in unison among retailers over price cycles. The graph of retail petrol prices in Melbourne during May 2006 (Figure 4.2) provides a useful illustration of the market in metropolitan areas.

Figure 4.2—Melbourne pump prices in May 2006[25]



24 ACCC, *Submission 31*, p. 101.

25 Caltex Australia, *Submission 55*, p. 22.

4.35 The chart shows the average pump price by brand during May against the Caltex TGP (used here as an indicator of spot market wholesale petrol prices). It indicates that the intense discounting (where petrol was sold below TGP) was driven by Woolworths and Coles and followed by most other major brands. The Committee notes that characteristics of competitive markets are price transparency and volatility. Evidence of these is apparent in the above chart. With a couple of exceptions, the prices essentially track each other. This is typical of price following behaviour in the metropolitan areas that exhibit price cycles although to many people the pattern is indicative of collusive behaviour. However, while some witnesses thought that such a pattern could be consistent with collusion in the market, it is also evidence of competitive behaviour.[26]

4.36 Although parallel movements in price may be consistent with collusion, they are not, of themselves, indicative of it. Parallel price movements are equally consistent with the market being highly competitive. Indeed, where one is considering a commodity like petrol, whose properties are essentially uniform, one would expect retailers to compete primarily on price, not quality. In such circumstances, rational economic actors in a competitive market would seek to match one another's prices, since failure to do so would naturally lead to consumers purchasing from suppliers who offer lower prices. That is particularly so in an industry where both prices and price movements are so transparent. In fact, the committee heard much evidence which suggests that the petroleum retailing industry is one of the most consumer-aware industries in Australia: because of the high level of price transparency, a large number of consumers do consciously seek out the lowest prices, and are assisted in doing so in many capital city markets by media (usually radio) reports which, on a daily basis, alert them to the location of the petrol stations selling at the lowest prices. A market in which retailers seek to match one another's prices would ordinarily be thought to be a competitive market.

4.37 There are two other powerful indicators which are inconsistent with collusion: volatility and profitability. In a market where near-to identical (or parallel) prices are the result of collusion, one would not expect to see significant price volatility. On the contrary, price volatility is one of the surest indicators of competition. The whole point of collusion is to attempt, through artifice, to maintain prices at higher levels than would be achievable in a competitive market; such collusive arrangements are almost invariably characterized by stability at that inflated price, not volatility. For similar reasons, the relatively low level of profitability of the industry, characterized by narrow retail margins which sometimes fall below zero, is also inconsistent with collusion – since the whole point of collusion is to achieve a supra-competitve profit.

4.38 In short, while uniformity of price may be consistent with collusion, it is equally consistent with competition. If such a market were indeed being collusively manipulated, one would also expect to see relatively high and stable prices. But where

26 Senator George Brandis, Chair, & Professor Paul Kerin, Melbourne Business School, *Committee Hansard*, 26 September 2006, p. 57.

a market in which prices tend to uniformity is also characterized by price volatility and narrow (often negative) margins, it is both counterintuitive and irrational to conclude that the price uniformity (or parallelism) is the product of collusion: on the contrary, all of the other relevant indicia are only consistent with competition.

'Price gouging' and 'profiteering'[27]

4.39 Some submissions claimed that oil companies are practicing 'price gouging' and 'profiteering' with petrol prices.[28] The question of whether petrol resellers have engaged in 'price gouging' and 'profiteering' is a complex one, which raises several issues.

4.40 Firstly, the concepts 'price gouging' and 'profiteering' do not have clear meanings in Australia. Although European and American laws contain anti-gouging provisions[29] these terms are not used in the TPA. Mr Samuel suggested that price gouging means:

> …taking advantage of circumstances that give you an unusual ability to charge prices that would not normally be reflective of the competitive price. In other words, having market power.[30]

4.41 Furthermore, the ACCC advised that the concepts of 'price gouging' and 'profiteering' would usually be associated with market power and it is not clear how they would apply in the context of an industry that supplies an internationally traded commodity such as petrol. Petrol prices in Australia tend to follow Singapore refined petrol prices because refiners in Australia have to compete with refiners in the region in marketing refined petrol in Australia and Asia.

