INQUIRY INTO FUEL PRICES IN THE NORTHERN TERRITORY

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May 2005

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OVERVIEW

The Northern Territory Government commissioned this Inquiry into Fuel Prices in the Northern Territory in February 2005. At the time there was a degree of public and media concern that the price of fuel (both petrol and diesel) in the Territory was "*unnecessarily high*". In particular, there was a view that during the period from late November 2004 to late January 2005 retail petrol prices (the price paid by the motorist at the pump) had initially increased in line with increases in world crude oil prices, but had not subsequently decreased in line with reductions in world crude oil prices.

The Inquiry and this Report aims to better inform the Government and the people of the Northern Territory about:

- How prices paid for fuel by Territory motorists in general (as distinct from some snapshot point in time) compare with what motorists elsewhere in Australia pay;
- Whether prices paid for fuel by Territory motorists are in general "unnecessarily high"; and
- Whether and why prices, wholesale and retail margins and input costs are higher in the Northern Territory.

The Inquiry and Report also seek to address related questions, including:

- Whether competition is effective amongst the main players in the Northern Territory fuel market, including the impact of "fuel discounters" and
- What could bring about a reduction in fuel prices paid by Territory motorists?

The formal Terms of Reference for the Inquiry are set out as an Attachment to this Report.

While the Inquiry was concerned with "fuel" prices, this Report focuses on petrol. Diesel essentially involves the same supply and distribution channels as petrol (though in smaller volumes); and comparable market forces operate. However, relatively little data and information is available for diesel. The finding and conclusions in this Report about petrol broadly apply to diesel.

In gathering evidence for this report, the Inquiry has consulted with a range of interested parties. Early in the Inquiry, public notices were published in various Territory newspapers advising of the Inquiry's contact details and inviting written submissions to be forwarded to the Inquiry. The Inquiry also contacted key stakeholders across the Territory, including the oil majors, Territory distributors, some retailers, and various other organisations such as the Service Station Association, Motor Trades Association, Local Government Association, Australian Petroleum Agents and Distributors Association, Australian Automobile Association of the Northern Territory and Australian Institute of Petroleum. Private meetings were held with interested parties in Darwin, Alice Springs and Sydney. Details of submissions received by the Inquiry are listed as an attachment to this report.

The next chapter of the Report describes the main characteristics of the national market for fuel and the specific characteristics of the Northern Territory market. Chapter 3 sets out the detailed analysis of what Northern Territory fuel prices do look like over a reasonable period of time. The final chapter sets out the Inquiry's suggestions about expected near- and medium- term developments which are likely to influence fuel prices in the Territory. Recommendations are set out through the body of this Report and are repeated in the last chapter.

The Main Findings

- Territory motorists in general do pay a consistently higher price for fuel than do motorists in other capital cities and in other comparably sized locations in Australia, however, the price difference is not “unreasonable” when the contributing factors are understood. In the more remote areas (and in some centres such as Alice Springs), the price differential is large. In Darwin and in recent times Katherine, the price differential is relatively modest – indeed, the price differential is lower than might be expected (for reasons set out below). Importantly, the price differential in the Territory generally has been relatively stable over the past 10 years or so, though the Darwin and Katherine price differential is reducing (and is likely to continue to reduce). Not surprisingly, there is also a price differential for a number of basic commodities sold in the Territory – not just fuel.

- The perceived increase in the fuel price differential over the recent December-January period – especially in Darwin - was real. In large part, this appears to reflect some stickiness (or “asymmetry” in technical language) in the way in which retail fuel prices change – especially in locations where there is no oil refinery. That is, the evidence suggests that retail prices did not increase as quickly when world crude oil prices were increasing in late 2004 (sticky price increases) and consequently did not decrease as quickly when world crude oil prices were decreasing early in 2005 (sticky price decreases). In the last few months, the differential has returned to the more usual levels (though during the course of the past few months it has been lower in Darwin and Katherine than the long term trend).

- Darwin (and the Territory generally) petrol prices are not as volatile as in other capital cities, other than Hobart and, for different reasons and in recent years, Perth. This also explains why prices tend to be stickier when there are large movements in world crude oil prices. The most important reason for the relative stability of fuel prices in the Territory (as with Tasmania) is the absence of an oil refinery. Where there is an oil refinery, there tends to be a pattern of fuel price support, price discounting and price volatility, rather than the more stable and “stickier” price changes typically experienced in the Territory.

- The evidence is clear: Territory petrol price movements (and the same is the case for diesel) have relatively low volatility; that is, they tend not to change markedly within weekly periods and there has been a relatively stable differential over other Capital Cities and comparably sized locations for the past 10 years or so.

- Territory motorists in general *do* tend to pay more than motorists in comparably sized locations elsewhere in Australia. The question is whether prices are “unnecessarily high”? The general answer is that prices are *not unnecessarily* high: they are a direct consequence of the small and remote Territory market given an industry where cost structures tend to be similar across Australia (and arguably somewhat higher in the Territory). Prices in the Territory are higher primarily because the volume of fuel (whether petrol or diesel) sold by the average Territory distributor and retail outlet is very much smaller than is the case with other capital cities and other comparably sized locations, while the fixed costs of operating the distribution business and the retail outlet is at least the same, if not higher. In addition to low volumes, the transport costs of distribution to more remote areas adds to the higher costs and price structure in the Territory (Transport costs are not a major issue in the case of Darwin, which receives its fuel from Singapore).

- In the case of the more remote locations and centres such as Alice Springs (sharply contrasting with Katherine in recent times) there is an even higher price differential (compared to comparably sized locations elsewhere in Australia). This reflects the extremely small volumes of fuel sold by distributors and retailers, the high fixed costs of operating a petrol station and the higher costs of transport to remote locations. The higher price differential in some Territory locations also clearly reflects the absence of "vigorous competition" amongst retailers. In some locations, there is only one retail outlet and, not surprisingly, margins and prices in these locations might be regarded as "unnecessarily high" – for fuel as well as for other commodities.

- Competition in the supply of fuel in the Northern Territory varies significantly across different parts of the Territory. In Darwin, the emergence of the major supermarket chains (Coles and Woolworths) together with the continued presence of BP and Mobil has provided a degree of competitive pressure. Indeed, it could be argued that the small average volumes of Darwin service stations, with relatively high fixed operating costs, might be expected to result in even higher retail margins and a consistently higher price premium relative to other comparably sized locations across Australia. The fact that the Darwin retail margin and price differential has not generally been higher in recent years (with the exception of relatively short periods such as last December-January) is likely to be the result of a degree of effective competition amongst the main players.

- Based on what has happened in Katherine in recent times, the entry of an independent fuel discounter – the distributor/retailer United - is likely to see even greater competitive behaviour in and around Darwin, leading to even tighter retail margins and a lower price differential. Other centres, such as Alice Springs and Tennant Creek, do not appear to enjoy the benefits of effective competition, though this may change if there is entry by new players such as United. However, the very remote locations with only one retail outlet do not enjoy anything like "effective" competition – and are most unlikely to ever benefit from competitive pressures.

- Effective competitive pressure from the major retail chains (Woolworths/Caltex and Coles Myer/Shell) as well as the large oil majors (BP and Mobil) is likely to continue to influence retail margins and, hence, the price paid by motorists. Where there is additional entry by independent fuel and grocery distributor/retailers such as United, the Inquiry expects even greater pressure on margins and hence the price paid by motorists. However, effective competition is only likely in Darwin and the larger centres. The small, remote locations in the Territory will not benefit from competitive pressures.

- The inevitable rationalisation of the industry will see a continued decline in the smaller independent petrol retailer. This is an inevitable consequence of the way in which the industry is changing across Australia, not just the Territory. However, as long as there is effective competition between the major fuel/retail players, the economies that are being achieved through rationalisation will flow to tighter distribution and retail margins and downward pressure on the price paid by Territory motorists.

- The benefits from greater average volumes and improved economies of scale in distribution and retail will be mirrored in the improved economies at the new Vopak operated fuel import terminal. The Inquiry understands that, notwithstanding higher capital costs and smaller total storage volumes, with improved handling and other operating efficiencies there is not likely to be an increase in wholesale costs. Indeed, as a result of efficiencies, on balance there may possibly be a small reduction in such costs.

- The Inquiry concludes that, with the notable exception of the more remote areas, market forces will operate to ensure that the price paid for fuel by Territory motorists is not “unreasonably high”. In particular, market forces will help ensure that the premium paid by Territory motorists reflects fundamental commercial and market realities.

- The involvement of the Territory government (and any State or Territory government in Australia) is best focussed on helping ensure that market forces do operate as best they can. To this end, the Inquiry’s Recommendations to the Government are directed towards ensuring that competitive processes are allowed to work and include:

  Ensuring motorists are well informed about what fuel prices actually are at service stations (compulsory price boards across the Territory);

  Ensuring motorists in more remote areas, or passing through these areas, are well informed about fuel prices in these locations (retail fuel price monitoring and publication);

  Implementing a consumer awareness program about fuel prices and trends in fuel prices;

  Publicly identifying areas of concern where competitive forces appear not to be working and margins and prices appear to be “unreasonably high”, with referral to the ACCC for investigation under the provisions of the Trade Practices Act where appropriate;

  Supporting competition in the fuel industry at the national level by encouraging the Australian Government to repeal the Sites and Franchise Acts.

The Inquiry has benefited from submissions and information provided by a number of groups and individuals (listed as an Attachment). In addition, the Australian Institute of Petroleum has provided the Inquiry with much of the data. Finally, the support and assistance of Kirsten Krauklis and Stephanie Biesaga is gratefully acknowledged.

Thomas G Parry
May 2005

1 THE NORTHERN TERRITORY FUEL MARKET

The market for fuel across Australia is dominated by the four oil majors. Fuel prices the Northern Territory, as in the rest of Australia, reflect a complex range of factors including crude oil prices, refinery processing costs, distribution and marketing costs, government taxes, exchange rates and international and national market forces of supply and demand.

1.1 Industry Structure

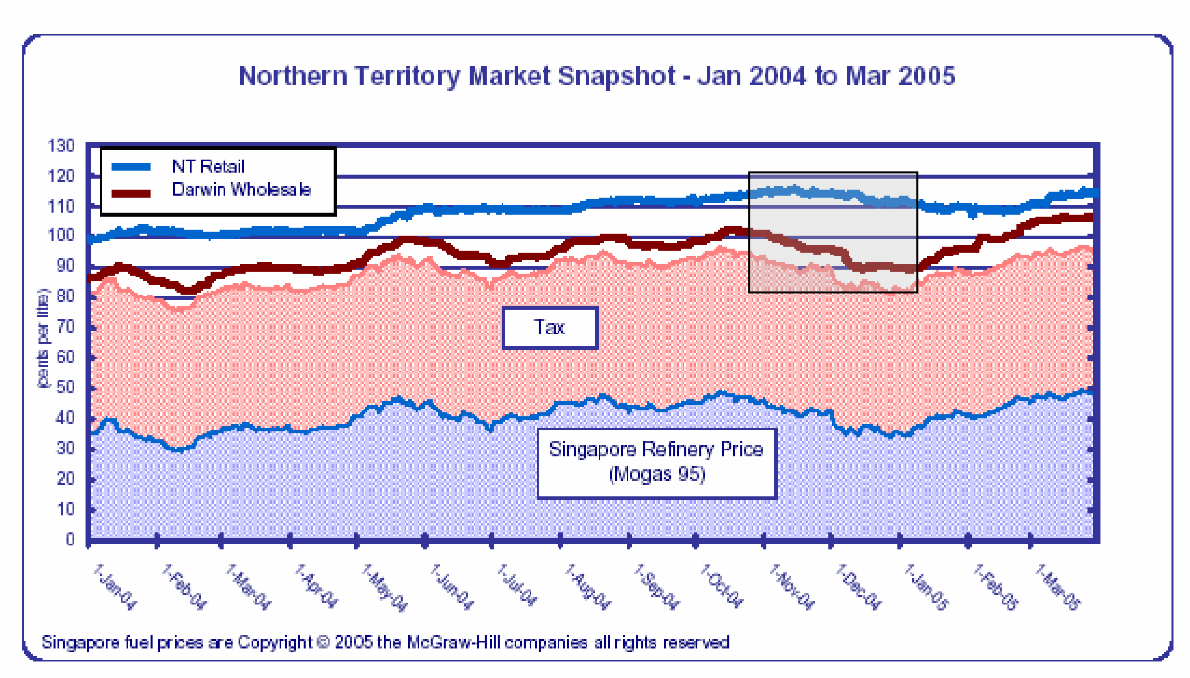
The four major players in the Australian petroleum industry are BP, Caltex, Mobil and Shell. These multinational petroleum companies own all of Australia's refinery capacity and have a strong presence in wholesale and retail petroleum markets across Australia, including the Northern Territory.

In the Northern Territory, each oil major has long term fuel supply agreements with the distributors or resellers that supply service stations, many of which are branded sites operating under a variety of commercial and pricing arrangements and ranging from oil company owned to fully independent.

The absence of a refinery in the Northern Territory means that fuel for Darwin and the Top End is typically imported from Singapore and stored in terminals before being distributed to service stations, whereas fuel for Alice Springs and Central Australia is typically freighted from Adelaide via road transport. Other regional centres, including Tennant Creek, are predominantly supplied from Darwin.

1.2 What influences fuel prices?

The major components of fuel prices are international prices for refined petroleum products; Australian Government excise, GST and state government subsidies; and margins for storage and distribution, wholesaling and retailing. The contribution of each of these components to the retail price of fuel in the Northern Territory is shown in the chart below, which also clearly demonstrates a widening in the retail margin, including distribution, prior to the announcement of the Inquiry in early February 2005, and a narrowing of the margin since that time.



Source: Australian Institute of Petroleum

1.2.1 International prices

Fuel prices in Australia, and the Northern Territory, closely track movements in international prices, which are determined by market forces rather than production costs.

International prices affect Australian retail prices through the link between wholesale prices and the import parity price. Regardless of whether petroleum products are refined in Australia[1] or refined overseas and then imported to Australia, the ex-refinery price of fuel in Australia is based on an the international benchmark for the Asia Pacific region, the Singapore[2] refinery price, with add-ons for shipping, wharfage, insurance and other costs associated with delivery of the product to Australian ports. This means that the price of Australian fuel is largely determined by the price of imported fuel, even though Australia imports only around 13% of demand for petrol and 17% of demand for diesel,[3] reflecting the competitiveness of the petroleum market in the Asia Pacific region.

If prices in Australia were set below international prices, producers could export fuel to take advantage of higher world prices, leading to a situation where Australia may experience fuel shortages. Further regulation to ensure supply at a lower price may act as a disincentive for exploration and investment in the Australia's petroleum industry.

As petroleum products are internationally traded commodities, developments on the other side of the world can have consequences for fuel prices in the Northern Territory. The main contributing factors to movements in the Australian price for fuel are global production levels of crude oil,[4] which is the major input cost in petroleum production; changes in the value of the Australian dollar compared to the US dollar, as the world oil market trades in US dollars; and the varying or seasonal demand for petrol across the globe.

[1] In 2002/03 about 66 per cent of the oil used in Australian refineries was imported.
[2] Singapore is Australia's closest major refiner and marketing centre and is the most likely source of imported product into Australia.
[3] http://www.caltex.com.au/pricing_pla.asp
[4] The most relevant crude oil price for Australia is that of Tapis crude, which is sourced from oil fields in Malaysia.

As the price of unleaded petrol in Australia is linked to the spot price of Singapore Mogas 95 Unleaded and the price of diesel is linked to a combination of the spot prices of Singapore Gasoil (80 per cent) and Singapore Kerosene (20 per cent),[5] there can be substantial differences in price movements between unleaded petrol and diesel reflecting differing supply and demand characteristics. Therefore, although diesel is marginally cheaper for a refiner to produce than petrol, it is not always cheaper than petrol in the marketplace.[6]

1.2.2 Taxation and Subsidies

A large component of the price of petrol is the tax levied by the Australian Government. This comprises the petroleum product excise, which is set[7] at 38.143 cents per litre (cpl) for petrol and diesel, and GST of 10 per cent on the price of petrol at the pump, which is ultimately paid to the states and territories. While the petroleum product excise does not vary with price, the amount of GST varies with the level of the retail price. As such, the higher the retail price, the higher the GST.

The taxation of fuel in the Territory is lessened by the Australian Government's Fuel Sales Grants Scheme and Petroleum Products Freight Subsidy Scheme. The Fuel Sales Grants Scheme was introduced to compensate regional and remote motorists for fuel price increases associated with the introduction of the GST and provides retailers with a grant of 1 cpl in Darwin, 2 cpl elsewhere in the Territory and 3 cpl in exceptional circumstances. The Petroleum Products Freight Scheme subsidises the costs of transporting eligible petroleum products to 166 remote areas of Australia[8] by reimbursing fuel distributors for transport costs incurred above an amount determined to be a reasonable cost to pay for freight. However, both schemes are to be abolished from 1 July 2006 as part of the Australian Government's reform of fuel excise[9], with funding to be redirected to land transport infrastructure and improvements in regional and outer metropolitan areas.

The taxation of petrol is also offset by state government subsidies in some jurisdictions, including the Northern Territory. The subsidies range from 8.35 cpl in Queensland to zero in the Australian Capital Territory, Western Australia and parts of New South Wales and South Australia. The total tax on unleaded petrol in Darwin, at 45.8 cpl, is the third lowest of the Australian capital cities, behind Hobart at 45.7 cpl and Brisbane at 38.4 cpl.[10]

The varying state government subsidies are a manifestation of the former business franchises fees levied on petrol and diesel sales by all state and territory governments, except Queensland. Following a 1997 decision of the High Court that cast considerable doubt on the constitutional validity of state and territory business franchise fees, the Australian Government acted to protect the financial interests of the states and territories by imposing a uniform surcharge equivalent to the highest state business franchise fee. To ensure that the price of petrol remained unchanged, state governments undertook to return any excess revenues by way of the payment of subsidies. The Australian Government surcharge was discontinued with the introduction of the GST in July 2000; however, some state government subsidies remain. The Northern Territory Government continues to provide a subsidy of 1.1 cpl on the wholesale supply of fuel into the Territory.

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5 ACCC Report on the Movement of Fuel Prices in the September Quarter 2000.
6 Department of Industry, Tourism and Resources.
7 Excise indexation was abolished on 1 March 2001.
8 The 166 remote locations are mainly Indigenous communities in northern and central Australia.
9 As announced in the Australian Government's Energy Policy Statement.
10 Northern Territory Treasury, Petrol Prices February 2005, based on Shell data.

1.2.3 Margins

Due to commercial confidentiality concerning pricing, a full understanding of wholesale, distribution and retail margins in the Northern Territory is difficult to achieve. However, in general, margins in the Territory tend to be higher given the relatively lower volumes of fuel sold, with Territory retail petrol sales accounting for approximately 0.5% of total Australian retail sales.[11]

Refining

Australia has seven major operating refineries that supply the nation with almost 90 per cent of its demand for petroleum products.[12] BP has refineries in Kwinana (in Western Australia) and Brisbane, Caltex in Sydney and Brisbane, Mobil in Melbourne and Shell in Sydney and Geelong. Most of Australia's refineries are old and small by international standards and do not experience the economies of scale and more competitive cost structures of larger refineries in the Asia Pacific region. However, local refineries have enough capacity to supply the whole Australian market, allocating about 42 per cent of total refinery production to petrol and 29 percent to diesel.[13]

Australian refineries are price takers. With prices for products determined by prices in the Asia Pacific region, Australian refineries must price their output to be competitive with imports, regardless of the cost of importing and refining crude oil, or lose market share to imports. Importing refined fuel rather than purchasing locally refined fuel is a strategy frequently used by the larger independent wholesalers and retailers. Although the Australian market is dominated by fuel refined in Australia from local or imported crude, all major coastal centres have import facilities. Therefore, the profitability of the Australian refining industry is influenced by refining margins in Asia.

