The Senate

Economics Legislation Committee

Provisions of the Petroleum Retail Legislation Repeal Bill 2006

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Introduction

Background

1.1 The Petroleum Retail Legislation Repeal Bill 2006 was introduced into the House of Representatives on 30 March 2006 by the Minister for Industry, Tourism and Resources, the Hon. Ian Macfarlane MP.

1.2 On 30 March 2006, on the recommendation of the Senate Standing Committee for the Selection of Bills, the Senate referred the provisions of the Bill to the Economics Legislation Committee for inquiry and report by 2 May 2006[1].

1.3 An interim report was tabled out of session on 2 May 2006.

Conduct of the Inquiry

1.4 The Committee advertised the inquiry nationally and posted details on its internet site. In addition, it wrote to a number of organisations advising them of the inquiry and inviting them to make submissions.

1.5 The Committee received 9 submissions to its inquiry. These are listed at Appendix 1. Several supplementary submissions were also received.

1.6 The Committee held a public hearing at Parliament House in Sydney on Wednesday, 19 April 2006. A further hearing was held at Parliament House in Canberra on Monday, 8 May 2006 to hear evidence from officers from the Department of Industry, Tourism and Resources and the ACCC. Witnesses who presented evidence at the hearings are listed in Appendix 2.

1.7 The Hansard of the Committee's hearing and copies of all submissions are tabled with this report. These documents, plus the Committee's report, are also available on the Committee's website at:

http://www.aph.gov.au/senate/committee/economics_ctte/completed_inquiries/index.htm

1.8 The Committee thanks those who participated at this inquiry.

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1 Selection of Bills Committee, *Report No. 3 of 2006*.

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.

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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/Circulationdraft26July05200 50802154047.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

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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

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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**
• 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	• 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**
• Fully flexible operating structures allow immediate response to changes in the market structure	• 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**
• 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	• 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**
• 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	• 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**
• 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	• Nil
Benefits to Government	**Costs to Government**
• Save approximately $100,000 per annum in monitoring compliance with the Sites Act	• 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**
• Increased flexibility in the structure of refiner/marketer networks should decrease inefficiencies and associated overheads that may have been passed onto consumers.	• Ongoing rationalisation may reduce the number of retail sites.

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.
>
> …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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> …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:
>
> (i) payment for motor fuel at or below the usual wholesale price;
>
> (ii) payment of the usual wholesale price of motor fuel taken on consignment;
>
> (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;
>
> (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.
>
> …
>
> 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.
>
> 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.
>
> 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

Additional remarks from

Labor Senators

Labor Senators accept that the Petroleum Retail Marketing Sites Act and the Petroleum Retail Marketing Franchise Act 1980 and associated regulations represented an outdated model for regulation of the petrol retail sector, as they exclude major supermarket chains engaged in petroleum retailing and have been circumvented by major oil companies in some circumstances.

Labor Senators however, are of the view that the principle issue in encouraging competition in this sector, and indeed across all markets, is strengthening provisions in the Trade Practices Act against misuse of market power.

It is well known that section 46 of the Trade Practices Act has been rendered inefficient and ineffective because of a number of Federal Court and High Court cases. For example, in the Safeway case the concept of take advantage was brought into question. In the Rural Press case the concept of abusing market power in another market was brought into question. In the Boral case the very concept of market power was brought into question. The ACCC has effectively given up taking cases under section 46 of the Trade Practices Act because it knows it has now been rendered ineffective.

The Senate Inquiry into the Effectiveness of the Trade Practices Act on Small Business made a number of recommendations in strengthening the TPA, some of which the Government has committed to.

The measures in this legislation do not achieve the objective of encouraging competition in this sector in isolation from the section 46 reforms the Senate has previously called for.

Therefore, Labor Senators believe that the most efficient market outcome will not be achieved unless s46 reforms are implemented concurrently.

Labor Senators note the comments of Mr Cassidy from the ACCC:

> I would say that, to the extent that there are shortcomings in the current section 46—and that is obviously well-travelled ground—we think the answer to that is to amend the section (transcript Pg E-20)

The ACCC clearly supports strengthening of s46 to support competition in this and other markets.

