Minister for Consumer Affairs

Nauru House
80 Collins Street
Melbourne, Victoria 3000
GPO Box 2797Y
Melbourne, Victoria 3001
Australia
Telephone: +61 3 9655 6474
Facsimile: +61 3 9655 8681

The Secretary
Senate Economics Legislation Committee
Suite SG.64, Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

INQUIRY INTO THE PRICE OF PETROL IN AUSTRALIA

I write regarding the inquiry the Committee is conducting into the price of petrol in Australia and to provide for the Committee's information a copy of the report on automotive fuel prices prepared by Consumer Affairs Victoria (CAV) and released in June this year.

As you may be aware, the Victorian Government legislated to introduce terminal gate pricing for petrol and diesel in August 2001. Since that time CAV has been undertaking periodic assessments of the impact of terminal gate pricing on fuel markets and of trends in fuel prices more generally in Victoria and, for the purposes of comparison, in New South Wales and Queensland.

The attached report provides the most recent assessment of unleaded petrol, diesel and LP autogas prices. It covers the period January 2003 to April 2006 and analyses trends over time in absolute prices and in 'notional margins' through a comparison of international, terminal and retail prices.

The report points to a number of significant changes in fuel markets in Victoria and raises concerns about automotive fuel prices, in particular the terminal margins for petrol and diesel.

The analysis found that for petrol and diesel the notional margin between published terminal gate prices and a benchmark representing the price of landing refined product in Victoria had tended to increase over the review period. While the analysis of margins is based on notional prices and excludes actual costs, it points to the possibility of rises in actual margins.

Because retail prices increased more slowly than terminal gate prices, notional retail margins for the oil majors, supermarkets and independent retailers fell for petrol and diesel. Supermarkets tended to have the lowest notional retail margins putting competitive pressure on the independent retailers. Competition between supermarkets and independent retailers may be contributing to the continued rationalisation of service stations. Notional industry margins (terminal margins combined with retail margins) for petrol and diesel rose not only in Melbourne but also in Sydney and Brisbane.

Victoria
The Place To Be

Rising margins are a concern particularly so when international prices have risen significantly, the majority of domestically consumed fuel is produced and refined locally and the industry is undergoing changes in competition. A detailed examination of oil company prices and margins at this time is needed to ensure that the market is operating efficiently and that consumers are not being disadvantaged.

In June I wrote to the Commonwealth Treasurer, the Hon Peter Costello MP, calling for a national inquiry into fuel prices and providing a copy of the report. Attached for your information is a copy of my letter.

If you have any enquires regarding the report you are welcome to contact Dr David Cousins, Director of Consumer Affairs Victoria, on 03 8684 6015.

I look forward to the Committee's report on its inquiry.

Yours sincerely

MARSHA THOMSON MP
Minister for Consumer Affairs

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Attachments: Report on Automotive Fuel Prices in Victoria – January 2003 to April 2006
Letter to the Hon Peter Costello MP

Report on Automotive Fuel Prices in Victoria

January 2003 to April 2006

Consumer Affairs Victoria

Consumer Affairs Victoria
May 2006

DEPARTMENT OF JUSTICE

State Government Victoria

Contents

1 Introduction

In October 2003 Consumer Affairs Victoria ('CAV') released a report on the operation of the *Petroleum Products (Terminal Gate Pricing) Act 2000* ('the Act') and its effects on the wholesale automotive petrol and diesel market in Victoria. The report covered the two and half year period August 2000 to December 2002.

A key recommendation of that report was continued and upgraded monitoring of automotive fuel prices. As a result, CAV monitors international product prices and retail prices for petrol, diesel and LP autogas and terminal gate prices for petrol and diesel.

The current analysis is the first fuel pricing analysis since the release of 2003 report. It covers the period January 2003 to April 2006 and follows on from the assessments in the first report. Prices in Melbourne, selected centres in regional Victoria and, for comparison, Sydney and Brisbane are assessed. The report analyses trends over time in absolute and relative prices and in 'notional margins' through a comparison of retail, terminal and international prices.

The Report was prepared by staff of CAV and is published to further inform market participants and the public about fuel market and pricing.

2 Terminal Gate Pricing Scheme

2.1 Application of Terminal Gate Pricing

Victoria was the first Australian jurisdiction to introduce mandatory terminal gate pricing when the Act came into operation on 1 August 2001. The terminal gate price ('TGP') is the price at which fuel is first sold into the Victorian wholesale market and comprises an import-parity product price component, Federal Government excise, a 'terminal operating margin' and GST. It excludes discounts, rebates and optional charges for services beyond the terminal gate and applies to both contract and spot sales.

The objectives of the Act are to promote greater transparency in wholesale fuel pricing and to improve access to competitively priced fuel at terminals for all customers.

The Act applies TGP only to petrol and diesel fuels. While LP autogas is a fuel which is included under the Act, it was not declared at the time the Act was proclaimed. The approach which is taken to improving wholesale price transparency under the Act means that there would be no benefit from applying TGP to LP autogas.

The import parity approach taken under TGP improves price transparency by linking domestic wholesale prices to international fuel prices. Import parity pricing has been used for many years as the approach to petrol and diesel pricing in Victoria. It sets producer and refiner prices at the price of importing product into the Australian market. However, as this report demonstrates, there is already a very close relationship between movements in the retail price of LP autogas and the international benchmark price for LPG, the Saudi Aramco Contract Price ('SACP'). This relationship confirms that there is already a high level of wholesale price transparency in the LP autogas market.

Furthermore, since 2003 BP has voluntarily published daily on the internet a modified version of TGP for LP autogas. The BP initiative promotes price transparency by providing resellers with an indicative secondary wholesale price that can be compared with the SACP and retail prices to determine the local price build up.

2.2 Terminal gate pricing requirements

TGP legislation in Victoria consists of the Act, regulations, an order in council and a Determination by the Director of CAV. Together these instruments declare the suppliers which must set terminal gate prices, the fuels for which terminal gate prices must be set and the criteria for determining the Landed International Product Price ('LIPP'), a component of TGP.

At the time the Act was introduced the declared suppliers were the four 'oil majors' – BP, Caltex, Mobil and Shell – and the two independent terminal operators Trafigura Fuels Australia and Tri-State. The fuels first declared were lead replacement petrol ('LRP'), regular unleaded petrol, premium unleaded petrol and diesel. However, amendments to the legislation in 2005 revoked the declarations of the two independent operators, LRP and certain high performance proprietary premium petrol.

The legislative scheme places a number of obligations upon the declared suppliers including to:

- set a TGP for each declared fuel using a prescribed price formula;
- publish on the company's web site a TGP for each declared fuel at each time it is set or varied and not change a TGP more than once every 24 hours;

- base all contracts with resellers (distributors and retailers) on the TGP. TGP based contracts may include an allowance for discounts or rebates and charges for any of the specified optional services;
- disclose the amount of any optional service charges and any return on investment in leased sites, on request, to resellers and leaseholders respectively;
- disclose on the invoice for the sale of a load of fuel the TGP plus the price of any optional services, less discounts or rebates; and
- provide access to declared fuel from the terminal at the TGP and only refuse to supply fuel in the prescribed circumstances, such as a supply shortage, inability to pay, illegal supply, unsafe or small load and terminal scheduling.

2.3 Prescribed formulas

The legislation prescribes two pricing formulas, one for determining the daily TGP and the second for calculating the LIPP, a component of the TGP.

The prescribed TGP formula is:

- TGP = LIPP + excise and other taxes + a reasonable terminal operating margin + GST.

The prescribed LIPP formula is

- LIPP = Singapore spot purchase price + freight + insurance + wharfage.

3 Market description and definitions

3.1 Products

The report examines prices for three fuels – regular unleaded petrol, diesel and automotive liquefied petroleum gas ('LP autogas').

3.2 Supply stages and prices

The three stages in the supply of petrol and diesel where prices are examined are:

1. importation – an LIPP benchmark for petrol and diesel is estimated using component data purchased from Platts and sourced from the internet. The Singapore spot purchase prices referenced to calculate the benchmark LIPPs are MOPS 95 RON for regular unleaded petrol and an 80/20% blend of MOPS gasoil 0.05 and kerosene for diesel.
2. terminal – the TGPs published by terminal operators and sourced from the internet; and
3. retail – prices at retailers' pumps. Petrol, diesel and LP autogas in Melbourne, Sydney and Brisbane was purchased from Informed Sources (Australia) Pty Ltd. Retail pricing data for petrol in regional Victoria was sourced from the Australian Automobile Association website. Country retail prices for diesel and LP autogas are not published on this web site or elsewhere on the internet.