All seven refineries have undertaken or announced upgrades to meet new petrol and diesel standards imposed by the Australian Government's fuel standards program,[14] which are being progressively introduced between January 2002 and January 2006. Current industry estimates of the level of investment required to meet 2006 fuel standards is more than $1 billion with further investment required to meet post 2006 standards.

According to the Service Station Association, petrol manufactured to the new standards is not normally produced in the Asia Pacific region and the premium that the industry is charging for the new fuel is somewhere between 1 and 2 cpl. Australian refiners add this premium to the Singapore refinery price before finalising the adjusted wholesale price.

The Australian Government has announced that from 1 January 2006 to 1 January 2008, grants will be provided to refiners and importers for the production and supply of 50ppm sulphur premium unleaded fuel and 10ppm sulphur diesel as an incentive for the production of higher quality fuels before they are mandated under *the Fuel Quality Standards Act 2000*. However, the grant to refiners and importers to offset the additional cost of production or supply of lower sulphur diesel and low sulphur premium unleaded

[11] Mobil Oil Australia Pty Ltd.
[12] Australian Institute of Petroleum, Downstream Petroleum 2003.
[13] Department of Industry, Tourism and Resources.
[14] http://www.safan.com (Refining Supplement 1 – Australian Refining Scene)

petrol will be funded by motorists through a small increase in excise on all unleaded petrol from 2006 to 2008 and on diesel from 2007 to 2009.[15]

Of the seven refineries located in Australia, none are located in the Northern Territory (or northern Australia, for that matter). This means the Northern Territory does not experience the price volatility associated with excess refinery capacity or short term excess product at refineries. At times in southern cities, if an oil company has an over-supply it will discount the fuel and support the retailer with a rebate of up to 12 cpl.[16]

Wholesale

The Territory wholesale market comprises the four major petrol suppliers, BP, Caltex, Mobil and Shell, as well as the recently arrived independent Australian-owned oil company, United Petroleum. Fuel for Darwin is typically imported from Singapore and stored in terminals, whereas fuel for Alice Springs is typically freighted from Adelaide via road transport. At the time of the Inquiry, it appeared that BP, Mobil and Shell imported fuel to Darwin from Singapore, Caltex purchased the bulk of its fuel from BP and United purchased its fuel from Mobil.

Whether imported or sourced within Australia, once fuel is landed in terminals, wholesalers add a margin before on-selling the product to customers. The margin covers the wholesaler's storage and distribution costs and includes a profit component. The wholesale price for uncontracted bulk purchases from a fuel terminal is known as the Terminal Gate Price (TGP). This is the price at which any person with the necessary safety clearances can purchase fuel from terminals by the tanker load. The TGP is an indicative price as few, if any, uncontracted sales are made. Thus, actual wholesale prices in the Territory market are lower than the published TGPs, although not by a significant amount.[17]

Darwin TGPs tend to be consistently higher than most other capital cities. This reflects the small size of the Territory market, that is, the relatively low volume of fuel sold and the low intensity of competition. As many of the costs of running fuel terminals are fixed, the relatively lower volumes of fuel sold in the Territory require higher prices per litre of fuel in order to cover costs and make a reasonable return on investment. Although ocean freight charges to Darwin are typically lower than freight charges to southern capitals (around 0.5 cpl), it is claimed that this is counterbalanced by higher wharfage charges in Darwin.[18]

Although the oil companies differentiate their product, it is essentially all the same product. This is evident in their joint arrangements relating to supply and storage. It is not uncommon for a wholesaler to purchase fuel from a competitor or to store a competitor's product for a fee.

Distribution

All of the Territory's fuel wholesalers have long term supply agreements with distributors or resellers (the terms of which are commercially confidential) who supply service stations and rural customers, as well as small commercial accounts. BP fuel is distributed by Australian Fuel Distributors, Caltex fuel by Northern Fuel Distributors in the Top End and Indervon Pty

15 Department of Industry, Tourism and Resources.
16 Australian Fuel Distributors.
17 The Shell Company of Australia Limited.
18 The Shell Company of Australia Limited.

Ltd in Central Australia, Mobil fuel by Darwin Petroleum Services in the Top End and Sabadin Petroleum in Central Australia and Shell fuel by Fuelink.

Distributors buy bulk product from oil major terminals and deliver it to their own branded, oil major branded or non-oil major branded retail outlets. As distributors incur their own operational costs which they seek to recover in the market, distributor margins contribute to a higher retail price in the Northern Territory, relative to those metropolitan areas that experience direct delivery from terminals. Competition in the Territory fuel market is enhanced to the extent that the distributors compete with wholesalers to secure supply contracts with individual customers.

Retail

The Territory fuel market is supplied by retail sites which span almost the full range of business models from oil company owned (commission agency and franchise) sites to fully independent and unbranded service stations. Service stations operate under different commercial and pricing arrangements, use different sources of supply, and experience varying local pressures that influence retail margins.

Retail prices reflect wholesale prices, distribution costs plus associated costs and a margin. Retail prices in Northern Territory centres tend to be higher than comparably sized locations elsewhere in Australia, mainly due to higher input costs such as electricity and wages, and lower fuel volumes and shop sales over which to spread service station operating costs, as well as competitive factors relating to the size of the market, such as less vigorous competition. However, the average price premium over time in large centres such as Darwin tends to be relatively low. In more remote centres, the price premium can be quite large – reflecting the very low volumes, the remote locality and the effective absence of any competitive pressures on margins.

The relatively low volume of fuel sold by most Territory service stations is the most important factor explaining the relatively higher price for fuel in the Territory. As the costs of selling fuel are relatively constant, low volume stations require higher margins per litre of fuel sold to achieve a similar commercial return and remain financially viable. In Darwin, the average margin is 6 to 8 cpl with a monthly sales volume of 200,000 litres, whereas fuel margins in southern cities can be as low as 2 to 4 cpl based on monthly sales volumes of more than 500,000 litres. This means Darwin stations make 80% of the gross margin of interstate counterparts before accounting for rent, wages and other overheads, which can be higher in the Territory.[19]

Also, because of the smaller market size, Territory service stations on average have less opportunity to sell non-fuel items, which typically have a higher profit margin than fuel. Most service stations do not rely wholly on fuel sales for their profits. The performance of functions such as a workshop, car wash or general shop can affect the retail price. At larger stations and those with convenience stores attached, petrol sales may even be used as a ‘loss-leader’ to attract customers to more profitable sections of the station.

There is also a perception that the Territory’s regional centres are ‘over-pumped’, that is, there is relatively more retail outlets per capita than larger centres elsewhere. To the extent that Territory centres are over-pumped, lower fuels sales volumes imply a higher retail

[19] Australian Fuel Distributors.

margins requirement to ensure financial viability and a smaller customer base for associated non-fuel trade.

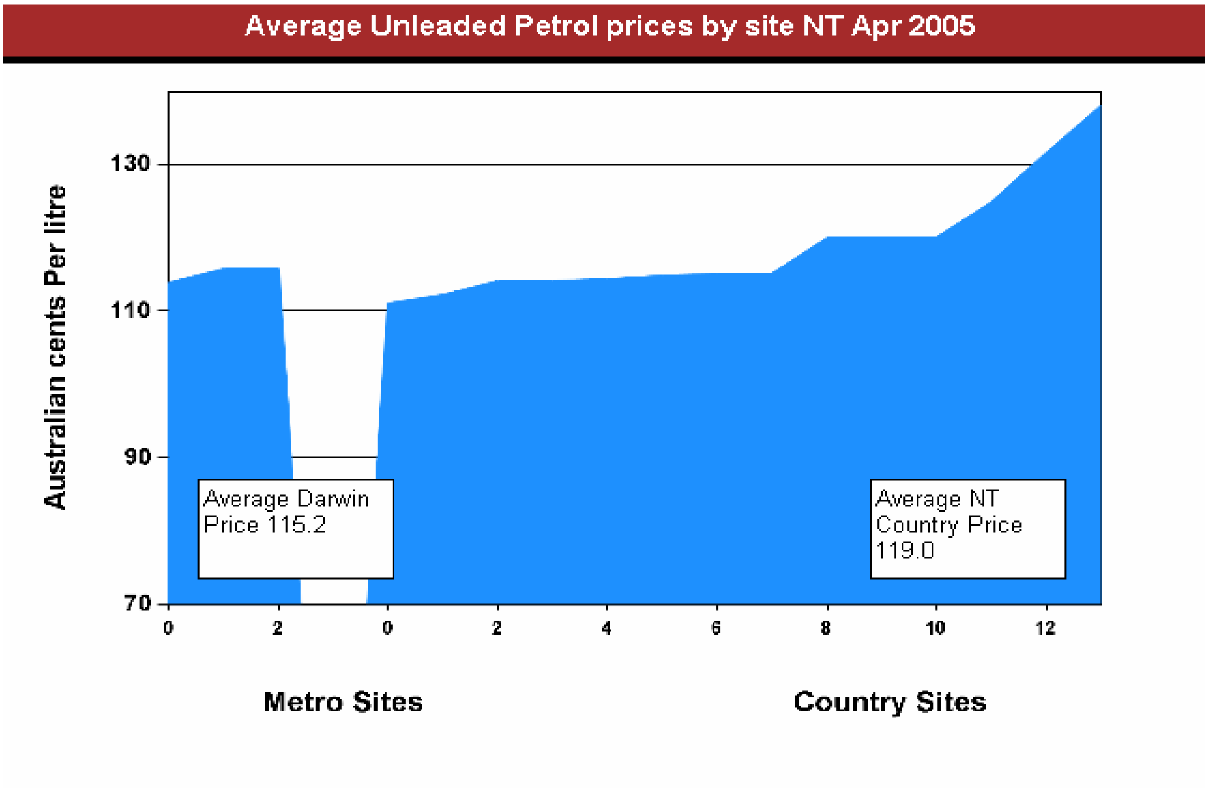
Another important factor in Territory petrol prices is the level of competition in the local market. While there is competition for sales at the wholesale and retail level, pump price discounting is limited by the inherent diseconomies of fuel supply to a small market.[20]

On the whole, and particularly in the more remote areas, Territory service stations are less likely to compete vigorously with their rivals. The degree of competition in the Territory is mainly affected by the relative absence of an independent retail chain (until the more recent entry of United), the extent of price support retailers receive and the extent to which discounts are available at the wholesale level. The lower level of competition also means that oil companies are not required to cut the cost of wholesale fuel to help their retailer match local competition, as happens regularly in metropolitan areas.

These pricing factors are intensified in remote Territory centres, which are further disadvantaged by their even smaller size and their remoteness. The price paid by motorists is a reflection of market forces, as fuel retailers set prices according to their commercial assessment of demand and competition in their area. Road transport and freight costs are a significant factor leading to higher retail prices in remote parts of the Territory. Also, as GST is based on the final price of fuel, consumers in regional and remote areas often pay a larger tax component given the geographical and economic factors that tend to lead to higher fuel prices. While the Australian Government's Fuel Sales Grant Scheme goes someway to offsetting these differences, the scheme will be abolished from 1 July 2006.

That said, the relatively recent arrival of national independent, United, into the Katherine and outer-Darwin markets has enhanced competition between retailers and resulted in retail prices that are below those in Darwin.

[20] Mobil Oil Australia Pty Ltd



Source: Shell Company of Australia - www.shell.com.au

Unlike the major capital cities, Territory petrol prices are not influenced by discernible price cycles. Petrol price variability is most common in the larger capital cities, where the density of population allows some service station operators to try to capture customers from outside their local area to increase market share. Price cycles tend to occur on a weekly basis and are influenced by factors such as supply shortages and surpluses and the degree of local competition. Petrol price variability also appears to be more prevalent in markets where large independent retail chains operate. **The volatility of petrol prices in major capital cities can create an exaggerated impression of price differentials if Territory prices are compared with the lowest available metropolitan price at a particular point in time, rather than the average metropolitan price.**

In the Australian market, diesel is often more expensive than petrol as diesel prices are not discounted to the same extent as petrol prices. Much less diesel is sold than petrol and dealers therefore concentrate on petrol discounting to drive overall fuel sales volumes and associated shop sales. This in part explains why the comparative margin between Territory prices and other averages has tended to be smaller for diesel than that of unleaded petrol.[21]

Consumer demand for fuel is price inelastic, that is, most motorists need to fill their car with fuel regardless of the cost. Motorists can try to reduce their fuel consumption, but there is no close substitute with which they can fill their tank. However, the mobile nature of the motor car means that motorists in metropolitan centres can, and do, respond to variations in price, if prices are displayed on highly visible price boards.

21 According to the AANT, the margin between Territory prices and the other averages has tended to be smaller for diesel than that of unleaded petrol prices.

Recommendation 1
That all retailers be required by law to display prices for all of their fuel products on adequately sized price boards that are visible to passing motorists and to ensure that the prices displayed on the price board match those displayed on the pumps and at the cash register.

1.3 Regulation of the Petroleum Industry

While petrol prices are determined be the free operation of market forces without any form of Government control, both the Australian and Northern Territory Governments have a role in the regulation of the petroleum industry.

1.3.1 Role of the Australian Government

The Australian Government regulates the retail petroleum industry through the *Commonwealth Petroleum Retail Marketing Sites Act 1980* which controls the proportion of sites that are allowed to be directly owned and operated by the four major oil companies, and the *Commonwealth Petroleum Retail Marketing Franchise Act 1980* which controls aspects of the franchise agreements between the majors and their franchisees.

Other wholesalers, including independent retail chains, are excluded from the scope of the Sites Act and are not subject to the same statutory limitations as the oil majors. While to some extent the oil majors have circumvented these restrictions through multi-use franchises (thus restricting independence in pricing), the legislation prevents the oil majors from operating on an equal footing to the independent wholesalers.

The Australian Government has announced its plans to reform the retail petroleum sector, replacing the outdated Sites and Franchise Acts with an Oilcode mandated under the *Trade Practices Act 1974*. The key elements of the proposed Oilcode include the introduction of terminal gate pricing principles to promote increased transparency and national consistency at the wholesale level of the petroleum sector, minimum standards and conditions for petrol re-selling agreements between retailers and suppliers, and an independent mechanism for settling disputes between industry participants.

Recommendation 2
That the Northern Territory Government support the repeal of the Australian Government's Sites and Franchise Acts in the interests of establishing a more competitive framework for the Australian petroleum industry.

1.3.2 Role of the ACCC

The Australian Competition and Consumer Commission (ACCC) is responsible for the investigation of anti-competitive behaviour in local markets and can take action under the *Trade Practices Act 1974* if there is evidence of anti-competitive behaviour.

Currently, the ACCC collects and analyses the retail prices of unleaded petrol, diesel and automotive liquefied petroleum gas in the capital cities and around 110 country towns across Australia, and monitors international crude oil and refined product prices and published terminal gate prices. The ACCC also prepares reports on petrol issues for the

Government, and provides advice on fuel issues to the Government and Government Departments on an ad hoc basis.

1.3.3 Role of the Northern Territory Government

The Northern Territory Government has various roles in relation to petroleum, including licensing fuel outlets in accordance with the *Dangerous Goods Act 2004*; ensuring the accuracy of fuel measurements in the market in accordance with the *Trade Measurement Act 2003*; administering the Territory fuel subsidy in accordance with the *Fuel Subsidies Act 2000*; and exercising other non-industry specific powers in relation to town planning, health and safety and the environment.

Within the scope of the relevant legislation, the Northern Territory Government allows competitive forces to determine the location of new service stations, with development applications assessed by the Government's Development Consent Authority. The Territory Government also allows for mixed businesses to enter the retail industry and for distributors to participate in wholesale and retail trade, further adding to competition.

Following discussions with recent entrants to the Territory retail market, the Inquiry considers there is no evidence of barriers to entry at the retail level that could be addressed by Government action. However, the Inquiry notes that the Northern Territory Government has recently entered into a three-year mandatory common use *Fuel Card* contract with BP Australia for the supply of fuel for Government vehicles. The contract card price for fuel is a discounted average of Northern Territory BP service station prices calculated daily within Darwin and Alice Springs and weekly elsewhere.

The Inquiry understands that the intent of the contract is to realise better value for money through economies of scale and that the pricing mechanism under the contract is similar to that applied in other states. However, the Inquiry considers that the Government could play a greater role in encouraging competition in the retail fuel market by issuing government vehicles with multiple fuel cards and encouraging employees to shop around for best price, as is the case in New South Wales.

Recommendation 3

That the Northern Territory Government consider moving away from the single tied system currently in place for government Fuel Cards and instead introduce a system that encourages government employees to shop around for the best price, thereby promoting competition in the Territory retail market.

The Northern Territory Government's Consumer and Business Affairs Office monitors fuel prices and maintains a website, *NT Fuel Watch*[22], which provides weekly high, low and mean prices for unleaded, premium unleaded, diesel and LPG for the Territory's major centres - Darwin/Palmerston, Alice Springs, Katherine, Tennant Creek and Nhulunbuy.

The Inquiry considers that this service could be enhanced by extending it to remote areas of the Territory, such as Yulara and Groote Eylandt, and by identifying and publishing the prices of outlying service stations at regular intervals.

22 http://www.nt.gov.au/justice/graphpages/cba/ntfuel/nt_fuel_watch.shtml.

The Inquiry notes that the Western Australian Government has introduced a range of fuel pricing arrangements, including legislation that requires retailers to fix fuel prices for a twenty-four hour period and to notify government of these prices in advance, making them available to consumers and other retailers via a telephone hotline and website. However, the Inquiry does not consider it appropriate to introduce such reforms in the Territory given the different dynamics of the Territory market, that is, the absence of discernible price cycles, and the uncertainty over whether consumers are benefiting from such reforms. The ACCC's December 2002 assessment of the fuel pricing arrangements in Western Australia concluded that the 24-hour rule is likely to have reduced rather than increased competition in the retail market.

Recommendation 4

That the Northern Territory Government extend its retail fuel price monitoring role to individual service stations in regional and remote areas of the Territory and that the Northern Territory News publish these prices on a regular basis as a service to the Territory community.

1.3.4 Other Regulatory Arrangements

Some states, most notably Western Australia[23], have introduced a range of regulatory actions impacting on the fuel industry, including the 24-hour price rule, a 50/50 price rule, a maximum wholesale price scheme, a retail cap and mandated terminal gate prices. These actions are discussed in detail in various fuel-related reports and websites and are not replicated in this report.

However, the Inquiry has considered the appropriateness of these actions and found it difficult to justify their implementation in the Territory without the certainty of long-term benefits for consumers. In the absence of any discernible evidence of market failure, there is no economic rationale for regulatory intervention in the petroleum market, particularly where it would interfere with competitive forces or increase compliance costs for industry and lead to increased fuel costs for consumers.

