Motor Trades Association of Australia

Mr Peter Hallahan
Secretary
Senate Economics Legislation Committee
Suite SG.64
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Hallahan

Please find attached a copy of the Motor Trades Association of Australia's (MTAA's) submission to the Senate Economics Legislation Committee Inquiry into the price of petrol in Australia.

The Motor Trades Association of Australia (MTAA) is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is the largest 'stand-alone' small business association in Australia, representing over 115,000 businesses in a sector which turns over more than $120 billion each year and employs over 316,000 people. As part of its representative role, MTAA represents the interests of service station operators and the Association therefore has a strong interest in matters relating to petrol pricing and welcomes the opportunity to make a submission to the Inquiry.

In its submission, MTAA has provided a brief overview of the factors which, in its view, influence the retail prices of petrol in Australia, including the wholesale price of petrol, refiner and retailer margins and the size and nature of the local market. MTAA also notes that the influence of some of those factors will vary from location to location and that variation may contribute to price differentials between certain locations.

MTAA also believes that the structure of the industry itself also plays an important role in influencing the level of retail petrol prices in Australia. At this point in time, the diverse nature and large number of industry participants has resulted in a highly competitive sector which in turn has helped to ensure that motorists pay the lowest prices possible for their petrol. However, recent structural changes, including the trend towards vertical integration and the more recent trend towards horizontal integration, threaten that diversity and price competition. In particular, MTAA would question how, in such a highly vertically and horizontally integrated market, the level of price competition is to be maintained unless there is access to fuel at a competitive wholesale price.

While MTAA is not an expert in the setting of wholesale prices, the Association has also provided some brief comments on the factors which, in its view, may influence the level of wholesale petrol prices in Australia.

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I trust that these comments are of assistance in your consideration of this matter.

Yours sincerely

MICHAEL DELANEY
Executive Director

26 July 2006

Motor Trades Association of Australia

Submission to the Senate Economics Legislation Committee Inquiry into the Price of Petrol in Australia

July 2006

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INTRODUCTION

Overview of the Motor Trades Association of Australia (MTAA)

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association represents the interests, at the national level, of over 90,000 retail motor trade businesses with a combined turnover of over $120 billion and which employ over 316,000 people. MTAA is therefore the largest 'stand-alone' small business association in Australia. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the Service Station Association (SSA) and the Australian Automobile Dealers Association (AADA). MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades ranging from motor vehicle body repair to automotive parts recycling. Those ATAs are as follows:

> *Australian Motor Body Repairers Association (AMBRA)*
> *Australian Motorcycle Industry Association (AMIA)*
> *Australian National Radiator Repairers Association (ANRRA)*
> *Australian National Towing Association (ANTA)*
> *Australian Service Station and Convenience Store Association (ASSCSA)*
> *Australian Tyre Dealers and Retreaders Association (ATDRA)*
> *Auto Parts Recyclers Association of Australia (APRAA)*
> *Automotive Repairers Association of Australia (ARAA)*
> *Automotive Transmission Association of Australia (ATAA)*
> *Engine Reconditioners Association of Australia (ERA of A)*
> *Farm and Industrial Machinery Dealers Association of Australia (FIMDAA)*
> *National Brake Specialists Association (NBSA)*
> *National Heavy Vehicle Repairers Association (NHVRA)*
> *National Rental Vehicle Association (NRVA)*
> *National Steering and Suspension Association (NSSA)*
> *National Vehicle Airconditioning Association (NVAA)*

All of the ATAs listed above are composed of the relevant sections of each of the MTAA Member bodies and are represented, at a national level, by MTAA.

The Association's affairs are directed by a Board on which each of MTAA's Member bodies is represented. The role of the Association is to:

- raise awareness in the community of the retail motor trades' significant contribution to the Australian economy (the trades have a turnover of over $120 billion and employ over 316,000 people);
- convey and promote to governments the interests of the retail motor trades;
- promote improved working relationships and practices with the motor trades' unions;
- on behalf of the Members of the Association, provide information about the trades to governments, the public and the trades' employees;

- work with governments to plan the future of the retail motor trades and their role in the economy and other areas of national planning;

- extensively enhance training and to develop work opportunities within the trades in co-operation with education and training authorities, the unions and government generally; and

- promote and enhance the reputation of the trades with its customers and the general public.

The range and depth of the activities of the membership of the Association can be seen from the following list of recognised trades, skills and tasks in the retail, service and repair sector of the automotive industry:

Air-conditioning Technicians	Dynamometer Operators
Auto Electricians	Engine Fitters
Automotive Accessory Retailers	Engine Performance Specialists
Automotive Dismantlers/Parts Recyclers	Engine Reconditioners
Automotive Engineers	Exhaust System Specialists
Automotive Glass Fitters	Farm Machinery Dealers
Automotive Parts Cataloguers	Fuel Injection Specialists
Automotive Radio and Stereo Specialists	Gas Fitters
Automotive Service Managers	Hire and Rental Vehicle Operators
Automotive Trimmers	Marine Automotive Engineers
Automotive Upholsterers	Motor Boat and Marine Dealers
Automotive Transmission Specialists	Motorcycle Dealers
Battery Makers and Reconditioners	Motorcycle Mechanics
Body Builders	Motor Mechanics
Brake Specialists	Panel Beaters
Car Alarm Fitters	Petrol Pump Attendants
Caravan Dealers	Radiator Repairers
Car Dealers	Spray Painters
Car Salespeople	Tow Bar and Trailer Fitters
Car Wash Operators	Tow Truck Operators
Chassis Builders and Repairers	Truck Builders and Operators
Commercial Vehicle Body Fabricators	Tuning Specialists
Detailers	Tyre Fitters
Diesel Engineers	Tyre Retreaders
Diesel Injection Technicians	Wheel Alignment Specialists

MTAA's Interest in the Inquiry

As part of its role as the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry, MTAA represents the interests, at a national level, of service station operators, including single site franchisees, multi-site franchisees, commission agents, branded independents and unbranded independents. As a consequence of that representative role, the Association has a strong interest in matters relating to the price of petrol in Australia and has been actively involved in petroleum industry policy development for many years.

