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PRESENTATION
TO

AUSTRALIAN GOVERNMENT
SENATE STANDING COMMITTEE
ON ECONOMICS

INQUIRY INTO THE PRICE OF PETROL
IN AUSTRALIA

SUBMISSION BY
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INTRODUCTION:

I thank the Senate Committee for the invitation and opportunity to provide this presentation and to make myself available for questions.

By way of background, - I am the Principal of -
HEH Australian Petroleum Consultancy Co
which provides consultancy support, guidance and mediation services to Petroleum Distributors, Service Station Operators, Associations, Biofuels Manufacturers, Oil Company Majors, Governments and the media.

We are also publishers of the monthly email newsletter -
Australian Petroleum Marketers News (APMN)
which provides news and commentary on issues of importance for petroleum marketers.

I have been continuously involved in the oil industry in Australia for in excess of (40) years in various capacities including – Senior Executive with the Shell Co of Australia, the operation of my own large petroleum distributorship/wholesaler company, the management of a wholly owned Mobil wholesale subsidiary company, as CEO of the Service Stations Association and National President (3 terms) of the Australian Petroleum Agents and Distributors Association (APADA)

Also, I had the privilege of serving on the Government's Trebeck Fuel Tax Inquiry.

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OVERVIEW:

Senators will be aware that this will be about the 44th inquiry into petroleum pricing and other related issues. Such inquiries have been motivated by the now all too familiar consumer concerns of escalating petroleum prices, alleged exploitive and predatory pricing of players within the industry, the effects of dominance of market power, diminishing competition, and, more recently, the introduction of the major supermarkets into petrol retailing, which have captured some 65% of the petrol retail market in Australia.

It is also worthy of note that petroleum industry refining and marketing infrastructures in Australia have significantly declined over the years. We have shrunk from (9) major oil companies down to (4), with one of those four giving the appearance of preparing itself to exit the Australian market. A major Australian refinery (Adelaide) has been mothballed in an environment where there is significant under capacity for refining in Australia. The wholesale market (distributors in regional areas) has shrunk from some (4,500) to around (130) across Australia. Service Stations have declined from around (22,000) to around (6,500).

It is not unreasonable to suggest that most of the foregoing infrastructure reduction was necessary due to changing world economics in petroleum pricing and the globally, relatively small Australian market.

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

A key factor in factually determining the behaviour of players within the industry within Australia in recent times has been the development of independent price information providers – such as Informed Sources and their Motormouth Internet service, Fueltrac – providing wholesale and import parity pricing detail and our own HEH Petroleum Consultancy, which reviews and analyses the data provided. These services have enabled greater transparency within the capital city areas and highlighted the pricing trends and margins of the major petroleum marketers.

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Attached are two of our pricing graphs which highlight recent trends and the increased profit margins being achieved within the industry.

Consumers are now starting to experience the effects of unchecked ever increasing concentration of market power in the petroleum industry in Australia. The major players within the industry have already, in unison, moved to significantly increase their margins at a time when the refiner marketers have been making record profits from their refiner margins caused by high oil prices.

It is our strongly held view, that unless steps are taken by Government to introduce effective monitoring of the industry and change the Trade Practices Laws to protect the consumer and small business from abuse of market power, this committee will assuredly be back here again in a very short time frame, re-examining the issues that have prevailed for the past 45 inquiries and have never been remedied.

THE ISSUES OF IMPORTANCE INFLUENCING PETROLEUM PRICING: With RECOMMENDATIONS:

1: Proactive Price Monitoring:

The objective of any corporation, whether it is large or small, is to maximise its profit for the benefit of its shareholders and that is the way of the commercial world and is the way it should be. The Australian oil refiner marketers, supermarkets, distributors and service station operators and other players within the petroleum industry are no different and certainly share the same profit objective.

Oil refiner marketers throughout the world, including Australia, not unreasonably, are voracious in their pursuit of their profit objectives, maximising returns on their massive capital investment for the benefit of their shareholders.

However, conflict of those interests sometimes occurs when the commodity being traded (like petroleum) provides an intrinsic essential community service. The profit objectives of the corporation can clash with the interests of the community as a whole.

Such conflict of interest in the petroleum industry has regularly occurred throughout the world and has caused governments, in the interests of their communities, to introduce varying legislative mechanisms to protect the essential service provided to their communities. These have included trade practices regulations, price control, price monitoring and various other mechanisms permitting governments to promptly intercede when required, to protect the public interest.

