Chapter 3

Issues

Overview

3.1 This Bill and the associated Oilcode have proved contentious because two of the main affected groups, the refiner/marketers and the petrol retailers (and in particular, franchisees and branded independents) have competing interests that can be difficult to reconcile.

3.2 For its part, the Australian Institute of Petroleum (AIP), which represents the refiner/marketers, considers that they are unreasonably restrained by the existing legislation and strongly support the Bill. They argue that they are unable to compete on an equal basis with their principal emerging competitors, the supermarket chains and other independents, who are not subject to the Sites or Franchise Act and who therefore operate with lower cost structures.

3.3 The refiner/marketers see the constraints placed on them by the current legislation as inequitable, inefficient and no longer appropriate for an industry that has undergone significant structural change over the last two decades, and particularly in the last five years. They see competition with the supermarkets, who achieve growing sales through the use of shopper dockets, as a major threat to their viability. They have lost market share to this group, and almost 50 per cent of fuel in metropolitan areas[1] is now sold through supermarkets.

3.4 The refiner/marketers link their future viability to their ability to compete on more equal terms. Several noted that the presence of Sites and Franchise Acts adds to the perception of sovereign risk associated with investing in Australia, and affects their ability to attract investment.[2] BP Australia (BP) also advised that the parent company does not refine in countries where it has no retail presence, raising questions about that company's future presence as a refiner, should it be unable to establish what it considers to be a viable retail network.

3.5 The AIP and refiner/marketers appear to accept the introduction of an Oilcode somewhat reluctantly, advising that this was an area of significant compromise for them in the reform package negotiations. Nonetheless, they support the Oilcode as part of the reform package.

3.6 The owners and operators of some service stations, including franchisees and branded independents (who sell fuel under the brand of one of the refiner/marketers

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1 AIP, *Submission 5*, p. 4.

2 See for example AIP evidence, *Proof Committee Hansard*, p. 2.

but own or lease their own sites and set their own prices) fear the market power that they consider repeal of the Acts will give to the refiner/marketers. This group was largely represented during the inquiry by the Service Station Association (SSA) and the Motor Trades Association of Australia (MTAA). They acknowledge the shortcomings of the legislation as it stands, but do not support its removal at the present time, because they do not consider that the proposed Oilcode, or the Trade Practices Act in its current form, provide sufficient protections for industry participants in relation to matters such as tenure, guaranteed access to fuel supplies, predatory pricing or dispute resolution. They assert that the reform package will reduce competition.

Structural change in the petroleum retailing industry

3.7 The last thirty years has seen enormous structural change and rationalisation in the petroleum retailing industry. In 1980, there were approximately 20 000 petrol stations operating.[3] These were run predominantly by nine vertically integrated refiner marketing companies. By 2000, the number of service stations had declined to 8177, [4] and the number of refiner marketers to 4. The number of stations continues to decline, and in 2004 had fallen to 6649.[5] A number of different management structures, including franchising, have been adopted in the industry in response to competitive pressures and regulatory requirements. The diversity of the industry is well illustrated in the EM.[6]

3.8 The late 1980s and 1990s saw the entry of a number of independent operators. A surplus of fuel supplies in the Asia Pacific region allowed this group to increase their market share by importing independently. This group was not subject to the Sites and Franchise Acts, as they predominantly used commissioned agent arrangements to sell their fuel. This group of independent operators (Liberty, Gull, Matilda etc) has a significant presence in the fuel market and is estimated to operate approximately 700 sites.[7] The capacity of these independents to source fuel from overseas has been diminished in the last three years because of a drying-up of excess capacity due to rising demand in China and India; and because of the introduction of more stringent fuel quality standards in Australia. As a result, the independents no longer have the capacity, which they enjoyed a decade ago, of leading discounting in the national markets by purchasing surplus fuel on the spot market for lower prices than were available to branded retailers under their long-term supply contracts. Notwithstanding that loss of competitive advantage the independents are nevertheless generally acknowledged as still having lower operating costs than the refiner/marketers and franchises.

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3 BP, *Submission 2*, p. 3.

4 AIP, *Submission 5*, p. 6.

5 AIP, *Submission 5*, p. 6.

6 See EM p. 6 for pie chart representation of market share.

7 From EM, p. 6.

3.9 Woolworths entered the fuels market in 1996, establishing a network of 300 sites. The shopper docket loyalty scheme proved to be an effective marketing tool and the EM estimates that the company now holds approximately 450 sites. Again, Woolworths outlets are not subject to the Sites or Franchise Acts. Coles Myer also entered the market in 2003, establishing a franchise arrangement with Shell covering 580 sites.