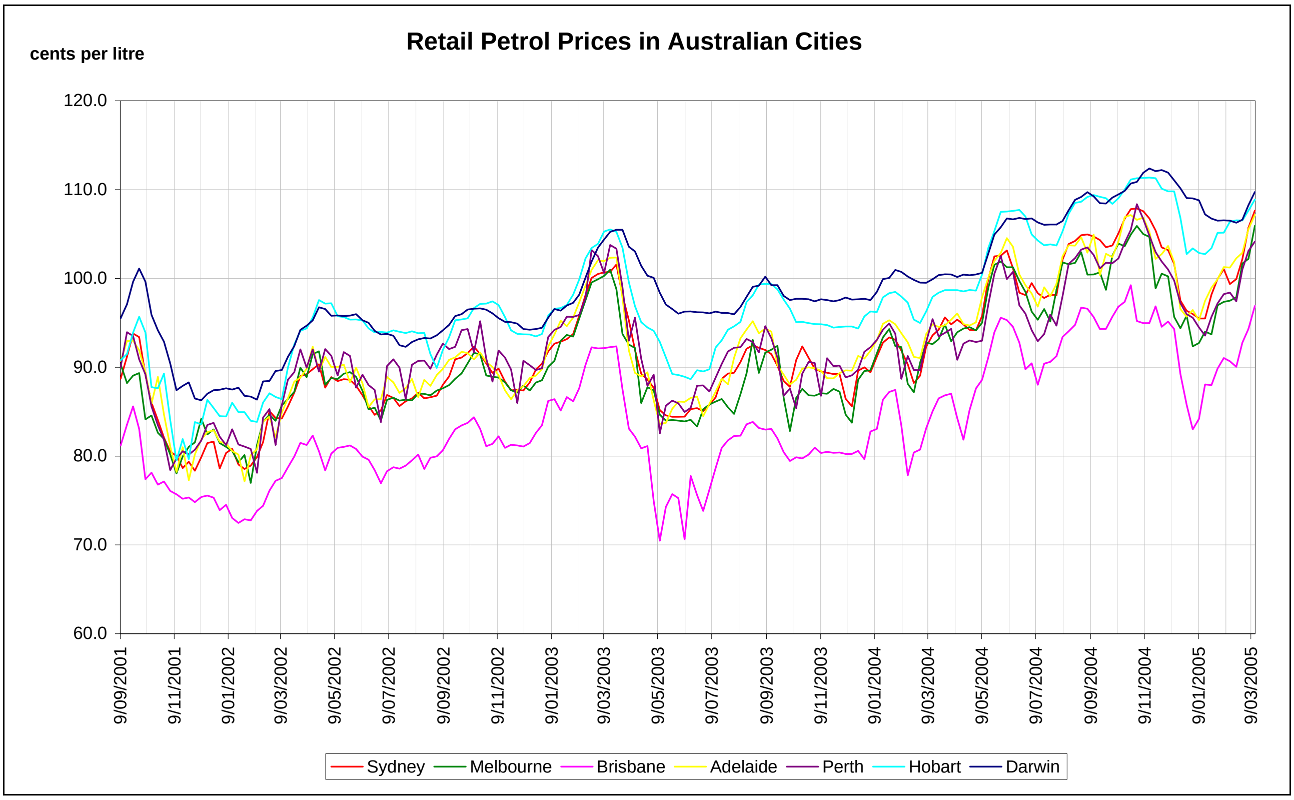
[23] http://www.fuelwatch.wa.gov.au.

2 NORTHERN TERRITORY FUEL PRICES

The prices of fuel and other goods in the Northern Territory generally follow national trends, and petrol broadly accounts for no more of the Northern Territory household budget than it did twenty years ago. However, consumers tend to be more sensitive to changes in petrol prices than other household goods, as petrol is purchased regularly and is a substantial part of the household budget. While relative fuel prices are higher in Territory centres, this can be explained by a combination of factors including lower sales volumes and corresponding higher margin requirements, an absence of aggressive competition and the remoteness of Territory locations.

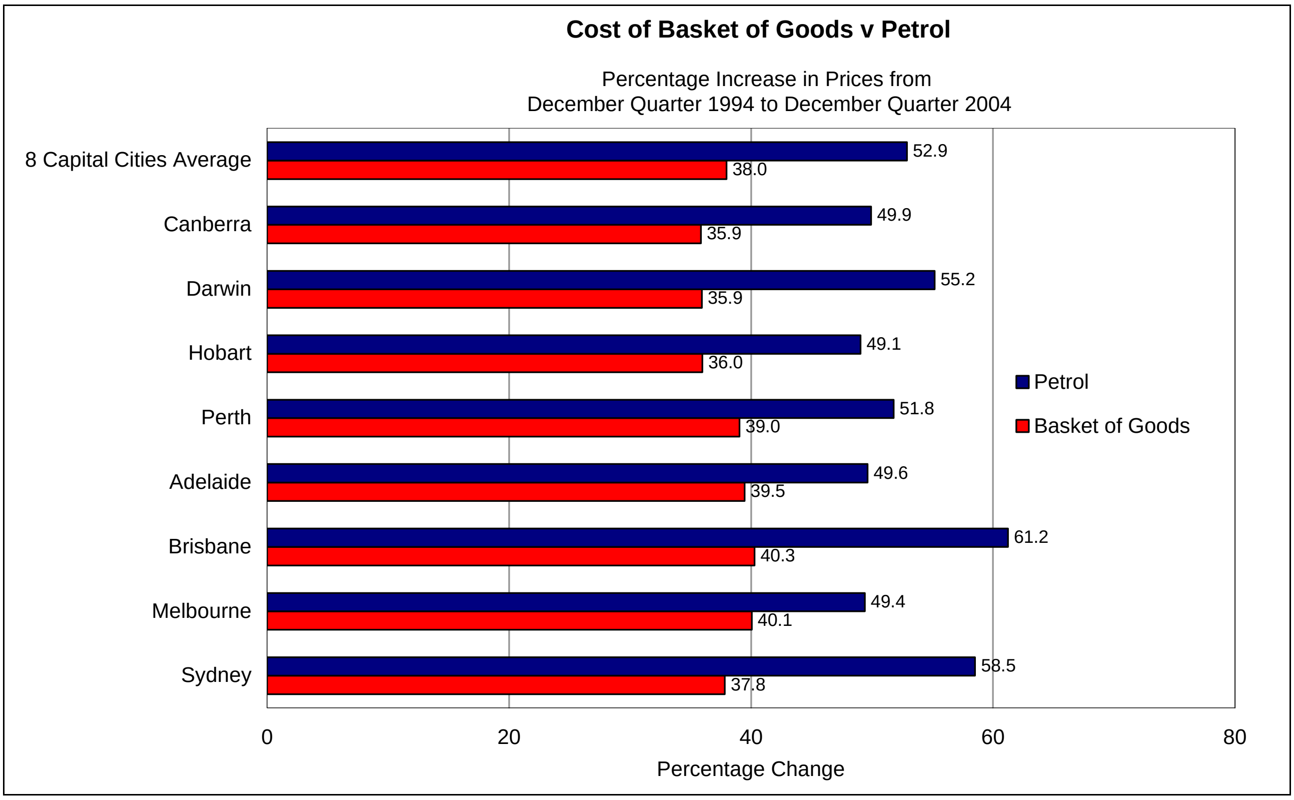
2.1 General Price Levels

The graph below sets out the movement in unleaded petrol prices in the major Australian cities (except Canberra) since September 2001. The graph shows that movements in Darwin fuel prices generally echo the trends found in other capitals. However, in the period late November 2004 to late January 2005 Darwin prices did not decrease to the same extent as prices in the other capital cities. This would appear to reflect issues of lower price volatility and increased price "stickiness" associated with Darwin, i.e. over a longer time period, the differential between Darwin and the other capitals is relatively stable. Nonetheless, as the graph demonstrates, there have been several other (albeit shorter) periods over which Darwin prices did not decrease by as much or as quickly as the other capitals (e.g. early/mid 2003.)



Source: Australian Institute of Petroleum

The next graph shows the increase in the retail price of unleaded petrol in the ten years to December 2004, compared to the increase in the price of a basket of commodities,[24] for each of the eight capital cities in Australia. In broad terms, increases in the price of petrol and other goods in Darwin over the past ten years have not generally been substantially different to those in the other capital cities.[25]



Source: Australian Institute of Petrol and the Inquiry.

The proportion of average weekly earnings needed to purchase 40 litres of petrol in Darwin is almost the same now as it was 20 years ago, at approximately 4.5 per cent, and only around 0.25 percentage points higher than the Australian average, which is largely due to changes in average weekly earnings. This is illustrated in the following graph.

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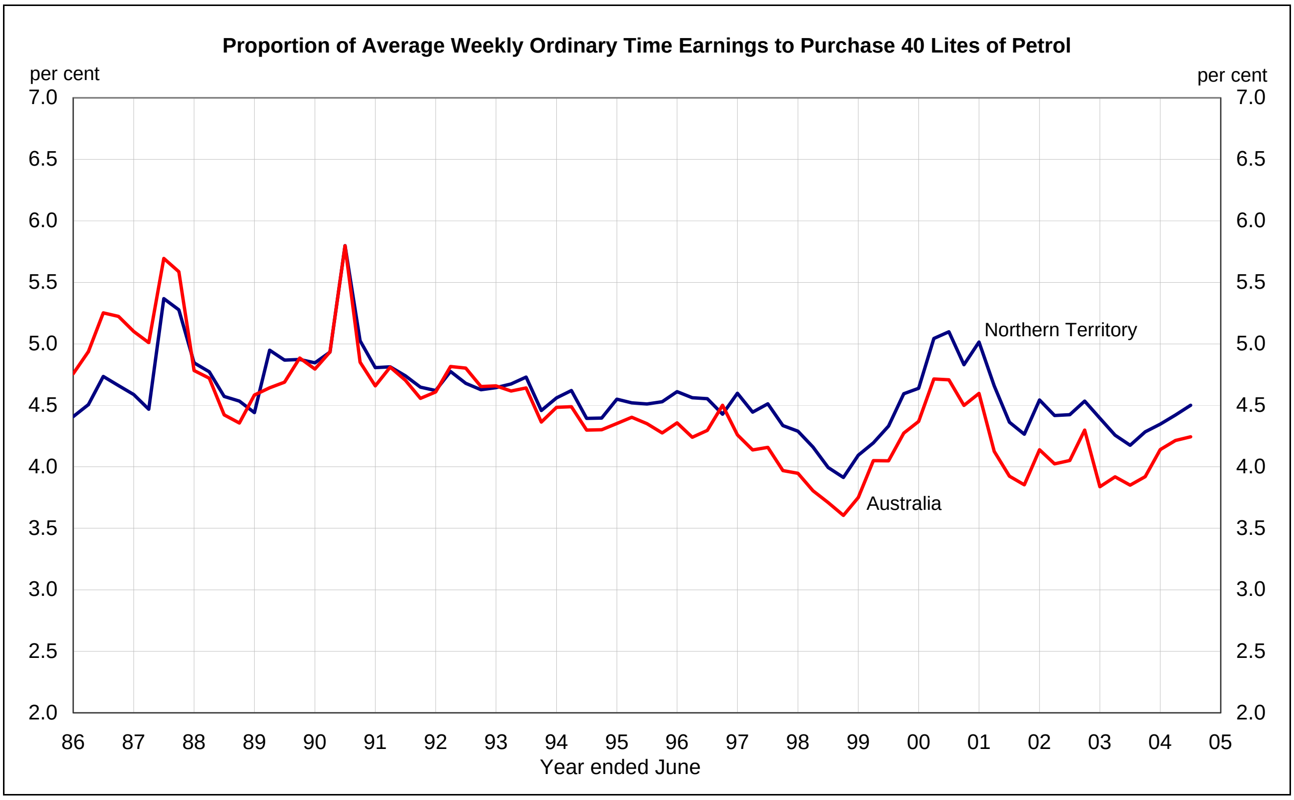
24 Estimated cost of a basket of goods based on Australian Bureau of Statistics Average Retail Prices of Selected Items and Household Expenditure Survey data.

25 As the graph compares two points in time, the reported increase in petrol prices may be affected by petrol price volatility. Note changes to fuel tax arrangements in Queensland account for part of the increase in petrol prices over the ten years to December 2004.



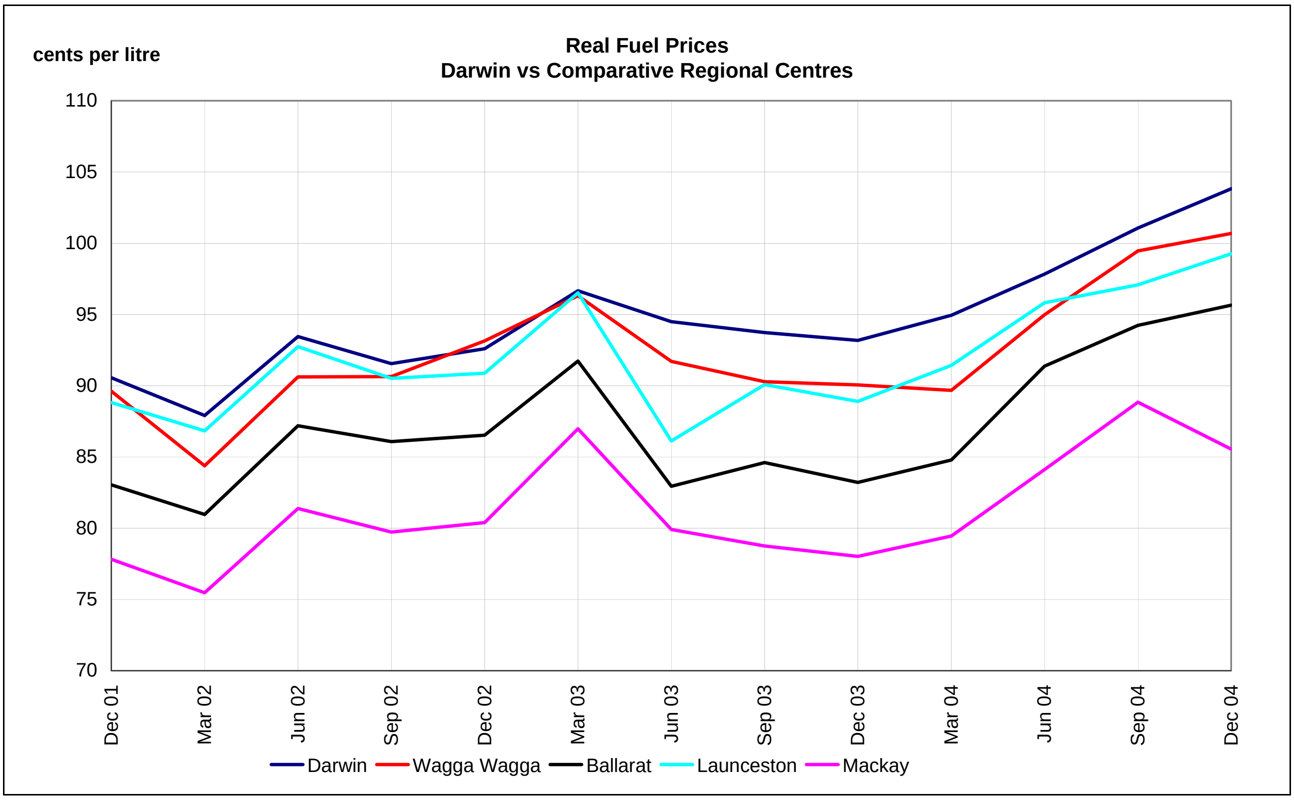
Source: Australian Bureau of Statistics

2.2 Petrol Price Levels

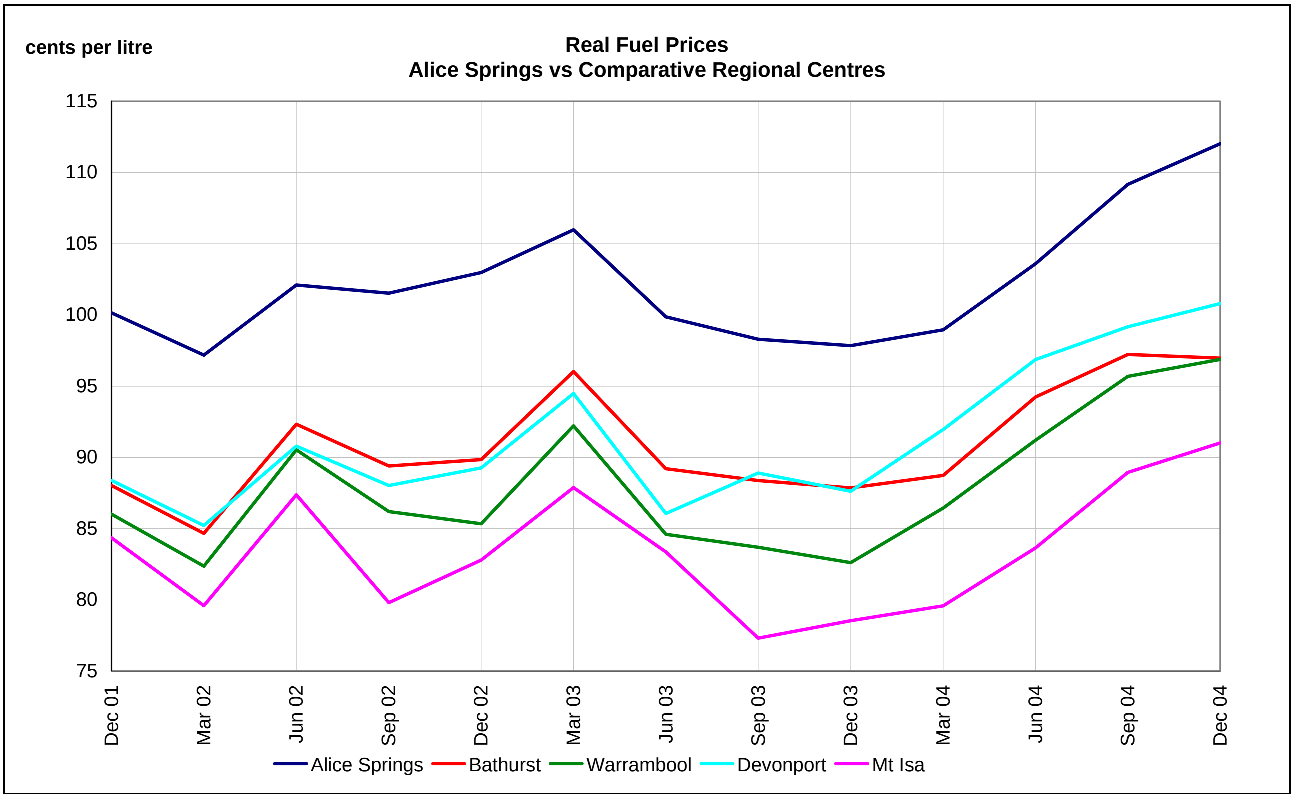
While movements in Northern Territory retail fuel prices typically mirror national trends, prices tend to be higher than other comparably sized centres.[26] The differential is greater in the more remote Territory locations, as evidenced by the graphs below.[27] However, in comparing centres, it is important to remember that prices in some states include state government subsidies. These subsidies range from 8.35 cpl in Queensland, 1.95 cpl in Tasmania, 1.1 cpl in the Northern Territory and zero in the Australian Capital Territory, Western Australia and parts of New South Wales and South Australia.

[26] Comparable locations used by the Inquiry were selected on the basis of population size and remoteness.

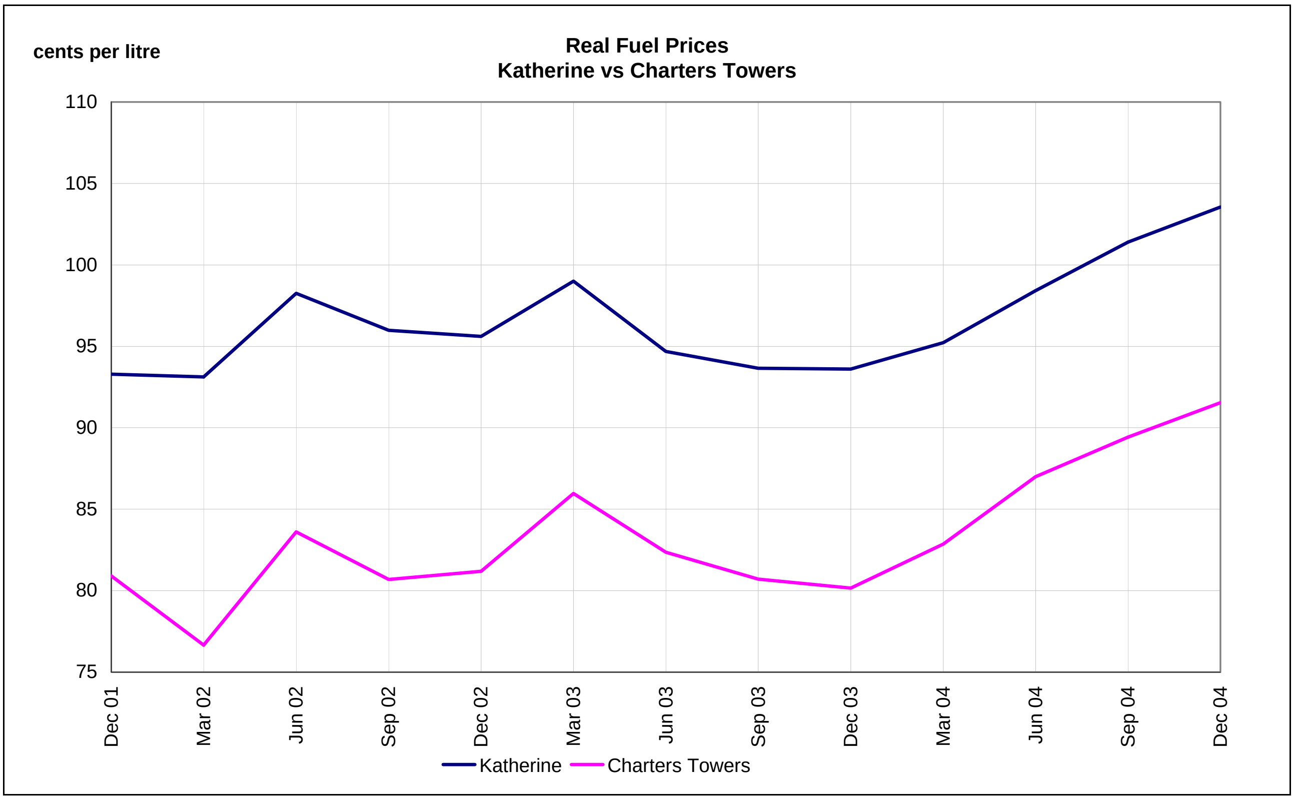
[27] Underlying data sourced from the Australian Institute of Petroleum. Further detail of prices and margins on unleaded petrol is included in Attachment 1.



