APCO SERVICE STATIONS PTY. LTD.
A.C.N. 007 229 898

Head Office: 343 - 355 Thompson Road
North Geelong, 3215

Ph. (03) 5278 6988
Fax. (03) 5278 6768

SUBMISSIONS TO SENATE INQUIRY

RETAIL PETROL PRICING

16th August 2006

APCO SERVICE STATIIONS PTY LTD

SUBMISSIONS TO SENATE INQUIRY INTO PETROL PRICING

Introduction

1. Apco Service Station Pty Ltd ("Apco") is an independent petrol retailer based in Geelong.

2. Apco owns nineteen service stations in Melbourne and country Victoria. In particular the service stations are situated in Geelong (8), Ballarat (2), Bendigo (2), Melbourne (2), Barwon Heads, Hoppers Crossing, Bacchus Marsh, Wangaratta and Warrnambool. A site is presently under construction at Albury.

3. Each service station has a convenience store and is operated by a franchisee.

4. The business was established by Ron Anderson in 1981 and is now conducted by his sons Peter and Robert Anderson.

5. Apco was one of the first petrol retailers to introduce price discounting in Victoria in the early 1980's. The company has since acquired a reputation as a petrol discounter. Its policy is to generally sell petrol at a price which is below the price of its competitors by being the first to reduce and the last to increase its price during each petrol price cycle.

6. Apco was a party to the proceedings of the ACCC against petrol retailers in Ballarat and is a party to the proceedings against retailers in Geelong.

7. We are therefore in a good position to inform the Committee about the retailing of petrol, the issues arising from the Ballarat case and the consequences for petrol retailing of that case.

The Price Cycle

8. Petrol retailing is an example of competition in its purest form as competitors declare their price not only to their customers but also to their competitors by posting it on large display boards.

9. The cycling of petrol prices is an established feature of petrol retailing in the cities and larger regional centres. However, there is generally little understanding of what drives the cycle and of why it does not occur in some locations.

10. Independent petrol retailers play a significant part in the cycling of petrol prices. They can be classified as discounters or margin retailers. Discounters seek sales volume through always having

the lowest price. They endeavour to compensate having low margins by achieving high sales volumes and by creating additional profit from increasing the turnover in their convenience stores. Margin retailers prefer to keep their price up for as long as possible or raise their prices first in order to preserve their margins on lower sales volume. Discounters usually have what are called high profile sites.

11. Price cycling rarely occurs in some towns and cities in country Victoria because of the absence of an discount independent retailer. Over the years, Apco has opened sites at places such as Warrnambool, Ballarat, Bendigo, Wangaratta and will soon do so at Albury. By doing so, it has caused petrol price cycling to be introduced and a significant lowering of the average petrol price at these places. (*See the press reports attached and marked "A")*)

12. The downward cycle of petrol prices occurs when the discount independent retailers progressively reduce their price so as to be the cheapest price in the localities in which their sites are located. They must do so to maintain their reputation as a discounter and to maintain the turnover in the convenience store from which they typically derive royalties. Eventually a margin retailer declares that it cannot continue to sustain losses and raises its price. The discounters immediately follow as they too need to stop losing money and to take advantage of the higher margins that are available at the top of the cycle. However, a short time after the price is raised the discounters begin the downward cycle by undercutting their competitors. Other retailers must follow as petrol is an extremely price sensitive product. Prices will continue to decline to a point where the retailer is often selling at less than its cost price or below the amount required to recover operating expenses. The capacity of a retailer to stay at the bottom on the cycle will depend on factors such as the wholesale price at which it is buying fuel, the financial strength of its business, the extent to which it is able to offset losses through a convenience store and, in the past, the payment of price support by the oil companies.

13. Sites are often operated by franchisees who act as a commission agent for the sale of the franchisor's petrol and own the business conducted in the convenience store. They are usually paid an amount per litre of fuel sold by the franchisee. Although they do not set the price at which the fuel is sold, it is their interest to have a competitive board price as they rely directly on profits from their convenience store. In other words, the more people who come to the site to buy petrol, the higher the turnover in their convenience store. They are therefore often quick to reduce the board price but slow to increase it when instructed to do so by the franchisor because they want to maintain their turnover.