For LP autogas, only the retail price and an international 'indicator' supply base price are examined. The international indicator used for LP autogas is the SACP for propane. It is not a landed price as it does not include freight and wharfage. The SACP is sourced from the LPG Australia website.

3.3 Basis of prices and margins analysed

Only retail prices are the prices of actual transactions in the fuel market. Prices at the other stages are 'notional' prices. LIPPs for petrol and diesel are estimates calculated according to the prescribed formula. TGPs are also determined according to the prescribed formula and are published by terminal operators as the prices at which they are willing to sell, but are not necessarily the prices at which sales occur.

Three *notional* margins are estimates calculated in the following way:

- notional terminal margin – TGPs adjusted for excise and GST less LIPPs;
- notional retail margins – retail prices adjusted for GST less TGPs; and
- notional industry margins – retail prices adjusted for excise and GST less LIPPs, in other words terminal plus retail margins.

Note: The notional retail margin covers both retail and wholesale costs and profits.

3.4 Suppliers

The suppliers included in the analysis are:

- Terminal suppliers: The declared suppliers BP, Caltex, Mobil and Shell – referred to as 'the oil majors' – and the Hastings terminal operator, Trafigura.
- Retailers: The retail outlets are grouped according to the 'brand' they display: the oil majors; 'the supermarkets' (Coles Express/Shell and Caltex/Woolworths) and 'independents' (the rest). The 'total market' figure aggregates all retailers.

4 Pricing Analysis

The review period for this analysis is 1 January 2003 to 30 April 2006. Metropolitan Melbourne is the focus of the analysis, but comparisons are made with metropolitan Sydney and Brisbane and with 23 major towns across regional Victoria.

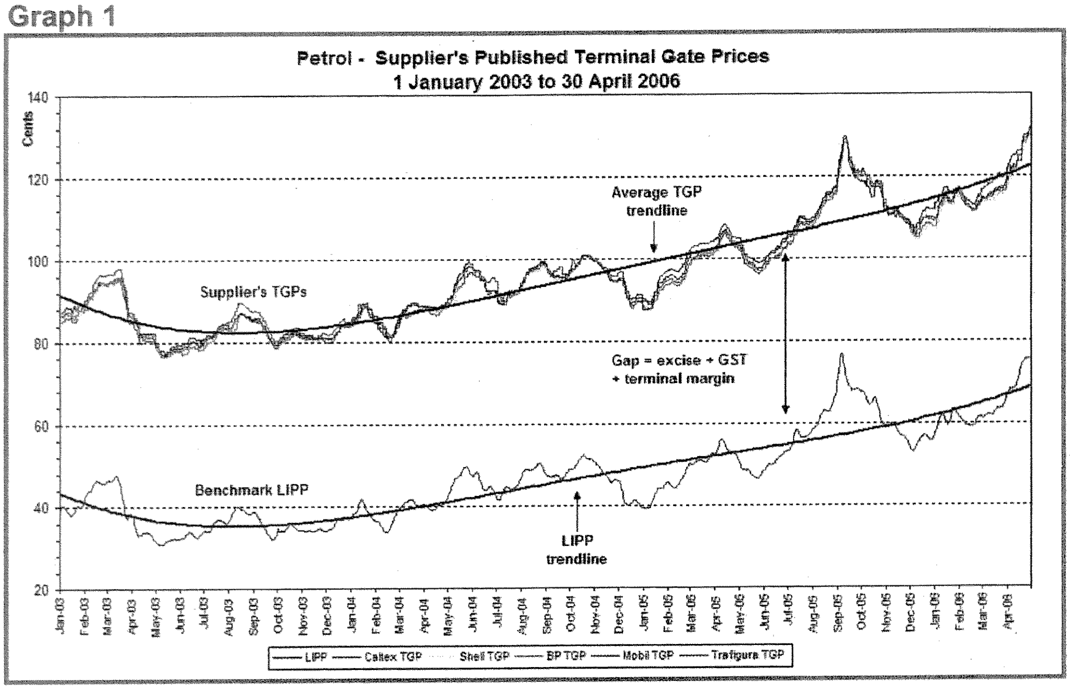
4.1 Terminal gate prices and margins

[i] Regular unleaded petrol

Graph 1 plots the average daily benchmark LIPP and published TGPs for the four declared suppliers (BP, Caltex, Mobil and Shell) and for Trafigura. The graph shows TGPs fluctuating around an upward trendline following decreases during 2003. TGPs followed movements in the LIPP for petrol.

Mobil tended to have the highest TGPs while Trafigura shifted between having the highest and the lowest TGPs.

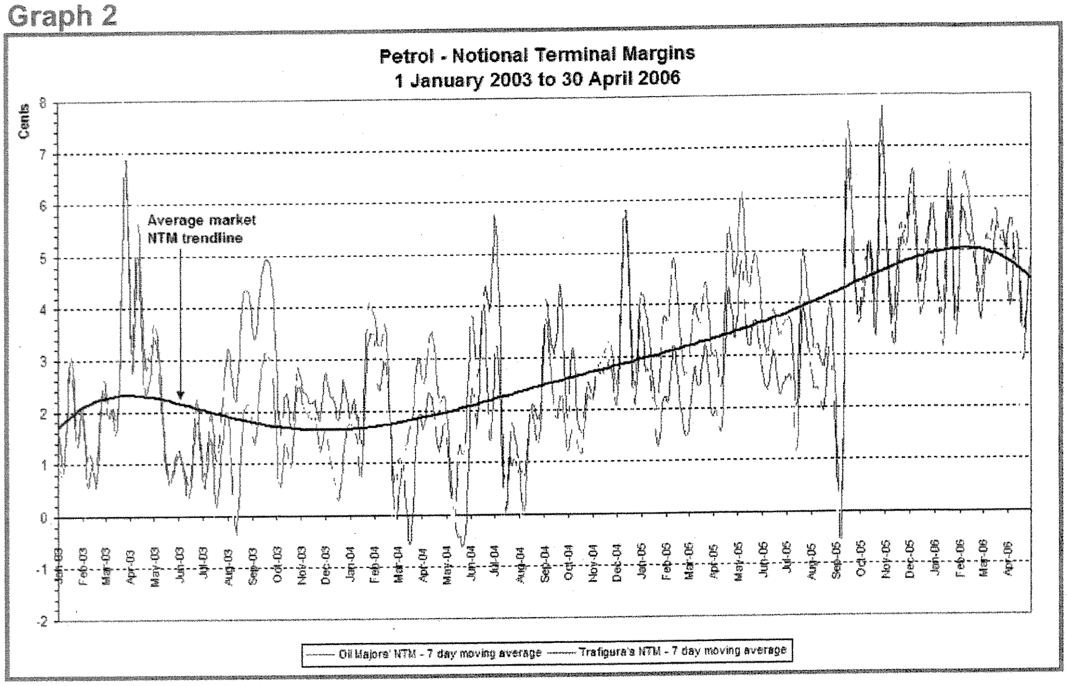
Graph 1



Graph 2 plots the average daily notional terminal margin ('NTM') for the oil majors and for Trafigura. The NTM is the difference between the TGP and the LIPP, adjusted to exclude excise and GST. The graph includes a trendline for the whole market which combines NTMs for all terminal suppliers.