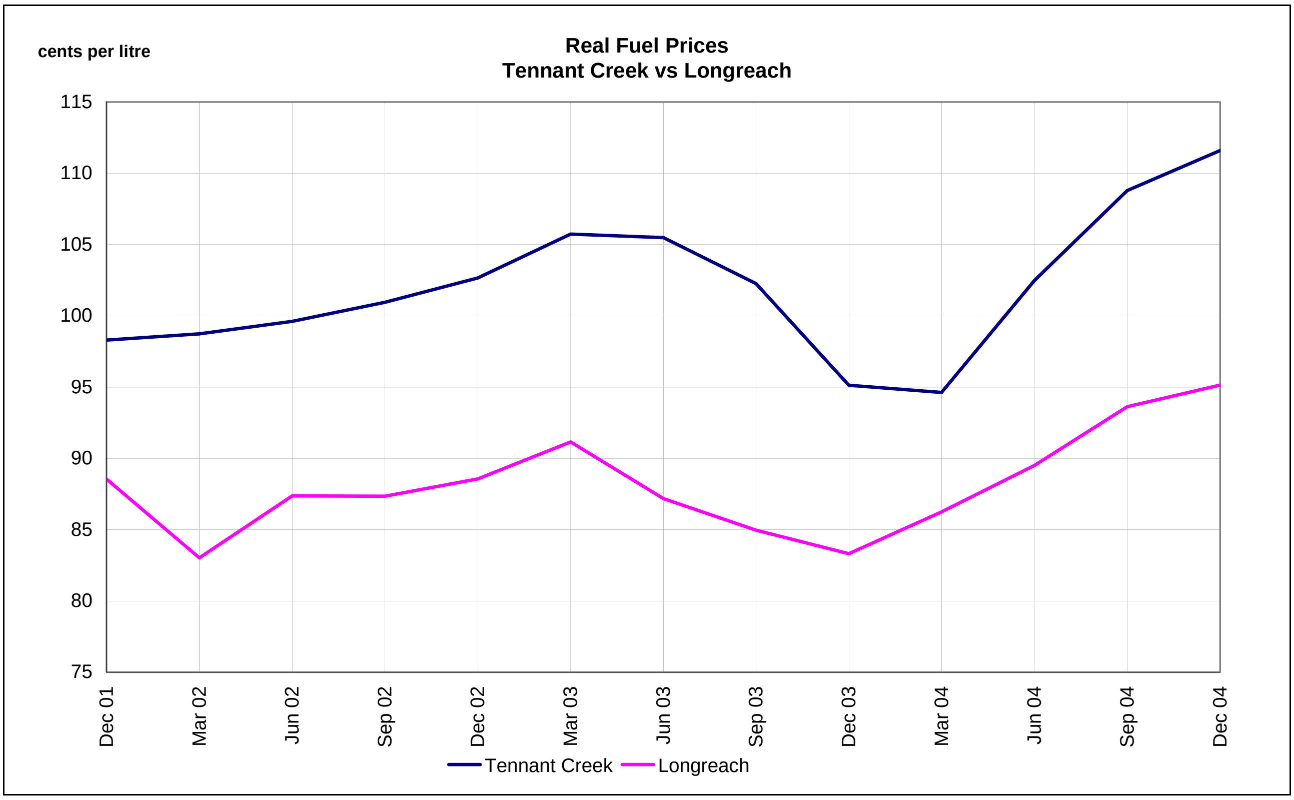
Source: Australian Institute of Petrol and Australian Bureau of Statistics.



Source: Australian Institute of Petrol and Australian Bureau of Statistics.

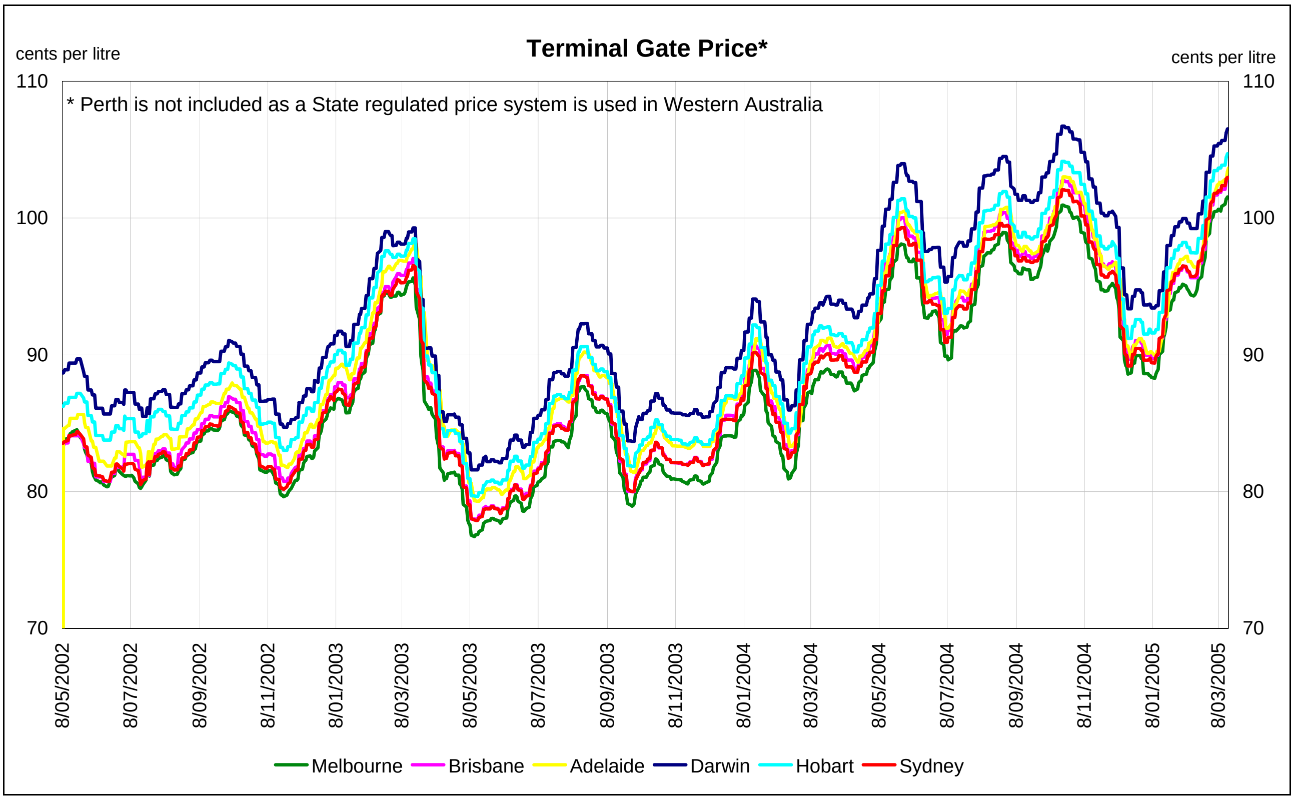


Source: Australian Institute of Petrol and Australian Bureau of Statistics.



Source: Australian Institute of Petrol and Australian Bureau of Statistics.

The higher prices found in the Northern Territory occur because of a combination of factors. Firstly, industry participants in the Territory face a significantly lower volume throughput coupled with equivalent or higher fixed costs compared to other comparably sized locations across Australia, especially the mainland capital cities. This implies a higher unit cost of fuel sold in the Territory. At the wholesale level, this reflects higher costs at the terminal, and in shipping, handling and storage. At the retail level, it involves the costs associated with energy (a significant input into retail costs),[28] labour and rent, as well as distribution costs. Thus the Territory generally faces higher wholesale and retail margin requirements compared to other comparably sized locations (see graphs below).[29] That is, a business selling lower volumes of fuel will need a higher margin per litre of fuel sold to offset the same overhead costs.



Source: Australian Institute of Petrol.

Differences in Terminal Gate Prices in part reflect varying fuel standards between the states. In its submission to the Inquiry, Caltex claimed that such differences result in higher petrol prices in Western Australia, South Australia, the Northern Territory and New South Wales (in summer months) relative to other states.[30]

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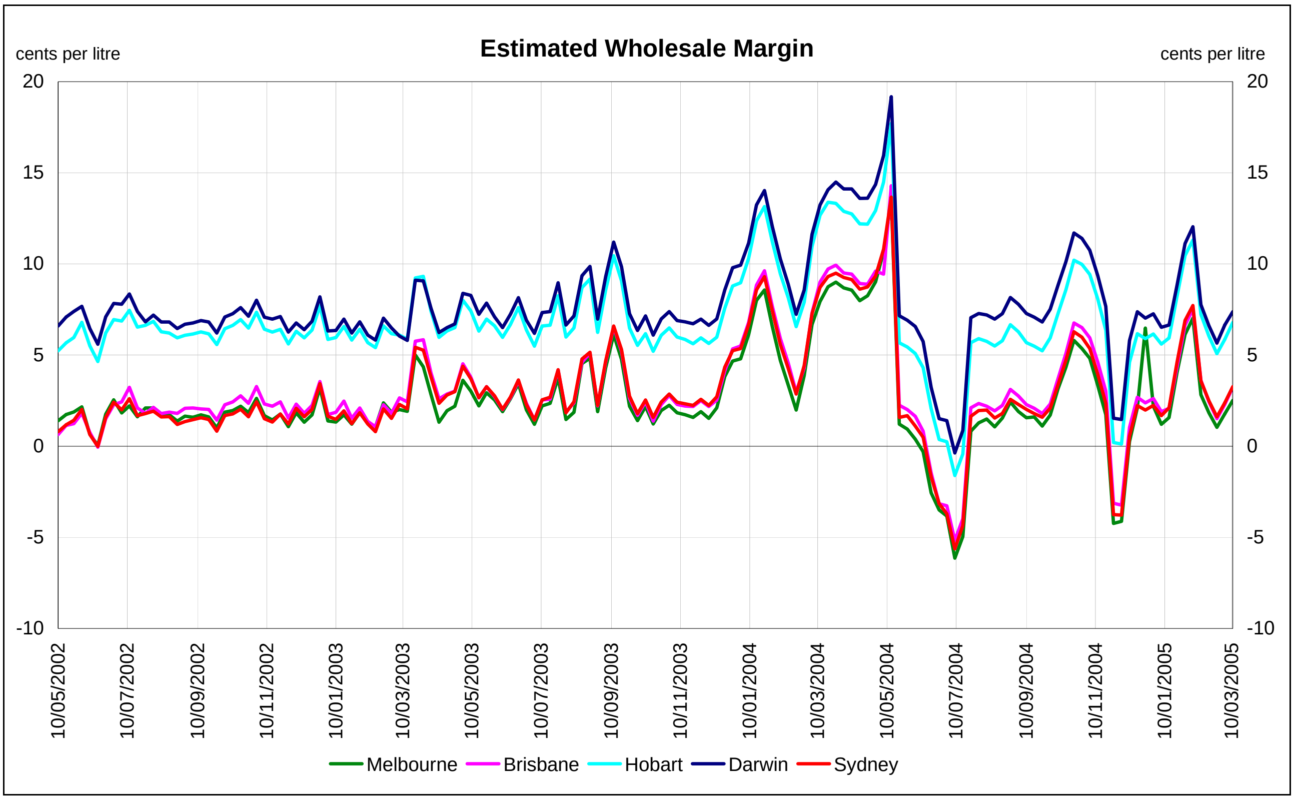
28 Confidential information provided to the Inquiry suggests that energy costs are higher in the Northern Territory compared with other locations.

29 Underlying data sourced from the Australian Institute of Petroleum and Shell Company of Australia - www.shell.com.au. The Inquiry notes there may be an anomaly in the data for refinery prices over the period May-June 2004 (affecting wholesale margin calculations). The Inquiry was unable to clarify this issue prior to preparing the final Report.

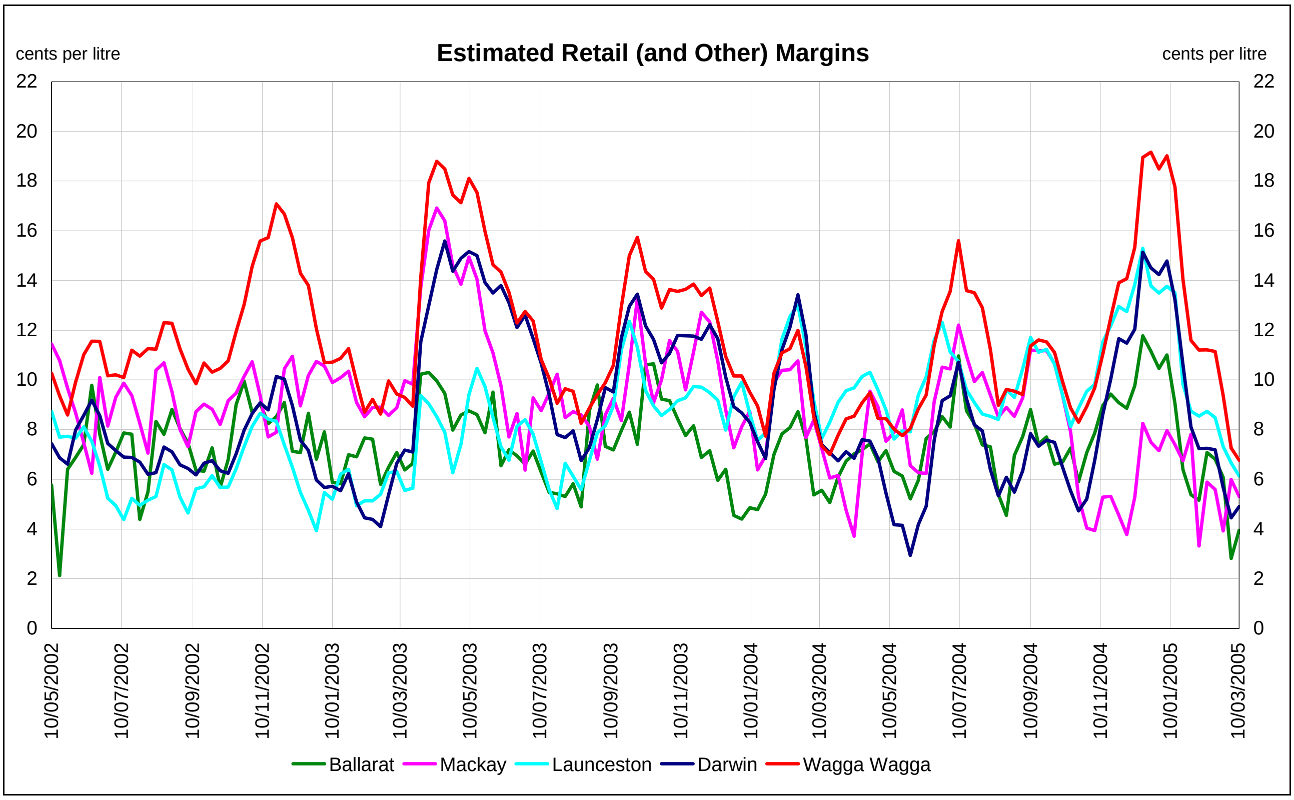
30 Submission by Caltex Australia Limited, page 3.



Source: Australian Institute of Petrol and Inquiry analysis.

It is noticeable in the graph above that the wholesale margin for both Hobart and Darwin is higher than for Melbourne, Brisbane and Sydney, which have much higher sales volumes.

Retailer margins in Darwin appear to have been similar on average over the last three years to those in other locations in Australia with comparable populations. While the decline in the Darwin retail margin in January and February of this year is marked, it is important to note that this is not the first time that Darwin retail margins have been less than 6 cents per litre.



Source: Australian Institute of Petrol and Inquiry analysis.

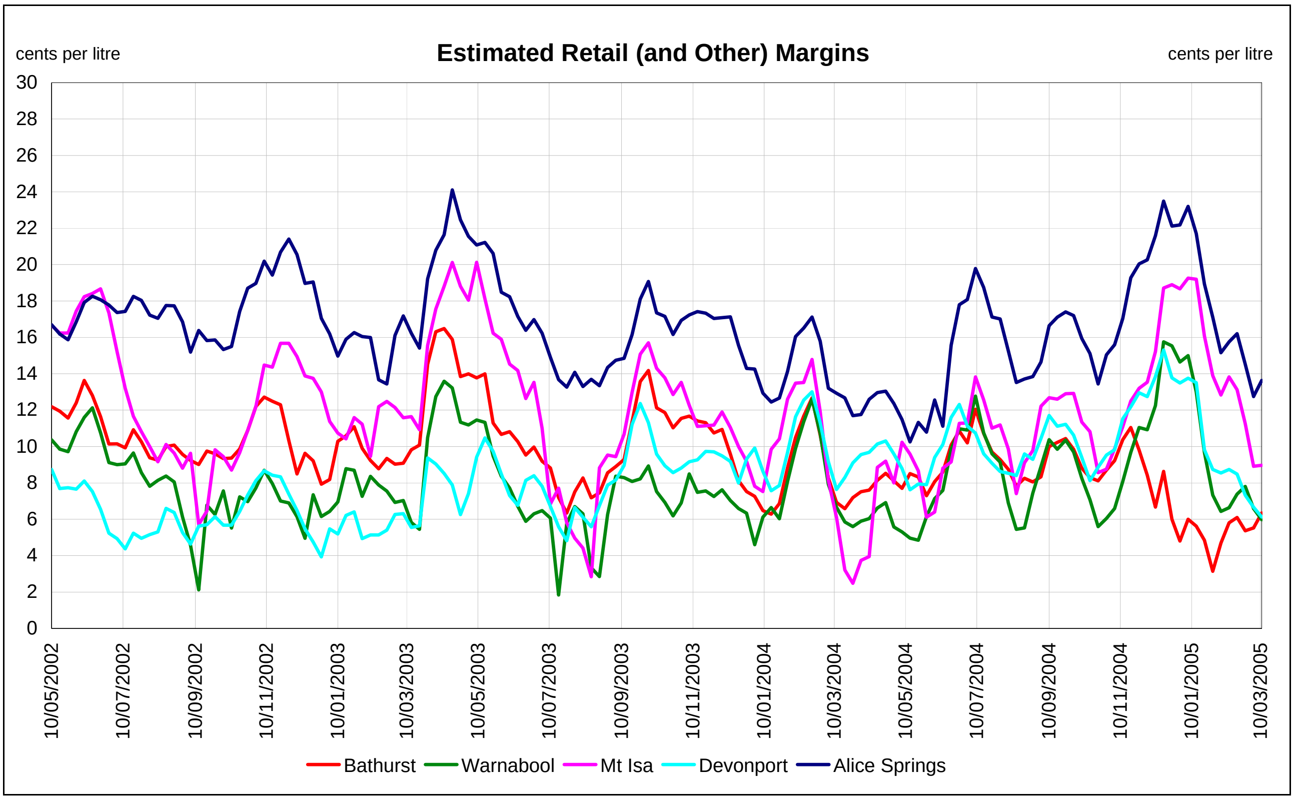
Secondly, in general there appears to be less vigorous competition between industry participants in the Northern Territory compared to other locations in Australia (again, especially the mainland capital cities). Clear and consistent price cycles, present in the major capital cities and generally considered evidence of a more competitive market,[31,32] are largely absent from the Northern Territory. In the absence of a refinery, the Northern Territory does not experience the price volatility found in the major capital cities that is associated with oversupply due to excess refinery capacity and/or short-term oversupply of product (see below for a discussion of petrol price movements).