Ideally, the Government should commit to immediately legislating the following recommendations of the Senate Committee in relation to s46 of the TPA:

Recommendation 1

> The Committee recommends that the Act be amended to state that the threshold of 'a substantial degree of power in a market' is lower than the former threshold of substantial control; and to include a declaratory provision outlining matters to be considered by the courts for the purposes of determining whether a company has a substantial degree of power in a market. Those matters should be based upon the suggestions outlined by the ACCC in paragraph 2.16 of this report.

Recommendation 2

> The Committee recommends that the Act be amended to include a declaratory provision outlining the elements of 'take advantage' for the purposes of s.46(1). This provision should be based upon the suggestions outlined in paragraph 2.28 of this report.

Recommendation 3

> The Committee recommends that the Act be amended to provide that, without limiting the generality of s.46, in determining whether a corporation has breached s.46, the courts may have regard to: the capacity of the corporation to sell a good or service below its variable cost. The Committee recommends that the Act be amended to state that: where the form of proscribed behaviour alleged under s.46(1) is predatory pricing, it is not necessary to demonstrate a capacity to subsequently recoup the losses experienced as a result of that predatory pricing strategy

Recommendation 4

> The Committee recommends that s.46 of the Act be amended to state that, in determining whether or not a corporation has a substantial degree of power in a market for the purpose of s.46(1), the court may have regard to whether the corporation has substantial financial power. 'Financial power' should be defined in terms of access to financial, technical and business resources.

Recommendation 5

The Committee recommends that s.46 be amended to state that a corporation which has a substantial degree of power in a market shall not take advantage of that power, *in that or any other market*, for any proscribed purpose in relation to that or any other market.

Recommendation 6

The Committee recommends that s.46 be amended to clarify that a company may be considered to have obtained a substantial degree of market power by virtue of its ability to act in concert (whether as a result of a formal agreement or understanding, or otherwise) with another company.

Senator Ursula Stephens **Senator Ruth Webber**

Democrats Minority report

For decades the Australian Democrats have argued that a strong small business sector is essential to the economic and social health of Australia – that small business has a value of itself.

Our views on the *Petroleum Retail Legislation Repeal Bill* (the Bill) are necessarily coloured by that perspective. We strongly support the workings of a free and fair market, as evidenced by our work on corporations, trade practices and tax law, but we have long been concerned that a weak *Trade Practices Act* (TPA) does not deliver sufficiently fair competition for small business with sufficiently adequate protections from predatory pricing and the abuse of market power.

In that respect we set great store on the recommendations of the Majority, which we support, in the Senate Economics Reference Committee Report of March 2004 on: *The effectiveness of the* Trade Practices Act 1974 *in protecting small business*. If those 17 recommendations were implemented, that cover the misuse of market power, unconscionable conduct, collective bargaining, creeping acquisitions, divestiture, and the powers and resources of the Australian Competition and Consumer Commission (ACCC) – then fair and free competition would be greatly strengthened in Australia. Further, there would then be less of a case for industry-specific regulation if the general law was so strengthened.

The Democrats have opposed the earlier version of this Bill, arguing that stronger TPA powers are first required to address the abuse of market power and to introduce the threat of divestiture on over-mighty corporations. We said then that TPA reform was a precondition to considering whether this industry regulation could be lifted or modified.

As Democrat Senator Murray said in 2003[1]:

> Workplace, tax, corporations, finance and trade practices laws are the main laws affecting the functioning of the market and the regulation of the behaviour of corporations. In matters of competition and consumer interest, all over the world the law restrains great commercial power because of the known abuse of power that often accompanies it. When it comes to the size and behaviour of corporations, the Trade Practices Act 1974 is Australia's prime protective device. Yet the act is weaker and deficient in its protective capabilities in comparison to countries like the United Kingdom and the United States.
>
> ….I have said before that big business roars approval at the dynamism of the American market but fiercely condemns a major contributor to that dynamism—that is, the effects of antitrust or divestiture laws. We need those regulatory tools in Australia. Balanced divestiture laws are the corollary of balanced merger laws. We

