



**LEGISLATIVE ASSEMBLY FOR THE
AUSTRALIAN CAPITAL TERRITORY**

**REPORT OF THE
SELECT COMMITTEE ON PETROL PRICING**

SEPTEMBER 1997

RESOLUTION OF APPOINTMENT

The Assembly established the committee on 27 June 1996 to inquire into and report on the means of reducing petrol prices in the ACT and any related matters so that they are similar to those in other cities.

The committee was required to report by the last sitting day in June 1997.

On 15 May 1997 the Assembly resolved to delete the reporting date for the committee.

MEMBERSHIP OF THE COMMITTEE

Mr Bill Wood MLA, (Chair) (Appointed 18 February 1997, elected Chair 20 February 1997)

Mrs Louise Littlewood MLA, (Deputy Chair) (Appointed 18 February 1997, elected Deputy Chair 20 February 1997)

Mr Paul Osborne MLA

Ms Rosemary Follett MLA, (former Chair) (Resigned from the Assembly 12 December 1996)

Mr Trevor Kaine MLA, (former deputy Chair) (Discharged from the committee 18 February 1997)

SECRETARY: Bill Symington

ASSISTANT SECRETARY: David Skinner

CONTENTS

RESOLUTION OF APPOINTMENT	iii
MEMBERSHIP OF THE COMMITTEE	iii
PREFACE	vii
EXECUTIVE SUMMARY	ix
CHAPTER 1. BACKGROUND	1
CHAPTER 2. PRICE COMPARISONS	2
Sydney	2
Competition	3
Import Parity Comparison	4
Price Breakdown	5
Conclusion	7
CHAPTER 3. STRUCTURE OF THE ACT MARKET	9
Dominance of Oil Company and Franchised Sites	9
Exclusive Ties	9
The Oil Company View	11
Retail Margin	11
Open Access and the 50 per cent Supply Rule	12
Horizontal Integration	13
Conclusion	14
CHAPTER 4. PLANNING AND LAND REGULATIONS	16
Site Premium	16
Headleases	17
Level Playing Field	18
Locational Controls	19
Land Use	20
Conclusion	21
CHAPTER 5. GULL AND WOOLWORTHS	22

Background	22
Discounting	23
Shopping Dockets	23
Wholesale Sources	24
Consumers	24
Tilting the Playing Field	25
Supermarkets in Petrol Retailing: International Experience	26
Retail Space	28
Exit Arrangements	29
Conclusion	29
CHAPTER 6. MULTIPLE SITE FRANCHISING	31
Efficiency	32
Exemptions	33
Anti-competitive Aspects	34
Conclusion	34

PREFACE

This report does not break new ground. It is not a fallow field, having been thoroughly ploughed in the past.

This report does not offer a startlingly new insight to the ACT petrol market and it does not offer dramatic solutions to what has been a perennial complaint of most Canberran motorists that they pay too much for petrol.

This is not a parochial ACT complaint. It has been a consistent irritation for motorists throughout Australia over the past two or three decades and has prompted any number of Federal, State and ACT inquiries over that time.

What this report does do, and I believe does well, is to bring together the streams of opinion within the ACT market in such a way that the average Canberran who reads the report, as much as the expert industry reader, will comprehend the structure of the ACT industry and the factors which influence prices.

This is the report's strength. The committee has sifted the views of all parties within the industry and the consumer interest and has presented these clearly and without prejudice. The issues are there to be assessed by the community, by members of the Assembly and by the ACT Government.

And the committee has been able to arrive at a balanced position which gives it the confidence to offer certain clear and unambiguous conclusions and to make recommendations, some of which are within the power of the ACT Government to action and others which will require the co-operation of the Federal Government in freeing up the market.

In essence, it has to be recognised that the ACT community and economy is not insulated from the wider Australian economy nor is the petrol market capable of being regulated in isolation from the immediate NSW and the national markets.

At a time when Woolworths and Gull are placing renewed pressure on retail prices, there is scope for the ACT Government to modify the ACT trading environment in those areas where it has imposed regulations which have the effect of preventing the full development of a competitive petrol market.

The Government has acknowledged that intervening in the market by way of introducing new players is necessary to bring about reduced prices.

The committee trusts that the entry of these new players will have long term repercussions affecting a higher level of competition.

Bill Wood, MLA
Chair

18 September 1997

EXECUTIVE SUMMARY

This section summarises the conclusions reached by the committee and lists the recommendations in each of the report's chapters.

Chapter 2: Price Comparisons

Most Canberrans use Sydney petrol prices as a comparison with ACT Prices and it is normal for Canberrans driving to Sydney to especially note the disparity between Canberra prices and the lowest prices posted by service stations located on major trunk routes into Sydney through Parramatta and Liverpool. However, direct comparisons are not necessarily reliable indicators and there must be reservations about the implications of price disparities.

Nevertheless, the average Canberra margin above the import parity terminal gate price for unleaded petrol has been significantly higher than the margins applying in Adelaide, Brisbane, Sydney and Melbourne.

Further, it has been shown that the ACT is paying more than Sydney for the retail and distributor margin, even more for freight and significantly more for the oil company wholesale margin.

Chapter 3: Structure of the ACT Market

The high number of company/agent and franchised sites and virtual absence of independents in the ACT market has the effect of restricting competitive pressures at both the retail and wholesale levels.

Oil majors have significant outlays in the ACT retail petrol market and consider that they have a right to generate reasonable income through fuel sales at franchised sites. However, the committee believes that there may be some scope for increasing competition at the wholesale level by giving franchisees and distributors greater power to make commercial decisions about the terms and conditions of buying wholesale petroleum products from oil companies.

RECOMMENDATION 1

The committee recommends that the ACT Government make representations to the Commonwealth Government regarding the development of measures which give franchisees and distributors more power in their bargaining relationships with oil majors, especially with regard to the pricing terms and conditions of sourcing wholesale supplies.

Chapter 4: Planning and Land Regulations

Almost all stake holders in the petrol pricing debate, as well as many inquiries into the subject, have identified ACT planning and land regulations as a key cause of the relatively high petrol prices in Canberra.

The petrol market, like other markets including retailing generally, is restructuring and undergoing change. The Government must now address these changes by taking the lead in undertaking a substantial review of those planning controls which bear upon the location of petrol reselling sites and which restrict competition within the industry.

RECOMMENDATION 2

The committee recommends that the Government review all land and planning controls affecting the location of service stations and the situation with disused petrol retailing sites with a view to freeing up the capacity for more market oriented redevelopment and the capacity for maintaining a competitive petrol retailing industry in the ACT.

RECOMMENDATION 3

The committee recommends that as new retailers enter the market they should as far as possible utilise existing vacant sites.

Chapter 5: Gull and Woolworths

Much of the evidence presented to the committee argued that the entry of these two players is or will be taking place under special conditions which will have the effect of creating an unlevel playing field and introducing further distortions in the market. However, the committee heard that the introduction of these two players will almost certainly place a downward pressure on retail prices.

It will take some time for the effects of Woolworths entry to the petrol market to settle down. However, franchisees are concerned that the entry of Woolworths and Gull to the market will siphon off their business in a situation where they have limited capacity to compete on even terms.

Any significant loss of business by franchisees could mean a reduction in employment opportunity by these businesses and a possible loss of amenity to local communities should closures be forced or franchisees be unable to offer a full range of motoring services such as vehicle servicing and repairs.

RECOMMENDATION 4

The committee recommends that the Government ease restrictions on retail space available in service stations.

Chapter 6: Multiple Site Franchising

There may be some scope for increasing the efficiency of retail networks through MSF.

However, no substantive evidence was presented to the committee showing the likely effects MSF will have on retail prices in the ACT.

In some circumstances exemptions to the *Fair Trading (Petroleum Retail Marketing) Act 1995* may be appropriate and in the best interests of various stake holders. The committee agrees that decisions to grant exemptions should be based on the type of cost-benefit analysis the Government currently employs. While it is important to maintain a degree of flexibility on this issue, the weight of evidence presented to the committee was not enough to recommend repeal of the legislation.

RECOMMENDATION 5

The committee recommends that the ACT Government further investigate the likely effects of multi-site franchising in the ACT and that the *Fair Trading (Petroleum Retail Marketing) Act 1995* remain in place until such time as these effects have been determined.

CHAPTER 1. BACKGROUND

1.1. In 1994, the ACT Legislative Assembly Standing Committee on Public Accounts conducted an inquiry into petrol supply arrangements in the ACT. In particular, the inquiry examined the entry of Burmah Fuels into the ACT retail petrol market. The committee also reviewed the attendant matter of petrol pricing in the ACT.

1.2. Since this time, however, there have been no lasting reductions in the cost of fuel products for ACT consumers. On June 27, 1996, the ACT Legislative Assembly established a select committee to *inquire into and report on means of reducing petrol prices in the ACT and any related matters so that they are similar to those in other cities.*

1.3. The committee placed advertisements in local newspapers calling for written submissions and subsequently received 17 submissions from numerous stake holders which are listed in Appendix A. The committee conducted a public hearing on July 29, 1997, taking evidence from representatives of 8 organisations which are listed in Appendix B.

1.4. While there have been innumerable inquiries into petrol prices in recent years, and many of the issues confronting the ACT Government remain the same, this committee has sought to report on the current status of the ACT petrol market and explore problems and possible solutions to achieving lower petrol prices in the ACT. A re-examination of issues related to ACT petrol prices is timely given the imminent entry of Woolworths and Gull Petroleum to the ACT market as well as the current debate surrounding multi-site franchising.