3.10 The refiner/marketers now control about 5 per cent of the sites currently operating in Australia. They maintain that the extra regulatory requirements that are imposed on them impose higher costs, prevent the development of viable networks and generally act to decrease their ability to compete. They therefore strongly support the reform package.

The AIP and refiner/marketers' perspective

3.11 Representatives of the refiner/marketers told the Committee that the restrictions of the Sites and Franchise Acts had reduced their competitiveness, adding significant administrative burdens and complexity. For example, Mr Bergeron of Mobil said:

> Mobil's ability to respond effectively and in a timely manner to the rapid changes in the retail fuels market has been limited by the constraints placed on us under the Sites and Franchise Acts. As a result, we have been less competitive in this market than we could have been and wish to be. Repeal of these Acts will remove a significant additional administrative burden and level of complexity and cost from Mobil's operations.
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> …Implementation of the Government's downstream petroleum reform package, including repeal of the Sites and Franchises Acts, is crucial to Mobil's ability to be fully competitive in the Australian market.[8]

3.12 The President of BP Australia, Mr Hueston, made a similar point:

> Reform is important to us largely because we do not have the freedom to operate the sites as efficiently as we can and thus to compete as best we can. This has become increasingly important over the last few years, as the supermarkets have entered the game but not with the same rules that apply to us. We have lost market share. They have as much right as anyone to be in the marketplace, but it is not a level playing field in terms of our ability to compete.[9]

3.13 The AIP and the refiner/marketers see the repeal of the Sites and Franchise Acts as necessary to remove barriers to competition and distortions in the market, a need they say is particularly acute in view of the profound alteration to the market structure as a result of the entry of the supermarkets. They argue that removal of the

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8 *Proof Committee Hansard*, 19 April 2006, p. 24.

9 *Proof Committee Hansard*, 19 April 2006, p. 33.

Acts will reduce service station costs and encourage retailers to adopt a broader business base and business activities. They maintain that the reform package, if implemented, would bring benefits to consumers and the industry by encouraging business efficiency in allowing the four refiner/marketers to choose the business models which best suit their customers.

3.14 Dr Tilley of the AIP explained that the removal of the restrictions on direct operations would allow the refiner/marketers to expand their networks to a more viable size, allowing economies of sale to be achieved:

> …if one of the majors currently has a limit of around 100 sites, it is probable, as we understand it, that a more viable network size would be 200 to 250 sites. That provides the basis for a totally different business model to be developed with economies of scale right through the chain of steps from getting the fuel from the refinery to the retail outlets, and it allows that network to develop a much more significant range of customer services such as convenience store operations or other activities that consumers are turning to service stations for….presumably it would give them access to a discounted terminal gate price.[10]

3.15 The Committee received evidence from several contributors who argued that the continued existence of the Sites and Franchise Acts casts doubt on the viability of Australia as an investment destination because of perceptions of sovereign risk. BP for example highlighted the difficulty it experiences in persuading its head office in the UK to invest in Australia, and how this is important for Australia's energy security:

> It also adds to the perception of Australia containing sovereign risk. If we are not allowed to operate the sites we own then that discourages investment. It is not a show stopper, as we have proven in the past. But, when the money is dished out internationally, sometimes we are at the back end of the queue.[11]
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> …
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> …energy security is becoming a major global issue. The infrastructure that is required to make sure that Australia keeps the market supplied is very important and requires continuous investment, whether it is in refineries or import terminals. It is increasingly hard for us to put up our hands for money as part of a global organisation and say that, because we own the infrastructure, we are not allowed to operate in the marketplace in the same way as other competitors but we still want the money to invest in that infrastructure…[12]

10 *Proof Committee Hansard*, 19 April 2006, p. 5.

11 *Proof Committee Hansard*, 19 April 2006, p. 34. (Mr Hueston)

12 *Proof Committee Hansard*, 19 April 2006, p. 35. (Mr Hueston)

3.16 BP submitted that if the proposed reforms do not proceed, then the future viability of the company's presence in Australia may be threatened. This could also lead to the closure of its two refineries, giving rise to energy security questions:

> In the longer term BP's viability in Australia would be under threat and we believe this would not help the country's security of supply. If reform does not proceed it is likely to lead to further market share gains for the two supermarkets. This would place further pressure on the long term viability of the other oil competitors (particularly for BP and Mobil who are not aligned with the major supermarkets). If BP exited the domestic retail fuel market it would raise a question mark over our Perth and Brisbane refineries - BP does not operate refineries that are not in service of its retail customers and businesses.[13]

3.17 BP also indicated that its ability to develop and market alternative fuels could also be constrained if the reform proposal fails.