[1] Hansard Adjournment 13 August 2003

> do not have effective divestiture laws. It is a strange and illogical policy that can prevent mergers to maintain effective competition but cannot require divestiture also to maintain effective competition.
>
> ….In Australia, many markets are experiencing oligopolisation—a concentration of power in the hands of a small number of competitors. This is partly a natural result of economies of scale: the big get bigger and as they do they develop the ability to operate more cheaply and efficiently. Over time, the smaller players are forced out of the market. That is the way of the market, and it is valuable while it promotes efficiency, innovation and competition—but only up to a point. Eventually, the destruction of competitors results in the destruction of competition, or the predatory intimidation of competitors reduces effective competition. Where that has occurred or will occur, the state must intervene to save the market from eating itself. By its very nature, the power to order divestiture should be regarded as largely a reserve power. As international precedents indicate, it would be seldom employed. It should be used rarely and used responsibly. Its great virtue is as a cautionary power, making oligopolies careful of abusing their market power. It would be used only where necessary to maintain or restore competition.

The Australian Democrats accept that there is a need to update the regulation governing the petroleum sector in response to the significant structural changes that have recently occurred in the sector, particularly the entrance of Woolworth's Coles and other supermarket chains into the petroleum retail market.

The Bills Digest notes that key stakeholders in the industry are concerned about 2 key issues:

- Commission agency arrangements covered by Oilcode.
- No industry specific restrictions on pricing behaviour.

We agree that the new regulations are likely to offer significant improvements in the transparency in the wholesale pricing of fuel and allowing access for small businesses to the terminal gate price. However, differential pricing will still apply based on volumes as the market dictates. That is, a large chain such as the Coles-Myer controlled Shell franchises can be expected to receive a superior price to an independent since they are likely to purchase far greater volume.

This will have the effect of increasing the barriers to entry in the market and could lead to an increase in the concentration of industry participants and a commensurate reduction in outlet choice for consumers. We are concerned that the result will be a significant reduction in the number of franchisees and small business operators', except perhaps for uneconomical regional/rural sites. This is evidenced in part by BP who have recently begun buying back their franchise network in anticipation of this Bill, according to the Service Stations Association (SSA).

The Motor Trades Association of Australia (MTAA) the SSA and others had concerns about the impact of the legislation and oil code, on independent retailers. The MTAA argued that it would be important for an effective regulatory framework to be in place

to deal with issues relating to the misuse of market power, and that the TPA needs to be strengthened:

> MTAA therefore believes that it is important that there is an effective regulatory framework in place to deal with issues relating to the misuse of market power. In that regard, MTAA is concerned that despite the issue being mentioned as an element of the reform process in the 2002 Downstream Petroleum Industry Framework, the proposed reforms do not adequately address the concerns that service station operators have in relation to anti-competitive behaviour in the retail petroleum sector; in particular, predatory pricing, the misuse of financial power and the misuse of market power in one market to gain substantial power and reduce competition in another market. MTAA strongly believes that the *Trade Practices Act 1974* needs to be strengthened to address those concerns.
>
> In that regard, the Association is aware that the Australian Government has foreshadowed amendments to section 46 of the *Trade Practices Act* which it proposes will address the issue of predatory pricing. MTAA notes however that at the briefing on section 46 organised by the Department of Industry, Tourism and Resources for Oilcode stakeholders and held on 27 April 2005, the Department's own legal adviser confirmed MTAA's view that the *Trade Practices Act* does not adequately address predatory pricing and that the Government's proposed amendments will not resolve that issue. 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.[2]

As noted in the Bills Digest, the Chief Executive Officer of the SSA, Mr Ron Bowden, has predicted that between 1000 and 1500 service stations would close and another 200 franchisees would leave the industry in the next two years. Mr Bowden also predicted that, in the longer term, the Government's proposals would increase concentration in the industry and that market power would be in the hands of a few large companies, which would lead to higher prices. Mr Bowden also claimed that the repeal of the Acts would affect the oil majors differentially. With respect to independents, they may find that both their fuel sales volumes and convenience store sales will increase.[3]

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[2] Motor Trades Association of Australia, *Submission 4*, p. 4.
[3] Bills Digest No. 116, p. 4.

