ACAPMA
Australasian Convenience and Petroleum Marketers Association

7th July 2008

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir,

Please accept this letter as the Australasian Convenience and Petroleum Marketers Association (ACAPMA) submission to the Senate Economics Committee inquiry into the *National Fuelwatch (Empowering Consumers*) *Bill 2008; National Fuelwatch (Empowering Consumers Consequential Amendments) Bill 2008.*

ACAPMA is a national employer body representing the interests of distributors and retailers in the fuel industry. Our members are predominantly regionally based delivering about 35% of the product to the end user or consumer in Australia, and handle about 75% of all country sales either through retail service stations or delivered directly to primary producers, industrial, commercial and aviation accounts.

We are pleased to be given the opportunity to provide comment on the Fuelwatch scheme and by addressing specific points within the terms of reference we hope to address the concerns that ACAPMA members have with the proposed scheme, i.e. its impact on the independent fuel retailer.

ACAPMA members believe that the current deregulated retail fuel market provides the most beneficial outcomes for all participants. Regardless of the perception, the retail fuel market in Australia has, on its own merit produced a highly competitive configuration, equally in the number of participants and the price structure used by all to compete for the consumer's dollar. A market as competitive and mature, where customers and retailers balance their wants for price and margin continually, as we find in Australia, can only be constructed when it is free of constraints or distortions, allowing competition to thrive. In all markets there are threats that endeavour to impede the function of competition, Australia is no exception and those who have the ability to legislate or operate within the fuel market need to be mindful of how statutory requirements may lead to the concentration of market power, affecting the consumer's right to get the most competitive price continually.

We**,** like many in the industry**,** feel that the Senate Economics Legislative Committee Inquiry has been timely in the debate over Fuelwatch, allowing constructive comments on it merits to and misunderstandings of, the retail fuel industry, rather than an emotional media debate inflamed by a lack of knowledge.

As indicated, the attached pages contain our comments on the points raised in the terms of reference, but we would be pleased to discuss these and any other petroleum issues with the members of the Senate Economic Legislative Committee.

Yours sincerely

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General Manager

Encls.

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<u>Comments on issues raised in the Senate Economics Committee terms of reference.</u>

- ***the impact of the proposed Fuelwatch scheme on the price consumers will pay for motor fuel (including unleaded petrol, diesel and LPG) in metropolitan areas, regional centres and rural Australia;***

There has been a great deal of effort devoted to informing the customer on retail petrol pricing and the weekly cycle phenomenon. This has been instituted by the ACCC, AIP and all major refiner/marketers and wholesalers. Unfortunately the sad reality is that not many people bother to look at these on the web or read informative articles in the paper, and the media and many politicians**,** whilst hopefully having some idea of realities, gain more mileage by attacking the industry. Whilst we know that Australia has the fourth lowest petroleum price in the world, and that Government excise and taxes make up over 40% of the retail price, petrol has always been seen by the public as a "grudge" purchase and to explain the complexities of the internationality of the pricing formulae at the refining and terminal level is in the majority what needs to be understood or accepted.

ACAPMA members would agree that there is a requirement for transparency in pricing, but the landscape in the Australian fuel market has changed. A reduction in number of refineries and refiners, Australia becoming a net importer of both crude oil and refined product; with 70% of our current crude oil requirements coming from overseas and 15% of the refined petrol now being sourced internationally to satisfy the demand from all sectors - the days of excess volume being dumped cheaply on the local spot market have long ceased. In addition, the impact of buy-sell arrangements, based on International Parity Pricing, between refiner/marketers has meant that international factors directly influence the price of petrol.

ACAPMA members realise these adjustments to supply and demand within Australia and internationally are now the underlying drivers of the petrol price**;** nevertheless we contend that, international factors notwithstanding, the current refiner oligopoly, with its captured volume, needs to supply further clarification as to how the Terminal Gate Price (TGP) is achieved; this will fundamentally allow the customer to better determine if the published retail board price is credible.

Fuelwatch will not address the magnitude of international supply and demand pressures on the Australian retail market, because fundamentally petrol prices are dictated by international factors**,** i.e. the $US/$AUD exchange rate, price of crude oil and the international market for refined petrol**;** therefore it will have little meaningful impact on the retail price of fuel. This opinion was echoed by the ACCC in the December 2007, report into the price of unleaded petrol, which suggested if some of the issues in the report, a Fuelwatch scheme being one, were addressed – "there will not be a significant drop in petrol prices. It can only be measured in a few cents per litre (cpl)." What might be a 1.5cpl gain to the Australian motorist today will soon be eroded by a spike in demand in the US during the holiday driving season, a reluctance by OPEC to increase production, a war in Nigeria or a cooling in Australia's relationship with Vietnam or Indonesia.

If the above is true for the whole Australian fuel market, then a Fuelwatch scheme will have even less impact on reducing the price paid by consumers in regional and rural Australia.