In Australia, we do not have an effective mechanism to promptly intercede where considered necessary, to protect the public interest with domestic petroleum pricing.

The ACCC has a watching Brief; however, under current laws can do little to protect the public interest in this essential public service area of petroleum pricing. It also, has such a diversified portfolio of responsibility making it difficult for it to intimately monitor the essential pricing elements prevailing.

The proposed introduction of a mandated **Oilcode** in March of 2007 will not do anything to address petroleum pricing issues.

This writer has, for a number years, been advocating the need for a **Petroleum Industry Ombudsman** dedicated to the public interest with a particular responsibility to mediate identified conflict of interest with petroleum pricing. Such an appointment would require specific legislation to enable the office to monitor and mediate on pricing issues considered not in the public interest, to be able to issue orders to provide information and show cause and to refer identified areas of conduct in breach of trade practices law to the ACCC for investigation and prosecution as required. The Ombudsman office would also handle all manner of consumer complaints, reconcile industry conflicts, be an adviser to governments on petroleum issues and enable them to refer consumer and public interest queries to the office.

The unassailable fact is, that if such a monitoring initiative is not taken in what is a major essential service industry, this inquiry will have to be re-convened time and time again to attend to consumer anger and disquiet at how petroleum issues are managed by government. We are in a sense, because of recent major changes in the industry, at the crossroads in petroleum industry pricing. The increasing duopoly of the supermarket alliances, the probable exit of one of the major oil companies and diminishing competition, are all pointing to a commercially unhealthy competitive environment. In more dramatic, but not unreasonable terms – the Australian consumer is under threat within the current petroleum pricing environment.

Recommendation:
That a proactive petroleum price monitoring mechanism, (Ombudsman model preferred) with the authority to mediate pricing issues found not to be in the public interest, needs to be established to protect consumer interest

2: Import Parity Pricing (IPP):
Senators will be aware that Australia's petroleum pricing is predicated on an "import parity" model. As an essential element of understanding the machinations of pricing within the Australian market-place that model needs to be clearly understood and we therefore confirm its content hereunder:-

- A (7) Day Rolling Average of median range refined product sales (MOPS) ex Singapore is used as the benchmark.
  Plus
- Shipping costs to Australian ports plus insurance etc
  Plus
- Federal Government Excise of (38.14)cents per litre
  Plus
- A Local cost Indicator of (7.20)cents per litre
  It is from this sector that rebates, discounts and some terminalling costs are usually derived.
  Plus
- Goods and Services Tax (GST) 10%
- **= Import Parity (IPP) Indicator Price.**

It is to the IPP price that reseller margins are added and State Subsidy adjustments are applied, if any.

4: Movements in Terminal Gate Pricing (TGP):

Terminal Gate Pricing (TGP) was introduced by the industry to create transparency and ease of access to pricing data for the wholesale sector of the petroleum industry. Its data, published daily on the internet by the major oil companies, represents the price a particular major oil company would charge for its product/s picked up at the terminal in full tanker lots which would be paid for at time of delivery. It is common industry practice for that price to reflect a price penalty for deliveries made on credit.

Until recently, the TGP was generally set by the major oil companies at a level of around 4-5cpl below the IPP.

However, **as the attached pricing graphs reveal,** the oil company majors, in unison, have recently moved their TGP pricing to around the level of the IPP which has given them a margin increase of around 4-5cpl. This will have the effect of forcing up consumer pricing by the same amount.

In view of the extraordinary profits achieved by the oil majors through their heightened refiner margins resulting from high world oil prices, to make such a significant blatant margin grab at a time when consumers were suffering severe financial stress through record petroleum prices, this conduct must be considered as insensitive to market conditions and a direct indicator of commercial behaviour that was not in the public interest.

Recommendation:

The ACCC be requested to investigate how all of the majors in unison raised their wholesale prices by around the same amount at around the same time, to determine why they found it was necessary to do so and was there collusion?

This is a classic position where a singular proactive industry monitor with appropriate powers would have reacted to protect consumer interest

5: Major Oil Supermarket Alliance Pricing:
The entry of the two major supermarkets into direct petrol retailing in Australia has undoubtedly been a major marketing success as consumers readily embraced the perceived benefit of the discount shopper docket programs. The shopper docket discount programs success has resulted in the two major supermarkets and their respective petroleum alliances capturing around 65% market share of the retail petrol market in Australia. It is anticipated that market share will increase as both supermarkets roll out more sites into the program.