THE RELATIONSHIP BETWEEN THE LANDED PRICE OF CRUDE OIL, REFINING COSTS, THE WHOLESALE PRICE AND THE RETAIL PRICE

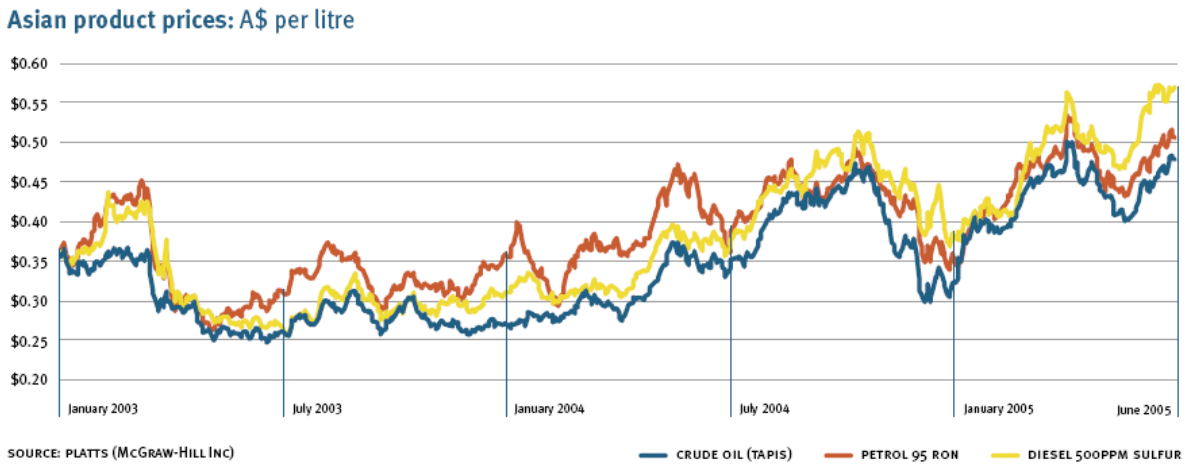
Overview of Current Pricing Arrangements

Prior to 1 August 1998, the Australian Government, through the Prices Surveillance Authority (PSA), regulated the maximum wholesale price of petrol and diesel. In order to determine the maximum endorsed wholesale price, the PSA used an import parity indicator which consisted of three components: the import parity component (the landed cost of ex-refinery petrol from Singapore which consisted of the spot price of fuel, shipping, wharfage, and insurance costs as well as an adjustment for the exchange rate), the assessed local component (costs associated with downstream activities including terminal, marketing and distribution costs as well as a return on assets employed in that sector) and a government charges/subsidies component. Following the de-regulation of pricing in the industry, prices are now determined by individual industry participants but MTAA understands that those prices are still determined on an import parity price basis.

The wholesale price of petrol (the ex-refinery price) produced at refineries in Australia is therefore, as MTAA understands matters, not based on the actual cost of the crude oil that has been refined to produce the petrol or the actual cost of importing refined product into Australia. Wholesale prices in Australia are instead determined by a theoretical import price parity calculation, which involves adjusting an international benchmark price for refined petrol (an average of the spot price of Singapore Mogas 95 Unleaded) for Australian fuel standards, wharfage, insurance and shipping to Australia. This calculation is undertaken in US dollars and the calculated wholesale price is then converted into Australian dollars. This means that movements in the relevant international benchmark and the Australian/US dollar exchange rate exert considerable influence over the wholesale price of petrol in Australia irrespective of whether the petrol is refined domestically or imported from overseas.

While there is a strong correlation between the price of crude oil and the price of refined petrol products, there also are a range of other supply and demand factors which influence the price of refined petrol products. Consequently, the Singapore Mogas 95 Unleaded benchmark does not always closely follow movements in the relevant Asian benchmark for crude oil, Malaysian Tapis, and as can be seen from Figure 1 below, the movement of the two benchmarks can, at times, be quite different.

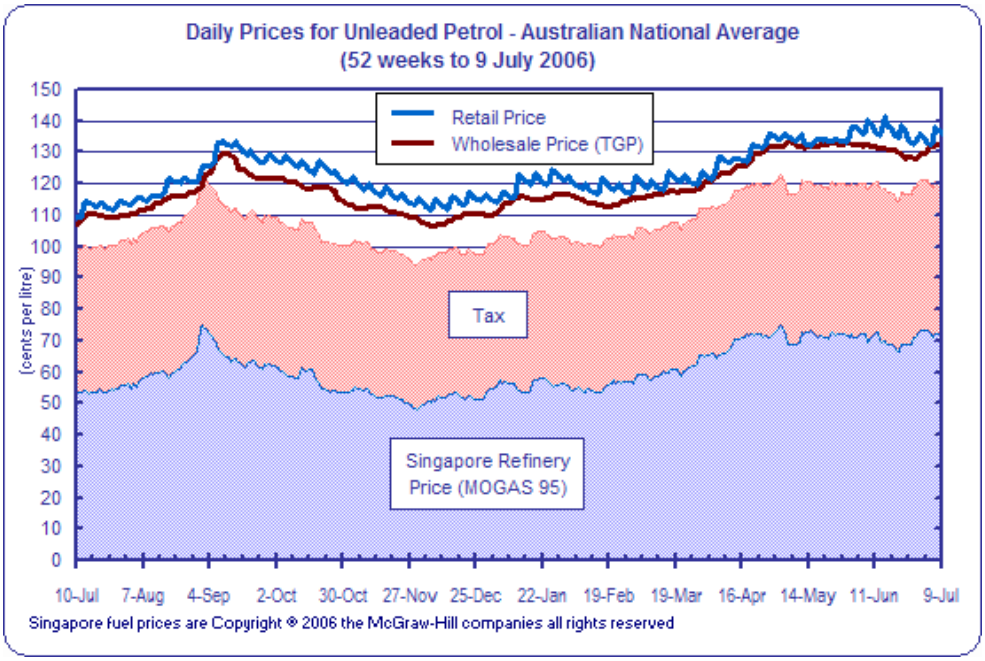
Figure 1 - Asian Product Prices (A$ per litre)



Source: Australian Institute of Petroleum 2006, *Downstream Petroleum 2005*, AIP, Canberra, 8.

The retail price of petrol is largely determined by the wholesale price of petrol and the level of government taxation, but it is also affected by the level of government subsidies (for example, the Queensland Government's 8.354 cents per litre subsidy) and the level of gross retail and refiner margins. As the wholesale price of petrol is largely determined by movements in the relevant international benchmark, retail petrol prices in Australia will also be influenced by movements in the international benchmark, although those movements may take one or two weeks to flow through to the retail price. Figure 2 below highlights the relationship between retail petrol prices, wholesale petrol prices and the relevant international benchmark, Singapore Mogas 95 Unleaded.