Competition in retail petrol markets is also thought to be increased in the presence of a significant independent discount chain, and the nature of retail competition in the Territory does appear to be changing, especially in Katherine and Darwin, with the increased role of the national supermarket chains and the fuel discounter, United. There appears to be a lack of price support from oil companies for franchise operators in the Territory.

Thirdly, more remote areas generally have higher petrol prices because of higher transport costs, given the distance from refineries and import terminals. For centres outside of Darwin, volumes and competitive pressures are even lower and distribution costs higher, leading to higher margin requirements (see graph below).

31 See, for example, statement by the ACCC to the Senate Economics Legislation Committee hearing, 17 February 2005, (available at www.aph.gov.au/hansard pages E 29, E 32).

32 According to the ICRC, evidence for the link between competition and price cycles "includes the low profitability of the industry and the fact that the troughs of the cycle often see fuel sold at or below wholesale cost." *Inquiry into Motor Vehicle Fuel Prices*, Independent Competition and Regulatory Commission, September 2001.



Source: Australian Institute of Petroleum and Inquiry analysis.

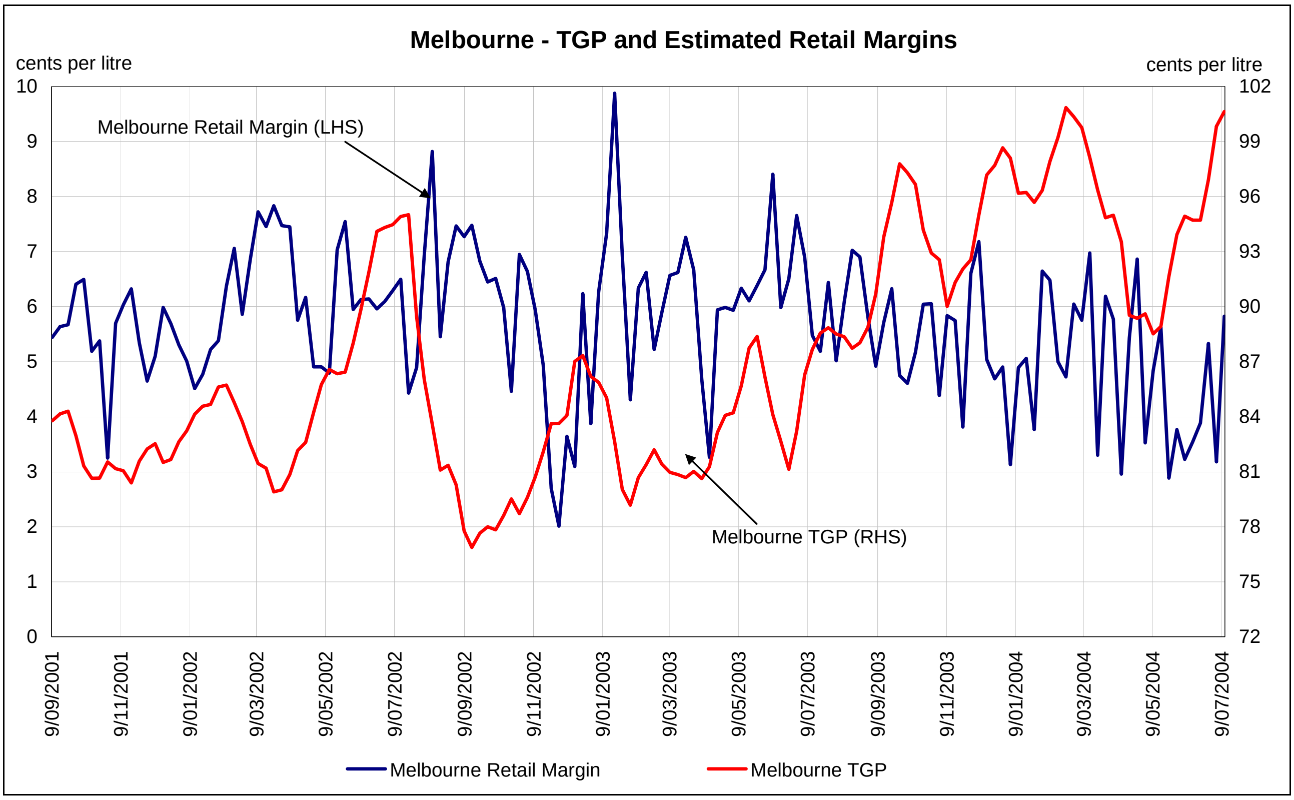
2.3 Movements in Petrol Prices

As mentioned previously, petrol prices in the major capital cities are influenced by regular discount cycles. According to the ACCC, these cycles tend to occur on a weekly basis, with peaks in prices at times of relatively high demand, often Fridays and/or before public holidays.[33] Price cycles appear to be influenced by many factors – including competition for local market share, short-term excess product (or capacity) at refineries, oil company support of franchisees, changes in demand and movements in refiner margins.[34] Outside these centres, petrol prices do not tend to move in cycles; the major determinant of petrol prices in these areas is movements in the price of international refined product.

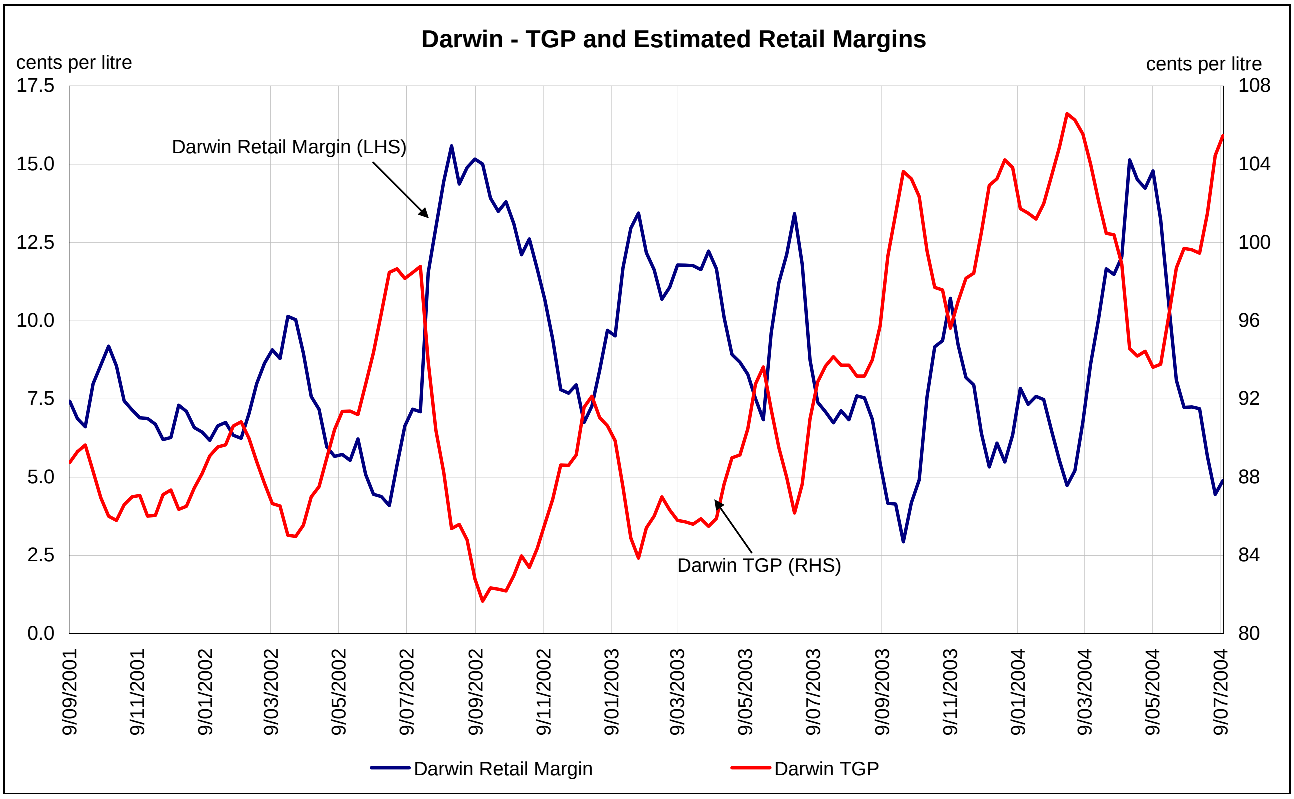
The graphs below, which show movements in Terminal Gate Price (TGP) and retail margins in Melbourne and Darwin, demonstrate the retail price cycles found in major mainland capital cities, demonstrated by the volatility of margins in Melbourne, compared to Darwin. Notwithstanding the price volatility associated with discounting, the graphs also show a general tendency for margins to fall when refinery prices (and thus TGPs) are high, and vice versa, which may result from efforts to keep retail prices more stable.

33 ACCC, *Report on the Movement of Fuel Prices in the September Quarter 2000*, October 2000

34 ACCC, Reducing Fuel Price Variability, December 2001.



Source: Australian Institute of Petroleum and Inquiry analysis.



Source: Australian Institute of Petroleum and Inquiry analysis.

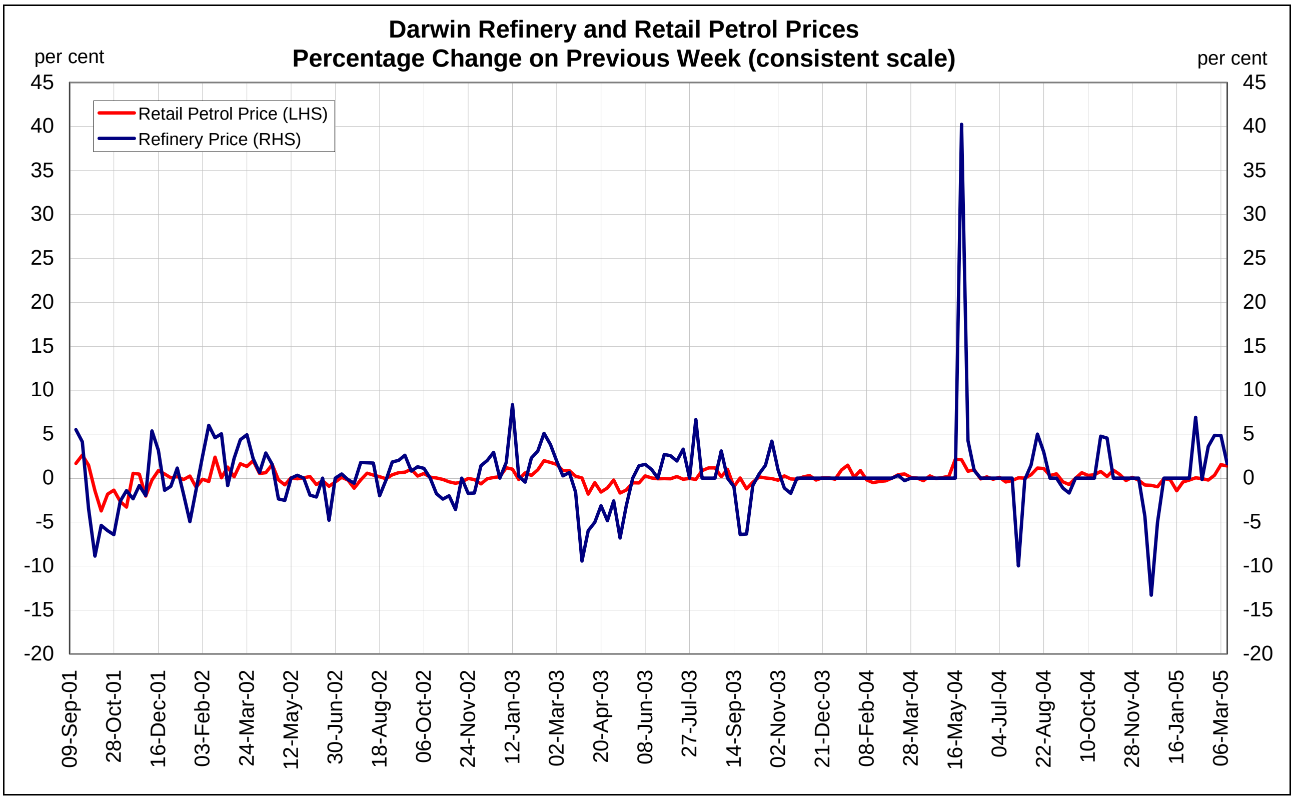
There are signs that the entry of a new fuel discounter in Katherine and Darwin has had some impact on competition in the short term. The Inquiry understands that there was evidence of price competition in Katherine in the first two months of the discounter's entry; although by the third month of operation fuel discounting appeared to be less significant.

In Darwin, the new entrant's presence has had an influence on localised prices, but the small and localised scale of entry has meant there has been a limited decrease in broader petrol prices in the Darwin region.

It is generally accepted that fuel prices demonstrate an element of price rigidity or "stickiness" in that movements in the international refined product price may take some time to be reflected in retail petrol prices. While it is not clear at what point in the chain this rigidity occurs (i.e. at the wholesale, distribution or retail level, or possibly across all three), prices in more remote areas tend to be stickier than those in the major metropolitan cities, due to the absence of price discounting and the slower turnover of fuel in country areas and thus longer time lag to re-stock fuel.[35] This is consistent with the observed price stickiness in the Territory during the recent December-January period.

Concern has been expressed that falls in the price of international refined product may not be reflected in retail petrol prices. As demonstrated in the following graph,[36] the same applies to *increases* in the price of international refined product. In evidence to the Senate Economics Legislation Committee hearing (17 February 2005) the ACCC suggested:

> *"… it would only be if we saw a major dislocation in these two movements that we would be saying there was a problem and it needed to be dealt with. But every time these issues are raised we look at the international benchmarks and the international exchange rate and consistently with the informal monitoring that we run through the year we see that the retail prices are actually moving in accordance with the movements in those rates."*



Source: Australian Institute of Petroleum and Shell Company of Australia - www.shell.com.au.

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35 ACCC, *Report on the Movement of Fuel Prices in the September Quarter 2000*, October 2000, page 45.

36 As noted previously, there may be an anomaly in the data for refinery prices over the period May-June 2004.

The higher retail fuel prices paid by Territory motorists can generally be explained by lower sales volumes and higher margin requirements compared to other comparably sized locations, as well as the remoteness of some Territory centres. The absence of price cycles and heavy discounting, as found in the major capital cities, implies that competitive pressures may be more limited in the Territory. New entrants into the Northern Territory fuel market can be expected to enhance competition and lead to some further downward pressure on retail margins. However, it is likely that there will continue a degree of higher prices in the Territory relative to other mainland locations, reflecting the particular circumstances of the Northern Territory fuel market – small scale distribution and retail with dispersed and remote population and in many locations very limited competitive pressure.

Given the understandable concerns about higher petrol prices and a view that perhaps prices are "*unnecessarily high*", the Inquiry believes that consumers would benefit from the dissemination of information about the determinants of prices, price movements and the underlying dynamics of petroleum product markets.

Recommendation 5

That the Northern Territory Government implements a consumer awareness program that explains factors underlying petrol prices and provides information on the movement of fuel prices (perhaps via a website). A greater understanding of the dynamics of the market together with greater monitoring of retail prices would not only increase consumer awareness, but allow government to 'express concern' to the industry if prices and/or margins exceed appropriate levels.

3 LIKELY DEVELOPMENTS

The petroleum industry in the Northern Territory, like the rest of Australia, is evolving in response to the challenges associated with competition from non-traditional players, particularly the convergence of petroleum and convenience / grocery retailing offered by supermarkets and large independents. The industry is also under pressure to deliver more efficient business structures at the retail and wholesale levels in order to deliver better offerings and margins across combined petrol and retail sales.

The retail market across Australia is experiencing a significant rationalisation that has seen small independently owned outlets replaced by larger outlets with greater volumes and lower unit costs, including retail chains offering the convenience of both fuel and grocery items. This trend has been more pronounced for longer in other capital cities and large regional centres in the other States although it is noticeably increasing in Darwin.

We expect that new entrants to the Territory retail market, particularly in Darwin and the larger centres, will further enhance competition and lead to further downward pressure on retail margins. Although competition and therefore retail fuel prices are expected to improve in Darwin over coming months, there is not likely to be any improvement in the more remote locations of the Territory, given the very limited or non existent competition in those locations.

3.1 Convergence of petroleum and grocery retailing

The relatively recent entry of major supermarket chains into fuel retailing across Australia has dramatically increased the level of sales subject to “shopper docket” schemes tying petrol discounts with grocery purchases. According to Coles Express,[37] an estimated two million docket redemptions occur in the Australian industry each week and there are now well in excess of 100 fuel discount schemes operating in Australia, offered by retailers and other businesses both large and small.

In the Northern Territory, the Woolworths co-branding arrangement with Caltex and the alliance between Coles Myer and Shell currently sees a 4 cpl discount off the retail market price of fuel upon presentation of a shopper docket discount voucher. The Inquiry understands that the Coles Express strategy is to match the board price of the lowest priced competitor as often as possible, rather than to set the price of fuel in the market. In the first year of Coles Express’ operation in the Northern Territory, many hundreds of thousands of dockets were redeemed at a value of more than half a million dollars.[38]

The Motor Trades Association (NT) reported in its submission to the Inquiry that the entry of supermarkets into the fuel retail sector with the associated discount voucher arrangements has led to the departure of a significant number of franchisees from the industry and is causing substantial pressure on remaining service station operators. According to the Motor Trades Association, the Service Station Division which once boasted 20 members in Darwin now has a membership of two financial participants, with the reduction in numbers caused by the departure of franchisees during the current restructuring process.

[37] Coles Express is the fuel and convenience retailer formed following the development of an alliance between Coles Myer and Shell.

[38] Coles Express.

The ACCC conducted an extensive review of the tying of petrol discounts to grocery sales by both Coles Myer and Woolworths and announced on 6 February 2004 that the introduction of shopper docket schemes had encouraged competition and lower prices in the Australian fuel market. The ACCC explained the convergence of petroleum and grocery retailing as an attempt by retailers to increase petrol and grocery sales through satisfying changing consumer lifestyles and particularly a growing preference for convenient, fast, one-stop shopping. The ACCC concluded that shopper docket petrol discounts are the latest innovations in industries that have been undergoing significant change for some time and, in themselves, cannot be said to be responsible for any of the effects on smaller independent businesses.

Supermarkets have been part of the United Kingdom and French retail fuel markets for over 10 years. While supermarkets have been successful in capturing significant market shares, the markets in those countries have remained competitive in delivering petrol products to consumers from a range of oil major, supermarket and independent sites.[39]

The smaller independent fuel retailers have been the most affected by this process of change as they tend to require higher margins on their lower sales volumes to remain viable. Their ability to compete with other market participants is constrained as they often operate on a smaller scale with a lower volume throughput and more limited shop facilities, and without the supply discounts or price support that may be available to the oil majors or larger independent chains.