1.5. The issues surrounding competition and the scope for price discounting in the ACT are necessarily intertwined with the make-up and operation of the petroleum industry at the national level. This report touches on a number of national issues and some of the findings of the Australian Competition and Consumer Commission's (ACCC) Inquiry into the Petroleum Products Declaration, but focuses on the elements particular to the ACT market.

1.6. This report is divided into 7 chapters. Chapter 2 reports on a number of inter-city price comparisons submitted to the committee as well as the breakdown of petrol prices. Chapter 3 examines the current make-up of the ACT petrol market and the dominance of the oil majors. Chapter 4 provides an examination of the effects of land and planning regulations on petrol prices. Chapter 5 looks at the likely effects Gull and Woolworths will have in the ACT and Chapter 6 explores multi-site franchising.

CHAPTER 2. PRICE COMPARISONS

Sydney

2.1. Sydney is often used in petrol price comparisons with the ACT as it is the closest major city to Canberra and the major source of fuel supplies for the region. However, the committee was told that comparisons with Sydney prices can be misleading if they fail to take into account the heterogenous nature of the Sydney market along with its fluctuating prices brought about by intense discounting periods. The Australian Institute of Petroleum (AIP) noted in its submission that:

It is particularly important to avoid any comparison of low points in the discount cycles in one city to prices in another city, at a particular time. Each city has its own competitive pressures and market movements. Prices averaged over time... give a truer picture.

...it is [also] misleading to compare prices in one particular part of Sydney to prices in the overall ACT market, as different parts of the market in each city have different dynamics and prices¹.

2.2. The MTA-ACT cited data from the Australian Bureau of Statistics (ABS) which shows that 1995-96 average retail petrol prices in the ACT have been between 3 and 4.4 cents per litre greater than Sydney². The MTA-ACT submitted that:

It might be argued that this difference of up to 4 cents per litre can be largely explained by (a) the freight differential [1.6 cents per litre]³ and (b) the general effect of Sydney prices of periodic discounting in various “hot spots”, as well as a substantial number of very low standard retail sites (with equally low operating costs) the like of which would not be tolerated in Canberra.

2.3. The organisation went on to say that:

If these differences are recognised, it must be asked whether there is any real scope for enduring reductions in Canberra petrol prices relative to Sydney.⁴

2.4. The AIP submitted the analysis that even after freight charges and state/territory franchise fees are taken out of the picture, average retail petrol prices

¹ Submission 8. p. 8.

² Submission 7. p. 17.

³ A freight charge is an amount included in the retail price to cover the transport of fuel products to various locations. The amount of freight charge payable varies widely between different locations. Some areas pay no freight charge at all. The freight component of ACT prices is 1.6cpl.

⁴ Australian Bureau of Statistics ‘Average retail prices of selected items, eight capital cities’ ABS Catalogue No. 6403.0 cited in Submission 7. p. 17.

between 1994 and 1996 have still been higher in Canberra than Sydney by 2.2c cents per litre (cpl). The average Canberra price over the period was also higher than Melbourne (3.1cpl), Brisbane (2.4cpl) and Adelaide (2.3cpl)⁵. It is difficult to determine whether these variances can be explained away by 'periodic discounting in various hot spots'.

2.5. It must be noted that under this analysis Canberra was shown to experience lower retail prices than both Hobart and Darwin.

2.6. The committee was told that Sydney has a much larger price range than Canberra. In its submission, the ACT Government noted that:

In December 1996 [the period with the largest Sydney price range], Canberra retail prices ranged from 75.8cpl to 78.2cpl while Sydney ranged from 58.6cpl to 90.8cpl. These figures indicate a price range in Canberra of 2.2cpl compared with a Sydney figure of 32.2cpl. It is interesting to note that while the lowest price in Sydney is 17.2cpl lower than Canberra's lowest price, the highest price in Sydney is 12.6cpl higher than Canberra's highest price.⁶

2.7. The large price range for Sydney reflects the heterogeneity of its market. While prices in 'hotspots' like Canterbury Road may often be extremely cheap, other parts of Sydney particularly on the North Shore tend to be much higher. The fact that many markets exist within the larger Sydney market makes it very different to Canberra which tends to experience uniform price movements across the board.

2.8. With similar population sizes to Canberra, both Newcastle and Wollongong experience lower petrol prices, possibly as a result of the flow-on effect of Sydney competition. An ACT Government submission noted that:

The price range for November 1996 shows Newcastle at 72.8cpl to 76.8cpl, Wollongong 71.9cpl to 72.9cpl, while Canberra was 74.9cpl to 77.5cpl. Lower prices may be explained by the close proximity of both these cities to Sydney (and the freight differential)⁷.

Competition

2.9. The committee accepts that while Sydney 'hot spots' are not appropriate benchmarks for the ACT, and these spots may well have the effect of lowering average Sydney retail prices, it believes there is still the capacity to reduce ACT petrol prices through increased competition. In 1992, the ACT Government Working Group on Petrol Prices noted that:

⁵ Based on ABS Catalogue No. 6403.0 cited in Submission 8. (MTA-ACT) p. 8.

⁶ Submission 12. p 6.

⁷ *ibid.* p. 4.

ACT residents can not reasonably expect to buy petrol at prices applying in Canterbury Road [a Sydney ‘hot spot’ area]... we believe that pump prices are at least 2 or 3 cents per litre higher than they would be in a more competitive environment.⁸

2.10. Contention about the level of competition has always been a key feature of the ACT petrol pricing debate. The committee heard variously that competition and therefore price discounting in the ACT was hindered by: the special treatment given to Burmah and Gull; low traffic volumes; lack of independents; and the high level of vertical integration and dominance of the oil majors in the ACT market.

2.11. Conversely, the committee was told that competition operates with relative efficiency in the ACT, but the scope for significant retail price decreases are restricted by the high investment risks due to ACT land and planning regulations, as well as the inefficiencies of retail networks resulting from the moratorium on multi-site franchising.

2.12. All these issues are dealt with in more detail throughout the report.

Import Parity Comparison

2.13. In 1996, McGullagh Management Consulting developed an import parity benchmark for the ACCC. This competitive benchmark took into account landed product costs, terminal operating costs, terminal capital costs, customer credit cost along with Commonwealth petroleum product excise and State franchise fees associated with petrol imports⁹. The 1996 ACCC report included an analysis (refer to Table 1) based on this model showing the ‘details [of] the average total margin between average actual retail prices [incorporates both wholesale and retail margin] and import parity terminal gate benchmarks for capital cities’¹⁰.

Table 1

Average capital city margin above import parity terminal gate price, unleaded petrol; March 1994 to March 1996¹¹

Capital City	Unleaded petrol Margin
Sydney	4.93
Melbourne	4.38
Brisbane	5.20
Adelaide	5.08
Perth	7.53
Hobart	13.01
Canberra	8.20
Darwin	11.12

⁸ ACT Government Working Group on Petrol Prices. (1992). ‘Report of ACT Government Working Group on Petrol’ p. 3.

⁹ ACCC. (1996). ‘Inquiry into the Petroleum Products Declaration’ Volume 1. p. 55.

¹⁰ *ibid.* p. 64

¹¹ *ibid.* p. 64.

2.14. According to this analysis, Canberra experienced the third largest variance above the import parity gate price. In its report, the ACCC noted that while any conclusions based on these figures should be treated with some caution:

it could be argued that competitive outcomes in retail petrol pricing were achieved in Adelaide, Brisbane, Melbourne and Sydney... Total margins in Canberra, Hobart and Darwin significantly exceed the competitive indicator¹².

Price Breakdown

2.15. The committee heard that NRMA and Shell have been working together to develop a degree of transparency in retail petrol prices. The results have been released in a publication series called *Petrol Gauge* which examines the breakdown of costs associated with retail petrol prices between various locations around NSW. The committee heard that *Petrol Gauge* is based on commercial-in-confidence information provided by Shell to the NRMA and relates solely to Shell's pricing behaviour in the market. Table 2 shows the NRMA/Shell breakdown of average Sydney and ACT unleaded petrol prices into individual components as of February 1997.

Table 2

Component	ACT	Sydney	Variance
Import or refinery price	23.9	23.9	-
Federal tax	34.7	34.7	-
State tax	7.9	7.9	-
Freight	1.6	0.6	1.0
Shell's company margin (wholesale)	4.5	2.3	2.2
Retailer and distributor margin	6.1	5.7	0.4
Retail Price	78.7	75.1	3.6 ¹³

All Figures are in cents per litre (cpl)

2.16. This table shows that the ACT is paying more than Sydney in the freight, Shell wholesale, and retail and distributor components. Shell's margin is the most significant variance. In the evidence to the committee, oil companies claimed that higher start-up costs associated with the ACT petrol market were largely responsible for this variance.

2.17. On the face of it, these figures also suggest that the retail and distributor component is a notable variance and one of the largest components of both Sydney and Canberra retail prices.

2.18. However, the MTA-ACT have argued publicly that these NRMA/Shell figures misrepresent both retailer and Shell margins. The MTA-ACT have argued that the

¹² *ibid.* p. 65.