3.18 Evidence given by Dr Tilley of the AIP encapsulated the position of the refiner marketers in relation to the reform proposal. He concluded that the Sites and Franchise Acts are both obsolete and anticompetitive:

> At a time when infrastructure is a major national issue, the Sites and Franchise Acts actively discriminate against the oil majors who are the main investors in petroleum infrastructure. The existence of these Acts continues to cast doubts over Australia as an investment destination by posing questions of sovereign risk. The downstream petroleum sector is undergoing rapid change at every level. Fundamental change has occurred through rationalisation of refineries and distributors and the expansion of major new competitors not bound by the Sites Act. Change in fuel retailing is being driven by major shifts by service stations to convenience retailing, that is, fast foods, groceries, et cetera. Innovation in retail business models is also happening as part of competitive responses to the entry of the supermarket alliances into the marketplace. General arm's-length access to wholesale fuel supplies and price transparency has substantially reduced the level of influence of the oil majors in the fuel retail market. Taken together, we see these changes making the Sites and Franchise Acts obsolete and anticompetitive.[14]

Concerns about the reform proposal

3.19 While the Government, the AIP, the refiner/marketers and other groups such as the Australian Automobile Association are convinced of the need to reform the Australian petroleum retail market, several other parts of the industry oppose the reform proposal in its current form. The Motor Trades Association of Australia (MTAA) and the Service Station Association (SSA) appear to hold the most severe

13 BP, *Submission 2*, p. 7.

14 *Proof Committee Hansard*, 19 April 2006, p. 2.

reservations. They assert that the proposed Oilcode will not improve competition in the industry. They also argue that the provisions of the Oilcode are inadequate, and that the Trade Practices Act requires amendment to address the issue of predatory pricing.

3.20 The MTAA and the SSA acknowledge the very significant structural change that has taken place in the industry and accept the need to 'update the regulation governing the sector'.[15] Accordingly, the MTAA has been a willing participant in discussions with the Minister, the Department and other stakeholders. The Association does not, however, support the proposed reform package, maintaining that passage of the Bill and the associated reforms 'will result ultimately in an erosion of the rights of our service station operator members and will not deliver a more competitive, transparent and efficient retail petroleum sector'.

3.21 The MTAA's concerns focus on five key areas:

- tenure;
- transparency of terminal gate pricing arrangements;
- access to supply;
- adequacy of dispute resolution procedures; and
- predatory pricing and the Trade Practices Act.

Tenure

3.22 Section 32 of the Oilcode regulations deals with the duration of fuel re-selling agreements, or tenure. The regulation specifies that agreements entered into before the Oilcode commences are to remain in place for the duration specified. The section has similarities with the Franchise Act in that it provides for agreements of up to 9 years duration (5 + 4) but also applies to commissioned agent arrangements, an expansion of coverage.

3.23 Departmental representatives advised the Committee that this provision had been included in recognition of the power imbalance that is recognised to exist in the industry:

> However, given the imbalance between the market share held by the wholesale fuel suppliers and that held by many retailers in the industry, if there are no minimum standards for the wide range of contractual arrangements, small businesses operating under franchise type and commission agency type arrangements will be vulnerable to the market power of fuel suppliers during negotiations, particularly in relation to tenure; hence, the government's commitment to introducing an oil code.[16]

15 MTAA, *Submission 4,* p. 1.

16 *Proof Committee Hansard*, 8 May 2006, p. 3.

3.24 While welcoming the expanded coverage, the MTAA told the Committee that tenure remains a major concern to it and service station operators. The source of this concern is proposed section 32(11)(c), under which a supplier may offer a retailer an agreement of less than the specified period if the total initial non-refundable amount that must be paid by the retailer to the supplier is less than $20 000. The regulation reads as follows:

> …the total initial non-refundable amount that any prospective retailer must pay, or agree to pay, to the supplier and any associates of the supplier, before commencing operations under a new or renewed fuel re-selling agreement, would be less than $20,000, excluding any of the following amounts:
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> (i) payment for motor fuel at or below the usual wholesale price;
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> (ii) payment of the usual wholesale price of motor fuel taken on consignment;
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> (iii) payment at market value for the purchase or lease of real property, fixtures, equipment, services or supplies that are needed to operate under the fuel reselling agreement;
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> (iv) security deposits for fuel stocks, real property, fixtures, equipment, services or supplies provided by the supplier.