14. Retailers need to know what their competitors are doing with their prices as they will quickly lose sales if they do not follow the cycle. The public are extremely price conscious. They will drive some distance to a service station to purchase petrol because it is a fraction of a cent cheaper.

15. Retailers inform themselves of their competitor's prices by regularly driving around the locality in which their site is situated, from ringing around their own sites, speaking to competitors, from their customers and simply by observing a change in the number of cars on their forecourt.

16. The major oil companies can afford to obtain market information by subscribing to Informed Sources. The Committee has been told of this service by the ACCC. However, it was not informed that oil company subscribers allow Informed Sources to connect into the consol of all their retail sites. The subscriber authorises the publication of the price movement information taken from each of its sites to other subscribers who are or course its competitors. We believe that the ACCC is aware of the way in which this service operates.

17. Regardless of whether competitors obtain their information "manually" (as is the case with most independent retailers because they cannot afford to pay for the information) or electronically, all that is happening is that retailers are exchanging <u>market information</u>. The speed with which this information is exchanged explains why 90% of the market in a locality moves within a short time.

18. Discount retailers need information about what is happening in the market place as they often need to raise their prices immediately the market moves to take advantage of the peak of the cycle to recover losses made at the low point in the cycle. This is another reason why prices appear to move quickly from the low point in the cycle. If a retailer misses a price move it may have to wait a week or more to catch the peak of the next cycle.

19. The perception that because prices move at the same time there must be price fixing between retailers has apparently been the reason why the ACCC has launchened what we will later demonstrate to be very destructive and, in terms of the preservation of competition in the market place, futile proceedings against independent retailers in Ballarat and Geelong.

20. The wholesale price of petrol charged by refiners also affects the length and depth of a price cycle. The capacity of a discounter to maintain discounted prices is prolonged if the wholesale price is reduced and shortened if the wholesale price increases during a price cycle .The wholesale price is known as the Terminal Gate Price and is the price at which most independent retailers purchase their petrol. This price varies from day to day. The timing of its purchase is important for an independent retailer as the frequency which the Terminal Gate Price changes can create problems for the retailer. It may have purchased petrol at a higher price than its competitor during the downward cycle so allowing the competitor to be more aggressive with its discounting.

Factors Currently Impacting on Competition in Petrol Retailing

The Presence of Coles and Safeway in the Petrol Retailing Market.

21. Coles and Safeway now have over 50% of the market. This necessarily means that their pricing polices have a substantial impact on competition in the market place. Contrary to the belief of the ACCC, this is not all good for the consumer.

22. The volume of petrol sales which Coles and Safeway now control has been largely taken from independent retailers. As a result many have left the industry and the competition that they created in the market place has been lost.

23. Because of the discounts offered to their supermarket customers, Coles and Safeway are less inclined to participate in the price cycle. They are usually the first to raise their prices. The extent of the price increase initiated by them is usually greater than the increases that had previously occurred at the end of the downward part of a cycle.

24. The remaining independent retailers are compelled to compensate for the loss of volume caused by the dominant position of Coles and Safeway in the market place by achieving higher margins on the petrol they sell. In other words, they have been forced to become margin retailers by following the price charged by Coles and Safeway. This allows them maintain greater margins than they previously obtained. As a result, independent retailers have been forced to become less competitive in order to survive in what is now a vastly different market place.

25. The public are the losers from this development as, although price cycling still occurs, the average price which they now pay is greater than it would have been before the competitive forces in the market place were distorted by the entry of Coles and Safeway. Furthermore, It is not unreasonable to presume that the public pays more for the groceries purchased at Coles and Safeway supermarkets to compensate for the petrol discounts which they receive for doing so.

The Control of the Supply of Petrol by the Oil Companies.

