

Manager
Transport Fuels Section
Energy Division
Department of Industry
GPO Box 9839
Canberra, ACT, 2601

Via email: transportfuels@industry.gov.au

**Australian Motor Industry Federation (AMIF)
Motor Trades Association of Australia Limited (MTAA)
Australian Service Station and Convenience Store Association (ASSCSA)**

**Submission to the 2014 /15 Review of the
*Competition and Consumer (Industry Codes–Oilcode) Regulation 2006 (Oilcode)***

Dear Secretariat,

AMIF, MTAA Limited and ASSCSA thanks you for the opportunity to provide a combined submission in relation to the current review of the *Competition and Consumer (Industry Codes–Oilcode) Regulation 2006 (Oilcode)*.

AMIF and MTAA Limited is the pre-eminent body representing the interests of over 100,000 retail motor trades businesses, which employ over 310,000 people and have an aggregated annual turnover in excess of \$208 billion. These figures, combined with the industry's scope and size, makes the retail motor trades the largest stand-alone small business sector in Australia. The Federation's membership consists of automobile chambers of commerce and the majority of state and territory motor trades associations.

A key sector of retail motor trades is the Australian Service Station and Convenience Store Association (ASSCSA) which is a National Industry Sector Association of AMIF and MTAA Limited. ASSCSA represents the specific national interests of thousands of service station / fuel retailers. It is governed by an Executive Committee composed of representatives of the Service Station (and Convenience Store) and Fuel Retailing Divisions of the state and territory Member Associations of AMIF and MTAA Limited.

The preparation of this submission is cognisant of input from these Members through their State and Territory organisations; the presented discussion paper and other materials pertinent to this important Review.

Submission preparation is also cognisant of other Commonwealth Government reviews in progress including the Competition Policy Review; Motor Vehicle Standards Act Review; issues, examinations and investigations surrounding fuel retailing since the last Oilcode review; and activities and outcomes achieved by the Australian Competition and Consumer Commission.

EXECUTIVE SUMMARY – AMIF / MTAA Ltd / ASSCSA POSITION

General observations:

- Oilcode is nowhere near as effective for the retail fuel industry as the legislation it replaced. Namely, the *Petroleum Retail Marketing Sites Act Cth 1980* (the Sites Act) and the *Petroleum Retail Marketing Franchise Act Cth 1980* (the Franchise Act).
- Since the removal of the sites act, almost all franchisees are now commission agents.
- This change has resulted in distancing the franchisee from the fuel price, yet from the public's view point, the franchisee remains culpable of price gauging and manipulation.
- In addition, the franchisee has, and continues to bear the burden of the increasing costs of fuel theft through dud credit cards and premises departure without payment (Drive-Offs). This issue needs to be addressed through Oilcode as oil companies need to be accountable for these costs due to other compliance requirements in regard to company specific site equipment, method of operation and administration.
- Although ASSCSA does support the concept of an Oilcode, the current legislation has been of little benefit to the small business sector of the retail fuel industry since the low point created at its introduction. It has proven to be particularly ineffective for commission agents.

AMIF MTAA Ltd and ASSCSA recommendations include:

- that amendments be put in place to ensure transparency and true competition occur at the wholesale level. A true Terminal Gate Price (TGP) system was in place in Victoria until the implementation of the Federal Oilcode.
- that the Victorian model **(see attachment)** replace the current TGP requirements in the Oilcode.
- that disclosure requirements be amended to include all relevant matters notified under the dispute resolution mechanisms of Oilcode.
- Greater utilisation of State Small Business Commissioners and / or the Commonwealth Small Business and Family Enterprises Ombudsman (when established).
- the current dispute process should be replaced with an Fuel Retailing Ombudsman or that specific powers be available to the Commonwealth Small Business and Family Enterprises Ombudsman (when established) to address expressed concerns.
- that the \$20k threshold be scrapped and that all tenancy agreements requiring adherence to a landlord's brand, require a 5 + 5 year lease; and
- Greater synergy with the recently reformed franchising code of Conduct, where applicable and not detrimental to specificities of fuel retailing.

Issues for consideration

1. General

The current (July 2013 - June 2014) DRA report identifies only 10 items brought to their attention, (across over 5,500 fuel outlets) indicating that there are no problems in the industry, or that the industry has no confidence in the Oilcode. We think the latter.

If the Oilcode was effective, why are onerous contracts that are unilaterally adjusted to control incomes allowed to proliferate?

Stories of victimisation of operators who speak up, surface from time. These are quite effective in keeping other the potential complainants subdued.

As for benefits to the customer from Oilcode, compliance to Oilcode is simply good business, as is good customer service, Oilcode provides no extra benefit to the customer.

Any good business will comply with company and association codes of practice. Oilcode has no real impact unless a dispute arises and it would appear that when that occurs, Oilcode is found wanting.

For Oilcode to be truly effective for small business fuel retailers, the following issues need to be carefully addressed in this review:

2. Terminal Gate Pricing (TGP)

- There is no current requirement for fuel resellers to sell at their posted TGP, only a requirement to post a TGP.
- Very few sales take place at the posted TGP, hidden post TGP discounts still dominate the wholesale market, due to the lack of transparency pre TGP discounts may also exist.
- Oil companies use this lack of transparency to stifle competition at the wholesale level.
- This lack of competition not only disadvantages independent service station operators, but also disadvantages consumers.
- The independent sector needs better access to wholesale discounts to provide more robust competition at the Retail level.
- Wholesale web sites display a wide range of TGP from 110.3 cents per Litre (cpL) to 121.7 cpL on the same day¹ Yet most retailers are unable to access these optional wholesale suppliers at all, due to their current 'locked in' supply arrangements. Giving the impression that the TGP serves no purpose other than to appease the government of the day.
- We recommend that amendments be put in place to ensure that transparency and true competition occur at the wholesale level. A true TGP system was in place in Victoria until the implementation of the Federal Oilcode. We recommend that the Victorian model (see attachment) replace the current TGP requirements in the Oilcode during this review.

3. Disclosure

- Current requirement is for a fuel retailer to disclose "Materially Relevant Facts". This requirement does not disclose enough information for a prospective tenant to make a fully informed decision.

¹ Source: Independent distributor and oil company web sites – accessed Tuesday 17 February 2015

- Disputations in “Master/Servant” relationships are ever present and remain a major issue in the Oilcode (and many other codes, such as the Franchising Code).
- A requirement that a fuel reseller’s history of dispute be included in the disclosure document would prompt a more progressive approach from a reseller in order to avoid devaluing the franchise.
- We recommend that the disclosure requirements be amended so as to include the disclosure of all relevant dispute notified under the dispute resolution mechanisms of Oilcode. Or any other dispute resolution means such as through state Small Business Commissioners.

4. Dispute Resolution

- Current Oilcode dispute resolutions are unenforceable and do not require parties to mediate in good faith.
- Unlike the Franchising Code, there is no requirement to attend mediation or to make efforts to resolve the dispute.
- Disputes that have been resolved have in some cases not been resolved to the satisfaction of the franchisees. The oil company positions are usually “take it or leave it”. In these cases, part of something was better than nothing at all.
- Because of this, we believe the current Dispute Resolution process is both ineffective and outdated.
- Outcomes must be binding and enforceable. This is currently not the case. Therefore, we believe the current dispute process should be replaced with an Ombudsman.
- This is desperately needed to resolve oil industry disputes. An entity with similar powers as the Telecommunications Ombudsman, a Fuel Industry Ombudsman would need sufficient authority to issue Cease and Desist orders to either disputing party and require attendance at mediation etc.
- Given our reliance on imported fuels, the Ombudsman’s office would also maintain a watch on fuel quality and fuel security.
- The Ombudsman position would need to be constructed in such a way as to ensure that this does not become just another ineffective wasteful bureaucracy, and funded by state and commonwealth governments and industry.
- Such an entity would need to be a person experienced in the downstream fuel industry both from the wholesale and retail perspective.

AMIF, MTAA Ltd and ASSCSA are able to assist with the identification of highly qualified and suitable independent candidates for such a position if of assistance to the Review Secretariat.

5. Tenure

- The current threshold of \$20k is being circumvented.
- We recommend that the \$20k threshold be scrapped and that all tenancy agreements requiring adherence to a landlord’s brand, require a 5 + 5 year lease.
- Oil companies and independent chains appear to be noncompliant with the Code.
- The relationship between the franchisee and the franchisor is often driven by personality and while this can often provide a positive outcome, in some cases it is necessary to have decisions founded on objective administration of the rules. It is readily accepted the environment of fear, uncertainty and doubt continues to circulate.
- Currently if you take an overview of the market across Australia, you will find the administration of the franchise differs from state to state and despite trying to put systems in place to remove the inconsistencies, they still exist. Oilcode should have the ability to re

collaborate the administration, ensuring a fair and level playing field. Having an administration system driven by neutral and impartial tools, that are transparent will ensure equality.

- Currently you can operate two franchise stores in two different states with identical key performance indicators and the viability will vary substantially because of the arbitrary nature of the administration.
- Franchisors have the ability to unilaterally amend the franchise which can have a severe impact on the value proposition to the franchisee. While change is unavoidable, franchisors need to be more collaborative in this process.
- Most decisions and enforcement positions imposed by franchisors are not transparently rationalised, in fact, often decisions are made and enforced without the need to explain.

Transparency must exist to single out right from wrong.

- All tenants need some security of tenure regardless of type of occupancy.
The current thirty day notice to exit for a Commission Agent for example, is unreasonable given the expenditure requirements some must endure.
Such as security systems installed by the tenant (at the cost to the tenant) and at the requirement of the franchisor/oil company/site owner.
At the expiry of their agreement, these must be purchased by that franchisor/oil company/site owner and this reimbursement must include buy-back of stock and equipment required by said franchisor/oil company/site owner, as they can be on-sold to the incoming tenant.
- When they pay a goodwill component at their ingoing, tenants should be entitled to a goodwill component when they exit the franchise, especially where their input/effort has improved the position of the business.
- Oil company exit fees to franchisees when selling their franchise after say, five years tenure was exorbitant at \$5,000, this has now escalated to \$50,000 with some corporations, making it impossible for franchisees to sell at all, in many instances.
Such barriers to entry are not considered to be a fair way to operate.
This fee must be reviewed and controlled.

AMIF, MTAA Ltd and ASSCSA representatives remain available at anytime in any location to provide further information and discussions if deemed useful to the review secretariats considerations.

Please contact Richard Dudley Chief Executive Officer Australian Motor *Industry Federation on (02) 62330811 if any further clarity, additional information, or an additional meeting is required.

Yours sincerely



Richard Dudley
CEO and Secretary
Australian Motor Industry Federation and MTAA Ltd
and on behalf of
The Australian Service Station and Convenience Store Association

27 February 2015

1. TGP Act 'Booklet'
2. Consumer Affairs Victoria (CAV) report on their review of the operation of the Victorian TGP Act 2000

TERMINAL GATE PRICING

A GUIDE TO THE PETROLEUM PRODUCTS
(TERMINAL GATE PRICING) ACT 2000



CONSUMER
& business
affairs
victoria

 **Victoria** The Place To Be

TERMINAL GATE PRICING

The Petroleum Products (Terminal Gate Pricing) Act will come into operation on 1 August 2001.

The Act aims to provide access to petroleum products directly from the terminal at a reasonable price and to provide transparency of pricing.

The Act places a number of requirements upon suppliers of petroleum products:

- Declared suppliers must publicly advertise a Terminal Gate Price (TGP) for declared petroleum products.

The TGP is defined as the landed international product price, plus excise, plus terminal operating margin, plus GST.

- Contracts between suppliers and distributors or retailers will be based on TGP plus additional services, less discounts or rebates.

- Invoices must identify the TGP plus the price of additional services that relate to the load less discounts or rebates.

- Declared suppliers must provide access to product from the terminal at the TGP. Access can only be denied in specified circumstances.

SUPPLIERS

The Act applies to suppliers who are declared. Declared suppliers at the date of commencement will be:

BP Australia Limited

Caltex Australia Petroleum Limited

The Shell Oil Company of Australia Limited

Mobil Oil Australia Pty Ltd, and

Trafigura Fuels Australia Pty Ltd where it sells or supplies declared products from the import terminal at Hastings.

PETROLEUM PRODUCTS

The Act applies to petroleum products that are declared. Declared products at the date of commencement will be:

- Petrol -leaded -96 RON

- Petrol -lead replacement -96 RON

- Petrol -unleaded -regular -91 to 93 RON

- Petrol -unleaded -premium -95 to 98 RON, and

- Automotive distillate.

Proprietary products and LPG will not be declared at the time of commencement, but may be declared at a future time.

IMPACT ON OIL COMPANIES

The Act requires that oil companies that are declared take action in a number of areas when supplying distributors or retailers.

Sales by oil companies to commercial customers and retail customers are not covered by the Act.

Only sales made in Victoria are covered by the Act including if the sale is made in Victoria from an interstate terminal operated by a declared supplier.

SETTING & ADVERTISING A TERMINAL GATE PRICE

Within 14 days of commencement, oil companies will need to set a TGP for declared products for each terminal. The TGP is defined as the addition of:

- the Landed International Product Price (which is defined in the Order in Council)
- excise and other taxes payable by the supplier
- a margin which covers all reasonable costs of operating the terminal and wholesale business and a reasonable return on investment
- GST

PRICE

The price at which declared products are sold by declared suppliers must be based on the TGP, plus transport, delivery, credit, brand and equipment charges, less discounts or rebates.

The Act requires that declared suppliers provide price information about optional services on request. However, it is not required that confidential price information be provided about a particular site or particular contract.

REFUSAL TO SUPPLY

A declared supplier can only refuse to supply a distributor or retailer under specified conditions:

- If there is a supply shortfall that has been notified to the Director, Consumer and Business Affairs, in the manner specified in the Regulations.
- If the load is less than 35,000 litres.
- If it would be unsafe or in contravention of any other Act or law.
- If it is not the practice of the supplier to provide products of that class at the time requested.

The TGP can be changed only once every 24 hours. The TGP is required to be published on the internet.

The TGP relevant to a particular sale is the TGP applying at the time the ownership of product transfers.

It is not the intention of the Act that suppliers be compelled to supply distributors or retailers who pose a credit risk. Declared suppliers are not required to sell to someone who would not or could not tender the price.

In relation to safety, it is expected that following current industry standards, such as the AIP Driver Accreditation and Safe Load Pass, would be applied to purchases from the terminal.

CONTRACTS

All new contracts entered into following commencement must be structured in line with the Act.

Contracts entered into before 1 November 2000 are not required to be in line with the Act. However, when renewed they will need to be consistent with the Act. This includes when options are exercised to extend a contract beyond the current term, such as exercising options under a franchise agreement.

Contracts entered into between 1 November 2000 and commencement become void to the extent that they are inconsistent with the Act. However, the contract otherwise remains in force. The parties to the contract may choose not to change the contract but operate in accord with the Act, to vary the contract so that it has no provisions counter to the Act or to enter into a new contract.

INVOICES

The Act requires that invoices identify the TOP, the price of additional services, and discounts or rebates that relate to the load. Price support and profitability support which are provided at a point in time subsequent to the sale or supply of the load are not required to be shown on the invoice.

Invoices do not have to be provided in this format where the sale occurs under a contract entered into before 1 November 2000.

RECORD KEEPING

The Act requires that declared suppliers maintain records as specified in the Regulations.

SCENARIOS SUCH AS SALES ON CONSIGNMENT AND ON FUEL CARDS

The interpretation of the Act in various scenarios has been documented and is available at:

[www .consumer. ViC.2OV .au](http://www.consumer.vic.gov.au)

IMPACT ON FUEL RESELLERS

The Act does not place any obligations on distributors and retailers-

However, it will change the structure of prices and contracts from a 'top down' pricing structure, based on discounts from a wholesale list price, to a 'bottom up' price structure based on TGP. It should provide greater transparency in the components of the price.

The Act opens opportunities for distributors and retailers to purchase petrol and diesel directly from the terminal at a reasonable price.

This may represent an important new opportunity for independent resellers to obtain fuel at a more competitive price and to expand their businesses.

In rural areas, it may introduce more opportunities for new distributors to develop business opportunities, knowing that they will have a right to access fuel direct from the terminal at a reasonable price. These new opportunities are likely only to be realised in the longer term.

IMPACT ON CONSUMERS

The Act will ensure that the price of supply from the terminal is transparent to consumers via the internet and therefore the total cost of the additional components added to determine the retail price in a particular location will be apparent.

It is not expected that there will be an impact on prices to consumers in the short term.

By opening new opportunities for distributors and retailers, the Act may lead to more competitive prices being available to consumers in the longer term.

In rural areas, it will be possible for consumers to band together into fuel cooperatives in the knowledge that they will be able, if they wish, to purchase fuel direct from the terminal.

FURTHER INFORMATION

Further information including:

- the Act
- the Regulations
- the Order in Council
- the Guidelines, and
- the Scenarios is available at:

[www .consumer. vic.gov .au](http://www.consumer.vic.gov.au)

If you have further questions after reading the information on the internet, please call (03) 9627 6000

Report on Terminal Gate Pricing in Victoria



**Consumer Affairs Victoria
September 2003**

Report on Terminal Gate Pricing in Victoria

**Review of Operation of the
*Petroleum Products
(Terminal Gate Pricing) Act 2000***

**Prepared by
Consumer Affairs Victoria
September 2003**

Executive Summary

Purpose of the Report (Chapter 1)

This Report reviews the operation of the *Petroleum Products (Terminal Gate Pricing) Act* 2000 (the Act) and its effects on the wholesale automotive petrol and diesel market in Victoria to the end of 2002. The Report was prepared by staff of Consumer Affairs Victoria (CAV) and is published to further inform market participants and the public about the efficacy of the regulatory scheme.

Objectives and outline of TGP legislation (Chapter 2)

Victoria was the first Australian jurisdiction to introduce mandatory terminal gate pricing when the Act came into effect on 1 August 2001. The terminal gate price (TGP) is a *base wholesale price* comprising an import-parity product price component, Commonwealth Government excise, a 'terminal operating margin' and GST. It excludes discounts, rebates and optional charges for services beyond the terminal gate and applies to both contract and spot sales.

The objectives of the legislation are to:

- ensure resellers have access to fuel at reasonable prices (but taking into account that many resellers are contractually tied to particular suppliers for substantial periods); and
- promote greater transparency in wholesale pricing through a 'bottom-up' price structure.

In addition, the Government considered the legislation might contribute over the longer term to improving the competitive position of Independents in the fuel market and reducing the differential between metropolitan and rural petrol prices.

The legislative scheme places a number of obligations upon the 'Declared Suppliers' of specified fuels. The Declared Suppliers are the four 'Oil Majors' – BP, Caltex, Mobil and Shell – and two independent terminal operators (Trafigura Fuels Australia and Tri-State) when those companies sell fuel through the terminal at Hastings. The main requirements are to:

- set a TGP for each Declared Fuel¹ using the prescribed price formula;
- publish on the company's web site a TGP for each Declared Fuel at each time it is set or varied and not change a TGP more than once every 24 hours;
- base all contracts with resellers entered into from 1 November 2000 on the TGP;
- make any optional service charges and any return on investment in leased sites available on request to resellers and leaseholders respectively;
- specify the TGP plus the price of any optional services for each sale of a load of declared fuel, less discounts or rebates; and
- provide access to Declared Fuels from the terminal at the TGP and only refuse to supply fuel in the prescribed circumstances.

¹ The Declared Fuels currently sold in Victoria are Lead Replacement Petrol (LRP), Regular Unleaded Petrol (RULP), Premium Unleaded Petrol (PULP) and Diesel.

CAV determines a 'Benchmark TGP' for monitoring the suppliers' published TGPs. The methodology adopted is broadly similar to that previously used in wholesale price regulation by the Prices Surveillance Authority (PSA) and then the Australian Competition and Consumer Commission (ACCC) until deregulation of petroleum product prices in 1998. The methodology adopted for the Benchmark TGP is consistent with industry practice.

Petroleum supply in Victoria (Chapter 3)

Demand by the Victorian market for automotive petrol and diesel is around 7,000 megalitres per year which is approximately 22 per cent of the Australian national market. The main source of supply is the two Victorian refineries owned and operated by Shell and Mobil in Geelong and Altona respectively. The Altona refinery supplies half of Victoria's fuel needs.

The Victorian market is supplied also by interstate refineries and imports. The major refiners occasionally source product from Singapore to meet supply imbalances. Trafigura is currently the only active independent importer into Victoria and imports from Asian and Middle-Eastern refineries.²

The two Oil Majors which do not own a refinery in Victoria (BP and Caltex) source the major part of their product from the local refiners. In the past, product was exchanged between the Oil Majors by 'refinery exchange' arrangements. However, refinery exchange was replaced in Victoria by 'buy-sell' arrangements on 1 July 2002. Although this horizontal arrangement between the Oil Majors has ended, there is still a degree of supply interdependence on a State-by-State basis among the four Majors.³ Shell and Mobil are the local suppliers in Victoria, but, for example, in Queensland BP and Caltex are the local suppliers. Just as refinery exchange only included the four Majors, under buy-sell each Major is supplied large volumes on an on-going basis *only* by one or more of the other Majors. The reciprocal customer-supplier relationships among the Majors across the various State markets is likely to provide some 'balance' to the relationship within any one State.

In contrast, the sole independent importer in Victoria (also a customer of one or more Majors) would only very occasionally supply small volumes to a Major in Victoria, such as in the event of a refinery disruption. Trafigura's customer relationship with the Majors in Victoria, is not reciprocated in any other region and lacks any countervailing aspect that may flow from that. This distinguishes Trafigura from the Majors declared under the Act, as do the distribution and retailing arrangements.

Wholesaling, distributing and retailing (Chapter 3)

The Victorian market is characterised by vertically integrated wholesale and retail operations by the four Oil Majors and a diverse mix of much smaller participants in wholesale, distribution and/or retail operations. The Oil Majors dominate wholesale and retail markets in Victoria. One estimate of this domination is that the Oil Majors account for over 90 per cent of wholesale sales and 65 per cent of retail sales in Victoria. Another estimate is that the

branded (exclusive supply) networks of sites supplied by the Oil Majors account for about 84 per cent of metropolitan service stations and about 92 per cent of country service stations.

² The term 'Independent/s' refers to wholesalers, distributors or retailers with whom the Oil Majors do not have any equity involvement and who do not operate under a tied branding arrangement with any Oil Major.

³ The refinery operators in other States are: Queensland BP and Caltex; New South Wales Shell and Caltex; Western Australia BP. In South Australia, Mobil ceased production of automotive fuels at the Port Stanvac refinery at the end of May 2003.

The overwhelming proportion of wholesale sales in Victoria are on a term contract basis with supply being exclusively from a single Oil Major. Some of the independent chains of service stations have supply agreements with two Oil Majors, with one usually providing the principal volume. 'Spot sales' account for only a small proportion of non-contracted sales.

Of the current six Declared Suppliers, only the four Oil Majors are vertically integrated with operations in refining, distributing and retailing.⁴ Integration forward is effected through the firms' own operations and various equity and contractual arrangements. The *degree* of integration into retailing may vary between the four companies and from State to State (even within one company), but each has an integrated structure in each State.

Trafigura imports through the terminal at Hastings and buys from the Oil Majors to resell at wholesale. It is only a Declared Supplier under the Act in relation to product sold from the Hastings terminal (whether imported or transported from a local refinery terminal). Importation by Trafigura represents no more than six per cent of total sales of Declared Fuels in Victoria. Trafigura delivers product ex-terminal but does not own, lease or operate any retail outlets. Trafigura predominantly supplies independent resellers. Issues of transparency do not arise to the same extent as all of Trafigura's transactions are arms length market transactions. Thus, the Oil Majors are fundamentally distinguishable from Trafigura by their vertical integration and, of course, the scale of their wholesale operations.

The industry's oligopolistic structure, extensive vertical integration, horizontal arrangements and pricing behaviour have resulted, over time, in scepticism on the part of some industry participants and the public generally about the 'robustness' of price competition in the industry. Implicit concerns about the degree of price competition generally underlay the concept of intervention to establish a TGP scheme.

Issues for assessment (Chapter 4)

The issues for consideration and assessment in the Report relate to the operation of the Act and the effects of the regulatory scheme on the market. The operational issues assessed in the Report include the scope of the application of the Act's requirements, the appropriateness of the current degree of prescriptiveness of some of these requirements and several aspects of the detailed administration of the Act.

Aspects of the Act's market impact are:

- do independent resellers' have access to supply, that is, has there been any refusal to supply and has the pattern of ex-terminal supply changed?
- is supply at 'reasonable' prices?
- can fuel be purchased in practice at the advertised base TGP?
- have the Declared Suppliers complied with the transparency requirements of the Act?
- is the published TGP a base from which an actual transaction price is built up according to additional services purchased?

The Report also briefly considers some indicators relevant to assessing the competitive position of independent resellers and examines some data on differences between metropolitan and rural petrol prices.

⁴ Tri-State is nominally declared but because it has not yet imported product it effectively operates outside the Act's regime.

Stakeholder assessment of the Act and its effects (Chapter 5)

CAV obtained the views of the Declared Suppliers and other market participants during consultations and in response to specific information requests.

■ ***Oil Majors***

BP and Mobil consider that the Act has had a minimal impact on the Victorian market. BP considers TGP provides necessary transparency to the market and assists in supporting a more realistic focus on the true costs of doing business. Mobil considers that TGP may have a role in wholesaling pricing as it is a means of increasing price transparency.

Caltex would prefer there to be no regulation and believes that the highly competitive nature of the market negates the need for regulation. If regulation were to remain in place, Caltex would like to see greater freedom with respect to how the TGP is to be determined by Declared Suppliers.

In general, Shell believes that the Act is working well. Shell commented that the objectives to provide greater price transparency and the ability for resellers to purchase spot fuel from the terminal at the posted price have clearly been met. Shell considers that there are a number of areas of detail in which the efficiency of operation of the Act could be improved while not compromising the objectives of the Act. Shell made several suggestions which are considered in the report.

■ ***Trafigura***

Trafigura considers its business to have been significantly disadvantaged by the Act. Trafigura's specific complaints about the Act relate to its perceived unfair disadvantage as a Declared Supplier in relation to other secondary wholesalers, some of which are affiliates of the Oil Majors, and the claimed impact of the Act in restricting its capacity to realise higher than average risk-related margins on product imports.

■ ***Independent resellers***

Consultations took place with representatives of the independent dealer groups, distributors and associated retailers. The views put by these parties tended to vary on some issues largely according to individual experience and contractual relationships with suppliers. A general assessment was that the Act was 'a step in the right direction'.

Buyers had attained physical access to terminals and access was no longer a concern under the TGP regime. Some claimed the effectiveness of the scheme was constrained by the ability of the Oil Majors to effectively control retail price levels at branded outlets and artificially or arbitrarily allocate margins between links in the chain. Some claimed the Oil Majors' 'top-down' pricing behaviour continued in practice.

While the operation of the Act clearly creates some additional costs for the Declared Suppliers, none of the Declared Suppliers raised the costs of complying with the Act's requirements as an issue during stakeholder consultations on the operation of the Act. The bulk of costs were incurred in the initial implementation phase due to factors such as alterations to invoicing systems. The ongoing costs are minimal. The administrative cost of supply shortfall notifications relative to the questionable benefit in practice were raised by Shell and this is addressed specifically in the recommendations.

Compliance by Declared Suppliers (Chapter 6)

CAV's assessment of compliance by the Declared Suppliers with the requirements of the Act, Orders, Determination and Regulations is summarised in the table below. While CAV has assessed that the Declared Suppliers are not fully complying with five of the requirements listed in the table on the next page, these matters are not considered to reflect substantial non-compliance with the scheme. The Declared Suppliers are generally considered to be operating within the spirit of the TGP legislation.

Discussion of operational issues (Chapter 6)

A number of operational issues were raised by stakeholders. Views expressed on these matters have been taken into account. Where specific changes to the scheme were suggested but no change is proposed by CAV, the basic issues are discussed in Chapter 6 along with the reasons for rejecting the proposed changes. The issues are:

- declaration of secondary wholesalers;
- 'opting out' of TGP in term supply agreements;
- contract and spot TGPs;
- spot price component of the LIPP;
- terminal operating margin component of the TGP;
- optional service charges to be added to the TGP;
- discounts or rebates off the TGP; and
- disclosure on invoices.

COMPLIANCE SUMMARY Requirement	Compliance	
	Full ¹	Partial ²
Calculation of TGP		
■ LIPP spot price component		✓
■ LIPP Freight component and adjustment		✓
■ LIPP Insurance and wharfage components	✓	
■ Terminal operation margin	✓	
Publication of TGPs		
■ Published on web site by 15 August 2001	✓	
■ Web site includes prescribed information (price and terminal location)		✓
Variation of TGPs	✓	
Optional Service Charges	✓	
Discounts and Rebates	✓	
Invoice Disclosure		✓
Price disclosure on request	✓	
Notification of Product Shortfalls		✓
Refusal to supply	✓	
Requirement to base contracts on TGP	✓	

- Notes:
- 1 'Full compliance' means that all suppliers are complying with all relevant requirements.
 - 2 'Partial compliance' means some suppliers are complying with all requirements while others are not, or that all suppliers are complying with some but not all relevant requirements.

Price Analysis (Chapter 7)

The purpose of the analysis was to determine if there was any change in pricing behaviour, particularly at the wholesale level, associated with the introduction of the Act and to provide an empirical base for the assessment of the market impact. The analysis examined automotive fuel prices over time at the importation, wholesale and retail stages. Only prices at the retail stage are prices at which transactions actually occur. Prices at the other stages are 'notional' prices due to the commercial confidentiality of such prices. The use of notional prices is a fundamental constraint on the empirical analysis.

The analysis also extended to 'notional industry margins' (NIMs), being retail prices less the (notional) landed international product price benchmarks. This is a gross margin incorporating the potential cost and profit components of prices through the terminal, distribution and retail stages of supply. Given the vertical integration of the Oil Majors, it is not possible to identify where the profit notionally available at each stage of the chain is actually captured.

The major findings of the analysis of prices and notional margins are:

- there was a significant step-change reduction in *published* RULP and diesel wholesale prices by four of the five suppliers on the introduction of the Act;
- published wholesale prices were above retail prices for substantial periods of time pre-TGP, but after the initial period of transition to the scheme were nearly always below retail prices in the post-TGP period;
- the step-change evident in published wholesale prices on 1 August 2001 was not evident in retail prices;
- there was no dramatic or exceptional movement in notional industry margins for either RULP or diesel immediately around the time of the introduction of the Act;
- there was, however, an upward shift in margins from around late October 2001 which was broadly sustained until the end of 2002 such that the average NIM prior to November 2001 was 5.2 cents per litre (cpl) and after then was 6.6 cpl;
- fluctuations in NIMs lessened after the upward shift compared to the preceding 14 months;
- there was no discernible change in the relativity of NIMs implicit in Oil Majors' and Independents' average retail prices following the introduction of the Act;
- the differential between country and city RULP retail prices decreased from an average of 4.6 cpl over the six months leading up to the Act's introduction to an average of 3.6 cpl over the ten months from August 2001 because city prices (and notional margins) rose relative to those in the country;
- the rise in RULP NIMs evident in Melbourne in the period after the introduction of the Act was *not* unique to Melbourne as each of Sydney, Brisbane, Perth and Adelaide experienced an increase in NIMS of greater or at least similar magnitude to Melbourne's; and
- there was a lift in NIMs in all five major capital cities around October 2001 that was sustained through 2002.

Assessment of market impact (Chapter 8)

An assessment of the impact of the Act at this early stage is necessarily tentative and market structure and participants' behaviour is also evolving. Even with a more comprehensive data set over a longer term period than was available for this review, attributing 'cause and effect' to a particular variable in the market is problematic.

■ ***Extent of TGP-based sales in the wholesale market***

39.5 per cent of total sales volume of Declared Fuels to all customers was based on TGP by mid-2002. The largest proportion of sales in this category was for LRP (23.8 per cent), followed by diesel (22.2 per cent), RULP (21.8 per cent) and PULP (19.7 per cent). The proportion of total sales to independent resellers based on TGP was 55.1 per cent in mid-2002. CAV estimates that about one tenth of resellers may *potentially* be in a position to take advantage of TGP-based ex-terminal spot sales supply given current ownership and contractual supply arrangements.

■ ***Resellers' access to supply***

Resellers had access to terminals for fuel at prices based on the legislated TGP. Spot customers were able to draw fuel from terminals based on terminal gate prices, except for formal periods of shortage covering about 11 per cent of supplier product days. CAV's analyses suggest that the Act modestly enhanced the capacity of independent distributors and retailers to access ex-terminal supply. The proportions of total wholesale sales that were to independent resellers and were based on TGP increased during the review period and the proportion that was collected from terminals increased also.

■ ***Assessment of 'reasonableness' of wholesale prices***

The Act does not provide a definition of the 'reasonableness' of wholesale prices. Taken together, the changes in wholesale prices and the associated changes in notional margins indicate that *published* TGPs may be closer to actual transaction prices than previous published wholesale prices. Published TGPs are probably more 'realistic' in that sense and could be considered to be more 'reasonable'. The Act alone appears not to have changed actual *transaction* prices either up or down during the review period. No further assessment of the reasonableness of wholesale prices and margins can be made without data on the Declared Suppliers' actual costs, prices and profitability.

■ ***Transparency of wholesale pricing***

There was an improvement in the transparency of wholesale pricing. A degree of non-transparency to market participants remains in the form of discounts off published TGPs and charges that can be added to TGPs for optional services beyond the terminal gate. However, if buyers and sellers had complete knowledge of all transaction prices in a market, price competition in that and any downstream market would be severely constrained. Accordingly, the Act explicitly does not seek to prevent Declared Suppliers from providing discounts from the posted TGP for contracted or non-contracted customers.

■ ***'Bottom-up' price structures***

Terminal gate pricing being more likely to be more closely aligned to actual transaction prices than previous list prices, thereby facilitates a greater degree of bottom-up pricing in practice.

■ ***Long-term competitive position of Independents***

It is not clear that the competitive position of independent resellers improved following the introduction of the Act, but the review period is too short for the manifestations of improvement to develop.

■ ***Metropolitan and country retail pricing***

The average city-country retail price differential decreased because prices and notional industry margins increased in Melbourne (as they did in other capital cities) due to factors that are most probably not related to the Act.

■ ***Overall assessment***

CAV's assessment is that the Act's operation in the first year achieved its stated objectives of ensuring resellers have access to fuel at reasonable prices and of promoting greater transparency in wholesale pricing. Twelve months is too short to assess whether the Act has contributed to achieving the implied objective of enhancing the long-term competitive position of Independents. A significant change to competition in the market was not expected in a period of a year or two.

ACCC Report on Victoria's TGP Scheme (Chapter 9)

During the preparation of this Report the Commonwealth Government released a report by the ACCC on *Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia*. The ACCC found it difficult to form a view on Victoria's TGP arrangements because the extent to which they applied to the market in Victoria at the time was not clear to the Commission. However, it did conclude 'In terms of transparency, the Government's objectives appear to have been achieved'. In relation to any effect on competition the ACCC observed that competition in the petroleum industry is influenced by a wide range of factors and it can be difficult to isolate the effect of any one factor. CAV agrees with this observation.

The ACCC observed that terminal gate prices of the five declared suppliers tended to be relatively stable against its 'import parity indicator' over the 14 months after the TGP scheme came into effect.. While its measure of average Melbourne retail petrol prices increased by one cent per litre against its 'import parity indicator', the ACCC commented that it was not possible to conclude with certainty that this resulted from the TGP arrangements because the extent to which they applied in Victoria was not clear to it. The Commission also noted the increase may have been the result of factors unrelated to the introduction of the TGP arrangements. The exit of Liberty from retailing and the cessation of the refinery exchange arrangements between the Oil Majors were specifically referred to in this regard.

TGP Recommendations (Chapter 10)

CAV does not consider at this stage that there is a need for fundamental amendment of the Act and the administrative scheme operating under it. A number of matters were raised and views expressed by stakeholders in consultations in late 2002 and after the release of a draft report to the TGP Reference Group in June 2003. These have been taken into account by CAV in finalising the report.

There are some adjustments that could be considered to improve the operation of the Act and facilitate the achievement of its objectives. CAV recommends the following measures:

- revoke the declaration of the independent terminal operators (Trafigura and Tri-State) ;
- allow flexibility in the determination of the 'freight' component of the LIPP component of the TGP;
- require each TGP to be a 'temperature corrected' price;
- revoke the requirement the Declared Suppliers notify CAV of 'supply shortfalls';
- continue and upgrade monitoring the operation of the Act and the Victorian automotive fuels market generally; and
- clarify certain details of provisions of the legislation.

Proposal for a national code-based TGP scheme (Chapter 10)

During the preparation of this Report the Commonwealth Department of Industry, Tourism and Resources released its *Downstream Petroleum Industry Reform* package. The package is based on a mandatory industry code for the petroleum industry (*Oilcode*). A key element of the proposed code is a national terminal gate pricing scheme that incorporates several 'TGP principles' developed to promote increased transparency at the wholesale level of the industry.