3.25 The MTAA expressed concern that most agreements could easily be re-structured to take advantage of this exception, and those agreements would therefore not be subject to the minimum tenure provisions of the Oilcode. The MTAA submitted that it could not support a provision that could be easily circumvented.[17]

3.26 Evidence received from Associate Professor Frank Zumbo, a former member of the Franchising Policy Council, indicated that it was possible that franchise agreements could be structured to take advantage of the $20 000 threshold:

> We saw parallels in the franchising code. I was a member of the Franchising Policy Council for a couple of years and we saw examples of franchise agreements under that code being structured to avoid the definition of a franchise under that code. I can see how a franchise agreement could be structured in a way to take advantage of this exception.
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> …
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> There is a concern with any of these codes that any loose language or exception will be latched upon by those who do not want to be covered or who seek to avoid it. Often in franchising it is not the good franchisors that you need to worry about. They will do these things anyway. It is those so-

17 MTAA, *Submission* 4, p. 2.

> called bad franchisors who want to avoid the regulations that you have a problem with.[18]

3.27 There is clearly a degree of mistrust of the refiner/marketer companies on the part of the service station operators. In relation to the $20 000 threshold, the MTAA representative at the public hearing told the Committee:

> We have asked for that to be removed, obviously, because we have a history in this industry of the oil companies finding some way to circumvent legislation. The reality is that the oil companies give themselves up regularly on the basis of saying, 'Those Acts are not relevant anymore because everyone has found a way around them.' That just says to me that I would have to watch them on everything else that they might do in the future because, if there is a way, they will find a way.[19]

3.28 This issue was addressed by the AIP and some representatives of the refiner/marketers. The AIP advised the Committee that the recollection of the AIP member companies was that the $20 000 provision was proposed by a major independent chain. They considered that the intent of the minimum was to ensure that the business relationship was more substantial than a supply contract.

3.29 Two of the companies also addressed the issue on a confidential basis, one advising that none of the values of its franchises fell below $20 000, and another that provided the Committee with an assurance that the $20 000 provision would not be used to circumvent the Oilcode.

3.30 Caltex representatives also drew the Committee's attention to the new Star franchise agreements that they are putting in place, which provide for total tenure of 10 years, exceeding the Oilcode requirements. Caltex indicated that while it may change the mix of its business, it intended to persist with franchising:

> We believe that the new Star franchise is the way we want to grow our business. … We will still look at opportunities to company operate more stores, fewer stores or stores at different locations. But I suppose the predominant part of our business will still be under the franchise.[20]

3.31 The Committee pursued this matter with the ACCC. The ACCC pointed out that:

> While there is no specific general exemption from the Oilcode for investments of less than $20,000, Subsection 6(3) and 6(4) of the Oilcode state that the Oilcode does not apply to a fuel reselling agreements for which:

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18 *Proof Committee Hansard*, 19 April 2006, p. 68.

19 *Proof Committee Hansard*, 19 April 2006, p. 14.

20 *Proof Committee Hansard*, 19 April 2006, p. 46.

- the supplier reasonably believes that the amount of motor fuel that will be sold by retail at the site will be less than an average of 30 000 litres for each month of the term of the agreement; and

- at least 3 days before entering the agreement, the supplier gives to the prospective retailer a written statement setting out the grounds for the belief.

3.32 The ACCC considers that Regulation 32(11)(c) is unlikely to have a significant impact on the tenure of renewed agreements:

> This view is based on the fact that the Oilcode provides 3 types of fuel re-selling agreements where tenure is provided. For 'franchise-type' agreements, wholesale suppliers are required to offer tenure of nine years, for commission agent type agreements where the retailer has made an initial upfront investment of more than $20,000 the tenure period is a minimum of 5 years. For other commission agent type agreements, for payments of less than $20,000 there is no tenure specified although the minimum notice period for termination is 30 days (s37 (2)(a)) and the wholesale supplier is required to offer to buy back fuel and merchandise.[21]

3.33 The ACCC advised that it is important to note that the under 30,000 litres per month category of retailers under section 11 of the Oilcode will receive the protections offered under Part 2 of the Oilcode, which imposes obligations on suppliers with respect to their supply of petroleum without reference to fuel reselling agreements. Retailers also have access to the dispute resolution procedures.[22]

3.34 The Committee suggests that the Government revisit the question of whether the $20 000 provision in Section 32 of the Oilcode regulations is a non-negotiable element of the regulations. Indications received from the refiner/marketers indicated that it did not appear to be significant to them. If it proved possible to omit it, this may go some way towards allaying concerns about tenure.