Mr Cassidy for the ACCC told the Committee that section 46 of the TPA was unlikely to address the concerns of predatory pricing raised by the MTAA and others, because section 46 relates to horizontal conduct, whereas the situation outlined by the MTAA and others relates to vertical conduct:

> Section 46 is in a sense about so-called horizontal conduct—a firm with market power seeking to damage and eliminate one or more of its competitors. The Oilcode, the franchising code and indeed part IVA and part IVB of the act, which are about unconscionable conduct in the industry code divisions, are really about what we would call vertical conduct—that is to say, how a supplier treats those they are supplying to or how someone purchasing treats their supplier. Inevitably in those arrangements the supplier or the buyer is, if you like, the more dominant party and then you have got the individual firm in the middle who perhaps has the lesser economic power. Really what this is about is, as I say, that sort of vertical relationship rather than what we would see as being the more horizontal competitor type relationship that section 46 seeks to address.[4]

Mr Cassidy for the ACCC also suggested that the perceived threat to small business/independent retailers would not necessarily come from the changes to the regulations but from broader issues:

> Whether over time what you might call the stand-alone petrol retail outlets will be squeezed out by the integrated outlets is a much broader issue. Again, this goes to the economics of petrol retailing and perhaps a structural change that has been going on in that sector for at least the last 20 years.[5]

Mr Cassidy also noted that under the current regime the industry is very competitive, and that the increase of integrated service stations, and shopper dockets makes it a difficult environment for stand-alone small petrol retailers who rely predominately on the margins from the sale of petrol:

> **Senator WATSON**—In terms of the small independents limited access to a range of supply as compared with previously, can you see the small independents going broke if they are trying to compete with the Coles-Woolworths price, unless they can offer something additional like extra services or something? If they just compete on price, I can see them going broke.
>
> **Mr Cassidy**—Unfortunately, I think there is an element of truth in what you say. I would not characterise it just as being Coles-Woolworths because there is now quite a number of these arrangements around: Metcash, Foodland and Dimmeys. There are quite a number of arrangements where, if you like, people can basically acquire discounted petrol as a result of the other purchases they

[4] Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 20.

[5] Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 20.

> have made in one form or another. I think those sorts of arrangements obviously do make it difficult for small independents and also for, in a similar vein, what I refer to as the integrated service station operations, which not only have petrol but have fast food, groceries and whatever else. Similarly, they also make it a difficult and competitive environment for the small petrol retailer who is predominantly just relying on the margin he gets on the sale of petrol. On the other hand, the economics of the retail part of the petroleum industry operate on very fine margins. It is a very competitive industry.

Mr Cassidy also went on to say:

> I think the question starts from a proposition that the Sites Act has had an impact in restricting the acquisition of sites by the oil majors. I do not know that we would necessarily support that proposition. We think that the use of multifranchising arrangements has probably largely stepped around the Sites Act anyway. What I was getting to is that I think there is a fundamental driving force in petroleum retailing which means that the future is going to be with larger, integrated sites rather than with the smaller, stand-alone traditional petrol retailer. There will be areas where the traditional petrol retailer will continue to survive, perhaps where the competitive pressures are not as great. They would be, I expect, particularly in country and rural areas, but once you get to areas where there is high-volume demand then, as I say, I think the future of petrol retailing is with large integrated sites which are really more about retailing, of which petrol is just one commodity, rather than a dedicated retail petrol site as we have known it.[6]

The Democrats imagine that the idea that there are broader issues is little comfort to stand-alone retailers.

The Bills Digest also considered that under the current regime the market would continue to retract:

> Failure to pass the legislation would mean the continuation of the legal status quo. However, the industry's structure would be likely to continue to evolve with more reductions in service station numbers, and further development of the industry outside the coverage of the Franchise and Sites Acts.

The Democrats remain concerned that the contraction of the market will be to a large degree, a result of anticompetitive behaviour - a firm or firms with market power seeking to damage and eliminate one or more of its competitors.

That means section 46 changes matter greatly in competition between independent retailers and the supermarket oligopolists, which confirms our view of the importance of strengthening Section 46 of the TPA.

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[6] Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 23.

While broader issues may indeed by affecting the ability of small business to stay within the industry, our reading of the submissions to this Inquiry suggested that the changes to regulation may exacerbate the problems. The question before us is whether measures can be put in place to ensure small retailers and independents are not unfairly pressured or priced out of the market. We think the Government has a prime responsibility to ensure competition in this industry, as all others, is fair and equitable.

One of the most important things the government can do in this area is implement the 17 recommendations in the Senate inquiry *The effectiveness of the Trade Practices Act 1974 in protecting small business.*

It is the Democrats view that this bill should be postponed until the signalled changes to the TPA are before the parliament, so that we and the industry can be assured that predatory pricing issues and other competition matters can be adequately dealt with by the ACCC regulator.