A national approach to achieving these objectives is desirable. CAV considers that the objectives of Victoria's TGP scheme are broadly consistent with the Commonwealth proposal. However, it is recommended that the Victorian Government put its views to the Commonwealth on those aspects of the *Oilcode* TGP proposal that fall short of the Victorian scheme – particularly the basis of published TGPs and price disclosure requirements at the time of sales. In the event that a national code-based TGP scheme eventually comes into effect, it would be appropriate to review the Act to consider whether a continuing need for it existed. If, on balance, the national code-based scheme met the Victorian Government's objectives, suspension of the Act by revoking all declarations would be appropriate to avoid duplication of regulation administration and compliance costs. Industry stakeholders favoured the operation of only one TGP scheme.

LP autogas issues (Chapter 10)

On proclamation of the Act declaration of LP autogas was deferred to allow for a further consideration of the issues and for experience to be gained with the operation of TGP for petrol and diesel markets. Analysis by CAV suggests that there is some transparency at a high level through the very strong correlation over time between the international 'Saudi Aramco Contract' benchmark price ('SACP') and Melbourne autogas retail prices. Autogas notional industry margins exhibit marked fluctuations, but where sharp rises occur they are not sustained over time. Over the same period as the reference period for the TGP assessment autogas margins have declined slightly, in contrast to the rise in petrol margins. Combined with a less concentrated market structure than petrol, the existence of two major suppliers that are not integrated forward into retailing (BHP and Esso) and the likely entry of additional primary suppliers, these factors suggest that a legislated requirement for TGP is not warranted.

CAV understands that at least one wholesaler is proposing to shortly begin publishing its wholesale prices for autogas non-contract sales, by region. This initiative will introduce further transparency into the autogas market and provide resellers and consumers with an

indicative wholesale price level between the SACP international benchmark and retail prices. Competitive pressures may result in other wholesalers following the initiative and increasing transparency and price information in the market in general.

Table of Contents

1	Introduction and Background	1
1.1	Introduction	1
1.2	Background to the Act	1
1.3	Parliamentary consideration of TGP legislation	3
1.4	Implementation of TGP	4
2	The Legislative Scheme.....	5
2.1	Introduction	5
2.2	The legislation	5
2.3	Overview of legislative requirements	5
2.4	Definitions and practices adopted	6
3	Petroleum Market Context.....	10
3.1	Introduction	10
3.2	Petroleum supply in Victoria	10
3.3	Oil Majors' interstate supply arrangements.....	10
3.4	Distribution and retailing arrangements	11
3.5	Developments in retailing	14
3.6	The Victorian spot market	16
4	Issues for Assessment	18
4.1	Introduction	18
4.2	Overview of Act's objectives	18
4.3	Identification of operational issues.....	19
4.4	Identification of market impact issues	21
4.5	Issues beyond scope of review	23
5	Stakeholder Assessment of Act	24
5.1	Introduction	24
5.2	Declared Suppliers	24
5.3	Independent resellers.....	28
5.4	RACV	29
6	Assessment of Compliance and Operational Issues	30
6.1	Introduction	30
6.2	Declared Suppliers and Declared Fuel	30
6.3	Contract and spot TGPs.....	31
6.4	'Opting out' of TGP in term supply agreements	32
6.5	Definitions of TGPs	32
6.6	Publication and variability of TGPs	35
6.7	The price of supply	36
6.8	Price disclosure.....	37
6.9	Requirement to supply	38
6.10	Contracts.....	39
6.11	Summary of compliance.....	40

7	Price Analysis	41
7.1	Introduction	41
7.2	Purpose and scope of analysis	41
7.3	Data sources, method and constraints	42
7.4	Wholesale prices	44
7.5	Victorian retail prices	47
7.6	Notional industry margins in Victoria	51
7.7	Interstate comparison of NIMs	55
7.8	Broader market developments: Liberty exits retailing	58
7.9	Melbourne pricing in national context	60
7.10	Summary of findings	61
8	Assessment of Market Issues	62
8.1	Introduction	62
8.2	General extent of TGP-based wholesale sales	62
8.3	Resellers' access to supply	65
8.4	Assessment of 'reasonableness' of wholesale prices	68
8.5	Transparency of wholesale pricing	69
8.6	'Bottom-up' price structures	69
8.7	Long-term competitive position of Independents	70
8.8	Metropolitan and country retail pricing	71
8.9	Impact on pricing during product shortages	72
8.10	Summary of assessment	72
9	Response to the ACCC Report on the Victorian TGP Scheme	74
9.1	Introduction	74
9.2	Market Coverage	74
9.3	Transparency	74
9.4	Access	75
9.5	Wholesale prices	75
9.6	Retail prices	76
9.7	Competition	78
9.8	Operation of TGP	79
9.9	Overall assessment of the Victorian TGP	80
10	Recommendations and future direction	81
10.1	Introduction	81
10.2	Recommendations	81
10.3	Proposed national TGP scheme	86
10.4	Consideration of LPG pricing issues	86

List of Appendices

Appendix A: Glossary	88
Appendix B: Comparison of Victorian TGP Scheme with Proposed Commonwealth Scheme	91
Appendix C: Interstate Notional Industry Margins	94
Appendix D: Crude Oil Pricing and Refining Margins	95
Appendix E: Petroleum Products Terminal Gate Pricing Reference Group	96
Appendix F: Comments on draft recommendations and CAV response	98

List of Graphs

Graph 7.1: Melbourne LIPP, RULP and Diesel, 1 August 2000 - 31 December 2002	44
Graph 7.2: Melbourne RULP LIPP and TGPs (ex-GST) for 5 Declared Suppliers, 1 August 2000 - 31 December 2002	45
Graph 7.3: Melbourne Diesel LIPP and TGPs (ex-GST) for 5 Declared Suppliers, 1 August 2000 - 31 December 2002	46
Graph 7.4: Melbourne Notional Terminal Margins, RULP and Diesel, 1 August 2000 - 31 December 2002	47
Graph 7.5: Melbourne RULP Average Retail Prices (ex-GST) and LIPP, (seven-day moving average), 1 August 2000 - 31 December 2002	48
Graph 7.6: Melbourne Diesel Average Retail Prices (ex-GST) and LIPP (seven-day moving average), 1 August 2000 - 31 December 2002	49
Graph 7.7: Melbourne RULP Average Wholesale Prices and Majors' and Independents' Retail Prices, (ex-GST) and LIPP (seven-day moving average), 1 August 2000 - 31 December 2002	50
Graph 7.8: RULP 'City-Country' Retail Price Differential, 1 February 2001 - 30 June 2002	51
Graph 7.9: Melbourne RULP and Diesel MINs (seven-day moving average), 1 August 2000 - 31 December 2002	52
Graph 7.10: Melbourne RULP MINs, 1 September 2000 - 31 December 2002	53
Graph 7.11: Melbourne RULP Oil Majors' and Independents' Average NIMs, (seven-day moving average), 1 August 2000 - 31 December 2002	54
Graph 7.12: Victorian RULP Average City and Country NIMs, 1 February 2000 - 30 June 2002	55
Graph 7.13: RULP Average NIMs for 4 Interstate Capital Cities and Melbourne, 1 August 2000 - 31 December 2002	56
Graph 7.14: RULP Average of 4 Interstate Capital Cities' NIMs, 1 September 2000 - 31 December 2002	57
Graph 7.15: RULP 4 Interstate Capital Cities' NIMs Mid-August - mid-November 2001	57

List of Tables

Table 2.1:	Reference Products Used for LIPP	9
Table 3.1:	Service Station Types of Operation in Victoria - December 2000.....	14
Table 6.1:	Shortfall Notifications	39
Table 6.2:	Summary of Compliance	40
Table 7.1:	Average Notional Industry Margin around the Introduction of the Act	52
Table 7.2:	Four Capital Cities' RULP NIMs Before and After Introduction of the Act	58
Table 7.3:	Liberty/Woolworths Outlets' Average 'Discounts' off Market Average RULP Prices	59
Table 8.1:	Proportion of Total Sales to Independent Resellers that were based on TGP and Collected at Terminals	66
Table 8.2:	Proportion of Total Sales to Independents that were based on TGP	67
Table 8.3:	RULP NIMs Based on Prices at Majors' and Independents' Melbourne Outlets	70
Table 9.1:	CAV Response to Stakeholder Issues Reported by the ACCC	79
Table 10.1:	Proposed Technical and Administrative Amendments to the Act	84

List of Figures

Figure 2.1:	TGP Cost Build-Up	7
Figure 3.1:	Comparison of Oil Majors' and Independent Terminal Operators' Business Models	12
Figure 8.1:	Regular Unleaded Petrol Wholesale Sales by Type of Sale after Introduction of the Act	63
Figure 8.2:	Diesel Wholesale Sales by Type of Sale after Introduction of the Act	63
Figure 8.3:	Regular Unleaded Petrol Wholesale Sales by Type of Sale after Introduction of the Act	64
Figure 8.4:	Regular Unleaded Petrol Wholesale Sales by Type of Sale after Introduction of the Act	64

Chapter 1

Introduction and Background

1.1 Introduction

This Report examines the operation of the *Petroleum Products (Terminal Gate Pricing) Act 2000* ('the Act') and its effects on the automotive petrol and diesel market in Victoria to the end of 2002. The Report was prepared by staff of Consumer Affairs Victoria ('CAV') and is published to further inform petroleum products market participants and the wider public of Victoria about the efficacy of the regulatory regime.

CAV also engaged a consulting firm, Economic & Energy Analysis Pty Limited (EEA), formerly Worley Energy Commerce Pty Ltd, to provide data necessary for the calculation of petroleum import parity prices and CAV's benchmark terminal gate prices and to provide information on the market context of the Victorian terminal gate pricing scheme. CAV staff and EEA undertook consultations with petroleum product market participants to obtain their views on the operation of the Act. EEA also provided background to the pricing analysis and assessment of market impacts contained in the Report. CAV obtained extensive data on retail petrol and diesel prices from Informed Sources (Australia) Pty Ltd ('Informed Sources').

However, CAV takes sole responsibility for the views expressed in this Report, including the recommendations contained in Chapter 10, except where specifically attributed to other organisations or persons. EEA and Informed Sources are not responsible for the assessments, conclusions or recommendations expressed in this Report.

This Chapter provides a background to the introduction of the Act. Chapter 2 sets out the legislative requirements of the Act and Chapter 3 describes the market context. Chapter 4 sets out the issues for assessment in the Report. Chapter 5 reports the views of the industry stakeholders on the Act's operation. The Declared Suppliers' compliance with the legislative requirements is assessed in Chapter 6. Chapter 7 contains the pricing analyses which provide a base for part of CAV's assessment of the impact of the Act. CAV's assessment of the Act against its objectives is contained in Chapter 8. CAV's response to the ACCC's findings regarding the operation of TGP in Victoria is provided in Chapter 9 and Chapter 10 sets out the recommendations for improvement to the regulatory scheme.

1.2 Background to the Act

Mandatory terminal gate pricing ('TGP') was introduced in Victoria on 1 August 2001 under the Act. The Act promotes transparency of wholesale prices for automotive petrol and diesel fuels and access to supply at terminals at competitive prices for all customers. The Act had its origins in a Private Members Bill which was passed with amendments by the Victorian Parliament in November 2000.

1.2.1 Fuel price monitoring

In April 2000 in response to record high retail prices the State Government set up the *Victorian Fuel Price Monitoring Initiative*. Under 'the Initiative', fuel prices in Melbourne and 27 regional markets across Victoria were monitored and published over the period from May to September 2000. Retail and international prices were monitored for unleaded petrol, diesel, automotive LPG and bottled LPG.

The Initiative's findings were published in a Report released in October 2000.⁵ During the preceding 12 months petrol, diesel and LPG retail prices increased significantly. Unleaded petrol prices had increased by around 26 per cent. The Report concluded that the major causes of increases in Victorian retail prices were movements in international fuel prices, the Australian exchange rate, excise indexation and the introduction of the GST and associated tax changes.

The Report also provided evidence of a substantial gap between Melbourne and country prices that could not be fully explained by transport costs associated with distance from terminals. Average monthly unleaded petrol prices in regional markets were found to have increased by 20 per cent and were up to 11 cents per litre higher than in Melbourne.

The Victorian Government's concern about the impact of high prices on consumers and communities and the lack of a national response by the Commonwealth Government resulted in separate action to address the issue of wholesale price transparency. Victoria was the first Australian jurisdiction to introduce mandatory terminal gate pricing.

1.2.2 Previous consideration of TGP policy

TGP has been under discussion as a regulatory policy option in Victoria and nationally for many years. Generally underlying the concept is an implicit concern about the degree of price competition in the automotive fuels market. In a competitive market there would be no need for intervention to establish a TGP scheme. The industry's oligopolistic structure, extensive vertical integration, horizontal arrangements and pricing behaviour have, over time, resulted in scepticism on the part of some industry participants and consumers about the 'robustness' of price competition in the industry.

The meaning of TGP has varied over time and often varies according to the objectives of the advocate. Amongst other advocates, TGP was proposed in Victoria in 1993 by the then Coalition Government's 'Petrol Pricing Committee' and referred to the 1994 Industry Commission inquiry into the petroleum industry.⁶ The Industry Commission, which was conducting its inquiry on behalf of the Commonwealth Government, dismissed the concept primarily on the basis of its assessment that the wholesale petroleum market was competitive at the time. It considered that regulation would not be effective in preventing price discrimination. The Victorian Government and key industry stakeholders were critical of the Industry Commission's Report.

In 1996 the Victorian Government and the Commonwealth Coalition Parties jointly released a policy statement outlining a system of petrol wholesaling pricing that was claimed to be more equitable and transparent. Under the proposal, oil companies would post daily wholesale prices at the refinery gate and any distributor or retailer with an approved tanker would be supplied on a non-discriminatory basis.

The policy proposal was referred to the Australian Competition and Consumer Commission ('ACCC') to assess its potential for lowering country fuel prices and enhancing wholesale price transparency and accountability. The 1996 ACCC *Public Inquiry into the Petroleum Products Declaration* found that:

Competition at the wholesale level is enhanced by suppliers permitting access to and offering prices at the primary terminals, with add-ons for services or value provided beyond the terminal gate. This pricing approach can foster efficient

⁵ Consumer Affairs Victoria, *Information on Fuel Price Trends in Victoria*, Victorian Fuel Price Monitoring Initiative, October 2000.

⁶ Industry Commission, *Petroleum Products Report No. 40, 5 July 1994*, Australian Government Printing Service, Melbourne, pages 148 -149.

entry into distribution and retailing and increase opportunities for rural price competition in the longer term, as well as allowing efficiency based rationalisation to continue.⁷

In 1998, the Commonwealth Government announced the 'Petroleum Retail Sector Reform Package'. Key elements of the proposed package were open access to terminals and development of a new mandatory *Oilcode*. On considering the proposed *Oilcode*, the Senate Rural and Regional Affairs and Transport Legislation Committee recommended that it should deal with competitive tendering for transport from terminals and ensure that access to terminals was at the best price regardless of location. However, the Reform Package was abandoned in 1999 when agreement amongst industry stakeholders could not be reached. The Reform Package and *Oilcode* concept was revived recently and a draft code is currently being considered by industry stakeholders.

In summary, these inquiries supported a pricing structure based on a wholesale price which excluded post-terminal costs, was available to all customers, and covered contract and spot sales. It was not proposed that discounting be eliminated or access to city discounts be extended to all customers. The Reform Package and the ACCC proposal envisaged TGP as being introduced through voluntary arrangements; the ACCC in particular did not support a legislative approach.

1.2.3 Oil Majors' wholesale pricing

By 2000 the four major oil companies operating in Victoria – BP Australia Limited, Caltex Australia Petroleum Pty Ltd, Mobil Oil Australia Pty Ltd and The Shell Company of Australia Pty Ltd – had voluntarily introduced what each company described as 'TGP' arrangements. (These companies collectively are referred to as 'the Oil Majors'.) While Caltex, Mobil and Shell advertised terminal gate prices, their approach did not adopt TGP with the intent of the proposal of the ACCC in its 1996 Inquiry Report.⁸ Their TGPs appeared to be set on a top down formula resulting in price levels similar to the ACCC maximum endorsed wholesale prices. These prices were also subject to various commercial arrangements.

BP moved most in the direction of the approach envisaged by the ACCC's Report by setting a competitive price exclusive of post-terminal costs. While the price was not publicly advertised it was available on application. BP also operated other pricing arrangements concurrently with terminal gate pricing.

1.3 Parliamentary consideration of TGP legislation

A Private Member's Bill, the *Petroleum Products (Pricing) Bill*, was introduced into the Victorian Parliament in June 2000. The purpose of the Bill was to limit the difference in the retail price of petrol and automotive LPG between Melbourne and regional markets. Limits, based on distance from Melbourne, were to be set on the margins which could be added to the daily average Melbourne retail price as set by the Director of Consumer Affairs Victoria.

The Bill was withdrawn in response to comments on its limitations and replaced in September 2000 by the *Petroleum Products (Terminal Gate Pricing) Bill*. The second Bill was concerned with TGP and temperature correction. Temperature correction was subsequently withdrawn from the Bill on the understanding that a national approach would be pursued through amendment to the model Uniform Trade Measurement Legislation.

⁷ Australian Competition and Consumer Commission, *'Inquiry into Petroleum Products Declaration'*, Volume 1 - Main Report, August 1996, Australian Government Publishing Service, page 122.

⁸ Australian Competition and Consumer Commission, *'Inquiry into Petroleum Products Declaration'*, Volume 1 - Main Report, August 1996, Australian Government Publishing Service, pages 120 - 125.

The approach to TGP proposed in the second Bill was to create a base wholesale price for the independent suppliers which was available to all customers. It included discounts and rebates, and allowed price support to be provided by suppliers. Separate charges could be added to the terminal gate price for optional services.

The intentions of the Bill were to address perceived problems in the petroleum products market, including:

- a lack of transparency in the component costs in wholesale pricing;
- uncompetitive wholesale prices which were often higher than the retail price at franchise outlets and the average Melbourne retail price;
- a lack of access to competitive prices and terminals for independent distributors and retailers;
- fluctuating retail prices in Melbourne and larger regional markets; and
- a substantial difference in retail prices between Melbourne and regional markets.

A number of amendments to the Bill were proposed to address issues identified in consultation with stakeholders. The Bill was passed by Parliament with bi-partisan support and the Act received royal assent on 21 November 2000.

The amendments resulted in a TGP arrangement which requires each terminal operator to move to a 'bottom-up', rather than 'top-down' pricing structure. The TGP is a *base wholesale price* comprising an import parity-pricing component, excise, a terminal operating margin and GST. It excludes discounts, rebates and optional service charges and applies to both contract and spot markets.

This approach to TGP intends to allow terminal operators to negotiate different pricing structures for different categories of customers; allow supply arrangements to be transparent to customers; and, while allowing for refusal to supply in specified circumstances, promote better access to terminals. Access to more competitive prices is to be promoted by setting the relationship between the TGP and the supply price.

1.4 Implementation of TGP

Administration of the Act is CAV's responsibility. A 'Reference Group' of stakeholders was established in December 2000 to ensure smooth implementation. The Reference Group membership and terms of reference are detailed in *Appendix E*.

The Reference Group advised on a range of implementation issues such as the petroleum fuels and suppliers to be declared; the criteria for determining the landed international product price; publication of terminal gate prices; the notification of shortfalls in the availability of fuels; record keeping requirements; and the application of the Act to a number of supply arrangements and business models. Agreement on issues settled by the Reference Group was incorporated into the Orders in Council, Determination and Regulations made under the Act and the supporting administrative guidelines. At the time of announcing the proclamation of the Act, the Minister for Consumer Affairs advised industry stakeholders that decisions regarding implementation issues could be considered at some future date once experience had been gained with the operation of the Act.

Chapter 2

The Legislative Scheme

2.1 Introduction

The main requirements of the legislated TGP are outlined in this Chapter. A brief comparison is made with the voluntary TGP arrangements introduced by BP, Caltex and Shell in other States. Chapter 6 provides CAV's assessment of the Declared Suppliers' compliance with the legislative requirements.

2.2 The legislation

TGP legislation in Victoria consists of:

- the *Petroleum Products (Terminal Gate Pricing) Act* 2000 which places obligations on Declared Suppliers of Declared Fuels;
- the *Petroleum Products (Terminal Gate Pricing) Regulations* 2001 ('Regulations') which prescribe the manner in which TGPs are published, fuel shortages are notified, records are kept and the inspection arrangements;
- two Orders in Council ('Orders') which together declare the suppliers, petroleum fuels and the criteria for determining the Landed International Product Price (LIPP); and
- a Determination by the Director of Consumer Affairs ('Determination') which details the methods required to calculate two of the LIPP criteria, namely the spot price and the freight costs.

Guidelines to interpret the Act, Regulations, Orders and Determination were also prepared to assist stakeholders with the administration of the legislation.

The Act, Regulations, Determination and the first Order in Council came into operation on 1 August 2001. A second Order in Council came into operation on 18 December 2001 to declare Tri-State Petroleum Victoria Pty Limited ('Tri-State'). Tri-State did not import fuel into Victoria during the period of this Report.

2.3 Overview of legislative requirements

The Act, Regulations, Determination and Orders together place a number of obligations upon the Declared Suppliers of Declared Fuels. The Declared Suppliers are the Oil Majors BP, Caltex, Mobil and Shell and the independent terminal operators Trafigura Fuels Australia and Tri-State (where those companies sell fuel through the Hastings terminal). The main requirements are listed below.

- A Declared Supplier must set a TGP for each Declared Fuel using the prescribed formula. The Declared Fuels are Leaded Petrol⁹, Lead Replacement Petrol (LRP), Regular Unleaded Petrol (RULP), Premium Unleaded Petrol (PULP) and Diesel.
- Declared Suppliers must publicly advertise a TGP for each declared fuel on their web site at each time it is set or varied and may not change a TGP more than once every 24 hours.

⁹ Under the National Fuel Quality Standards the production and sale of Leaded Petrol ceased in Victoria on 1 January 2001.

- Contracts between Declared Suppliers and resellers must be based on the TGP and may include an allowance for discounts or rebates and charges for any of the specified optional services.
- Declared Suppliers must make their optional service charges and any return on investment in leased sites available on request to resellers and leaseholders respectively.
- Invoices for the sale of a load of Declared Fuel must specify the TGP plus the price of any optional services that relate to that load, less discounts or rebates.
- Declared Suppliers must provide access to Declared Fuels from the terminal at the TGP and may only refuse to supply fuel in the prescribed circumstances.

The Act also requires Declared Suppliers to:

- notify CAV in writing when a shortage arises in the supply of fuel;
- keep certain records available for inspection including published TGPs, the formulas used to calculate TGPs, any written refusals to supply fuel, invoices or details of information included in invoices; and
- convert contracts entered into or renewed on or after 1 November 2000 to a TGP basis.

For enforcement purposes the Act incorporates the inspection powers of Part 10 of the *Fair Trading Act 1999* thereby allowing CAV to investigate alleged breaches. To enable inquiry into general questions of compliance, section 10 empowers the Director of Consumer Affairs to require Declared Suppliers to provide information and documents. The Act imposes penalties for breaches by Declared Suppliers of between \$500,000 to \$1 million.

2.4 Definitions and practices adopted

The Act, Orders and Determination prescribe two pricing formulas, one for calculating the Landed international Product Price ('LIPP') and the second for determining the daily TGP.

2.4.1 Definition of Landed International Product Price

The criteria which a Declared Supplier must use to calculate the LIPP for a Declared Fuel are set out in the August 2001 Order in Council and Determination and are consistent with established Australian oil industry practice.

- [i] In the case of an imported petroleum product¹⁰ which has been imported for sale or purchased for resale by a Declared Supplier who does not operate a refinery/s the criteria are:
- the actual amount paid for the imported petroleum product; or
 - the criteria set out in [ii] below.
- [ii] In the case of a petroleum product supplied by a Declared Supplier who operates one or more refineries with one or more pipe-line connected terminals the criteria are set out below:
- A 'Singapore spot price'. The method specified for calculating the spot price is flexible. A Declared Supplier has a number of options including selecting the relevant Platts Singapore Products Assessment (Spot) Price ('PSPASP'); the PSPASP that most closely approximates the Australian quality requirements, adjusted by an

¹⁰ Imported petroleum products in the August Order refer to Declared Fuels which are imported into Victoria from overseas refineries.

appropriate premium or discount (as the case may be); or a weighted average of a number of PSPASPs for one or more refined products that approximate(s) that class of products.

- Freight costs, either:
 - (a) the notional cost based on the Worldscale 100 Freight Rate to Melbourne adjusted by the Average Freight Rate Adjustment ('AFRA') plus a reasonable allowance for a clean-ship premium; or
 - (b) the actual shipping cost to the Declared Supplier where a cargo of imported petroleum product exceeds the Worldscale/AFRA cost, calculated using a methodology outlined in the Determination.
- A provision for insurance and loss based on a reasonable percentage of the product value plus freight.
- The wharfage charges for the petroleum products determined by the relevant Victorian port authority.

In summary the prescribed LIPP formula is (with the exception of wharfage all elements must be converted to Australian dollars):

$$\text{LIPP} = \text{Relevant PSPASP/s} + \text{freight}^* + \text{insurance} + \text{wharfage}$$

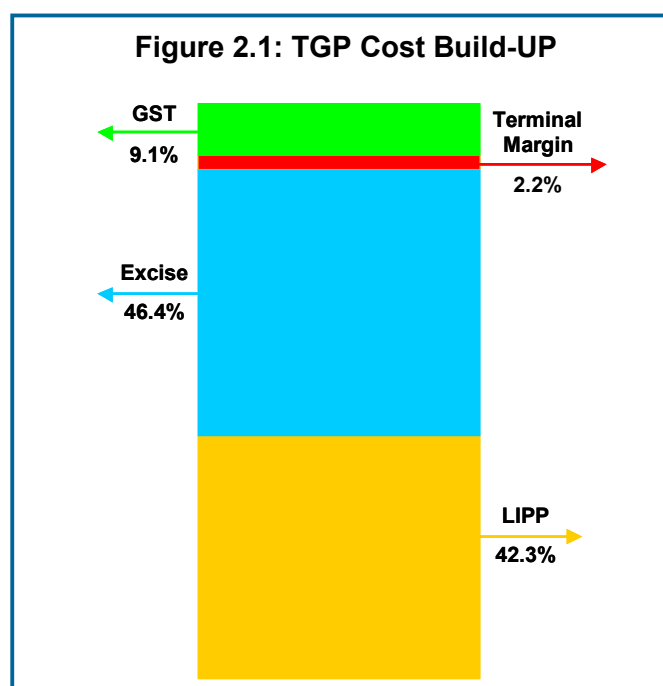
* (Worldscale 100 to Melbourne by AFRA)

2.4.2 The TGP

Section 5(4) the Act specifies the formula which a declared supplier must use to determine a TGP for a declared fuel. The prescribed TGP formula is:

$$\text{TGP} = \text{LIPP} + \text{excise and other taxes} + \text{a reasonable terminal operating margin} + \text{GST}.$$

Figure 2.1 demonstrates the relationship between the components building-up the TGP based on average prices for December 2002. The actual transaction price is the TGP *plus* optional service charges *less* discounts or rebates plus GST. Section 6 of the Act specifies the charges which may be added to or deducted from a TGP.



TGPs may vary between Declared Suppliers, even where suppliers sell fuel from the same terminal, that is Mobil and BP at Yarraville and Shell and Caltex at Newport. Also Declared Suppliers operating more than one terminal may set different TGPs at different terminals. However, Shell, which operates terminals at both Newport and Geelong, has chosen to set a single TGP for each Declared Fuel regardless of the terminal.

The Victorian approach to TGP differs from that taken in Western Australia. The Western Australian Government has operated two wholesale pricing systems since 2000.

Under the initial scheme operated in Western Australia the Department of Consumer and Employment Protection set a daily maximum wholesale price ('MWP') for spot sales of RULP at specified terminals. The MWP did not apply to the sale of other petroleum fuels or to sales under contract. In October 2002 it was announced that the MWP regime 'had not worked as well as the [Western Australian] Government intended' and that a TGP system, similar to the Victorian approach, would be introduced 'to increase transparency in petrol pricing and encourage a more competitive spot market for wholesalers'.¹¹ The new scheme commenced in December 2002.

Following the introduction of mandatory TGP in Victoria Shell¹², Caltex¹³ and BP¹⁴ introduced voluntary national TGP arrangements. While the system introduced by Shell is similar to the Victorian TGP, it also applies to commercial retail sales such as sales to farmers. The Caltex TGP differs from the Victorian TGP in two ways:

- while the calculation of the TGP is based on import parity pricing it also includes an 'adjustment factor' to take into account prices set at competing terminals by independent importers and local refiner-marketers; and
- it only applies to spot sales; therefore, it does not apply to franchisees or other customers under contract.

Similarly, the BP TGP arrangement differs from the Victorian TGP as it only applies to spot sales.

Mobil and Trafigura also post wholesale prices referred to as TGPs on their web sites for a number of other States.

2.4.3 Calculating CAV's 'benchmark' TGP

For the purpose of monitoring the Act, the TGP values for each active Declared Supplier were compared with the Benchmark TGP. It should be noted that while PULP is defined under the December 2001 Order as petrol of 95 to 98 Research Octane meeting (RON), in practice, each of the Declared Suppliers posts a TGP for PULP at 95/96 RON. In Victoria, Shell, BP and Mobil each also offer a 'proprietary' high performance petrol product at 98 RON for which TGPs are not required to be posted. For PULP, the benchmark TGP has been developed to reflect petrol at 95/96 RON.

¹¹ Media Statement: 17 October 2002, 'Government announces new terminal gate price system for fuel'. The Hon John Kobelke Minister for Consumer and Employment Protection, Western Australia.

¹² Shell introduced voluntary TGP arrangements in other States (New South Wales, Queensland, South Australia, Northern Territory and Tasmania) on 13 February 2002, Shell Media Release, 'Shell' New National terminal Gate Price: "Fairer, simpler and more transparent", 13 February 2002.

¹³ Caltex introduced voluntary TGP arrangements in other States (New South Wales, Queensland, Tasmania, South Australia and Northern Territory) on 7 May 2002, Caltex Media Release, 'Caltex announces new terminal gate pricing policy', 7 May 2002.

¹⁴ BP has been operating TGP arrangements since May 1998 but commenced publishing spot TGPs in South Australia, New South Wales and Queensland on 1 June 2002, BP Press Release, 'BP make wholesale fuel pricing more transparent', 1 June 2002.

When calculating the Benchmark TGP, a number of factors were considered. Accepted industry practice for calculating the landed price component for RULP and diesel was taken into account. The methodology adopted is broadly similar to that previously used by the Prices Surveillance Authority ('PSA') and the ACCC for determining the landed price component of the intervention price with adjustments made to reflect the particular freight, wharfage etc. costs for the port of Melbourne. For LRP and PULP a similar approach was used except that Mogas 97 was adopted as the nearest equivalent product. A constant nominal terminal margin was used for all products. In practice, terminal margins differ for the four products (being highest for the lower volume products of LRP and PULP) to reflect volume based cost differentials and market conditions.

In summary, the reference products set out in **Table 2.1**, modified as appropriate by a premium to reflect Australian refining standards, were adopted to determine the PSPASP (the single most important component of the LIPP).

Table 2.1: Reference Products Used for LIPP				
	Regular Unleaded Petrol (RULP)	Lead Replacement Petrol (LRP)	Premium Unleaded Petrol (PULP)	Diesel (ADO)
Singapore refined product(s) references used	Mogas 95 RON	Mogas 97 RON	Mogas 97 RON	nominal blend of 80 per cent gasoil (@0.5 per cent) and 20 per cent kerosene

Wide consultation with a number of oil industry participants including the Declared Suppliers was also conducted to identify if the selected approach is out of step with current industry practice. Through these consultation sessions it became clear that while all Declared Suppliers use slightly different approaches for determining their respective TGPs, the methodology adopted for the Benchmark TGP is consistent with industry practice. Not surprisingly, the approaches used by the different Declared Suppliers was the closest for RULP and diesel, where the broad methodology previously established by the PSA/ACCC for the intervention price series still prevails.

Chapter 3

Petroleum Market Context

3.1 Introduction

This Chapter briefly describes the market into which the legislated TGP was introduced in Victoria and demonstrates the dominance of the Oil Majors in production, supply, wholesale and retail arrangements. In this context the exit of Liberty from retailing, the termination of refinery exchange and the Victorian spot market are also discussed.

3.2 Petroleum supply in Victoria

Sales in the Victorian market for automotive petrol and diesel were about 6,960 megalitres in 2001-02¹⁵ which was approximately 22 per cent of the Australian national market for those petroleum products. The dominant source of supply for these products is the two local refineries, which are owned and operated respectively by Shell in Geelong and Mobil in Altona. Mobil, for example, claims that its Altona refinery alone supplies half of Victoria's fuel needs.¹⁶

Of the total annual production of the two Victorian refineries, approximately 60 per cent is marketed in Victoria, 20 per cent is shipped to other state-based Australian markets and 20 per cent is exported to New Zealand and the South West Pacific.

The Victorian market is supplied also by interstate refineries and by imports. The major refiners occasionally source product from Singapore to meet supply imbalances. Trafigura is currently the only independent importer into Victoria and sources product from Asian and Middle-Eastern refineries. CAV understands such importation by Trafigura currently represents no more than six per cent of sales of the Declared Fuels and about four per cent of total petroleum products sales in Victoria. These proportions are likely to decrease over time due to wholesale supply arrangements in the joint venture between Woolworths and Caltex (see Chapter 3.5) and potential difficulties in sourcing complying fuel from independent regional refineries after the product specification changes for petrol scheduled to be introduced on 1 January 2004 (see Chapter 6.5.1).

3.3 Oil Majors' interstate supply arrangements

The two Oil Majors which do not own a refinery in Victoria (BP and Caltex) source the major part of their product from the local refiners. In the past, product was exchanged between the Oil Majors by 'refinery exchange' arrangements. However, refinery exchange was replaced in Victoria by 'buy-sell' arrangements on 1 July 2002.

Under refinery exchange BP and Caltex in Victoria would draw on product in Melbourne and repay this 'borrowing' by supplying a like quantity of product, by product grade, to the 'lending' refinery (Shell or Mobil) from one of their interstate refineries. While there were a number of variants on these arrangements they were all based on a 'molecular' exchange of generic products, rather than on market-based location or quality differentials.

¹⁵ Australian Petroleum Statistics 2001-2002 published by the Commonwealth Department of Industry Tourism and Resources.

¹⁶ Esso Mobil Australia, 'Facilities & Operations' on website <http://www.mobil.com.au>.

The economic rationale for refinery exchange was to avoid the coastal shipping costs which would have been incurred if each Oil Major had shipped its own product to meet demand in interstate markets where it had no refinery. However, a consequence of these arrangements was the sharing of capital and operating costs.

The termination of refinery exchange was preceded by the departure from the practice of producing uniform product grades of petrol and diesel across all States. Western Australia, Queensland and South Australia each legislated for product grades which exceeded the then Australian standard and were related to the output capabilities of refineries in their respective States.

'Buy-sell' is the industry term for the market-based purchases of product which have replaced refinery exchange. From the standpoint of TGP, buy-sell provides an arms-length supply price which was not previously available. Although the horizontal arrangement between the Oil Majors has ended, the existence of seven refineries across six States means there is still a degree of supply interdependence on a State-by-State basis among the four Majors.¹⁷ Shell and Mobil are the local suppliers in Victoria, but, for example, in Queensland BP and Caltex are the local suppliers. Just as refinery exchange only included the four Majors, under buy-sell each Major is supplied large volumes on an on-going basis *only* by one or more of the other Majors. The reciprocal customer-supplier relationships among the Majors across the various State markets is likely to provide some 'balance' to the relationship within any one State.

In contrast, Trafigura, the sole independent importer in Victoria (and customer of one or more Majors) would only very occasionally supply relatively small volumes to a Major in Victoria such as in the event of a refinery disruption. Trafigura's customer relationship with the Majors in Victoria is not reciprocated in any other market and lacks any balancing factor that may flow from that. This distinguishes Trafigura from the Majors declared under the Act, as do the distribution and retailing arrangements discussed below.

3.4 Distribution and retailing arrangements

The Victorian market for petroleum products is characterised by vertically integrated wholesale and retail operations by the Oil Majors and a diverse mix of smaller participants in wholesale, distribution and/or retail operations. As a result the Oil Majors dominate wholesale and retail markets in Victoria. It is estimated that the Oil Majors account for over 90 per cent of wholesale sales and 65 per cent of retail sales in Victoria. The Victorian market structure reflects the general national market structure.

The Oil Majors operate business models which are characterised by vertically integrated relationships between their refining, wholesale and retail operations. The *degree* of integration into retailing may vary between the four companies and from State to State (even within one company), but each has an integrated structure in each State. Integration is achieved through a variety of strategies which include ownership of the operations and/or infrastructure, equity partnerships, franchising and exclusive supply arrangements. Each of these arrangements results in a different level of integration with the Oil Major's business. As these relationships mean that the Oil Majors do not deal with completely separate business entities they give the Oil Majors a degree of control and a business presence in all sectors of the market. However, these arrangements also mean that the price at which products are exchanged between different parts of the business network are notional rather than market based and, therefore, less transparent.