Figure 2: Daily Prices for Unleaded Petrol – Australian National Average (52 weeks to 9 July 2006)



Source: Australian Institute of Petroleum 2006, *Market Snapshot*, AIP, Canberra, viewed on 10 July 2006, http://www.aip.com.au/pricing/snapshot.htm.

A breakdown of the retail price of petrol also highlights the importance of product cost and government taxation in the overall composition of retail petrol prices. For example, the average cost of a litre of fuel in Sydney on 11 July 2006 could be broken down into the following components:

Product Cost	79.5 cents per litre (cpl)
Tax (excise and GST)	50.3cpl
Retail and Refiner Margin	4.3cpl
Retail Price Per Litre	134.1cpl

Source: Shell Australia Limited website (www.shell.com.au), viewed on 11 July 2006.

The retail price of petrol in particular locations will also be affected by other factors, including the size of the market, the number of competitors and distribution, storage and transportation costs. These factors and their impact on retail petrol prices are discussed in more detail below.

The significant impact that the wholesale price of petrol has on the overall level of retail petrol prices in Australia highlights the importance of a competitive wholesale sector of the petroleum industry. MTAA considers that a nationally consistent and transparent terminal gate pricing regime is a key component in ensuring that the wholesale sector is competitive, as such a regime improves

pricing transparency and thereby reduces the ability of market participants to engage in anti-competitive behaviour. While the Australian Government's proposed amendments to the regulatory framework governing the retail petroleum sector purport to introduce a truly transparent terminal gate pricing regime, the proposed arrangements still allow suppliers to discount the wholesale price at the terminal gate. In MTAA's view, any arrangement that allows for discounts at the terminal gate is hardly transparent, is little different from the current opaque wholesale pricing arrangements and is therefore unlikely to improve the transparency of wholesale pricing in the market.

MTAA also considers the competitiveness of pricing in both the wholesale and retail petroleum sectors is also dependent on the ability of all service station operators, particularly independent service station operators, to access supply at competitive wholesale prices. Without access to supply, service station operators cannot remain in the industry and the ability of market participants to secure supply will therefore have a significant impact on the number and diversity of competitors in the industry. Service station operators will also be unable to remain in the industry in the longer term if they cannot access a supply of *competitively priced* petroleum products as they simply will not be effective competitors if their wholesale price is uncompetitive in comparison to the wholesale prices paid by other market participants.

In that regard, MTAA and its Member bodies recently undertook a survey of their service station members and seventy-one per cent of the respondents to that survey indicated that they had previously paid a wholesale price which was higher than the price at which their closest supermarket/oil company joint venture site was retailing their fuel. Fifty-three per cent of respondents had also previously purchased fuel at a wholesale price which was higher than the retail price of their closest oil company site. While the survey respondents represented a relatively small percentage of market participants, the survey results are consistent with previous anecdotal advice provided to MTAA.

MTAA therefore notes that transparency of wholesale pricing arrangements and the ability of market participants to secure access to a competitively priced supply of petroleum products will have a significant impact on the level of retail prices and the degree of retail price competition in the market. In that regard, MTAA strongly believes that a greater number and diversity of competitors is more likely to encourage retail price competition than a smaller number of highly vertically integrated larger competitors.

Historical Reasons for the Use of Import Price Parity

Australia introduced import parity pricing for all Australian-produced crude oil in August 1978. It was said at the time that import parity pricing was being introduced to encourage energy conservation, oil exploration in Australia and the development of alternative energy sources. It has also been argued that import parity pricing is needed to avoid potential fuel shortages in Australia as without import parity pricing, international prices may be higher than Australian prices and Australian refiners may therefore have an incentive to export their refined products overseas to take advantage of those higher prices and international refiners may also have no incentive to export petroleum products to Australia.

Singapore was apparently chosen as the relevant price benchmark because it was the major trading centre in Asia for petroleum products, the most likely source of fuel imported into Australia and the closest major refining centre to Australia.

Issues with the Use of Import Price Parity

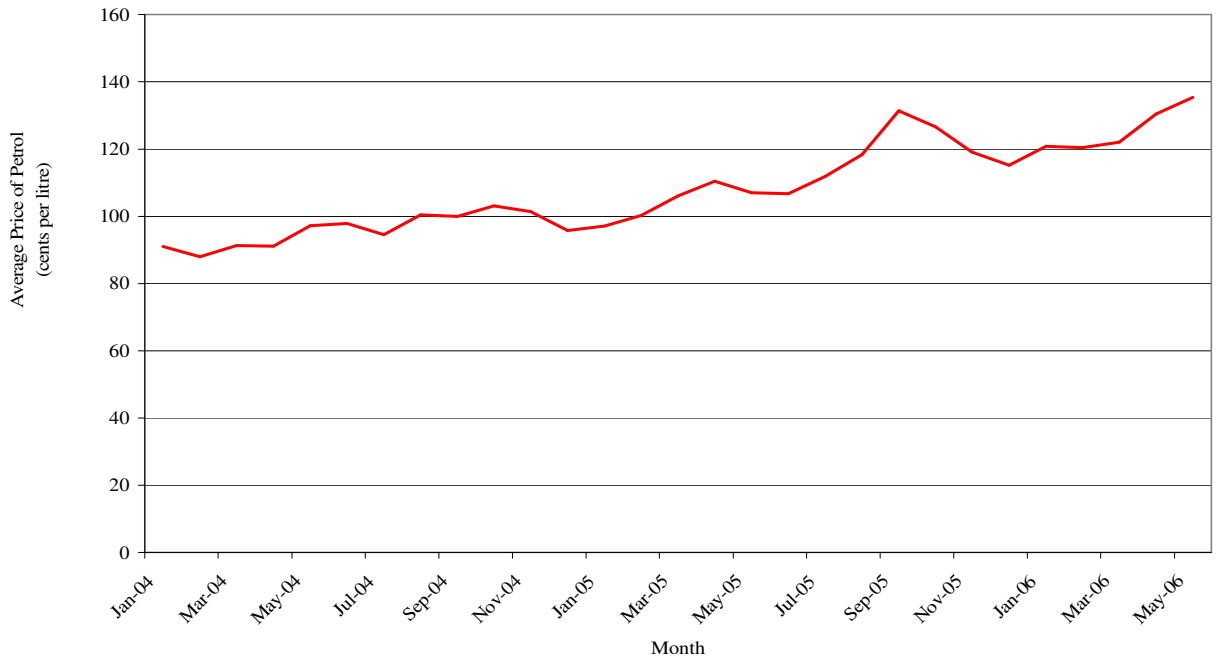
While MTAA understands the reasons behind the use of import parity pricing, the Association suggests that, in light of new refineries in Asia and Australia's fuel standards, the Committee may wish to consider addressing the following issues during the course of its inquiry:

- is Singapore is still the appropriate benchmark? and
- if not, is there another regional market which may be a more appropriate benchmark?