Senator Lyn Allison **Senator Andrew Murray**

Comments by Senator Joyce

The removal of restrictions of market share on the major oil companies will bring an exacerbation of the pressure on independents currently brought about by the two major retailers: Coles and Woolworths.

The desire that was apparent in the initial implementation of legislation in 1980 to bring a wide participation in the fuel retail market is still a just outcome for Australia.

I do not see the repeal of the legislation and the implementation of the Oil Code as fulfilling those initial objectives and, as such, note my dissent in the purpose of this repeal in protecting the rights of independent service stations.

This form of legislation does not protect the current independents and is not the optimum outcome which should be achieved to keep the wide participation in the Australian market place.

Senator Barnaby Joyce
The Nationals
Senator for Queensland

Appendix 1
Submissions & Additional Information

Submissions

Submission Number	Submitter
1	Service Station Association Ltd
2	BP Australia Pty Ltd
3	Australian Automobile Association
4	Motor Trades Association of Australia
4a	Motor Trades Association of Australia
5	Australian Institute of Petroleum
5a	Australian Institute of Petroleum
6	Confidential
7	Caltex Australia Limited
8	The Shell Companies in Australia
9	Australian Competition & Consumer Commission

Additional Information

Information provided by Victorian Automobile Chamber of commerce (VACC):

1 Press Release – 2nd May 2006

2 Early copy of the Oilcode Regulations

3 Ethanol Blends in Petrol – A position Paper produced by the Service Station & Convenience Store Division

4 The Australian Oil Industry – An information booklet produced by Motor Trades Association of Australia (MTAA)

5 Victorian Automobile Chamber of Commerce (VACC) Proposal for a Service Station Structural Adjustment Fund – *The Environmental Clean-Up Fund*

Answers to Questions on Notice received from Australian Competition & Consumer Commission (ACCC) dated 9 May 2006

Appendix 2

Public hearings and witnesses

Wednesday, 19 April 2006 - Sydney

BAILEY, Mr Alan, Manager, Issues and Government Relations
Mobil Oil Australia Pty Ltd

BARRETT, Mr Paul, Deputy Executive Director
Australian Institute of Petroleum

BEATTIE, Mr Richard, Group Manager, Corporate Affairs
Caltex Australia Ltd

BERGERON, Mr Matt, Fuels Marketing Director
Mobil Oil Australia Pty Ltd

BORTOLOTTO, Mr Fury, Vice Chairman
Service Station and Convenience Store Division
Victorian Automobile Chamber of Commerce

BOWDEN, Mr Ron, Chief Executive Officer
Service Station Association Ltd

CONROY, Mr Terrence Philip, Division Manager
Service Station and Convenience Store Division
Victorian Automobile Chamber of Commerce

DICKENS, Mr Nathan, General Manager, Policy
Australian Institute of Petroleum

FRILAY, Mr William John (Bill), Manager, Government Relations
BP Australia Pty Limited

HALSTEAD, Mr Richard, Chairman
Australian Service Station and Convenience Store Association
Motor Trades Association of Australia

HUESTON, Mr Gerald Robert (Gerry), President
BP Australia Pty Ltd

PUCAR, Mr Leo, National Manager, Retail, Caltex Australia Ltd

SCRYMGEOUR, Mr Mark, Manager, National Franchise Development
Caltex Australia Ltd

TILLEY, Dr John William, Executive Director
Australian Institute of Petroleum

ZUMBO, Associate Professor Frank, Private capacity

Monday, 8 May 2006 - Canberra

CASSIDY, Mr Brian David, Chief Executive Officer
Australian Competition and Consumer Commission

CHMIELEWSKI, Mr Konrad, National Manager, Industry Codes
Australian Competition and Consumer Commission

DOBINSON, Mr Gary Martin, Director, Petrol Monitoring Section
Australian Competition and Consumer Commission

PAYNE, Mr Stephen, General Manager, Minerals and Fuels Branch
Department of Industry, Tourism and Resources

RIDGWAY, Mr Nigel Cameron, General Manager, Compliance Strategies Branch
Australian Competition and Consumer Commission

SQUIRE, Mr Martin, Manager, Petroleum Refining and Retail Section
Department of Industry, Tourism and Resources