Terminal gate pricing

3.35 All of the refiner marketers now post terminal gate prices (TGP) for wholesale fuel on their internet sites. The Oilcode will also require them to continue to do this in relation to declared products.

3.36 With the exception of BP, which told the Committee that it sells 70 per cent of its product at TGP, the other refiner/marketers rarely sell fuel at the TGP. Most provide discounts to large volume customers and those with term supply contracts, and in some stages of the retail market cycle, also provide rebates known as price support. The Oilcode specifically permits discounting, resulting in some purchasers of

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21 ACCC, response to questions taken on notice, 9 May 2006.

22 ACCC, response to questions taken on notice, 9 May 2006.

wholesale fuel buying at a price that is not transparent to their competitors. The extent of discounts is a private matter between the parties to the supply contract, which in the ordinary course of commerce would not ordinarily be disclosed, although the ACCC can require disclosure to it of such information on a confidential basis as part of an investigation. As well, such information would be the subject of disclosure, subject to appropriate court orders to protect commercial sensitivity in litigation in which this was a relevant issue.

3.37 The MTAA submitted that nationally consistent and transparent terminal gate pricing arrangements are an essential component of a competitive retail petroleum sector. The Association considers that a transparent TGP reduces the ability of market participants to engage in anti-competitive behaviour. The MTAA is critical of the TGP provisions in the Oilcode, arguing that:

> …any arrangement which allows for discounts at the terminal gate is hardly transparent, is little different from the opaque wholesale pricing arrangements which are currently in place in the sector, and is therefore unlikely to improve the level of transparency or competition in the sector.

3.38 The MTAA concluded that the introduction of the terminal gate pricing provisions of the Oilcode are unlikely to increase the transparency of wholesale pricing in the retail petroleum sector.[23]

3.39 It is clear that bulk fuel discounting to high volume retailers is a cause of great concern among smaller branded independents, which are unable to secure the same bulk volume discounts, particularly when competitors such as Woolworths list retail prices that are lower than their wholesale price. Evidence given by the Victorian Automobile Chamber of Commerce illustrates the perceived problem:

> I had a phone call yesterday from a member. His purchase price was $1.25 or 125c. I think it was about 126.5c by the time the delivery charge was added in. The board price down the road was $1.22, less the 4c discount, which made it $1.18. He said, 'I just can't go on any longer; I have to get out of this industry.' I am now getting calls like that on a regular basis.[24]

3.40 Mr Bortolotto, who operates a Shell outlet in Victoria and who gave evidence on behalf of the VACC expressed the same frustration:

> We just want fair competition. It was mentioned earlier that a contract will be given to someone who buys three billion litres. I cannot buy three billion litres. I can buy maybe three million litres, but I cannot buy it at the best price that should be available to me, as is available to the Coles Myers, the Safeways and all the rest of the big players in the game. The terminal gate price should be a true price of the product—the price for all of us. Why are

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23 MTAA, *Submission 4*, p. 3.

24 *Proof Committee Hansard*, 19 April 2006, p. 60.

> they discounting it to them? Why am I disadvantaged by the volume I can buy and by the volume a lot of other people out there can buy?[25]

3.41 The AIP expressed opposition to any moves to further regulate TGP, arguing that it would be anti-competitive:

> The suggestions that have been made by some opponents to market reform that there should be a fixed and regulated terminal gate price below which there can be no discounting or anything else has been actively debated and discussed during the consultation process. Certainly in our view, and in the view of many others, it would be quite anticompetitive to regulate terminal gate prices and not permit discounting or other business activities that provide some sort of offset below terminal gate prices. I think you will find that in most Australian business sectors companies and operators who are very large purchasers of goods and services are usually able to negotiate some sort of discount for volume services.[26]

3.42 Mr Beattie of Caltex explained the discounting on bulk purchases from the refiner/marketer's perspective:

> …while the terminal gate price is for that single tanker load, 35,000 litres, if you want to buy 3 billion litres from us, we are going to give you a better price. …Of course, if you are taking the higher volumes, it is not unreasonable that you will get the better price. It certainly allows us to be sure that what we produce in the refineries has a definite place in the market.[27]