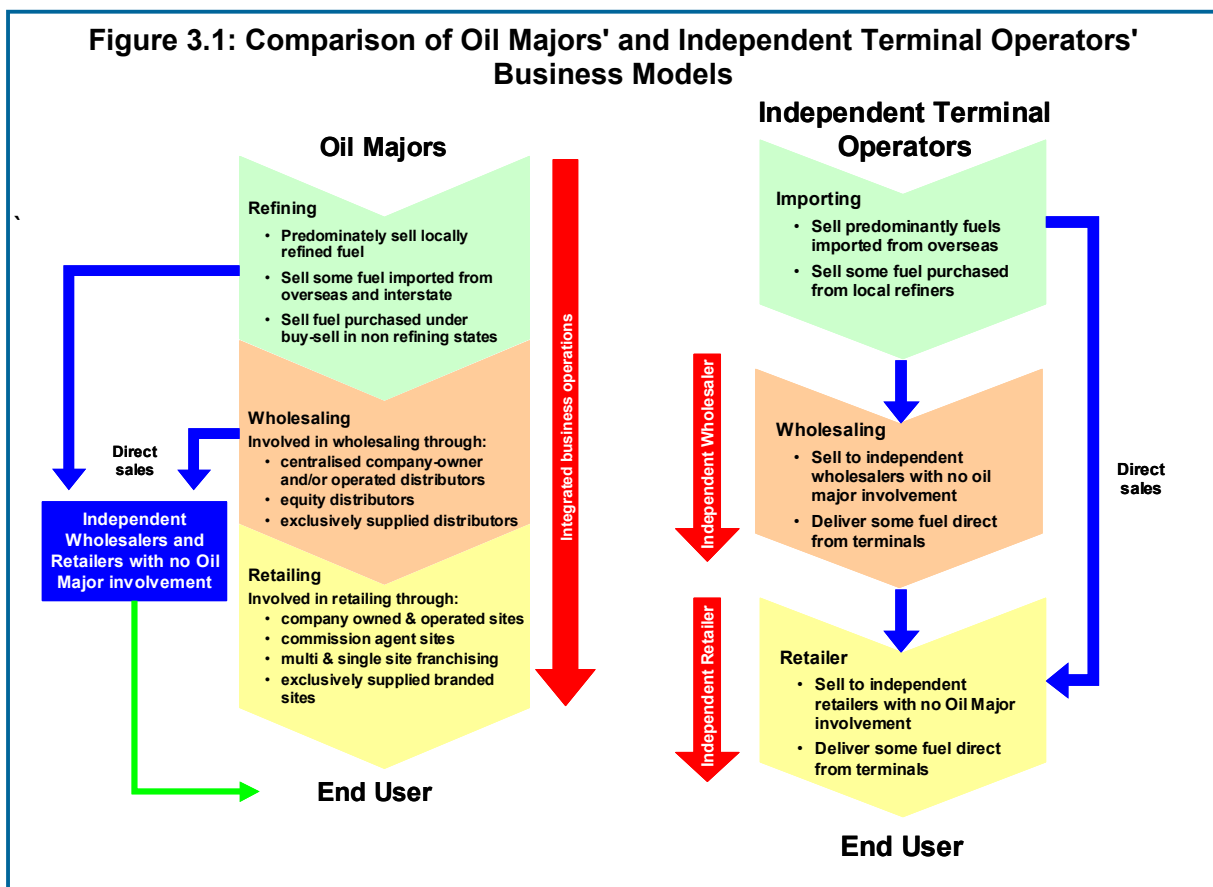
¹⁷ The refinery operators in other States are: Queensland BP and Caltex; New South Wales Shell and Caltex; Western Australia BP. In South Australia, Mobil ceased production of automotive fuels at the Port Stanvac refinery at the end of May 2003.

At the same time the Oil Majors also sell to independent wholesalers and retailers under supply agreements or occasionally on a spot basis at negotiated market prices. Issues of transparency arise with regard to such transactions as these businesses compete directly with the Oil Majors when they resell fuel.

In contrast to the Oil Majors, the independent terminal operators (Trafigura and Tri-State¹⁸) operate business models which may at most integrate their wholesaling and distribution functions but where they have no ownership or operational involvement with their customers' businesses and, therefore, no influence in downstream markets. The independent terminal operators generally source the majority of their product from overseas and sell predominantly under contract at terminals to secondary wholesalers or retailers. These transactions are between separate business entities and, therefore, are negotiated market based and transparent to the parties.

The independent terminal operators also participate in the market as secondary wholesalers purchasing fuel from the Oil Majors for resale either through the independent terminal at Hastings, where they are Declared Suppliers, or from the Oil Majors' terminals. Issues of price transparency, similar to those for transactions between the Oil Majors and independent resellers, arise for Trafigura and for Tri-State when it is an active wholesaler. Also, as noted in Chapter 3.3, their purchases from the Oil Majors in Victoria occur in a different overall commercial relationship compared to 'Major-to-Major' transactions.

Figure 3.1 illustrates the different business models adopted by the Oil Majors and independent terminal operators.



¹⁸ Tri-State has not imported product into Victoria since the commencement of the Act on 1 August 2001.

The dominance of the Oil Majors in wholesaling/distribution has been evident for some time. Of the 140¹⁹ distributors currently operating in Australia more than half display the Caltex brand. Caltex has continued to support distributors as independently managed equity partners focusing on the smaller volume business in country areas. This arrangement complements direct distribution operations by Caltex ex-terminal. Initially Shell held some equity in a small number of distributors but has now acquired all equity in these businesses and is in process of moving to centralised company-operated distribution operations. In contrast, BP holds equity in two of 16 distributors across Australia. The two equity distributors are in New South Wales and South Australia. BP has a single distributor, Advance Petroleum, operating throughout Victoria.²⁰ Mobil has also moved to rationalise distribution operations into much larger businesses but with a mix of equity structures. Of some 28 national distributors, the majority are distributors in which Mobil has significant equity, a small number are independently owned and some 25 per cent are wholly owned by Mobil.²¹

In parallel to the rationalisation of distributors, multi-sites franchise arrangements have become increasingly important in the retail sector. A survey of the refiners conducted by CAV in November 2002 identified a total of 613 service stations and 13 independent unbranded distributors and retailer chains in Victoria. Of these, single-site franchisees accounted for approximately 8.1 per cent of sales, multi-site franchisees accounted for around 35.8 percent, branded independents accounted for around 21.6% and unbranded independents accounted for around 34.6%.²²

The single site franchised service stations were mainly Caltex branded sites, the other three refiners having moved to multi-site franchise arrangements. While the number of sites under a multi-site agreement varied, 26 multi-site franchise networks controlled 289 service stations. In a recent development involving Coles Myer Limited ('CML') and Shell and discussed in Section 3.5, CML is to purchase the right to operate the Shell franchise network. This means that Shell will have a single franchisee operating across Australia. In Victoria, prior to this development, Shell operated two multi-site franchises controlling 158 service stations.

The dominance of the Oil Majors is also illustrated by the data on service station ownership collected by the Australian Institute of Petroleum ('AIP') in 2000. **Table 3.1** on the following page is based on AIP data and shows that the Oil Majors had a direct interest as owner or franchisor in 43.1 per cent of metropolitan service stations in Victoria. A further 18.5 per cent of metropolitan sites were operated by owner dealers but supplied ex-terminals by the Oil Majors. Distributor sites with Oil Major equity and/or branding accounted for another 22.8 per cent of sites. As a result, the branded networks of sites supplied by the Oil Majors accounted for 84.4 per cent of metropolitan service stations. This dominance is even more apparent in country areas where the Oil Major supplied (owned/equity and/or branded) sites accounted for 92.4 per cent of service stations.

¹⁹ Number of distributors estimated by APADA as operating in Australia in June 2003.

²⁰ In addition to one distributor serving Victoria and Tasmania, BP has the following distributors by State: one each in South Australia and the Northern Territory, three in QLD, four in NSW, and six in Western Australia.

²¹ Source: informal comment from the Australian Petroleum Agents and Distributors Association to Economic & Energy Analysis Pty Limited.

²² A survey of the four Oil Majors was conducted by CAV in November 2002. Data was provided by individual companies on a confidential basis and on the understanding that data would be aggregated.

Table 3.1: Service Station Types of Operation in Victoria - December 2000

Type of Service Station	Victoria Metropolitan Number	%	Victoria Country Number	%
Refiner Marketer:				
▪ Direct operation	28		1	
▪ Commission agency, or similar	19		3	
▪ Franchise	353		60	
Total	400	43.1%	64	6.2%
Independent Networks	121	13.0%	5	0.5%
Supermarket networks	21	2.3%	13	1.3%
Owner-dealer supplied ex-terminal by AIP member company	172	18.5%	23	2.2%
Supplier by distributor:				
▪ Distributor with refiner-marketer equity				
· owned/leased by distributor	0		95	
· other, with refiner-marketer branding	0		280	
· other	70		83	
Total	70	7.6%	458	44.1%
▪ Other distributor with refiner-marketer branding				
· owned/leased by distributor	10		32	
· other, with refiner-marketer branding	46		275	
· other	85		108	
Total	141	15.2%	415	39.9%
▪ Other non-branded distributor (estimate)	3	0.3%	60	5.8%
TOTALS	928	100%	1038	100%

Source: Based on data published by the Australian institute of Petroleum (AIP) web site: www.aip.vic.gov.au

3.5 Developments in retailing

There are a number of recent developments which are affecting the dynamics of fuel retailing in Victoria. These include the exit of the independent Liberty Oil Australia Pty Ltd ('Liberty') from retailing and the expansion of the grocery retailers, CML and Woolworths into fuel retailing through arrangements with Shell and Caltex respectively.

Until mid-2001 Liberty played a significant role in retailing in Victoria. The Liberty chain of service stations was established in 1995 and operated mainly in Victoria, NSW and Queensland.²³ Liberty had been one of the competitive factors in Melbourne petrol pricing, generally setting prices below the market average to generate volume. Just prior to the introduction of TGP in Victoria, Liberty announced that it was 'taking on the oil giants' in a

²³ Liberty's fuel was mainly supplied by Caltex, with minor volumes sourced from imports. Caltex supply of Liberty resulted from a condition of the court-enforceable undertaking given by Caltex to the Trade Practices Commission to facilitate its 1995 merger with Ampol. The undertaking required that up to one billion litres of fuel per year, be supplied to Independents on reasonable commercial terms. In its 1996 report the ACCC concluded that Independents are an important factor in reducing retail prices and that higher levels of Independents in a market are associated with lower margins.

discount war, that it wanted to retain its reputation as a discounter and that it would 'see how deep their pockets are'. At the same time a Shell representative was reported as saying the Oil Majors were 'losing money'.²⁴

However, shortly after in July 2001, Woolworths disclosed that it had signed an agreement to lease 69 Liberty outlets, which would be progressively converted to Woolworths' Petrol Plus sites. Under these arrangements Liberty, which also operated as a wholesaler to other service stations, was to continue to supply fuel to the Woolworths leased outlets under existing arrangements with Caltex.²⁵ Liberty is now concentrating on wholesale marketing of fuel and may not, therefore, have an interest in promoting lower retail prices.

Woolworth's expansion of its fuel retailing network into the ex-Liberty sites is an indicator of the changing character of competition in the grocery and liquor retailing markets and the fuel retailing market, especially in Victoria. This tends to shift the point of retail competition from the board price to that of selective offers only to grocery customers.

A further development in fuel retail price competition in the Victorian market occurred when CML and Shell announced in May 2003²⁶ that they had formed a 20-year alliance. CML is reported as paying \$94 million to replace existing Shell multi-site franchisees for the rights to operate 584 service stations across Australia. A six-month trial at 148 sites in Victoria began in July 2003 and if successful will be extended nationwide by mid 2004.

Under the alliance the sites are co-branded Coles Express and Shell. Shell is the exclusive supplier of wholesale fuel and CML is said to be setting the retail price. In response to CML's expansion, Woolworths and Caltex announced in August 2003 their proposal to establish a 50/50 joint venture company to retail fuel. The company is to start operating in January 2004 and will lease all the Woolworths Petrol Plus outlets, some 289 outlets (94 of which are in Victoria), and selected Caltex franchise sites, bringing the total national network to around 450 sites. Both Shell and Caltex will continue to sell fuel through their commission agent and owned sites and, in the case of Caltex, its franchisees not included in the joint venture arrangements.

It is reported that neither CML nor Woolworths 'wanted to encourage a petrol price war'.²⁷ However, while margins in petrol retailing are very small, a petrol price war could be triggered as CML and Woolworths use discounts to encourage shoppers to spend more in their traditional retailing businesses. To date, CML has matched Woolworths' board prices and discount offer. Both CML and Woolworths offer a 4 cents discount off the board price for petrol to selected customers from their supermarkets and liquor stores.

In the context of initiatives from the grocery majors, Metcash Trading (the wholesale supplier of IGA supermarkets) has confirmed that it is seeking an Oil Major partner to offer a cut-price fuel deal.²⁸ It has also been reported that Foodland Associated is likely to introduce a form of petrol offer, after trailing offers in Queensland and Perth and entering into an agreement with Shell in New Zealand.²⁹

The withdrawal of Liberty and the expansion of the grocery retailers into fuel retailing may have influenced the character of competition from Independents³⁰ in the Melbourne market.

²⁴ Herald Sun Newspaper, 21 June 2001, *"Price War Squeezes Fuel Sellers"*.

²⁵ Herald Sun Newspaper, 7 July 2001, *"Woolies leases Liberty Oil sites"*, 11 February 2003, *"Bowser Blitz is Hurting"* and 15 February 2003, *"Coles Puts its Foot on Gas"*.

²⁶ Media Release *"Customers the winners from Coles- Myer Shell Alliance"*, 27 May 2003.

²⁷ Herald Sun Newspaper, 28 May 2003, *"Petrol deal pumps Coles"*.

²⁸ The Herald Sun Newspaper, 9 April 2003, *"Bowser war looms"*.

²⁹ The Australian Newspaper, 22 May 2003, *"NZ buy boosts Foodland's to near record"*.

³⁰ The term 'Independent/s' refers to wholesalers, distributors or retailers with whom the Oil Majors do not have any equity involvement and who do not operate under a tied branding arrangement with any Oil Major.

The pricing strategies of CML and Woolworths' appear to provide their grocery customers with substantial discounts below the board price; therefore, they may not be inclined to discount board prices below the market before applying coupon discounts.³¹ However, the growing trend of 'coupon' discounts to specific customers can have a substantial effect on board price competition. This is one of the factors, identified in this Report, which could have influenced pump prices in the Review Period. Liberty and Woolworths pricing strategies are discussed further in Chapter 7.8.

Service station groups and Independents are voicing concerns about moves by Woolworths and CML into petrol retailing. The VACC is of the opinion that these moves 'could well mark the end of pump-price competition'.³² Long-term price effects of these structural and behavioural changes could appropriately be examined on a national basis by the ACCC,

A further factor affecting Independents may arise from the exclusive fuel supply arrangements between Woolworths and Caltex. While Trafigura currently supplies Woolworths, the joint venture means that from January 2004 Woolworths will source fuel exclusively from Caltex. This arrangement combined with the new fuel specifications may impact on Trafigura's capacity to import competitively priced fuel. As Trafigura supplies fuel to independent resellers and meets spot demand its viability is important to competition in Victoria.

While an analysis of the changing character of fuel price competition in Victoria is not within the scope of this report. However, it is clear that major supermarket groups across Australia have been in negotiation with the fuel industry for some years following the successful expansion of Woolworths petrol offer to its customers.

3.6 The Victorian spot market

The structure of the Victorian wholesale petroleum market is not conducive to the emergence of a 'spot market'. It has only a small number of suppliers (two refiners and one independent importer) and few non-aligned competing buyers.

On the supply side the Oil Majors generally operate their refineries and terminals on a 'just in time' production basis to meet supply to contracted customers. Therefore, if production from one refinery is disrupted the alternative source of supply is increased production from the other local refinery, inter-state coastal or road delivery from another domestic refinery, direct cargo imports from Asian refineries or a combination of these. With the possible exception of increased production from the other Victorian refinery, each of these alternatives is likely to involve increased costs and risk to the Oil Major or independent importer seeking to meet the unforeseen market shortage. An Oil Major or importer would require an adequate return to schedule a one-off cargo of product within a narrow time window to meet a product shortfall in the Victorian market for both contracted and non-contracted customers.

The overwhelming proportion of wholesale sales in Victoria are on a term contract basis with supply being exclusively from a single Oil Major. Some of the independent chains of service stations have supply agreements with two Oil Majors, with one usually providing the principal volume. 'Spot sales' account for only a small proportion of non-contracted sales and generally occur where the buyer can achieve a price advantage or where there is a disruption to their contracted supply. As Shell has had the lowest published TGP on most occasions since the Act came into effect, it is to be expected that it would capture the

³¹ Woolworths recently increased its standard discount in Melbourne to 4 cents per litre below the board price and CML admitted 'Woolworth's increase in its petrol discounting rate was significantly impacting [our] sales growth.' See Herald Sun Newspaper, 11 February 2003, *"Bowser Blitz is Hurting"*.

³² Herald Sun Newspaper, 4 June 2003, *'Beware petrol price war'*, Executive Director VACC.

majority of the few non-contract transactions. Alternatively, where supplies are unavailable from the contracted supplier, the buyers who are least aligned with their contracted supplier may be expected to seek short-term supply from any alternative supplier with available product.

Chapter 4

Issues for Assessment

4.1 Introduction

The issues for consideration and assessment in the Report are set out in detail in this Chapter. They are grouped into two categories: one relating to the operation of the Act and compliance with its requirements; and the other relating to the effects of the regulatory scheme on the market. The issues relate to the objectives of the Act and its implementation. The fundamental issue for assessment is: to what extent did the first year of operation of the Act achieve the objectives?

4.2 Overview of Act's objectives

At the time of Parliament's consideration of *Petroleum Products (Terminal Gate Pricing) Bill* the Government indicated that the purpose of the Bill, as amended, was to 'respond to the problems being experienced by small independent fuel distributors and retailers and rural consumers.'³³ The perceived problems included: a lack of transparency in the components that made up wholesale prices; Independents paying wholesale prices that were sometimes higher than the retail prices at the Oil Majors' franchised outlets; and the popularly-held view that retail prices in country areas were 'unjustifiably' higher than average Melbourne retail prices.

However, the Act was clearly intended to influence the *wholesale* pricing of automotive fuel, rather than retail prices. On several occasions in the parliamentary processes, the Government cautioned about raised expectations for the proposal's potential impact on such matters:

The bill is not a panacea to high fuel costs or the differential between metropolitan and rural prices, but is one small step in the right direction.³⁴

In the Parliamentary debates leading to the passing of the Bill certain objectives were clearly stated, while others can be implied from contributions of the government members and the links with the Government's existing policy and fuel pricing initiatives. As noted in Chapter 1, an implicit concern about price competition in the industry generally underlies proposals for establishing TGP schemes.

The stated objectives were to:

- [i] ensure resellers have access to fuel at reasonable prices (but taking into account that many resellers are contractually tied to particular suppliers for substantial periods); and
- [ii] promote greater transparency in wholesale pricing with a 'bottom-up' structure.

In addition, some implicit objectives that the Government considered the legislation might contribute to in the longer term were to:

- [iii] improve the competitive position of Independents in the fuel market; and

³³ Parliament of Victoria, Hansard, Second Reading Speech, Hon G D Romanes MP, *Petroleum Products (Terminal Gate Pricing) Bill*, 15 Nov 2000, page 1224.

³⁴ Parliament of Victoria, Hansard, Second Reading Speech, Hon G D Romanes MP, *Petroleum Products (Terminal Gate Pricing) Bill*, 15 Nov 2000, page 1224.

[iv] reduce the differential between metropolitan and rural petrol prices.

The objectives of open access to terminals and transparency of wholesale prices were considered to be mutually supportive. These objectives would be achieved through the statutory requirement for Declared Suppliers to determine, publish and apply TGPs for the sale of the Declared Fuels. The implicit rationale for this requirement is along the following lines.

- Price transparency is enhanced by mandating a specific mechanism of import-parity related TGP together with the disclosure of specified costs and charges for credit, transport, branding and other services (if applicable) to an ex-terminal sale. In effect, the existing wholesale price is 'unbundled' into its component parts for all potential buyers to see and better compare across sellers.
- Enhanced price transparency by these means assists all resellers, including Independents, to achieve 'reasonable prices' and also supports more meaningful oversight of petroleum pricing by Government in the public interest.
- Availability of petroleum product supply at the mandated TGPs is ensured by obliging the Declared Suppliers to supply Declared Fuel at nominated terminals to a distributor or retailer except in the prescribe circumstances of a supply shortfall, unacceptable credit risk or substandard tankers.

While the Government's discussion of objectives referred to specific concerns about Independents, the Act specifies TGPs which apply to sales to *all* classes of retailers without distinction, including the Oil Majors' franchised and branded outlets. The Act also makes no distinctions between prices to apply for term contract and spot sales.

4.3 Identification of operational issues

A range of issues relating to the scope and operation of the Act are detailed below. These issues are concerned with whom and to what transactions TGP should apply, the flexibility of the TGP requirements and other administration and compliance issues arising from the requirements of the Act. Factors considered include whether there are anomalies relating to the fair operation of the Act, barriers to ready compliance, or unreasonable costs of compliance.

4.3.1 Scope of application of TGP

[i] Declaration of independent terminal operators

Is the continued declaration of the two independent terminal operators, Trafigura and Tri-State, appropriate, given the different business operations by these companies and the Oil Majors and the consequent different implications for pricing transparency?

[ii] Compulsory application of TGP

Some large informed wholesale and/or retail customers may wish to escalate contract prices on bases other than TGP. An issue is whether there should be a provision for a Declared Supplier to supply on other than TGP terms, if requested by the purchaser. The Act does not require Declared Suppliers to price to commercial end-use customers on the legislated TGP.

[iii] Contract roll-overs

As contracts come up for renewal or review, they must be negotiated on a TGP basis. However, some stakeholders have suggested that some 'evergreen roll-over' arrangements are in place with no defined re-negotiation date.

[iv] Single Terminal Gate Price

Should the use of multiple TGPs be permitted, with differentials for spot and contract sales to reflect the different costs of servicing these customers? Would the adoption of such a differential facilitate spot sales?

4.3.2 Flexibility of TGP requirements

[i] Terminal Margin

Is the terminal margin requirement too prescriptive? Should there be more flexibility to allow sellers to reflect supply and demand pressures?

[ii] Optional Service Charges

Should a 'catch-all' category be added to the categories of optional services specified under the Act to allow for any other categories of additional charges? Possible additional categories of services included charges reflecting the provision of petroleum storage and marketing assets and temperature correction.

[iii] Freight Criteria used in the LIPP

Should a more appropriate adjustment to Worldscale other than AFRA be specified, for example the recently established Platts Asian Region factor or Drewry South East Asia?

[iv] Definition of imported product for determining the LIPP

Now that refinery exchange arrangements between Oil Majors have broken down, the two refiners which do not have refineries in Victoria (BP and Caltex) either buy product from the local refiners (Mobil and Shell) or ship product from their interstate sources. Do these arrangements have any bearing on the setting of their TGPs?

4.3.3 Other administration and compliance issues

[v] Process for Supply Shortfall

Is the shortfall notification requirement necessary? Should suppliers have the ability to respond to supply shortages by raising prices to dampen demand? This is linked to the terminal margin issue.

[vi] Discounts and Rebates

Does the ability of suppliers to sell to some customers below published TGPs (through discounts or rebates) negate the aim of improving the competitive position of Independents and entrench the Oil Majors' control of the distribution and retail of fuel? There are substantial issues under the Trade Practices Act in any structure that sets a floor price.

[vii] Invoicing of Separate Add-on Charges

Is the invoice disclosure requirement, which may require the concurrent support of separate invoicing systems in different jurisdictions, too burdensome? Is disclosure on a price advice notice separate from the actual transaction (for example, rate schedules sent intermittently by facsimile), rather than itemised on invoices, sufficiently transparent?

4.4 Identification of market impact issues

The Act intends to affect the behaviour of market participants and market outcomes, particularly at the wholesale level. There are several aspects of its impact on the automotive fuel market.

4.4.1 Resellers' access to supply at 'reasonable' prices

To assess whether the pattern of ex-terminal supply has changed in the period since the introduction of the Act, the Report examines:

- the volume of sales collected from terminals by Independents, at TGP-related prices, relative to the total volume of sales to Independents; and
- any instances of reported refusal to supply at a terminal, as well as the register of shortfall notifications under section 9 of the Act.

Measurable indicators relating to the Act's impact on resellers' access to supply in the Victorian market for the Declared Fuels include:

- the proportion of total sales (volume) to resellers which were at TGP-related prices; and
- the proportion of all sales (volume) to Independents that were at TGP-related prices.

The first of these measures will show the extent to which TGP has been applied across all classes of customer, including the volume of sales to oil company franchisees on contracts which must be converted to a TGP- basis on renewal or review. However, franchisees do not have the ability to negotiate on price or physically pick-up fuel from terminals.

The above measures are indicators of the intended impact of the Act in ensuring access to more transparently priced fuels ex-terminal. The issues of access and "reasonable" pricing are assessed in Chapter 8.3 and 8.4.

4.4.2 Transparency in wholesale pricing and 'bottom-up' pricing

One of the persistent concerns of resellers has been the lack of transparency in wholesale pricing. The subject of complaint has been what is sometimes described as 'top-down' pricing. This is where the supply price to the reseller is arrived at by applying a discount or rebate to an Oil Major's published wholesale list price. Resellers complained that the cost-based components of such a price were not disclosed to them. In their view, this practice resulted in a level of wholesale list prices that was 'artificial' (in that few, if any, buyers accessed the list price) and facilitated what they considered to be objectionable pricing practices, such as the 'discriminatory' application of discounts and/or price support. In addition, country resellers and consumers objected that they were unable to determine the appropriateness of their buying prices relative to those prevailing in Melbourne.

The provisions of the Act require a TGP to be publicly available as a starting point for pricing and that defined 'add-ons' be quoted for optional services provided beyond the terminal. In

this way the Act attempts to promote a base from which an actual transaction price is built up according to additional services purchased – a ‘bottom-up’ price in contrast to the previous practice. Nevertheless, in price negotiations discounting is permitted off the published TGP.

Under the Act, Declared Suppliers must disclose on invoices for sale or supply, the current TGP, any discounts or rebates and any other charges for services beyond the terminal. The issue for assessment is whether Declared Suppliers in practice have:

- complied with the price transparency requirements;
- published TGPs in the prescribed manner; and
- made available to any distributor or retailer on request details of charges for optional or ‘add-on’ services.

A key test of the effectiveness of enhanced price transparency is whether or not fuel can be purchased in practice at the advertised base TGP. This can be assessed by linking data supplied by the Declared Suppliers with qualitative information provided in the consultations with Declared Suppliers and other industry participants. This issue is assessed in Chapter 8.5 and 8.6.

4.4.3 Long-term competitive position of Independents

During the Second Reading debate in the Legislative Assembly, the Victorian Treasurer noted that the Bill had ‘the potential to improve transparency of pricing arrangements and provide additional choice and competition’.³⁵ The potential for more transparent pricing to assist the competitive position of Independents has been hypothesised for some time. For example, in the 1996 Inquiry Report referred to in Chapter 1, the ACCC made a number of recommendations intended to promote more effective price competition, particularly through imports to independent terminals and independent distribution and retail networks.

A change to a pricing ‘culture’ based on price negotiation at the terminal gate is recognised by some as particularly relevant to rural retail petrol pricing. Provision for rural Independents to access terminals and negotiate buying prices from a disclosed terminal base price arguably could enhance their opportunity to market fuel competitively in the longer term. The establishment of rural buying groups could also be facilitated by such a change in pricing culture.

There are a number of indicators that could give a measure of any movement towards such a change in pricing culture benefiting the competitive position of Independents. Measures examined in this Report include:

- trends over time in the notional margins over buying prices available to Independents, before and after the implementation of the Act; and
- in the longer term, entry by new Independents reflecting an improved viability of independent product distribution.

This issue is discussed in Chapter 8.7.

4.4.4 Metropolitan and country retail pricing

The original Private Member’s Bill was proposed with the intention of limiting the difference in fuel prices between metropolitan Melbourne and rural areas. The objective was to help Victorians in regional areas achieve the lowest price the market could provide. While the original Private Member’s Bill did not proceed due to its impracticality, the Victorian Treasurer

³⁵ Parliament of Victoria, Hansard, 1 November 2000, page 1304.

stated during the Second Reading debate: 'the Government strongly supports the intent of the bill – that is, greater transparency, a reduction in metropolitan regional price differentials, and increased competition'.³⁶

While the Act does not have provisions aimed at reducing the city-country differential, it was implied in the debates surrounding the Bill that lower differentials may also be an outcome of the proposed scheme over time. A change in differentials between country and city petrol prices can be measured by the systematic comparison of average Melbourne retail prices with average petrol prices in country regions before and after the implementation of TGP. CAV has obtained survey data on average petrol prices in Melbourne and eleven towns during the eighteen-month period to 31 July 2002. Analysis of this data will show whether differentials changed from previous levels following the introduction of the Act and may also assist in the assessment of other factors that possibly contribute to any change. This issue is discussed in Chapter 8.8.

4.5 Issues beyond scope of review

At the time of Parliament's consideration of the Private Member's Bill market participants, industry and consumer associations and members of Parliament raised a wide range of objectives for reform of the Victorian petroleum product market. The objectives were not necessarily consistent. This reflected widespread concern in the Victorian community about fuel pricing following rising world petroleum prices, the falling value of the Australian dollar and the introduction of the GST. (The impact of world petroleum prices on domestic prices is outlined in *Appendix D*.) It also followed a period where the priorities of the ACCC had changed after deregulation of wholesale petrol and distillate prices in 1998 and continuing rationalisation by the Oil Majors.

The range of outcomes sought by the various participants in the public debate over petrol pricing included:

- reduced overall wholesale price level for petrol;
- reduced overall retail price level for petrol;
- elimination of price discounting/rebates/price support;
- prevention of 'predatory' pricing by the Oil Majors;
- divorcement of oil companies from retailing; and
- reduced retail price variability in Melbourne.

While such outcomes were referred to in the public debate at the time, the Victorian Government clearly did *not* identify these as its objectives for the Act. Accordingly, the operation of the Act is not assessed against these outcomes. Some of these issues have been considered in reports of previous inquiries, such as the ACCC's Report titled *Reducing fuel price variability* completed in December 2001.

³⁶ Parliament of Victoria Hansard, 1 November 2000, page 1304.

Chapter 5

Stakeholder Assessment of Act

5.1 Introduction

This Chapter summarises the views of the Declared Suppliers and other market participants expressed during consultations and provided by them in response to requests from CAV.

5.2 Declared Suppliers

5.2.1 Information on extent of application of Act

Pricing arrangements under supply agreements entered into before 1 November 2000 are not required to comply with TGP legislation. Figures 8.1 to 8.4 in Chapter 8 indicate the proportion of total product sales since 1 August 2001, as reported by the four Oil Majors, that were supplied reflecting TGP under the Act. These indicate that for RULP over the four quarters to July 2002 the proportion of total wholesale sales based on TGP increased from 34 per cent to 43 per cent. The proportion of total sales to independent resellers that were based on TGP increased from 41 per cent to 49 per cent.

TGP was expected to be of particular relevance to the operation of independent service station chains and to distributors who are not bound by exclusive branded supply agreements. At October 2002, the Oil Majors reported that of the 130 independent retailers they supplied on contract in Victoria, 126 of those agreements were now based on TGP. The Oil Majors also reported that of the 22 independent and equity distributors at that time, eight were supplied on a TGP basis.³⁷

5.2.2 Perceived impacts

The view of the respective Declared Suppliers regarding the Act and its impacts are summarised below.

■ **BP**

BP strongly supports the TGP approach and initiated TGP in 1998 when it was adopted as the basis of pricing for distributors and independent resellers. BP advocated a legislative approach in Victoria as it considered that the prevailing system was no longer serving the industry or the public. BP saw TGP as a 'bare bones' price with no add-ons, minimal or no discounts and as providing necessary transparency to the market.

BP believes the positive effects of TGP are a move towards greater confidence in the pricing system in both city and country locations. In time, a combination of TGP and buy-sell refinery arrangements may dampen price cycles while retaining competition. BP considers that the impact on absolute prices has been minimal as expected, given the intense competition already in the industry. BP's concern with the Victorian TGP is its focus on spot sales, when in fact almost all sales are on a term basis and also the constraints that the invoicing requirements place on their systems.

³⁷ Consumer Affairs Victoria, survey, October 2002.

Like Shell, BP has adopted nominally TGP-related price differentials in supply prices to its multi-site franchised operators to avoid retail selling prices which discredit wholesale prices when falling below wholesale prices.

■ **Caltex**

Caltex is supportive of bottom-up pricing, but believes that the prescribed methodology for calculating TGPs is restrictive and not always in line with true costs. Caltex has pointed out that since the end of refinery exchange, its fuel costs in Victoria are related to the buy-sell price that can be negotiated with the local refiners. The buy-sell price is market driven and movements in the buy-sell price will not always be in line with movements in the import parity price.

Caltex would prefer there to be no regulation with respect to TGP and believes that the highly competitive nature of the market negates the need for regulation. If regulation is to remain in place, Caltex would like to see greater freedom with respect to how the TGP is to be built up.

Caltex believes that the current Victorian spot market is minimal (less than 1 per cent of sales volume).

Caltex also considers that TGP arrangements are inconsistent with section 20 of the Commonwealth *Petroleum Retail Marketing Franchise Act* 1980 (Franchise Act) which requires that the Oil Majors not discriminate against franchises with regard to pricing matters. In these circumstances Caltex is of the view that for TGP to be effective this Act should be repealed.

■ **Mobil**

Mobil considers that the Act has had a minimal impact on the market. Mobil believes that the wholesale market has remained competitive following the introduction of the Act but that the TGP legislation could not be said to have had any discernible impact on retail pricing. Mobil is of the view that the retail market is subject to different competitive influences and simply introducing regulation at the wholesale level does not have a direct impact on retail market behaviour or retail pricing. As a result, with respect to Mobil's franchised operations, the formal adoption of TGP has had little if any impact on the structure of actual prices.

Mobil is reviewing the structure of its pricing arrangements and believes that a TGP mechanism has a role in wholesale pricing as a means of increasing transparency, however it believes that the current legislative requirements are administratively burdensome and provide insufficient flexibility to allow such a mechanism to work effectively.

■ **Shell**

In general, Shell believes that the Act is working well. Shell commented that, 'The objectives to provide greater price transparency and the ability for resellers to purchase spot fuel from the terminal at the posted price have clearly been met'. Shell informed CAV that it had gone well beyond the mandatory requirements of the Act by extending the TGP philosophy to its distributor operations and to markets in other States.

Shell considers the Act to have made a valuable contribution in supporting rational and transparent cost-based pricing in the Victorian products market. The introduction of the Act coincided with a push by Shell to rationalise its own pricing structures and it considers the Act has provided positive support in this context, without otherwise distorting the market. While Shell reports that its sales volume in Victoria has declined, this has been in consequence of its consolidation strategy and not as a consequence of the Act.

Shell considers that there are a number of areas of detail in which the efficiency of the operation of the Act could be improved. Shell commented that none of these would compromise the objectives of the Act. Shell's suggestions are as follows:

[i] Freight and LIPP

The Determination which prescribes the freight rate to be used in determining the LIPP should be removed. As with other elements of the LIPP, Declared Suppliers should be free to select the freight rate which they believe is the most appropriate given their own commercial circumstances.

[ii] Section 6 of the Act

The Act lists a non-exhaustive range of optional services which can be added to the TGP. It should be amended to include the provision for 'other services'.

[iii] Section 7(5) of the Act relates to invoicing requirements

The Act prescribes the information which must be contained on an invoice. Clearly customers need to know the cost of add-on services. For Shell's customers this information is agreed up front and included in their supply contracts. In Shell's view mandating how information is communicated to the customer is overly prescriptive and adds administrative costs. Shell suggests an amendment to the Act which picks up the wording of Section 7(2) for example:

A Declared Supplier who sells or supplies a load of petroleum products of a declared class must make available to any distributor or retailer, on request, details of the charges for any optional services provided by the Declared Supplier in relation to the sale or supply of a declared class of petroleum products.

[iv] Notifications of supply shortfall

In Shell's view, the requirement to notify the Director of Consumer Affairs Victoria of any shortfall in the availability of Declared Fuels creates an unnecessary administrative burden. Shell is unaware of any circumstances where a customer has been denied a TGP sale by it or any other supplier. Shell stated:

Shell clearly has a commercial incentive as well as a legal obligation to supply customers at our TGP. In the unusual circumstances where we did not have sufficient supply to meet the demands of spot customers, we would explain this situation to them and if necessary to officers of the Department. In our view, given that issues of non supply have not arisen since the TGP Act was implemented, it is simpler and more practical to respond to these circumstances on a case by case basis, rather than creating an on going reporting requirement.