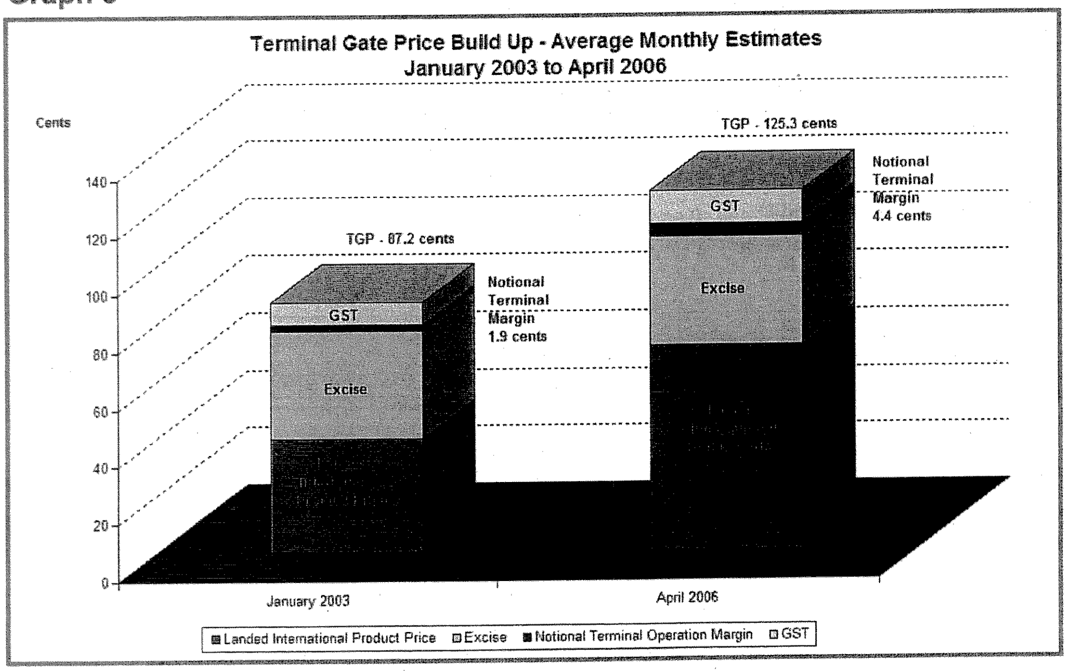
Because the overall increase in TGPs was larger than the increase in the LIPP, NTMs – particularly after early 2004 and for the oil majors – increased sharply following decreases in 2003. There was a one cent step increase in NTMs for petrol in September 2005.

Graph 2



Graph 3 compares the components building up the average monthly TGP for all suppliers between January 2003 and April 2006. It shows that over that period NTMs increased by 2.5 cents a litre (from 1.9 cents a litre to 4.4 cents a litre). Based on the quantity of petrol purchased nationally in 2004-05 the increase in NTMs represents a total Australian-wide increase in revenue of $495 million for the terminal operators.

Graph 3

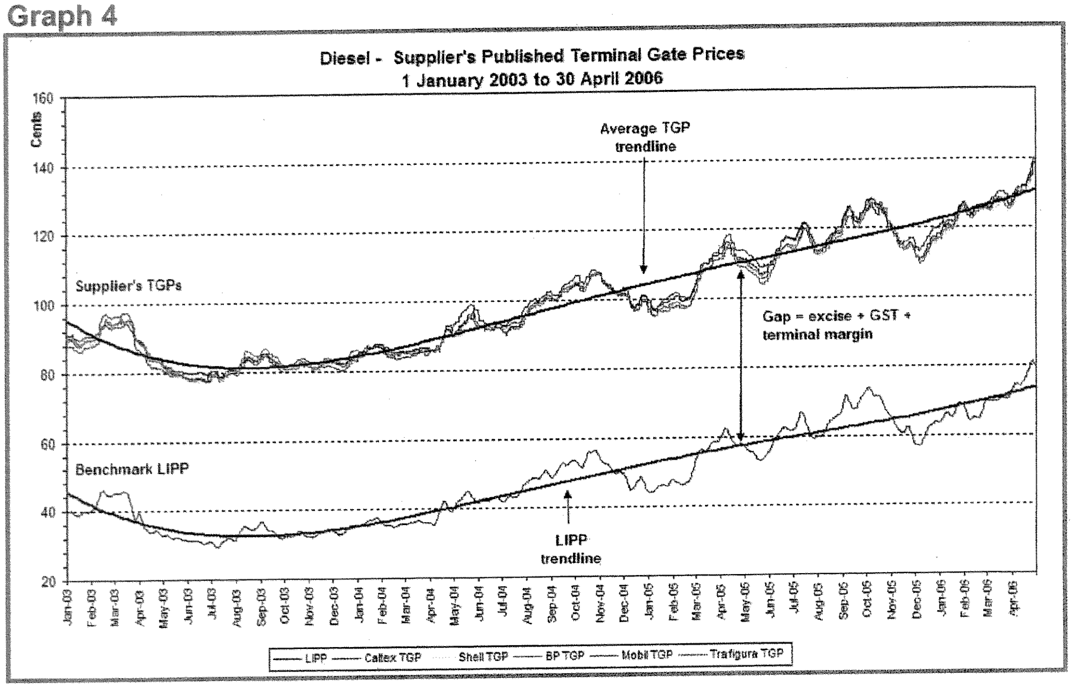


Note: The NTMs shown in *Graph 3* are average monthly calculations. The NTMs plotted in the trendline in *Graph 2* are not an 'average' measure at any point in time as they are influenced by prices and movements across the whole review period. They are rolling averages over the whole period to the date shown. Therefore, the NTMs quoted in Graph 3 do not exactly match the NTMs indicated in *Graph 2*.

[ii] Diesel

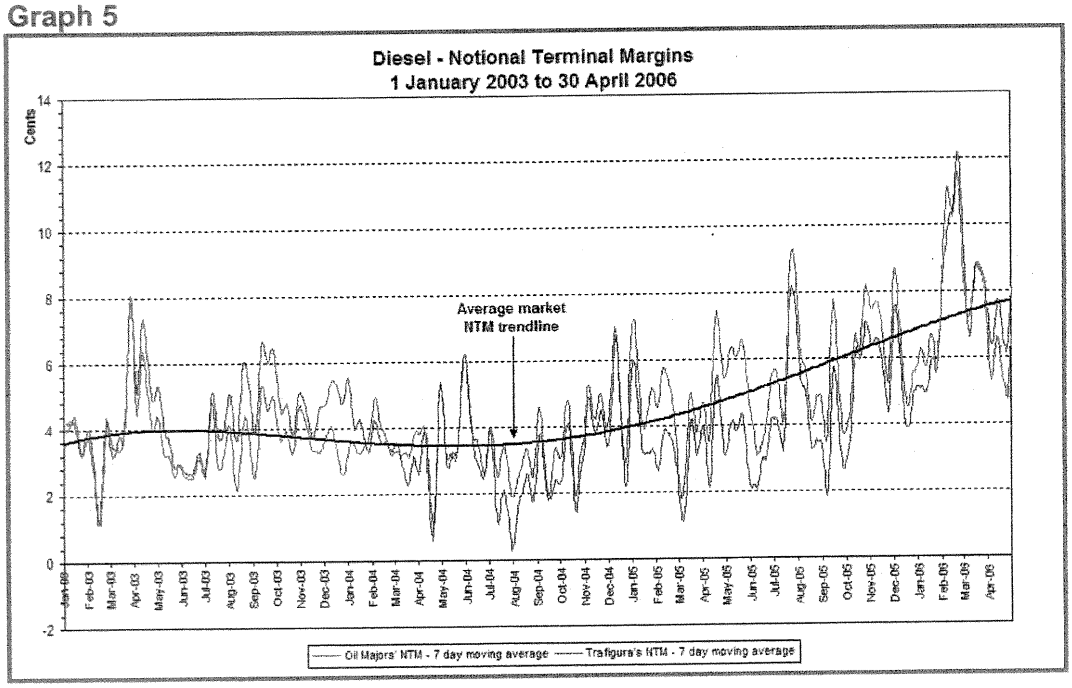
Graph 4 shows that diesel TGPs increased in the same way as petrol TGPs and in line with movements in the LIPP. Mobil generally had the highest TGPs. The lowest TGPs were set by Caltex up to March 2004 and Trafigura for much of the time after that date.

Graph 4



Diesel NTMs also increased steeply as shown in *Graph 5*. NTMs for diesel increased by 2.2 cents (or 56%) from 3.9 cents in January 2003 to 6.1 cents in April 2006. Similar to petrol, diesel NTMs increased because increases in TGPs were greater than increases in LIPPs. The increase in the oil majors' NTMs was higher than for Trafigura.