4.42 Mr Stephen French, General Manager, Competition and Consumer Policy Division, Australian Treasury told the Committee that the TPA is more focused on ensuring there are competitive markets which will work to neutralise any such behaviour:

> You might see conduct which some describe as price gouging, but I suspect that in any market you will see other competitors operating to undercut that sort of behaviour or you will see other competitors entering into the market where markets are uncompetitive. From our perspective, we focus on ensuring that the market is competitive, and the law is focused on that rather than on those sorts of effects that you might see from time to time.[31]

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27 ACCC, *Submission 31*, pp 101–102.

28 See for example, Australian Taxi Industry Association, *Submission 27*, p. 2; *and* Mr Steve Gibbons MP, Federal Member for Bendigo, *Submission 49*, p. 4.

29 Dr Warren Mundy, Director, Bluestone Consulting, *Committee Hansard*, 26 September 2006, p. 50.

30 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 3 August 2006, p. 27.

31 Mr Stephen French, General Manager, Competition and Consumer Policy Division, Australian Treasury, *Committee Hansard*, 28 September 2006, p. 36.

4.43 Nevertheless, the Committee understands that witnesses use the terms 'price gouging' and 'profiteering' to suggest that oil companies are taking advantage of particular circumstances to charge more for their products than would otherwise be the case. However, on closer inspection, there is no persuasive evidence of such conduct because for each of the components that contribute to the petrol price, there is a market determined price that is transparent, at least to the participants in the market:

> Mr Richards outlined the sorts of margins which are associated: maintaining terminals, marketing and the retail margin for the service stations—service stations have to get something out of it. It is the Singapore refinery price and the crude price. You work all the way down that and you include freight—and each of those is a market. The market for freight is a market; when you have strong demand for freight the price rises. So unfortunately there are a range of components there which you have to get a handle on. I have totted up 12 separate items that you would have to get a good handle on, and I think I am probably underestimating to some extent the sorts of components which go into it.
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> So, yes, it is more complicated than the price of bananas but at least we can go to a place like Platts or Reuters and say, ‘Look, there is the freight cost, there is the Singapore refinery price and there is the Tapis price.’ And if you had a significant differential between the terminal gate prices and the retail price, or between the terminal gate prices and, say, the Singapore gasoline price then it would become clear to all who monitor those sorts of things.[32]

Predatory pricing[33]

4.44 One of the difficulties in considering claims of 'predatory pricing' is that the term has no strict legal definition, and means different things to different people. Ordinarily, claims of 'predatory pricing' seem intended to invoke section 46 of the Trade Practices Act, which prohibits, in defined circumstances, 'misuse of market power' – which is itself a legally controversial concept. The Trade Practices Act does not explicitly recognise or define 'predatory pricing'.

4.45 Nevertheless, what most people who use the expression intend to convey is the use of price discounting in order to drive weaker competitors out of the market. Such conduct may, depending on the circumstances, constitute a breach of section 46. But it is an error to regard any competitive discounting which results in a competitor being driven out of the market, as conduct which is, or should be, unlawful. As the courts have said many times, the purpose of the Trade Practices Act is to protect competition, not individual competitors, and the result of a competitive market may well be that economically unviable participants will be forced out. Nor do other common commercial phenomena, including loss-making strategies to establish or

32 Mr Craig James, Chief Economist, Commonwealth Securities, *Committee Hansard*, 26 September 2006, p. 36.

33 ACCC, *Submission 31*, pp 103-104.

expand market share, or discounting to bulk-volume purchasers, constitute unlawful behaviour – although, in particular circumstances, they may. Yet all of these phenomena are sometimes carelessly described as 'predatory pricing'.

4.46 Section 46 prohibits a company with a substantial degree of market power from taking advantage of that power for a proscribed purpose. The proscribed purposes are:

- eliminating or damaging a competitor in that market or another market;
- preventing entry to that or another market; and
- deterring or preventing competitive conduct in that or another market.