¹³ NRMA & Shell. (1997). "Petrol Gauge: Issue 2" p. 3.

category of ‘retail and distributor’ margin is deceptive because Shell and other oil companies are more often than not the distributors for their own wholesale supplies. Following on from this, the MTA-ACT argued that the figures presented for this category are not representative of actual retail margins but reflect an ill-defined mix of Shell’s distributor margin along with dealers’ retail margins.

2.19. The MTA-ACT submitted its own breakdown of retail petrol prices. Table 3 shows a dissection of ACT pump price as of 25 July 1997 provided to the committee by the MTA-ACT¹⁴.

Table 3

Component	Cost (cpl)
Federal Government	34.7
ACT Government	7.9
Oil Company	29.0
Freight	1.6
Operator/Dealer	-0.31
Wholesale Price	73.21
Pump Price	72.9

2.20. These figures show oil companies receiving 29 cents per litre of fuel, while dealers are actually making a loss of 0.31cpl. In its submission, the MTA-ACT noted that where the ruling price in the market is below the wholesale price charged by an oil company (as in this example), dealers lose money on their sales until the end of the month (in this case 0.31cpl) when price support is made available.

2.21. Price support is a retrospective discount on the wholesale price given to dealers in the face of low or negative retail margins. The MTA-ACT claimed that this support is only available through the ‘grace and favour’ of oil companies¹⁵. In its submission, the MTA-ACT claimed that Shell recently announced that it was reducing the level of price support from a 3.5cpl retail margin to a 3cpl margin¹⁶. Under this analysis the dealer margin would be 3cpl after price support with 26cpl going to the oil company.

This dealer margin is significantly less than the margin implied in the NRMA/Shell *Petrol Gauge*.

2.22. The MTA and the Service Station Association (SAA) have publicly argued that through a practice of ‘clawback’ dealers’ margins are further reduced by oil companies through royalty fees, petrol card transactions and other charges¹⁷. In its report, the ACCC made mention of ‘clawback’ alleged by various stake holders during its 1996 inquiry. The ACCC acknowledged these allegations stating that clawback:

...involves the oil majors allegedly applying excessive

¹⁴ Submission 16. p. 2.

¹⁵ Refer to section entitled ‘Retail Margin’ in Chapter 3. p. 11-12.

¹⁶ *ibid.* p. 3.

¹⁷ Submission 18.

charges to country dealers on non-fuels products and services, and through franchise agreements, as a means of 'appropriating some of country retailers' apparently high margins... [It was] claimed that the techniques applied include high rent, franchise fees, inspection fees, credit card charges, special discounts to users of fuel cards, brand fees and a percentage of non-fuel sales¹⁸.

2.23. While this alleged practice was raised in the public hearing¹⁹, no substantive evidence was presented to the committee in this regard. If such practices do exist, the distribution of retailer and oil company margins becomes even more difficult to determine.

Conclusion

2.24. Most Canberrans use Sydney petrol prices as a comparison with ACT prices. It is normal for Canberrans driving to Sydney to especially note the disparity between Canberra prices and the lowest prices posted by service stations located on major trunk routes into Sydney through Parramatta and Liverpool.

2.25. However, the committee accepts that direct comparisons are not necessarily reliable indicators for the reasons noted earlier in this chapter. The committee must also have reservations about the implications of price disparities. While the disparities exist, there are also wide price differences within the Sydney area itself. For example, committee staff who visited Sydney recently noted that prices for unleaded petrol on the same trunk road within the Parramatta area varied between 70.9 cpl and 75.9cpl while prices were generally 75.9cpl in Canberra.

2.26. The fact is that Canberra service stations do not have access to the highly trafficked trunk routes which characterise large areas of Sydney, which generate major potential volume sales, attract more independents and deliver more price competition.

2.27. Nevertheless, it has been shown that as a measure of the competitive factor the average Canberra margin above the import parity terminal gate price for unleaded petrol has been significantly higher than the margins applying in Adelaide, Brisbane, Sydney and Melbourne.

2.28. Further, it has been shown that the ACT is paying more than Sydney for the retail and distributor margin, even more for freight and significantly more for the oil company wholesale margin.

2.29. In a national market it is beyond the capacity of this committee to do other than bring to the attention of the Assembly and the community the factors bearing upon price structures in the ACT. That has been the function of this chapter.

¹⁸ ACCC op. cit. p. 88.

¹⁹ Transcript. p. 55. Mr. Watts.

2.30. The following chapters deal with discrete areas of the market and propose means by which the ACT can benefit from a more rigorous exposure to competitive forces. The attainment of that goal will require a combination of actions by the ACT Government in creating the conditions conducive to an effective competitive environment and the cooperation of the Federal Government in ensuring that the market is regulated in a manner consistent with attaining full and appropriate economic benefit for consumers and the industry.

CHAPTER 3. STRUCTURE OF THE ACT MARKET

Dominance of Oil Company and Franchised Sites

3.1. A number of stake holders pointed to the dominance of vertically integrated oil majors in the ACT petrol market as one of the main factors bearing on the relatively high petrol prices in Canberra.

3.2. The Motor Traders Association ACT (MTA-ACT) argued that:

vertical integration in the petroleum industry [is] the antithesis of competition if you have any regard at all for the Hilmer Competition Principles, because what the oil companies want to do and have been gradually doing over the years... is to take greater control of the market from out of the ground into the motorist's tank²⁰

3.3. The ACT petrol market has the highest number of franchised and company/agent sites in Australia. Recent figures show that 63.5 % of all ACT sites are franchised, while 30% are company/agent owned. These sites account for 97 % of the petrol sold in the ACT.²¹ The committee heard that the virtual absence of independent retailing in the ACT market affects both wholesale and retail price competition²².

3.4. The committee was told that company/agent sites are sites which are owned or operated by the oil majors: Ampol, BP, Mobil and Shell²³. Oil companies are able to set retail prices in these sites. Franchised sites refer to sites which are operated by a business person who leases the site from a franchisor (usually an oil major) and sells the branded product of an oil major.

Exclusive Ties

3.5. In theory, franchisees are able to set retail prices but it was the contention of organisations such as the ACT Chamber of Commerce and Industry, the NRMA and the MTA-ACT, that exclusive supply arrangements are largely responsible for oil majors setting excessive wholesale prices and consequently larger retail prices in the ACT.

3.6. Explaining exclusive supply arrangements ACCC noted that:

Product ties are reinforced by inclusions in such arrangements of guarantees on borrowings and tied lease of land, buildings and equipment. An oil major only need

²⁰ Transcript, p. 30. Mr Riding-Hill.

²¹ Submission 7, p. 19.

²² Evidence presented by Confederation of ACT Industry and NRMA cited this as an impediment to competition in the ACT.

²³ Submission 12, p. iii.

own one of the capital assets necessary to operate a retail business, either the site, the pumps or storage facilities, to insist on exclusive supply, thereby effecting vertical integration through contractual conditions. It is only when retailers provide their own capital and own their pumps and storage that they can sell unbranded product and so choose between suppliers [hence independent].²⁴

3.7. Both BP and Ampol argued that exclusive supply arrangements with franchisees are both appropriate and necessary in order to achieve reasonable returns on their investments. In evidence presented to the committee, Ampol argued that:

...we have got incredible costs of doing business. If we do not sell our product through those sites [franchised sites] we are making no return on that cost. So if you [potential operator] want to buy petrol from anyone [then] you set yourself up with your own site. You take out the headlease or purchase the site and then you bargain with whomever you can to buy the cheapest fuel.

Why would we sell someone else's product on a site which we own?²⁵

3.8. On vertical integration, enabled through exclusive supply contracts, the ACCC concluded that:

The Sites Act [*Petrol Retail Marketing Sites Act 1980* - Cwlth] has been bypassed using vertical arrangements to gain control of downstream activity. These exclusive ties eliminate any countervailing power which the franchisees might otherwise have had. As a consequence, each oil major and its branded chain can be considered as one entity when assessing the level of competition in the industry.²⁶

3.9. Accepting that franchised sites are, in effect, controlled by oil majors, only 6.5% of ACT sites are independent in nature (five sites). This number is significantly less than both the Sydney market in which 23 percent of sites are independent, and the national average across major centres of 25 percent²⁷. A number of submissions argued that without a strong independent retailing sector in the ACT, exclusive supply arrangements severely limit competitive pressures on oil companies to engage in wholesale discounting²⁸.

3.10. In other major cities, the large buying power of independent retailers, who are able to choose where to source their product, necessitates price competition between oil majors at the wholesale level. This occurs because oil companies have the

²⁴ ACCC. op. cit. p. 32.

²⁵ Transcript p. 23 & 25 Mr Grimes.

²⁶ ACCC. op. cit. p. 43.

²⁷ Submission 12. p. 3.

²⁸ Both the Attorney General's background paper (submission 12) and the NRMA submission made this point.

capacity to increase sales volume and market share through the lower wholesale prices offered to the large independent market.

3.11. In the ACT however, a ‘captive market’ seems to exist at the retail level in which the overwhelming majority of retailers (franchisees) are locked into supply arrangements that guarantee volume to the oil companies. Consequently, vigorous wholesale price competition does not offer any benefits in terms of additional volume to these companies. The committee heard that without this competitive pressure, oil companies tend to set excessive wholesale prices.