Graph 5



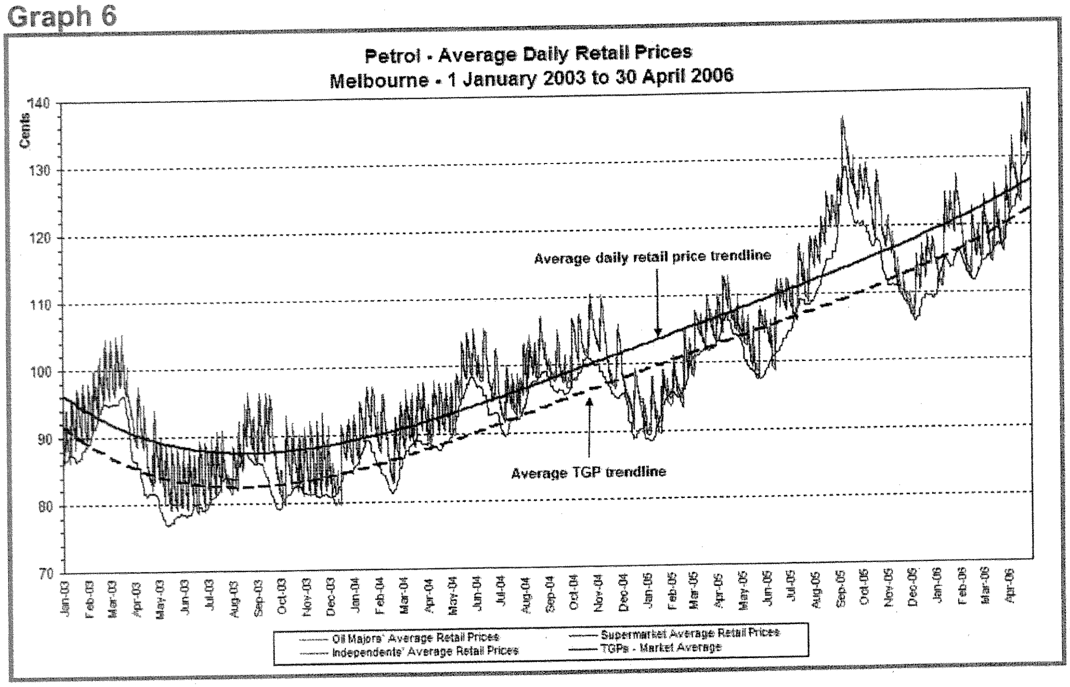
4.2 Retail market prices and margins

[i] Regular unleaded petrol

Graph 6 plots average daily retail prices and TGPs for petrol. Between January 2003 and April 2006 average monthly petrol retail prices increased by 56%. Retail prices increased for all retailers (oil majors, supermarkets and independents) in line with movements in TGPs and LIPPs. In general, the supermarkets led market prices down but also frequently led market prices up.

On several occasions in 2003 and 2005 average daily retail prices were below TGPs. Since mid 2004 Melbourne retail price cycles have been less frequent and the magnitude has decreased (the difference between the peak and trough of a price cycle).

Graph 6

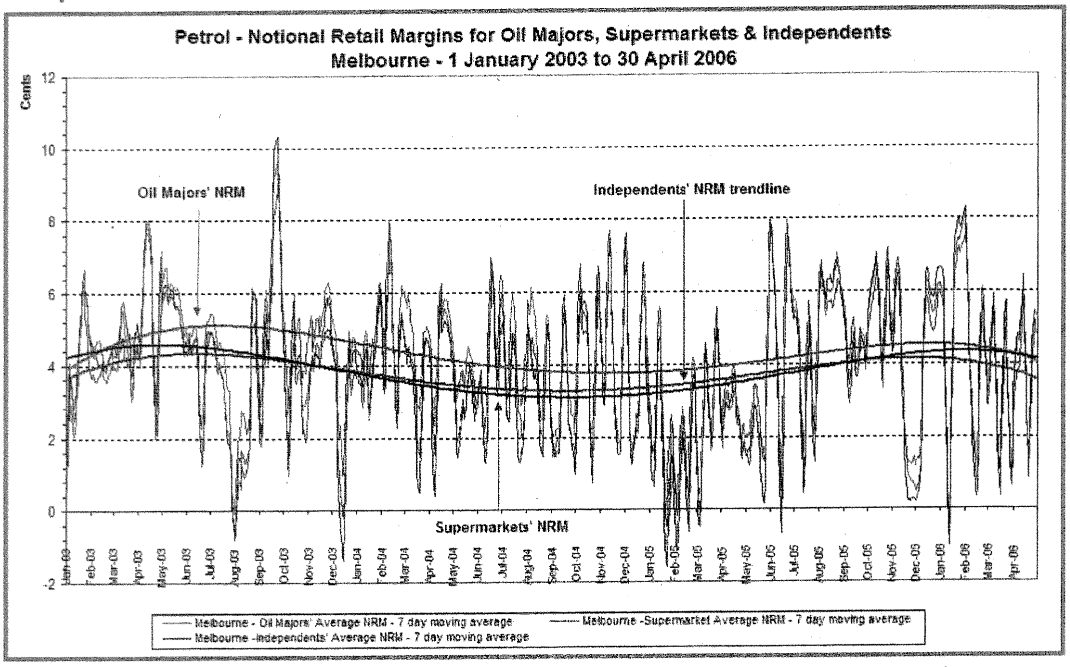


Graph 7 plots the average daily notional retail margin ('NRN") for petrol for all retailers (oil major, supermarket and independent). The NRM is the difference between the average daily retail price and the TGP, adjusted to exclude excise and GST.

There was a marginal decline in NRMs for petrol of 0.01 of a cent from 4.2 cents in January 2003 to 4.1 cents in April 2006.

While the oil majors had the highest NRMs, competition from the supermarkets put downward pressure on NRMs for all retailers retailers. Between November 2003 and August 2005 average supermarket NRMs were below the average NRMs for the independents and oil majors thereby putting pressure, in particular, on the independent retailers whose competitive strategy has traditionally been to offer the lowest prices at the pump. The impact of this competitive pressure may be contributing to the continued rationalisation of service stations. (The Australian Institute of Petroleum estimates that the number of service stations across Australia has reduced from about 8,000 in 2000 to 6,500 in 2004.)