The entry of supermarkets into the Northern Territory fuel market is contributing to a rationalisation of the industry at the retail level. To the extent that this leads to the departure of some smaller independent operators, it will result in larger volumes for remaining operators, contributing to greater economies and, subject to competitive pressures in the market, likely downward pressure on retail margins.

The Inquiry expects that additional competitive pressure in the market place will help ensure that the greater economies from higher average sales (of both fuel and groceries) will flow to lower retail margins at the petrol pump.

3.2 Independent Retail Chains

Experience in Australia and overseas suggests that the key to increased price competition in the petroleum market is not government regulation or subsidies but the spread of effective independent operators.

Unlike the smaller independents that tend to be price followers, the larger independent chains tend to have a significant influence on retail price competition. The independent retail chains often lead the market down in the petrol price cycles that occur in the major metropolitan cities. They are able to do this through achieving economies of large scale operation and discounts from suppliers because of the large volume of fuel purchased.

The recent entry of an independent Australian-owned oil company, *United Petroleum*, into the Territory's wholesale and retail markets has had a significant influence on price competition, leading to lower retail prices for consumers in the outer-Darwin and Katherine regions.

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39 Australian Government's Securing Australia's Energy Future

Similar to the supermarkets, the United model is based on convenience. United seeks higher volumes of throughput by selling fuel at a lower retail price than competitors and relying on the sale of shop items with a greater profit margin. Shop purchases of $50 or more are rewarded with a discount voucher offering a 6 cpl discount off the retail price of the next fuel purchase.

The Inquiry understands United is looking to increase its presence in the Northern Territory and is likely to open new outlets in Darwin in the short term and other regional centres in the longer term. The experience of United opening in the outer-Darwin and Katherine regions suggests that the arrival of United in Darwin will put further pressure on retail margins and could result in lower retail market prices for consumers than might otherwise be the case.

While increased competition and lower margins may lead to the closure of some smaller service stations that are not able to benefit from economies of scale in their volume sales, it also creates opportunities for new entrants to the market, such as United, to acquire strategically located outlets without the potential delays of planning requirements and the up-front capital investment that is required to develop new retail outlets.

3.3 The New Darwin Industry Fuel Terminal

The Territory's four major wholesalers, BP, Caltex, Mobil and Shell, will relocate their operations to the Darwin Industry Fuel Terminal following completion of construction, anticipated in July 2005. The joint user terminal will be independently operated by Vopak Terminals Darwin Pty Ltd, a subsidiary of the Netherlands company Royal Vopak NV.

The new Terminal represents a capital investment of $55 to $60 million and a fuel capacity of 113 million litres, which is less than the combined capacity of Darwin's existing facilities at 145 million litres. The extent to which these factors (capital cost and smaller volume economies) may put upward pressure on fuel prices is likely to be tempered by the improved economies and operational efficiencies achieved through the replacement of numerous ageing facilities with one state-of-the-art storage system and improved shipping and transport arrangements. This includes the Northern Territory Government's bulk liquids pipelines that run from the East Arm Wharf to the Terminal. Vopak has a commercial licence to use these pipelines which remain available for third party access.

The Darwin Industry Fuel Terminal will be capable of expansion by a further 40 million litres and will be an open access terminal that facilitates potential competition in fuel wholesaling, distribution and retailing.

On balance, the Inquiry believes that the new Fuel Terminal will be neutral or slightly favourable with respect to wholesale fuel costs and, as an open access terminal, will be positive with respect to the effect of potential entry and competition on the Top End fuel market.

3.4 Remote Centres

The disparity between fuel prices in major metropolitan centres and the Territory's regional and remote centres is expected to increase with the cessation of the Australian Government's Fuel Sales Grants Scheme and Petroleum Products Freight Subsidy Scheme from 1 July 2006 - part of the Australian Government's reform of fuel excise. The intent of both these schemes has been to reduce the cost of fuel in regional, rural and remote communities; however, there is uncertainty as to whether the intended benefits have fully accrued to consumers.[40]

The removal of the Fuel Sales Grant, which compensates consumers for higher prices associated with the Goods and Services Tax, will have a significant impact in remote centres as the higher the retail price of fuel, the larger is the GST component.

Higher prices in remote areas reflect very low volumes and higher freight costs. However, perhaps the more significant influence is the lack of effective competition – both in terms of distribution and retail. In some Territory locations, there is effectively a single source of supply, with no competitive pressure on price. This phenomenon is not limited to sales of fuel, but extends to retail sales generally in a number of Territory locations.

The Inquiry is not aware of any market developments that are likely to see any improvement in competition and, hence, in the retail price of fuel in remote areas of the Territory. Competition is the essential element in reducing fuel prices and operators with economies of large scale operation play an important role in this regard. It is therefore important that the Northern Territory Government continue to adopt a pro-competition stance to the fuel industry and ensure there are no regulatory barriers to entry that prevent access to the market place for new entrants.

However, it is the ACCC which is responsible for the investigation of anti-competitive behaviour in local markets and can take action under the *Trade Practices Act 1974* if there is evidence of anti-competitive behaviour. T he ACCC will also investigate resale price maintenance and misuse of market power at the local or regional level, particularly when there are wider public interest implications.

The Inquiry is not in a position to conclude that there is or is not any anti-competitive behaviour in the sale of fuel products in particularly remote locations of the Territory. However, the very high price in some locations suggests that the ACCC might consider investigating whether there are any breaches of the Trade Practices Act. The Inquiry has referred some specific complaints to the Commission.

Recommendation 6

That general issues relating to very high fuel prices in remote areas be referred to the Australian Competition and Consumer Commission for investigation with regard to the provisions of the *Trade Practices Act.*

[40] Australian Government Fuel Taxation Inquiry Report, March 2002

4 SUMMARY OF RECOMMENDATIONS

Recommendation 1
That all retailers be required by law to display prices for all of their fuel products on adequately sized price boards that are visible to passing motorists and to ensure that the prices displayed on the price board match those displayed on the pumps and at the cash register.

Recommendation 2
That the Northern Territory Government support the repeal of the Australian Government's Sites and Franchise Acts in the interests of establishing a more competitive framework for the Australian petroleum industry.

Recommendation 3
That the Northern Territory Government consider moving away from the single tied system currently in place for government Fuel Cards and instead introduce a system that encourages government employees to shop around for the best price, thereby promoting competition in the Territory retail market.

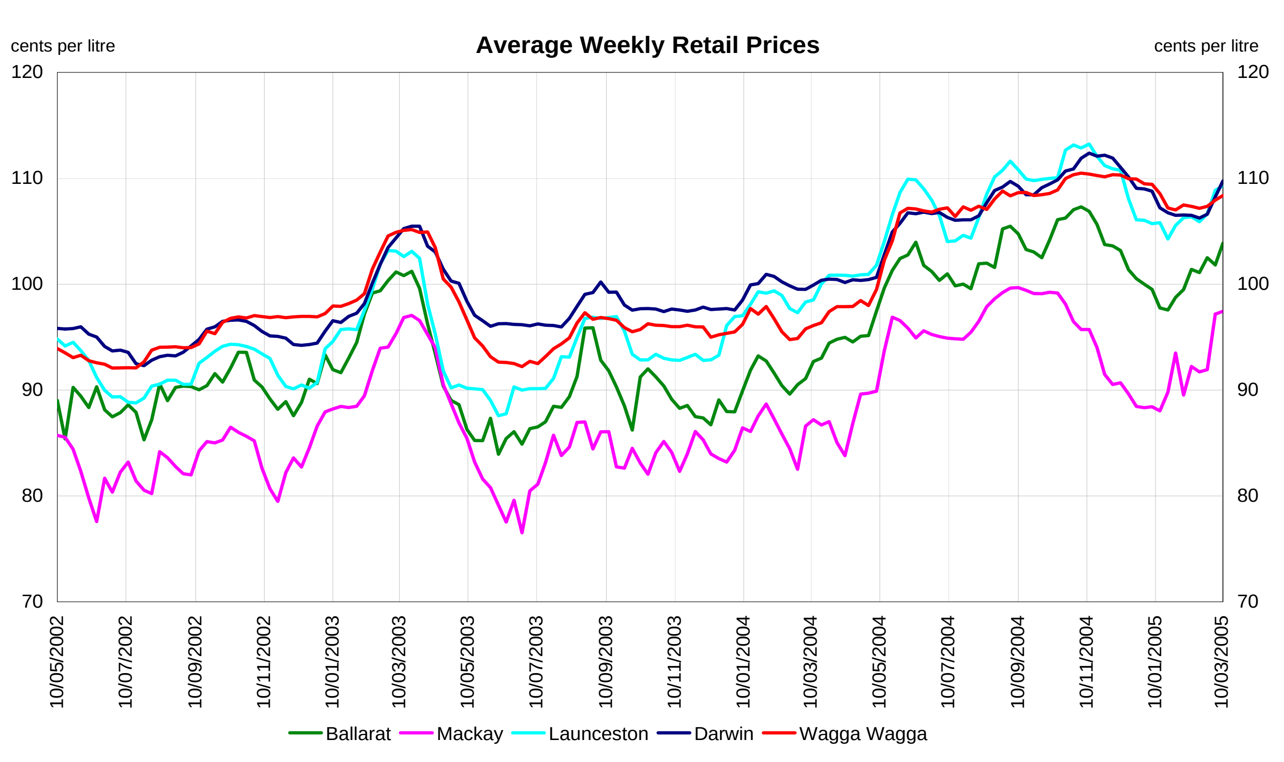
Recommendation 4
That the Northern Territory Government extend its retail fuel price monitoring role to individual service stations in regional and remote areas of the Territory and that the Northern Territory News publish these prices on a regular basis as a service to the Territory community.

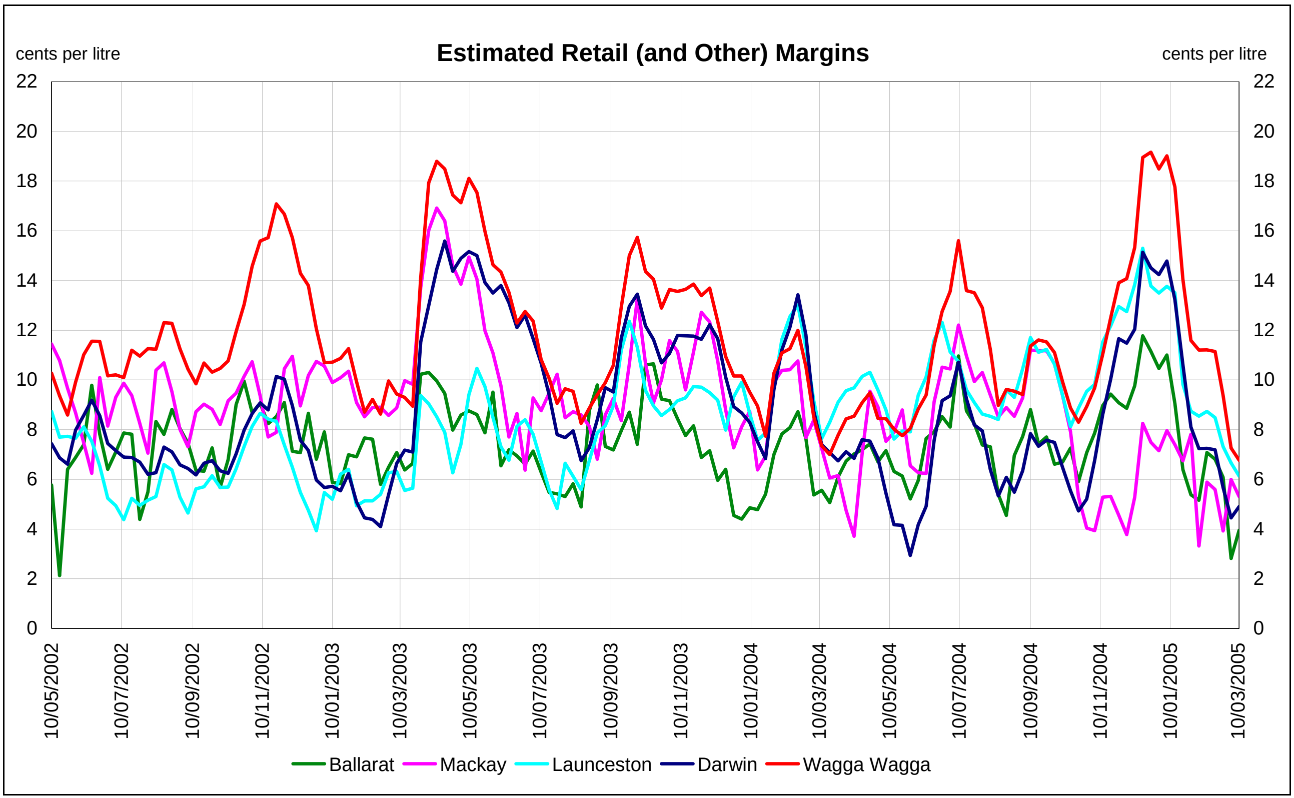
Recommendation 5
That the Northern Territory Government implement a consumer awareness program that explains factors underlying petrol prices and provides information on the movement of fuel prices (perhaps via a website). A greater understanding of the dynamics of the market together with greater monitoring of retail prices would not only increase consumer awareness, but allow government to 'express concern' to the industry if prices and/or margins exceed appropriate levels.

Recommendation 6
That issues relating to high fuel prices in remote areas be referred to the Australian Competition and Consumer Commission for investigation with regard to the objectives of the *Trade Practices Act.*

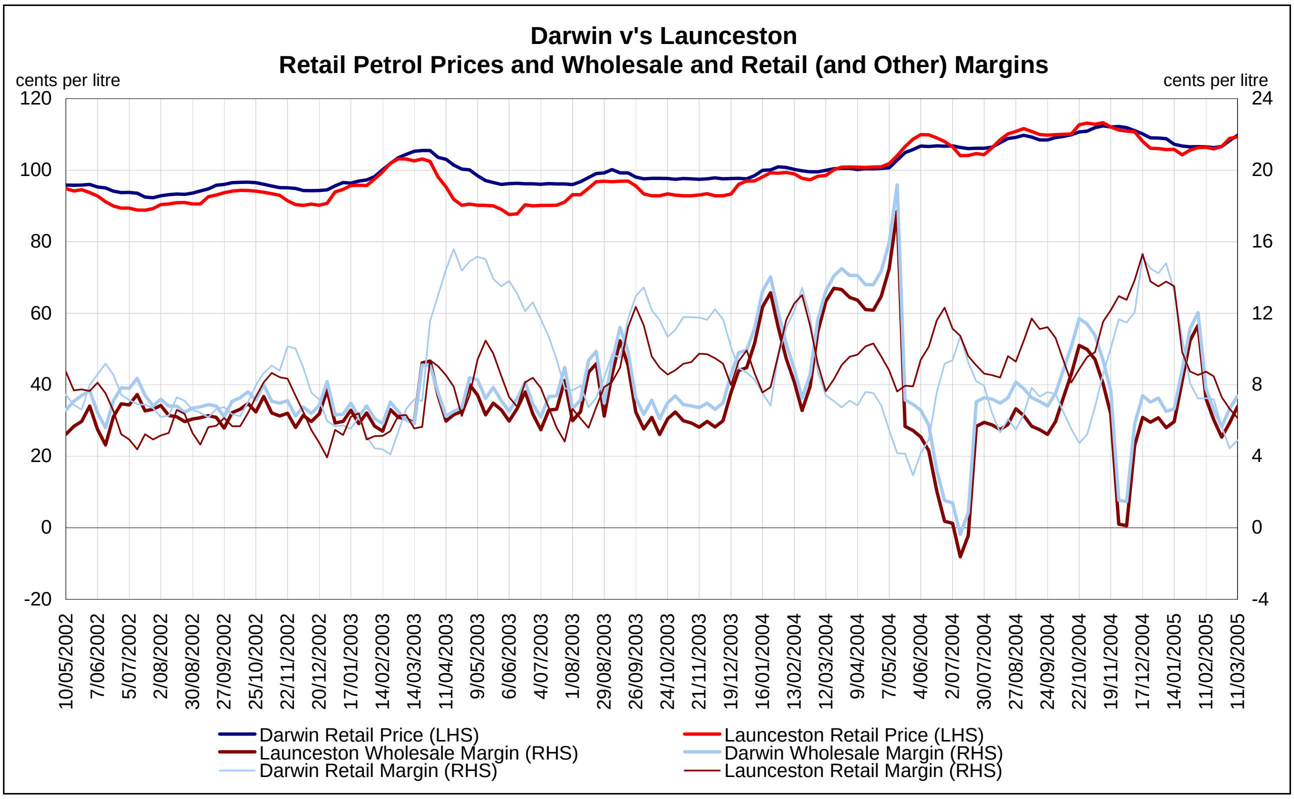
ATTACHMENT 1 NORTHERN TERRITORY UNLEADED PETROL PRICES AND MARGINS[41]

Darwin





41 Underlying data sourced from the Australian Institute of Petroleum and Shell Company of Australia - www.shell.com.au. Additional analysis undertaken by the Inquiry. The Inquiry notes there may be an anomaly in the data for refinery prices over the period May-June 2004 (affecting wholesale margin calculations). The Inquiry was unable to clarify this issue prior to preparing the final Report.