[v] Section 8 of the Act mandates that all sales by a Declared Supplier must be made on the basis of the TGP and that any contracts which are not made on a TGP basis are void

Shell believes that Section 8 is an unnecessary restriction on the rights of buyer and seller and should be repealed.

As you are aware, Shell has fully embraced the TGP model. This can be seen by the fact that we have actively migrated our customers to a TGP

basis even where there is no legislative requirement to do so (eg sales by Shell distributors and sales in other States.) However, there are circumstances where the buyer and seller may wish to transact on a non-TGP basis. Clearly this will only occur if it is in the mutual interest of both buyer and seller as the buyer would always maintain the right to purchase on a spot TGP basis.³⁸

■ **Trafigura**

Trafigura considers its business to have been significantly disadvantaged by the Act. Trafigura believes that its operations as a secondary wholesaler have been unfairly disadvantaged by the Act in competing with both the Oil Major wholesalers and with other secondary wholesalers such as Liberty, United, Triton, Oasis, Dunnings and BP Endeavour who are not Declared Suppliers and some of which are affiliates of the Oil Majors. Imported cargoes, which are sourced from its affiliated international trading partner, are a principal source of product supply, particularly from September to April when petrol supplies from domestic refineries are in tighter supply. Trafigura also has some contracted supply arrangements with domestic refiners. Trafigura's major customers are supplied under contracts which pre-date the Act and are consequently outside the provisions of the Act.

With its cost base resting on competitive product import parity, Trafigura claims it cannot build a viable business based on contracted term sales in competition with the Oil Majors, some of which it asserts are selling to competing independent chains, on occasion at prices below LIPP plus excise and taxes.

Trafigura considers the viability of its business to be linked to its capacity to meet short-term supply disruptions in the market by scheduling imported product, as and when required, with an adequate margin for the costs and risks associated with such imported cargoes.

Trafigura's specific complaints with respect to the Act relate to its perceived unfair disadvantage as a Declared Supplier in relation to other independent wholesalers and the related impact of the Act in restricting its capacity to realise higher than average risk-related margins on product imports. Secondary wholesalers are in direct competition with Trafigura but are not declared under the Act. These wholesalers bear no risk as they are unable to add incremental supplies to the market in times of shortage but have no restrictions on their margins. Also in times of tight supply the Act allows Oil Majors, if they wish, to direct contracted sales to their affiliated secondary wholesalers. These suppliers are not declared and, therefore, are able to resell product at higher margins than are available to Trafigura in the same market.

Trafigura contends that the scheduling of import cargoes has a series of associated costs and risks. The purchase must be scheduled in advance of delivery and sales ex terminal are at a fixed price with significant direct working capital financing costs. The interval between committing for the cargo and selling it can be more than six weeks. In a volatile market environment this interval also has a substantial associated price risk which, in the case of 95 RON petrol in the Singapore market, cannot be fully hedged. Finally, all cargo importers carry a product quality risk – that is the product may be 'off spec' or otherwise downgraded during shipping, terminal and distribution operations.

As a result, Trafigura considers that there is no incentive under the Act for it to schedule product imports to cover potential shortages in the market, which will only increase given the closure of domestic refineries. Trafigura forecasts that product shortages may lead to higher price levels in the secondary wholesale market.

³⁸ Correspondence from Shell, 'Action: Review of TGP Legislation', 11 October 2002

Trafigura proposes four possible alternatives to its dilemma:

- That Trafigura be de-listed as a Declared Supplier and placed an equal footing with the other (and often larger) secondary wholesalers with whom it competes;
- declaration of all secondary wholesalers;
- termination of the Act – that is deregulation to the industry as a whole; or
- Amendment of the Act to distinguish in pricing terms between contracted and non-contracted sales to provide latitude for the latter to be supplied at short term pricing premiums. Trafigura prefers this option.

5.2.3 Compliance costs

While the operation of the Act clearly creates some additional costs for the Declared Suppliers, none raised the costs of complying with the Act's requirements as an issue during stakeholder consultations on the operation of the Act. The bulk of costs were incurred in the initial implementation phase due to factors such as alterations to invoicing systems. The ongoing costs are minimal. The administrative cost of supply shortfall notifications relative to the questionable benefit in practice were raised by Shell and this is addressed specifically in the recommendations in Chapter 10.

In the event that the mandatory industry code for the petroleum industry under Part IVB of the *Trade Practices Act* 1974 proposed by the Commonwealth Government (*Oilcode*) came into effect and the Victorian Government effectively suspended the Act, suppliers 'declared' under the code would probably still incur broadly similar compliance costs because of the similarities of the two schemes.

5.3 Independent resellers

Consultations took place with representatives of the Victorian Automobile Chamber of Commerce ('VACC') (members mainly franchisees), the Independent Petroleum Marketers Association of Australia ('PMAA') (independent dealer groups), and the Australian Petroleum Agents and Distributors Association ('APADA') (distributors and associated retailers). The views put by these parties tended to vary on some issues and depended on individual experience, contractual relationships with suppliers, prior experience in dealing with Oil Majors and industry pricing and structure.

A general assessment was that the Act introducing TGP 'was a step in the right direction... and could be used as a national template for reform of industry pricing practices'. Differing responses to fuel pricing issues by individual State governments, had resulted in concerns felt by the distribution and retail sectors.

The first year of operation of the TGP Act was described as a 'shake-out period', with not all the areas of concern being due to the Act. Some representatives said that some retailers had responded in ways that may not have been in their own interests such as pricing at sustainable levels.

Over a longer term, independent wholesalers and retailers would be favoured by an environment where virtually all sales were on TGP and the opportunity to negotiate supply price and conditions on a 'bottom-up' basis was available in conjunction with terminal access. While there was not a uniformity of views on all issues, a number of points were made by the independent resellers which are summarised below.

- Physical access to terminals had been attained by buyers who were willing to persevere; access was no longer a concern under the TGP regime.

- While all Oil Majors posted TGPs, Shell consistently set the lowest prices and was considered to be most closely abiding by the Act.
- Some other Declared Suppliers set TGPs at levels above what buyers would pay and then do deals below those levels. Few if any sales were made at TGP in these circumstances where the TGP was described as having little relevance.
- One view was that the ability (under the Act) for Declared Suppliers to discount from a TGP has reduced the effectiveness of TGP in delivering 'a level playing field' for buyers. The VACC, in particular, considers that discounting from the published TGP removes 'the potential for true and transparent competition between oil companies at the wholesale level'.
- Continued rationalisation and strengthened vertical integration by Declared Suppliers blurs the point at which TGP can effectively apply. The extent to which the Oil Majors can control retail price levels at branded outlets and artificially or arbitrarily allocate margins between links in the chain (combined with continued 'top-down' pricing behaviour) in practice has reduced the effectiveness of the Act.
- Most distributors and some retailers still buy under contracts based on a rebate off a wholesale list price. In some cases it was reported that the 'bottom-up' TGP plus add-ons was established to coincide with a wholesale list price less rebate or discount (for invoicing purposes). The parties said it was important that the industry move away from the 'top-down' wholesale list pricing approach. The VACC commented that it would appear from the disclosure of add-on charges on invoices that there was some double-dipping with for example branding, which may also form part of the franchise agreement or contract with Independents, and also credit charges.
- The spirit of the Act is to establish a new regime in fuel pricing in Victoria, based on TGP. Once existing contractual arrangements reach dates of review or renewal, all customers should buy fuel on a TGP basis. It is therefore important for CAV to monitor new agreements during the transition period. However, this transition may be weakened by the existence of 'evergreen rollover' arrangements with buyers (that is agreements that have no formal review or renewal dates).

5.4 RACV

The RACV said that from the consumers' point of view, the key issue in fuel pricing is transparency. The introduction of TGP had provided a greater understanding of pricing structure and influences. The posting of all current TGPs on web sites had also given a basis on which both country and city motorists could assess the reasonableness of pump prices.

The RACV commented on the sharp decline in the number of fuel price complaints it had received from motorists over the previous year. This decline seemed to have reflected the introduction of transparent 'bottom-up' price data, the removal of automatic indexation of excise duty on petrol and distillate and the lower level of world fuel prices over those experienced in 2000/01. TGP was credited with bringing more 'surety' to the market, with motorists more comfortable in the knowledge of open access to terminals.

The RACV's view was that while the Act was generally appropriate, some of the elements of TGP determination could be reviewed to allow for easier compliance by the industry. As a next step, the RACV would wish to see complete transparency throughout the distributor network to provide greater information on the country margins.

While the stakeholder consultation sought views on the implementation of TGP for Declared Fuels (that is petrol and diesel), the RACV also strongly advocated the extension of TGP to automotive LPG.

Chapter 6

Assessment of Compliance and Operational Issues

6.1 Introduction

This Chapter provides CAV's assessment of compliance by the Declared Suppliers with the legislated TGP requirements outlined in Chapter 2. Details of Declared Suppliers' operations were obtained through observation of market practices and consultation with Declared Suppliers and other industry participants.

6.2 Declared Suppliers and Declared Fuel

On announcing the arrangements for the commencement of the TGP legislation the then Minister for Consumer Affairs advised that proprietary products³⁹ and secondary wholesalers⁴⁰ would not be declared, but if there was continuing interest in the declaration of proprietary products or if there were issues relating to secondary wholesalers, these matters would be reconsidered.

6.2.1 Declaration of proprietary products

The declaration of proprietary products was not identified as an issue by industry participants during consultation. This is not unexpected as the August 2001 Order gives resellers access to Declared Fuels within the same octane range as the proprietary products. Therefore, with the exception of leaded petrol, which can no longer be supplied under the National Fuel Standards, the currently Declared Fuels appear to be appropriate. While CAV does not propose to reconsider the declaration of proprietary products, leaded petrol should be removed from the list of Declared Fuels.

6.2.2 Declaration of independent terminal operators

To address the issue of price transparency at the point at which Declared Fuels are first sold into the Victorian market the Act envisaged declaring suppliers which sell significant quantities of product through seaboard terminals. Price transparency then flows through the wholesale and retail markets by enabling transaction prices at different points in the supply chain to be compared with the price at the terminals. As a result, all suppliers operating seaboard terminals in Victoria were declared under the Act. This included the independent terminal operators, Trafigura and Tri-State, where they sell product through the independent seaboard terminal at Hastings.

At the time the Act was proclaimed Trafigura opposed its declaration and, as noted in the preceding chapter, has more recently advised that it considers that its business has been significantly disadvantaged through its declaration. Trafigura proposed a number of options to address its concern including that it be removed from the list of Declared Suppliers and alternatively that the Act be terminated.

³⁹ Proprietary products are special formula high octane fuels branded and marketed by the Oil Majors.

⁴⁰ Secondary wholesalers refers to businesses which purchase petroleum products from the seaboard refinery connected and/or import terminals and then on-sell that product to resellers.

As noted in Chapter 3.4 price transparency is not an issue where product is exchanged between separate business entities at market based prices but is a concern where vertically integrated businesses exchange product based on notional prices. A published TGP addresses this concern by enabling a customer whose business is integrated with their supplier to assess their price against a primary wholesale price indicator set for all customers. In this context CAV considers that declaration of Trafigura is not necessary to ensure price transparency for its customers. However, its continued declaration may create issues with regard to its role in the market, particularly the spot market.

CAV does not consider that the issues affecting Trafigura outweigh the general benefits arising across the whole market from the introduction of the legislated TGP arrangements and, therefore, does not support termination of the Act.

6.2.3 Declaration of secondary wholesalers

The term 'secondary wholesalers' refers to companies which purchase petroleum products from the seaboard refinery-connected and/or import terminals and then on-sell that product to resellers. Prior to the commencement of the Act, views varied on the declaration of secondary wholesalers. While the Oil Majors and Trafigura support the declaration of secondary wholesalers the PMAA, APADA, Liberty and other stakeholders opposed the declaration.

The main arguments in support of the declaration of secondary wholesalers are that they are in direct competition with the Oil Majors and independent terminal operators and the declaration of only primary wholesalers arbitrarily limits the application of the Act. Trafigura raised a further concern during consultations that secondary wholesalers affiliated with the Oil Majors, and with whom it competes, are unrestricted in their ability to raise prices during supply shortages. (See Chapter 5.2.)

There are a considerable number of secondary wholesalers of varying sizes operating in the Victorian market, including Trafigura. The Act was not intended to apply to these wholesalers nor can the requirements under the Act be easily applied to secondary wholesalers. CAV does not support the declaration of secondary wholesalers and is not aware of any evidence that such declaration would further improve price transparency.

The recommendations which CAV considers will address the concerns raised by Trafigura are outlined in Chapter 10.

6.3 Contract and spot TGPs

The legislation is based on the calculation and posting of a single TGP by each Declared Supplier, for each Declared Fuel. Some Declared Suppliers, however, have suggested that they should be allowed to charge separate TGPs for contract and spot sales. Under this arrangement the 'contract TGP' would be a more competitive price than the 'spot TGP' reflecting the benefits to the Declared Supplier of a guaranteed and regular demand for its product.

CAV does not support the introduction of separate TGPs for contract and spot sales. The price differential between contract and spot sales can be accommodated under the current legislation through discounts and add-on charges. Discounts can be negotiated with resellers who purchase under term contracts and additional charges may be made for spot sales where such sales incur costs which fall within the prescribed categories of add-on charges. There is also some concern that a separately listed 'spot TGP' may suppress the development of a spot market in Victoria. During stakeholder consultations, Trafigura made

the point that the currently posted TGPs are a much better reflection of transacted prices than the previously listed wholesale prices and, therefore, provide a market sensitive indicator of prices available to spot buyers.

6.4 'Opting out' of TGP in term supply agreements

Section 8(1) of the Act provides that a Declared Supplier must not sell or supply Declared Fuel to a reseller at a price determined other than on the TGP basis established by the Act. Any sale/supply contracts which are not made on a TGP basis are void, except contracts entered into before 1 November 2000.

As noted in Chapter 5.2, Shell expressed the view that Section 8 of the Act is an unnecessary restriction on the rights of buyer and seller and should be repealed. CAV understands that a variety of pricing formulae have been adopted in commercial supply agreements for many years as a means of protecting both buyers and sellers from the speculative risk of movements in the international commodity price of petroleum products. However, CAV considers that the ability to discount under the Act provides the ability for buyers and sellers to be similarly protected under TGP arrangements. Given the imbalance in the negotiating positions of the Oil Majors and resellers, acting on Shell's proposal is considered to be likely to result in an undermining of the Act's fundamental price transparency objective.

6.5 Definitions of TGPs

The TGP components assessed were the LIPP and the terminal margin. As noted in Chapter 2.4.1, the criteria which a Declared Supplier must use to calculate a LIPP for domestically refined fuel are a Singapore spot price, an amount for freight, a provision for insurance and wharfage.

6.5.1 Spot Price

All Declared Suppliers were considered to be complying with the prescribed criteria to calculate a spot price for RULP and diesel. The approaches taken for RULP had been to select a single PSPASP, and for some suppliers to add a premium, or to take a weighted mix of relevant PSPASPs.

Only three Declared Suppliers used the prescribed criteria to calculate spot prices for PULP and LRP. The remaining suppliers determined a TGP for these products by way of a differential or adjustment added to the RULP price. Where the adjustment is added in the pricing formula will determine whether the approach complies with the legislation. If the adjustment is added to the RULP spot price, it is consistent with the August 2001 Order which allows for a premium to be added to the relevant PSPASP to meet the local fuel specifications. Alternatively, if the adjustment is added to the RULP TGP once it has been determined, then it would be non-compliant as the legislation does not allow for a product premium to be added to the TGP. It appears that the Declared Suppliers concerned were using the latter approach. However, this did not result in unusual TGP levels as both approaches tend to result in the same TGP.

Some Declared Suppliers are seeking a less prescriptive approach to the calculation of the LIPP components such as the spot criteria. However, the current Order is considered to be sufficiently flexible as it provides a Declared Supplier with an exhaustive range of options to

select and build on the relevant PSPASP(s) and thereby calculate the spot price. During the Review Period there were a number of changes which had the potential to impact on the use of the prescribed spot criteria. These included the introduction of buy-sell arrangements and changes to the petrol and diesel product specifications.

With the breakdown in refinery exchange, buy-sell arrangements emerged between the local refiners (Mobil and Shell) and the other Declared Suppliers. An issue is whether these arrangements impact on the use of the spot price criteria. While it is noted in Chapter 5.2 that some Declared Suppliers consider that spot price movements are not relevant to buy-sell prices, which are negotiable and market driven, CAV is of the opinion that the spot price criteria remain applicable to the calculation of TGPs under buy-sell arrangements.

TGP applies to buy-sell arrangements in the following way. The local refiner determines a TGP using the spot criteria and makes it available to the purchaser, a Declared Supplier who does not operate a refinery in Victoria. The purchasing Declared Supplier also sets a TGP based on the spot criteria. The TGPs set by both the refiner and the purchaser are notional and do not reflect the actual costs of production and supply. If the local refiner's TGP less any negotiated discount does not provide the purchaser with a reasonable margin, then the purchaser will seek an alternative source of supply.

Following the introduction of buy-sell arrangements one Declared Suppliers' TGPs for a short period were several cents above its suppliers' TGPs. On enquiry by CAV it became apparent that the Declared Suppliers' TGPs for that period had been set on the buy-sell price plus a margin. The higher prices, however, were unable to be sustained in the market.

Changes to the petrol and diesel product specifications introduced through the National Fuel Standards, to date, have not affected the use of the spot criteria in Victoria. However, future changes may result in the need for Declared Suppliers to review the spot element used to build-up their LIPP and, furthermore, could pose a significant supply impediment for independent importers who are currently a considerable source of competition for Oil Majors.

Unlike Western Australia, South Australia and Queensland where additional State-based fuel quality requirements have been imposed, only the national fuel standards apply in Victoria. As a result, the maximum sulphur content for RULP and diesel reduced to 500 mg/kg on 1 January 2002 and 1 January 2003 respectively.⁴¹ As established international pricing markers exist for low sulphur RULP and diesel the new product specification did not affect the use of the spot criteria and it appears that TGPs posted by the Declared Suppliers were not affected.

However, the use of the spot criteria is likely to be affected by the product specification changes for petrol scheduled to be introduced on 1 January 2004. These changes include the reduction in the methyl tertiary butyl ether ('MTBE') content to 1 per cent (volume by volume) and the maximum olefins content to 20 per cent (volume by volume) and maximum 18 per cent (volume by volume) pool average over six months.⁴²

Trafigura, has asserted that the combination of the MTBE and olefins limits will make it almost impossible for complying fuel to be reliably sourced from independent regional refineries. If a situation were to develop where the new fuel specification makes it impossible for Trafigura to reliably source imports from independent regional refiners at a competitive price (that is the threat of imports is removed), there are likely to be very significant adverse impact on Victorian petrol TGPs. Such impacts are hard to quantify at this point in time, but could be significant. Similarly, the additional fuel quality standards imposed in some States

⁴¹ *Fuel Standard (Automotive Diesel) Determination 2001 and Fuel Standard (Petrol) Determination 2001* under the Commonwealth *Fuel Quality Standards Act 2000*.

⁴² *Fuel Standard (Petrol) Determination 2001* under the Commonwealth *Fuel Quality Standards Act 2000*.

(particularly Western and South Australia) have already proved an impediment to independent imports and have the potential to further impact on the movement and supply of petroleum products within Australia.

Therefore, at this time CAV does not consider that the spot criteria prescribed in the Order and Determination need to be amended for buy-sell arrangements or to increase flexibility for Declared Suppliers. With regard to the changes to petrol product specifications CAV considers that the National fuel standards should be structured in a manner that does not impede imports of product by Independents and that the Commonwealth should work with the States to ensure that no fuel quality standard provide an impediment to independent imports or to movements of fuel within Australia.

6.5.2 Freight, Wharfage and Insurance

While all Declared Suppliers used the Worldscale measure, only one used the required AFRA adjustment. Other Declared Suppliers used a Platts adjustment rate for Melbourne to Japan. While this is not in strict conformity with the letter of the Act, in practice, this had little effect on TGPs during the review period. The Declared Suppliers using the Platts adjustment expressed the view that Worldscale rates adjusted by AFRA do not accurately reflect the spot shipping rates in the Asian market.

The general consensus among the Declared Suppliers is that Platts Shipping (refer to the Glossary in *Appendix A*) reflects the true costs of spot shipping more accurately than AFRA. A similar argument regarding shipping rates was made to CAV prior to the introduction of the Act when at least one Oil Major argued that shipping rates published for the Asian region by Drewry Shipping Consultants Ltd should be used. While the Worldscale rate is the appropriate base, the monthly AFRA adjustment reflects global conditions rather than those in the South East Asian region, as is the case with the recently introduced Platts adjustment.

The differential movements between shipping indicators from different sources have been significant in the past. At its peak in December 2000, the indicator for Platts Shipping was more than twice the equivalent clean-ship premium adjusted AFRA rate. During the review period, relatively stable shipping rates prevailed and there was no significant differential between Platts Shipping and the clean-ship premium adjusted AFRA rate. In fact, the clean-ship premium adjusted AFRA rate was an average of 8 per cent higher than the Platts Shipping rate for the review period.

All Declared Suppliers appeared to comply with the wharfage and insurance criteria.

6.5.3 Terminal Operating Margin

Declared Suppliers are free to determine a reasonable margin for establishing and operating a terminal. CAV's view of the costs which may be included to determine a terminal margin is provided in the administrative guidelines and include 'all reasonable costs of operating the terminal and wholesale business and a reasonable return on investment of operating the terminal facility and business and the wholesaling business.' The terminal margin, therefore, will vary by supplier, by product and by terminal.

The approach taken by Declared Suppliers to setting a terminal margin is considered to have complied with these requirements. Suppliers indicated that terminal margins were generally based on actual costs with allowances for depreciation and replacement cost and a return on investment. As a result, terminal margins remained fairly constant. Declared Suppliers generally indicated that terminal margins were adjusted once or twice during the review period and were up to 2 cents per litre.

While terminals margins had not been used to respond to supply conditions, some Declared Suppliers considered that CAV's interpretation of a reasonable terminal margin was too

restrictive and that it should be able to be adjusted for domestic supply conditions and for competition. Trafigura, noted that it would welcome the opportunity to be able to more actively compete for spot sales by adjusting its TGPs, and hence its terminal margin, in order to meet the market. CAV considers that its interpretation of the terminal margin is consistent with the intention of the Act and allows for a reasonable return on investment and that any relaxation of this approach would result in a general increase in the overall level of published TGPs. The use of discounting under the Act is considered to provide Declared Suppliers with sufficient flexibility to respond to supply conditions and competition. As previously noted, issues concerning Trafigura are to be separately addressed.

6.5.4 Temperature correction

The determination and posting of a TGP is affected by two pieces of legislation. Primarily, the TGP Act but also the *Trade Measurement (Fuel Measurement) Regulations* 2002. These regulations introduced mandatory temperature correction ('TC') of automotive petrol and diesel in Victoria and came into operation on 1 December 2002. While TGP and TC are computable some difficulties have arisen with regard to the pricing arrangements implemented by Declared Suppliers seeking to concurrently comply with both sets of requirements.

TC requires the Oil Majors and Trafigura, where they deliver fuel direct from terminals to resellers' sites, to calculate the wholesale price of the fuel for sale on the volume it would measure at 15⁰ Celsius, the Australian and international Standard Reference Temperature. In contrast the TGP Act, which commenced prior to TC, is silent on the reference temperature at which a TGP should be determined and posted thereby providing suppliers with the discretion to select the most appropriate temperature. However, a transparent approach to complying with both pieces of legislation is for Declared Suppliers to post TGPs at 15⁰C. While this has been the approach taken by most Declared Suppliers some pricing arrangements have compromised compliance with the TGP requirements or resulted in undesirable outcomes for customers.

For a short period one Declared Supplier with the aim of providing transparency to both wholesale and retail customers, posted two TGPs for each Declared Fuel available for sale from terminals in Victoria. This approach was contrary to the TGP scheme which requires that Declared Suppliers post a *single* TGP for the sale or supply of each Declared Fuel.

A further problem has arisen where the posted TGP is an 'ambient price', based on the daily average ambient temperature, and is subsequently adjusted to a per litre price at 15⁰C for each customer at the time of sale. While this arrangement complies with all of the legislated requirements it is considered to be inconsistent with the spirit of T C and has resulted in franchisees and independent resellers being unable to make purchasing decisions based on the published TGP. Specifying that the posted TGP is a temperature corrected price will overcome this problem and assist Declared Suppliers to base pricing arrangements on a consistent interpretation of the legislative requirements.

6.6 Publication and variability of TGPs

While the Act came into operation on 1 August 2001 Declared Suppliers were not required to set and publish TGPs until 15 August 2001. The form of publication is a notice on the Declared Supplier's web site, which states the TGP for each Declared Fuel and the terminal at which that TGP applies. All Declared Suppliers set and published the required TGPs on their web sites by the required date, with BP, Shell and Trafigura posting TGPs from 1 August 2001.

The information included on Declared Supplier's web sites generally complied with the legislation. TGPs were advertised for each Declared Fuel for or from a specified date, or for a specified period of time. However, two suppliers did not publish the terminal/s at which TGPs apply. There were some minor problems with the publication of TGP during the initial period of implementation with data entry errors resulting in some TGP spikes and some TGPs being published retrospectively.

The Act prohibits Declared Suppliers from changing posted prices for Declared Fuels more than once every 24 hours. In compliance with this requirement some Declared Suppliers adjusted their TGP daily while others altered their prices two or three times a week. Other than this requirement the legislation is not prescriptive about adjustments to TGP. Therefore, to provide clarity on the granularity⁴³ of adjustments to posted TGPs CAV, in consultation with Declared Suppliers and other industry stakeholders, agreed on the minimum increase or decrease which may trigger an adjustment to a published TGP.

One implication of the publication of daily TGPs is that the Declared Suppliers and prospective buyers are now better able to monitor each others' price movements. Trafigura, however, commented that the 24-hour requirement limited its ability to adjust prices in response to the Oil Majors and/or supply conditions and would like to be able to adjust posted TGPs more frequently.

While recognising the important role which Trafigura plays in the spot market CAV does not consider that the removal of the 24-hour requirement will change the frequency with which Declared Suppliers adjust posted TGPs. This is because LIPP calculations can only be carried out once every 24 hours and as they are usually based on a seven-day rolling average this has the effect of smoothing out TGPs. Furthermore, resellers, in particular Independents, need a guaranteed period of price stability in which to consider a TGP offer and may be disadvantaged if TGPs have the potential to move more frequently.

6.7 The price of supply

Declared Suppliers are prohibited from including charges for optional service or discounts and rebates in the calculation of a TGP, these must be separate additions to or deduction from the published TGP.

6.7.1 Optional Service Charges

The optional service charges or add-on costs, which a Declared Supplier may add to the TGP to determine the total supply price, are specified in the Act and include transport services, delivery services, credit services, brand fees and the provision of equipment. All Declared Suppliers charged some optional services charges and the categories of charges made complied with those specified in the Act.

During the period leading up to the implementation of the Act, and again during consultations on the operation of the Act, a number of industry stakeholders, including Shell as noted in Chapter 5.2, proposed the inclusion of a 'catch-all' optional service charge category to ensure that suppliers, distributors and retailers are not disadvantaged by the Act and to allow for any new service charges which may arise. CAV has considered the possible charges, such as a charge for supplying temperature corrected fuel, and concluded that no case has been made for a 'catch-all' category. However, if other specific charges arise in the future, CAV will consider adding such specific charges to the list in the Act.

⁴³ Granularity refers to the size of the movement in a TGP calculated using a consistent application of the prescribed formula which would trigger a change in a Declared Suppliers' posted TGP.

6.7.2 Return on retail assets

The Act allows Declared Suppliers to add to the TGP an amount for return on their retail assets. Therefore, any such charge builds-up from the TGP to the final supply price. While this category of additional charge by a Declared Supplier may include rent on a per litre basis it must be disclosed on request and on the sales invoice. Disclosure ensures that the charge is transparent to the customer.

Two Declared Suppliers advised that they made charges which fall within the category. These charges were referred to as 'return on investment' or 'return on retail assets'.

6.7.3 Discounts or Rebates

Declared Suppliers reported that they provided a variety of discounting arrangements. Some suppliers provided discounts or rebates from the TGP for the sale of a load of fuel; some provided price or profitability support subsequent to the sale; some provided discounts from the optional service charges and some provide a combination of discount arrangements. All of these discount arrangements are consistent with the requirements of the Act. In response to a survey from CAV the Oil Majors reported that over the 12 months period from 1 August 2001, a relatively constant proportion of just over 30 per cent of sales volume based on TGP were subject to a discount to the TGP itself with, while further sales were subject to discounts to the optional service charges.

Discounted optional services charges are seen by some Declared Suppliers as necessary to ensure that they do not breach section 20 of the Commonwealth *Petroleum Retail Marketing Franchise Act* 1980 which requires that suppliers not discriminate against franchisees in respect to the price payable for the delivery of fuel or any discounts, allowances, rebates or credits. However, the exemption in that section appears to apply to differences in price which may arise where the 'discrimination makes only reasonable allowance for differences in the cost ... of ... sale or delivery resulting from the differing places to ... or quantities in which the motor fuel is supplied to the franchisees'.

Stakeholders' views varied on whether the legislation should allow discounts and rebates to be negotiated under TGP. Shell and BP considered that the elimination of generalised but variable 'rebates from List' was a principal objective in moving to TGP. However, as reported in Chapter 5.3 the independent resellers considered that discounts and rebates had reduced the effectiveness of TGP.

CAV does not consider that the Act should be amended to eliminate discounting and rebate arrangements. While discounts and rebates reduce the transparency of TGP, they contribute to price competition. All resellers should have the ability to negotiate a price advantage for volume and contract supply aspects of a sale. Furthermore, representatives of the ACCC expressed the view that it was considered to be inappropriate and inconsistent with the spirit of the *Trade Practices Act* to deny buyers and sellers the ability to negotiate on price and conditions.

6.8 Price disclosure

6.8.1 Disclosure on Invoices

A review of example documentation provided by Declared Suppliers and other industry stakeholders suggests that, where applicable, optional service charges and discounts which relate to the sale of a load of fuel are being printed on invoices. However, a number of stakeholders have complained that the prescribed information is not consistently printed on invoices.

One supplier has indicated that while it does not print the required information on invoices it is complying with the spirit of the legislation by providing the information by email or fax provided following the delivery of the fuel. Some resellers, however, expressed concern and confusion at price information received after the sale.

As reported in Chapter 5.2 Shell has proposed that it not be mandatory for the prescribed information to be disclosed on the invoice rather than it be provided on request. CAV does not propose amending the Act to change the invoicing requirements. The requirement to disclose information about the charges contributing to the final supply price of Declared Fuels is considered to be fundamental to ensuring price transparency and should not be limited. Also, if a spot market develops further invoice disclosure will be an integral component of price transparency.

6.8.2 Disclosure on Request

Declared Suppliers are also required to provide quotes to resellers, when requested, on the price of any optional service charges or any return on investment in leased a site. Access to this category of price information was not raised as a concern by stakeholders. Since the introduction of TGP at least one supplier has disclosed the categories and the amount of the charges for their optional service charges on its web site.

6.9 Requirement to supply

To ensure potential customers have access to terminals the Act requires that Declared Suppliers provide written notification when they have no fuel available for spot sales and do not refuse to supply Declared Fuels except on the prescribed grounds, for example, where the load is uneconomic, there are safety considerations or due to terminal scheduling.

6.9.1 Notification of product shortfalls

Up to 31 July 2002 49 shortfall notifications had been lodged with CAV. These are summarised in **Table 6.1**. All Declared Suppliers except Shell lodged notifications. The majority of notifications were lodged during November 2001 to January 2002 with all products being in short supply.

While Table 6.1 implies full compliance by Declared Suppliers with the shortfall notification requirements, during the initial period of implementation a number of notifications were refused as they failed to provide all prescribed information or were provided in anticipation of a likely or expected shortfall rather than as evidence of an existing shortfall.

Table 6.1 also suggests that Declared Suppliers were less likely to be in shortfall during 2002. This may not be the case. Two Declared Suppliers have advised that while their fuel stocks were, on occasion, only sufficient to meet contractual commitments, they did not lodge notifications as they were unlikely to receive requests for spot sales.

Table 6.1: Shortfall Notifications

	Number of Days in Shortfall					Total No of Supplier Product Days	No. of Shortfall Notifications
	RULP	Diesel	PULP	LRP	Total		
August 01	6	0	16	1	23	620	6
September 01	11	7	10	13	41	600	8
October 01	0	0	0	0	0	620	0
November 01	33	3	23	29	88	600	15
December 01	118	107	114	119	458	620	12
January 02	28	6	45	45	124	620	5
February 02	0	0	0	0	0	560	0
March 02	0	0	28	28	56	620	1
April 02	0	0	4	4	8	600	0
May 02	2	0	0	0	2	620	2
June 02	0	0	0	0	0	600	0
July 02	0	0	0	0	0	620	0
Total	198	123	240	239	800	7300	49

6.9.2 Refusal to supply

Refusal to supply Declared Fuel in the prescribed circumstances or in other situations has not been raised as a concern by stakeholders, apart from one occasion during the first weeks after commencement of the Act. Most Declared Suppliers include supply details on their web site such as payment and credit arrangements, the size of the load, safety requirements and ordering procedures.

6.10 Contracts

Information provided to CAV by four of the Declared Suppliers indicates that by October 2002 around 124 or 95 per cent of contracts with independent retailers were based on TGP. In Chapter 5.3 some Independents are reported as commenting that the implementation of TGP may have been weakened by the existence of 'evergreen' contracts which have no formal review or renewal date and, therefore, will not be converted to TGP. A survey of the Oil Majors by CAV suggests that there are only a very small number of these contracts and that there is not evidence to suggest that these contracts are undermining the operation of TGP. CAV does not propose any amendment to the Act regarding this issue. However, if a particular contract is of concern CAV will respond to the situation.

6.11 Summary of compliance

Table 6.2 provides a summary of Declared Supplier's compliance with the requirements of the Act, Orders, Determination and Regulations.

Table 6.2: Summary of Compliance		
Requirement	Compliance	
	Full¹	Partial²
Calculation of TGP		
▪ LIPP spot price component		✓
▪ LIPP Freight component and adjustment		✓
▪ LIPP Insurance and wharfage components	✓	
▪ Terminal operation margin	✓	
Publication of TGPs		
▪ Published on web site by 15 August 2001	✓	
▪ Web site includes prescribed information (price and terminal location)		✓
Variation of TGPs	✓	
Optional Service Charges	✓	
Discounts and Rebates	✓	
Invoice Disclosure		✓
Price disclosure on request	✓	
Notification of Product Shortfalls		✓
Refusal to supply	✓	
Requirement to base contracts on TGP	✓	
Notes: 1 Full compliance means that all suppliers are complying with all relevant requirements. 2 Partial compliance means some suppliers are complying with all requirements while others are not, or that all suppliers are complying with some but not all relevant requirements.		

CAV has assessed that the Declared Suppliers are not fully complying with five of the requirements listed in Table 6.2. These matters are not considered to reflect substantial non-compliance and Declared Suppliers are generally considered to be operating within the spirit of the TGP legislation. The comments below indicate that these matters are not undermining the operation of the TGP legislation. However, these instances of non-compliance are noted by CAV and will be followed-up with individual Declared Suppliers.

- **Spot Price.** Two Declared Suppliers may not be directly basing TGP for all Declared Fuels on impart parity pricing.
- **Freight Adjustment.** One Declared Supplier is using an internationally recognised freight rate adjustment which is more suited to the Asian Pacific Region and which only became available after the commencement of the Act. In Chapter 10 it is recommended that the freight rate adjustment requirement be amended.
- **Internet Information.** Two Declared Suppliers are not naming on their web sites the terminals in Victoria at which their TGPs apply.
- **Invoice Disclosure.** One Declared Supplier is disclosing the prescribed invoice information subsequent to the sale.
- **Shortfall Notifications.** Two Declared Suppliers did not lodge shortfall notifications during product shortages as they were unlikely to receive requests for spot sale at these times. In Chapter 10 it is recommended that the shortfall notification requirements be amended.

Chapter 7

Price Analysis

7.1 Introduction

The purpose of the analysis is to determine if there was any change in pricing behaviour, particularly at the wholesale level, associated with the introduction of the Act on 1 August 2001. This chapter provides the empirical base for that part of the assessment of the Act relating to wholesale and retail pricing behaviour in the Victorian automotive fuels market. (See Chapter 8)

7.2 Purpose and scope of analysis

The analysis examines automotive fuel prices over time at several stages in the supply chain:

- importation;
- wholesale; and
- retail.

It is important to note that only prices at the retail level are the prices at which transactions actually occur. Prices at the other stages are 'notional' prices. Prices at the import stage are calculated in abstract rather than on actual transactions by importers of fuel. Similarly, prices at the wholesale level are also only notional prices in the sense that neither published 'list' prices (prior to the Act) nor published TGP prices (after the Act) are necessarily actual transaction prices. Actual transaction prices at the import and wholesale level are not available due to the commercial confidentiality of such prices.⁴⁴ This is a fundamental constraint on the empirical analysis.