Overview of Current Trends in Prices and Margins

As Figure 3 highlights, the average retail price of petrol in Australia has increased quite significantly over the last few years and there appears to be a general upwards trend emerging in relation to retail petrol prices. The increase in the retail price of petrol has been caused by a range of factors, including higher world oil prices and tighter international and domestic supply and demand conditions (both temporary and ongoing).

Figure 3: Average Retail Price of Petrol in Australian Metropolitan Areas 2004-2006



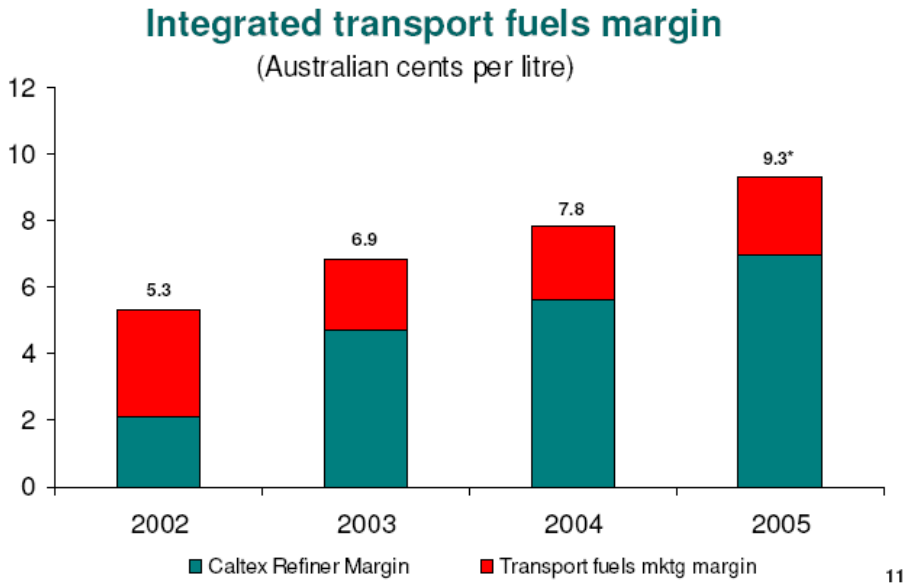
Source: Department of Industry, Tourism and Resources 2006, *Petrol – Frequently Asked Questions*, DITR, Canberra, viewed on 11 July 2006, www.industry.gov.au.

The tighter supply and demand conditions have also delivered improved wholesale margins to refiners over the last few years. In contrast, retail margins have remained fairly consistent over the same period due to intense competition at the retail level. For example, the Caltex Refiner Margin[1] rose from US$1.82 a barrel in 2002 to US$8.40 a barrel in 2005 – an increase of 361 per cent. In

[1] According to the Caltex website, the Caltex Refiner Margin represents the difference between the cost of importing a standard basket of Caltex products to Eastern Australia and the cost of importing the crude oil required to produce that basket of goods. It equals the average Singapore refiner margin + a product quality premium + a crude discount / (premium) + product freight – crude freight – yield loss.

contrast, Caltex's transport fuels marketing margin has remained fairly consistent since 2003 (see Figure 4).

Figure 4 - Caltex Integrated Transport Fuels Margin: 2002-2005



Source: David Reeves 2006, *2005 Full Year Results Presentation*, Caltex Australia Petroleum Pty Ltd, Sydney, viewed on 12 July 2006, http://www.caltex.com.au/corporate_inv_res.asp.

REGIONAL DIFFERENCES IN THE RETAIL PRICE OF PETROL

It is not uncommon for the retail price of petrol to differ, sometimes quite significantly, between different locations in Australia. Those regional differences occur because of the influence of a number of factors, including the volume of petrol sold at a site, the level of non-petrol sales at a site, the capacity of the service station operator to use discounting to generate increased traffic and sales, the level of distribution and storage costs, government subsidies and the level of competition in the local market.

The retail price of petrol will be influenced by the volume of fuel sold at the site, as a higher volume of fuel sales will increase the capacity of the service station operator to accept lower margin on each litre of fuel sold. The volume of fuel sold at a particular site will also affect the service station operator's ability to spread its costs which will, in turn, affect the retail price of petrol sold at the site. A high volume of fuel sales will enable the service station operator to spread its operating costs over a greater volume of fuel, thereby reducing the impact that those costs have on the per litre price of fuel sold at the site. In contrast, the operator of a low volume site will have to allocate its operating costs over a smaller volume of fuel, thereby increasing the impact that those costs have on the per litre price of fuel sold at the site. The volume of fuel sold at a particular site may also affect the ability of the site's operator to negotiate discounts with its fuel supplier(s) and that in turn may have an impact on the retail price of petrol sold at that site. In that regard, it is likely that operators of higher volume sites will be in a better position to negotiate discounts due to their superior bargaining position (in comparison to operators of smaller volume sites).

The price of petrol sold at a particular site may also be influenced by the site's level of non-fuel sales. This is because high levels of non-fuel sales will enable the service station operator to spread its operating costs over a broader range of products and to thereby reduce the impact that those

costs have on the price of individual products sold at the site, including fuel. In contrast, low levels of non-fuel sales will limit the operator's ability to spread its costs and will likely mean that the operator will need to rely more heavily on its retail margin on fuel products to recover its operating costs. In those circumstances, the operator is likely to require a higher retail margin on fuel products and that in turn may result in a higher retail price. The profit margin on non-fuel products is also traditionally higher than the profit margin on fuel products and a high level of non-fuel sales may therefore improve the capacity of a service station operator to reduce its margin on fuel products (either on an ongoing basis or as part of a short term price discounting strategy) without affecting the financial performance and viability of its business. The level of non-fuel sales at a particular site is therefore likely to influence the retail price of petrol at the site and may also affect the ability of the site's operator to engage in price discounting.