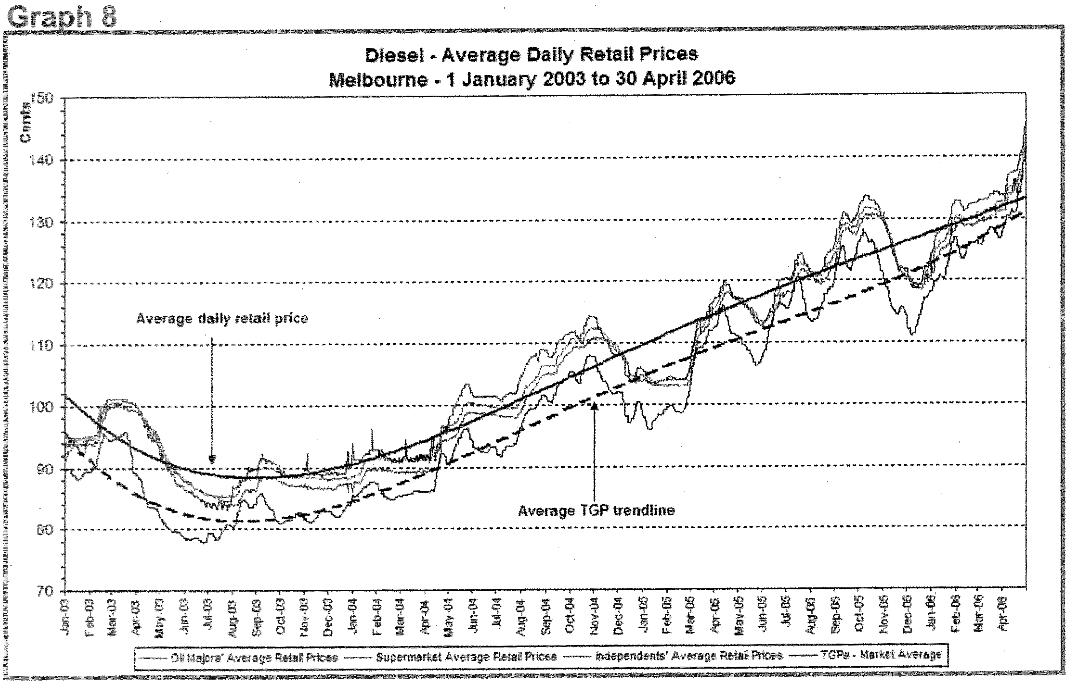
Graph 7



[ii] Diesel

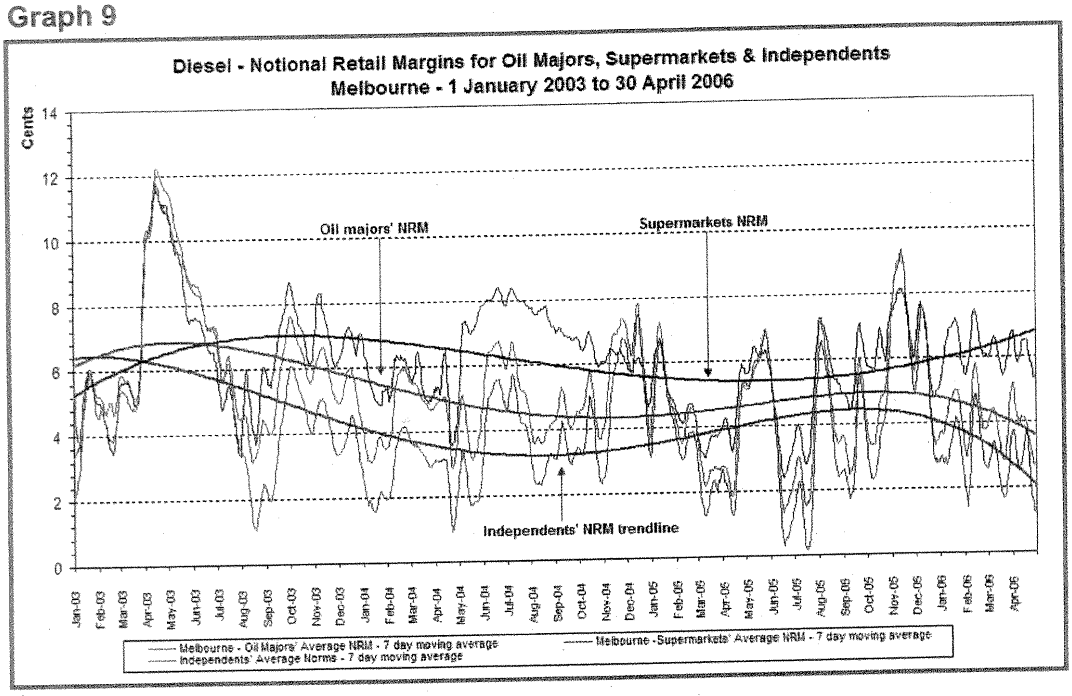
Graph 8 plots average monthly retail prices for diesel which increased by 54% over the review period. Retail prices increased for all retailers in line with movements in TGPs and, in turn, LIPPs, Overall the supermarkets had the highest average daily retail prices and the independent retailers the lowest.

Graph 8



Overall, the average market NRMs for diesel decreased more steeply than petrol NRMs declining by 1.1 cents from 5 cents in January 2003 to 3.9 cents in April 2006. Contrary to this trend, supermarket NRMs remained high while the oil majors' and independents' NRMs fell as shown in *Graph 9*.

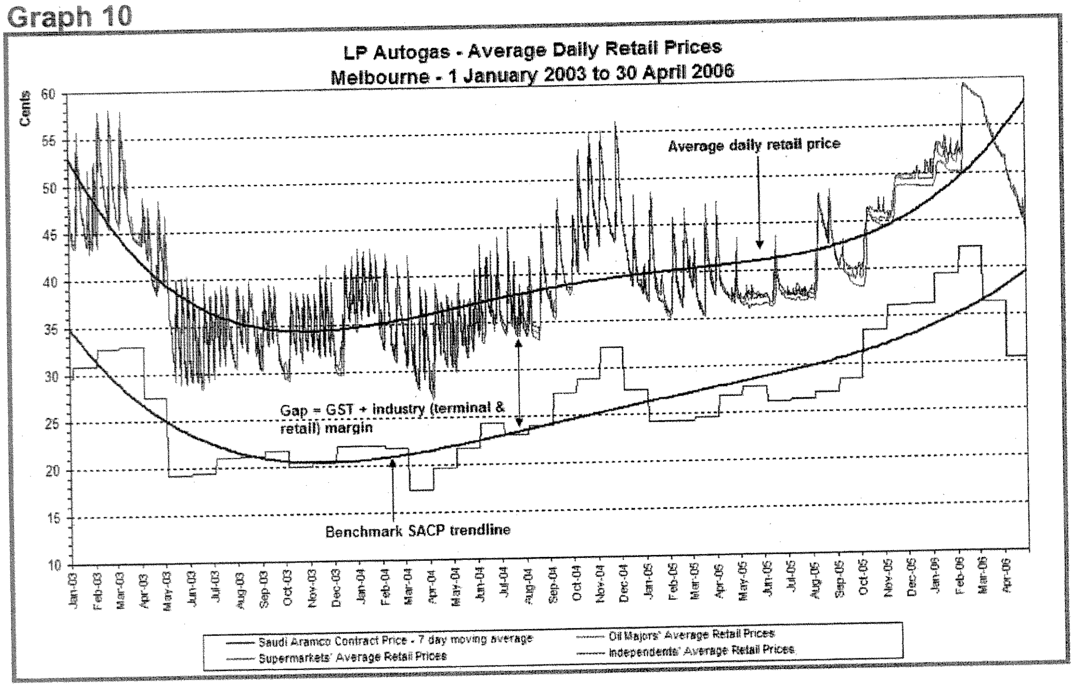
Graph 9



[iii] LP autogas

After an initial fall during 2003, average daily retail prices for LP autogas rose but began to fall again at the end of the review period, see *Graph 10*. This graph also shows that magnitude and frequency of the weekly price cycles declined in August 2004 and in May 2005 and had ceased to occur by February 2006.

Graph 10

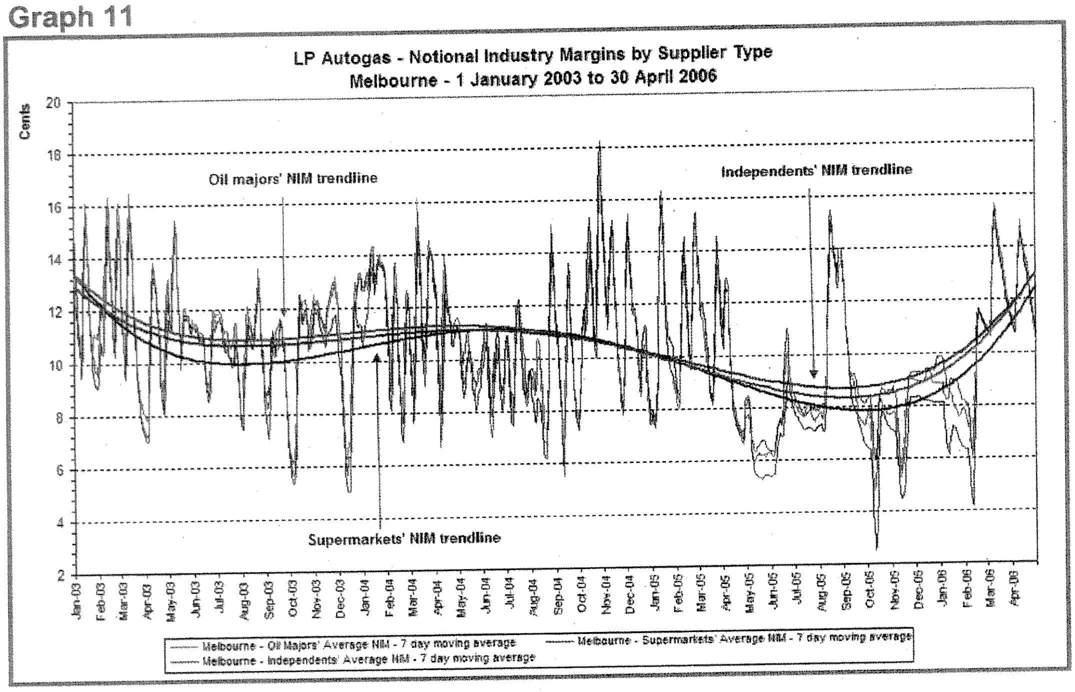


4.3 Industry margins

Graph 11 plots average daily notional industry margin ('NIM') for LP autogas. For LP autogas the NIM is the difference between average daily retail prices and the SACP (as the international benchmark price for LPG), adjusted to exclude excise and GST. Therefore, the NIM combines the terminal and retail margins. Separate terminal and retail margins have not been assessed for LP autogas.

NIMs for LP autogas fluctuated over the review period. NIMs decreased up to early 2006 and then increased sharply. There was a 1.7 cent a litre upward adjustment in NIMs between January and February 2006 coinciding with the elimination of the weekly price cycles. NIMs at the oil majors' branded retail retailers fell by the largest amounts, followed by the NIMs for the supermarket and independent retailers. In the absence of a wholesale price indicator it is not clear whether movements in LP autogas MINs were due to changes in the margins for terminal operators or retailers or both.