3.12. The 1992 Working Group summarised the problem as follows:

the ACT wholesale market reflects the structure of the retail market. The lack of independents means that wholesalers do not have to compete for independent business as happens in Sydney, nor do they have to support their own sites in the face of retail price cutting by independents or other dealers.²⁹

The Oil Company View

3.13. In their submissions, most of the oil majors pointed to the low volumes of traffic, rather than a ‘captive’ and vertically integrated market, as the reason for minimal wholesale discounting in the ACT. BP submitted that discounting in the form of price support for franchisees, is uncommon because ‘the nature of the service stations - with insufficient traffic available or accessible - militates against discounting in Canberra. The additional volume does not render the lower price worthwhile’.³⁰

3.14. Oil majors also asserted that, if relatively high retail prices do exist in Canberra, they are largely a result of the efforts of owners and operators to recoup the high outlays associated with acquiring and maintaining a site in the ACT. These issues are dealt with in more detail in Chapter 4.

Retail Margin

3.15. While the AIP maintained that ‘franchisees purchase fuel wholesale from the refiner-marketer, and set their own retail margin and prices’³¹, MTA-ACT argued that oil companies are able to limit competition at the retail level by restricting the ability of franchisees to set retail prices.

3.16. Explaining this, the MTA-ACT submitted that franchisees:
operate on too low a margin; the oil companies keep the retail margin low through a combination of their ability to set the ruling price in an area [through company/agent sites] and their use of the price support mechanism [a retrospective discount

²⁹ ACT Government Working Group on Petrol Prices. op. cit. p. 37.

³⁰ Submission 9. p. 4.

³¹ Submission 8. p. 4.

on the wholesale price].³²

3.17. Following on from this, the MTA-ACT went on to say that:

On a given day, the ruling price could be anywhere from - 2cpl [cents per litre] to +4.5cpl relative to wholesale. If the retail margin is lower than say 3.5cpl, the companies may offer price support to bring the franchisee's margin up to 3.5cpl. If the retailer should decide to charge less than the ruling price, the company will not provide price support. Written instructions are not necessary to ensure franchisees do not charge less than the ruling price in those circumstances.³³

3.18. Through the price support mechanism, it appears that oil companies are able to fix the parameters under which a franchisee could feasibly set a retail margin. The ability for oil companies to establish ruling prices, in conjunction with their control over the margins of franchisees, places these companies in a position to exercise a large degree of control over retail prices.

Open Access and the 50 per cent Supply Rule

3.19. Legal Advice from the Attorney General's Department was made available to the committee regarding the logistics of using Territory law to ensure that franchisees are able to shop around for up to 50% of their wholesale supplies - effectively negating exclusive supply arrangements and giving franchisees some degree of independence.

3.20. While it appears feasible for the ACT Government to legislate towards this end, attempts in both Victoria and Western Australia have failed in the past. The Attorney General's Department acknowledged that this course of action is a 'legal minefield' and that 'the likelihood of a challenge to such legislation is high'.³⁴ It appears that the more appropriate path to achieving workable outcomes in this area exists at the Commonwealth level.

3.21. The committee heard that the Federal Government has recently foreshadowed a move to open up access to wholesale petrol supplies. The Australian Petroleum Agents and Distributors Association (APADA) told the committee that:

...the undertakings which Mr Costello [the Federal Treasurer] has sought from the oil companies are essentially the following: any buyer can buy from any oil company terminal source which, in effect, is tantamount to untying of supply.

3.22. However, APADA pointed out that:

³² Submission 13. p. 11.

³³ *ibid.* p. 11.

³⁴ Submission 12, Appendix H.

these undertakings are in the context that it is recognised that existing contracts and franchise agreements will override the... [open access] rights.³⁵

3.23. In the context of federal regulation, APADA proposed a situation in which the right would exist ‘to request a renegotiation of that contract or distributor agreement’. Under this proposed regime, oil companies would give enforceable undertakings to ‘negotiate commercial pricing terms and conditions [with distributors and possibly franchisees] and if they do not then... [an] arbitrator can step in’.³⁶

3.24. This regime, it was argued, would give distributors and franchisees greater negotiating power in their relationship with oil majors.

Horizontal Integration

3.25. Horizontal integration in the petroleum industry primarily refers to practices such as ‘borrow and loan arrangements, whereby one company provides product or storage to assist a rival company to overcome logistical problems or an unforeseen supply shortfall’.³⁷ In the context of the industry at the national level, the ACCC expressed concerns over horizontal integration between the oil majors. It noted that this type of integration, ‘may... have a net anti-competitive effect, by providing the opportunity for price coordination’.³⁸

3.26. In its submission, the Confederation of ACT Industry (CAI)³⁹ suggested the possibility of collusion between oil companies as an element affecting ACT petrol prices, stating these companies had maintained ‘prices in the ACT, and done so in the knowledge that the other oil companies would not lower prices, and hence release downward pressure on prices.’ The CAI went on to say that ‘the oil companies have taken this course of action to their mutual benefit because they retain the profit in full from the excessive prices which consumers pay’.⁴⁰

3.27. The Confederation advised that:

In contrast with the ACT, the metropolitan areas have an undisclosed system of price maintenance. This reduces the amount of market information available to oil companies on their competitors, and therefore there is less market-friendly behaviour, and greater competition.⁴¹

3.28. It was not made clear to the committee exactly how the Confederation construed this collusion and the Confederation provided no evidence to support the claim that collusion, as conceived by the *Trade Practices Act 1974* (Cwlth), actually

³⁵ Transcript, p. 52. Mr Watts.

³⁶ Transcript, p. 54. Mr Watts.

³⁷ ACCC, op. cit. p. 127

³⁸ ACCC, op. cit. p. 127

³⁹ The Confederation of ACT Industry has since merged with the ACT Chamber of Commerce to become ACT Chamber of Commerce and Industry.

⁴⁰ Submission 4, p. 1.

⁴¹ *ibid.* p. 1-2.

exists. However, the ACCC, which is responsible for monitoring and accessing any anti-competitive effects of horizontal arrangements, found that:

Each oil major has developed close formal horizontal relationships with other majors. These arrangements may substantially lessen the level of competition. It is pertinent that some parts of the industry have recently been found to be in breach of the trade practices legislation with respect to price fixing and resale price maintenance.

3.29. In evidence to the committee, BP commented on the allegations of collusion saying that:

If we are colluding we are the biggest mugs in the world because we are not doing it very well. We made about three per cent last year, after tax. This year our retail sector, which has about \$500m of assets is so close to zero profits that it might as well be zero.⁴²

3.30. In 1992, the ACT Government Working Group raised the concern that retailers may also have some disincentives to engage in price competition. The Group noted that:

The attitude of dealers may be a contributing factor to current market conditions in the ACT. Dealers feel that if one dealer lowers his or her price it is tantamount to starting a discount war right across the ACT.⁴³

Conclusion

3.31. The committee finds that the high number of company/agent and franchised sites and virtual absence of independents in the ACT market has the effect of restricting competitive pressures at both the retail and wholesale levels. Exclusive supply arrangements place franchised sites firmly within the control of oil companies.

3.32. In testimony to the committee, NRMA argued that:

...a very high proportion of sites in Canberra are owned or franchised directly by oil companies and therefore they have a very very direct relationship with retail pricing. And frankly the oil companies are now being a little bit more up front and saying, "Well, we sell petrol, we'll get as much money for petrol as we can". So, if they are going to enter markets that do not show a high degree of competition, they are going to charge what the market will bear.⁴⁴

⁴² Transcript p. 45. Mr Frilay.

⁴³ ACT Government Working Group on Petrol Prices. *op. cit.* p. 24.

⁴⁴ Transcript. p. 3. Mr Anderson.

3.33. The committee acknowledges that oil majors have significant outlays in the ACT retail petrol market, and notes their assertion that they have a right to generate reasonable income through fuel sales at franchised sites. However, the committee believes that there may be some scope for increasing competition at the wholesale level by giving franchisees and distributors greater power to make commercial decisions about the terms and conditions of buying wholesale petroleum products from oil companies. The committee found that a '50 per cent supply rule' is not an appropriate means of achieving this end.

3.34. Issues associated with the anti-competitive effects of horizontal and vertical integration and collusion in the petroleum industry are primarily the domain of legislators and regulators at the Commonwealth level. The committee found that although these issues are of concern to the ACT community, it is the role of the ACCC and others to assess and ameliorate impediments to competition in this regard.

RECOMMENDATION 1

3.35. The committee recommends that the ACT Government make representations to the Commonwealth Government regarding the development of measures which give franchisees and distributors more power in their bargaining relationships with oil majors, especially with regard to the pricing terms and conditions of sourcing wholesale supplies.

CHAPTER 4. PLANNING AND LAND REGULATIONS

4.1. Almost all stake holders in the petrol pricing debate, as well as many inquiries into the subject, have identified ACT planning and land regulations as a key cause of the relatively high petrol prices in Canberra. The main thrust of evidence and submissions from oil companies points to ACT planning and land regulations as the chief cause of variance between ACT and Sydney prices.

4.2. The committee heard that past and present restrictions on land use, location, number of sites and retail space have placed a large premium on sites and consequently increased the investment risk associated with petrol retailing in the ACT. Following on from this, it was argued that owners and operators must necessarily charge higher prices to recoup the large outlays which have been paid for sites.