3.43 The Committee notes that the MTAA took this matter up with the Minister, the Hon. Ian Macfarlane MP. The Minister made the Government's position clear, stating that banning discounting at the terminal gate would affect petrol prices:

> Such a ban would seriously restrict the competitiveness of larger retailers, which rely on economies of scale, both in purchasing and selling to deliver cheap petrol. A ban on discounts would inevitably raise wholesale and retail petrol prices.[28]

3.44 Such a decision would also be inconsistent with the Government's competition policy objectives.[29]

3.45 The Committee understands the difficulties faced by small operators in this increasingly competitive industry. It is difficult for many of them to purchase

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25 *Proof Committee Hansard*, 19 April 2006, p. 57.

26 *Proof Committee Hansard*, 19 April 2006, pp 4-5.

27 *Proof Committee Hansard*, 19 April 2006, p. 53.

28 Correspondence from the Minister for Industry, Tourism and Resources to MTAA, 11 March 2005. Included in the MTAA submission.

29 EM, p. 31.

wholesale fuel in sufficient volumes to obtain a discount comparable to that that is likely to be available to their large competitors. However, it is inescapable that discounting for large volume sales is a normal aspect of arrangements in most fields of commerce. As such, it does not indicate anti-competitive behaviour.

Access to supply

3.46 Division 3, section 11 of the proposed Oilcode specifies that a wholesaler of a declared petroleum product must not unreasonably withhold supply to a customer. The exceptions to this requirement are if the wholesaler does not have sufficient supplies available to meet the customer's requirements; if there is doubt about the customer's ability to pay; or if the wholesaler reasonably believes that the customer cannot receive or transport the product in compliance with all required occupational health and safety requirements.

3.47 The MTAA nonetheless holds concerns about the supply provisions. While acknowledging the provisions in the Oilcode, the MTAA submitted that it considers the Oilcode does not provide any customer with the right to actually access supply. The MTAA considers that controlling access to supply may give certain market participants a substantial degree of market power and the potential exists for some of those participants to misuse that power.[30] However, these concerns seem to be based upon either a failure to appreciate the remedies available under the Oilcode, a misunderstanding of the requirements of S.46 of the Trade Practices Act, or perhaps both.

3.48 The Committee asked officers of the Department of Industry, Tourism and Resources about the guaranteed supply provisions. Officers confirmed that the Oilcode prevents wholesale suppliers from unreasonably refusing to supply resellers who meet the appropriate health and safety standards and have capacity to pay. However, officers acknowledged that where there is a shortage of product, obtaining supply may be problematic.

3.49 Officers confirmed that prospective purchasers will be in a better position under the Oilcode if there are difficulties associated with obtaining supply than would have been the case if they had to rely on S 46 of the Trade Practices Act for enforcements:

> **CHAIR**—It seems to me, Mr Squire, that, plainly, a prospective purchaser at the terminal gate is in a stronger position now because of that provision in the Oilcode than they would have been if they had to rely on section 46 of the Trade Practices Act, because that provision does not depend upon them establishing the various thresholds that it would currently be necessary to establish under section 46 before refusal to supply constitutes a contravention of that provision.

30 MTAA, *Submission 4*, p. 5.

Mr Squire—Yes, Senator.[31]

3.50 The Committee questioned departmental officers as to whether wholesalers could use supply being wholly committed as a reason to withhold product. The officers responded that:

> They would face that now, and under the Oilcode you would be able to go to the dispute resolution adviser and say, 'I was refused supply because' and he can investigate whether the refusal to supply was reasonable or not.[32]

3.51 Officers also confirmed that retailers in dispute with a wholesaler over supply are not obliged to use dispute resolution, but also have the option of enforcing their rights under the Oilcode by seeking a mandatory injunction in the Federal Court.

3.52 In relation to securing supply in the current market, officers told the Committee that:

> …what the evidence is showing there is that in a market shortage you are in a potentially better position to have a secure supply contract with a wholesale supplier or an independent importer. Relying on the spot market in a market where there is a shortage of product would be a difficult method of operation.[33]

Dispute resolution procedures

3.53 Part 4 of the Oilcode provides for the establishment of a dispute resolution scheme and the appointment of a Dispute Resolution Adviser (DRA). The disputes in question may relate to failure on the part of a wholesaler to supply a declared product, terminal gate pricing, and any aspects of fuel reselling business dealt with in Part 3 of the Oilcode. The dispute resolution process is non-binding, and does not preclude court action on the part of the complainant.