Graph 11



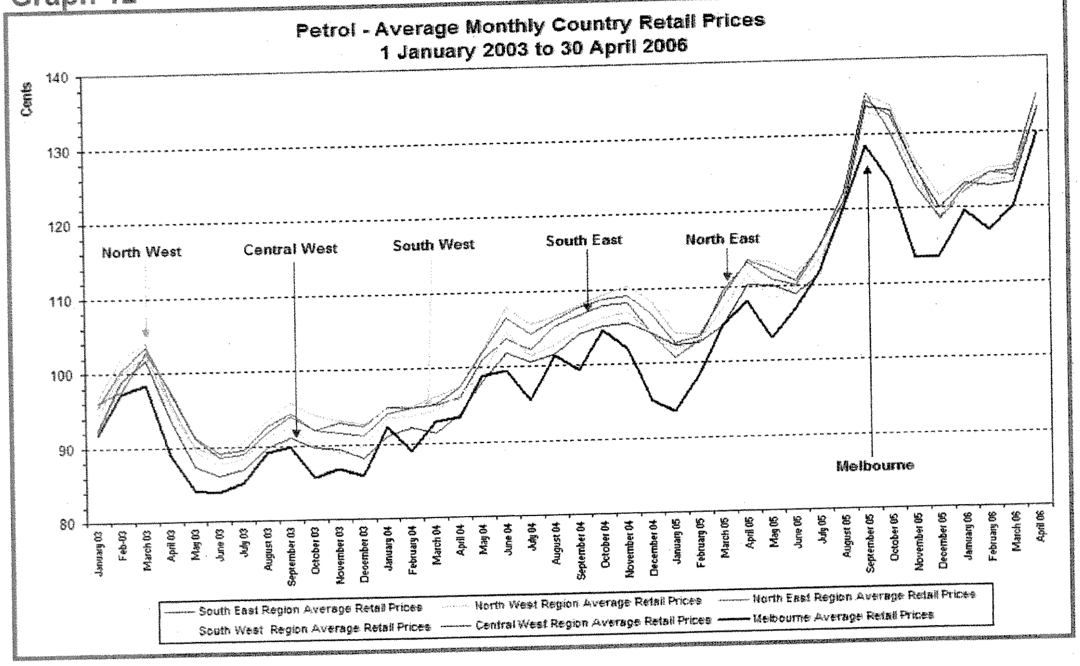
2.4 Country/City petrol retail price differences - Victoria

Average monthly retail prices in country centres were generally above Melbourne retail prices, except in the central west region during March and April 2004 see *Graph 12*.

Country retail prices followed the upward trend evident in Melbourne prices. Over the review period country retail prices were consistently above Melbourne prices – on average by almost 5 cents a litre. The average difference was about 1 cent a litre higher in the last 12 months of the review period (May 2005 to April 2006) than in the preceding 2¼ years. The country-city price differential was larger during periods when Melbourne prices were falling as country prices were slower to adjust downwards.

On average, the sampled towns in the North West region had the largest price gap above Melbourne followed by the North East, South East, South West and Central West. However, this regional 'ranking' fluctuated over time.

Graph 12



Note: Centres in regional area include:

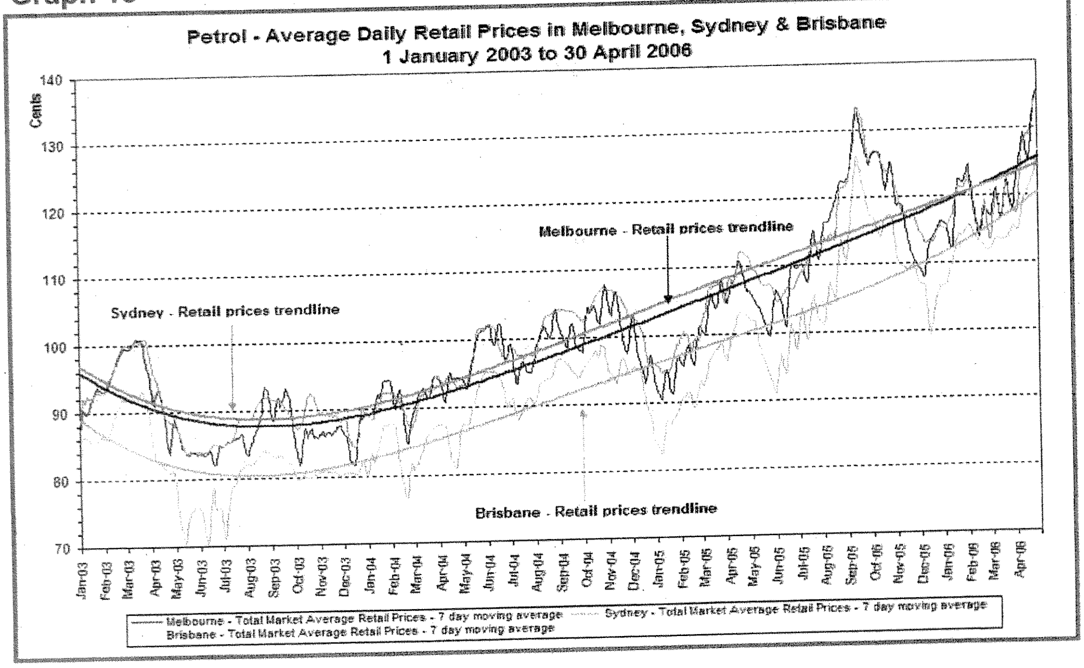
- North West country region - Swan Hill, Mildura, Bendigo and Echuca;
- North East country region - Mansfield, Wangaratta, Wodonga, Shepparton, Benalla and Yarrawonga;
- South East country region - Wonthaggi, Traralgon, Sale, Bairnsdale, Lakes Entrance and Orbost;
- South West country region - Geelong, Colac, Portland and Warrnambool; and
- Central West country region - Ballarat, Ararat and Horsham.

4.5 Interstate comparisons

4.5.1 Petrol

Graph 13 plots average daily retail prices in Melbourne, Sydney and Brisbane and shows that average daily retail prices in the three capital cities increased at around the same rate. Towards the end of the period prices began to converge.

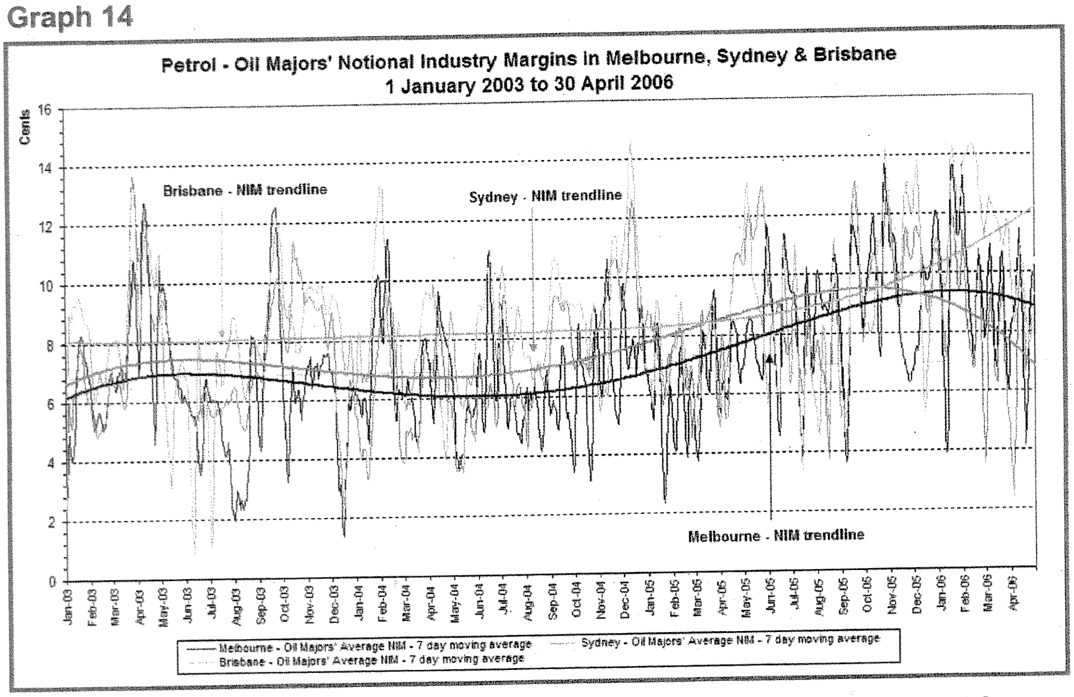
Graph 13



Sydney had the highest average retail prices and Brisbane the lowest prices. However, when adjusted for the 8.354 cent subsidy paid to retailers by the Queensland Government, Brisbane retail prices were on average 1 cent higher than Melbourne retail prices.