The size and composition of a service station's potential customer base may also influence a service station operator's pricing behaviour and the retail price of fuel sold at the site. For service station operators located in some areas of Australia, the small or less transient nature of their potential customer bases will mean that deep price discounting is unlikely to be an effective commercial strategy to generate increased customer flows and sales. As a result, the price cycle in those areas is likely to be smoother and, to a certain degree, less volatile than the price cycles which occur in areas where price discounting is more common.

The distribution, transport and storage costs incurred by a service station operator will also influence the retail price of fuel sold at its site. In some areas of Australia, service station operators will not be able to source fuel supplies directly from the terminal and will instead have to rely on a distributor to supply their fuel products. In those circumstances, the service station operator is likely to incur additional costs in sourcing the fuel (in comparison to operators who source their fuel directly from the terminal) as the distributor will incorporate its own retail margin into the price it charges the service station operator and those additional costs are likely to be passed through to the retail price of petrol. For example, MTAA is aware of a small country service station operator whose fuel prices increased by around 4 cents per litre when its distributor was taken over by a distributor which MTAA understands is majority owned by a major oil company. The operator had previously paid the terminal gate price plus delivery costs, but following the change in ownership, the operator's cost of fuel was the terminal gate price plus delivery costs plus a distributor margin of around three to four cents. The higher cost of fuel was, understandably, passed on to motorists in the form of higher prices.

The cost of transporting and storing fuels will also vary from location to location and it is likely that those costs will be passed on to consumers by the service station operator. Service stations which have high distribution, transportation and storage costs are therefore likely to have higher retail prices of petrol than service stations with low distribution, transportation and storage costs.

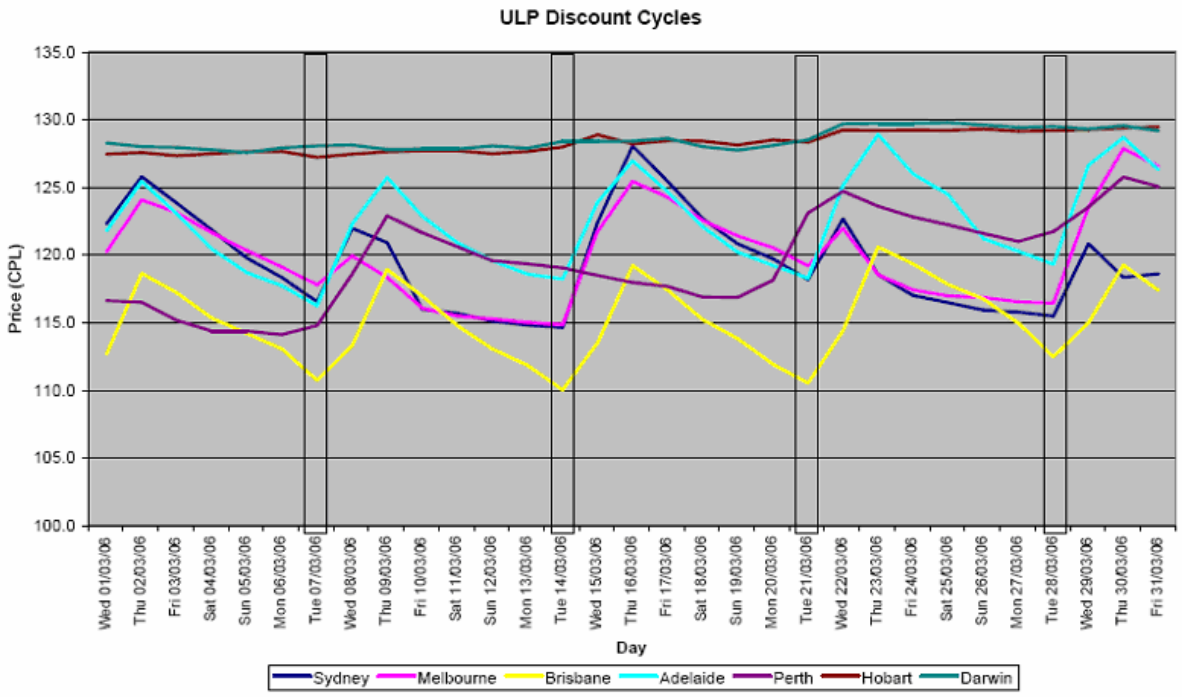
The influence of each of the above factors will vary from location to location and that in turn will cause the retail price of fuel to differ, sometimes quite significantly, between different locations in Australia. In that regard, it is worth noting that service stations located in rural and regional tend to have lower levels of fuel and non-fuel sales and higher costs associated with distribution, transport and storage than service stations located in metropolitan areas and it is therefore likely that retail prices at many rural and regional service stations will be higher than prices at their metropolitan counterparts. It is also worth noting that some governments also provide subsidies which reduce the cost of fuel (the most notable being the Queensland Government) and which may therefore create price differentials between various states or between different locations within a state or territory.

VARIATIONS IN THE RETAIL PRICE OF PETROL AT PARTICULAR TIMES

The retail price of petrol can fluctuate, sometimes quite significantly, during the course of a day or a week. While retail price fluctuations are a matter of irritation and confusion to some motorists, they are also confusing and irritating for service station operators (for the physical changing of prices on boards and pumps and also because of the complaints from motorists that the fluctuations inevitably and understandably generate). However, for all the publicity that retail price fluctuations attract, it needs to be made clear that not all motorists experience the highs and lows of the price cycle.

The fluctuations (or price discounting) are more prevalent in the major metropolitan areas and much less prevalent in rural and regional areas. The extent of price discounting within the major metropolitan areas however also varies quite significantly from suburb to suburb. It is also worth noting that some metropolitan areas, such as Darwin and Hobart, do not experience the marked price cycles experienced in other major metropolitan areas of Australia (as highlighted in Figure 5 below). It is therefore motorists in particular locations, rather than all motorists, who benefit from price fluctuations in the retail price of petroleum.

Figure 5: Unleaded Petrol Price Discount Cycles in Major Metropolitan Areas (March 2006)



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Source: FUELtrac Pty Ltd 2006, *ULP Discount Cycles*, FUELtrac, Brisbane, viewed on 11 July 2006, http://www.fueltrac.com.au/zone_files/news_images/ulp_price_cycles.pdf.

