

Via email: economics.sen@aph.gov.au

Mr John Hawkins
The Secretary
Senate Standing Committee on Economics
P O Box 6100
Parliament House
Canberra ACT 2600

Dear Mr Hawkins,

Inquiry into National Fuelwatch (Empowering Consumers) Bill 2008 and the National Fuelwatch (Empowering Consumers) (Consequential Amendments) Bill 2008

I have pleasure in enclosing a submission to the Senate Standing Committee on Economics' Inquiry into the National Fuelwatch (Empowering Consumers) Bill 2008.

The submission has been prepared by the Trade Practices Committee of the Business Law Section of the Law Council of Australia. The submission has been endorsed by the Business Law Section of the Law Council of Australia. Owing to time constraints, it has not been considered by the Directors of the Law Council.

As a matter of general concern of the Business Law Section of the Law Council of Australia, with the use of infringement notices in such legislation, is the fact that they raise significant constitutional law problems which the Australian Law Reform Commission has foreshadowed in dealing with this matter more generally.

Furthermore, the Business Law Section is strongly of the view that legislation of the kind envisaged by the Fuelwatch provisions be subject to a sunset clause of three years.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'W Grant', written in a cursive style.

Bill Grant
Secretary-General

14 July 2008

Enc.

**Trade Practices Committee
of the Business Law Section
of the Law Council of Australia**

Submission to the Senate Inquiry into the National Fuelwatch (Empowering Consumers) Bill 2008

Summary

The Trade Practices Committee of the Business Law Section of the Law Council of Australia ('**TP Committee**') submits that the *National Fuelwatch (Empowering Consumers) Bill 2008* ('**Fuelwatch**') should not be enacted.

The TP Committee is of the view that the Fuelwatch proposal would introduce a layer of industry-specific regulation which is not justified unless it would result in a significant net benefit to the public.

It is submitted that the evidence currently available in respect of Fuelwatch does not justify the proposed law.

Competition Policy

The *Trade Practices Act 1974* (**the Act**) and national competition policy in Australia have focussed upon freeing up market forces so that competition may be relied upon to produce the best outcomes for consumers and for the Australian economy.

The TP Committee takes the view, consistent with core competition policy in Australia, that Australia should avoid regulating to restrict the competitive dynamics of a market or to introduce industry-specific regulation unless such regulation is clearly justified.

The Case for Fuelwatch

The Australian Competition and Consumer Commission (**ACCC**) has submitted that the principal objective of Fuelwatch is to address the information asymmetry that currently exists in respect of petrol prices as between major retailers on the one side, and smaller independent retailers and consumers on the other.¹

In addition, the ACCC has argued that the market for petrol is unique in that prices change frequently and unpredictably.²

Reliance has been placed on the experience of a similar scheme in Western Australia over the last seven years. Although that experience is encouraging as it appears to reflect positive results over a significant period of time, it is noteworthy that:

- (a) it is not clear why it has been positive - the ACCC seems to have been surprised that the results of its studies indicated that prices had not increased

¹ Senate Standing Committee on Economics (5 June 2008), Graeme Samuel, E 28, E 48; E 65-6; E 68-9

² Ibid at E 27.

relative to eastern Australia and that the aggregate market share of independents had not declined;³ and

- (b) the positive outcome is still relatively marginal - the ACCC appears to be primarily relying upon the results of the econometric modelling as a means of assuring that Fuelwatch is unlikely to cause harm to the public, rather than as support for the proposition that Fuelwatch could result in any significant public benefit.⁴

The lack of understanding of the competitive dynamics underpinning the results in Western Australia and the marginal nature of those results raise doubts as to whether the Western Australian experience is a reliable and safe guide to the introduction of Fuelwatch in other states. Questions remain, for example, whether the structures of the markets in other states are the same as the structure of the Perth market.

Furthermore, the results of the ACCC's econometric modelling cannot be reviewed or verified because the ACCC has not released its full econometric modelling nor (apparently for reasons beyond its control) the data upon which it conducted its modelling.

Information Asymmetry

The TP Committee submits that most markets in Australia involve some degree of information asymmetry and therefore such asymmetry does not provide adequate justification for interfering in the normal competitive dynamics of a market. Consumers will often have imperfect information and will almost always have less price comparison information than retailers.