Melbourne generally had the lowest notional industry margins (NIMs) for petrol while Brisbane had the highest, see *Graph 14*. The NIM is the difference between average daily retail prices and LIPPs, adjusted to exclude excise and GST.

Graph 14

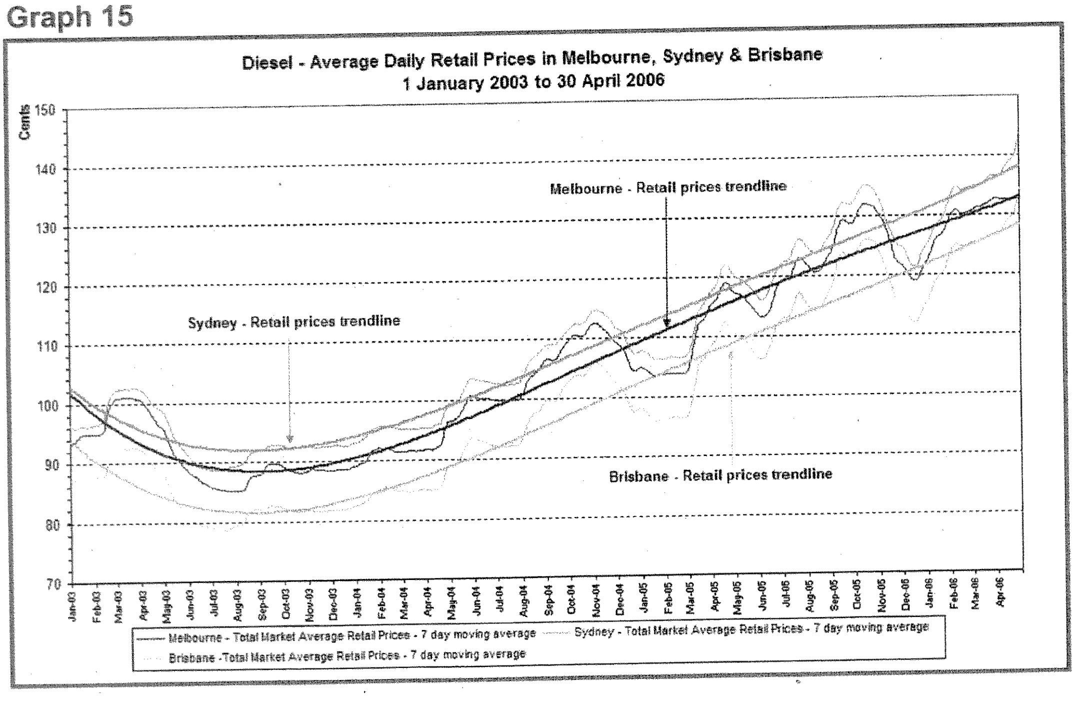


Note: The excise allowance in the MIM calculation for Brisbane is adjusted for the Queensland Government subsidy of 8.354 cents and for Melbourne for the Victorian Government subsidy of 0.429 cents.

4.5.2 Diesel

Average daily retail prices for diesel in Melbourne, Sydney and Brisbane increased at roughly the same rate, see *Graph 15*.

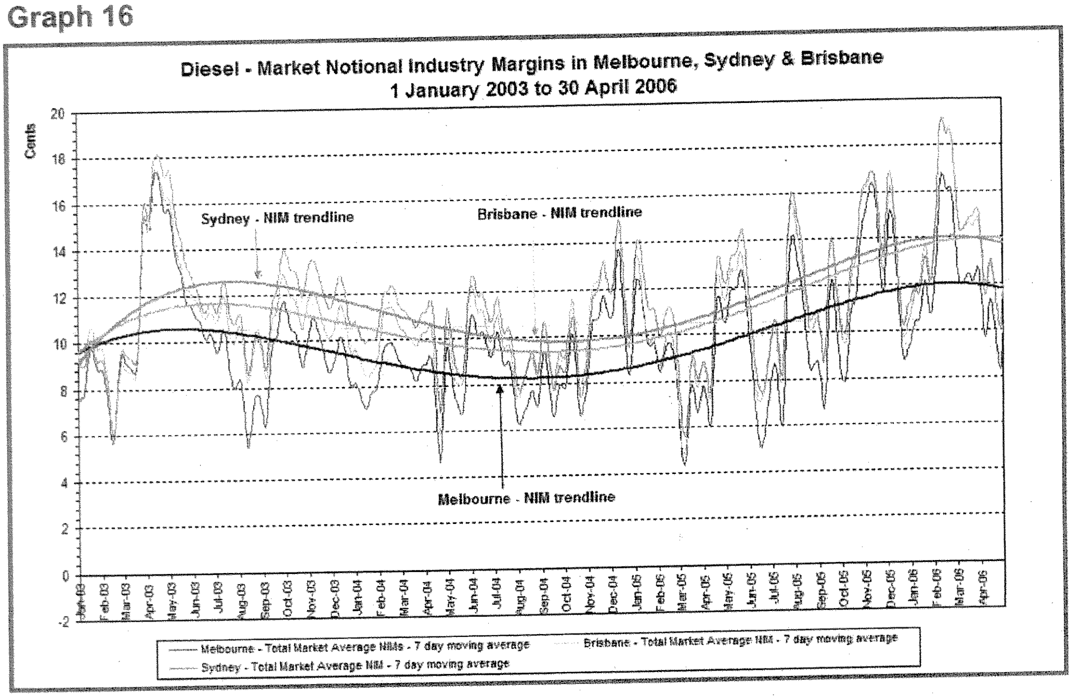
Graph 15



Sydney had the highest average retail prices and Brisbane the lowest prices. However, when adjusted for the 8.354 cent subsidy paid to retailers by the Queensland Government retail prices in Brisbane were on average 1.5 cents higher than in Melbourne.

Graph 16 shows that Melbourne generally had the lowest diesel NIMs while Sydney had the highest NIMs. The gap in NIMs between Melbourne and the other two capitals increased.