Fluctuations in the retail price of petroleum occur for a variety of reasons, including competition between sites and the increased price competition caused by the use of shopper dockets. Competition in the retail petroleum sector is essentially based on price because of the fairly homogenous nature of petroleum products and because consumers are relatively indifferent to brand but highly sensitive to price. As a result, service station operators rely heavily on price competition to increase and to protect their market share.

Service station operators will therefore drop their prices to attract additional customers and increase their sales volumes of both fuel and non-fuel products or to match their competitors' prices to ensure that they do not lose market share. A recent report on automotive fuel pricing in Victoria by Consumer Affairs Victoria noted that, in Melbourne, the supermarket/oil major alliances generally led retail prices down but also frequently led market prices up as well.[2] While different market participants may fulfil that leading role in other Australian markets, service stations in those areas will be forced to match the discounted prices set by their competitors or they will lose market share. At some point however the discounting will reach a point at which it is commercially unsustainable and prices will then begin to increase and the cycle will repeat itself.

The provision and withdrawal of franchisee price support (or rebates) by some of the major oil companies also contributes to fluctuations in the retail price of petroleum. Price support basically involves a major oil company providing their franchisees with a rebate on the wholesale price of their fuel. This type of support is given selectively and is not available in all areas. In order to receive price support, eligible franchisees also must not set their retail price above a specified maximum price. Price support tends to be greatest during periods of heavy discounting and once it is withdrawn, prices tend to rise again. It is worth noting that the Australian Competition and Consumer Commission has previously suggested that price support schemes might be a long-term strategy by participating oil companies to maximise profits by controlling the retail prices set by franchisees and by removing or limiting competition from independents.[3] MTAA would support the Commission's views in that regard.

The introduction of shopper docket schemes has also provided additional price competition in the retail petroleum market, which is placing enormous pressure on all operators in the market, including independent operators and franchisees in particular. As Committee Members will be aware, those schemes are designed to increase traffic at participating supermarkets and to drive higher grocery sales at those supermarkets. However, MTAA acknowledges that at time of high petrol prices, the schemes are providing some apparent relief, albeit minor, to motorists assuming, which it may not be appropriate to do, that that is not recovered through higher grocery and other prices. The Association is concerned however about the long-term prospects for competition in the market if the schemes contribute to the exit of substantial independent operators from the market and Australia is left with a market dominated by the oil major/supermarket alliances, BP and Mobil. To that extent, it is MTAA's view that such an outcome would result in the loss of the substantial benefits of strong competition in the market and while the shopper docket schemes may survive that rationalisation, the real question will be "off what price will the cents a litre discount be given?".

It is also worth noting that the broad combination of shopper dockets, price support, the need to secure supply and the impact of commercial arrangements applied to the ownership of fuel delivered to service stations by some major oil companies means that the ability to set and control retail petrol prices is, with very few exceptions, effectively in the gift of the major oil companies.

[2] Consumer Affairs Victoria 2006, *Report on Automotive Fuel Prices in Victoria*, State Government of Victoria, Melbourne, 10.

[3] Australian Competition and Consumer Commission 2001, *Reducing Fuel Price Variability*, ACCC, Canberra, 34.

THE INDUSTRY'S INTEGRATED STRUCTURE

The Australian petroleum industry is highly integrated, with strong links between the refinery, wholesale, distributor and retail levels. The major oil companies participate in all components of the supply chain, although their direct operation of retail sites has been limited, until recently, by the operation of the *Petroleum Retail Marketing Sites Act 1980* (Cth) and its regulations. Those restrictions have however been removed by the amendment of the relevant regulations and there are therefore no longer any controls on the number of retail sites that can be directly operated by the oil majors. The level of vertical integration in the industry is therefore likely to increase as some oil majors (BP in particular[4]) move to directly operate an increased number of their sites.

As can be seen from Figure 6, the major oil companies dominate the wholesale level of the market, with those companies operating all of Australia's major refineries. Those refineries produce the vast majority of Australia's petroleum supplies, although an increasing amount of refined fuel is being sourced from overseas refineries. The oil majors however also dominate the importation of refined petroleum products through their control of the vast majority of the suitable storage facilities at Australia's ports. As such, the wholesale sector of the industry is highly concentrated and the major oil companies wield a significant degree of influence over the sector.

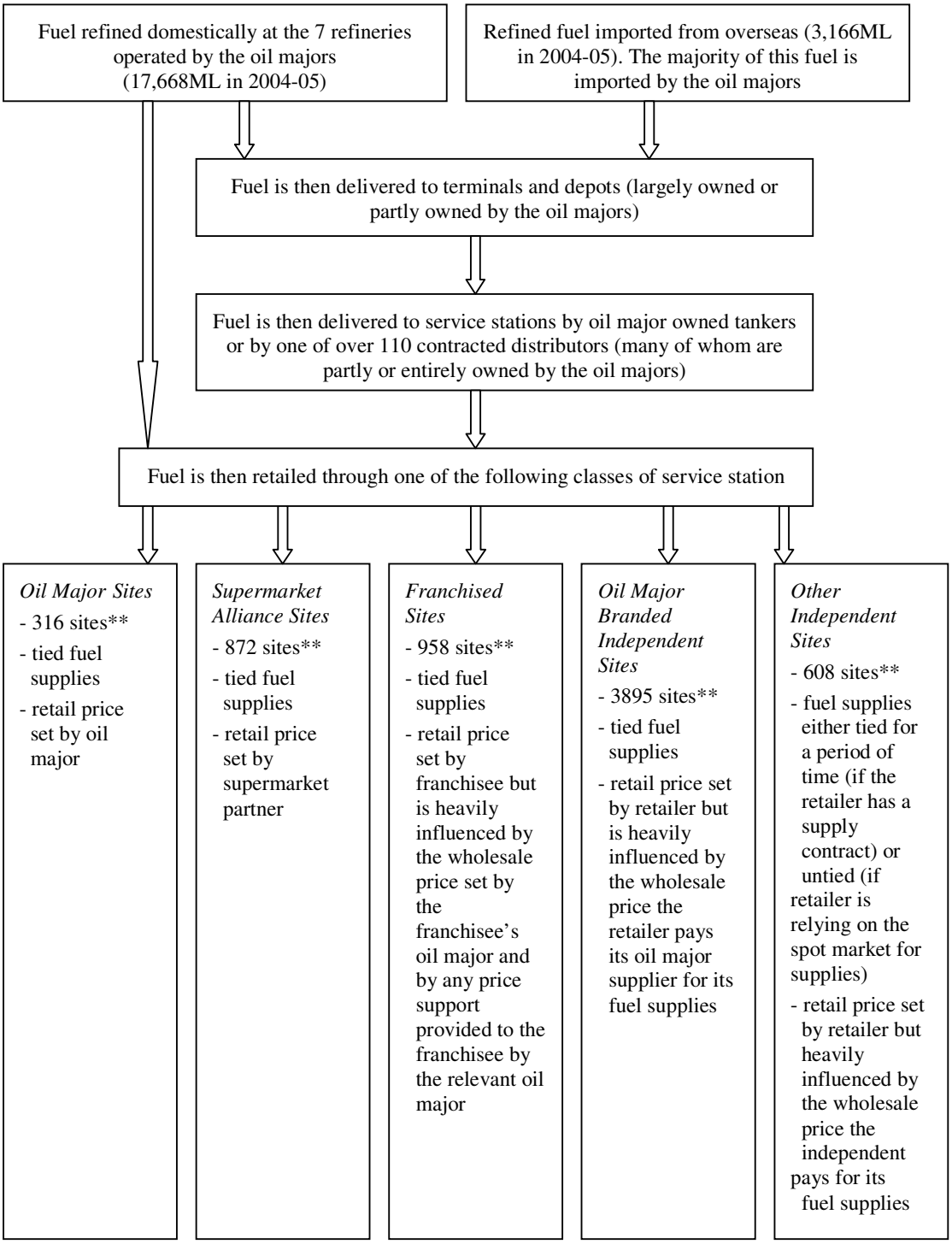
The oil majors' control of the wholesale sector also enables them to wield a significant degree of influence over the retail sector of the industry. While oil companies may not directly control the setting of prices at many sites, the vast majority of retail sites are tied to a particular oil major for their fuel supplies. The oil majors can therefore 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 suppliers from an alternative supplier.