4.47 When considering allegations of breaches of section 46 there are many issues that need to be addressed. A threshold question is whether the corporation in question in fact enjoys a substantial degree of power in a market. Even if it could be shown that the corporation has a substantial degree of power in a market, the ACCC then needs to demonstrate that it has 'taken advantage' of that power for one of the three proscribed purposes. As a consequence of court decisions in the last few years, in particular that of the High Court in *Boral Besser Masonry Ltd v ACCC* in February 2003, section 46 cases are becoming increasingly difficult to prove,[34] and the ACCC, as the institutional litigant, has not commenced any new section 46 cases since that decision.

4.48 Retailers selling petrol below cost does not of itself constitute abuse of market power. To fall into that category, such behaviour would need to be targeted at one or more competitors (i.e. it needs to have the purpose of damaging a competitor) over a sustained period. Competitive pricing to gain market share or to respond to general competitive pressures is not predatory.

4.49 Several witnesses gave the Committee their definitions of what constitutes predatory pricing in the petrol industry. These include:

- retailing petrol at prices below the Terminal Gate Price (TGP);[35]
- discounting the Terminal Gate Price to different buyers with insufficient transparency;[36]
- below-cost pricing by one of the major players in the market;[37] and
- selling at a price either below cost or at a very slim margin, with a focus on forcing existing competitors out of the market.[38]

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34 Senator George Brandis, Chair, *Committee Hansard*, 3 August 2006, p. 20.

35 Mr Russell Delahaye, Motor Trade Association of Queensland, *Committee Hansard*, 23 August 2006, p. 44.

36 Mr Peter Fitzpatrick, Motor Trade Association of Western Australia, *Committee Hansard*, 20 September 2006, p. 47.

37 Mr Kevin Hughes, HEH Australian Petroleum Consultancy Co, *Committee Hansard*, 27 September 2006, p. 105.

4.50 There is generally a thin line between conduct that breaches section 46 and vigorous competition. In Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd (1989), a section 46 case, the High Court noted that:

> Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away … these injuries are the inevitable consequence of the competition section 46 is designed to foster.

4.51 The ACCC has examined a number of claims of abuse of market power in the petroleum industry, but has been unable to find sufficient evidence to indicate a breach of the TPA.

4.52 Some industry participants have in the past called for industry-specific arrangements to address concerns of misuse of market power in the petroleum industry. The ACCC considers that the petrol industry is no different from other industries and therefore section 46 provisions should apply. This is consistent with the Hilmer report into national competition policy which stressed the desirability of the universal application of competition law.

4.53 Mr Brian Cassidy, Chief Executive Officer, ACCC described for the Committee what action the ACCC takes when it receives a complaint of predatory pricing or uncompetitive behaviour:

> Service station A may say, 'Service station B'—which is owned by a competing oil company—'is undercutting me and trying to drive me out of business.' What we do when we receive that sort of allegation…is move to intensive surveillance of prices in that relative geographic area so that we can watch and see who moves first and who then responds. That is the sort of detailed information that we get. We have done a number of these sorts of investigations and it indicates to us that in any particular area it will probably not consistently be the same company or the same service station that will lead prices down. One week it may be an independent because they have managed to acquire a fairly competitively priced load of fuel and they seek to take advantage of that by dropping their price at what they think is an opportune time. It may be one of the major oil company sites in another week because the oil company finds that it has a surplus of product. Despite all the tanks that you see at refineries, the oil companies have a fairly fine margin in terms of how much product they can store. Our experience is that in a particular area you will not be able to say that it is this particular service station that consistently leads prices down. It will vary from one week to the next according to the circumstances of the particular service stations.[39]

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38 Mr Alan Evans, President, NRMA, *Committee Hansard*, 28 September 2006, p. 20.