The period over which prices are analysed is 28 months from 1 August 2000 to 31 December 2002. This is referred to hereafter as 'the reference period'. The reference period is somewhat arbitrary. The starting point was selected on the basis that one year before 1 August 2001 preceded any consideration of the issues by Parliament and at least encompassed a complete cycle of any seasonal influences on pricing. The end date was the latest practically consistent with the preparation of the Report and also provided a full seasonal cycle after initial 'teething' problems in the day-to-day operation of the Act were resolved. Much of the analysis revolves around a comparison of prices before the Act came into effect with prices after the commencement of operation of the Act. As the Act came into effect on 1 August 2001, the 12 months period before that date is referred to as the 'pre-TGP reference period' and the 16 months period after that date is referred to as the 'post-TGP reference period'.

Although both diesel and petrol prices are considered in parts of the analysis, the analysis primarily focuses on prices for RULP given its dominance of sales of petrol (81 per cent of total sales) and larger volumes than diesel (about 20 per cent greater than sales of diesel).

⁴⁴ Section 10 of the Act, however, provides that the Director of Consumer Affairs, for the purposes of monitoring compliance with the Act, may require a Declared Supplier to supply written information 'relating to that business'.

7.3 Data sources, method and constraints

Data sources and methods and some constraints on the analysis are discussed below in relation to import prices, wholesale prices and retail prices.

[i] Landed international product prices (LIPP) benchmark

Petrol and diesel, and crude oil (the primary input into their manufacture), are internationally traded commodities. International prices for petrol, as with other commodities traded freely on the world market, are set by supply and demand factors rather than production costs. About 65 per cent of Australia's crude oil refinery input is from overseas sources. Petrol imports during 2001-02 comprised 7.7 per cent of total sales in Australia, while the corresponding figure for diesel imports was 9.5 per cent. The bulk of these imports are by the Oil Majors to supply areas where refineries do not exist, such as the Northern Territory, and to meet their own needs in supplementing refinery production. Imports by companies other than the Oil Majors amounted to 5.6 per cent of total petrol sales and 1.8 per cent of total diesel sales.⁴⁵ Australian prices for domestically-sourced crude oil and fuels refined from it are closely linked to international prices because imported product is a significant part of the market and domestic producers have the option of exporting their product at world prices or selling it locally. (See *Appendix D*.)

Thus, the prices at which automotive fuels can be imported into Australia provides a useful reference point for assessing domestic prices. The estimation of import parity prices is central to the price analysis because it provides a benchmark for observing wholesale and retail price movements over time and a base for estimating (notional) margins to fuel suppliers at various stages in the supply chain.

The import parity prices used in the analysis were estimated by EEA from proprietary data subscription sources. The broad components of the landed international product price adopted for petroleum product 'A' in the analysis are:

Import parity = Product A Singapore spot price + freight + insurance + wharfage

This formula provides an estimation of prices at which product could be imported into Melbourne up to the point where an importer would incur any costs involved in unloading and storing product at a terminal ready for distribution into the Victorian market, that is, terminal costs and margins are *not* included in the import parity price.

As the import parity estimation is used as a reference base for the purposes of our analysis of wholesale and retail prices and notional margins received by suppliers, Commonwealth excise levied on petroleum products (currently 38.143 cents per litre) net of the Victoria subsidy of 0.429 cpl for petrol and 0.751 cpl for diesel is added to the import parity estimates to provide a landed international product price referred to as the 'LIPP benchmark'. Thus:

LIPP benchmark ⁴⁶ = import parity price + (excise – State subsidy)

[ii] Wholesale prices

Data on daily wholesale prices were sourced directly from the Oil Majors and Trafigura. Wholesale prices are those prices described as such and published by these companies. Prior to 1 August 2001 these prices were comprised on the landed international product price, a terminal margin, excise, post terminal distribution and marketing margin and GST. Three of the Oil Majors referred to this price as a 'TGP'.

⁴⁵ Department of Industry, Technology and Resources, Canberra, November 2002, '*Petrol Fact Sheet*' and '*Diesel Fact Sheet*'.

⁴⁶ Where the acronym LIPP is used in Chapters 7 and 8, it is used as an abbreviation for the LIPP benchmark.

Wholesale prices after 1 August 2001 are the TGP's published in accordance with the Act and exclude any charges for services provided beyond the terminal gate. (The calculation of TGP's in accordance with the Act is described in detail in Chapter 2.4). As the prices are not necessarily the prices at which actual transactions occurred, they must be treated as notional prices only. Prices are exclusive of the imposition of the GST.

[iii] Retail prices

Data on retail prices was obtained from Informed Sources which is a specialist market information company. The data is obtained in relation to a large sample of retail outlets on a daily basis by Informed Sources. The price recorded is the price displayed on pumps and price display boards at retail automotive fuel outlets. Prices at the retail level are thus the prices at which actual transactions occur, although GST has been excluded to show only the amount available to the supplier (as one eleventh of the transaction price is payable to the Australian Taxation Office as GST).⁴⁷

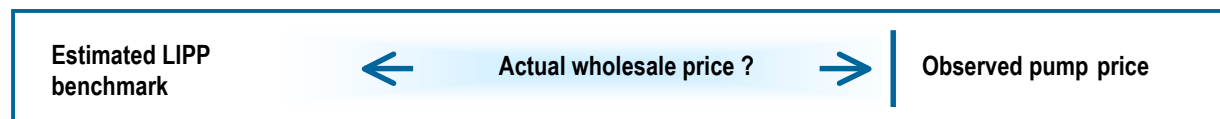
[iv] Notional margins – wholesale/terminal and industry

The price data described above is also used to calculate 'notional margins' applying at the various stages of the supply chain. The notional margin is simply the difference between prices at two stages of supply and is a 'gross' margin in the sense that it would incorporate both the operating costs and any profit of operators at the downstream stage of supply in the particular comparison. The notional margins are defined below:

- notional wholesale margin = 'wholesale' price (*pre*-TGP period) – LIPP benchmark;
- notional terminal margin = TGP (*post*-TGP period) – LIPP benchmark;
- notional industry margin = Retail price – LIPP benchmark.

The analysis of margins focuses on the notional industry margin (NIM) because the retail price is a transaction price and there is at least an objective basis to the LIPP benchmark, although it is still a notional price. The other price margin definitions do not contain any transaction prices. CAV has no information about actual transaction wholesale prices in either the pre- or post-TGP periods. Actual wholesale prices over time are most likely to be located at some point along a continuum between retail prices and LIPPs. There may be short periods where they may be above retail prices or below the LIPP. This uncertainty about actual wholesale prices can be represented diagrammatically as below.

The calculations of margins in this chapter compare the TGP's on a particular day with the LIPP estimated for the same day. CAV understands that in practice the LIPP on which the Declared Suppliers determine their TGP's is a rolling average of LIPPs over the seven days preceding the day on which the TGP is determined. Notional terminal margins were also calculated on this basis and the trends apparent from an analysis on that basis do not significantly differ from those presented in this chapter.



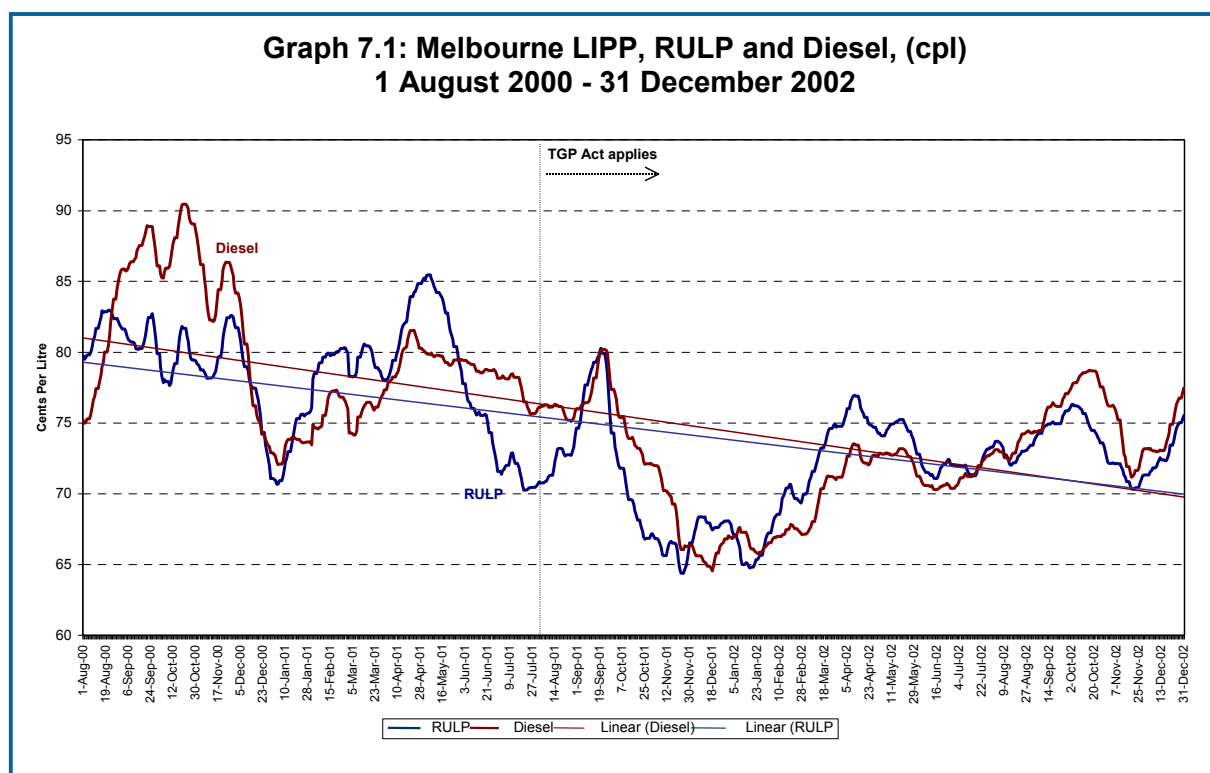
⁴⁷ Except in the case of Woolworths/Safeway operated outlets where customers with discount vouchers (obtained through purchases at the same company's supermarket outlets) buy at a price lower than the displayed pump price.

7.4 Wholesale prices

7.4.1 Import parity benchmark prices (LIPPs)

Graph 7.1 plots the RULP and diesel LIPP Benchmarks for Melbourne (including excise⁴⁸) expressed in cents per litre ('cpl') estimated on a daily basis over the period 1 August 2000 to 31 December 2002. Prices are exclusive of GST. The graph shows RULP price levels fluctuating around a downward trendline until early/mid 2002. A substantial price range of about 21 cpl, or 33 per cent of the lowest price in the period, is evident. The highest was 85.4 cpl on 5 May 2001 and the lowest price was 64.4 cpl on 25 November 2001. At the end of the period the RULP LIPP was about 75 cents per litre made up of about 37.3 cpl imported product price and 37.7 cpl net excise.

The graph also shows the diesel price levels fluctuating around a slightly steeper downward trendline until early/mid 2002. A substantial range of nearly 26 cpl, or 40 per cent of the lowest price in the period, is evident. The highest was 91.2 cpl on 22 October 2000 and the lowest price was 65.3 cpl on 18 December 2001. At the end of the period the diesel LIPP was about 77 cents per litre made up of 40 cpl imported product price and 37.4 cpl net excise. While the date of the introduction of the Act is marked in Graph 6.1 for completeness, one would not expect the pattern of the prices of an internationally traded commodity to vary because of a legislative enactment in Victoria and the graph does not suggest that.



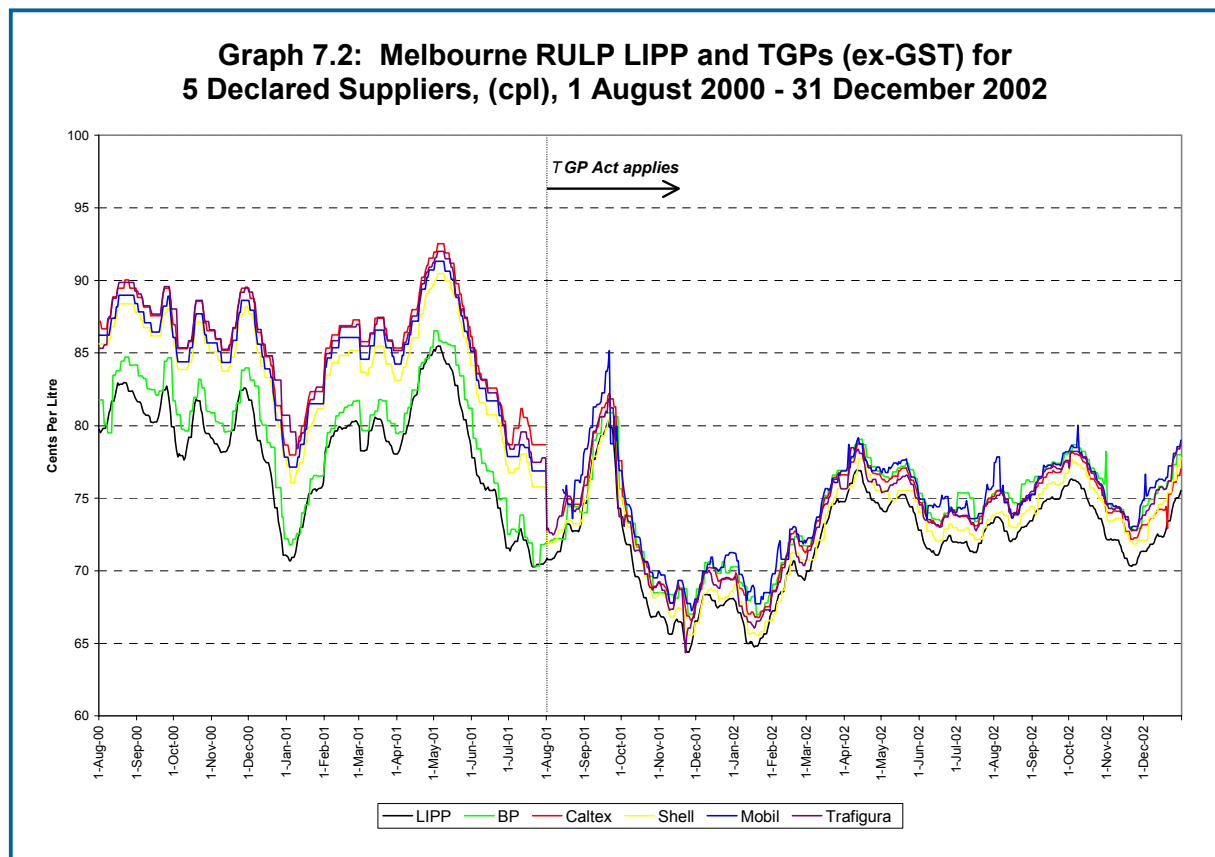
⁴⁸ The excise incorporated in the graphs of LIPPs is a 'net excise' calculated by deducting the relevant State subsidy amount paid to suppliers collecting excise from the applicable Commonwealth excise amount.

7.4.2 Wholesale/terminal gate prices and LIPPs

[i] RULP

For each of the five suppliers declared under the Act, **Graph 7.2** plots the RULP wholesale prices in the pre-TGP reference period and the published TGPs of the same suppliers in the post-TGP reference period. Prices are exclusive of GST. The significant features of this part of the graph are:

- a significant step-change reduction in published wholesale prices by four of the five suppliers (Mobil, Caltex, Shell and Trafigura) on the introduction of the Act;
- a narrower range of five Declared Supplier's prices in the post-TGP reference period compared to the more dispersed pattern in the pre-TGP period where BP's price was consistently substantially below the others; and
- the tendency in the post-TGP period for Shell's TGP to be consistently lower than the other suppliers' TGPs.



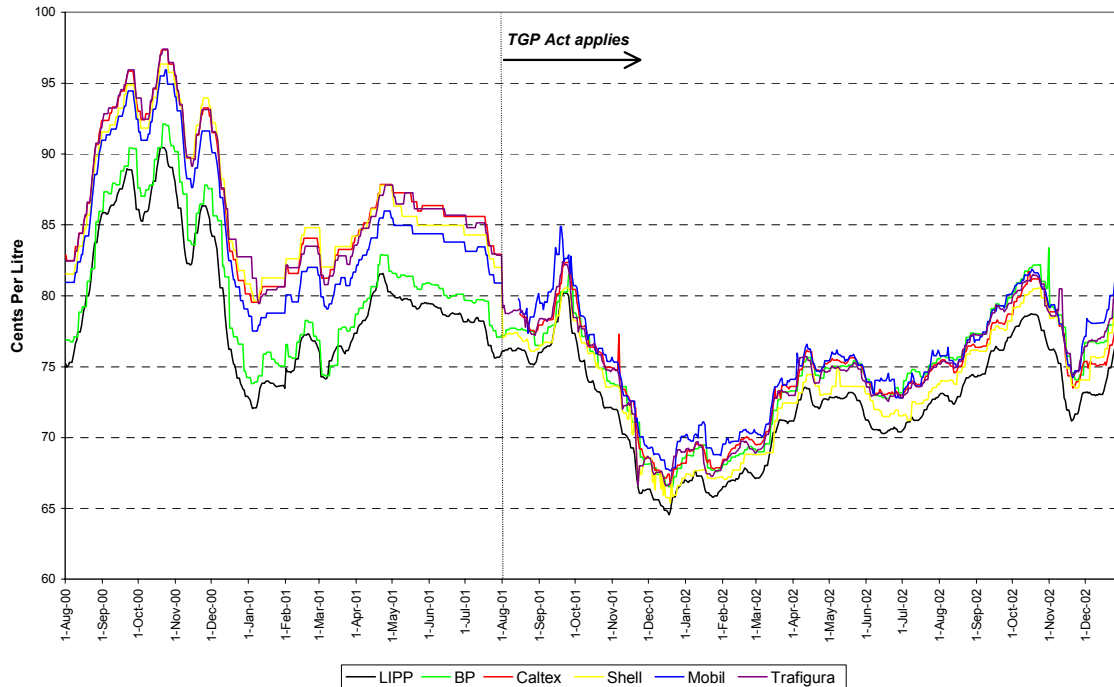
[ii] Diesel

For each of the five Declared Suppliers, **Graph 7.3** plots the diesel wholesale prices in the pre-TGP reference period and the published TGPs of the same suppliers in the post-TGP reference period. Prices are exclusive of GST. The significant features of this part of the graph are essentially a mirror of RULP in Graph 7.2:

- a significant step-change reduction in published wholesale diesel prices by four of the five suppliers (Mobil, Caltex, Shell and Trafigura) on the introduction of the Act;
- a narrower range of all five suppliers' prices in the post-TGP reference period compared to the more dispersed pattern in the pre-TGP period where BP's price was consistently significantly below the others; and

- the tendency in the post-TGP period for Shell's TGP to be consistently lower than the other suppliers' TGPs.

Graph 7.3: Melbourne Diesel LIPP and TGPs (ex-GST) for 5 Declared Suppliers (cpl), 1 August 2000 - 31 December 2002



7.4.3 Implied notional terminal margins

Graphs 7.2 and 7.3 also plot LIPP benchmarks in addition to TGPs for RULP and diesel. The difference between the average of the five Declared Suppliers' TGPs and the LIPP benchmark is the average notional wholesale margin (pre-TGP) or notional terminal margin (post-TGP). **Graph 7.4** plots the average notional margins calculated in this way for both RULP and diesel.

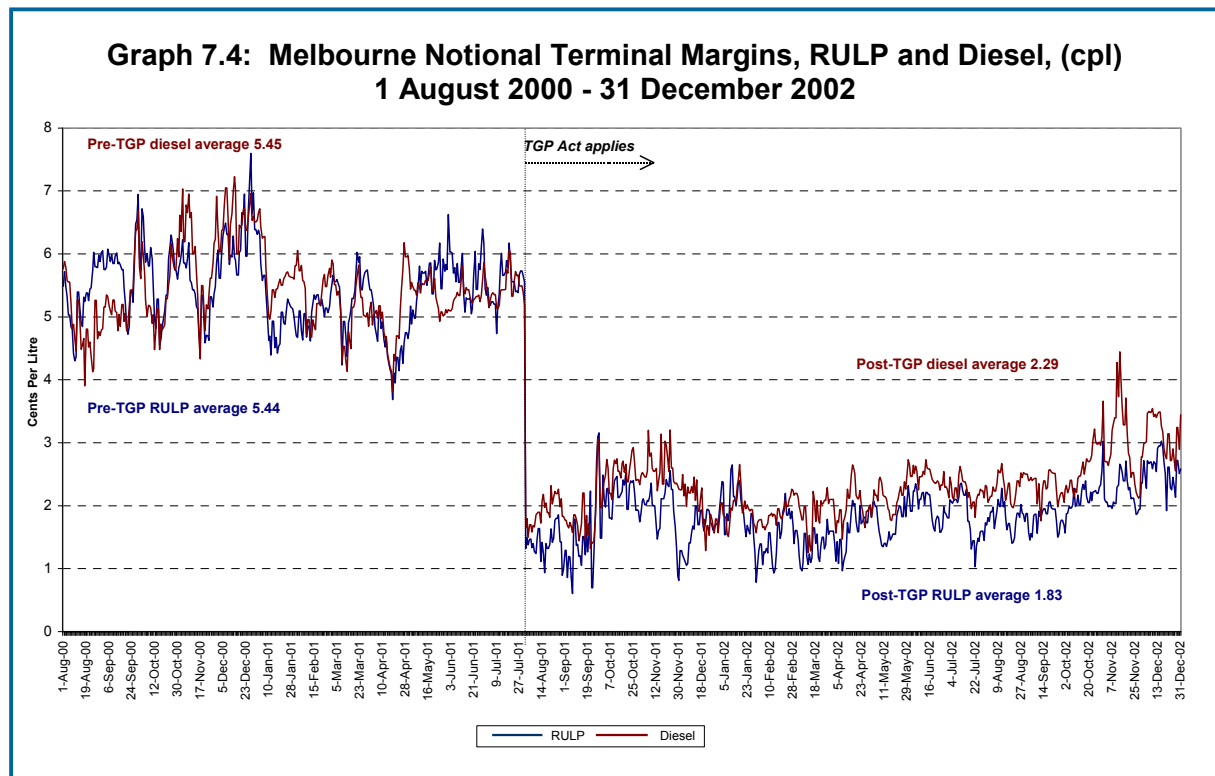
[i] RULP

The feature of Graph 7.4 is the marked downward shift in the notional margin line on the introduction of the Act on 1 August 2001. Over the pre-TGP reference period the average notional margin was 5.4 cpl. This fell by about 4.2 cpl on the day of the commencement of the Act and the average over the post-TGP reference period was 1.8 cpl. The average masks the differing changes in notional margins of individual Declared Suppliers. When comparing margins immediately before and after the introduction of the Act, the notional margins decreased by 6.5 cpl for Caltex, 4.2 cpl for Shell, 2.9 cpl for Mobil and 5.2 cpl for Trafigura. In contrast, BP's notional margin fell by only 0.2 cpl.

[ii] Diesel

Similarly for diesel, the feature of Graph 7.4 is the marked downward shift in the notional margin line on the introduction of the Act, although the magnitudes of the changes are smaller than for RULP. Over the pre-TGP reference period the average notional margin was 5.5 cpl. This fell by about 3.4 cpl on the day of the commencement of the Act and the average over the post-TGP reference period was 2.3 cpl. The average for diesel also masks the divergent positions of individual suppliers. When comparing margins immediately before

and after the introduction of the Act, the notional margins decreased by 4.4 cpl for Caltex, 5.1 cpl for Shell, 1.4 cpl for Mobil and 3.9 cpl for Trafigura. Similar to the RULP situation, BP's notional margin was basically unchanged.



[iii] Post-TGP period

Graph 7.4 suggests a slightly increasing notional terminal margin for both RULP and diesel over the post-TGP reference period. The average notional margin for RULP of the five Declared Suppliers in the December quarter 2002 was 2.3 cpl compared to 1.9 cpl in the same quarter of 2001. Notional RULP margins appear to rise a little faster towards 3 cpl from November 2002. In the post-TGP period, Shell's TGPs for both diesel and RULP were generally the lowest *published*. For example, on average over the period it was about 1.7 cpl less for RULP than Mobil's published TGP that was often the highest. (Of the five Declared Suppliers, Shell and Mobil are the only operators of refineries in Victoria.) Shell's *apparent* lower pricing could be explained by varying discounts offered by the Declared Suppliers off posted TGPs. Actual transaction wholesale prices of the other suppliers are most likely closer to Shell's prices than their published TGPs suggest.

As noted in Section 7.3 above, little significance should be attached to these notional margins due to the lack of data on actual transaction prices. It is most unlikely that actual margins of suppliers at the terminal stage decreased by the amounts indicated in the estimation of notional margins.

7.5 Victorian retail prices

Unlike LIPP benchmarks and wholesale product prices, data on retail prices reveals actual transaction prices. Retail prices can be examined in a number of ways. The major variables of concern in CAV's retail price analysis are those where a change in pricing at the wholesale stage of supply (the focus of the Act) would be likely to have a significant effect on retail

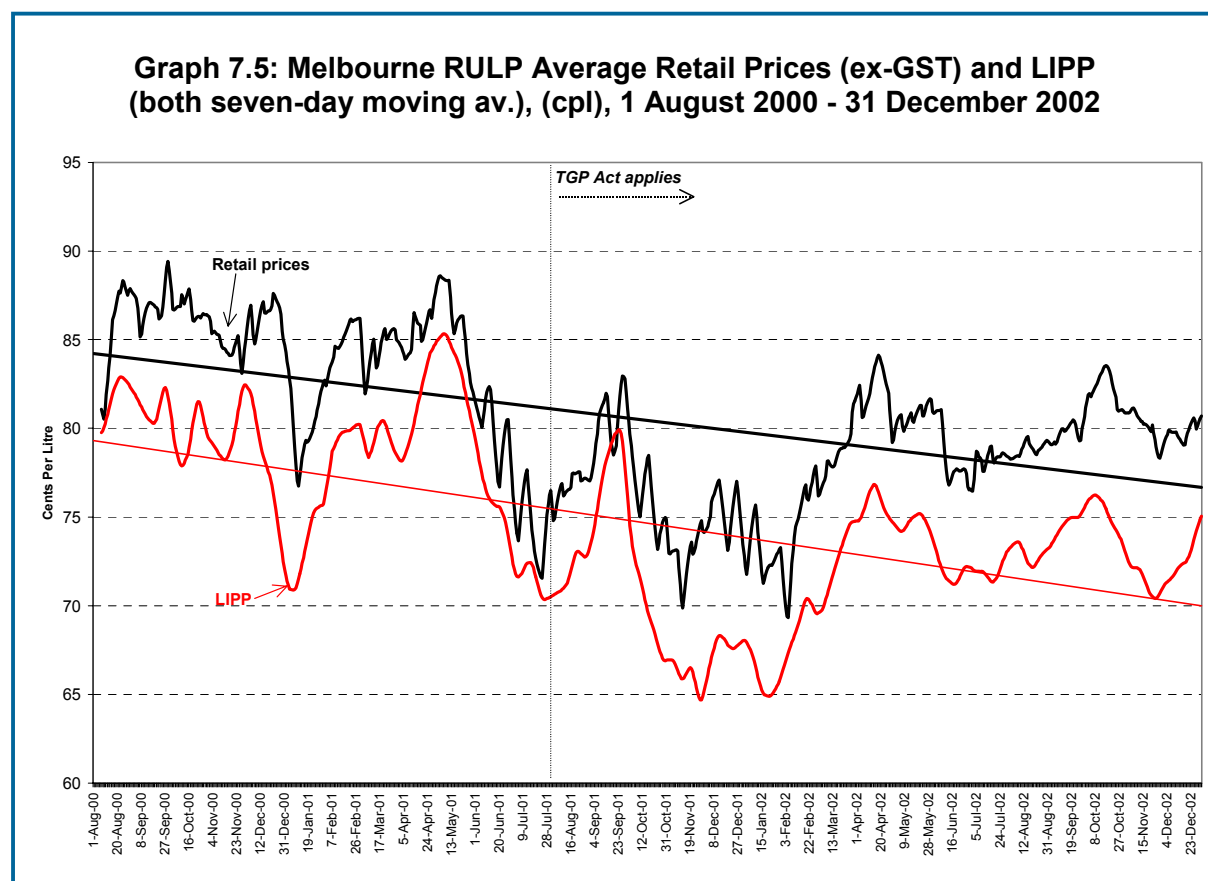
pricing. Thus, the retailer's 'supplier status' (whether Oil Major controlled/branded or independent) and geographical location (whether metropolitan Melbourne or country) are of most interest. Before examining retail prices reflecting these characteristics, price movements in the Melbourne market as a whole are considered.

7.5.1 Metropolitan market as a whole

[i] RULP

Graph 7.5 plots average daily retail RULP prices in metropolitan Melbourne on a seven-day moving average basis. Prices are exclusive of GST. The effect of Melbourne's typically seven-day discount cycle on daily NIMs is 'smoothed' out by calculating a seven-day moving average series and, for consistency, this is also applied to LIPP data. (This smoothing technique is also applied to RULP data for the other capital cities for consistency in Section 7.7 below.)

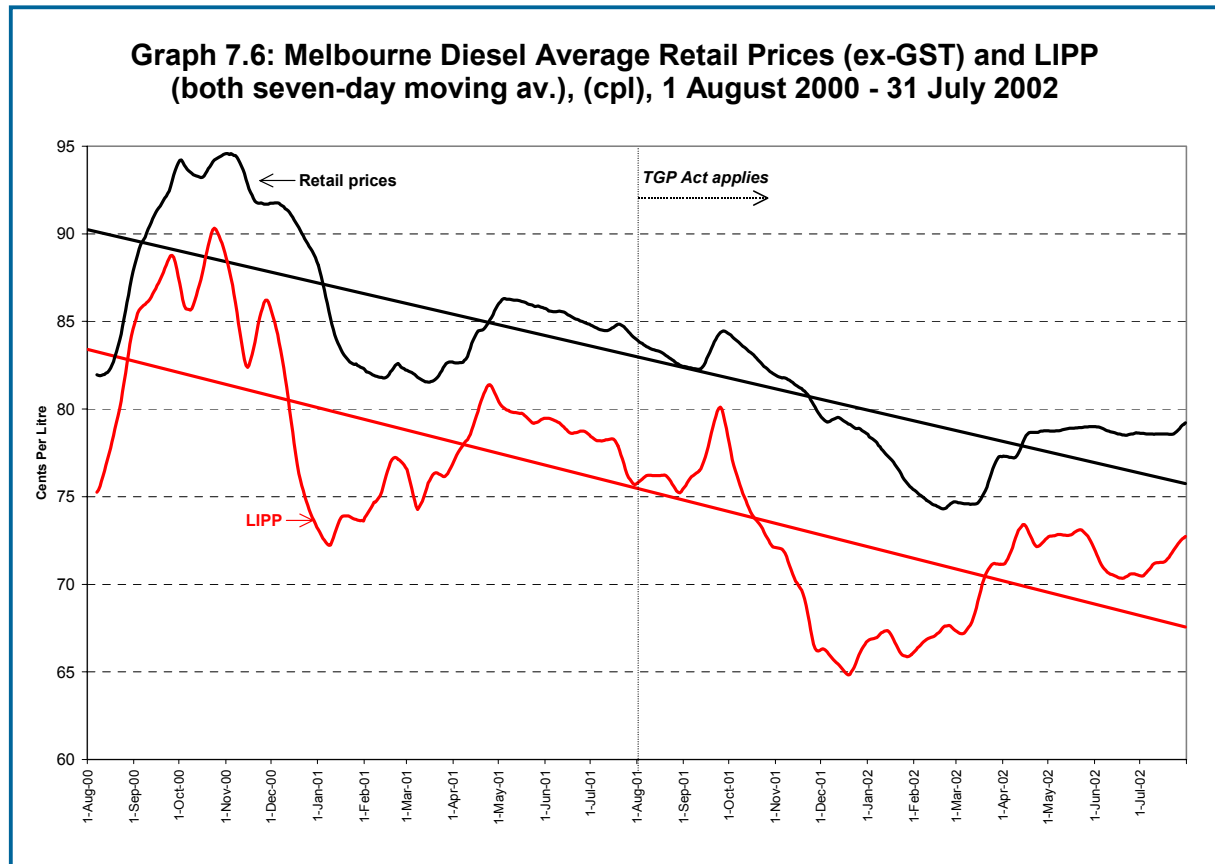
Average retail prices generally track the LIPP benchmark (from Graph 6.1). Retail prices over the reference period fluctuated, sometimes sharply, around a decreasing trend until around early 2002 when prices began to rise following a substantial rise in the LIPP. The graph suggests a widening of the difference between the two lines (the notional industry margin) from about October/November 2001. This is explored further in Section 7.6 below.



[ii] Diesel

Due to the significant diesel volume sold under contract prices unrelated to the service station board price, the diesel retail price data should be treated with caution. **Graph 7.6** plots average daily retail diesel prices in metropolitan Melbourne on a seven-day moving average basis mainly for consistency of presentation with Graph 7.5 as weekly price cycles are less a feature of diesel pricing. Prices are exclusive of GST. Average retail diesel prices

also generally track the LIPP benchmark. Retail prices over the reference period fluctuated around a decreasing trend until March 2002 when prices began to rise following a substantial rise in the LIPP. The graph indicates a significantly varying difference between the two lines over the reference period. This is explored further in Section 7.6 below.



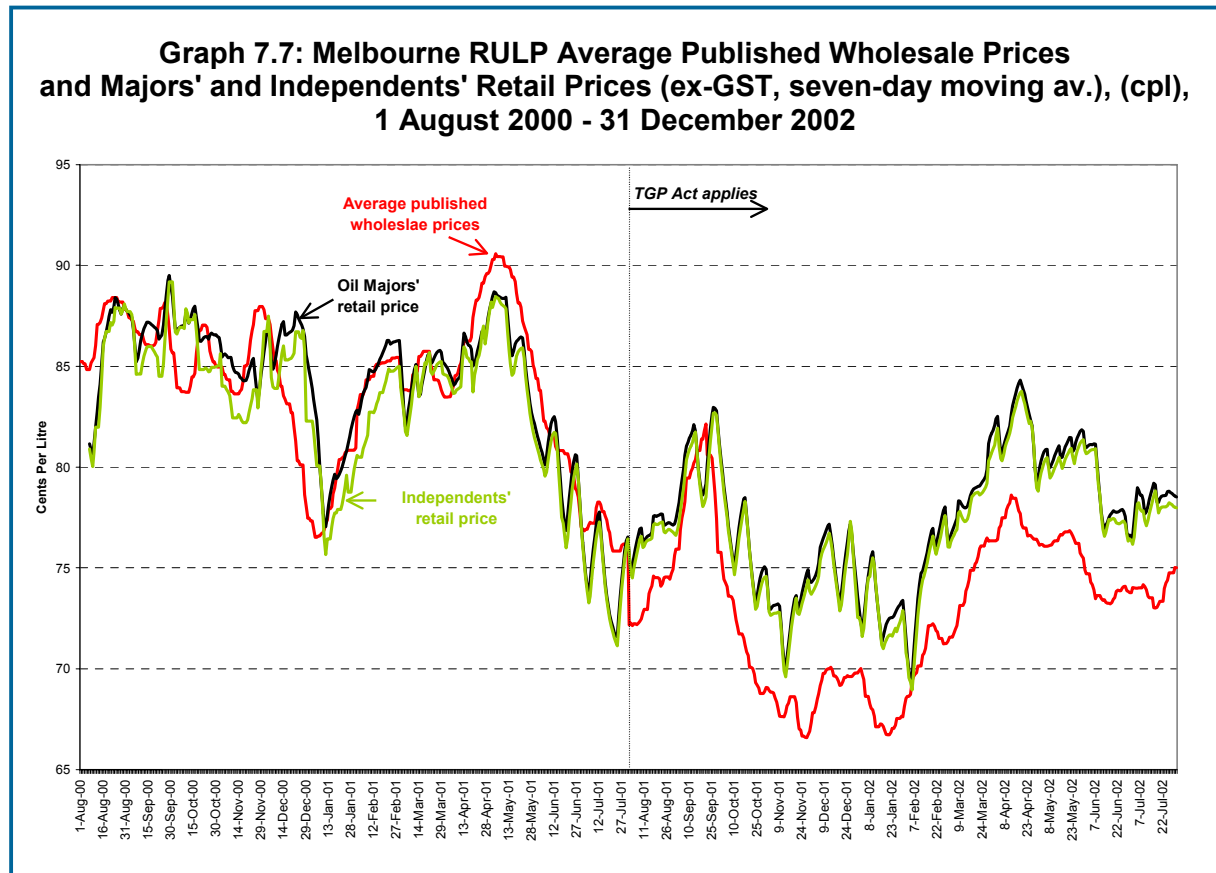
7.5.2 RULP 'majors versus Independents' price differences

Graph 7.7 plots average retail RULP prices of metropolitan outlets with a brand of one of the Oil Majors and the average retail prices of outlets with an independent reseller brand. The period of retail price data differentiating between prices of the majors and Independents ends at 31 July 2002. The graph also plots the average of published wholesale RULP prices of the five Declared Suppliers.