26. Independent retailers are required to pay the wholesale price demanded by the oil companies. As the oil companies are also retailers and no doubt have arrangements with Coles and Safeway for the supply of product, they are able to significantly influence the retail price of petrol from the oil companies.

27. It may be presumed that Coles and Safeway obtain supply at a price which is less than that available to independent retailers. Because of the volume supplied to these companies, the oil companies are able to in effect control the retail market through their wholesale pricing structure. The wholesale price of petrol paid by a retailer determines the price which it can charge its customers. Therefore, a retailer with a favourable supply arrangement is able to have a greater influence on the retail price of petrol to the detriment of its competitors. The independent retailers have been the losers from this development because, as previously explained, their capacity to compete is determined by the price at which they can purchase their petrol.

28. The capacity of independent retailers to continue as competitors in the market place is largely beyond their control because of their inability to obtain certainty of supply at a price that allows them to be competitive. Oil companies will not commit to a long term supply arrangement with Apco. At the end of the current arrangement, they could simply inform Apco that they have no capacity to supply because of the requirements of their own retail outlets or their customers such as Coles and Safeway. The prospect of this occurring is increased because of the declining refining capacity of the oil companies in Australia.

29. The ability of oil refiners to control the market place is demonstrated by the fact that Premium Unleaded products such as Synergy, Optimax and Vortex are not made available to independent branded retailers such as Apco. This refusal to supply is detrimental to the survival of independent retailers as the market share of premium ULP is growing substantially due to the oil refiner's aggressive and successful marketing strategies that are designed to encourage motorists to use these premium products. Typically the retail margin for Premium ULP (Optimax, Synergy, etc) is higher than standard ULP so the average retail margins of oil companies grow as the market share of these products increases. This gives a further competitive advantage to the major retailers.

30. The constant threat of not being able to obtain regular supply is possibly the greatest problem facing independent retailers. Any interruption to supply would be potentially fatal to their business.

<u>The Actions of the ACCC against Independent Retailers.</u>

31. We agree unreservedly that petrol retailers who engage in price fixing should be prosecuted and punished according to the law.

32. However, we believe that the Committee should be made aware of the consequence of the Ballarat case for petrol retailing in Ballarat.

33. The Ballarat proceedings were against 7 independent retailers who owned or supplied service station sites in the city of Ballarat. There were Leahy Petroleum Pty Ltd, Triton 2001 Pty Ltd, J Chisholm Pty Ltd, Justco Pty Ltd, Apco Service Stations Pty Ltd and Balgee Oil Pty Ltd. Most of the corporate respondents were small family run businesses.

34. In the first instance, all respondents either admitted or were found by the court to have contravened the Act. Apco subsequently successfully appealed the finding against it.

35. The Act provides that the penalty for a contravention is $10 million. As the number of contraventions found against Apco was 29, it faced a penalty of $290 million. Other respondents were found to have contravened the Act on 69 occasions.

36. At the penalty hearing, respondents submitted details of their assets and liabilities to the court and the ACCC advised the court of the penalties it sought.

37. Despite the fact that, on any interpretation of the financial statements submitted on behalf of Apco that its capacity to pay a substantial penalty was limited, the ACCC sought a penalty against Apco of $11 million. It was apparent to us that the intention of the ACCC in doing so was to cause Apco to be put out of business.

38. The court imposed a penalty of $3 million on Apco (and $200,000 on its director Peter Anderson) and a total of $23 million on all respondents. These were acknowledged to be "crushing" penalties but were considered necessary to warn others against offending. It is understood that few of the fines has been paid. It would be of interest to know of the cost to the ACCC of investigating and prosecuting the Ballarat case.

39. It should be noted that this was the first time any of the respondents had offended.

40. The inevitable consequence was that each of the respondents other than Apco and Chisholm (which is a margin retailer with low volume sites) have left the industry and disposed of their sites. Approximately 10 sites that were previously operated by independent retailers are now operated by the oil companies and Coles.

41. The alleged period of price fixing occurred during 1999 and 2000. At this time Ballarat market was acknowledged to be the most competitive retail fuel market in Victoria. There existed an aggressive fuel price cycle created between independent competitors who often brought down retail board prices

below wholesale prices for long periods of time so allowing the motorist to purchase fuel at 'below cost' levels.