Darwin v's Launceston
Retail Petrol Prices and Wholesale and Retail (and Other) Margins
cents per litre
cents per litre
120
100
80
60
40
20
0
-20
24
20
16
12
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10/05/2002
7/06/2002
5/07/2002
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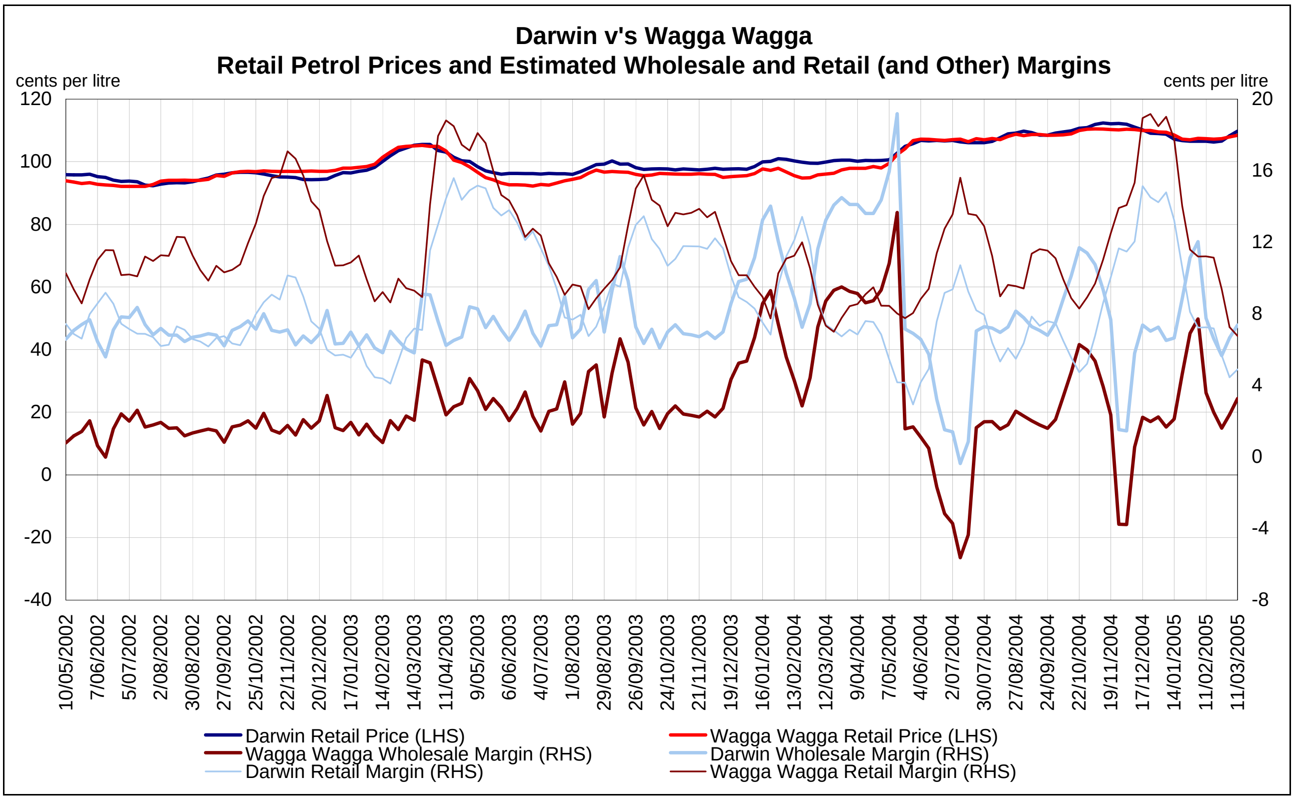
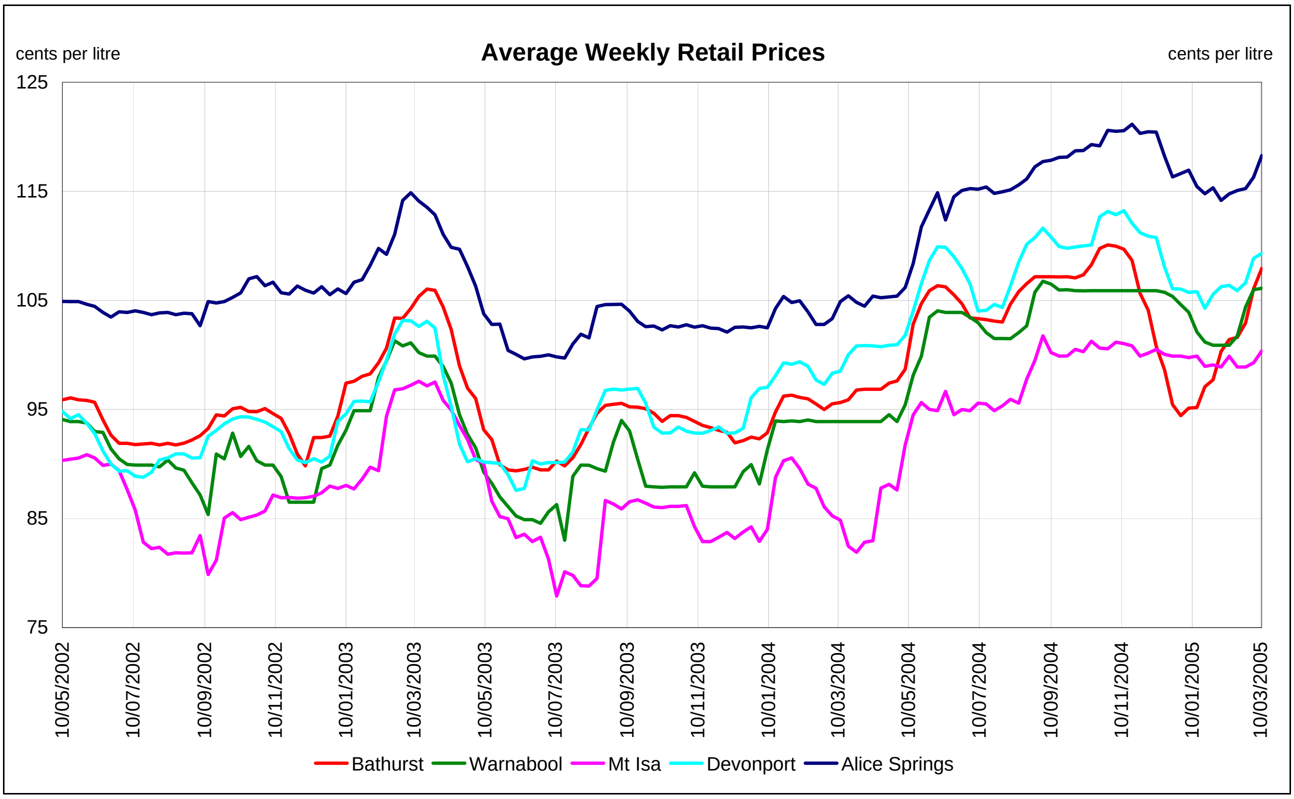
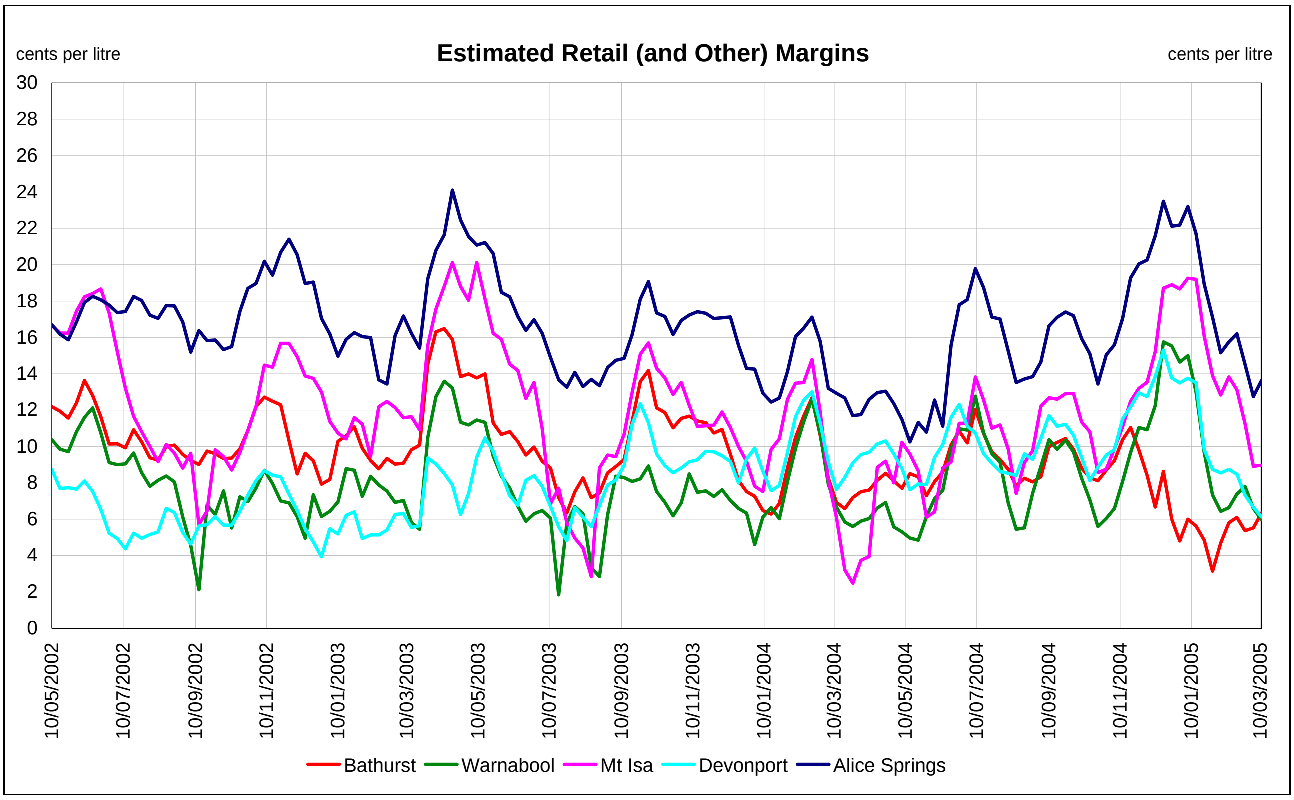
14/03/2003
11/04/2003
9/05/2003
6/06/2003
4/07/2003
1/08/2003
29/08/2003
26/09/2003
24/10/2003
21/11/2003
19/12/2003
16/01/2004
13/02/2004
12/03/2004
9/04/2004
7/05/2004
4/06/2004
2/07/2004
30/07/2004
27/08/2004
24/09/2004
22/10/2004
19/11/2004
17/12/2004
14/01/2005
11/02/2005
11/03/2005
Darwin Retail Price (LHS)
Launceston Retail Price (LHS)
Launceston Wholesale Margin (RHS)
Darwin Wholesale Margin (RHS)
Darwin Retail Margin (RHS)
Launceston Retail Margin (RHS)

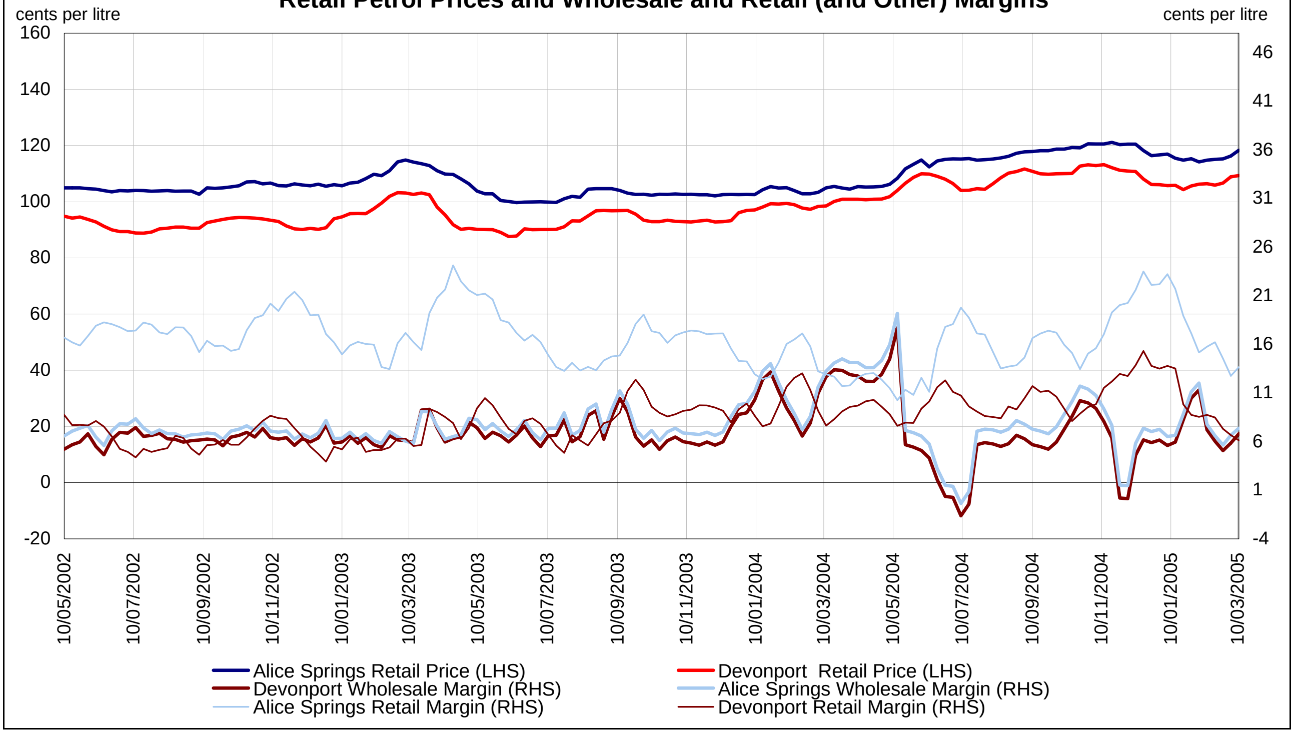

Darwin v's Wagga Wagga
Retail Petrol Prices and Estimated Wholesale and Retail (and Other) Margins
cents per litre
cents per litre
120
100
80
60
40
20
0
-20
-40
20
16
12
8
4
0
-4
-8
10/05/2002
7/06/2002
5/07/2002
2/08/2002
30/08/2002
27/09/2002
25/10/2002
22/11/2002
20/12/2002
17/01/2003
14/02/2003
14/03/2003
11/04/2003
9/05/2003
6/06/2003
4/07/2003
1/08/2003
29/08/2003
26/09/2003
24/10/2003
21/11/2003
19/12/2003
16/01/2004
13/02/2004
12/03/2004
9/04/2004
7/05/2004
4/06/2004
2/07/2004
30/07/2004
27/08/2004
24/09/2004
22/10/2004
19/11/2004
17/12/2004
14/01/2005
11/02/2005
11/03/2005
Darwin Retail Price (LHS)
Wagga Wagga Retail Price (LHS)
Wagga Wagga Wholesale Margin (RHS)
Darwin Wholesale Margin (RHS)
Darwin Retail Margin (RHS)
Wagga Wagga Retail Margin (RHS)

Alice Springs

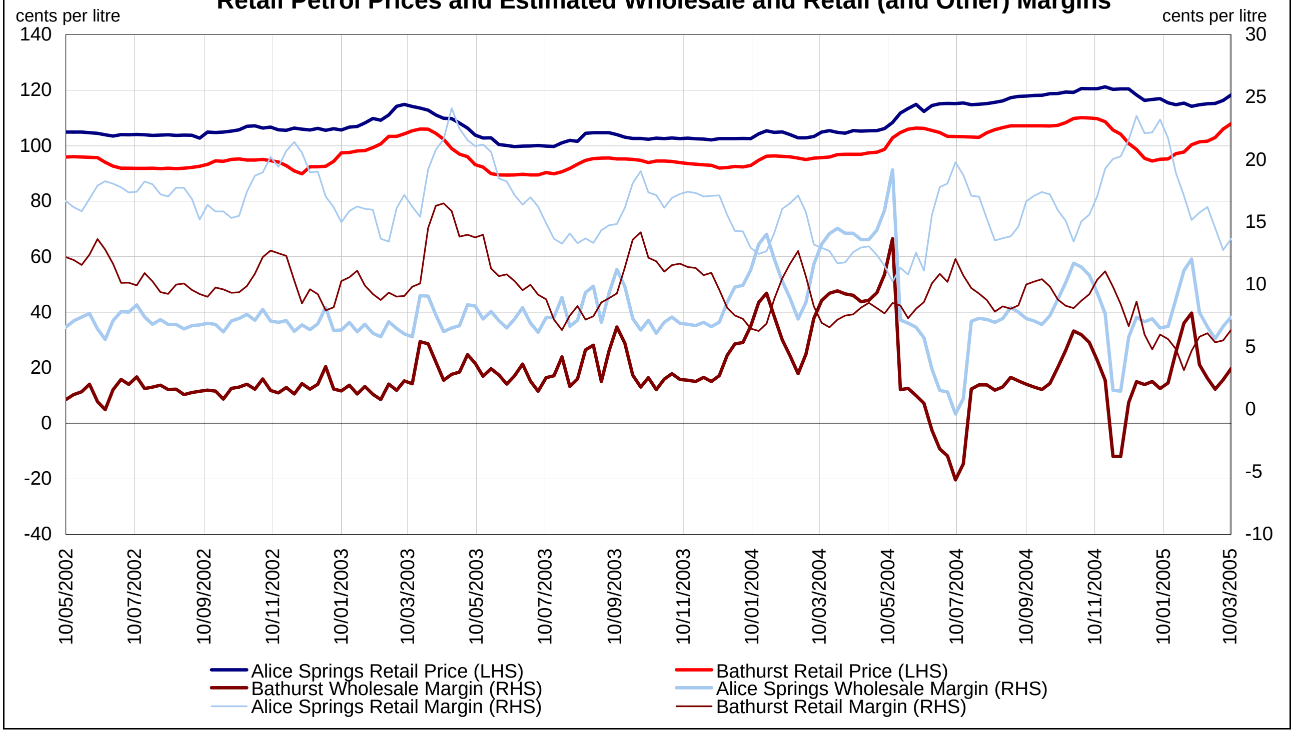




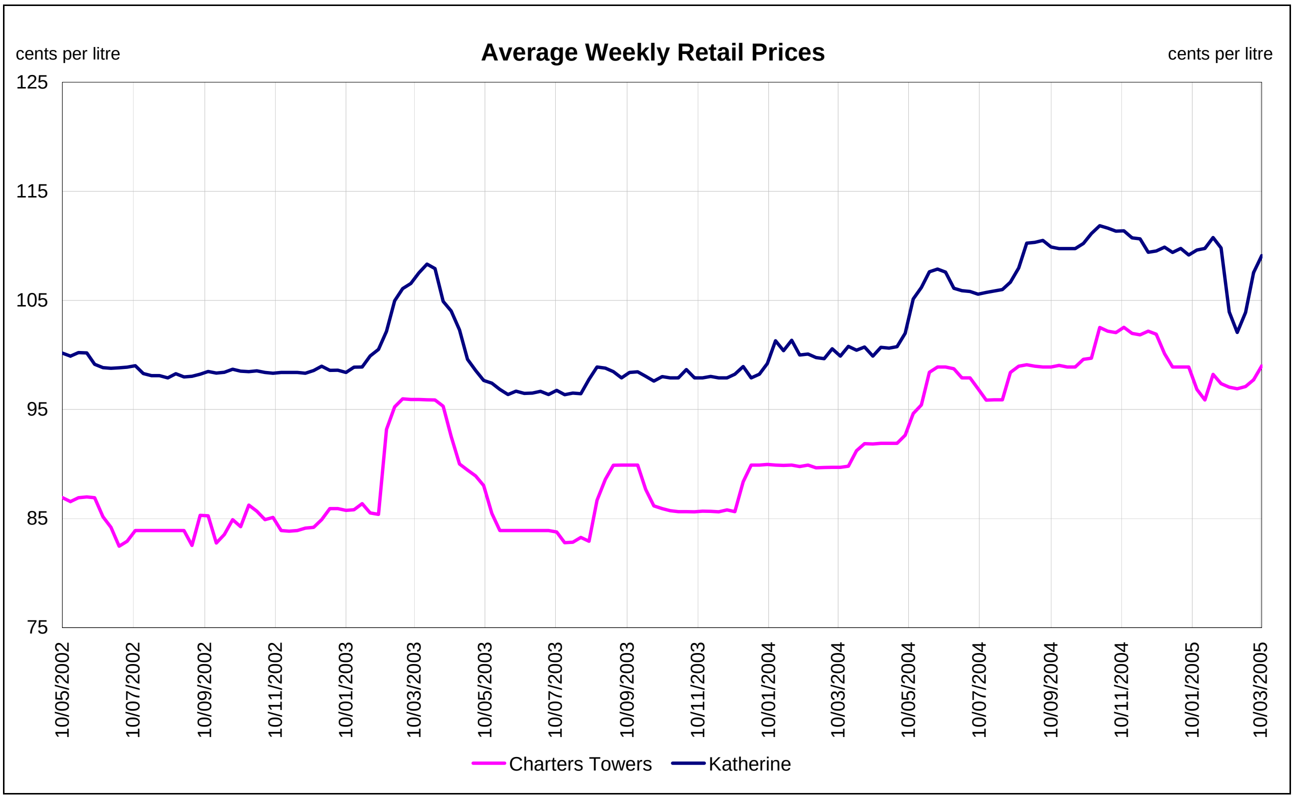
Alice Springs v's Devonport
Retail Petrol Prices and Wholesale and Retail (and Other) Margins

