

Chapter 2

The Bill and the Reform Package

The Bill

2.1 This is a simple Bill, which will, if passed, repeal two Acts:

- The *Petroleum Retail Marketing Sites Act 1980* (the Sites Act); and
- The *Petroleum Retail Marketing Franchise Act 1980* (the Franchise Act).

2.2 The Bill also makes a consequential amendment to the *Jurisdiction of Courts (Cross-vesting) Act 1987*, a matter which was not raised during this inquiry.

The reform package

2.3 The Bill is a central component of the Government's 'Downstream Petroleum Reform Package' (the reform package). The Government has indicated that as part of this reform package, it will also introduce a mandatory industry code, to be known as the Oilcode.

2.4 While not referred to the Committee, the Oilcode is regarded by all affected organisations and acknowledged by the Government to be an integral part of the reform package, and the Committee has therefore had regard to it in its inquiry.

2.5 As part of the process of introducing the reform package, the Government has also made regulations to omit regulation 3 of the Petroleum Retail Marketing Sites Regulations 1981. The effect of this amendment is to suspend the reporting and compliance obligations that currently apply to the major oil companies under the Sites Act. This Act is therefore effectively inoperative, unless the regulations are subsequently withdrawn or disallowed. Officers of the Department of Industry, Tourism and Resources explained that this was necessary because a number of franchises would come up for renewal during the period of consideration of this legislation, and the sites would necessarily be operated temporarily by the oil companies until the Parliament had voted on the Bill. Officers considered that the oil companies would technically be in breach of the legislation during this period, hence the requirement to suspend the reporting and compliance provisions. The suspension was not intended to preempt the Parliament's decision on the Bill. Officers explained the need to suspend the Sites Act in the following terms:

Market uncertainty would be created because a number of oil major franchise agreements are coming to the end of their nine-year tenure cycle under the franchise act and the oil majors must make a decision about the future of each individual retail site. Under the current legislative framework, the oil majors may temporarily operate a retail site for a period of up to eight months while they determine the best business structure for that site. However, while the repeal Bill is under consideration by the parliament, the

oil majors may not be able to meet the sites act requirement of temporarily operating a site in good faith.

To explain that, under the sites act, to temporarily operate a site, the franchisor must have a good faith intention to either dispose of or franchise a site at the end of the temporary operation period. The introduction of the reform package into parliament would diminish the ability of the oil majors to meet this intent while the passage of the package was uncertain, as they may choose to alter the business structure of individual fuel retail sites should the repeal Bill be passed by the parliament. This uncertainty may force the oil majors to re-enter nine-year franchise agreements, close retail sites or enter into arrangements with third parties, despite a different business structure being more appropriate. So the government considered that the oil majors would not be able to meet the good faith requirements of the current sites act while the whole reform package was being debated by parliament.¹

Previous reform proposals

2.6 The Government's policy since its election in 1996 has been to deregulate petroleum retailing, including repeal of the Sites Act and the Franchise Act following an independent review. To date, moves to repeal these Acts have always failed to proceed because of difficulties in obtaining industry consensus on the proposed reforms.

2.7 This is the Government's second attempt to repeal these Acts, the first being in 1998, when a repeal bill similar to that considered by the Committee was introduced following a review by the Australian Competition and Consumer Commission (ACC). Like the current reform proposal, the 1998 proposal also included a mandatory Oilcode.

2.8 The Rural and Regional Affairs and Transport Committee considered the Government's 1998 proposal to repeal the Acts. The Committee was of the view that bill should be passed subject to amendments:

- the completion and tabling of the Oilcode in the Parliament as a regulation pursuant to Part IVB of the *Trade Practices Act 1974*; and
- establishment of an appropriate dispute-settling mechanism to arbitrate disputes with regard to access according to the franchise agreement.

2.9 There were two minority reports - one from the Australian Democrats and one from the ALP. Neither supported the repeal Bill. The ALP predicated support of the repeal bill on the drafting of an Oilcode that is agreed by all parties.

2.10 The Government did not proceed with the 1998 bill because the affected parties could not agree on the Oilcode proposal.

1 Senate Economics Legislation Committee, *Proof Committee Hansard*, 8 May 2006, p. 2.

2.11 Two previous reports by government agencies have recommended the repeal of these Acts. These were a 1994 report of the Industry Commission (now the Productivity Commission), and a 1996 report of the ACCC, *Inquiry into Petroleum Products Declaration*.