42. Today there is little or no price cycling in Ballarat. Apco's records show that in 1999/2000 there were typically about 40 and sometimes over 60 price movements per month. Of these movements prices moved up 3 to 4 times and down on the other occasions. In 2006, there have been typically only one or two price movements per month. The price of petrol is permanently set at about the maximum price in the cycle that occurs in Melbourne. This has been the subject of comment by Mr David Cummins from the RACV (*See press report and RACV comparison of Ballarat and Melbourne petrol prices attached and marked "B")*

43. The ACCC has in effect acted in contravention of its charter by causing a reduction of competition in the market place in Ballarat. It has destroyed the competition that previously thrived in the Ballarat market by seeking and obtaining penalties that forced independent retailers out of business. Surely the better approach would have been to punish the offenders but only to the extent that allowed them to continue in business.

Application of the Trade Practices Act in the Petrol Retail Industry

44. The Committee has expressed interest in the concerns raised by the ACCC about its ability to prove contraventions of section 45 of the Act.

45. The ACCC suggested that the difficulty arises because of the reluctance of the courts to accept circumstantial evidence and because witnesses were being instructed by their lawyers to deny that there was ever any commitment to move prices after a communication between competitors.

46. As the Committee is aware, Apco successfully defended the allegations of price fixing against it in the Ballarat market. It is also a respondent to a prosecution against numerous retailers in the Geelong market.

47. Although judgement has not been handed down in the Geelong case, some of the offences alleged against Apco and Mobil (and other respondents) were dismissed by the court during the trial because there was insufficient evidence to prove the allegations.

48. In the Ballarat case it was alleged that Apco agreed with its competitors as to the time and the amount of a price increase so as to end discounting in a number of price cycles in 1999 and 2000. The ACCC relied on mobile telephone records and price movement information obtained from Apco and other

respondents together with the evidence of individual respondents who had pleaded guilty in return for being offered a leniency agreement by the ACCC.

49. The ACCC alleged that the receipt by Apco of market information from competitors in the form of what it said were coded messages that suggested that the market had already moved up (for example, "go for a drive") and the fact that Apco later increased its price (initially on 69 occasions in 18 months but later reduced to 29 occasions because it was agreed that, after speaking to competitors, Apco could not have been engaging in price fixing because either it did not move or it reduced its price on the days that were abandoned by the ACCC) lead to an inference that Apco was a party to a price fixing understanding or arrangement.

50. Apco defended the allegations because, consistent with its policy of being the cheapest petrol retailer in Ballarat, it moved its prices only after obtaining market information from other sources such as its franchisees and from personally observing the price movements of its competitors and then only when it considered that it could gain a competitive edge on its competitors. The Full Court agreed that such behaviour was not consistent with a commitment by Apco pursuant to an arrangement or understanding with competitors to increase its price after receiving market information.

51. The strategy of the ACCC in the Ballarat proceedings was to join a large number of parties to the action. This meant that the trial was long and expensive. It required the commitment of huge resources to the conduct of the trial by the ACCC and any respondents who wanted to defend themselves. Inevitably, few of the respondents could afford to do so. Yet the ACCC was able to provide almost unlimited resources in the prosecution of the action and to employ the best legal representation in doing so.

52. As individual respondents included employees of the corporate respondents they were even less able to defend the proceedings. It is not surprising that many chose to admit guilt and give the evidence required by the ACCC to prove their case in return for a promise that the ACCC would seek a lighter penalty against them.

53. The ACCC has suggested that respondents' lawyers now prepare witness. Apco absolutely denies that this occurred in its defence of the Ballarat of the Geelong cases.

54. The evidence of admitting respondents presented to the court by the ACCC to prove its allegations against the defending respondents in the Ballarat case was in the form of witness statements. It was apparent from the evidence of some of these witness that their statements were either prepared or

settled by the ACCC's solicitors and were the subject of several drafts before the ACCC would accept that the witnesses had said enough to warrant being given a leniency agreement. It might be said that the ACCC was in fact preparing its own witnesses.