Reference to the attached graphs reveal that the duopoly in petrol retailing is starting to reveal margin trends that are not in the consumer interest. **Of even greater concern, it would not be unreasonable to believe the trends are starting to reflect the increasing strength and power of the developing duopoly.**

In assessing the margins being achieved by the supermarket alliances, reference needs to be made to their assessed margin below the IPP line, which is estimated to be at around 7cpl., with the margins achieved above the IPP line to be added to that figure. At the top of the pricing cycle the trends are indicating total margins have risen to around 17cpl. Prior to the supermarkets entering the market, independent and franchisee marketers were experiencing margins of between 1-7cpl which reflects that the consumer, based on the recent duopoly trends, has not benefited from the introduction of supermarket discount pricing.

The attached graphs also reveal what appears to be an unreasonable delay in implementing price decreases. The delay in implementing price falls may be considered reasonable if price rises were not immediately applied. Such price management does of course provide the oil majors and supermarkets with very significant inventory gain profits.

Recommendation:
The increasing duopoly with the supermarket alliances requires very close proactive monitoring to ensure consumer interest is protected.

6: Cyclical Pricing:

In spite of consumer anger at the "on again - off again nature" of retail cyclical petrol pricing, it appears now to have entrenched itself by the oil majors and their alliances in their pricing programs.
Cyclical pricing is not, as the majors have claimed, caused by competitive necessity, neither is it caused by the IPP pricing model, it is simply a device originally used by major oil to give it greater control over its pricing strategies, with particular emphasis that it helps to disguise the level of margin being achieved.
Also, it has been used in the past, as a predatory mechanism to pressure competitors when retail board pricing has been dropped by the majors and their supermarket alliances below the TGP, the price level at which independents are forced to buy at.

It is however, at the bottom of the cycle, an attraction for consumers to buy at a perceived discount. However, consumer anger is created when the price, over night may rise by as much as 15cpl.

The major issue with cyclical pricing in the Australian environment is the influence of the supermarket alliance duopoly, in that the peaks at both the top and bottom ends of the cycles have become higher. Reference to the attached graphs provide clear evidence of these trends.

Recommendation:
Once again, as previously stated, the consumer would appear to urgently need, for their protection, the appointment of a proactive industry monitor who could analyse pricing trends, identify exploitive and or predatory behaviour and take remedial action.

3: Federal Government Taxation:

It should be noted that the GST component of 10% is applied to the Federal Government Excise amount of 38.14cpl. This has the effect of a "tax on tax" position in the amount of 3.81cpl and is double dipping to the detriment of the consumer. It is also worthy of note that it is also against the government's own public policy regulations not to create "tax on tax" positions.

Recommendation:
The Federal Government in conjunction with the States should move to rectify this anomaly which would immediately create for the consumer a saving of 3.8cpl.

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Temperature Correction:

Prior to the introduction of temperature correction laws in each State via the COAG facility, Service Station operators and distributors were obliged to absorb the significant losses incurred through the major oil companies not temperature correcting their petroleum sales. **However, in spite of each State introducing laws that obliged the major oil companies to provide temperature correction for sales ex their terminals, two of the majors have deliberately not complied with the intent of the law, thus incurring additional cost for consumers, subject to geographic location, of around 2cpl.** One company temperature corrects at time of delivery to comply with the law and then applies a temperature correction charge post delivery. The second major oil company not complying with the intent of the law offers the option of - a temperature corrected delivery at an additional price, or a non temperature corrected delivery at a lesser price.

This is a classic example of the voracious efforts of some of the majors to enhance their profits at the expense of the consumer.

Recommendation:
The government should be urged, in the interests of consumer protection, to correct the loophole and ensure that all refiner marketers, unambiguously, abide by the intent of the temperature correction laws.

CONCLUSION:

It is pertinent to note that the reasons causing the creation of this Inquiry – public anger and disquiet relating to petrol pricing, the community fear of petroleum price exploitation, the influence of petroleum prices on the economy and a general mistrust of the mechanisms in the pricing processes, will all continue to prevail unless an effective proactive petroleum price monitoring system is established. In reality, the outcomes of this Inquiry will be a test of the integrity of the government's resolve to implement a lasting and effective mechanism that will give the Australian community confidence in our petroleum pricing processes.

I thank Senators for the opportunity to present these independent views on important issues relative to petroleum pricing in Australia.

Attachments:-

- **Graph – ULP Petrol Prices – 1/2/06 to 19/7/2006**
- **Graph – ULP Petrol Prices – 1/8/06 to 26/9/2006**
- **Graph – Diesel Prices - 1/8/06 to 26/9/2006**

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