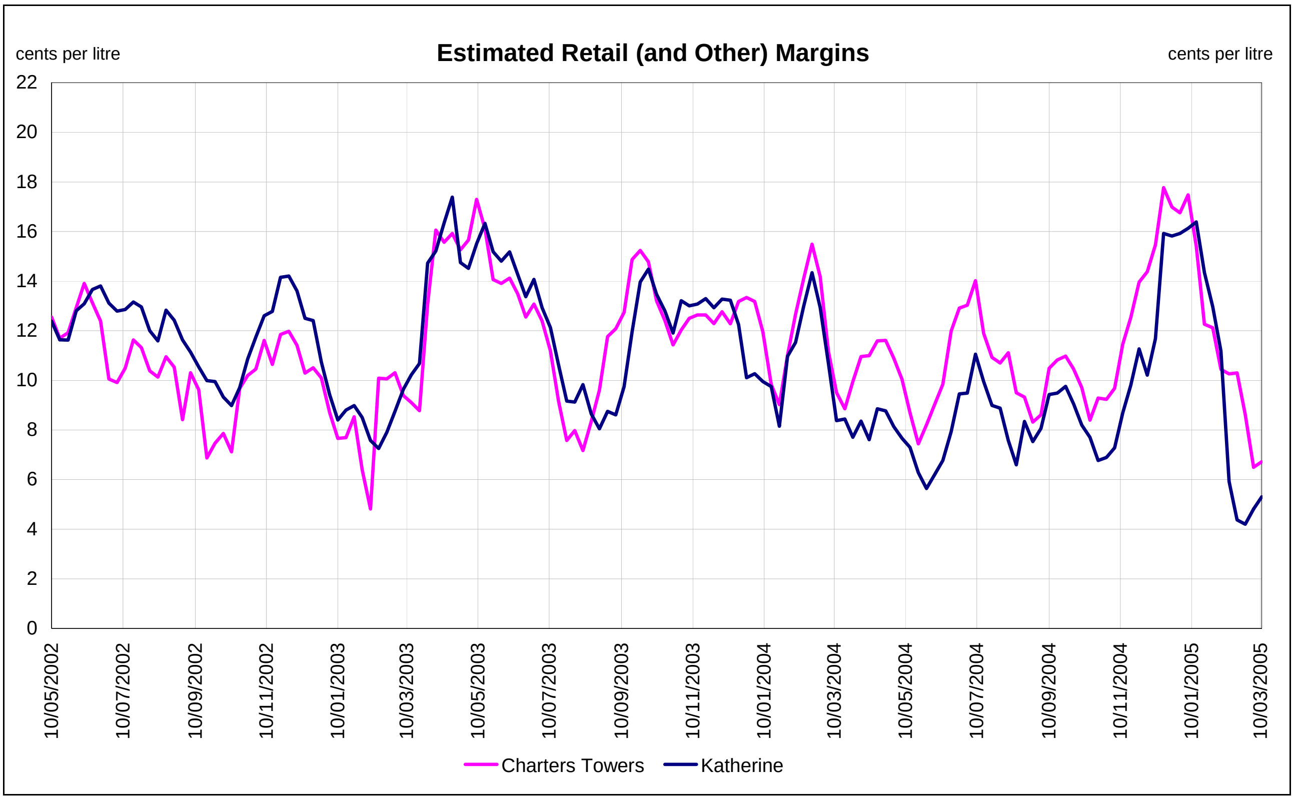


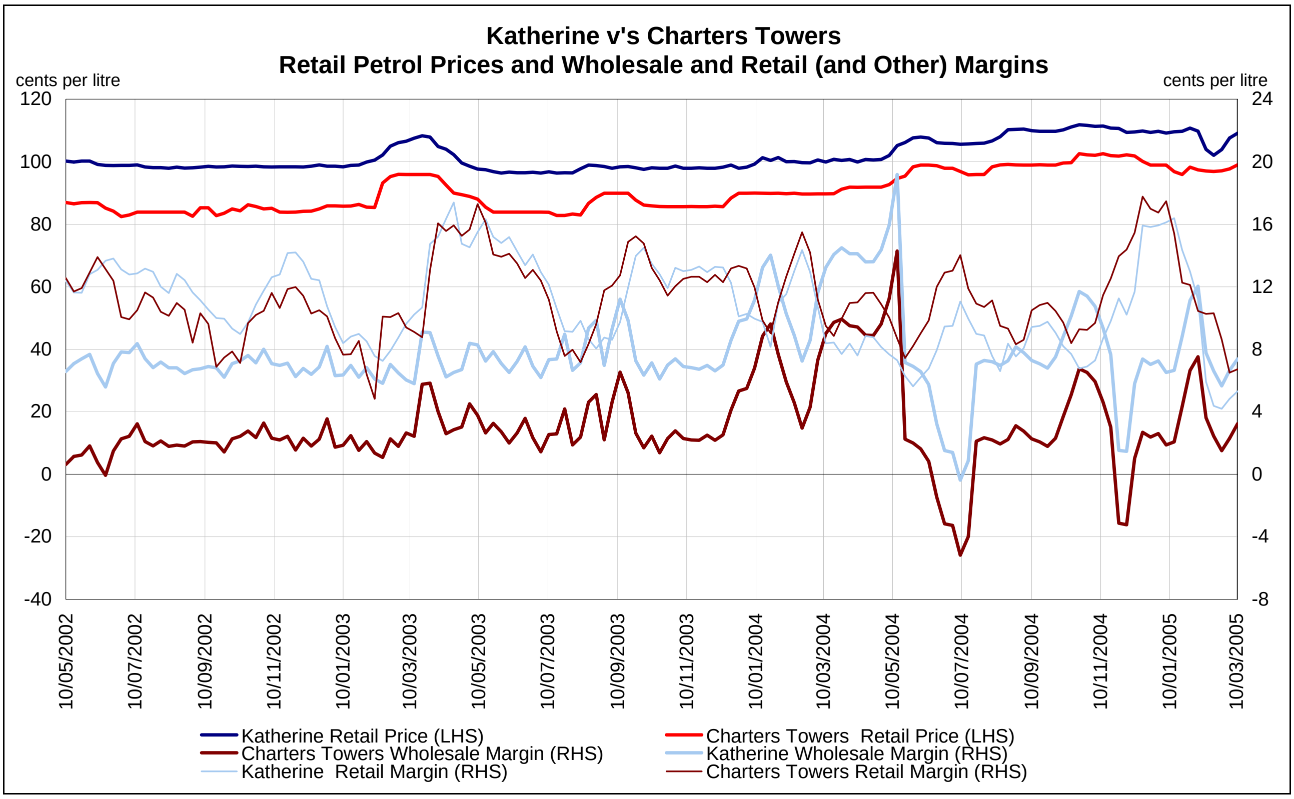
Alice Springs v's Bathurst
Retail Petrol Prices and Estimated Wholesale and Retail (and Other) Margins



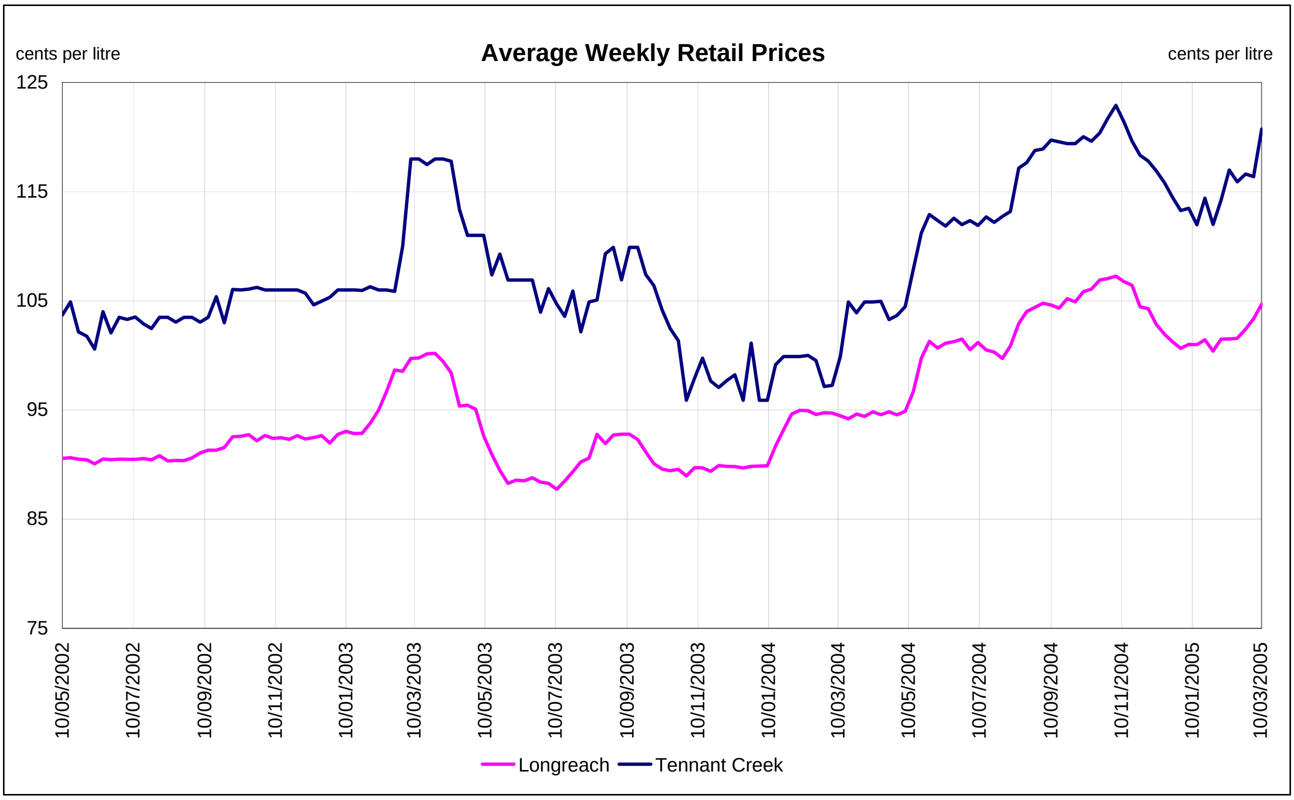
Katherine

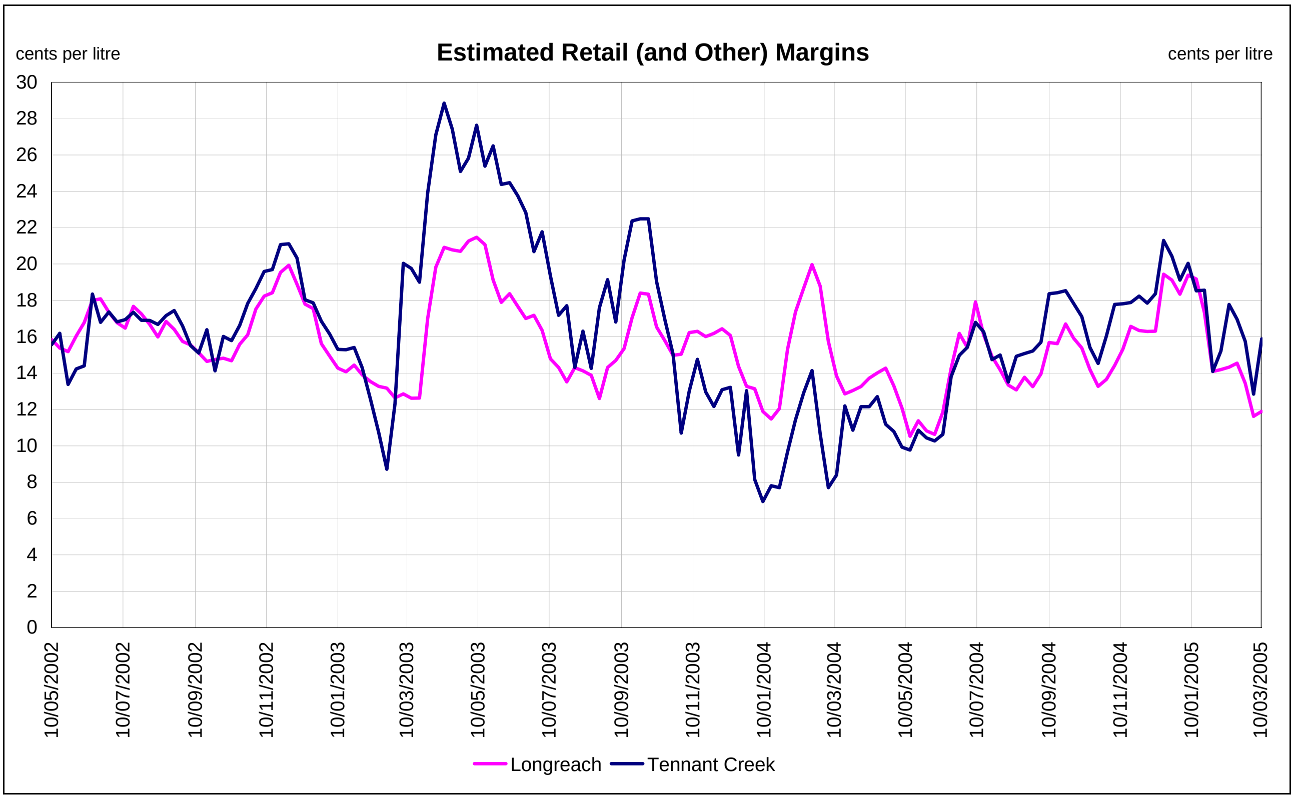

Average Weekly Retail Prices
cents per litre
cents per litre
125
115
105
95
85
75
10/05/2002
10/07/2002
10/09/2002
10/11/2002
10/01/2003
10/03/2003
10/05/2003
10/07/2003
10/09/2003
10/11/2003
10/01/2004
10/03/2004
10/05/2004
10/07/2004
10/09/2004
10/11/2004
10/01/2005
10/03/2005
Charters Towers
Katherine

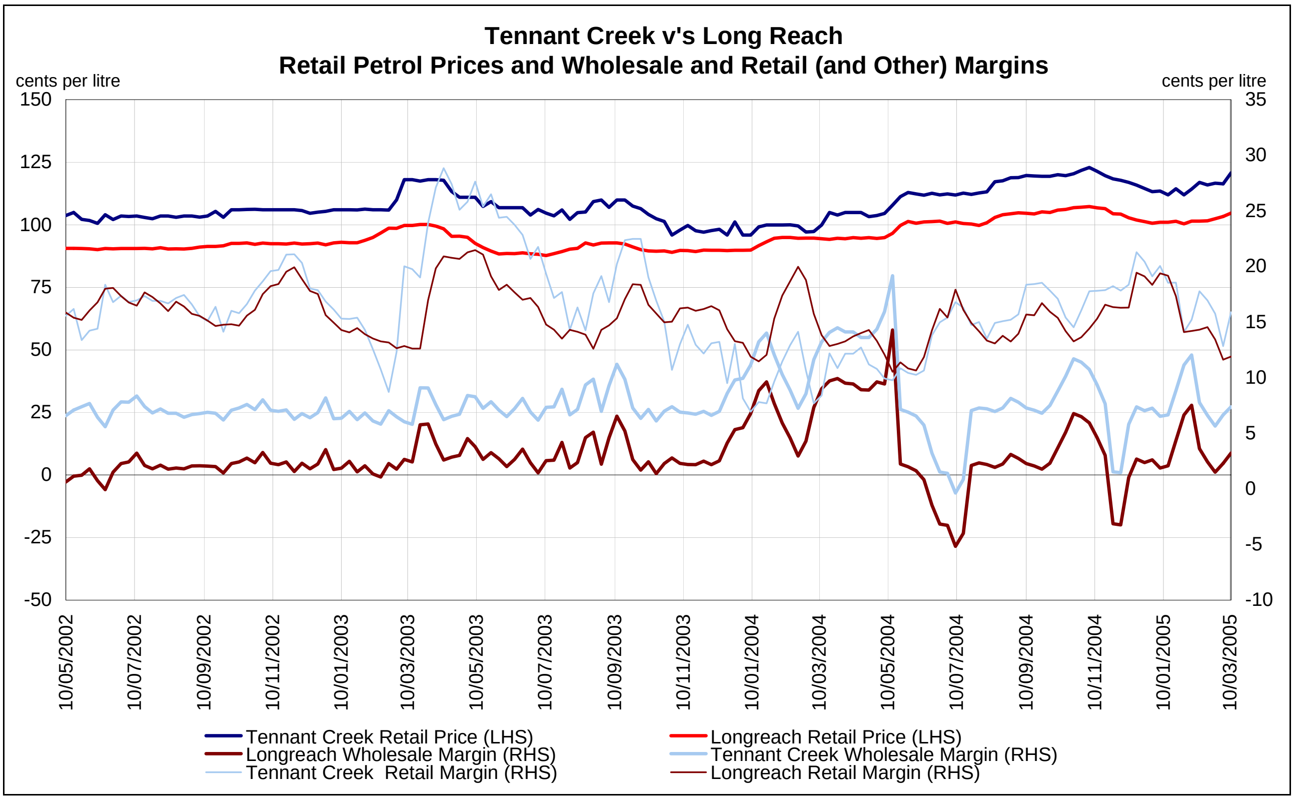

Estimated Retail (and Other) Margins
cents per litre
cents per litre
22
20
18
16
14
12
10
8
6
4
2
0
10/05/2002
10/07/2002
10/09/2002
10/11/2002
10/01/2003
10/03/2003
10/05/2003
10/07/2003
10/09/2003
10/11/2003
10/01/2004
10/03/2004
10/05/2004
10/07/2004
10/09/2004
10/11/2004
10/01/2005
10/03/2005
Charters Towers
Katherine



Tennant Creek




Estimated Retail (and Other) Margins
cents per litre
cents per litre
0
2
4
6
8
10
12
14
16
18
20
22
24
26
28
30
10/05/2002
10/07/2002
10/09/2002
10/11/2002
10/01/2003
10/03/2003
10/05/2003
10/07/2003
10/09/2003
10/11/2003
10/01/2004
10/03/2004
10/05/2004
10/07/2004
10/09/2004
10/11/2004
10/01/2005
10/03/2005
Longreach
Tennant Creek


Tennant Creek v's Long Reach
Retail Petrol Prices and Wholesale and Retail (and Other) Margins
cents per litre
cents per litre
-50
-25
0
25
50
75
100
125
150
-10
-5
0
5
10
15
20
25
30
35
10/05/2002
10/07/2002
10/09/2002
10/11/2002
10/01/2003
10/03/2003
10/05/2003
10/07/2003
10/09/2003
10/11/2003
10/01/2004
10/03/2004
10/05/2004
10/07/2004
10/09/2004
10/11/2004
10/01/2005
10/03/2005
Tennant Creek Retail Price (LHS)
Longreach Retail Price (LHS)
Longreach Wholesale Margin (RHS)
Tennant Creek Wholesale Margin (RHS)
Tennant Creek Retail Margin (RHS)
Longreach Retail Margin (RHS)

ATTACHMENT 2 SUBMISSIONS AND MEETINGS

The Inquiry received written submissions from the following parties.

- Automobile Association of the Northern Territory
- Australian Fuel Distributors Pty Ltd
- BP Australia
- Caltex Australia Limited
- Coles Express
- Kelly, R
- Mobil Oil Australia Pty Ltd
- Motor Trades Association (NT) Incorporated
- The Shell Company of Australia Limited

During the course of the Inquiry, meetings were held with the following parties.

- Australian Competition and Consumer Commission
- Australian Fuel Distributors Pty Ltd
- Automobile Association of the Northern Territory
- BP Australia
- Caltex Australia Limited
- Consumer and Business Affairs
- Darwin Petroleum Services
- Department of Infrastructure, Planning and Environment
- Mobil Berrimah
- Mobil Oil Australia Pty Ltd
- Mr Turner
- Northern Territory Treasury
- Service Station Association (NT)
- Shell Company of Australia
- United Petroleum Australia

ATTACHMENT 3 TERMS OF REFERENCE

INQUIRY INTO FUEL PRICES IN THE NORTHERN TERRITORY

Terms of Reference

The Inquiry is to:

- consider and report on the prices paid for fuel by Territory motorists - with reference to the prices paid in comparably sized locations elsewhere in Australia;
- examine the reasons for the high fuel prices paid by Territory motorists including reasons given by the fuel companies and others;
- provide a comparison of the wholesale and retail margins and input costs such as transport in the Northern Territory and other locations;
- examine the effectiveness of competition in the Northern Territory amongst the major fuel companies, wholesalers and retailers;
- examine the impact of fuel discounters in the Northern Territory market compared to elsewhere in Australia;
- report on what could bring about a reduction in the fuel prices paid by Territory motorists.

The Inquiry is to be headed by the former Chairman, Independent Pricing & Regulatory Tribunal NSW and former ACCC Associate Commissioner Tom Parry.

Submissions from fuel companies, retailers, other interested parties and members of the public will be invited.

The Inquiry is expected to be completed and a public report produced by May 2005.