3.54 The ACCC explained the objectives of the dispute resolution process and how it will operate:

> It is the ACCC's view that the Dispute Resolution Advisor (DRA) will provide a non-binding dispute resolution system for industry disputes. A key objective of the DRA is to provide a non-legalistic, cost effective, timely and commercially-orientated dispute resolution process.
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> There are two distinct types of disputes under the proposed Oilcode to which the dispute resolution system applies. The first applies to a wholesale supplier who fails to supply a declared petroleum product to a customer. The second applies to any other dispute arising from Part 2 (terminal gate price) or Part 3 (Fuel re-selling business) of the proposed Oilcode.

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31 *Proof Committee Hansard*, 8 May 2006, p. 8.

32 *Proof Committee Hansard*, 8 May 2006, p. 11.

33 *Proof Committee Hansard*, 8 May 2006, p. 11.

> With respect to disputes relating to a failure to supply, the DRA may become directly involved in resolving disputes. There is no requirement in the case of such disputes for the parties to first attempt to negotiate a resolution.
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> With respect to all other issues covered by the proposed Oilcode negotiation between the parties is required before that dispute can be referred to the DRA. If negotiation between the parties fails, the Code provides that the DRA will appoint a mediator to mediate the dispute or provide other such assistance to enable the parties to resolve the dispute in an efficient manner.[34]

3.55 The MTAA expressed concern about the scope of the dispute resolution process:

> The Association notes that the matters which can be mediated…are significantly narrower than the matters which form part of the business relationship between the parties to a fuel reselling agreement. MTAA is therefore concerned that the dispute resolution process may therefore prove to be an ineffective alternative to legal action because it is possible that, in many circumstances, the matters under dispute may be broader than those matters covered under the Oilcode.[35]

3.56 In relation to the allegation that the scope of the dispute resolution process under the Oilcode is too narrow, the ACCC expressed the view that the scope of the dispute resolution process is sufficiently comprehensive:

> While there are some things which are covered under the franchising code dispute mechanism which are not covered under the Oilcode mechanism, there are other things which are covered under the Oilcode mechanism which are not covered under the franchising code. So whether, in total, that leaves you with a narrowing is probably a matter of judgment. From our point of view, we do not see any issue that should be subject to the Oilcode dispute resolution mechanism that is not covered. We cannot see any obvious standout or exclusion, if I can put it that way.[36]

3.57 The MTAA also expressed concern about the non-binding nature of the dispute resolution process:

> The Association also notes that a mediator appointed under the Oilcode's dispute resolution process may also only make a non-binding determination about the dispute and such a determination is likely to be of little value in a commercial environment. While MTAA acknowledges that service station operators will still have a prima facie recourse to legal remedies, the Association considers that the pursuit of those remedies is unlikely to be a

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34 ACCC, *Submission 9*.

35 MTAA, *Submission* 4, pp 4-5.

36 *Proof Committee Hansard*, 8 May 2006, p. 11.

> viable proposition for many service station operators as the costs associated with doing so would simply be prohibitive. This is one of the reasons why MTAA sought to have the dispute resolution process available under the Oilcode extended to all matters which form part of the business relationship between the parties…[37]

3.58 While the dispute resolution process is non-binding, evidence received from Associate Professor Frank Zumbo indicates that non-binding dispute resolution can nonetheless be effective. He advised that under the franchising code of conduct, around 70 per cent of cases were resolved in a non-binding process.[38] Mr Cassidy of the ACCC gave similar evidence, also advising that the cost was low, around $800.[39]

3.59 There are a number of other options available in situations where the non-binding process is unable to reach a solution. Associate Professor Zumbo said that some of these may still be privately resolved. Others may go to Court, although this may be an expensive option that is out of the reach of many small operators.

3.60 A further option is that the complaint may be taken to the ACCC, who will have responsibility for enforcing the Oilcode, by the DRA or the complainant. The ACCC advised that it would be likely to examine matters in relation to the Oilcode referred to it by the DRA:

> The DRA, as we understand it—as with what is called the OMA under the Franchising Code of Conduct—will have disputes to look at, some of which will perhaps potentially involve a breach of the code and some of which will not. The DRA is not limited to disputes that look as if they are purely an actual breach of the code. Where, in the DRA's view, they do involve a breach of the code or potential breach of the code and they are referred to us, they are certainly something we would have a look at—and, I think, feel obliged to have a look at, given where they have come from.[40]

3.61 Overall, the ACCC assessed the dispute resolution provisions as adding to the competitive structure of the industry. The option offers independents and others a more easily exercisable option than having to rely on the complex provisions of s46 of the Trade Practices Act.[41]

Predatory pricing and the Trade Practices Act

3.62 The MTAA submitted that the proposed reforms to the petroleum retail sector do not adequately address the concerns that service station operators have in relation to anti-competitive behaviour in the retail petroleum sector. Aside from the concerns

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37 MTAA, *Submission* 4, pp 4-5.