55. The ACCC has also relied on the evidence of admitting respondents who have been given leniency agreements in its action against independent retailers in Geelong. This action has been defended by all respondents and is awaiting judgement.

56. The circumstantial evidence to which the ACCC refers in saying that courts are reluctant to accept such evidence in the Ballart and Geelong cases is the huge number of mobile phone records of each respondent and details of the time and the amount of the increase in petrol prices over the period when the breaches of the Act were said to have occurred.

57. This circumstantial evidence was not rejected by either the Federal Court or the Full Federal Court in the Ballarat case.

58. The ACCC's prosecution of Apco and Mobil as parties to a price fixing arrangement or understanding in the Geelong case failed. This occurred in part because the circumstantial evidence presented by the ACCC was found to be deficient in that it omitted details of phone calls and price movements that were considered by the court to be relevant to the case even though the details were available to the ACCC at all times.

59. We therefore fail to understand the basis on which the ACCC claims that there is an emerging trend in these cases for the courts to reject circumstantial evidence.

60. As Apco has had the unfortunate experience of having to defend itself in two ACCC prosecutions we can say that, given the huge financial advantage that the ACCC has when compared to small business and individuals who are prosecuted, the standard of proof should not be lowered to make it easier for the ACCC to prosecute alleged offenders.

61. In reality justice is denied when it cannot be afforded. It has been the practice of the ACCC to date in the retail petrol industry to institute proceedings that are so substantial and complex that an individual or small business cannot possibly afford to defend them. They have no alternative but to "take the easy way out" and admit the allegation against them regardless of the fact they may not have broken the law.

62. Apco defended the proceedings because it believed that it had done nothing wrong. Yet by doing so it suffered enormous financial strain. Its reputation in the market place as a petrol discounter was

severely tarnished, particularly as the ACCC actively sought publicity about the proceedings when they were launched *(See press report attached and marked "C")* and when they were concluded in the lower court. Even with the payment of its costs by the ACCC as ordered by the court, Apco will still be substantially out of pocket in terms of legal fees not recoverable, the cost of executive time devoted to the proceedings and the impact on its business during the proceedings.

63. We suggest that perhaps the reason why the ACCC considers it difficult to prove contraventions of the Act in the petrol industry is because no price fixing has or is occurring. After all, it might be expected that, after all the publicity which has been given to the Ballarat and Geelong cases, price cycling might have ended by now.

Conclusion

64. At the retail level, the preservation of competition in the market place is the most effective way of ensuring that the public obtains the cheapest petrol.

65. The increasing dominance of the market by Coles and Safeway and the progressive decline in the number of independent retailers has and will continue to remove the competitive element that has been a feature of the market place. It is inevitable that price cycling will become less of a feature of petrol retailing as independent retailers struggle to retain a margin on their substantially reduced volumes and Coles and Safeway compensate for the discount which they provide to their supermarket customers by holding up the price of petrol.

66. As is often the way with big business, it sets out to dominate the market in which it operates. Because petrol is a uniform product, small independent retailers can only seek to compete on price. With the vesting of overwhelming market power in the oil companies and in Coles and Safeway, their ability to do so is rapidly diminishing.

67. Independent retailers do not seek market protection. They only require a level playing field on which they can compete.

68. A level playing field could be created by :-

- Requiring that there is a common Terminal Gate Price for all purchasers of petroleum products from oil companies.

- Fixing the Terminal Gate Price for at least one month before it can be changed (as occurs with LP Gas)

- Compelling oil companies to supply all retailers and to ration petrol on a pro rata basis if there is shortage of supply.

69. We have the impression as an independent retailer that the ACCC, the oil companies and Coles and Safeway seem determined to ensure that retailers such as ourselves are denied the opportunity to compete fairly in the market place.

Peter Anderson *Ronald Anderson* *Robert Anderson*

Apco Service Stations Pty Ltd