The nature of a fuel retail business in regional and rural Australia differs greatly from that of a metropolitan site, lower population and smaller operations with a greater reliance on petrol margins than on other complementary profit centres necessitates a model of operation vastly different to what the majority of consumers would recognise. The higher prices in the country compared to the city are principally due to, higher service station operation costs, higher cost of supply to service stations and more sites and therefore more competition in the metropolitan area. Additionally, with lower passing trade, discounting in most cases does not necessarily translate into more customers and sales.

In country areas where competition is considerably less, a Fuelwatch scheme with a 24 hour rule we believe is predicative and not reactive almost encouraging collusive practice, which may not necessarily achieve a competitive outcome for consumers.

- ***the impact of the proposed Fuelwatch scheme on competition between motor fuel retailers and the operation and viability of independent motor fuel retailers;***

Whilst there was always going to be some natural attrition, the emergence of the supermarkets into the retail petrol market has accelerated and increased the reduction in numbers. This situation was very predicable and the current competitive position and influences that prevail in today's fuel market are the result of this rationalisation and polarisation.

The never ending focus on retail fuel pricing is also influencing the reduction in service station numbers. A Fuelwatch scheme**,** while providing comprehensive and current information on prices, locations and trends, is great for the motorist**,** it will have a terminal impact on independent retailers. By identifying lower prices, which are often involved with supermarket alliances, and are often below the daily TGP, which can be below cost for many resellers, can at times put pressure on up to 30% of the market which may not be able to compete at that point in time.

The eventual impact of Fuelwatch on this activity will be full market control by the majors and supermarket chains. Whilst this will be fiercely competitive for some time, it will eventually mean the demise of the majority of independent retailers. The unsustainable margins will sort out all but the biggest and leave the market with fewer sites and higher margins. This can mean that the government will be helping accelerate the demise of the independent/non-aligned service stations, and support an oligopoly, which will lessen competition over time.

- ***other economic costs of the proposed Fuelwatch scheme, including the compliance costs of the scheme for industry, particularly independent retailers;***

ACAPMA members are under no elusion that the added weight of compliance to be imposed by the Fuelwatch scheme will be a burden to business.

Major oil companies and national retailers that operate in the fuel market have sophisticated systems to establish their board price, they have dedicated teams that monitor and adjust prices according to a criteria set by the company. It would be wrong to say that there will not be a compliance cost to be met by them, but we believe most majors are already there regarding the mechanism required.

An independent retailer participating in Fuelwatch faces an imposing economic cost – the failure of a family business.

To understand this comment, you need to recognise the nature of an independent fuel retailer's operation. In a majority of the instances the independent retailer runs all facets of the business on a daily basis. This would include, but not be limited to, working at the counter; or, if a mechanic, servicing vehicles, monitoring stock, dealing with suppliers, merchandising and cleaning, paper work to comply with accounting and tax regulations (GST), banking and paying wages; all this, while trying to balance a family life.

ACAPMA members know that these points are not in themselves a reason to oppose Fuelwatch. On the other hand, to place on top of these the burden of a scheme with tight daily time limits, the inability to adjust in a timely fashion and heavy penalties for non-compliance would, in our view, be catastrophic.

The experience of our members in Western Australia has proven that even the best managed independent business has had difficulty in administering the current scheme. We have been told of times where unmanned sites in the far reaches of the state have had to get price boards installed at great cost, only to be breached by the monitoring authority because a member of the public had rearranged the numbers; this led to further cost installing a locking mechanism. Another operator found that the nearest staff member to an unmanned site was a two hour drive, severely affecting the ability to adjust board prices when required; not to mention the cost of wages and travel. Others have had to install elaborate systems to maintain pricing across their independent network at a cost that can only eventually be passed on to the consumer. However, the most fundamental cost experienced by our members in WA is the inability to compete freely in the market.

- ***intraday price volatility in the retail market, established price cycles in each state and territory, and consumer awareness of price cycles;***

To call intraday price movements volatile implies that they are explosive in nature and unpredictable, this is far from the truth, the established price cycle is just that - an established cycle. Remove the emotion that surrounds the price cycle and consumers would be very aware of the "cheap" day to buy fuel and what days, in their area should be avoided.

What the public fails to understand in its frustration of what it would consider is the "nonsensical" price cycle, is that in most weeks this cycle takes the retail price below TGP, that price the refiner/marketer would be using as a benchmark for selling fuel to the retailer. The public quite rightly cannot accept as true that a business would sell product at a loss, almost in a weekly sense, which in reality has often been the case over the last ten years.

We do not believe that below cost is a sustainable industry process, regardless though at this stage it is the function of a highly competitive market, one that requires the independent retailer to continually nip at the heels of major oil companies and supermarket retailers. ACAPMA members realise a scheme that legislates constrain to fluidity of the intraday pricing process, locking retailers into below cost selling for a full 24 hours, will eventually hand even more power to a group of businesses that have grown exponentially since the Ampol/Caltex merger in 1995, further concentrating the market.