38 *Proof Committee Hansard*, 19 April 2006, p.70.

39 *Proof Committee Hansard*, 8 May 2006, p. 28.

40 *Proof Committee Hansard*, 8 May 2006, p.18.

41 *Proof Committee Hansard*, 8 May 2006, p.11.

described in the previous sections of this report, the Association said that it believed that the Trade Practices Act needs to be strengthened to address those concerns:

> 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 and the trend toward vertical integration, mean that it is imperative that any reform package for the sector includes appropriate amendments to Part IV of the *Trade Practices Act* which will ensure that the Act deals effectively with all types of anti-competitive behaviour, including predatory pricing. The Government's petroleum sector reforms as currently proposed do not include such amendments and as a result the Association cannot support the repeal of the two petroleum sector-specific Acts.[42]

3.63 Associate Professor Frank Zumbo concurred that the Act requires amendment, stating that he thought the Act is 'ineffective to deal with the most important issues of predatory pricing and other abuses of market power'.[43] He told the Committee that he thought that many of the concerns expressed by opponents of the reform package could be alleviated if the capacity of the Act to deal with the misuse of market power could be improved:

> In terms of unconscionable conduct, I am of the belief that the provisions of the Trade Practices Act need to be strengthened. The premise that we can deal with these issues under the Trade Practices Act is based on the view that we have an effective Trade Practices Act. We have heard this morning, particularly from the franchisee organisations, that an effective Trade Practices Act would go a very long way in dealing with their concerns. I would echo those comments. An effective Trade Practices Act dealing with the misuse of market power under section 46, with unconscionable conduct and, perhaps going further, with potentially unfair contractual terms, would allay many of the concerns that have been raised by the franchisee organisations.[44]

3.64 In the Explanatory Memorandum, the Government has indicated that it intends to bring forward amendments to s46 during 2006 which will allow the courts to consider below-cost pricing and recoupment for consideration of misuse of market power, in accordance with many of the recommendations made by the Senate Economics References Committee in its 2003 Report on the effectiveness of the Trade Practices Act in protecting small business.[45]

3.65 These proposed amendments are not, however, part of the reform package.

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42 MTAA, *Submission 4*, p. 5.

43 *Proof Committee Hansard*, 19 April 2006, p. 69.

44 *Proof Committee Hansard*, 19 April 2006, p. 67.

45 EM, p. 9.

Conclusions and recommendation

3.66 The Committee agrees that the *Petroleum Retail Marketing Sites Act 1980* and the *Petroleum Retail Marketing Franchise Act 1980* are no longer effective and have failed to keep pace with structural changes in the petroleum retail industry. These Acts expose different parts of the industry to different regulatory requirements that are now difficult to justify.

3.67 The entry into the market of the supermarket chains, and their market strength, mean that it is necessary to ensure that all participants can compete on equal terms. Failure to do this is likely to lead to a lessening of competition if the refiner/marketers withdraw from the market altogether, as is possible if their competitive disadvantage is not addressed. The Committee is also concerned that failure to address these issues may lead to a loss of refining capacity, raising serious issues of energy security.

3.68 The Committee therefore supports the repeal of the Acts.

3.69 The Committee considers that the proposed Oilcode will significantly improve the situation of many industry participants, particularly commissioned agents, who currently do not enjoy any of the protections afforded by the Franchising Act. These groups will also have access to a low cost dispute resolution scheme for the first time.

3.70 The Committee notes the concerns of some industry participants about some aspects of the Oilcode, particularly in relation to tenure, and the potential for abuse of market power. The Committee does not believe that the concerns about tenure are well founded, but suggests that the Government revisit the issue of the $20 000 threshold for extended tenure under the Code. The Committee also notes that the Government has indicated that it intends to bring forward amendments to s46 of the Trade Practices Act 1974, which is a more appropriate way in which to address these concerns.

Recommendation

The Committee recommends that the Bill be passed and the Oilcode be enacted.

Senator George Brandis
Chair