According to the Australian Institute of Petroleum, there were 6649 service stations operating in Australia in 2004.[5] While MTAA expects that the number of service stations has declined since then, MTAA understands that as of July 2006 there are around 488 Caltex/Woolworths sites, 1400 Caltex/Ampol branded sites, 602 Shell/Coles sites, 513 Shell branded or supplied sites, 1453 BP branded or supplied sites and 1048 Mobil branded or supplied sites (figures based on information obtained from oil company websites and publications). Around 800 other sites are operated under the major independent brands (7-Eleven, United, Gull, Matilda, Neuman and so forth) located around Australia. There are also a number of smaller non-branded service stations located throughout Australia.

[4] Evidence to the Senate Economics Legislation Committee, Parliament of Australia, Sydney, 19 April 2006, E33 (Gerald Hueston).

[5] Australian Institute of Petroleum 2006, *Submission to the Inquiry into the Provisions of the Petroleum Legislation Repeal Bill 2006*, AIP, Canberra, 6.

Figure 6 – Australia's Fuel Supply Chain

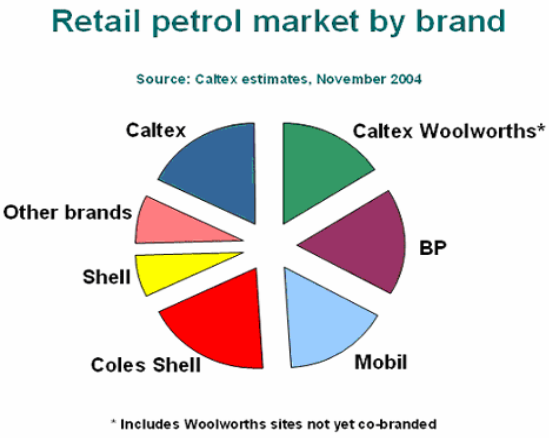


** These figures are 2004 figures and the structure of the market has evolved since then. (Source: Australian Institute of Petroleum 2006, *AIP submission to the Senate Economics Legislation Committee Inquiry into the Provisions of the Petroleum Legislation Repeal Bill 2006*, 8; Department of Industry, Tourism and Resources 2006, *Petrol – Frequently Asked Questions*, DITR, Canberra, viewed on 11 July 2006, www.industry.gov.au).

Compiled by MTAA for the Australian Service Station and Convenience Store Association, July 2006.

In terms of market share, it is quite difficult to obtain accurate market data as market share figures are commercially sensitive. That said however it is MTAA's understanding (based on information provided by confidential industry sources) that Caltex, Shell and the two joint venture supermarket alliances have at least sixty per cent of the Australian retail petroleum market. That view is supported by Figure 7 which provides a breakdown of the Australian retail petroleum market by brand based on the estimates of Caltex Australia Petroleum Pty Ltd.

Figure 7: Market Share of Australian Retail Petroleum Market by Brand (November 2004)



Woolworths recently announced that its comparable sales of petrol for the fifty-two weeks to 25 June 2006 were 21.6 per cent higher than its comparable sales of petrol for the fifty-two weeks ended 25 June 2005. Coles Myer Limited has also announced similar increases in sales volumes in the recent past. While some of that increase in sales is attributable to higher petrol prices, some is also attributable to increased market share, with Woolworths' weekly sales volume reaching 76 million litres in the final week of the year ended 25 June 2006. As such, the market shares of the supermarket alliances are likely to be significantly higher than those illustrated in Figure 7.

Source: Caltex Australia Petroleum Pty Ltd, *Petrol Pricing – The Plain Facts*, Caltex, Sydney, viewed on 12 July 2006, http://www.caltex.com.au/pricing_pla.asp; Woolworths Limited, 'Full Year Sales Results: 52 weeks to 25th June 2006' (Press Release, 18 July 2006).

In relation to the above market share estimate, it is worth noting that the supermarket/oil company alliances have probably increased their market share at the expense of other market participants since 2004 and they are therefore likely to have a larger market share than that illustrated in Figure 7.

In such a highly vertically and horizontally integrated market, the Association would question how the level of price competition is to be maintained unless there is access to fuel at a competitive wholesale price.

ANY OTHER RELATED MATTERS

MTAA considers that the regulatory framework governing the retail petroleum sector also has the potential to affect the level of retail petrol prices in Australia. As the Committee will be aware, the Australian Government is currently seeking to alter that regulatory environment by repealing the two retail petroleum sector-specific Acts; the *Petroleum Retail Marketing Sites Act 1980* ('the Sites Act') which limits the number of sites that an oil company may operate, and the *Petroleum Retail Marketing Franchise Act 1980* ('the Franchise Act') which provides tenure and other rights to petrol franchisees, and introducing a mandated oil industry code of conduct under the *Trade Practices Act 1974* ('the Oilcode').