Site Premium

4.3. In relation to the effect of ACT land and planning regulations on petrol prices, the NRMA submitted that these regulations:

impose a high barrier to entry, with retailers in the market paying a substantial premium to enter the market... which is eventually borne by the motorist in terms of higher retail prices. As there exist high barriers to entry, so too are these also high barriers to exit. To this extent the oil majors, rather than consider the possibility of exiting the market and incur a capital loss, will endeavour to maximise the returns on their costly businesses by reducing the level of price support and any discounting to their franchisees.⁴⁵

4.4. Shell summed up the basic position of oil companies, arguing that these regulations have the effect of:

- Restricting entry to the ACT market which limits competitive forces.
- Sustaining a larger premium for land on which service stations can be developed. This premium accrues to the ACT government. The consequent increase in development costs is ultimately borne by ACT consumers.⁴⁶

4.5. In relation to the notion that the 'premium accrues to the ACT Government', BP argued that if the premium was not applied to sites, the Government would need to find alternative sources of revenue. BP submitted that:

- the current system attracts a higher upfront payment than would otherwise be the case
- consequently, this adds a premium to petrol prices

⁴⁵ Submission 6. p. 7-8

⁴⁶ Submission 5. p. 1.

- but the upfront payment is a payment to the ACT Government, ie in effect to the ACT consumer who would otherwise have to pay higher taxes (basically equal to the petrol price premium) to meet the shortfall in Government revenue
- the ACT consumer is thus in a zero sum game. Indeed the local consumer may be better off because non-ACT visitors also contribute to the premium payment.⁴⁷

4.6. In a similar vein, AIP submitted that:

The chief beneficiary of the high cost land release policy was the ACT Government. In effect, the policy traded initial benefits to Government cash flow against higher petrol prices.⁴⁸

4.7. However, a Price Surveillance Authority report construed the premium differently, arguing that it reflected ‘the capitalised value of the protections from competition inherent in the [previous] ACT sites release policy’⁴⁹. This policy placed restrictions on the location and number of sites based on the population of given areas, effectively guaranteeing a market for each site.

4.8. In this view, site developers have in the past paid the premium in the knowledge that other operators would not open service stations in their ‘territory’. It can be argued that this protection from competition must necessarily come at a price - a price which it seems many developers were prepared to pay. The 1992 Working Group noted that ‘the value of land for a service station is... a function of its volume or goodwill rather than the intrinsic value of the land itself’⁵⁰.

4.9. It must be noted that although the policy of limiting the number of sites by population was abandoned in 1988, the Working Group noted that the current land bidding system still has the effect of rationing sites, thereby eliciting a premium payment from developers⁵¹.

Headleases

4.10. In recent years, many sites have been purchased by private developers who have subsequently headleased the sites to various oil companies. The disparities between Canberra and Sydney for headlease costs gives some indication of the extent of premiums applicable to Canberra sites.

4.11. In its submission BP noted that:

Recent headlease costs for a large throughput (10 million litres per annum) Sydney sites are around \$350,000pa. The

⁴⁷ Submission 9. p. 5.

⁴⁸ Submission 8. p. 2.

⁴⁹ Prices Surveillance Authority. (1991). ‘Study of ACT Petrol Prices’ p. 4.

⁵⁰ ACT Government Working Group on Petrol Prices. op. cit. p 47.

⁵¹ *ibid.* p. 49.

headlease on Chisholm was originally between \$900,000 and \$1,000,000 pa, but in today's market a more likely level would be \$750,000 pa. The throughputs of these sites would be about 10 million litres pa. This differential of \$400,000 in annual costs translates into a cost per litre of 4-5 cpl.⁵²

4.12. Representatives of Ampol presented confidential evidence to the committee which showed that the high headlease costs of many ACT sites have added significant amounts to retail prices. In relation to this, Ampol attested that:

What this information can show is the incredibly high cost of doing business at some of these locations. We have a site which is listed here where our head lease fees amount to 11 cents per litre on the product that is going through that site. Now to give you an example we have got our internal mechanisms for transfer prices which attempt to look at approximately what an independent wholesaler could buy product for... We use that as an approximate benchmark, with our internal calculations, to sort out profit between our refining arm and our marketing arm. Now with an 11 cent a litre head lease fee, we have only got approximately 7 cents to play with as retail arm. So, we are way behind the eight ball to start with.⁵³

4.13. The 1992 Working Group Report found that in conjunction with the 'site premium', headleases present oil companies and franchisees with additional costs which must be recovered through their respective margins.

4.14. The Working Group concluded that the extra layer of investment involved in headleasing leads to inflated petrol prices. It noted:

the higher cost structures inherent in this type of arrangement tend to place unnecessary pressure on the retailer and promote higher ACT retail prices.⁵⁴

Level Playing Field

4.15. BP asserted that the ACT's planning controls and leasing system has had the effect of keeping petrol prices higher than would otherwise be the case. However, it argued that it would be 'inappropriate' to change land bidding rules as "(a) substantial investment has already been made by investors on the basis of the current rules, with substantial losses to them consequent to any change, (b) it would create an unlevel playing field, with new players gaining a substantial advantage over existing players, and (c) there is no guarantee that retail prices will reduce... This was evident through the Burmah lease example.'⁵⁵

⁵² Submission 9. p. 5.

⁵³ Transcript p. 14. Mr Grimes.

⁵⁴ *ibid.* 48.

⁵⁵ Submission 9. p. 6.

Locational Controls

4.16. Many witnesses and submissions argued that the former NCDC system of local 'village' based sites has had the effect of reducing price competition in the ACT. Sites located near local centres are, in the main, low volume sites which have little capacity to increase throughput by offering retail price discounts. Furthermore, it appears that motorists are not 'active' in their purchasing behaviour and are generally content to purchase fuel at their local service station regardless of price. The 1992 Working Group cited an NRMA survey which showed that most motorists would *sometimes, rarely or never* drive out of their way to obtain 1 - 5cpl cheaper fuel.⁵⁶

4.17. Following on from this the Working Group noted that:

One ACT retailer in a suburb with a busy shopping area informed the Working Group that he had experimented with his prices by lowering and raising them in a range of 2cpl without having any appreciable effect on his volume. By contrast, in regions of Sydney where sites are located along arterial roads the Working Group was told that a difference of even 1cpl can result in the loss of approximately 50% of volume within a few days.⁵⁷

4.18. However, this situation may have changed somewhat since the introduction of more sites on major roads. The MTA-ACT argued that motorists are very active and price sensitive shoppers. In their evidence to the committee, the MTA-ACT submitted that:

...a lot of people, particularly in the ACT... feel inclined to look for cheaper fuel no matter whether it is point one of a cent [cheaper]... they will in fact avail themselves of the opportunity.⁵⁸

4.19. In relation to controls on the location of sites, NRMA submitted that:

It would be more fruitful for the government to allow the market to locate sites where demand and volume exists, rather than dictating to the industry where it should market its fuel.⁵⁹

4.20. By allowing the market to determine the location of sites⁶⁰, it is likely that more sites would be developed along major thoroughfares where higher traffic volumes lead to increased sales. A higher density of sites along main roads could conceivably lead to enhanced price competition at the retail level because passing

⁵⁶ ACT Government Working Group on Petrol Prices. op. cit. p. 25.

⁵⁷ *ibid.* p. 45.

⁵⁸ Transcript. p. 31. Mr Ellis.

⁵⁹ Submission 6. p. 7.

⁶⁰ It must be noted that currently many major roads such as Northbourne Avenue and Adelaide Avenue are 'Designated Areas' under the National Capital Plan. The body responsible for administering the Plan, the National Capital Authority (NCA), has in the past objected to the placement of service stations in these areas.

motorists would be able to more easily judge and access the lowest price amongst a number of closely located sites. Site operators would then be in a position to attract additional volume through price competition.

4.21. However, a significant loss of visual amenity may be the result of such a change in planning policies. BP posed the problem as follows:

Canberra wants a competitive and efficient network. But, we suggest, Canberra does not want a Canterbury Rd type solution, ie, a highly competitive market brought about through excessive and very low quality sites. This solution carries with it a chaotic, unaesthetic, and asset inefficient outcome.⁶¹

Land Use

4.22. A number of oil majors argued that restrictive land use policies had the effect of increasing investment risk as a petrol retailing site could not be re-developed for alternative purposes. The committee heard that these barriers can have the effect of reducing the efficiency of a retailing network.

4.23. In evidence to the committee, Ampol stated that:

Something that is stopping us rationalising our network further are the planning laws - not being able to change from a service station site to a block of units on that site. It is just one more level of regulation that we are working under in Canberra. You find then that you have got a real risk, a capital risk, of opening a new service station to compete in the market, because you do not know what you can do with it if it ends up being a dud down the track.

In Sydney, for instance, you do not have those problems. You can easily convert them to other land usages.⁶²

4.24. The Government has focussed on this issue and provided to the committee a draft policy in respect of how disused service station sites will be handled in planning and local centre redevelopment.⁶³ Essentially the draft policy is linked to the principles contained in the Retail Policy - Local Centres Development Incentives and is to allow for a greater range of uses to be carried out on a site.

4.25. The draft policy provides, inter alia, that redevelopment proposals must demonstrate that the sale of petrol is no longer commercially viable.

⁶¹ Submission 9, p. 8.

⁶² Transcript, p. 27. Mr Grimes.

⁶³ Submission 17

Conclusion

4.26. As the committee observed at the beginning of this report, there have been innumerable inquiries into the ACT petrol market and the issues confronting the ACT government remain the same.

4.27. In essence, the petrol market like other markets, including retailing generally is restructuring and undergoing change. The Government should now take the lead in undertaking a substantial review of those planning controls which bear upon the location of petrol reselling sites and which restrict competition within the industry.