In the case of petrol, the ACCC has suggested that the information asymmetry is a result of the major retailers subscribing to a sophisticated price information sharing arrangement administered by Informed Sources Pty Ltd, which apparently enables them to know almost immediately of price movements at individual sites.⁵

If the cause of the problem is the level of price transparency resulting from the Informed Sources arrangement, then a question arises as to whether the Informed Sources arrangement has, or is likely to have, the effect of substantially lessening competition.

If the arrangement is likely to substantially lessen competition in any market for petrol in Australia, it would be actionable under section 45 of the Act. If not, then it is submitted that the arrangement and the information asymmetry to which it contributes should not be regarded as a problem that justifies the introduction of special regulations governing the pricing of petrol.

³ Senate Standing Committee on Economics (5 June 2008), Brian Cassidy, E 48.

⁴ Above n 1, E 15, E 16.

⁵ Above n 1, E 7.

Supposed Uniqueness of the Retail Petrol Industry

The TP Committee submits that the nature of the retail petrol industry is an insufficient justification for the imposition of Fuelwatch. Petrol may be unusual in that its price fluctuates often, but it is often the case with many consumables that consumers will not know which reseller will be the cheapest source of a product on a particular day and will not have the time or opportunity to shop around. This is a common element of markets which is not unique to petrol.

Thus whilst consumers would prefer to know that if they see a low price at a service station on their way to work, they will have the opportunity to take advantage of that price later in the day on their way home, so too would a person who sees a special offer for a coffee and a roll on a café blackboard on their way to work wish for the offer to be available later in the day when they are hungry. Of course, this is often not the case.

The disappointment resulting from price fluctuations, as well as the fluctuations themselves, are the consequences of market forces within a competitive market environment and often consumer convenience or preferences should not justify an interference in the competitive dynamics of the market and new industry-specific laws.

Australia should have confidence that the application of the general Act will result in consumers obtaining the benefits from competition between retailers, including competition in the form of innovation and special offers (even if the offers are for limited periods of time).

Fundamental Change to Petrol Retailing

Fuelwatch would result in a fundamental change to the way petrol is sold and should therefore be taken cautiously due to the risks which it poses (see below). Whilst the empirical support from the Western Australian scheme is encouraging, further investigation of the potential impacts of a national Fuelwatch proposal is required and should be made available to the public before it is implemented in other states.

Competition Lessened

Fuelwatch will eliminate diurnal competition - competition within each day - thereby interfering with a key element of competitive dynamics, namely, market ability to react quickly to changes. Fuelwatch will distort competition and deprive consumers of some of the benefits of a competitive market place by freezing competition for 24 hours through the requirement that competitors wait 24 hours before responding to changes in price.

For example, if a service station lodges its price by 2pm under the Fuelwatch proposal and overnight, prior to its notified price taking effect in the marketplace, there is a significant change in oil prices making its stock of petrol more valuable, the service station would be prevented from increasing its petrol prices for 24 hours. There may be an incentive, in those circumstances, for the service station to limit the volume of petrol it sold during the day in order to obtain a higher price the following day.

No doubt many would regard this example as a case of a service station seeking a windfall profit, but it seeks to illustrate how the proposed Fuelwatch laws would interfere with the competitive dynamics of the market. In a similar vein, a service station proprietor will be prevented from engaging in a pro-competitive response to the lower prices of its competitors for 24 hours.

Competitive Gaming

Fuelwatch may encourage gaming by the large petrol retailers and could result in price leadership. Although Fuelwatch raises the stakes for a price leader because it could be “out of the market” with its pricing, Fuelwatch also increases the potential rewards because, if the price leadership is successful, Fuelwatch will reinforce that success by preventing cheating. The ability to detect cheating and discipline companies who attempt to cheat are elements well-recognised in the establishment and conduct of price fixing cartels. If Fuelwatch is in place, the industry does not need to worry about detecting cheating or disciplining those who cheat, because Fuelwatch will prohibit competitors from reducing their published prices within the 24 hour period and impose penalties upon any who do so.

Risk to Small Independents

Fuelwatch poses a number of risks to independent petrol retailers. First, they may be financially ‘squeezed’. For example, a major petrol retailer might choose to set its prices low for the purpose of undercutting an independent retailer and causing it substantial loss or damage because the independent retailer would be priced out of the market for 24 hours. Such conduct could be quite effective as the major retailer would be able to absorb the consequences of pricing low in a particular locality, as sales in that locality would only be a small proportion of its total Australian sales, but the independent retailer is likely to be prone to financial collapse after only a few (and not necessarily consecutive) days of lost petrol sales. Such conduct could lead to further consolidation of the petrol retail market, eliminating independent retailers.