The Committee will also be aware that MTAA considers that the Australian Government's proposed amendments to the retail petroleum sector's regulatory framework will not deliver a more competitive, transparent and efficient retail petroleum sector. MTAA holds that view because it believes that the proposed 'reforms' do not adequately address a number of key issues, including the transparency of terminal gate pricing arrangements, access to supply and protections against

misuse of market power. Each of these factors has, in MTAA's view, a significant impact upon either the level of transparency in the sector or the ability of individual businesses within the sector to compete effectively and therefore impacts upon the level of competition and pricing transparency in the market as a whole.

MTAA is also concerned that the repeal of the Sites and Franchise Acts will allow the major oil companies to exert increased influence over the retail market by removing the final constraints on vertical integration in the industry. The Oilcode, as drafted does not address continuing concerns about vertical or more recent concerns about the degree of horizontal integration across the whole retail market. 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 in the industry and create barriers to entry which may preclude other more efficient competitors from entering the market in the future.

MTAA also believes that the proposed Oilcode, in its current form, will not provide a framework that ensures that the current level of competition in the market will continue in the long term. This is because the Oilcode does not address the fundamental threat to competition in the retail petroleum market; that is, the increasing dominance of the supermarket/oil company alliances, which now account for well over fifty per cent of the market, and their ability to use grocery operations to cross-subsidise fuel retailing activities and to consequently drive more efficient and effective competitors, both large and small from the retail petroleum market. Unless the proposed amendments address that issue, there is a significant possibility that the structure of the market will reflect that of the retail grocery market: a duopoly. Such an outcome will be of detriment to motorists in the longer term as a duopoly is likely to mean less price competition and higher retail prices for petrol.

In MTAA's view, the significant structural changes which have occurred in the retail petroleum sector over the last decade, including the growing market power of Coles and Woolworths, the trend towards vertical integration and the more recent trend towards horizontal integration, mean that it is imperative that any reform package for the sector includes appropriate amendments the misuse of market power provisions contained in Part IV of the *Trade Practices Act* to ensure that the Act deals effectively with all types of anti-competitive behaviour, including predatory pricing and the misuse of financial power. The Government's petroleum sector reforms as currently proposed do no include such amendments.

The proposed reforms therefore do not adequately address the concerns that service station operators have in relation to anti-competitive behaviour in the retail petroleum sector; in particular, predatory pricing, the misuse of financial power and the misuse of market power in one market to gain substantial power and reduce competition in another market. MTAA strongly believes that section 46 of the *Trade Practices Act* needs to be strengthened to address those concerns. The strengthening of the *Trade Practices Act* will allow for more effective competition in the market, the potential benefits of which will be passed on to consumers in the form of price competition.

In that regard, the Association is aware that the Australian Government has foreshadowed amendments to section 46 of the *Trade Practices Act* which it proposes will address the issue of predatory pricing. It is, however, MTAA's view that the Government's proposed amendments to the *Trade Practices Act* will not address our service station members concerns about below-cost selling practices in the retail petroleum market.

Biofuels/Ethanol Blends

MTAA considers that the proposed Oilcode will result in small competitors, namely the independent operators, leaving the petroleum retail market. Such an outcome will be of detriment to motorists not only due to the lessening of price competition, but due to its potential to limit access to biofuels and blended fuels such as ethanol.

In 2001, the Federal Government announced its commitment for Australia to produce 350 million litres of biofuels by 2010. While some of the major oil companies have begun selling biofuels and blended fuels at some service stations throughout Australia, it is the independent sector which has being the driving force behind attempts to increase the presence of those fuels in the Australian retail petroleum sector. One of the ways in which independent service station operators have been attempting to make biofuels and blended fuels more appealing to motorists is by passing on the Government subsidies to the consumer.

In that regard, it is worth noting that in a recent interview with Prue Adams for the ABC television series Landline[6], Mr John Honan, Managing Director of the Manildra Group, estimated that ethanol can be sold for approximately forty cents less than the price of petrol and that therefore petrol blended with ten per cent ethanol (E10) should be four cents less than the price of regular petrol. While the Australian Government is calling for fuel producers to pass on the subsidy they receive from the Federal Government[7], the Landline report also noted that while the independent service station operators are more likely to be passing those savings on to consumers, BP was defending its move to sell its ethanol blended petrol at the same price as regular petrol.

Meeting the Government's target of 350 million litres of biofuels by 2010 is not just about production but also consumption, which means that the products need to be widely available for motorists. The viability of independent service station operators is central to encouraging consumer consumption of biofuels and blended fuels because those retailers sell a significant proportion of the total amount of those fuels that are sold in Australia each year and have been more receptive to the concept of biofuels and ethanol blends than other market participants. The proposed changes to the regulatory environment of the retail petroleum sector threaten the viability of independent service stations and therefore have the potential to threaten the effectiveness of biofuels and ethanol blended fuels in the Australian market.

The future of biofuels and ethanol blends in the Australian market is also dependent on the ability of independent retailers who retail those fuels to secure access to a competitively priced supply of petroleum products, as there are statutory limits on the composition of some biofuel and ethanol blends. For example, ethanol blends may only contain up to ten per cent ethanol which means that suppliers or retailers of those fuels must be able to secure sufficient fuel supplies to be able to produce and retail their E10 blend. Those supplies must also be competitively priced if E10 and other biofuel blends are to be an attractive and viable alternative to conventional fuels for Australian motorists. At this stage, the current and proposed regulatory frameworks for the retail petroleum sector do not address the important issue of access to supply and it is therefore possible that some biofuel and ethanol suppliers and retailers may experience difficulties in securing the fuels supplies they require in order to be able produce and sell certain biofuel and ethanol blends.

[6] ABC Television, 'Fuel for Thought, *Landline*, 9 July 2006 http://www.abc.net.au/landline/content/2006/s1679589.htm (viewed on 12 July 2006).

[7] 'Biofuels subsidies should be passed on', *The Sydney Morning Herald* (Sydney), 9 July 2006.

CONCLUSION

MTAA trusts that these comments and observations have been of assistance to the Committee in its consideration of this matter.

MTAA
National Secretariat
Canberra

July 2006