The key features of the graph over the period 1 August 2000 to 31 July 2002 are:

- average retail prices of the Oil Majors and the Independents *broadly* moved very closely together, but where they moved differently the Independents' prices were consistently lower;
- in the period between September 2000 and May 2001 there were frequent periods when the Independents' prices were below the Oil Majors', but after mid-2001 the two categories of prices exhibit closer alignment;
- the marked change in the relationship between average published wholesale prices and average retail prices prior to the Act compared to after (published wholesale prices were *above* retail prices for substantial periods of time pre-TGP, but in the post-TGP period were nearly always below retail except for one very brief period); and
- the step-change in published wholesale prices on 1 August 2001 evident in Graph 6.2 is not evident in retail prices.

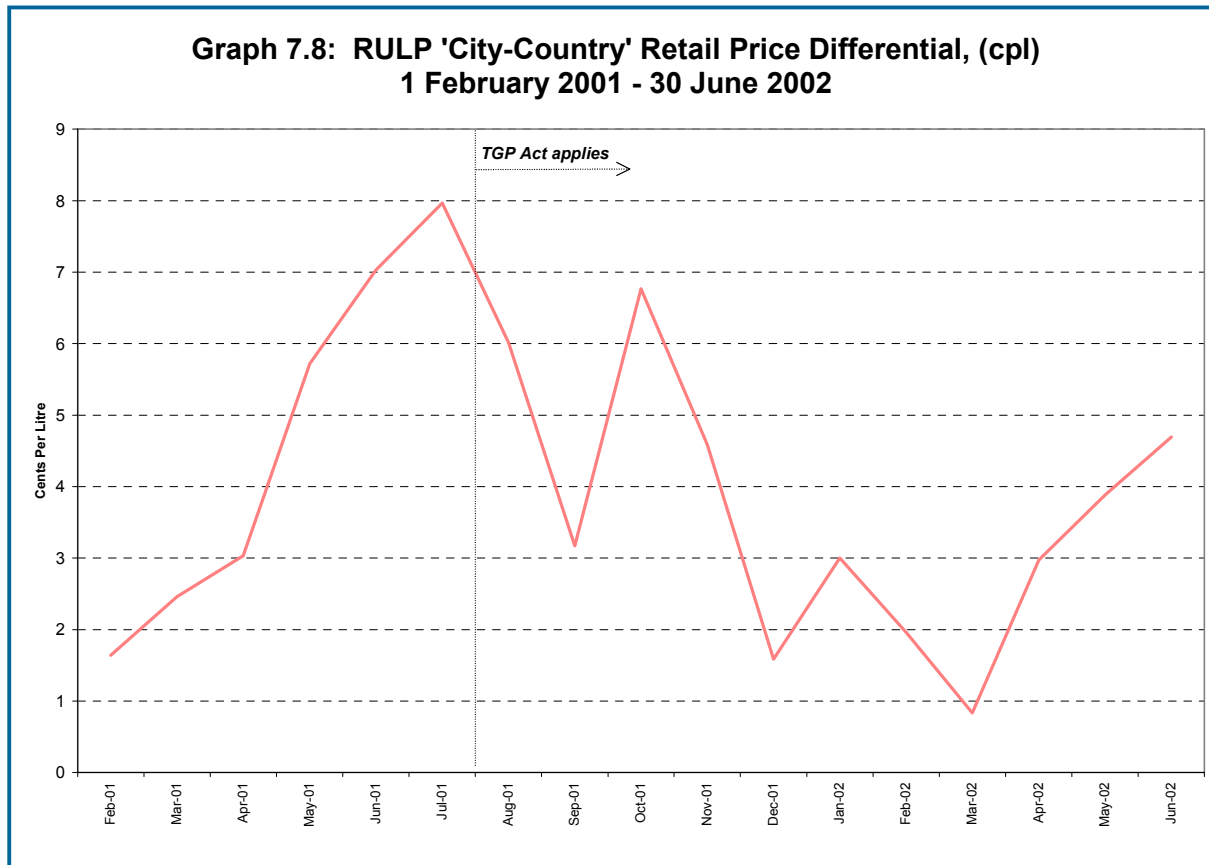
The last point suggests that the introduction of the Act did not result in a change in actual transacted wholesale prices between terminal operators and Independents and is consistent with the comment in Section 7.4 above that it is most unlikely that actual margins of suppliers at the terminal stage decreased by the amounts indicated in the estimation of notional margins.



7.5.3 Country and city-country differential

In addition to daily average RULP retail prices in metropolitan Melbourne, data was also obtained regarding average RULP retail prices in a sample of 11 major towns across Victoria on a monthly basis. The towns in the sample were Ararat, Bairnsdale, Ballarat, Benalla, Bendigo, Echuca, Korumburra, Mildura, Seymour, Warrnambool and Wodonga. Prices in these towns were then averaged across all 11 towns to give a 'country' average for the purposes of comparison with Melbourne 'city' prices. The period covered in the country data was February 2001 to June 2002: six months prior to the introduction of the Act and ten months of its operation. This is a relatively short period so not too much weight should be placed on conclusions drawn from the analysis.

Graph 7.8 plots the difference between average monthly RULP city and country prices (as defined) from February 2001 to June 2002. The difference is calculated as 'country price minus city price', thus a value above zero means that the country price is higher. The differential decreased from an average of 4.6 cpl over the six months leading up to the Act's introduction to an average of 3.6 cpl over the ten months from August 2001. It should be noted that city-country differentials vary significantly from month to month so that longer-term data would be more instructive. An obvious question is whether the differential decreased in the period because city prices 'rose' or country prices 'fell' (or some combination of both). Reference needs to be made to the LIPP benchmark and estimated notional industry margins to address this question. This is done in Section 7.6.3 below.



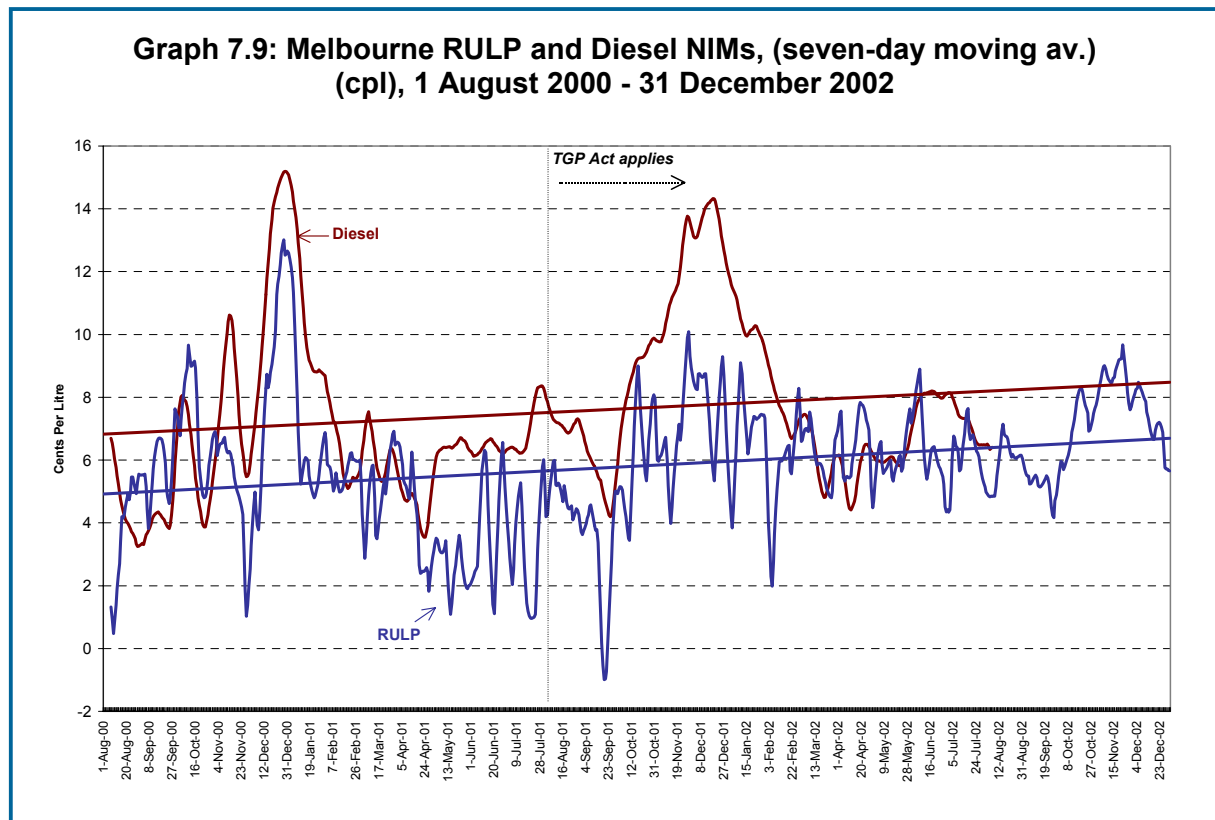
7.6 Notional industry margins in Victoria

The notional industry margin is defined as the retail price minus the LIPP benchmark of the same date. NIMs were also calculated using an LIPP benchmark based on a seven-day rolling average basis and the trends apparent from an analysis on that basis do not significantly differ from those presented in this section. NIM is a 'gross' margin reflecting the narrow non-product costs and profit margins of terminal operators, wholesalers, distributors and retailers.

Given the vertical integration of each of the Oil Majors through to retailing, some retail sales of fuel result in all of the profit notionally available at each stage of the chain being captured by a single entity. In contrast, the profit elements in retail sales through independent resellers could be taken by up to four separate entities - Oil Major, independent terminal operator, independent distributor and independent retailer. However, the Oil Majors clearly dominate the refinery/terminal stage and distribution stages of supply (taking into account the trend for Oil Majors to rationalise and acquire equity interests in distributors) and have a very significant share of retail sales through large-volume, directly-owned or commission agency sites and multi-site franchised operations in Melbourne. The actual splits between entities at the various supply stages cannot be estimated without transaction volume and price data.

7.6.1 Metropolitan market as a whole

Graph 7.9 plots the NIMs for RULP and diesel over the reference period, except that the data series for diesel retail prices ends at 31 July 2002 rather than 31 December 2002 as for RULP. Diesel NIMs are higher on average than RULP NIMs: 6.2 cpl compared to 5.8 cpl over the reference period. The graph shows marked fluctuations around an increasing general trend for both RULP and diesel. The peak NIMs for both fuels during the reference period were in the December-January months of each year.



The graph does not show a dramatic or exceptional movement (in the context of marked fluctuations over the whole period) in NIMs for either fuel immediately around the time of the introduction of the Act. **Table 7.1** below estimates average RULP and diesel metropolitan NIMs on a quarterly basis around the introduction of the Act. The NIMs for RULP and diesel in the first quarter of the Act's operation were not greatly out of line with margins in preceding quarters, although the second quarter saw margins increase further, particularly diesel NIMs. As noted above, peak margins in the total reference period were around the December-January period.

Table 7.1: Average Notional Industry Margins around the Introduction of the Act

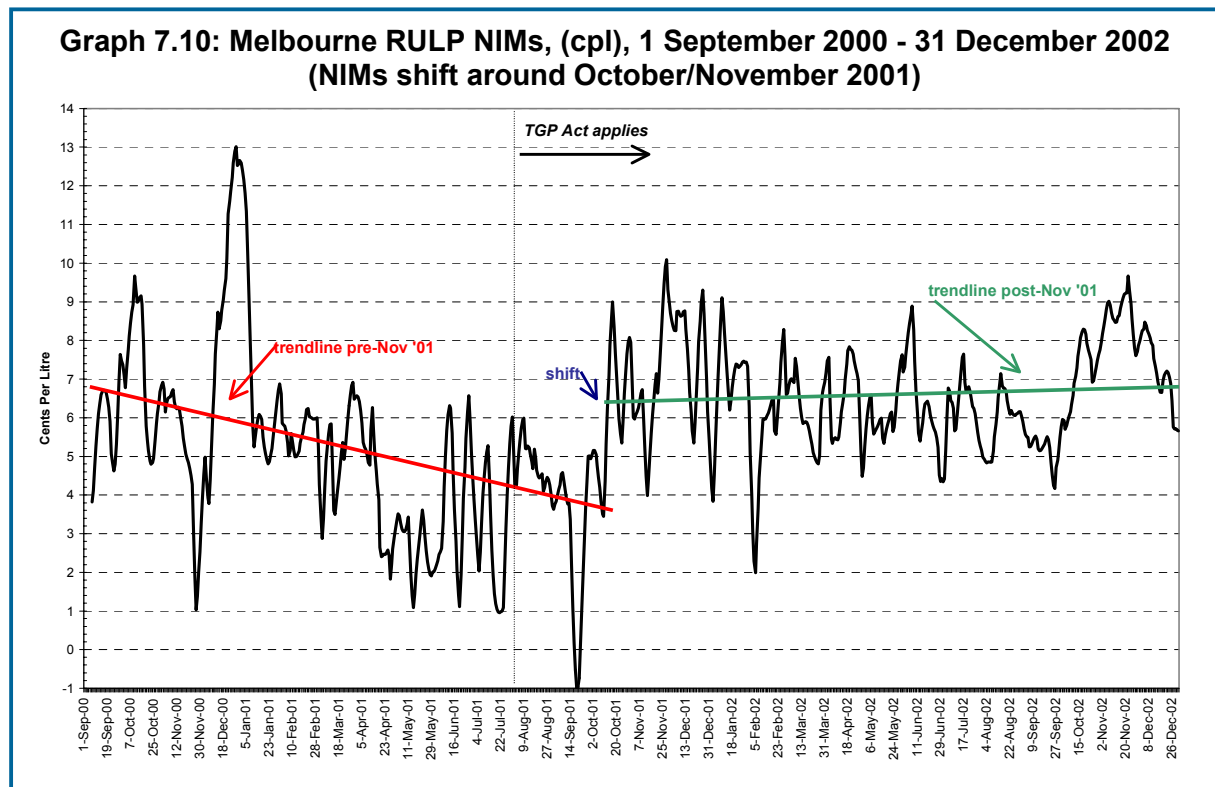
	Quarter	RULP NIM (cpl)	Diesel NIM (cpl)
<i>Pre-TGP</i>	Feb-Apr '01	4.9	5.6*
	May-Jul '01	3.6	6.7
<i>Post-TGP</i>	Aug-Oct '01	4.7	7.2
	Nov '01-Jan '02	7.1	11.8

* The diesel shortage in December-January 2001 led to higher margins in the following months.

However, for RULP a view over the whole reference period in Graph 7.9 suggests a change in the pattern of NIMs from about late October 2001:

- there was an upward shift (although still with fluctuations subsequently) of over 2 cpl around late October 2001 which was broadly sustained for the rest of the reference period; and
- although there were still significant fluctuations in NIMs after the upward shift around October 2001, these were of a lesser amplitude than over the preceding 14 months.

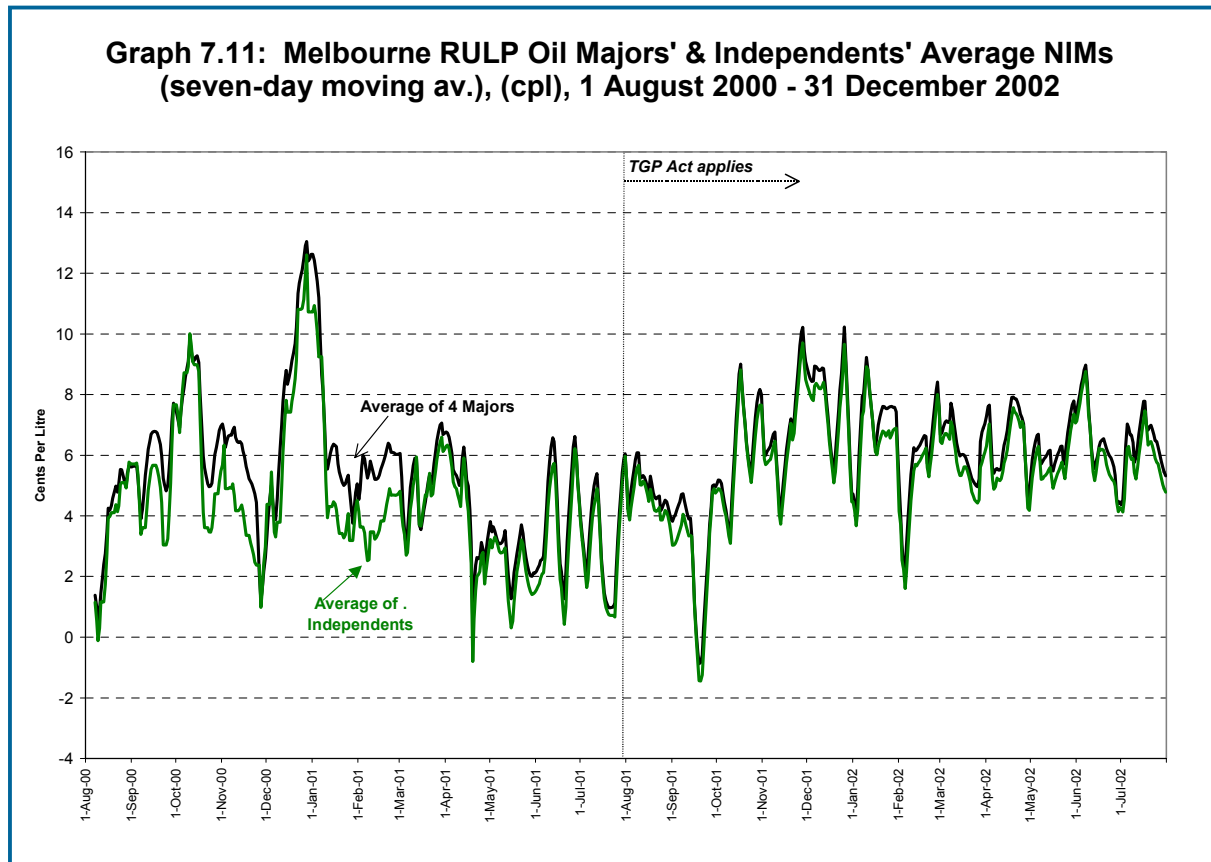
The upward shift in metropolitan RULP NIMs is highlighted by **Graph 7.10**. This plots NIMs averaged over the Melbourne metropolitan market over a 28 months period from 1 September 2000 to 31 December 2002: 14 months either side of the timing of the apparent shift in NIMs in Graph 7.9. Trendlines for the pre- and post-November 2001 periods are also displayed. The trendline in the former period is downwards; in the latter period slightly upwards. The average NIM over the whole 14 months up to November 2001 was 5.2 cpl and over the whole 14 months after November 2001 was 6.6 cpl – suggesting a lift of nearly 1½ cpl averaged over the reference period. NIMs in the latter period also display less extreme fluctuations than in the period before the shift.



7.6.2 'Oil Majors versus Independents' RULP metropolitan difference

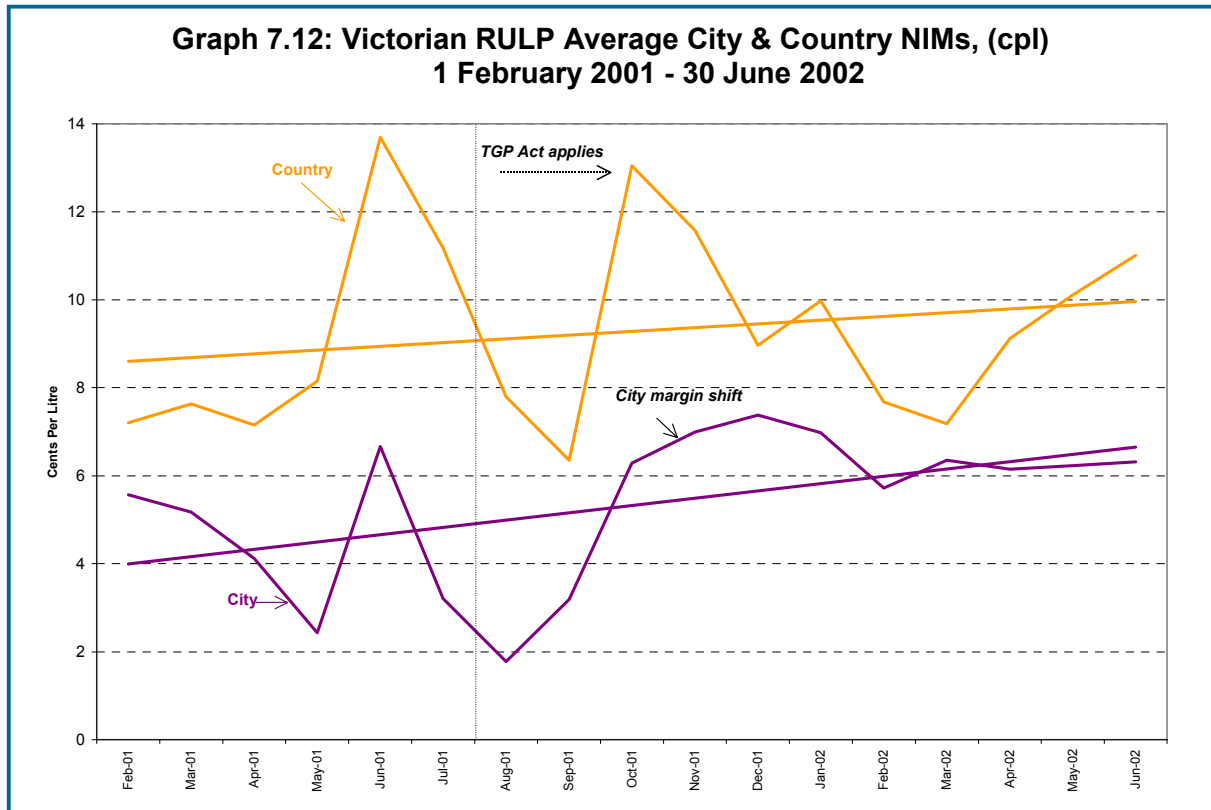
Graph 7.11 plots city RULP NIMs utilising two sets of retail prices: one averaged across the Oil Majors' branded outlets and the other averaged across Independents' outlets. The graph indicates that RULP sold through Oil Majors' outlets has higher NIMs on average than that sold through Independents' outlets. The average NIM over the reference period for RULP sold through Oil Majors' branded outlets was about 5.7 cpl and about 5.0 cpl for fuel sold at Independents' outlets. NIMs for the two categories broadly track closely together, except for occasional periods where the average NIM at Independents' outlets falls below the average of the Oil Majors' outlets for varying periods. From around March/April 2001 the falls appear to be of lesser magnitude (that is, the reduction in Independents' NIMs relative to the Oil Majors' is less) and of shorter duration. The most sustained periods where Independents' NIMs were below the Oil Majors' were from approximately late October to early December 2000 and early January to end of February 2001. (For smaller volume automotive fuel products (LRP and PULP), average NIMs of the Oil Majors' retail outlets were lower than those of Independents' outlets.)

There is no discernible change in the pattern immediately around and following the introduction of the Act. The lift in NIMs identified in the Melbourne market as a whole is clearly evident for both Oil Majors' and Independents' average NIMs.



7.6.3 City-country price differentials and NIMs

By relating average country and city retail prices to the LIPP benchmark it appears that the city-country price differential decreased over the February 2001 to June 2002 period mainly because city NIMs rose relative to country NIMs. **Graph 7.12** plots notional industry margins implied by average country and city prices. While average NIMs in both locations were trending upwards, city NIMs increased more. In the six months pre-TGP, country NIMs averaged 9.2 cpl; in the post-TGP period that had increased only slightly to 9.3 cpl. In contrast city average NIMs increased from 4.5 cpl pre-TGP to 5.8 cpl in the post-TGP period. Graph 7.12 also highlights that the upward shift in city NIMs occurred from October/November 2001 to be consistently close to or over 6 cpl in the period to June 2002.



7.7 Interstate comparison of NIMs

The most marked feature of the prices and margins analysis is the lift in notional industry margins on RULP sold in the metropolitan Melbourne market that occurred around October/November 2001. Before any causal relationship between the Act and industry margin rises can be hypothesised, it is useful to examine NIMs in the other major metropolitan RULP fuel markets to determine if this development was unique to the Melbourne RULP market and perhaps *potentially* related in some way to Victoria's TGP regime.

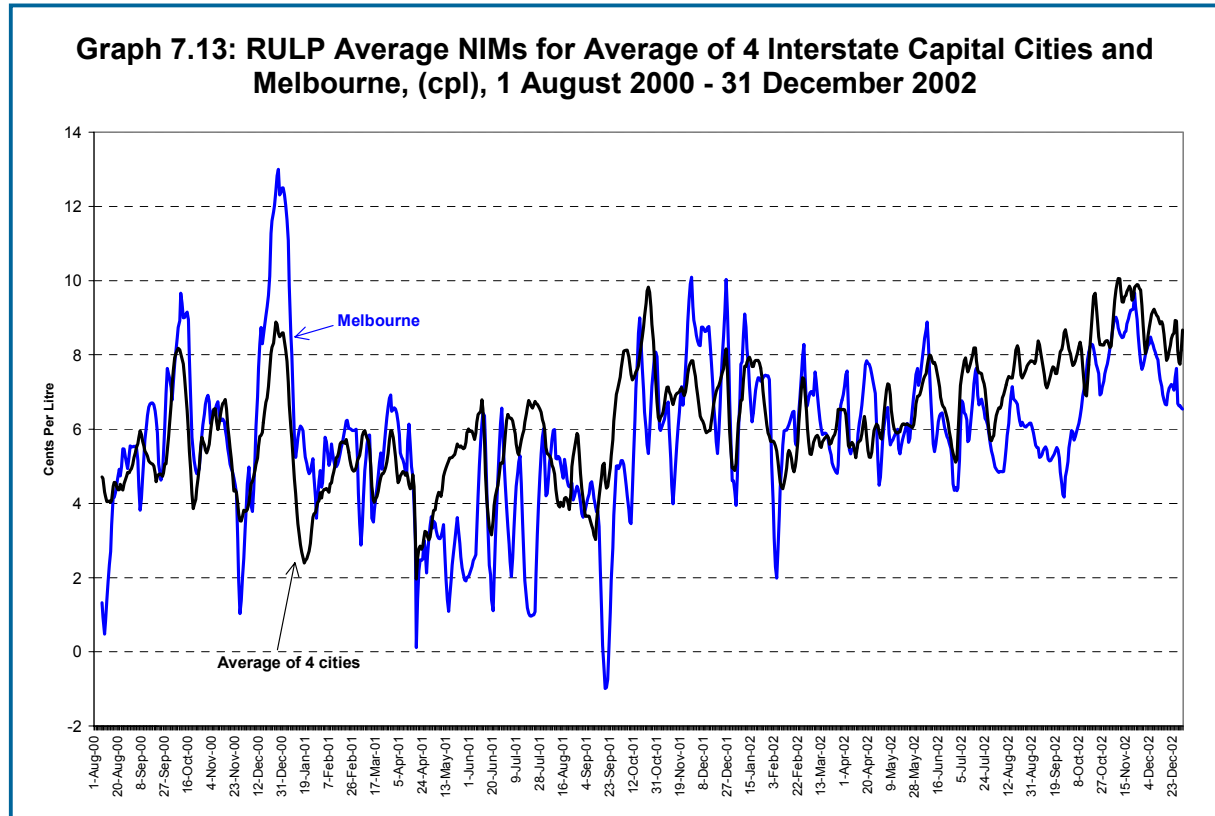
Accordingly, RULP, LIPP and retail prices data were obtained for four other capital cities: Sydney, Brisbane, Perth and Adelaide. NIMs were calculated for each capital city. The same data definitions apply as for the Melbourne calculations. Data was available for the same analysis reference period, that is 1 August 2000 to 31 December 2002. New South Wales, Queensland and South Australia do not have legislated TGP regimes. Western Australia had a legislated TGP regime with significant differences to Victoria's.⁴⁹

The average NIMs in each of the four interstate capital cities were calculated and then averaged to provide the 'average of 4 cities' NIMs.⁵⁰ This is plotted against the Melbourne average NIMs for the same period in **Graph 7.13**. While the graph indicates some differences between Melbourne and the average of the interstate cities – Melbourne has

⁴⁹ Between April 2001 and December 2002 the Western Australian Government set on a daily basis a maximum wholesale price (WMP) for RULP. The formula used to set the MWP was based on the landed international product price.

⁵⁰ The average is the simple arithmetic mean of data for the four cities. Data is not weighted by volumes of RULP sold at retail in each metropolitan market.

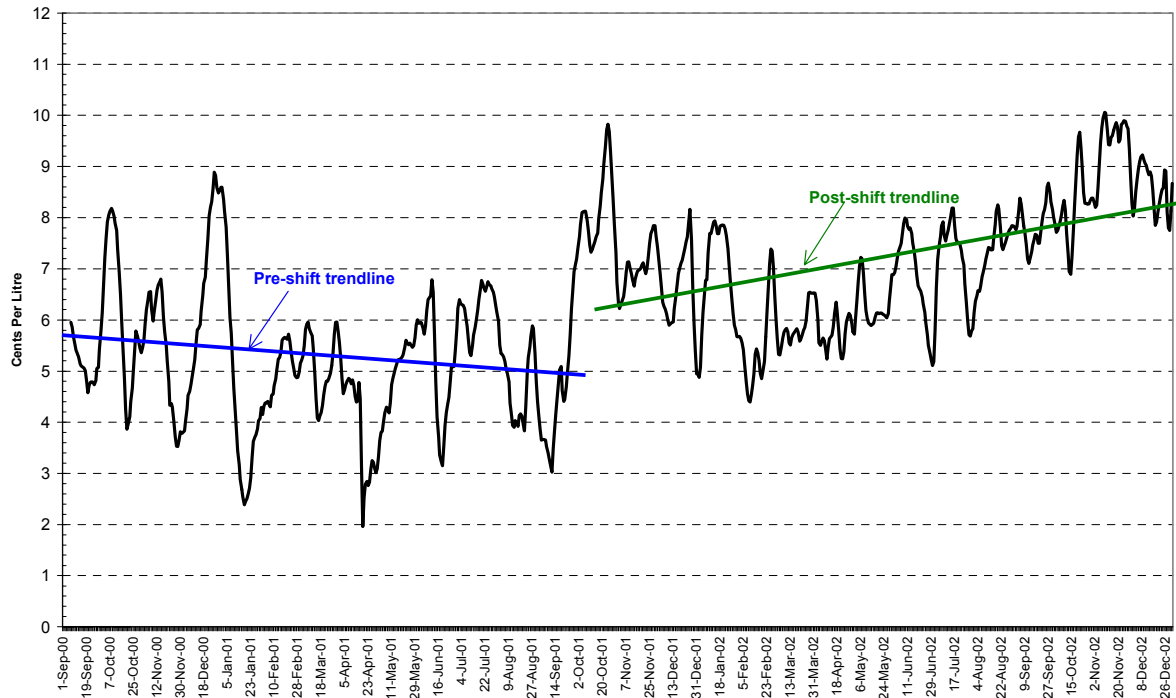
more pronounced peaks and troughs and tends to have lower NIMs than the average of the other cities (5.8 cpl compared to 6.2 cpl) – the average of the four cities also shows a sustained rise in NIMs roughly similar to Melbourne's. The shift occurs slightly earlier than in Melbourne, from around early October 2001.



Graph 7.14 applies the trendline analysis of Melbourne NIMs in Graph 7.10 to the average of the four cities' NIMs shown in Graph 7.13. This indicates a sharper initial lift that then settles back partially and results in a shift of the order of 2 cpl over about a month and a half. The four cities' average NIMs rose by more than Melbourne's through 2002.

NIMS for each of the four cities are plotted individually in *Appendix C*. This confirms that RULP NIMs in each of the four cities moved upwards, by varying extents, from around October 2001 and tended to be sustained at higher levels through to the end of 2002. Thus the average is not distorted by extreme values in only one city's data. **Graph 7.15** focuses on the period from mid-August to mid-November 2001 to highlight the upward movement in NIMs in each of the four cities around early October 2001.

Graph 7.14: RULP Average of 4 Interstate Capital Cities NIMs, (cpl)
1 September 2000 - 31 December 2002
(NIMs shift around mid-October 2001)



Graph 7.15: RULP 4 Interstate Capital Cities' NIMs
(seven-day moving av.), (cpl), over mid-Aug to mid-Nov 2001

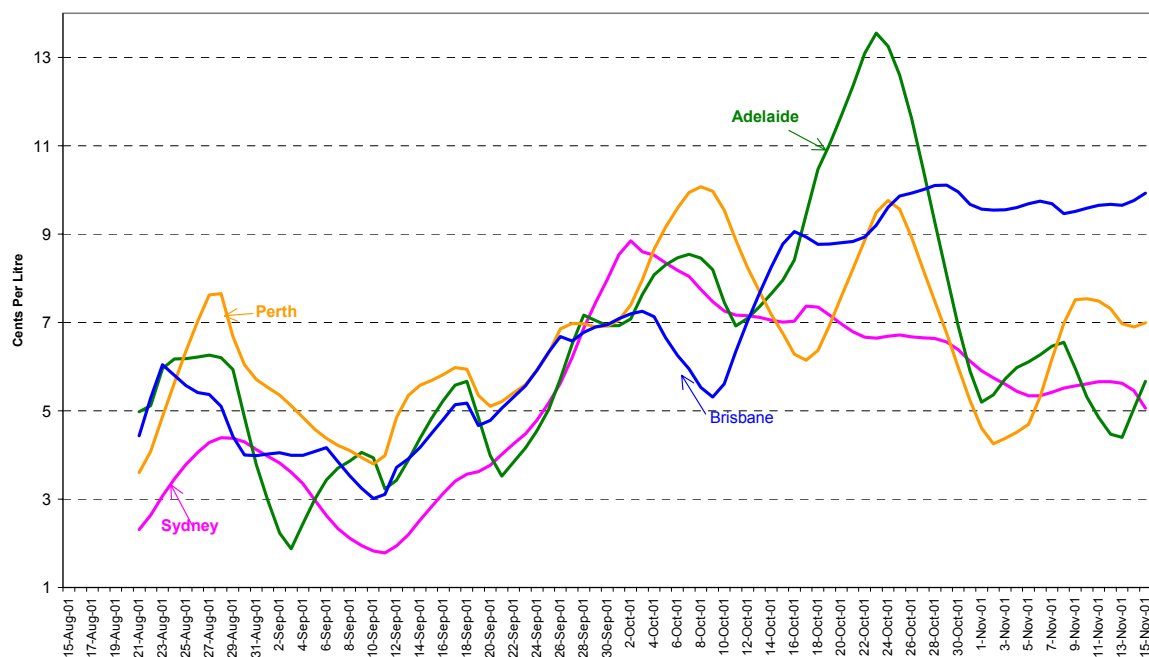


Table 7.2 contains the results of calculating average NIMs for each city over each of two periods obtained by splitting the reference period roughly in half according to the apparent timing of the rise in NIMs. The period before the margin 'shift' is 1 August 2000 to 31 September 2001 and the period after the shift is 1 October 2001 to 31 December 2002. Average NIMs in Brisbane rose the most, by 3.3 from about 4.7 to 7.9 cpl; followed by Perth (+2.2 cpl), Adelaide (+1.4 cpl) and Sydney (+1.3 cpl).⁵¹ The change in the average of the four cities was +2.0 cpl. By comparison, as noted above, the pre/post-shift change in Melbourne NIMs was +1.4 cpl.

City	NIM before (cpl)	NIM after (cpl)	Change (cpl)
Brisbane	4.7	7.9	+3.3
Perth	5.8	8.0	+2.2
Adelaide	5.2	6.5	+1.4
Sydney	5.0	6.3	+1.3
Average of 4 cities	5.2	7.2	+2.0

The comparative data on NIMs for Melbourne and the four major interstate capitals clearly indicate that:

- the rise in NIMs evident in Melbourne in the period after the introduction of the Act was *not* unique to Melbourne;
- each of the four interstate capital cities experienced an increase in NIMs of greater or at least similar magnitude to Melbourne's; and
- there was a lift in NIMs in each city around October 2001 that was sustained into 2002.

7.8 Broader market developments: Liberty exits retailing

The interstate comparison suggests there was a significant development (or developments) in RULP retail pricing during 2001 that was (were) associated with a rise in NIMs around October 2001 that was broadly sustained through 2002. The automotive fuel market is a dynamic market and a period of more than two years inevitably will contain developments in market structure and conduct that influence industry margins.

One development across major capital city markets during 2001-02 that *prima facie* might be regarded as potentially having an effect on retail pricing, and indirectly NIMs was the decision by Liberty Oil to divest its retail arm to Woolworths to concentrate on its wholesale business. An agreement in 2001 to lease its retail sites to Woolworths Plus Petrol was put into effect over the period July 2001 to January 2003. Sixty-two Liberty-owned sites changed operational hands across several States in this period, with 40 (65 per cent) changing hands in the sixth months between 1 October 2001 and 31 March 2002.