Furthermore, it is unlikely that section 46 of the Act, whether in its current form or with the amendments currently proposed by the Government, would be a safeguard against such conduct. For example, it may be difficult to show that there was a substantial degree of market power (or even market share) on the part of the major retailer, or that there was a “taking advantage” of such market power, or that the discounting was for a “sustained period”. An anti-competitive purpose, alone, would be insufficient.

Second, the competitiveness of independent petrol retailers would be reduced by the effect of Fuelwatch on the petrol price cycle. Fuelwatch is likely to have the effect of lengthening and flattening price cycles,⁶ creating problems for independent retailers because they are only really price competitive when they manage to price below the major retailers during the peak of a price cycle.

Third, one of the consequences of the Fuelwatch proposal will be the effect of pricing “errors” for small independent retailers. If an independent retailer’s price is higher than its closest competitors, it will be “out of the market” for that day. It will lose not

⁶ ACCC report, 247.

only most of its petrol sales for that day, but shop sales as well, which are often critical to the viability of many independent retailers. An independent retailer can withstand far fewer of these pricing “errors” than the major retailers.

The potentially detrimental effects of Fuelwatch on independent retailers are of particular concern because independent retailers make a significant contribution to competition in Australian petrol markets and, if they were to disappear, the markets would be dominated entirely by the major retailers.

May Encourage Price Collusion

Due to the potentially severe financial consequences for a petrol retailer of being “out of the market” by having notified a price higher than its closest competitors, the Fuelwatch proposal may actually encourage more unlawful price collusion. The proposal will create greater incentives for retailers to collude prior to notifying their prices under the proposal.

Possible Circumvention

The objectives of fixing petrol prices for 24 hour periods and advising consumers of those prices is likely to be undermined by the current “shopper docket” offers and ad hoc offers of other discounts for purchases of other goods or services. A service station that wishes to reduce its notified prices could alter its signboard by offering a discount per litre on condition that a customer spends a small amount in-store.

For example, one chain has recently been offering a discount of 4 cents per litre on condition that a customer spends at least \$2.00 in the service station’s store, and this has been in addition to its existing “shopper docket” offers. Such a discount could be varied from one day to the next, or even within a day, without apparently contravening the proposed Fuelwatch law.

Alternatively, a service station could make its notified price more attractive by offering a litre of milk or a loaf of bread for one cent with a petrol purchase.

Fuelwatch, therefore, may establish a maximum price for a service station, but may not be effective in preventing the service station from effectively lowering its notified price. This would reduce the intended incentive to quote low in notifying the following day’s prices. It would also permit petrol retailers to counter any competitors’ attempts to quote a low price because they would have 14 hours to prepare and implement a special offer response which could be selectively targeted only at the low priced service stations.

Distortion of Information

Fuelwatch could lead to distorted public perceptions of where cheap petrol is available, undermining the purported beneficial effects of the proposal. As most consumers would be likely to inform themselves of relative petrol prices via the nightly news rather than the Fuelwatch website, they could form the erroneous opinion that a particular chain has cheap petrol because it frequently has low prices at a particular site. Furthermore, due to the considerably larger size of the Melbourne or Sydney markets for petrol in comparison with the market in Perth or Western Australia, the effect which this could have on the effectiveness of Fuelwatch for

consumers or on independent retailers cannot be accurately gauged from the Western Australian experience.

Rights Affected

Fuelwatch will affect the rights of business people, whether their businesses be large or small. Why should the government seek to force a business to trade at a price which, through no fault of the business, is uncompetitive? The inability of the business to lower its price in order to be competitive (and to benefit consumers purchasing from that business) is a very serious consequence that flows from the desire to create incentives to make Fuelwatch work.

Infringement Notices

The TP Committee is particularly concerned with the proposed imposition of pecuniary penalties through the use of infringement notices, a mechanism which affects a party's rights by effectively reversing the onus of proof. It is submitted that the use of infringement notices should not be expanded, particularly to laws governing competition or other business practices, as they undermine traditional legal principles and processes.

Conclusion

Unless the overall benefits of Fuelwatch can be shown to be compelling, the imposition of regulation is highly undesirable.

Fuelwatch would signal an unfortunate descent into regulated markets and away from the free market principles underpinning the Act and modern competition policy in Australia.

For the above reasons, the TP Committee urges the Senate Committee to recommend that this legislation not be passed, or at least not until it has been more thoroughly assessed to determine if it would result in a significant net public benefit.