This suggests, however, that price is the only determining factor when consumers and retailers buy and sell fuel, an assumption that is incorrect.

At any time of the day a fuel retailer posts a board price based on a series of factors, including traffic direction and intensity, level of fuel underground, day of the week, cost of finance and customer behaviour; also taken into account is the most influential, competition in the local market. Conversely, this must balance with the consumer's dynamic factors, i.e. How much fuel do I have? Where am I traveling? Do I have time to purchase now? Do I have enough money? This is a dynamic process of adjustment in relation to everything else.

The Fuelwatch scheme threatens to meddle with this mechanism by fixing the price for 24 hours, which will only harm retailers and customers; the consumer's ability to get the best deal at all times will be diminished and a fuel retailer's right to adjust the board price to reflect the market will be lost. At best, a customer will pay too much; at worst, an independent fuel retailer will go out of business.

- ***the potential use under the Fuelwatch scheme of sophisticated pricing strategies by motor fuel retailers who have more than one retail outlet, and how they may take advantage of the 24 hour rule;***

In 2007, the Trade Practices Legislation Amendment Bill (No.1), set to modify the Trade Practices Act to better legislate against the concept of predatory pricing, a practice where a company reduces the price at which it sells; sometimes below the cost of the product for a period of time, the sole aim of this continued policy would be to profit by changing the structure of the market.

Under s. 46(1AA):

> *A corporation that has a substantial share of a market must not supply, or offer to supply, goods or services for a sustained period at a price that is less than the relevant cost to the corporation of supplying such goods or services, for the purpose of:*
>
> *a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market; or*
> *b) preventing the entry of a person into that or any other market; or*
> *c) deterring or preventing a person from engaging in competitive conduct in that or any other market.*

ACAPMA members recognise that a Fuelwatch scheme could help coordinate predatory pricing within a market by allowing larger players to implement, what WA independent operators have called "rolling price leaders".

This phenomenon, as described by WA members**,** is where the media highlight the lowest priced service stations, allowing those with the biggest networks to roll leading prices through the market; having different service stations with the same brand being publicised as the cheapest in a region at different times. An independent operator with a smaller or no network of sites; being less able to employ this pricing tactic, are at a competitive disadvantage. When viewed individually each case of price leading may not look like it contravenes s. 46(1AA), but when it is applied across a city or region we contend that the practice is sustained and damages competition. If this practice was allowed to continue on a national scale, in time the independent's position in the market would decline to such an extent that it would prevent them from engaging in competitive conduct, leaving powerful players to drive the price to consumers up.

ACAPMA members do not look to legislative or monitoring authorities to provide a guarantee of profitability or protection from legitimate competition; conversely, we do not see it is correct for these same authorities to create a precedent where the incentives to compete are eroded, or condone anti-competitive pricing structures. Fuelwatch, we believe will only provide more legitimacy to pricing practices that the Trade Practices Legislation under s. 46(1AA) tries to eliminate.

- ***the impact of Fuelwatch on discounting, as well as the amplitude and duration of price cycles, including any penalties that will apply to motor fuel retailers for not fixing prices for 24 hour periods;***

It should be noted that of the five capital cities prices surveyed by the ACCC in the December 2007, report into the price of unleaded petrol, for the six months January 2007 to June 2007, Perth had the lowest amplitude in price of 7.7cpl, which on average was 1.1cpl less than the other four cities, Melbourne had the highest at 9.5cpl. Notwithstanding the actual price at a given time, consumers in Perth have missed out on the best possible price when compared to the level of discounting in other states. The same report also highlights the variances in the duration of the price cycle in each city, showing that the average days within the price cycle in Perth in 2007, was almost 15 days, compared to all other capitals at less than 8 days. Again the consumer has not received the advantages of open competition, having to pay what they might consider a higher price for a greater length of time.

This occurs because Fuelwatch affects the nature of risk in the making of pricing decisions, making a business more risk adverse due to the inability to quickly adjust a price during the trading period within the subsequent 24 hours.

Simply, the operator of a service station will not risk placing the price at its most competitive level for the next 24 hours, in the fear that it will be uncompetitive with the market. It could be argued this is true for the top of the pricing cycle as well, in that the operator will not post the highest price for the same reason. For ACAPMA members this becomes even more critical as independent operators are less likely to be able to cross-subsidise the profitability of their business, i.e. to use a business in a different region or market sector to help reduce the risk of sustained low margin pricing in another, a practice that supermarket chains use to great advantage with the shopper docket programs they sponsor.

There lies the problem with a Fuelwatch scheme on discounting and the price cycle for the consumer, it will reduce the amplitude of discounting and increases the duration of the cycle, all because a regulation will affect the dynamic equilibrium of fuel pricing, providing the operator with only one reliable way to remain profitable and competitive, reducing the level of risk. When setting the price a fuel retailer therefore increases the margin to create a buffer between the best possible price and the most sustainable price, leaving the consumer to pay more for fuel more often.