4.28. While the committee acknowledges that there is a draft policy on this matter, it is concerned that the draft appears to rely too heavily upon proof that petrol retailing is no longer viable before consideration is given to redevelopment of sites. This appears to exemplify the fact that there is too much regulatory overlay and intrusion in the market. In other words, government continues to be intimately involved in what should be normal market driven decisions.

RECOMMENDATION 2

4.29. The committee recommends that the Government review all land and planning controls affecting the location of service stations and the situation with disused petrol retailing sites with a view to freeing up the capacity for more market oriented redevelopment and the capacity for maintaining a competitive petrol retailing industry in the ACT.

RECOMMENDATION 3

4.30. The committee recommends that as new retailers enter the market they should as far as possible utilise existing vacant sites.

CHAPTER 5. GULL AND WOOLWORTHS

Background

5.1. In recent years, ACT governments have attempted to increase competition at both wholesale and retail levels by encouraging independents into the market place. As noted earlier on, independents have the capacity to increase competition at the wholesale level because oil companies must vie for their business. This, in turn, gives independents the capacity to source fuel more cheaply than franchisees and consequently to offer retail price discounts in the hope of increasing sales volumes.

5.2. The ACT Government submission cited a recent Hyde consultancy Report to the ACCC which suggested that increased numbers of independents are associated with lower price margins⁶⁴. Following on from this, the Government submission noted that 'increased competition, brought about by the entrance of a strong independent influence, is most likely to bring about change in the ACT market'⁶⁵.

5.3. In its 1996 report, the ACCC concluded that 'higher levels of independents are associated with lower price margins, confirming the view that independents are an important factor in restraining prices'⁶⁶.

5.4. In keeping with the goal of encouraging independents to the ACT market, favourable conditions were given to Burmah Fuels in 1993, allowing it to secure a site at Kingston for less than the market cost. Many submissions argued that this created an unlevel playing field and had the effect of undermining investor 'faith' in the market. These positions were clearly reflected in the findings of the 1994 review of Petrol Supply Arrangements conducted by the ACT Legislative Assembly's Standing Committee on Public Accounts.

5.5. Initially Burmah offered substantial retail price discounts which had the effect of placing downward pressure on prices throughout the entire ACT market. However, in its submission, the NRMA observed that these price discounts were short lived and Burmah is no longer considered a discounter. The committee heard that Burmah stopped discounting after entering an exclusive supply arrangement with an oil major⁶⁷.

5.6. The Government of the day had indicated that to maintain competitive pressure, further independents were to be encouraged to enter the ACT market. In late 1994, it offered three additional sites for use by non-majors. The current Government elected in February 1995 did not immediately proceed with the tenders and Gull Petroleum is only now developing two of these sites.

⁶⁴ Submission. p. 13.

⁶⁵ Submission 12. p. 13.

⁶⁶ ACCC. op cit. p. 77.

⁶⁷ Transcript. p. 5. Mr Anderson.

5.7. As noted earlier, Woolworths⁶⁸ is also planning to enter the ACT retail market in the near future.

5.8. The impending entry of discounters Woolworths Plus and Gull petroleum to the ACT petrol market drew considerable comment from all stake holders at the public hearing.

5.9. The committee heard that Gull is currently developing two sites, one at Belconnen and the other at Hume. The committee understands that Woolworths is planning to establish a number of sites, with the possibility of some sites being located in carparks in close proximity to its supermarkets. The committee is aware that these sites are likely to be located in Conder, Mawson, Tuggeranong Town Centre⁶⁹ and Belconnen Town Centre⁷⁰.

5.10. Much of the evidence presented to the committee argued that the entry of these two players is or will be taking place under special conditions which will have the effect of creating an unlevel playing field and introducing further distortions in the market. However, the committee heard that the introduction of these two players will almost certainly place a downward pressure on retail prices.

Discounting

5.11. The committee was told that Woolworths has provided significant price discounts in many regional centres. In this regard, the MTA-ACT submitted that:

When they went into Goulburn they maintained a position of 4c a litre underneath the market. In fact, they blew it 6c initially, but they maintained about 4c.⁷¹

5.12. The committee heard that the entry of Woolworths will 'affect the whole of the ACT from where they are because Woolworths has stated categorically that it will sell fuel at the lowest price within a two kilometre radius of that site, less 2c a litre discount for every shopper docket of \$30 or more that person produces at the site'.⁷² Experience has shown that the Canberra market is sensitive to retail price reductions - even one discounter can have the effect of reducing petrol prices across the board. This was evident with the introduction of the Burmah site.

Shopping Dockets

5.13. In August 1997, BP announced a shopping docket discount scheme for the ACT⁷³. BP will provide a 2 cpl discount for consumers who purchase more than \$30 worth of groceries from any of the 42 local supermarket outlets involved in the

⁶⁸ There was some contention during the public hearing as to whether Woolworths could be considered an independent.

⁶⁹ The Tuggeranong site is now operating.

⁷⁰ ACT Attorney-General and Minister for Fair Trading. Press Release. 21 August, 1997.

⁷¹ Transcript. p. 38. Mr Riding-Hill.

⁷² Transcript. p. 31. Mr Ellis.

⁷³ Canberra Times. August 13, 1997.

scheme. This initiative is likely to promote a degree of price competition in the retail petrol market as well as encouraging increased patronage of local retail stores.

5.14. This discount scheme may technically be in breach of the *Trade Practices Act 1974* under the ‘third line forcing’ provisions. However, in August 1997, the ACCC determined not to institute court proceedings against Woolworths and other retailers in this regard⁷⁴.

Wholesale Sources

5.15. The committee was told that one of the reasons Woolworths can offer such large price discounts stems from the fact that it is able to import cheap wholesale fuel products. In testimony to the committee, NRMA conjectured that Woolworths received wholesale fuel products for considerably less, perhaps ‘even 7 or 8 cents below’ the regional benchmark - Singapore⁷⁵.

5.16. The ACCC has supported the rise of imports as a means of bringing increased competition to the national wholesale market. In its 1996 report, the ACCC noted that:

there is a better prospect for increased competition in the future than currently exists, particularly if the independent sector and imports are strengthening. If successful, imports will inject competition into the industry and this is likely to flow through to country areas as importers or their independent wholesalers seek wider sales for their product.⁷⁶

5.17. At the time of the hearing, Gull was planning to source fuel for its Canberra sites from an oil major. Gull stated to the committee that it was able to shop around for the best wholesale price and conditions. Following on from this, the company asserted that ‘...in Perth, we are known as a discounter and price leader but we will be very price competitive here in this market’.⁷⁷

Consumers

5.18. The potential for significant price discounts from both Gull and Woolworths, will make the entry of these players particularly attractive to ACT consumers. The committee was told by NRMA that:

at Goulburn where there now is a Woolworths site and where you used to pay prices comparable or perhaps a little more than Canberra, it has had a very big effect on pricing...

We are a consumer advocate, we have a fairly strong view that any new entrants to the market are obviously to be encouraged, particularly if they are going to bring some price

⁷⁴ Canberra Times. August 15, 1997.

⁷⁵ Transcript. p. 6. Mr Anderson.

⁷⁶ ACCC. op. cit. p. 127.

⁷⁷ Transcript. p. 58. Mr Said.

competition.⁷⁸

5.19. NRMA went on to say that ‘the dilemma is whether if the ACT Government... favours the entry of Woolworths they are going to present Woolworths with the same conditions of entry as they do other oil companies’⁷⁹.

Tilting the Playing Field

5.20. Many of the witnesses suggested that the entry of Gull and Woolworths is taking place under special conditions which threatened the viability of existing owners and operators. They argued that new players should enter the market under the same conditions as existing players.

5.21. Commenting on the entry of Gull and Woolworths, BP submitted that:

When you have a circumstance where a new player - whether it be Burmah, or now Woolworths, Gull or anyone else - may be seeking or may be granted permission to develop service station facilities outside the bidding system and outside

the planning system, there is a clear inequity. The present sites were all established under a known and specific auction bidding system predicated under the planning system.

Auction

bids, whether by oil majors or private developers, were high because of this linkage. The bids benefited the ACT Government coffers and hence the ACT community, which is fine and we agree with that - but inevitably... this adds to the costs of operation in the ACT for all existing players.

It is our understanding that Woolworths is negotiating directly to place service station facilities on unleased public lands close to their existing stores. Further, the refiner marketers were forbidden to compete for the sites now held by Gull. All of these instances, both in the past or proposed, mean that all present players, including oil majors, small business franchisees and others are put several metres behind scratch in a 100 metres race.⁸⁰

5.22. The Woolworths marketing strategy for petrol retailing revolves around being able to locate sites closely to its supermarkets; if possible, immediately adjacent to a store. Where Woolworths plans to develop sites on unleased public land or on carparks, this approach to petrol retailing appears to be incompatible with existing ACT land and planning processes. It remains to be seen what concessions, if any, Woolworths will be given in this regard.

⁷⁸ Transcript. p. 3. Mr Anderson.

⁷⁹ Transcript. p. 3. Mr Anderson.

⁸⁰ Transcript. p. 42. Mr Frilay.

5.23. The committee is aware that the entry of Woolworths is being facilitated by the ACT Government to some extent through the offer of a direct grant at market value to a site in Mawson.