39 Mr Brian Cassidy, Chief Executive Officer, ACCC, *Committee Hansard*, 3 August 2006, pp 10–11.

4.54 In the past, such intensive monitoring has tended to focus on 'hot spots' generally in regional areas, although the ACCC has also investigated wider geographical areas as well.[40]

Supermarket chains

4.55 The supermarket chains have had a significant effect on the retail market for petrol following their entry into the market and they now account for about 40 per cent of fuel sales.[41] The Committee received evidence that it is now the supermarkets rather than the independent operators that drive petrol price discounting.[42]

4.56 On the one hand certain consumers are staunchly supportive of the supermarkets and their shopper docket schemes. The rapid increase in market share that the supermarket chains have been able to garner from the rest of the market illustrates this success. On the other hand, the ability of the supermarkets to offer 4 cents per litre (cpl) discounts and their wholesale arrangements with Caltex and Shell are viewed with suspicion by some competitors and consumers:

> The introduction of shopper-docket schemes by Woolworths and Coles may have sharpened competition in retail markets—although AAA's Tasmanian club, RACT, argues competition has not increased in Tasmania. Indeed as the supermarket chains gain market share, and as other retailers move to introduce similar shopper-docket schemes, retail competition might decrease. The movement of Woolworths and Coles into the retail market may also have reduced competition at the wholesale level, because Woolworths entered into an agreement to source products from Caltex rather than importing them from overseas.[43]

4.57 The ACCC examined retail prices in the five largest metropolitan cities over similar periods before and after Coles Express began operating in those cities. Relative to an independent benchmark, petrol prices were lower after the entry of Coles Express and the Woolworths/Caltex joint venture into the retail petrol market. The extent to which prices were lower varied with cities and time. It ranged from around 0.5 cpl to over 3.0 cpl. Additionally, rather than attributing the lower prices in recent times in the Perth market to the regulatory environment in Western Australia, there is evidence that it is a consequence of the entry of Coles Express into that market.[44]

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40 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 3 August 2006, p. 11.

41 AIP, *Submission 50*, p. 20.

42 Mr Brain Cassidy, Chief Executive Officer, ACCC, *Committee Hansard*, 3 August 2006, p. 45. *See also* Mr Desmond King, Managing Director and Chief Executive Officer, Caltex Australia, *Committee Hansard*, 13 October 2006, p. 10.

43 AAA, *Submission 29*, p. 13.

44 Mr Gerald Hueston, President, BP Australia, *Committee Hansard*, 27 September 2006, p. 68.

4.58 The shopper docket schemes have increased in popularity. A 2005 survey found that 73 per cent of motorists used shopper dockets.[45] This compared with only 25 per cent of motorists in 1999. Of the 73 per cent that used shopper dockets, the survey found that those that used the dockets 'every or most times they buy petrol' had doubled in the past two years.

4.59 The additional price competition in the retail markets is placing pressure on all operators including independent operators and franchisees in particular. The MTAA fears that the schemes will contribute to the exit of substantial numbers of independent operators from the market and Australia will be left with a market dominated by the oil major/supermarket alliances.[46]

4.60 However, the AIP countered such an argument, stating that the repeal of the Sites Act will enable all fuel suppliers to compete on an equitable basis, without certain suppliers (i.e. the four majors that are currently restricted by the Sites Act) being unreasonably constrained in their choice of retail business model. This will enable networks to be established that are commercially viable in size and hence enable the networks to optimise the economies of scale that exist in fuel retailing and convenience store operations.[47]

4.61 The NRMA is concerned that as the supermarket chains further increase their market share at the expense of the smaller independent retailers, the increasing dominance of the supermarket alliances will disadvantage motorists.[48] The concern for the independent operators is shared by many, including Mr Kevin Hughes, Principal, HEH Australian Petroleum Consultancy Co:

> …Service Station Operators and Distributors were and are, part of the small business backbone of Australia and many were and are, being forced from the industry by exploitive and unscrupulous commercial behaviour. Such market force behaviour has the effect, through diminishing numbers, particularly of independents, of reducing effective competition and increasing the concentration of market power in the hands of a very small number of market players. A highly undesirable scenario for the creation of a free and competitive market place.[49]

4.62 Some considered that the shopper docket schemes do not represent a true saving to consumers. They argued that the schemes are subsidised by higher grocery

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45 ACCC, *Submission 31*, p. 27.