Proposed Oilcode package

2.12 The proposed Oilcode is to be a mandatory industry code under Section 51AE of the *Trade Practices Act 1974* (the TPA). This Oilcode will be in the form of yet-to-be gazetted regulations which are to operate under the Trade Practices Act. The regulations currently exist in draft form as the Trade Practices (Industry Codes – Oilcode) Regulations 2006, and are published on the Department of Industry Tourism and Resources Website at:

<http://www.industry.gov.au/assets/documents/itrinternet/Circulationdraft26July0520050802154047.pdf>

2.13 The Committee was told that, although published as a 'draft', the Oilcode in its current form represents a final document which has been agreed between Government and members of the industry.

2.14 As a mandatory code, the Oilcode is binding on all industry participants. The ACCC provided the Committee with a useful summation of the process:

Section 51AD provides that a corporation must not, in trade or commerce, contravene an applicable industry code. Sub-section (2) of 51AD defines an applicable industry code. In brief, an applicable industry code is one that is declared by regulations under section 51AE, such as the proposed Oilcode. Hence, a breach of the prescribed mandatory industry code constitutes a breach of the Act.²

2.15 This code is intended to regulate the conduct of suppliers, distributors and retailers in the petroleum marketing industry. The Explanatory Memorandum (EM) for the Bill notes that the Oilcode will:

- establish minimum standards for petrol re-selling agreements between retailers and their suppliers to provide a baseline for negotiations, including strengthening of provisions (similar to those in the Franchise Act and the Franchising Code of Conduct) dealing with pre-disclosure, variation, agreed early surrender and expiry procedures to provide greater certainty and protection for parties;
- introduce a nationally consistent approach to terminal gate pricing (TGP) arrangements to improve transparency in wholesale pricing and allow access for all customers, including small businesses, to petroleum products at TGP, whilst not negating the ability of entities to negotiate individual supply agreements nor preventing the offering of discounts; and

2 ACCC, *submission* 9, p. 2.

- establish an independent downstream petroleum dispute resolution scheme and appoint a Dispute Resolution Adviser, to provide the industry with an ongoing cost-effective dispute resolution mechanism.³

The Sites Act

2.16 The Sites Act, which was introduced in 1980, limits the number of retail sites that the refiner/marketers (or oil majors – currently BP, Caltex, Mobil and Shell) may operate directly or on a commissioned agent basis. The Act applies only to these companies, not to others who have no refining operations in this country. Thus, while the supermarket chains now account for about 50 per cent of fuel sales in metropolitan areas, their activities do not fall under the scope of the Act.

2.17 As the EM for the Bill notes, this Act was introduced to limit the price setting activities of the vertically integrated refiner/marketers, by forcing them to use franchise arrangements at the majority of their sites to sell their product. The legislation also encouraged small business to enter the petroleum retailing sector, to enhance competition.

2.18 The Act contains regulation making powers to nominate the prescribed agencies to which the Act applies (ie: the refiner/marketers) and set a quota of sites that each of the companies may operate directly. Each quota is based on refining capacity in Australia. The quotas are restrictive and of the 6000 plus petrol stations currently operating, the companies were, until the compliance requirements were suspended, only permitted to directly operate a total of 424 sites. Individual companies' site quotas range from 87 to 136.⁴

The Franchise Act

2.19 The Franchise Act seeks to secure the rights of franchisees, setting out minimum terms and conditions for franchise agreements in the petroleum retailing industry. The Act describes in considerable detail the rights and obligations of the franchisor and franchisee. Provisions go to such matters as the nature of the obligations that may be imposed by the franchisor, supply of fuel, duration and renewal of franchises, and price discrimination in sales of motor fuel. This is not an exhaustive list of provisions.

Case for reform

2.20 The Government considers that the inequitable application of and inefficiencies created by the current legislation constitute a regulatory failure,⁵ and that the major structural changes that have taken place in the petroleum retail industry

3 Explanatory Memorandum (EM), p. 3.

4 Petroleum Retail Marketing Sites Regulations 1981, as amended, Schedule 1.

5 EM, p. 3.

have overtaken the Sites Act and the Franchise Act, creating a 'sub competitive retail environment, which imposes higher costs on Australian industry and motorists'.⁶

2.21 The Government considers that the existing legislation imposes additional costs on the refiner/marketers, and prevents them from responding effectively to changing market forces. These additional costs are ultimately passed on to consumers.

2.22 In the second reading speech, the Minister pointed out that the legislated terms and conditions in these Acts only apply to franchise arrangements, and offer no protection to small businesses operating under oil company, supermarket or independent retail chain commissioned agency retail arrangements.