Liberty generally set retail RULP prices below 'the market' and had a reputation as an active petrol price discounter and was regarded as an influence for price competition in city markets. A possible hypothesis is that the departure of Liberty from retailing during 2001-02

⁵¹ The increase in NIMs in Perth is in part due to product premiums introduced by BP, the local refiner, in response to progressive changes to the fuel specifications in Western Australia.

lessened price competition and, at least partly, contributed to or facilitated a rise in average NIMs over a period when import parity prices were broadly falling. One test of this hypothesis is to compare the prices of Liberty outlets relative to the market average *before* the period of handover to Woolworths with the prices of the same outlets (now *Woolworths Plus* outlets) relative to the market average *after* the handover. If the pricing behaviour of the new operators changed one would expect to see the average position of their prices relative to the market average change.

Table 7.3 below, based on prices displayed on boards, compares the average 'discount' below the market average at 48 Liberty/Woolworths outlets in the five major cities over the period August 2000 to December 2002. The table indicates that, on average, prices at these outlets when Liberty outlets were 1 to 2 cents below the market average price. The same outlets as Woolworths outlets were slightly closer to the market average, in other words as Woolworths outlets the level of 'discounting' as revealed on price boards at these outlets had decreased slightly. There are differences between the various capitals. The largest reduction in discounting was in the Adelaide outlets (reduced by 0.67 cpl on average), but in Sydney there was virtually no change.

Table 7.3: Liberty/Woolworths outlets' average 'discounts' off market average RULP price - based on sites' price boards			
City (no. of sites priced)	Av. Liberty (cpl)	Av Woolworths (cpl)	Change (cpl)
Adelaide (7)	1.07	0.40	-0.67
Brisbane (12)	1.43	0.86	-0.57
Melbourne (19)	0.85	0.67	-0.17
Perth (2)	1.98	1.82	-0.16
Sydney (8)	1.95	1.90	-0.05
Average of 5 cities	1.46	1.13	-0.33

A difficulty with this analysis is that Woolworths' supermarket customers could purchase at 2 cpl off the board prices at Woolworths' sites. Thus, depending on the proportion of total sales that were to supermarket customers qualifying for the discount, these sites' average actual prices may have been lower than when operated by Liberty. Some observers suggest that, although CAV has no data confirming this, the proportion of total sales with the 2 cpl discount applied is around 80 per cent. If correct, this implies that the Woolworths-operated sites' discounts on average would have been 1.27 cpl greater than the Liberty-operated sites', rather than 0.33 less.⁵² It is not possible to draw a firm conclusion from this data about the validity of the hypothesis that the exit of Liberty from retailing lessened price competition and thereby contributed to or facilitated a rise in average NIMs.

The reaction of crude oil and petroleum product prices to the events of 11 September 2001 can be quickly dismissed as having any lasting effects on prices. As Graphs 7.1 to 7.6 inclusive demonstrate, the 'spike' in product import parity prices and Melbourne retail prices following the terrorist attack was lower than previous peaks in these prices and, for RULP, prices had fallen to a new trough by early November 2001 which was the lowest trough in the reference period.

⁵² $1.13 \text{ cpl} + (2 \text{ cpl} \times 0.8) - 1.46 \text{ cpl} = 1.27 \text{ cpl}$

7.9 Melbourne pricing in national context

The analysis in sections 7.7 and 7.8 cautions against looking at pricing developments in the Melbourne market in isolation from broader developments in other States. The data showed that the RULP NIMs increase evident in Melbourne from late October 2001 was by not unique to that city. Table 7.2 shows similar or greater increases in four other capital cities around the same time. A question for further exploration, but one that is beyond the scope of this report to analyse in any detail, is: what might cause this apparent *national* development?

A speculative hypothesis might be that such a national development could be associated with the responses of the major market participants to a period of low and declining margins in 2000-01, rather than with a change in the legislative environment in one State.⁵³ Against a background of falling import parity prices after the spike associated with the 11 September terrorist attack, it may have been possible for one or more of the Oil Majors to initially improve operating margins by maintaining prices across the capital cities. Other majors and the Independents under similar pressure from relatively low margins may have refrained from initiating a vigorous competitive price response. Such a development of coinciding pricing intentions does not require understandings among market participants to price at particular levels. There is abundant timely market information available on prices by which the participants can monitor and interpret each other's independent pricing decisions.

The exit of Liberty from retailing from late 2001 may be a factor associated with this development, at least in some capital cities. It may have lessened the pressure of aggressive retail discounting in the market generally and could have facilitated this muted response by the rest of the market. Table 7.3, which shows (varying) reductions in the gap between market average prices and Liberty/Woolworths sites' average prices, arguably supports this hypothesis. Also, it is interesting to note one observation on Liberty's impact on retail prices in another capital city. The Tasmanian Government Prices Oversight Commission reports that, 'The apparent unleaded retail margin in Hobart has continued to increase since Liberty closed its Glenorchy site in November 2001'.⁵⁴

CAV considers that the data indicating an apparent national lift in RULP notional margins in late 2001 is sufficiently robust to warrant further exploration by the ACCC as the national body monitoring prices for petrol and other automotive fuels. Chapter 9 contains a summary of the ACCC's report on Victoria's terminal gate pricing arrangements. While also noting that implied notional margins (retail price less its 'import parity indicator' price) rose in Melbourne after August 2001, the ACCC did not extend its analysis to examine the timing of similar increases indicated by its own data on other cities.

⁵³ In December 2001, Caltex reported that it "had been savaged by falling refining margins to \$US1.45 in the first half of that year". A study of Singapore prices in 2001 showed that in the period just before the introduction of TGP, spot 95 RON motor spirit prices fell below the Malaysian Tapis crude price. By August 2002, Caltex was able to announce that refiner margins had improved from the 2001 average of \$US1.61 bbl to \$US2.60 bbl. See Herald Sun Newspaper, 7 December 2001, *Catex Sinks Lower* and The Australian Newspaper, 8 August 2002, *"We made a master but don't blame us"*.

⁵⁴ It also comments that the apparent unleaded retail margin in Launceston was 'about zero' in the three months following Liberty's entry into the Launceston market in mid-November 2001. April 2002, *Fuel Price Monitoring Report* published by Government Prices Oversight Commission on its website.

7.10 Summary of findings

The major findings of the preceding analysis of prices and notional margins in summary are:

- there was a significant step-change reduction in *published* RULP and diesel wholesale prices by four of the five suppliers on the introduction of the Act;
- there was a convergence of all five suppliers' published prices in the post-TGP reference period compared to the more dispersed pattern in the pre-TGP period;
- published wholesale prices were above retail prices for substantial periods of time pre-TGP, but after the initial period of transition to the scheme were nearly always below retail prices in the post-TGP period;
- the evident step-change in published wholesale prices on 1 August 2001 was not evident in retail prices around that period;
- in the period between September 2000 and May 2001 there were frequent periods when the Independents' retail prices were substantially below the majors', but after mid-2001 the two categories of prices exhibit closer alignment;
- there was no dramatic or exceptional movement in NIMs for either RULP or diesel immediately around the time of the introduction of the Act;
- there was an upward shift of over 2 cpl around late October 2001 which was broadly sustained until the end of 2002 so that the average NIM prior to November 2001 was 5.2 cpl and from November 2001 was 6.6 cpl – suggesting a lift of nearly 1½ cpl;
- fluctuations in NIMs lessened after the upward shift around October 2001 compared to the preceding 14 months;
- there was no discernible change in the relativity of NIMs implicit in Oil Majors' and Independents' average prices immediately around and following the introduction of the Act, but falls in independent outlets' average NIMs below the average NIMs of the majors' outlets were of lesser magnitude and of shorter duration after March/April 2001;
- the differential or 'gap' between country and city RULP retail prices decreased from an average of 4.6 cpl over the six months leading up to the Act's introduction to an average of 3.6 cpl over the ten months from August 2001 because city notional margins rose relative to country notional margins;
- the rise in RULP NIMs evident in Melbourne in the period after the introduction of the Act was *not* unique to Melbourne as each of the four major interstate capital cities experienced an increase in NIMS of greater or at least similar magnitude to Melbourne's; and
- there was a lift in NIMs in all five major capital cities around October 2001 that was sustained through 2002.

Chapter 8

Assessment of Market Issues

8.1 Introduction

The issues for consideration and assessment in the Report are set out in detail Chapter 3. This chapter considers those relating to the effects of the TGP scheme on the market. A note of fundamental caution regarding an assessment of the impact of the Act is necessary. Automotive fuel markets – whether looked at from regional, State, national or international geographic perspectives – are dynamic. Market structure and participants' behaviour is evolving. Even with a more comprehensive data set over a longer term period than was available for this review, attributing 'cause and effect' to a particular variable in the market, such as new legislation, is problematic. Also, the longer the period of observation the more other factors unrelated to the particular legislation may influence developments and the more complex the interaction among variables.

Each of the stated objectives of the Act is addressed below:

- resellers' access to supply in Section 8.3;
- supply at 'reasonable' prices in Section 8.4;
- transparency in wholesale pricing in Section 8.5; and
- 'bottom-up' pricing in Section 8.6.

In addition, the implicit objectives relating to the long-term competitive position of independent resellers and metropolitan and country retail pricing are addressed in Sections 8.7 and 8.8 respectively. Section 8.9 discusses some concerns raised by market participants. Section 8.10 summarises the overall assessment. Before addressing these issues some data on the extent of TGP-based sales of the four Declared Fuels provides useful background information.

8.2 General extent of TGP-based wholesale sales

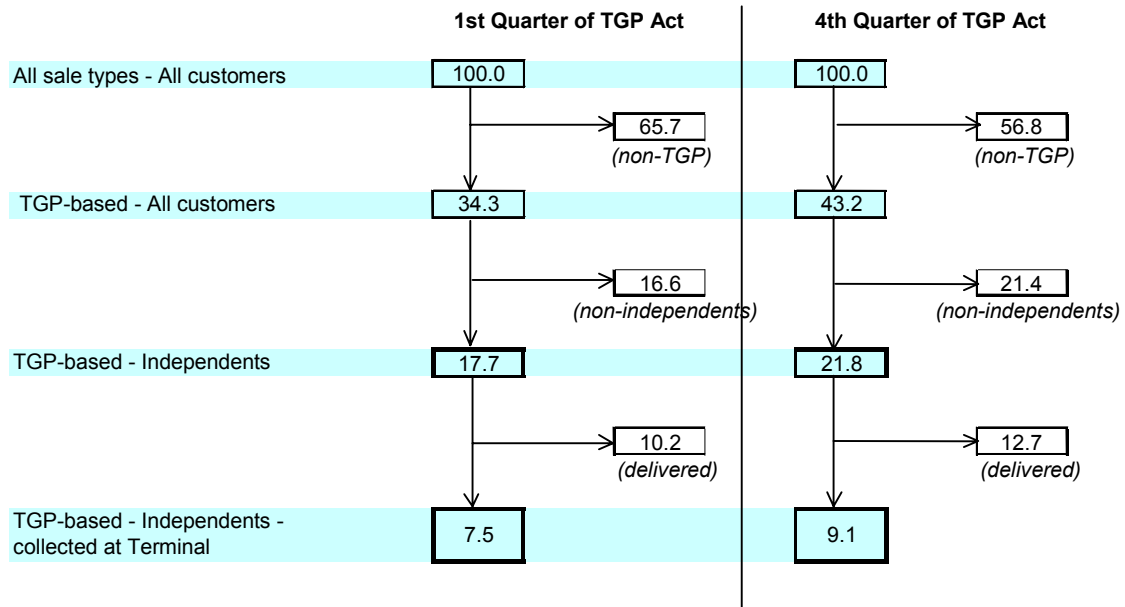
Data on sales for each of the four Declared Fuels by the four Oil Majors are summarised in **Figures 8.1 to 8.4** inclusive. Sales data from Trafigura was not available to CAV. Trafigura's volumes are understood to be very small compared to the Oil Majors. The omission of Trafigura data probably does not significantly alter the apparent trends. Figures 8.1 to 8.4 show the percentages of sales volumes by the various 'sales type' categories: whether TGP-based or not; whether TGP-based sales to independent resellers or to other customers; and whether TGP-based sales to Independents were collected from terminals by the resellers or delivered. The data relates to the first and fourth quarters⁵⁵ of the operation of the Act.

Sales across all reseller purchasers based on the legislated TGP were substantially more extensive for petrol products (around 43 per cent of total sales in the fourth quarter) than for diesel (around 30 per cent of total sales). Combining sales of all four fuels weighted together by volume, the overall proportion of total sales that were based on TGP was 39.5 per cent. However, these proportions include sales to oil company franchisees that do not have the ability to negotiate on price or physically pick-up fuel from terminals. These are not arms-length market transactions.

⁵⁵ First quarter is 1 August to 31 October 2001; fourth quarter is 1 May to 31 July 2002.

Figure 8.1: Regular Unleaded Petrol Wholesale Sales by Type of Sale after Introduction of TGP

Proportion of total sales by sale type* and customer status** (%)

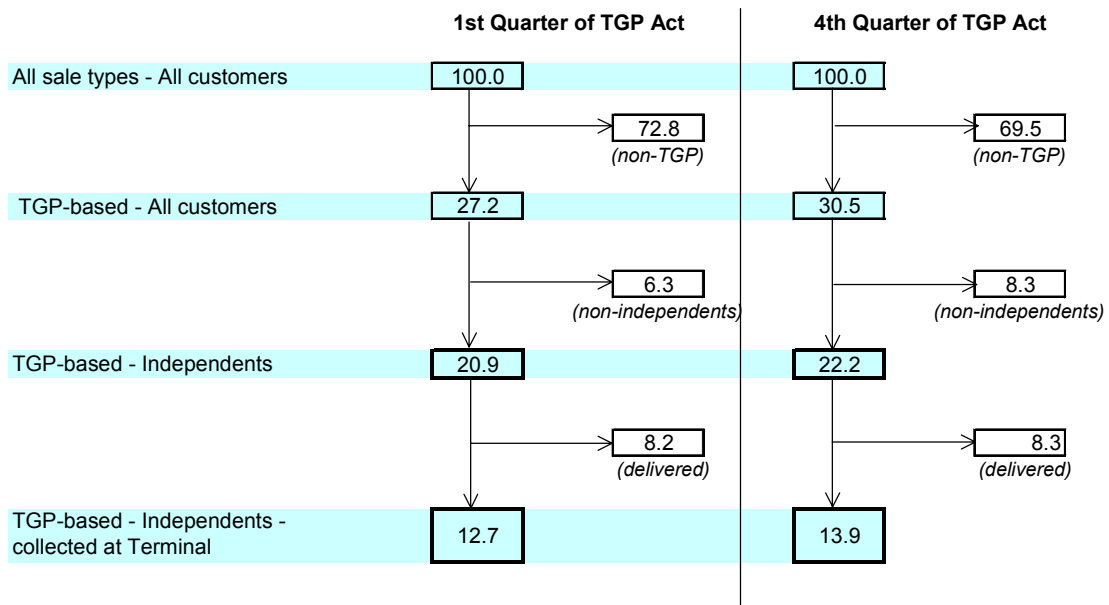


* 'Sales type' is whether transaction wholesale price is 'based' on published TGP or not (eg under contract pre-dating TGP Act)

** 'Customer status' is whether purchaser at wholesale is owned/controlled by one of four oil majors or independent of a major

Figure 8.2: Diesel Wholesale Sales by Type of Sale after Introduction of TGP

Proportion of total sales by sale type* and customer status** (%)

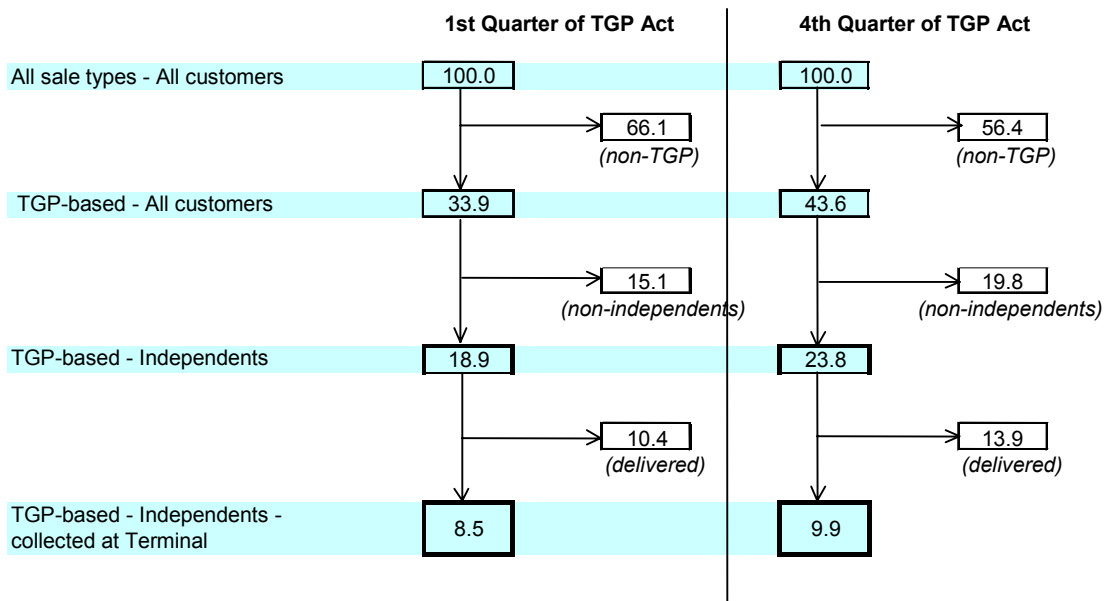


* 'Sales type' is whether transaction wholesale price is 'based' on published TGP or not (eg under contract pre-dating TGP Act)

** 'Customer status' is whether purchaser at wholesale is owned/controlled by one of four oil majors or independent of a major

Figure 8.3: Lead Replacement Petrol Wholesale Sales by Type of Sale after Introduction of TGP

Proportion of total sales by sale type* and customer status** (%)

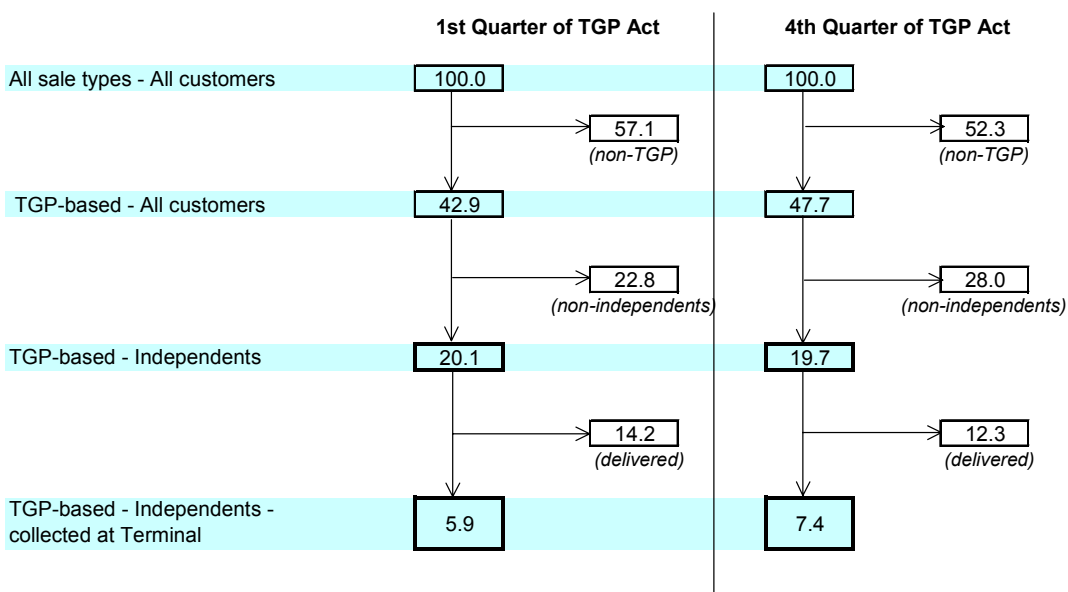


* 'Sales type' is whether wholesale transaction price is 'based' on published TGP or not (eg under contract pre-dating TGP Act)

** 'Customer status' is whether purchaser at wholesale is owned/controlled by one of four oil majors or independent of a major

Figure 8.4: Premium Unleaded Petrol Wholesale Sales by Type of Sale after Introduction of TGP

Proportion of total sales by sale type* and customer status** (%)



* 'Sales type' is whether transaction wholesale price is 'based' on published TGP or not (eg under contract pre-dating TGP Act)

** 'Customer status' is whether purchaser at wholesale is owned/controlled by one of four oil majors or independent of a major

Figures 8.1 to 8.4 indicate that about one fifth of total sales of each of the four fuels by the Oil Majors were to independent resellers in mid-2002. The largest proportion of sales in this category was for LRP (23.8 per cent), followed by diesel (22.2 per cent), RULP (21.8 per cent) and PULP (19.7 per cent). Combining sales of all four fuels, the overall proportion of total sales that were to independent resellers and based on TGP was 22 per cent in mid-2002.

An indicator of the extent to which TGP-based, ex-terminal supply may have been relevant to the Victorian automotive fuel market in 2002 relates to the proportion of retail outlets potentially in a position, given ownership links and contractually tied supply arrangements, to negotiate ex-terminal supply from one of the declared companies. The AIP estimates there were 1,966 service stations in Victoria at the end of 2002.⁵⁶ There are many types of ownership and operation and varying degrees of integration or links to the four refiner/marketers. These range from direct operation by a refiner/marketer to ownership and operation by an individual reseller without a major's brand. The AIP survey categorises 1,184 of these outlets (60 per cent) as 'sites able to negotiate ex-terminal supply'. BP provided data indicating that it had 226 dealer and distributor sites (that is without BP equity) in Victoria that are free to negotiate an ex-terminal gate price.

An alternative categorisation, based on a spot sales basis, may be a total of about 223 outlets (11 per cent) across Victoria.⁵⁷ The latter estimate is consistent with the CAV's survey of sales volumes to independent resellers collecting at the terminal (see Section 8.3 below). Thus, perhaps about one tenth of resellers may *potentially* be in a position to take advantage of TGP-based ex-terminal spot sales supply given current ownership and contractual supply arrangements.

8.3 Resellers' access to supply

Sales to independent resellers are the focus of the analysis because sales on a 'TGP basis' alone should be treated with some caution given the vertical links between the four Oil Majors and a major portion of service stations being located in Melbourne. At franchised, multi-franchised and directly operated sites it is of little consequence whether or not wholesale supply prices, which in these cases are not arms-length transactions, are recorded as a TGP-based price. Some indication of whether the Act enhanced access by fuel resellers to supply can be obtained by examining:

- whether the pattern of ex-terminal supply (measured by volumes of sales) to independent resellers changed in the review period;
- whether there were any instances of reported refusal to supply at a terminal; and
- whether there were any significant periods of supply shortfalls as indicated by the register of shortfall notifications under section 9 of the Act.

8.3.1 Patterns of post-TGP supply to independent resellers

Measurable indicators of the Act's impact on resellers' access to supply (that is purchase and physical collection of fuel from a terminal, not merely purchase) in the Victorian market include changes over time in the following:

- the proportion of total sales that were to resellers independent of the declared companies and were TGP-based;

⁵⁶ 928 metropolitan and 1,038 country. AIP Service Station Survey 'as at end 2002'. Published on AIP Website www.aip.com.au. See Table 3.1 in Chapter 3.

⁵⁷ Based on sites in 'independent' and 'supermarket' networks, sites supplied by non-branded, non-equity distributors and 'other' sites supplied by 'other distributors with refiner-marketer branding' (but without refiner-marketer equity).

- the proportion of total sales that were to independent resellers who collected fuel at terminals/depots and were TGP-based; and
- the proportion of sales that was TGP-based and collected from terminals/depots by independent resellers, relative to the total volume of sales to Independents.

Data relating to the first two of these measures for each of the four Declared Fuels are also summarised in Figures 8.1 to 8.4. The data compares sales recorded in the first and fourth quarters of the operation of the Act. The following conclusions can be drawn from these Figures:

- the proportion of total sales that were based on TGP and were to Independents increased from 17.7 to 21.8 per cent for RULP, 18.9 to 23.8 per cent for LRP and 20.9 to 22.2 per cent for diesel;
- the proportion of total PULP sales in this category fell very slightly from 20.1 to 19.7 per cent;
- for each fuel the proportion of total sales that were based on TGP and were to independent resellers who collected from terminals (the primary 'target' of the Act) increased slightly – from 7.5 to 9.1 per cent for RULP, 8.5 to 9.9 per cent for LRP, 5.9 to 7.4 for PULP and a lesser increase from 12.7 to 13.9 for diesel; and
- combining sales of all fuels, the proportion of total sales that were based on TGP and were to independent resellers who collected from terminals increased from 9.0 to 10.6 per cent.

Table 8.1 below estimates the proportion of sales at TGP-based prices collected from terminals by independent resellers, relative to the total volume of sales to Independents (that is, sales on all bases). The table shows that for each fuel the proportion of total sales to independent resellers that were based on TGP and collected from terminals by resellers increased from the first quarter to the fourth quarter. The largest increases were for PULP and RULP. Combining sales of all fuel types, the proportion increased from 22.8 per cent in the first quarter to 26.5 per cent in the fourth quarter.

Table 8.1: Proportion of Total Sales to Independent Resellers that were based on TGP and Collected at Terminal				
Period of TGP Act	Diesel (%)	RULP (%)	LRP (%)	PULP (%)
1 st quarter	40.9	17.2	18.7	18.9
4 th quarter	43.8	20.7	21.4	24.0

It is interesting to note that the Table also suggests that for *independent* resellers sales of diesel under the TGP regime are more extensive proportionally than sales of petrol. Over 40 per cent of total diesel sales to independent resellers were TGP-based and collected at the terminal, whereas only about 20 per cent of total petrol sales to Independents were of that type. This is unlike the situation for sales to *all* resellers, noted in Chapter 8.2 above, where sales based on TGP were more extensive for petrol than for diesel.

Table 8.2 below estimates sales based on TGP, whether collected at terminals by the resellers or not, as a proportion of the total volume of sales to Independents. The table shows that for each fuel except PULP, the proportion of total sales to independent resellers that were based on TGP increased from the first quarter to the fourth quarter. The largest increases were for LRP and RULP increasing from 41.5 to 51.4 per cent and from 40.7 to 49.3 per cent respectively. Combining sales of all fuel types, the proportion based on TGP increased from 47.5 per cent in the first quarter to 55.1 per cent in the fourth quarter.

Table 8.2: Proportion of Total Sales to Independent Resellers that were based on TGP

Period of TGP Act	Diesel (%)	RULP (%)	LRP (%)	PULP
1 st quarter	67.1	40.7	41.5	64.1
4 th quarter	69.9	49.3	51.4	63.7

8.3.2 Reported refusals to supply

The Act requires that, save for certain provisos such as safety and credit worthiness concerns, Declared Suppliers must supply full loads at (or below) the posted terminal gate price to any 'spot' customer, unless they have first filed a notice with CAV that they are experiencing a shortage. During the first twelve months of the Act, CAV did not receive any formal complaints from prospective purchasers refused access to fuel at the terminal gate price, during a period where a Declared Supplier had not notified CAV of a shortage.

8.3.3 Notifications of shortages

Also relevant to the issue of access is the number of shortfall notifications received by CAV from Declared Suppliers. Table 6.1 in Chapter 6 provides a table of shortfall notifications received by CAV. In summary, CAV received 49 shortfall notices covering some 800 out of 7,300 'supplier-product-days'.⁵⁸ In other words, formal shortage notices had been issues for 11 per cent of all possible supplier product days.

As noted in Chapter 3.6, there is a very limited spot market for petroleum products in Victoria. Declared Suppliers operate their terminals and manage their stocks to meet their commitments to contracted customers. During the stakeholder consultation sessions, some Declared Suppliers advised that there were many periods where their fuel stocks were only sufficient to meet contractual commitments and they had very limited capacity to provide spot volumes. They did not lodge formal shortage notices in these circumstances as they did not expect to receive requests for spot sales. It is therefore likely that had the spot market been more significant than it was during the review period, the number of formal shortage notices would have been greater.

8.3.4 General conclusions regarding access to supply

Resellers had access to terminals for fuel at prices based on the legislated TGP. Notwithstanding that the demand for spot sales is very limited, spot customers were able to draw fuel from terminals based on terminal gate prices, except for formal periods of shortage covering about 11 per cent of supplier product days.

The preceding analyses suggest that the Act modestly enhanced the capacity of independent distributors and retailers to access ex-terminal supply. The proportions of total wholesale sales that were to independent resellers and were based on TGP increased during the review period and the proportion that was collected from terminals increased also.

The available information does not provide evidence of the kind of shift in supply relationships to 'a [pricing culture] ...of price negotiation at the terminal gate, based on reasonable access' which the ACCC believed would enhance price competition at both

⁵⁸ There are five declared suppliers, four declared products and 365 days per year.

wholesale and retail levels.⁵⁹ Such a change could not be expected to occur in a period as short as 12 months. There are grounds for some doubt that this would occur even in the longer term. It would seem that the Oil Majors have structured their businesses on the requirement that long-term supply relationships are essential to continuity of supply for base load business. Independent distributors and retailers, either willingly or as a result of the sheer weight of market forces, are enmeshed in this structure based on long term supply arrangements. This would seem to be a fundamental characteristic of the Victorian and Australian wholesale markets for petroleum products. In the absence of a viable spot market in petroleum products in Australia, short term, ex-terminal sales of products, particularly RULP, to non-contracted customers will remain a minority source of supply to independent resellers in Victoria.

8.4 Assessment of 'reasonableness' of wholesale prices

The Act did not provide a definition of the 'reasonableness' of wholesale prices. The views of industry participants will differ on what might constitute reasonable prices (and associated margins) in given demand and supply conditions. There is no absolute assessment of reasonableness. For the purposes of the Review an appropriate question is what, if any, discernable effect did the introduction of the TGP have on wholesale prices?

The prices analysis in Chapter 7.4 demonstrated that on the commencement of the Act's operation a significant step-change reduction occurred in published wholesale RULP and diesel prices for four of the five suppliers. Thereafter there was a convergence of all five suppliers' prices to a tighter spread of prices in the post-TGP period, compared to the more dispersed pattern in the pre-TGP period. (See Graphs 7.2 and 7.3.) The margins analysis in Chapter 7.4.3 which draws on published wholesale prices, demonstrated that on the commencement of the Act's operation there was a reduction in notional terminal margins over import parity prices on average of about 4.2 cpl for RULP and about 3.4 cpl for diesel. Notional terminal margins tended to rise from around April/May 2002. As noted in Chapter 7.4 movements in notional terminal margins do not mean that terminal operators' actual margins changed in the same way.

Taken together, the changes in wholesale prices and the associated changes in notional margins indicate that *published* wholesale prices under the operation of the Act (TGPs) are closer to actual transaction prices than previous published prices. Published TGPs are probably more 'realistic' (that is, closer to actual prices) than wholesale prices published previously and in that sense could be considered to be more 'reasonable'.

Chapter 7.5 also noted that the step-change in wholesale prices was not evident in retail RULP and diesel prices and that there was no dramatic or exceptional movement in notional industry margins for either fuel around the time of the introduction of the Act. This suggests that the introduction of the Act did not result in a change in actual wholesale prices charged by terminal operators to resellers (independent or otherwise). The Act alone appears not to have changed actual transaction prices either up or down during the review period. In that sense, its first year of operation has not changed whatever the state of reasonableness of wholesale prices was prior to its introduction. No further assessment of the reasonableness of wholesale prices and margins can be made without data on the actual supply costs, prices, profits and profitability of the Declared Suppliers.

⁵⁹ Australian Competition and Consumer Commission, *Inquiry into the Petroleum Products Declaration*, August 1996, Volume 1, page 124.

8.5 Transparency of wholesale pricing

While ‘terminal gate prices’ (on varying bases) were posted by some of the current Declared Suppliers prior to the introduction of the Act, it is evident that these prices were not a good reflection of actual transacted wholesale prices. In addition to anecdotal evidence, this is supported in the price analysis in Chapter 7.4. There would have been no reason for the step-change in wholesale prices and the marked convergence of prices post-TGP if fuel sales had been transacted in volume at the published prices prior to the introduction of the Act.

The Act has brought about a substantial improvement in the transparency of wholesale pricing. Expressed alternatively, the Act has reduced the degree of non-transparency in wholesale pricing. Graph 7.4 of Chapter 7 is the clearest indication of that.

A degree of non-transparency to market participants in general remains in the form of discounts off published TGPs and charges that can be added to TGPs for optional services beyond the terminal gate. The exact quantum of these is known only to the parties to particular individual transactions. However, if buyers and sellers had complete knowledge of all transaction prices in a market, price competition in that and any downstream market would be severely constrained. Accordingly, the Act explicitly does not seek to prevent Declared Suppliers from providing discounts from the posted TGP for contracted or non-contracted customers. Declared Suppliers are also at liberty to discount optional service charges which has substantially the same effect as discounting the TGP.

8.6 ‘Bottom-up’ price structures

Some industry participants and observers have had long-standing concerns about so-called ‘top-down’ wholesale pricing. This refers to a pricing scheme where actual wholesale supply prices are arrived at through substantial and frequent discounts/rebates from wholesale ‘list’ prices.⁶⁰ By virtue of the long-standing and generalised nature of the discounts/rebates, wholesale list prices became to be regarded as an artificial construct obscuring actual supply prices and the costs and margins incorporated in them. The Commonwealth Franchise Act is also considered to have reinforced the industry’s retention of the ‘list rebate’ price system.

Given this history, a perceived benefit of the Act’s terminal gate pricing concept was that it is intended to be ‘bottom-up’, in contrast to the top-down list rebate system. The terminal gate price concept was intended to reflect only commercially-based supply costs and actual realised margins to the terminal gate. Other charges to purchasers relating to services beyond the terminal gate also would be explicitly identified and separately recorded. However, it appears that ‘list rebate’ pricing has persisted to some extent. During consultations, a number of Independents held concerns that some TGP offers might still be calculated on a ‘top-down’ approach by tailoring ‘add-ons’ to equate to a list price. At least one Oil Major confirmed that pricing to its franchised network was at list price less price support; this can allow for a greater influence by Oil Majors over retail prices. Other Declared Suppliers noted the requirements of the *Petroleum Retail Marketing Franchise Act* (see Chapter 6.6 for a discussion of this issue) which appear to require fuel to be sold to franchisees without price discrimination; this influenced their approach to TGP pricing to franchisees.

⁶⁰ This pricing system had its origins in the past regulation of ‘maximum endorsed wholesale prices’ (MEWPs) by the ACCC and its predecessor organisations. MEWPs were often set at levels unattainable in the marketplace for long periods of time. The suppliers ‘declared’ under this regulatory regime were obliged to notify their list (notional) prices to the regulator. Suppliers had an interest in preserving high list prices in preference to exposure to the perceived risk that the regulator may set maxima significantly below prices which were actually attainable in the market.

The substantial reduction in notional terminal margins on the commencement of the Act evident in Graph 7.4 of Chapter 7 would seem to have reduced the scope for the Declared Suppliers to offer discounts/rebates. In a competitive market it would be difficult for other Declared Suppliers to command a significant price premium above Shell's lower TGP's over time. Since sustained differentials in TGP's have prevailed, it is likely that the other four Declared Suppliers are providing continuing discounts (or at least greater discounts than Shell) to contracted customers. As noted previously, substantial reductions in notional terminal margins suggest that TGP's are now more closely aligned to actual transaction prices than was the case with previous list prices. To this extent the Act has facilitated a greater degree of bottom-up pricing in practice.

8.7 Long-term competitive position of Independents

The potential for more transparent pricing to assist the competitive position of independent resellers in the longer term has been posited for some time. Two indicators of enhancements to the long-term competitive position of the Independents could be:

- improvements over time in independent resellers' margins over buying prices following the implementation of the Act; and
- entry by new operators which would be consistent with improved viability of independent product distribution and reselling operations.

8.7.1 Independent resellers' margins

The analysis in Chapter 7.6 of notional industry margins based on Melbourne retail prices of the majors' branded outlets compared to margins based on prices of Independents' outlets indicated that Independents' NIMs on average were about 0.7 cpl less than majors' NIMs over the whole reference period. **Table 8.3** contains further analysis disaggregating the data into 'pre- and post-TGP' periods (each 12 months before and after the Act). Table 7.3 indicates that in the pre-TGP period RULP NIMs based in average Independents' retail prices were 1.1 cpl lower than NIMs based in average majors' retail prices; in the post-TGP period Independents' NIMs were 0.4 cpl lower than average majors' NIMs.

Table 8.3: RULP NIMs based on prices at majors' and Independents' Melbourne outlets

Period	Majors' branded outlets (cpl)	Independents' outlets (cpl)	Difference (Majors-Independents) (cpl)
Pre-TGP	5.3	4.2	1.1
Post-TGP	6.1	5.7	0.4
Change	+0.8	+1.5	-0.7

Unfortunately, this analysis of notional industry margins provides no insight into changes of independent resellers' actual margins. In the absence of data on actual transaction wholesale prices, it is impossible to apportion the increased industry margins implied by Independents' retail prices between the four majors (at the wholesale stage of supply) and independent resellers (at the retail stage), or some combination of both. In this context, it is

also instructive to recall that the LIPP benchmark on which NIMs are calculated itself represents only a notional cost base. The actual costs of petroleum production to the Oil Majors may be different.