46 MTAA, *Submission 28*, p. 15.

47 AIP, *Submission 50*, p. 24.

48 NRMA, *Submission 33*, p. 27.

49 HEH Australian Petroleum Consultancy Co, *Submission 70*, p. 3.

prices in the supermarkets[50] which not only creates a false economy for consumers, but unfairly elevates the price of groceries for those who do not purchase fuel.[51]

4.63 However, Mr Mick McMahon, Managing Director, Coles Express told the Committee that the Coles Myer Group does not cross subsidise its Coles Express outlets.[52] Nor does it run the petrol outlets as loss leaders - they are each intended to be a profit centre. Furthermore, the shopper docket scheme is a loyalty scheme to encourage shoppers to frequent Coles Myer stores:

> The fuel loyalty scheme for Coles Myer effectively replaced the shareholder discount scheme. The concern with the shareholder discount scheme was that it was available to a very narrow section of our customer base. It was worth more or less the same amount of money in terms of the cost of loyalty, but it was going to a very small section of the customer base. So the idea with fuel loyalty was to take a more egalitarian view, if you like, and say, 'Can we get an offer that is available to everybody and attractive to everybody?' As you have heard from some of the numbers that we have indicated, the fuel offer is certainly available to everybody. We saw it as the replacement of one loyalty mechanism with a broader based loyalty mechanism. And if we did not spend the money on fuel, we might spend it on FlyBuys, catalogues or TV advertising. That is what I mean by it being just a part of the marketing mix. [53]

4.64 When the Committee questioned Mr McMahon about how Coles Express was able to sell fuel for less than some petrol retailers were able to purchase it wholesale, he told the Committee that this was because Coles Express could sell greater volumes, and also because of the transactions in the convenience stores:

> The fuel discount scheme has been very successful for us in growing volumes. That means that if I have an average throughput that was already at the top end of the industry it is now higher by a significant factor. I do not know who you have in mind, but against somebody who, for instance, is at the bottom end of the average throughput scale, on a rate per litre that can make a huge difference.
>
> Secondly, the importance of the store these days cannot be underestimated in converting that custom account who comes for fuel. We will have stores with an offer that we have invested in which may well be doing as much as five or six times what some of the second tier—I will call them second tier

50 *See for example* ASPO-Australia, *Submission 15*, p. 9 *and* Mr John Turner, *Submission 37*.

51 Mr Michael Carr, *Submission 38*.

52 Mr Mick McMahon, Managing Director, Coles Express, *Committee Hansard*, 27 September 2006, p. 84.

53 Mr Mick McMahon, Managing Director, Coles Express, *Committee Hansard*, 27 September 2006, p. 85.

> for the sake of this example—operators are doing. That fundamentally changes the economics of the game.[54]

Conclusion

4.65 The Committee found that the dynamics of the Australian petrol industry have changed over the past decade or so. The market has evolved from one that was highly regulated with a variety of participants to a deregulated market in which there are fewer competitors at the wholesale level, as well as a smaller number of retail outlets. Nevertheless, the competitive forces are sufficient to place downward pressure on retail prices for consumers.

4.66 Despite receiving a variety of assertions about anticompetitive conduct in the industry, the Committee found no persuasive evidence that the industry is characterised by such conduct. To the extent to which anticompetitive conduct does exist, it is localised, isolated and rare and occurs in the form of collusion between individual operators such as the three instances which the ACCC prosectuted in 2005 and 2006. This behaviour is atypical of the industry. Parallel pricing as seen in the industry is not indicative of collusion; indeed, given the transparency and volatility of the market and low margins, it is in fact indicative of vigorous competition. Furthermore, there is no persuasive evidence of regular or systematic misuse of market power which might constitute a violation of section 46. Further, after taking into account the international factors it found that retail prices for fuel are not unnecessarily high.

4.67 Although the number of smaller independent petrol retailers will continue to decline, the larger independents appear to be doing well, despite the fact that the factors that allowed them to become established have changed. The continued viability of large independents is yet further evidence of the absence of predatory behaviour by the major retailers, while the attrition of small (usually one or two output) independents is a natural outcome of ordinary competitive pressures. The supermarket chains have taken over the role of the independents as a strong discounting force in the markets in which they operate.

4.68 The Committee considers that the Australian fuel market, particularly in the metropolitan areas, shows the characteristics of a strongly competitive market, from which consumers benefit.

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54 Mr Mick McMahon, Managing Director, Coles Express, *Committee Hansard*, 27 September 2006, p. 90.