2.23 The legislation, and in particular its objectives of encouraging small business participation, has also been legally circumvented through the adoption of multi-site franchising, an arrangement under which a single operator or company with a franchise agreement controls the operation of a number of sites. The number of sites range from two to several hundred. The EM describes multi-site franchising as 'an innovative response to the marketing inefficiencies that the Acts placed on their [the refiner/marketers] business structures. The EM notes that the most notable example of this was the 2003 divestiture of the Shell retail network to Coles Myer under a multi site franchise agreement covering 580 sites.'⁷

2.24 However, the most significant factor driving repeal of the Acts is structural change. The most significant structural change in the petroleum retailing industry has been the entry into the market of the supermarkets and large retail chains, and the Minister stated that the existing legislation needs to be seen in the context of this change. He pointed out that the business structures of these groups are not constrained by the legislation:

The legislation serves only to place an additional compliance burden on the major oil companies and to hinder the oil majors' freedom of choice in the selection of appropriate business models at all retail sites. The legislation also retains the disparity between the conditions provided to franchisees, who generally run oil major-owned service stations, and those provided to commission agents, who tend to run service stations on behalf of the independent retail chains.⁸

2.25 The Government recognises the power imbalances that exist between petrol retailers and their wholesale suppliers. The Government considers that the introduction of the mandatory Oilcode will ensure that small business operators will retain a competitive role in the industry. This option is considered to deliver greater

6 Second reading speech.

7 EM, p. 10.

8 Second reading speech.

economic benefits to the community than an alternative option considered by the Government, to simply abolish the Acts.⁹

2.26 The Explanatory Memorandum summed up the benefits and costs of the proposed reform package for stakeholders in the following table:¹⁰

Benefits to Refiner/Marketers	Costs to Refiner/Marketers
<ul style="list-style-type: none"> Fully flexible operating structures allow immediate response to changes in the market structure Save approximately \$200,000 per annum that was associated with compliance reporting under Sites Act 	<ul style="list-style-type: none"> Mechanisms in place to provide greater transparency in TGP Commission agents are required to have 5 years tenure and set minimum contractual requirements
Benefits to Importer/Marketers & Supermarkets	Costs to Importer/Marketers & Supermarkets
<ul style="list-style-type: none"> Fully flexible operating structures allow immediate response to changes in the market structure 	<ul style="list-style-type: none"> Requirement to comply with TGP arrangements for fuel wholesale suppliers Requirement to apply set minimum standards to fuel reselling agreements Potential for greater competition from refiner/marketers
Benefits to Franchisees	Costs to Franchisees
<ul style="list-style-type: none"> Fuel re-selling arrangements extend the minimum contractual requirements set by the Franchise Act and Franchising Code of Conduct and maintain nine years tenure. Would retain access to a low cost alternative dispute resolution service 	<ul style="list-style-type: none"> Requirement to seek legal and financial advice prior to entering into a fuel re-selling agreement (may be waived) Use of multi-site franchising has minimised the entry of small businesses into the industry through franchise agreements

9 EM, para 5.3.8, p. 28.

10 Reproduced from EM, pp 29-30.

Benefits to Commission Agents	Costs to Commission Agents
<ul style="list-style-type: none"> • Fuel re-selling arrangements would apply to operations where there is an up-front investment greater than \$20,000 by the agent. • Fuel re-selling arrangements would extend the minimum contractual requirements set by the Franchise Act and Franchising Code of Conduct and provide 5 year tenure. • Would receive access to a low cost alternative dispute resolution service 	<ul style="list-style-type: none"> • Requirement to seek legal and financial advice prior to entering into a fuel re-selling agreement (may be waived)
Benefits to Small Independent Operators	Costs to Small Independent Operators
<ul style="list-style-type: none"> • Would receive access to a low cost alternative dispute resolution service • Would have certainty of TGP during fuel purchases increasing ability to receive best price 	<ul style="list-style-type: none"> • Nil
Benefits to Government	Costs to Government
<ul style="list-style-type: none"> • Save approximately \$100,000 per annum in monitoring compliance with the Sites Act 	<ul style="list-style-type: none"> • Establishment and ongoing administration of the Dispute Resolution Service (DITR) • Undertake education and awareness campaign in relation to Oilcode (DITR and ACCC) • Monitor and enforce compliance with the Oilcode (ACCC)
Benefits to Consumers	Costs to Consumers
<ul style="list-style-type: none"> • Increased flexibility in the structure of refiner/marketer networks should decrease inefficiencies and associated overheads that may have been passed onto consumers. 	<ul style="list-style-type: none"> • Ongoing rationalisation may reduce the number of retail sites.