5.24. In this regard the Government submission noted that:

In terms of competition principles, the provision of a direct grant of land could be viewed as anti-competitive - that is, it favours one beneficiary over any other, and exempts it from a contestable process. However the Government's view is that this proposal is justified in terms of the community benefits (of greater competition in retail petrol and the opportunity for reduced petrol prices for the whole community)⁸¹.

5.25. At the time of writing this report, Woolworths has not determined whether the conditions of entry to this site are commercially viable.

5.26. The committee understands that Woolworths is taking over an unused site at the Tuggeranong Town centre during September 1997 and is aware that a Woolworths site at Belconnen is to be decided following negotiations between the ACT Government, Westfield and Woolworths.

5.27. BP claimed that the *ACT Fair Trading (Petroleum Retail Marketing) Act 1995* is not applied in a uniform fashion - to the detriment of existing players. BP submitted that:

In 1995 the ACT Government... put in place a moratorium on MSOs [multi-site operations]. This moratorium does not apply to Woolworths or Gull who are free to - and we understand, propose to - directly manage their sites... Direct management could be defined as the ultimate in multisite operation. It then becomes ludicrous that BP and its franchisees are prevented from entering into MSOs if they wish, when new players are going to utilise the ultimate MSO, that is without even franchising.⁸²

Supermarkets in Petrol Retailing: International Experience

5.28. A number of stake holders argued that while the entry of Woolworths might provide some benefits in the short term, price discounts will not necessarily last for a long time and may lessen competition in the long-term. APADA cited the French experience with regard to supermarket chains entering the petrol market. APADA stated that:

The hypermarkets in France...have about 53 per cent market share, and we heard before that Shell have pulled out of retail in France. I also understand that in France there is now a

⁸¹ Submission 17. p. 4.

⁸² Transcript. p. 43. Mr Frilay.

petrol inquiry going on to determine why the petrol prices have now become very high again since the hypermarkets came in. Woolworths coming into the market is not necessarily always good in the medium to long-term.⁸³

5.29. The MTA-ACT have publicly argued that the reduction of sites associated with the entry of Woolworths to the ACT will result in a further reduction in competition, eventually leading to higher retail prices. MTA-ACT cited the British experience with regard to the entry of supermarket chains to the petrol market. MTA-ACT submitted that:

we will simply end up after Woolworths comes into the market, and perhaps another grocer or two, in the same situation as has happened in the United Kingdom where there was a major disruption to petrol retailing when Tesco and Sainsburys entered the market. Over a period of some few years some 9000 service station operators went out by attrition.⁸⁴

5.30. The committee was told that a decision to allow Woolworths into the ACT market will, like in Great Britain and France, inevitably lead to many existing operators going out of business. A Shell Franchisee and Chairman of the Service Station Division for the MTA-ACT submitted that:

...the introduction of Woolworths or any clone of Woolworths, any type of discounter like Woolworths, will in fact only accelerate the process [of franchisees going out of business] and throw people out the back door⁸⁵.

We ask and we have asked the Government directly to stall, stop, do anything it can to prevent Woolworths, the further penetration of Woolworths in the ACT because our profitability is going out the back door.⁸⁶

5.31. The committee must have some reservations about the relevance to the ACT or, indeed, to Australia as a whole, of international experience with the entry of supermarket chains to the petrol market. For example, the committee is not resourced to test the market and regulatory conditions which apply in other countries. This sub-section of the report is included mainly to acknowledge that such market developments are well under way in other countries and that Australia is no less likely to be insulated from them than from other structural changes in the marketing of other products.

⁸³ Transcript. p. 51. Mr Watts.

⁸⁴ Transcript. p. 30-31. Mr. Riding-Hill.

⁸⁵ Transcript. p. 32. Mr Ellis.

⁸⁶ Transcript. p. 37. Mr Ellis.

Retail Space

5.32. The committee heard from both oil companies and franchisees that while Woolworths is in a position to sell petrol, ACT regulations limit the capacity of service stations to derive income from non-fuel sources like groceries. These parties argued that this situation creates an inequity in which Woolworths is able to take business away from petrol retailers, while the retailers are unable to properly compete in the convenience market. The MTA-ACT and a number of oil companies argued that this situation will threaten the viability of existing service stations after the introduction of Woolworths.

5.33. Currently, ACT regulations limit the amount of retail space a service station may have to 50 square metres in smaller locations and 150 square metres in higher order centres⁸⁷. Almost all the stake holders argued that this restriction limits the amount of non-fuel income an operator may generate, making the retail margin on fuel sales more important. The committee heard that extending the amount of space that service stations can use to sell convenience items may allow owners and operators to provide price discounts on petrol.

5.34. In evidence presented to the committee, Ampol stated that:

We do not just want to be selling fuel, because if you are just selling fuel, because... there is not the same incentive to discount as if you are selling lots more Mars Bars and fast food and everything else that you can put together on a service station site, as we are doing in other capital cities. So we would like the restrictions on shop size, opening hours, and those type of restrictions removed.⁸⁸

5.35. In evidence to the committee, Gull Petroleum submitted that:

...petroleum fuel... could be considered as a loss leader.... It is a fact of life you make more in a litre of Coke nowadays than you do in a litre of fuel.⁸⁹

5.36. Regarding the entry of Woolworths, an Ampol franchisee made the similar comment that 'if someone said they would come and buy \$30 worth of groceries in my shop I would probably be able to discount them too, because I would simply put 5 or 10 per cent on my top selling lines and be able to recoup my discount.'⁹⁰

5.37. AIP submitted that:

In Sydney, new service stations will now routinely plan on deriving over half the site income from non-fuel sources, to

⁸⁷ Submission 17. Attachment B. p. 1.

⁸⁸ Transcript. p. 28. Mr Grimes.

⁸⁹ Transcript. p. 62. Mr Said.

⁹⁰ Transcript. p. 34. Mrs Zdjelar.

allow low margin sales of fuel to be viable. This option is less open to ACT service stations.⁹¹

5.38. It must be noted that removing the restrictions on retail space in service stations may have a significant impact on local shopping centres.

Exit Arrangements

5.39. In light of industry developments like rationalisation and the ascendancy of discounters such as Woolworths, the MTA-ACT argued that arrangements should be made to provide franchisees with the means for 'equitable exit' from the petrol industry. In the public hearing, the MTA-ACT argued that:

there should be adequate exit arrangements for those people [franchisees] financially. In other words, if a person owned a business at Lyneham that was going to be taken away because Ampol decided that they were going to sell the site, we feel that that person needs to be looked after financially in the process. We believe that that is not only an oil company responsibility but it is also a government responsibility as well⁹².

5.40. The organisation went on to say:

We have had the same thing happen in the mining and the pharmaceutical industry. Those industries were restructured and the people in those industries were not sacrificed and totally disregarded and thrown out the back door. They were given a fair and equitable exit and they were allowed to leave the industry with dignity⁹³.

5.41. An ACT Government submission argued that any 'severance payment scheme... is not an option for the Government as it would breach provisions of the Trade Practices Act'⁹⁴.

Conclusion

5.42. The committee is aware that Australia-wide, Woolworths aims to identify and open some 200 sites by the year 2000⁹⁵. While the company seeks to establish a competitive market for petrol, the product is, in essence, seen by the company as a consumer item akin to any other item retailed by Woolworths stores. Essentially for this reason, Woolworths Plus Petrol does not offer the ancillary motoring services provided by service stations, and a key aspect of its marketing strategy is that their sites be co-located as far as possible with their supermarkets. This means that,

⁹¹ Submission 8. p. 10.

⁹² Transcript. p. 32. Mr Ellis.

⁹³ Transcript. p. 35. Mrs Zdjelar.

⁹⁴ Submission 17. p. 2.

⁹⁵ Woolworths Plus Petrol Concept

desirably, their sites be located in car parks adjacent to their stores so that patrons who wish to take advantage of the 2 cpl discount on presentation of a \$30 plus shopping docket have sightlines to the petrol bowsers and have a seamless transfer to the petrol reselling 'aisle'.

5.43. The committee's view is that the jury will remain out for some time while the effects of Woolworths entry to the petrol market settle down over a time. Anecdotally, the committee understands that after the initial flurry within discrete rural NSW markets following the entry of Woolworths these markets have settled down to a lower petrol price regime and, as importantly, there have been no permanent closures of existing service stations due to Woolworths entry.

5.44. The committee considers that the ACT market, being substantially larger in area, demographically and in terms of disposable incomes is not analogous to that of say Dubbo or Cooma where Woolworths sites have been operating for some time.

5.45. However, the committee acknowledges the concern of franchisees should the entry of Woolworths and Gull to the market siphon off any significant amount of their business in a situation where they have limited capacity to compete on even terms.

5.46. The committee is also concerned that any significant loss of business by franchisees could mean a reduction in employment opportunity by these businesses and a possible loss of amenity to local communities should closures be forced or franchisees be unable to offer a full range of motoring services such as vehicle servicing and repairs.

5.47. Accordingly, the committee is firmly of the view that regulations limiting the amount of retail space in service stations be reviewed as a matter of urgency.

RECOMMENDATION 4

5.48. The committee recommends that the Government ease restrictions on retail space available in service stations.

CHAPTER 6. MULTIPLE SITE FRANCHISING

6.1. Multiple-site franchising (MSF), regional area franchising (RAF) and multi-site operations (MSO) all describe a form of site rationalisation that is currently being implemented around Australia by Shell, Mobil and BP respectively. This type of rationalisation involves the operation of a number of sites by a single franchisee. After its merger with Caltex, Ampol has been restricted from this practice as part of its undertakings to the ACCC.