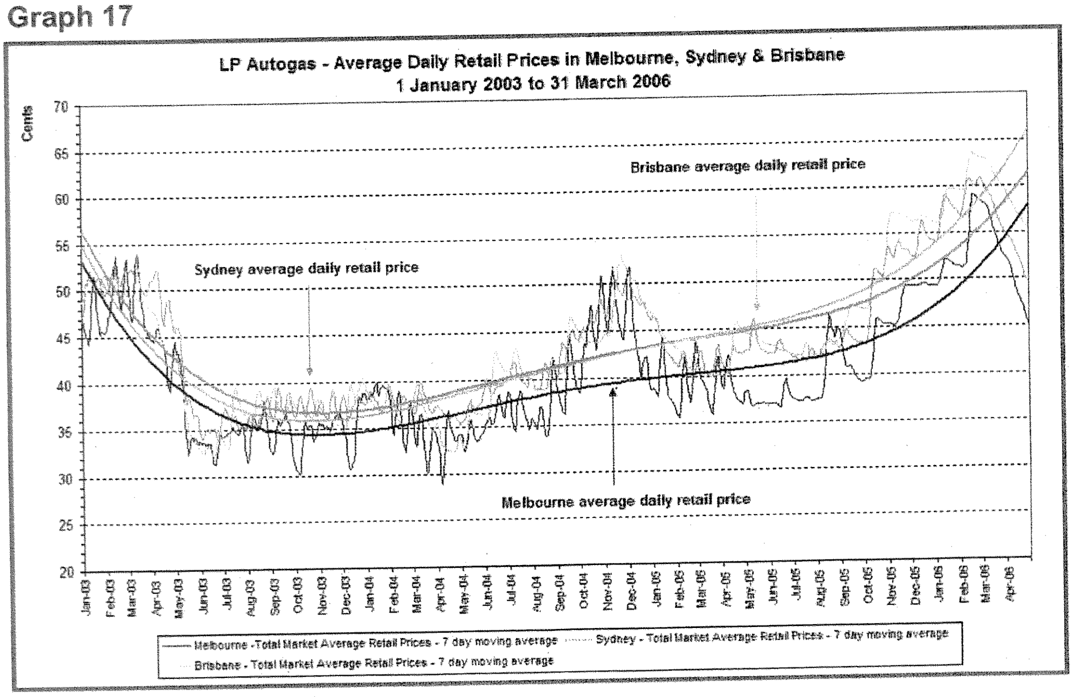
Graph 16



4.5.3 LP autogas

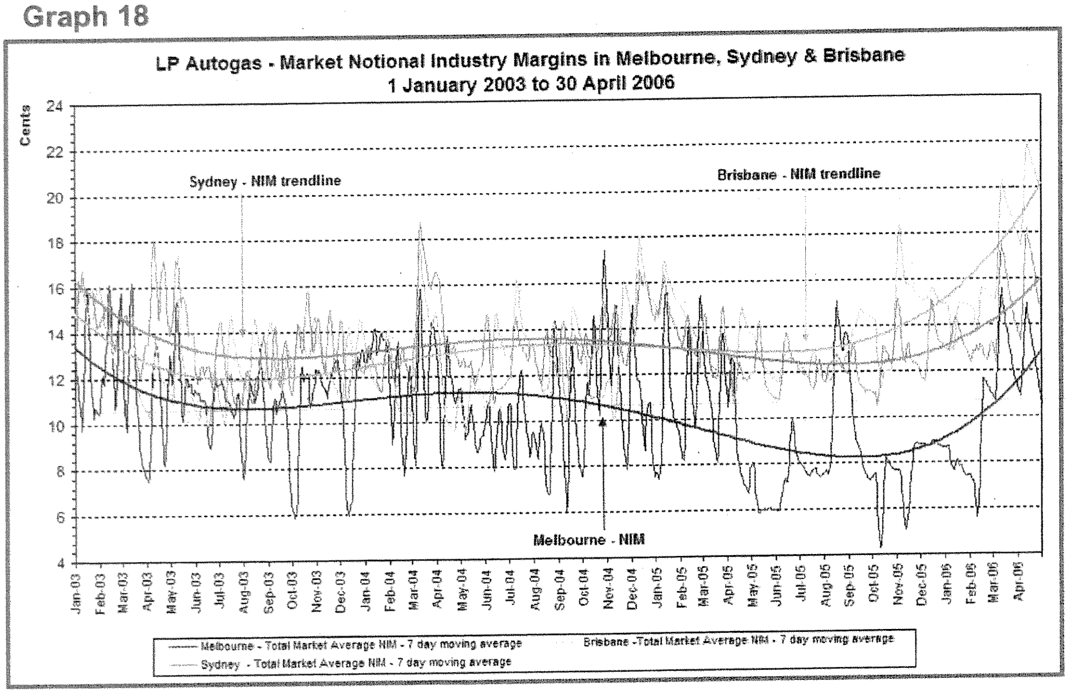
Graph 17 shows that Melbourne had the lowest average daily retail prices and the lowest price increases compared to Sydney and Brisbane. The gap between retail prices in Melbourne and the other two capitals increased.

Graph 17



Melbourne had the lowest NIMs, see *Graph 18.* NIMs in Sydney were also declining but at a much slower rate than in Melbourne. NIMs in Brisbane increased – retail prices in that city grew by more than the increase in the SACP. Similar to Melbourne there was an upward adjustment in NIMs in Sydney and Brisbane in March of 2.4 cents and 4.8 cents respectively.

Graph 18



Executive Summary

Victoria was the first Australian jurisdiction to introduce mandatory terminal gate pricing when the *Petroleum Products (Terminal Gate Pricing) Act 2000* ('the Act') came into operation on 1 August 2001.

The terminal gate price ('TGP') is the price at which fuel is first sold into the Victorian wholesale market and comprises an import-parity product price component, Federal Government excise, a 'terminal operating margin' and GST. It excludes discounts, rebates and optional charges for services beyond the terminal gate and applies to both contract and spot sales.

To assess the operation of the Act and to further inform market participants and the public about fuel markets and pricing, Consumer Affairs Victoria monitors and periodically reports on automotive fuel prices. The first report on TGP and fuel pricing covered the period 2000 to 2002. This report covers the period January 2003 to April 2006 and examines prices for three fuels – regular unleaded petrol, diesel and automotive liquefied petroleum gas ('LP autogas') – in Melbourne, selected regional centres in Victoria, Sydney and Brisbane. It analyses trends over time in absolute and relative prices and in 'notional margins' through a comparison of retail, terminal and international prices.

A number of trends in prices and margins emerge from the analysis.

Terminal gate prices and margins

- TGPs for both petrol and diesel fluctuated around a steady upward trend over the review period, following movements in their respective landed international product prices ('LIPPs'). The LIPPs, in turn, were influenced by the climbing price of crude oil.
- For both fuels, increases in TGPs exceeded increases in LIPPs resulting in rising average notional terminal margins[1], particularly after 2004 and for the oil majors (BP, Caltex, Mobil and Shell) compared to Trafigura[2] the independent terminal operator at Hastings.
- Average notional terminal margins for petrol increased by 2.5 cents a litre (or 131%) from 1.9 cents a litre in January 2003 to 4.4 cents a litre in April 2006. Over the same period notional terminal margins for diesel increased by 2.2 cents (or 56%) from 3.9 cents to 6.1 cents.

Retail market prices and margins

- Average daily retail prices for petrol and diesel in Melbourne rose significantly over the period – 56% for petrol and 54% for diesel. LP autogas retail prices fluctuated significantly during the period and were roughly at the same at the end of the period as at the start.
- Because retail prices for both petrol and diesel increased more slowly than their respective TGPs, average notional retail margins[3] declined marginally, more so for diesel than petrol, but with marked fluctuations. The supermarket retailers had the lowest notional retail margins for petrol between November 2003 and August 2005 thereby putting competitive pressure on the independent retailers. Whereas for diesel, the independent retailers tended to have the lowest notional retail margins. Competition between supermarkets and independent retailers may be contributing to the continued rationalisation of service stations.

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1 The Notional Terminal Margin is the difference between TGPs and LIPPs, adjusted to exclude excise and GST.

2 At the time of proclaiming the Act the suppliers declared and, therefore, those required to set TGPs were BP, Caltex, Mobil and Shell and Trafigura. However, following a review of the Act Trafigura ceased to be declared on 1 August 2005.

3 The Notional Retail Margin is the difference between average daily retail prices and TGPs, adjusted to exclude GST.

- Movements in LP autogas retail prices reflected movements in the international 'indicator' LP price, the 'Saudi Aramco Contract Price.

Interstate comparisons

- Average daily retail prices for petrol and diesel in Melbourne, Sydney and Brisbane increased, largely in parallel. Sydney consistently had the highest daily average pump prices for both petrol and diesel while Brisbane had the lowest, due to the Queensland Government subsidy of 8.3 cents a litre. However, when adjusted for the Queensland subsidy Melbourne had the lowest average daily retail prices for both petrol and diesel.
- Melbourne also consistently had the lowest average pump prices for LP autogas. The gap between LP autogas retail prices in Melbourne and the other capital cities tended to widen from late 2004 and was up to 5 cents by mid 2005.
- While notional industry margins for petrol and diesel generally increased in all three capital cities for LP autogas they decreased in Melbourne, increased in Brisbane and fluctuated in Sydney.
- Melbourne had the lowest notional industry margins (the terminal and the retail margins combined)[4] for petrol, diesel and LP autogas. Brisbane generally had the highest notional industry margins for petrol and Sydney had the highest for diesel.

Country/City petrol retail price differences - Victoria

- Average monthly retail prices for petrol in Victorian country towns followed the upward trend evident in Melbourne prices. Country retail prices were on average almost 5 cents above Melbourne prices. The country-city price differential was larger during periods when Melbourne prices were falling as country prices were slower to adjust downwards.
- On average, the sampled towns in the North West region had the largest price gap above Melbourne followed by the North East, South East, South West and Central West. However, this regional 'ranking' fluctuated over time.

Discount price cycles

- After mid 2004 discount price cycles for petrol and LP autogas became increasing less frequent and of a lesser magnitude reflecting a change in price competition in these markets.

Conclusions

While the analysis of margins is based on notional prices and excludes actual costs it points to the possibility of rises in actual margins. In the context of record high international prices due to world demand and supply conditions, an industry apparently undergoing changes in competition and only 15% of petrol sold in Australia being imported, it would assist understanding of price movements to have a further analysis of margins.

Victoria has supported a national approach to petroleum product prices since 1984. Maximum producer prices for LPG were set by the Federal Government until deregulation in 1991 and maximum wholesale prices for petrol were set by the Federal Government until deregulation in 1998.

It is difficult for Victoria to act alone on fuel issues as the Victorian market can not be isolated from the influence of the national and international markets. It would be more appropriate for the apparent trends in industry margins and their impact on prices to be considered on a national basis. A detailed examination of oil company prices and margins by the Australian Competition and Consumer Commission is needed to ensure that the market is operating efficiently and that consumers are not being disadvantaged.

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4 The Notional Industry Margin is the difference between average daily retail prices and LIPPs, adjusted to exclude excise and GST.