6.2. Multiple-site franchising, as it is widely known, has become a contentious issue in the petrol pricing debate. In 1995, the ACT Legislative Assembly passed the *Fair Trading (Petroleum Retail Marketing) Act* which effectively outlawed MSF. Since this time, the oil majors have strenuously argued that this law be repealed on the grounds that it is an impediment to their competitiveness and achieving lower petrol prices in the ACT. Consumer groups and many franchisees have supported the law, arguing that MSF represents a form of vertical integration and threatens both wholesale and retail price competition in the ACT market.

6.3. The Government foreshadowed that regulation in this area would need to be re-evaluated in light of any recommendations made by the ACCC regarding MSF⁹⁶. As recently as August 1997, the ACT Minister for Fair Trading announced ‘a more flexible approach to the Government’s consideration of requests for multi-site franchise operations’⁹⁷. In an ACT Government submission, the Minister pointed out that:

[he is] able to consider applications concerning the disapplication of the operation of the Act in particular circumstances⁹⁸.

6.4. The Minister also noted that:

Determining whether a particular exemption is in the public interest will still involve a careful weighing of deleterious effects of the introduction of multi-site franchising on competition against the positive effect of industry restructure⁹⁹.

6.5. In the report of the Inquiry into the Petroleum Products Declaration, the ACCC was equivocal in its position on MSF and other vertical arrangements. The ACCC acknowledged that MSF can have the potential to both encourage and discourage competition in wholesale and retail markets. In relation to MSF, the ACCC found that:

multi-site franchising should provide for increased managerial efficiency through flatter structures and lower costs.

⁹⁶ Submission 12. p. 10.

⁹⁷ ACT Attorney-General and Minister for Fair Trading. Press Release. 21 August, 1997.

⁹⁸ Submission 17. p. 2.

⁹⁹ *ibid.* p. 3

However, it may also enable the oil majors to monitor and to influence retail prices in a more targeted way, especially against independents.¹⁰⁰

Efficiency

6.6. It is becoming increasingly apparent that sites with low volumes are less likely to survive in today's market. A 1992 MTA survey determined that only sites with throughputs greater than 450kl per month were viable. Between 1992 and 1996 the number of sites in the ACT with throughputs less than 150kl fell from 36 per cent to 20 per cent¹⁰¹. This reflects the extent of rationalisation which has already taken place in Canberra. The committee heard that MSF is an efficient means of rationalising retail networks and that the current moratorium should be abolished.

6.7. Most of the oil majors contended that MSF is a means of improving the economies of scale associated with petrol retailing and consequently a means of reducing operating costs. They argued that this has the capacity to lower retail petrol prices for ACT consumers.

6.8. In this regard, BP submitted that:

We see MSOs as a possible means of reducing the cost of supply, and therefore a competitive weapon, to the consumer. We also see MSOs as a means of business development for a capable franchise.¹⁰²

6.9. In the same vein, Mobil submitted that:

The foundation of the system is a stronger franchisee/franchisor relationship with the specific needs of a local market being serviced by an entrepreneurial small business person.¹⁰³

6.10. Mobil went on to say that:

Economies of scale and business growth are they key economic drivers. The impact on competition is positive as the purpose of the system is to improve the competitiveness of Mobil's franchises by making the business more viable and efficient. The RAF system will not supply to independents or their franchises by making the business more viable and efficient presence in the market. There is no change to wholesale and retail pricing systems.¹⁰⁴

¹⁰⁰ ACCC. op. cit. p. 134.

¹⁰¹ Submission. 12. p. 10.

¹⁰² Submission 9. p. 9.

¹⁰³ Submission 3. p. 5.

¹⁰⁴ *ibid.* p. 5

6.11. Arguing on behalf of franchisees, BP stated that the ACT *Fair Trading Act 1995* not only makes the ACT retail network inefficient but makes it difficult for franchisees to exit an unprofitable business. In evidence presented to the committee, BP argued that:

Those dealers wishing to leave and sell franchises to either parent oil companies or existing franchisees are restricted at present, as the legislation prevents either us buying back sites or the existing franchisees operating more sites than they had in place in August 1995, without the Minister waiving the legislation on a case-by-case basis.¹⁰⁵

Exemptions

6.12. In its submission, the ACT Government noted that it had ‘sought the views of organisations representative of both the oil companies and motor trade as to the circumstances in which exemptions [from the Fair Trading Act] might be granted’¹⁰⁶. The Government submitted the following points as the basis of a cost-benefit analysis for any decision to provide an exemption.

Would a particular multi-site franchise proposal have a deleterious effect on the market:

- within a particular geographical area
- on major access roads

Would a particular multi-site franchise proposal:

- foster business efficiency;
- lead to rationalisation resulting in more efficient allocation of resources and in lower or contained unit costs;
- expand employment or prevent unemployment in efficient businesses;
- lead to employment growth in particular areas;
- be conducive to industrial harmony;
- assist efficient small business (for example, provide guidance on costing and pricing or marketing initiatives which promote competitiveness);
- improve in the quality and safety of goods and services and expansion of consumer choice;
- supply of better information to consumers and businesses to permit informed choices in their dealings;
- promote equitable dealings in the market; or
- promote industry cost savings resulting in contained or lower prices at all levels in the supply chain¹⁰⁷.

¹⁰⁵ Transcript. p. 43. Mr Frilay.

¹⁰⁶ Submission 17. p. 3.

¹⁰⁷ *ibid.* p. 3.

Anti-competitive Aspects

6.13. The MTA-ACT expressed a number of concerns about MSF. It claimed that:

multi-site franchising is a means for oil companies to directly influence the operation of the retail market, contrary to the intentions of the Franchise Act [*Petroleum Retail Marketing Franchise Act 1980 Cwlth*] and the Sites Act [*Petrol Retail Marketing Sites Act 1980 Cwlth*].¹⁰⁸

6.14. In this view, MSF represents a mechanism by which oil majors can extend their vertical integration and its anti-competitive effects. The MTA-ACT further claimed that through predatory pricing oil companies can use MSF as a means of forcing out smaller competitors. The MTA-ACT submitted that:

a multi-site franchise arrangement is a very effective tool for undermining the viability of any other individual franchisee
or
competitor in the market area. He can undercut prices until such time as that franchisee is forced into the position of
being
a “willing seller” of his service station to a “willing buyer”.
The willing buyer is of course the only possible buyer, being the parent oil company, since the site has become unviable.¹⁰⁹

6.15. Reflecting on the benefits of MSOs asserted by the oil majors, the MTA-ACT submitted that:

while multi-site franchising may increase efficiencies and reduce costs, as claimed by the oil companies, there is no reason to believe that any of those savings would be reflected in lower retail petrol prices to the consumer.¹¹⁰

Conclusion

6.16. The committee heard that there may be some scope for increasing the efficiency of retail networks through MSF. Alternatively, the committee heard that this type of rationalisation may have the effect of allowing oil companies to further control retail prices in the ACT, as well as providing these companies with extended scope to practice predatory pricing policies which would lead to a further reduction of sites and competition in the ACT.

6.17. However, no substantive evidence was presented to the committee showing what the likely effects MSF will have on retail prices in the ACT.

¹⁰⁸ Submission 13. (MTA-ACT) p. 2.

¹⁰⁹ *ibid.* p. 2.

¹¹⁰ *ibid.* p. 2.

6.18. The committee accepts that in some circumstances exemptions to the *Fair Trading (Petroleum Retail Marketing) Act 1995* may be appropriate and in the best interests of various stake holders. The committee agrees with the Government that decisions to grant an exemption should be based on a cost-benefit analysis of the type outlined above¹¹¹. The committee believes that while it is important to maintain a degree of flexibility on this issue, the weight of evidence presented to the committee was not enough to recommend the repeal of the legislation.

RECOMMENDATION 5

6.19. The committee recommends that the ACT Government further investigate the likely effects of multi-site franchising in the ACT and that the Fair Trading (Petroleum Retail Marketing) Act 1995 remain in place until such time as these effects have been determined.

Bill Wood, MLA
Chair

18 September 1997

¹¹¹ Submission 17. p. 3.

APPENDIX A: LIST OF SUBMISSIONS

1. Australian Institute of Petroleum (AIP)
2. Ampol Petroleum P/L
3. Mobil Oil Ltd
4. Confederation of ACT Industry
5. Shell Oil Coy of Aust
6. NRMA
7. Motor Trades Assn ACT
8. AIP
9. BP Australia
10. Australian Petroleum Agents and Distributors Assn
11. Ampol Petroleum P/L
12. ACT Attorney-General and Minister for Fair Trading (Backgrounder)
13. Motor Trades Assn ACT
14. MTA
15. Gull Petroleum
16. MTA-ACT
17. ACT Attorney-General and Minister for Fair Trading
18. MTA-ACT

APPENDIX B:

WITNESSES BEFORE THE COMMITTEE

1. NRMA represented by Mr. Anderson
2. ACT Chamber of Commerce and Industry represented by Mr Monagle
3. Ampol represented by Mr Grimes and Mr Claxton
4. The MTA-ACT represented by Mr. Riding-Hill, Mr Ellis and Mrs Zdjelar
5. BP represented by Mr Frilay and Mr Maule
6. APADA represented by Mr Watts
7. Gull Petroleum represented by Mr Said
8. The Attorney-General's Department represented by Mr Quinton