The observation that gross industry margins appear to have increased were supported anecdotally by some refiner/marketers and retailers in the course of consultations for this review. A representative of one Oil Major indicated that in his assessment the increase in gross industry margins is apportionable roughly equally to wholesale terminal margins and retail margins. However, given the extensive vertical integration of the Oil Majors, the highly concentrated and Oil Major-dominated nature of the wholesale market in Victoria (and nationally), and the effective dominance of the Oil Majors in influencing retail prices generally, it is arguable that any increase in the industry's actual margins would be more likely to be taken mostly by the Oil Majors rather than by the independent resellers.

If there has been an increase in Independents' actual margins, which is problematic, it is difficult on available empirical data to assess whether this is attributable to the operation of the Act. No stakeholder in consultations suggested a direct causal link between the introduction of the Act and improved margins. Some independent retailers attributed improved margins to more 'rational' pricing behaviour by independent retailers, perhaps in part reflecting enhanced price transparency facilitated by the TGP regime. These Independents' hypothesis is that with more information regarding supply prices, the impulse to meet and exceed retail price discounting by others may be moderated.

8.7.2 New entry by independent resellers

In the longer term, entry by new independent operators would reflect an improved viability of independent product distribution. No systematic industry entry/exit statistics were available to CAV in relation to enterprises and sites operated by the independent distribution and retailing sectors. Several stakeholders commented that the retail margins experienced in the first half of 2001 (which on many days saw retail prices below supply cost) were not sustainable and forced some retailers out of the market. While Liberty exited the market over this period, Woolworths extended its network of branded independent sites with a marketing strategy linked to its supermarket chain business. There appears to have been no new entry in the review period.

8.7.3 Conclusion on Independents' competitive position

It is not clear that the competitive position of independent resellers improved following the introduction of the Act. In any event the review period is too short for the manifestations of improvement to develop and be maintained. Further monitoring of industry developments would be required to make a meaningful assessment.

8.8 Metropolitan and country retail pricing

While the Act does not have provisions aimed directly at reducing the city-country retail price differential, it is implied that lower differentials may also be an outcome over time of a change in pricing culture to one of price negotiation at terminal gate. Chapter 7.6.3 indicated that the average city-country retail price differential for the eleven Victorian towns covered by the analysis reduced by about 1 cpl based on a comparison of the six months prior to the introduction of the Act with about a year of its operation. Both country and city retail prices rose relative to nominal supply costs (the LIPP benchmark).

However, notional industry margins rose more in metropolitan Melbourne than in the country towns in the data sample. Chapter 7.7 demonstrated that a rise in city margins of at least similar magnitude also occurred in Sydney, Brisbane, Perth and Adelaide over the same period. Given this circumstance, the large short term fluctuations that can occur in Victorian city-country price differentials and the limited period of data examined, no assessment can be made at this point about the impact of the Act on city-country price differentials. A longer period of monitoring of data across more country locations would be required before a meaningful assessment could be attempted. Even then, separating the effects, if any, of the Act from the effects of ongoing structural and behavioural changes on city-country retail price differences would be difficult.

8.9 Impact on pricing during product shortages

The total installed refining capacity provided by Mobil's operations in Altona and Shell's operations in Geelong is approximately sufficient to meet Victoria's total market requirements for Declared Fuels. In practice refined products are imported into Victoria and exported from Victoria to interstate and overseas product markets. Although no disaggregated published statistics are available for imports and exports from the Victorian refineries, it is likely that there have been more movements of product by coastal tank ship into Victoria since the termination of the refinery exchange agreements. There are particular times when there are significant imbalances between product demand in Victoria and available ex-refinery supplies. In the event of Declared Fuels being in excess supply, CAV Guidelines allow these excess supplies to be cleared as so-called 'spot transactions' for which 'an additional price discount' will apply.⁶¹

Alternatively, there may be a shortage in the availability of Declared Fuels. In recent years shortages have arisen from unscheduled shut-downs due to equipment failure, delays in recommissioning plants after shut-downs, and on some infrequent occasions, strikes or union work bans. As detailed in Chapter 6.8, during the Review Period there were considerable shortages of all Declared Fuels during the summer months of November 2001 to January 2002. These shortages were attributed to a longer than planned refinery shutdown and accounted for 84 per cent of the total number of days of shortfall notified during the Review Period. During this period Trafigura reported that it was able to source additional import cargoes to meet much of the shortfall. As a result, its monthly sales of Declared Fuels during this period increased by more than 50 per cent over its average monthly sales for the prior period of calendar year 2001. Ordinarily, Trafigura's non-contract sales are a much less significant proportion of the company's total sales. This shortfall period was the only time during the review period that a Declared Supplier made significant non-contract sales. Trafigura reports that it considers that the Act constrained the company from recovering a premium in its prices which it considers would appropriately reflect the significant incremental costs and risks associated with sourcing cargoes to meet a short-term deficit in alternative supplies for non-contract customers.

8.10 Summary of assessment

The main points from the preceding assessment of the Act's first year of operation are:

- resellers had access to terminals for fuel at prices based on the legislated TGP;
- the capacity of independent distributors and retailers to access ex-terminal supply was modestly enhanced;

⁶¹ *Petroleum Products (Terminal Gate Pricing) Act 2000, Guidelines, CAV, May 2001, Page 5.*

- published wholesale prices under the operation of the Act (TGPs) were probably closer to actual transaction prices than previous published prices and thus could be considered to be more reasonable;
- no further assessment of the reasonableness of wholesale prices and margins can be made without data on *actual* supply costs, prices, profits and profitability of the Declared Suppliers.
- there was an improvement in the transparency of wholesale pricing;
- TGPs being more likely to be more closely aligned to actual transaction prices than previous list prices, thereby facilitating a greater degree of bottom-up pricing in practice;
- it is not clear that the competitive position of independent resellers improved following the introduction of the Act, but the review period is too short for the manifestations of improvement to develop; and
- the average city-country retail price differential (based on a sample towns) decreased because industry margins increased in Melbourne (as they did in other capital cities) due to factors most likely not related to the Act.

From these points it is evident that the Act's operation in the period examined achieved its stated objectives of ensuring resellers have access to fuel at reasonable prices and of promoting greater transparency in wholesale pricing. As noted in Chapter 5, the Act has not imposed significant ongoing compliance costs on Declared Suppliers and CAV does not incur significant costs in administering the ongoing requirements of the scheme. The period to date is too short to assess whether the Act has contributed to achieving the implied objective of enhancing the long-term competitive position of Independents. A significant change to competition in the market was not expected in the initial year or two.

Chapter 9

Response to the ACCC Report on the Victorian TGP Scheme

9.1 Introduction

On 23 April 2003, the Commonwealth Government released a report by the ACCC on *'Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia'*. This Chapter provides CAV's response to each of the ACCC's findings regarding the operation of the legislated TGP scheme in Victoria.

9.2 Market Coverage

ACCC Findings

The ACCC was unable to determine what proportion of the Victorian market was covered by the legislated TGP scheme. While it understood that the spot market was small it was unable to determine how many contracts fell under TGP, however, the Report noted that some Declared Suppliers had advised that some contracts were based on TGP. It was also reported that the ACCC had been advised that some contracts may include 'evergreen' roll-over provisions meaning that they may not be covered by TGP.

CAV Comment

To assess the extent to which TGP had been adopted in the market CAV analysed data on sales volumes provided by the four Oil Majors. This data is presented in Chapter 8.2. In summary, it was found that the proportion of sales volume based on TGP grew over the Review Period so that by the period May to July 2002 39.5 per cent of total petrol and diesel volumes sold to all categories of customers were based on TGP. Of total volumes sold to independent resellers 55.1 per cent were based on TGP.

CAV confirms that the spot market in Victoria is small and that the market preference is for supply under contract. Some stakeholders also raised with CAV the concern that contracts with 'evergreen' roll-over provisions may restrict the adoption of TGP. However, a survey of Oil Majors suggests that there are very few contracts with such provisions.

9.3 Transparency

ACCC Findings

The ACCC concluded that 'The TGP arrangements in Victoria have improved the level of transparency' through the requirement for Declared Suppliers to publicly advertise TGPs.⁶² However, the ACCC reported that opinions of industry participants differed on transparency. Some expressed the view to the ACCC that the existence of discounting meant that there was little 'real' transparency.⁶³

⁶² Australian Consumer and Competition Commission, *'Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia Western Australia'*; December 2002, page 82.

⁶³ ACCC December 2002 Report, page 81.

CAV Comment

CAV considers that the Act has moderately enhanced the transparency of wholesale pricing. All Declared Suppliers published TGP's which were more likely to be closer to actual transaction prices than the previous list prices. CAV agrees that a degree of non-transparency in general still remains through discounting from published TGP's. However, the Act does not seek to enforce absolute transparency by prohibiting discounting or by requiring the publication of actual prices because to do so would hinder, not promote, price competition.

9.4 Access**ACCC Findings**

While not drawing any conclusion about the impact of the legislated TGP on access, the ACCC noted that while some small independents had purchased fuel at spot TGP's a larger independent 'had been unable to source as much fuel as it wished from the spot market'.⁶⁴

CAV Comment

CAV assessed access through patterns of ex-terminal supply to independents, instances of reported refusals to supply and supply shortages. From the results of the analysis, which is reported in Chapter 8.3, CAV has concluded that resellers had access to fuel at terminals at prices based on TGP and, despite limited demand for spot sales, customers were able to draw from terminals at the TGP. No formal complaints were received that access had been refused to fuel at the TGP. As a result, CAV has concluded that there have been no access problems and that there was a moderate improvement in the capacity of independent resellers to access ex-terminal supply.

The shortfall notifications received by CAV indicate that during the Review Period there were several occasions when there was a general shortage of petrol and diesel in Victoria. These product shortages or other supply constraints, rather than the TGP regime, may have contributed to the larger independent referred to in the ACCC Report being unable to source sufficient product.

9.5 Wholesale prices**ACCC Findings**

With regard to the impact of TGP on wholesale prices, the ACCC concluded that, 'There appears to be a reasonable range of terminal gate prices published by the five declared companies'.⁶⁵ On comparing TGP's to their import parity indicator (IPI) ⁶⁶ the ACCC reported that the TGP's of the five Declared Suppliers 'tended to be relatively stable against the IPI'.⁶⁷

CAV Comment

While CAV did not specifically assess the relatively between Declared Suppliers' TGP's in this Report, the Quarterly Impact Assessments on TGP previously undertaken by Fueltrac Pty Ltd confirm the ACCC's finding.

⁶⁴ ACCC December 2002 Report, page 81.

⁶⁵ ACCC December 2002 Report, page 84.

⁶⁶ The IPI is a wholesale price indicator and is defined as comprising three elements: an import parity component; an assessed local component; and State subsidies, excise and GST, see page 27 of the ACCC's December 2002 Report.

⁶⁷ ACCC December 2002 Report, page 84.

In this Report CAV assessed the objective of the Act to create 'bottom-up' pricing and found that this had been achieved as TGPs are now more 'reasonable' prices and that notional terminal margins had substantially reduced on the commencement of the Act.

The analysis of the relativity between TGPs and a benchmark LIPP also found a slight increase in notional terminal margins for RULP and diesel over the period following the introduction of TGP. Notional terminal margins rose fairly consistently towards 3 cents per litre, from late 2002.

9.6 Retail prices

9.6.1 Relationship between TGPs and retail prices

ACCC Findings

The ACCC noted that on 17 days (4 per cent of days) following the commencement of the Act (between 14 August 2001 and 30 September 2002) the average of the Declared Suppliers' TGPs were above average retail prices in Melbourne.⁶⁸ All but two of these days were in the initial two months of the scheme's operation. Thus, in the latest full year of its analysis the average of the TGPs were above average retail prices on only 0.5 per cent of days. The ACCC's report did not contain any data on the relationship between average published wholesale prices and average retail prices before the introduction of the TGP scheme.

CAV Comment

CAV considered that the relevant period for assessing the impact of TGP on the relationship between TGPs and retail prices should include a pre and post TGP comparison. Therefore, CAV assessed prices over the period 1 August 2000 to 31 July 2002 and found, as noted in Chapter 7.6, that there was a marked change in the relationship between average published wholesale and retail prices in Melbourne after the introduction of the Act. Before the introduction of the Act average published wholesale prices were *above* average retail prices for sustained periods. After the introduction of the Act and the initial period of transition to the scheme, average published TGPs were nearly always *below* average retail prices.

9.6.2 Retail price level

ACCC Findings

The ACCC assessed average daily retail prices against its benchmark IPI (although this is a *wholesale* price indicator it was above average daily retail prices on 67 per cent of days during the review period)⁶⁹ and found that average retail prices had increased by 1 cpl in Melbourne. The ACCC reported comments from some of the Oil Majors that the Victorian TGP arrangements had led to less discounting from the terminal gate price and that any discounting is within a narrower band. The ACCC observed that the removal of discounts, particularly to the larger independent chains, reduces the degree of competition in the marketplace and leads to higher average prices.⁷⁰

However, the ACCC was unable to conclude with certainty that the increase in retail prices in Melbourne had resulted from TGP. Other factors unrelated to the introduction of TGP which

⁶⁸ ACCC December 2002 Report, page 61.

⁶⁹ ACCC December 2002 Report, page 69.

⁷⁰ ACCC December 2002 Report, page 85.

the ACCC considered may have affected retail prices were the exit of Liberty from retailing and the breakdown of refinery exchange arrangements.

CAV Comment

CAV analysed retail prices and observed the increase noted by the ACCC. To understand the reasons for the increase an analysis of the notional industry margin (NIM) was undertaken. The results of the analysis are presented in Chapter 7.6 and, amongst other trends, found that there was a distinct upward shift in the NIM for RULP of around 2 cents per litre in late October 2001 which was broadly sustained until the end of 2002.

Further analysis found that the increase in NIMs was not due to a change in the relativity of margins between the Oil Majors and Independents. The only change in the relationship between Independents' and Oil Majors' NIMs occurred in March/April 2001 after which falls in Independents' average NIMs below Oil Majors' average NIMs were of a lesser magnitude and of a shorter duration.

CAV agrees with the ACCC that other factors complicate the analysis. As noted in Chapter 8.2, only about 7 per cent to 9 per cent of all RULP sales volume was on TGP to Independents and collected at terminals. However, unlike the ACCC, CAV explored other reasons in some detail. There reasons were:

- The exit of Liberty from retailing.

CAV considered the departure of Liberty from retailing during 2001-02 as a possible explanation and, therefore, compared prices at Liberty to Woolworths sites in Melbourne and other capital cities. While there were differences between the capitals it was found that at Woolworths outlets the level of discounting had decreased slightly, by 0.33 cents per litre, (ranging from a reduction in Adelaide of 0.67 cents compared to 0.05 cents Sydney). This reduction in discounting represents an increase in NIMs of about 5 percent. It is not possible to draw a firm conclusion that the exit of Liberty from retailing lessened competition and thereby contributed to, or facilitated a rise in average NIMs.

- The breakdown of refinery exchange arrangements.

As refinery exchange arrangements formally terminated in December 2001 this was well after the October 2001 increase in NIMs.

- Movements in retail prices in other interstate capitals.

Movements in retail prices in other capital cities which do not have mandatory TGP schemes were analysed and it was found that this increase in NIMs was not unique to Melbourne. Each of the four major mainland capitals assessed (Brisbane, Perth, Adelaide and Sydney) experienced an increase in NIMs of greater or at least similar magnitudes to Melbourne. The interstate analysis, therefore, suggests that the increase in NIMs, and hence retail prices, may be due to factors unrelated to the legislated TGP in Victoria.

The ACCC did not analyse the impact of the exit of Liberty on retail prices. Also, the ACCC's own data demonstrates the increase in interstate capital city retail prices in Table 3.7 in Chapter 3 and in Charts A1, A2, A3, A4, A5, A6, A7 A8 and A9 in Appendix A.⁷¹ However, the ACCC did not further explore or discuss the impact of interstate developments on the retail price increases.

In response to the ACCC's comments concerning the impact of reduced discounting on competition and average price levels, CAV notes that while discounting may be reduced it is at a lower level. Graph 7.4 in Chapter 7 demonstrates that RULP TGPs fell by about 3.6 per

⁷¹ ACCC December 2002 Report, pages 77 and 141 to 149.

cent on commencement of the Victorian Act. As a result, the after-discount price for resellers may not have changed. Similarly, their capacity to discount to their customers and, therefore, their competitive position may not have changed.

9.6.3 City-country price differential

ACCC Findings

The ACCC found that the city-country price differential decreased by 0.8 cpl following the introduction of TGP but that this was mainly due to a higher increase in Melbourne retail prices of 1.3 cpl. It was also reported that Victoria's city-country price differential decreased by less than in the four other States where the differential decreased, namely Queensland, South Australia, Western Australia and Tasmania. The ACCC found that, 'The reason for the decrease in the city-country differential in Victoria was that the increase in city prices was greater than the increase in country prices'.⁷²

The ACCC did not consider that it was possible to conclude that TGP had resulted in the increase in country prices because the extent to which TGP applies to the Victorian market is not clear and there may have been other contributing factors.

CAV Comment

The Act does not have provisions aimed directly at reducing the city-country price differential. Using a different data source, size and review period CAV also concluded that the average city-country price differential decreased by 1 cpl, but that the reduction was due almost entirely to an increase in city prices as country prices increased only very slightly.

CAV analysed city and country retail price increases and found that in the six months before TGP commenced country NIMs averaged 9.2 cpl; while in the period after TGP NIMs had increased only slightly to 9.3 cpl. In contrast, city average NIMs increased from 4.5 cpl pre-TGP to 5.8 cpl in the post-TGP period. From the CAV's analysis, whatever explains the city NIMs increase is also likely to explain the reduction in Victoria's city-country price differential.

9.6.4 Retail price cycles

ACCC Findings

The ACCC concluded that the legislated TGP had a 'minimal effect on the price cycles in Melbourne'.⁷³

CAV Comment

CAV did not assess the impact of the legislated TGP on retail price cycles in Melbourne. The elimination or reduction of retail price cycles was not identified by the Victorian Government as one of the objectives of the Act and, therefore, was beyond the scope of CAV's review.

9.7 Competition

ACCC Findings

The ACCC did not draw any firm conclusions regarding the effect of TGP on competition. It noted that competition may be influenced by a wide range of factors and that other more recent factors such as the exit of Liberty from retailing and the breakdown of refiner

⁷² ACCC December 2002 Report, page 86.

⁷³ ACCC December 2002 Report, page 85.

exchange may have had an effect on competition. The ACCC also commented that TGP 'may have an adverse effect on competition, through reducing the level of discounting'.⁷⁴

CAV Comment

CAV agrees with the ACCC's observation that a range of factors influence competition and that it is difficult to isolate the effects of any single factor. The approach taken by CAV was to assess the impact of TGP on the competitive position of Independents. It was found that while the Independents' average NIMs improved following the introduction of TGP to 0.4 cpl below the average NIMs for the Oil Majors, no new Independents appear to have entered the Victorian market during the Review Period. CAV, therefore, concludes that it is not clear that the competitive position of Independents has improved as the Review Period is too short for any sustained improvement.

9.8 Operation of TGP

The ACCC reported a number of stakeholders concerns with the operation of TGP. Each of these is summarised below with a response from CAV.

Table 9.1: CAV Response to Stakeholders Issues Reported by the ACCC	
ACCC Findings	CAV Response
<ul style="list-style-type: none"> The LIPP formula should no longer be based on the Singapore Spot Price but should reflect buy-sell arrangements. The LIPP formula should allow all Declared Suppliers to use actual costs. 	CAV considers that the LIPP formula is applicable to buy-sell arrangements, see Chapter 6.5.1.
The LIPP formula should refer to the Platts rather than the AFRA freight adjustment.	CAV considers that the freight adjustment of the LIPP formula should be more flexible, see Chapters 6.5.2 and 10.2.2.
<ul style="list-style-type: none"> The TGP formula does not allow adjustments for supply and demand. There is no incentive to supply additional fuel as TGPs cannot be adjusted during product shortages. 	CAV considers that the current approach to the terminal margin provides Declared Suppliers with a reasonable return on investment and that the ability to discount provides sufficient flexibility to respond to supply conditions and competition, see Chapter 6.5.3.
TGP requirements imposes administrative costs on industry with little benefit to consumers.	During consultations with CAV this concern was raised by Declared Suppliers, in particular with regard to the shortfall notification requirement. CAV considers that the shortfall notification requirement should be removed, see Chapters 6.9.1 and 10.2.4.
<ul style="list-style-type: none"> A number of procedural issues including invoicing are very prescriptive. The disclosure of optional service costs on invoices is not necessary and the information is already provided to consumers. 	CAV considers that the invoice disclosure requirement is fundamental to price transparency and, therefore, does not propose any change regarding this requirement, see Chapter 6.8.1.

⁷⁴ ACCC December 2002 Report, page 82.

9.9 Overall assessment of the Victorian TGP

ACCC Findings

The ACCC found it difficult to form a view on Victoria's TGP arrangements because the extent to which they applied to the market in Victoria at the time was not clear to the Commission. However, it did conclude 'In terms of transparency, the Government's objectives appear to have been achieved'.⁷⁵

CAV Comment

CAV considers that the legislated TGP in Victoria has improved access to supply, reasonableness of wholesales prices, price transparency and created a degree of 'bottom-up' pricing.

⁷⁵ ACCC December 2002 Report, page 87.

Chapter 10

Recommendations and future direction

10.1 Introduction

Based on the preceding analysis and assessment CAV does not consider there is a need at this stage for fundamental amendment of the Act and the administrative scheme operating under it. There are some adjustments that could be considered to improve the operation of the Act and facilitate the achievement of its objectives. Several are proposed in this chapter.

A number of matters were raised and views expressed by stakeholders in the period leading to the drafting of the report. These were taken into account in drafting the report. Where specific changes to the scheme were suggested but no change is proposed by CAV, the basic issues are discussed in Chapter 6 along with the reasons for rejecting the proposed changes.

A draft version of this report was provided to the TGP Reference Group for comment in June 2003. A meeting of the Group was held on 24 June and written comment sought from stakeholders by mid-July. Written comments on the draft were received from five members of the Group: BP; Mobil; Trafigura; the RACV; and the ACCC. The verbal comments at the meeting and subsequent written comments have been considered and taken into account in finalising the report.

Major points in written comments on the specific draft recommendations are summarised briefly in *Appendix E*, along with reference to the sections of this report that provide the basis for the CAV's response which generally was to maintain the draft recommendation.

There was general agreement among industry stakeholders that access to supply at terminals is no longer an issue for resellers. As to transparency, the Independents maintained their view that discounts off published TGPs, rebates and price support should be prohibited to achieve their concept of complete transparency. On the future of the Victorian scheme if the TGP component of the proposed national *Oilcode* comes into operation, the stakeholder group favoured the application of only one TGP scheme. A common view among stakeholders was that the Act should be repealed if the national *Oilcode* TGP scheme comes into operation as multiple schemes will add to the costs and complexity of operations.

10.2 Recommendations

10.2.1 Revoke the declaration of the independent terminal operators

The independent terminal operators declared under the Act are Trafigura, declared when the Act commenced in August 2001, and Tri-State, subsequently declared in December 2001. These companies were declared along with the Oil Majors because they supply Declared Fuels from seaboard terminals which are the primary point from which fuel is sold into the Victorian wholesale market. While these suppliers also operate as secondary wholesalers, purchasing fuel from the Oil Majors for on sale, they are only declared where they supply fuel from the Hastings terminal.

As discussed in Chapters 3.4 and 6.2 the independent terminal operators sell fuel under contract and on a spot basis to independent wholesalers and retailers on market based prices. Tri-State has not sold fuel through the Hastings terminal since the commencement of

the Act and there is no indication that it is likely to in the foreseeable future. Trafigura sells the major proportion of its fuel through this terminal to customers who also purchase from other suppliers, including the Oil Majors. Therefore, concerns regarding the lack of price transparency, which arise when suppliers and their customers are in vertical relationships by virtue of equity, franchise or exclusive arrangement, are not apparent with regard to sales involving the independent terminal operators.

In addition to the absence of integration forward into retailing, Trafigura's position in the Victorian market is clearly distinguishable from each of the Oil Majors with respect to:

- the absence of any reciprocal supply relationships with any Major which limits its relative negotiating position in the wholesale market;
- the absence of any refining capacity interstate which means its only alternative supply is importation; and
- its independently-sourced product represents a very minor component of overall supply – with the likelihood of diminished significance in the future as the Caltex-Woolworths joint venture and product specification changes come into effect.

Trafigura argues that it has been disadvantaged as a result of its declaration and CAV has observed through the shortfall notifications that Trafigura may not have been as active in the spot market as it may have been had it not been declared.

In recognition of the differences in structure, operations and market position and significance of Trafigura and Tri-State it is recommended that the declaration of the independent terminal operators be revoked. CAV does not consider that this action will weaken price transparency in the market generally nor does it consider that equity between these companies and the declared Oil Majors is offended by revocation, given the differences between them.

10.2.2 Allow flexibility in 'freight' component of LIPP

While the Worldscale rate is the appropriate notional base for the freight component of the LIPP, it was noted in Chapter 6.4.2 that the general consensus among the Declared Suppliers is that Platts Shipping is a better adjustment factor because it reflects the true costs of spot shipping more accurately than AFRA. The monthly AFRA adjustment reflects global conditions rather than those in the relevant South East Asian region, as the recently introduced Platts adjustment does. Shell specifically submitted that Declared Suppliers should be free to select the freight rate which they believe is the most appropriate given their own commercial circumstances.

In order to accommodate recent developments and possible future improvements in freight cost indicators, it is recommended that each Declared Supplier be permitted to select the internationally-recognised freight cost indicator it considers most appropriate. CAV would expect that the selected indicator would be used consistently over time and only change with good reason related to the rigor and accuracy of the measure. Selecting different freight cost indicators from time to time simply to obtain a larger freight amount in the calculation of the LIPP and TGP would not constitute a 'good reason'.

10.2.3 TGP to be a 'temperature corrected' price

The introduction of temperature correction ('TC') in December 2002 has resulted in a pricing practice which highlights the need to specify the temperature at which fuel must be measured to determine and post a TGP. As the Act is silent on a TGP temperature it does not prohibit a posted TGP being different to the actual price per litre charged to a reseller for a particular load of fuel, which under TC must be the price at 15^o Celsius. Therefore, to ensure that the posted TGP is identical to the actual per litre price for a sale it is

recommended that the temperature for determining a TGP be specified at the Australian and international standard reference temperature for the measurement of fuel which is 15^o Celsius.

Both the RACV and Mobil commented on this recommendation but did not support a temperature corrected TGP. The RACV considers that a temperature corrected TGP would detract from motorists understanding of a 'true TGP'. CAV considers that while a temperature corrected TGP may be higher than an 'ambient' TGP, it reflects a more transparent price for a litre of fuel as it accounts for stock costs arising from changes in temperature/volume. Therefore, comparing local pump prices to a temperature corrected TGP provides resellers and motorists with a more transparent indicator of the built-up of costs to their location. As most Declared Suppliers already post temperature corrected TGPs the recommendation will ensure consistency between information published on the intranet.

The RACV noted that Shell publishes on its web site temperature corrected prices and also ambient prices for commercial (end-use) customers. The publication of ambient prices will not be affected by the recommendation to require temperature corrected TGPs as these prices relate to retail sales which are not covered by TGP or TC.

Mobil is concerned that this recommendation could mean that any future changes to TC may unintentionally impact on TGP. Given that both TGP and TC are specific in their application to particular categories of wholesale sales this is unlikely to be the case. Furthermore, while Mobil publishes temperature corrected TGPs, this is not required to comply with the TGP arrangements and that where different prices are published and charged for a sale this erodes transparency and certainty in the marketplace and is frustrating for resellers.

10.2.4 Remove requirement to notify 'supply shortfalls'

It is questionable, given that issues of non-supply have not arisen yet under the TGP scheme, whether the requirement on Declared Suppliers to notify any shortfall in the availability of Declared Fuels achieves any significant worthwhile end. As noted in Chapter 6.8, while shortfall notifications implied that supplies were less likely to be in shortfall during 2002, this was not the case because two suppliers with fuel stocks only sufficient on occasions to meet contractual commitments did not lodge notifications as they were unlikely to receive requests for spot sales.

In Shell's view, the requirement to notify shortfalls in the availability of Declared Fuels creates an unnecessary administrative burden. Shell suggested it is simpler and more practical to respond to the circumstances of insufficient supply to meet the demands of spot customers on a case by case basis, rather than creating an on going reporting requirement. The aim of the shortfall notification requirement is to assure resellers that they are being refused fuel because of a product shortfall. It is considered that this aim could be achieved in the marketplace without a separate reference to government. Therefore, CAV considers there is merit in Shell's proposal and recommends accordingly that the notification requirement be terminated. If this course was adopted, CAV would require that Declared Suppliers provide a documented explanation of the shortfall to spot customers on a case-by-case basis and provide the detail of such cases to CAV on request.

10.2.5 Continue monitoring of Declared Suppliers

A major finding of the review is that an insufficient period has passed to assess the impact of the Act in relation to its objectives. A logical progression from the assessment in Chapters 6 and 8 is that monitoring over a longer period is required to fully assess the impact of the Act and determine its usefulness.

The Act has intentionally been constructed to be light-handed with the primary focus on price transparency as instrumental to other objectives. The Act has been structured not to be unduly prescriptive and the recommendations of this review further extend the 'light-handedness' of the regulatory scheme. Given that Declared Suppliers have considerable latitude, CAV considers that having effective, on-going monitoring in place is necessary to ensure that Declared Suppliers remain committed to the principles and spirit of the Act over time. Accordingly, a continuation of monitoring by CAV is recommended. Specifically, it is proposed that future monitoring involve a capacity to undertake the types of price and margin analyses contained in Chapter 7.3 to 7.7, including country-city price differentials and notional industry margins.

Likely significant developments in the automotive fuels market more generally in the year ahead also suggest that continued monitoring would be prudent. The relationships established between Shell and Coles Myer and between Caltex and Woolworths are likely impact significantly on competition in the wholesale and retail markets. The position of Trafigura will be affected by the exclusive supply arrangement between Caltex and Woolworths and Independent resellers face a dynamic market with the spread of supermarket-based discounting off pump prices.

10.2.6 Clarify certain provisions of the legislation

The practical administration of the Act by CAV and consultations with stakeholders required to comply with its provisions have revealed several minor aspects of the drafting of the legislation that could be clarified. They are outlined in **Table 10.1** below with a brief statement of the issue and the intent of the proposed change. It is recommended that these changes be given effect by appropriate amendments to the legislation.

Table 10.1: Proposed technical and administrative amendments to the Act		
Requirement	Proposed Amendment	Comment
Definition of Distributor - s.3	Amend the definition of 'distributor' to refer to a person who is wholesaling petroleum products and who acquires title to the goods for resale.	The definition is very broad and could catch the customers of Declared Suppliers who were not intended to be covered by the Act, such as transport companies.
Add definition of retail - s.3	Add the definition of retail to clarify that it means a sale to an end user where the end user is a person or a business who either wholly or principally uses (not resells) fuel.	The Act is not intended to apply to sales to commercial customers who are primarily end-users but who also retail small amounts of fuel, such customers include co-operatives, transport and industrial companies. An amendment is required to clearly place sales to commercial customers outside the Act.
Subsequent declarations - s.5	Amend to ensure that suppliers who are declared after the Act commences are required to set and post TGPs.	A drafting amendment. The Act is not clear on the obligations of suppliers declared after the commencement date of 1 August 2001.
Terminal Gate Price - s.5(1)	Amend to clarify that a Declared Supplier must set a TGP for a sale or supply to a distributor or retailer.	An amendment is required to clearly specify the class of customer who must be supplied on a TGP basis.

Requirement	Proposed Amendment	Comment
Return on assets in a site - s.5(8)(h)	After 'assets owned' add 'or leased'.	This amendment is required to clarify that the section refers to assets leased, as well as owned, by a Declared Supplier at a retail site.
Price of Sale or Supply and Invoicing - s.6 & 7(5)	Amend to clarify that the TGP formula and invoicing requirements only apply to wholesale sales to distributors and resellers.	Such an amendment would clarify the application of these sections. This section may be interpreted to apply more broadly than intended.
Information Requested on Optional Services - s.7(2)	Amend to clarify that the request for information on optional services is in respect to that distributor or retailer.	This provision could enable a distributor or retailer to request price information on optional services which may apply to other retailers and distributors and which may be confidential.
Pre-existing Contracts – Entered Into Before 1 November 2000 - s.8(2)	Amend to clarify that the invoicing requirements only apply to contracts entered into on or after 1 November 2000.	This amendment would clarify that the invoicing requirements apply to deliveries under all contracts entered into after 1 November 2000.
New Contracts - s.8(3)	Amend to add a new subsection to clarify that contracts entered into on or after the commencement of the Act are void to the extent that they are inconsistent with the Act.	The application of the transitional arrangements could be improved through amendment.
Refusal to Supply - Credit Risk - s.9(1)	At the end of the subsection after the word 'retailer' add 'who tenders of the required price.'	The proposed amendment covers situations where financial settlement for the supply of petroleum product/s is unable to be made by the distributor or retailer under the Declared Supplier's normal commercial arrangements.
Section 10 Penalties	Amend to insert a penalty for failure to produce documentation and answer questions.	There is currently no penalty for a Declared Supplier who refuses to provide information and documentation to the Director of CAV.
Technical Amendment - s.11	Replace 'as reference' with 'a reference'.	A minor technical amendment of a typographical nature.
Regulation Penalties - s.13	Amend to enable penalties for contravention or failure to comply with the Act to apply to the regulations.	There is currently no penalty for a Declared Supplier who fails to comply with the requirements in the regulations.

10.3 Proposed national TGP scheme

In March 2003 the Commonwealth Department of Industry, Tourism and Resources released its *Downstream Petroleum Industry Reform* package. The package is based on a mandatory industry code for the petroleum industry (*Oilcode*) under Part IVB of the *Trade Practices Act* 1974. One of the key elements of the proposed code is a national terminal gate pricing scheme that incorporates several 'TGP principles' developed to promote increased transparency at the wholesale level of the industry.

The Commonwealth's principles define a terminal gate price simply as 'the price for a wholesale sale of a declared petroleum product' because the principles 'are intended to represent the minimum requirements for any terminal gate pricing model'. CAV considers transparency in the market is further enhanced under the Victorian scheme by the requirement to relate TGPs to an identifiable and objective price benchmark such as import parity prices. In addition to the absence of any price benchmark in the proposed scheme, the limited disclosure of price information at the time of purchases required under the proposal is of concern to CAV.

On releasing the Reform Package the Department stated that, 'An important feature of the [TGP] principles will be that they are consistent with existing arrangements in States and Territories'. CAV considers that the objectives of Victoria's TGP scheme are broadly consistent with the Commonwealth proposal. A national approach to achieving these objectives is desirable. It is recommended that the Victorian Government put its views to the Commonwealth on those aspects above that fall short of the Victorian scheme. In the event that a national code-based TGP scheme eventually comes into effect, it would be appropriate to review the Act to consider whether a continuing need for it existed. If, on balance, the national code-based scheme met the Victorian Government's objectives, effective suspension of the Act by revoking all declarations would be appropriate to avoid duplication of regulation administration and compliance costs.

Appendix B provides a comparison between the Victorian legislated TGP and the proposed national scheme as CAV currently understands it. Items of difference are shaded in grey.

10.4 Consideration of LPG pricing issues

LPG autogas is a fuel which may be declared under the Act. However, declaration of LPG autogas was deferred at the time of proclamation of the Act to allow further investigation of the issue and for experience to be gained with the operation of TGP for petrol and diesel. In addition to the experience of TGP with other fuels examined by this report, there have been two major developments since August 2001 relating to LPG. These are:

- the mid-2002 report of the Essential Services Commission ('ESC') on its inquiry into market power and pricing in the domestic LP bottled gas market in Victoria; and
- the Commonwealth Government's *2003-04 Budget* announcement of its decision to phase in excise on LPG autogas commencing from July 2008.

While acknowledging that the ESC's inquiry was directed to the market for LP bottled gas for household use and that there are substantial differences in market structure compared to the autogas market, the ESC's findings of the exercise of market power in both the upstream and downstream markets and information disparities between marketer/retailers and end-use

consumers may raise concerns about pricing issues in the autogas market.⁷⁶ Although some time away, the imposition of excise at the wholesale stage of supply may exacerbate existing retailer and consumer concerns about producer/marketer margins and price transparency generally.

CAV considered these factors in combination warranted revisiting the issue of transparency in the LPG autogas market at the time of providing the draft report to stakeholders. The issue was raised at the June 2003 meeting of the TGP Reference Group and written submissions were received from stakeholders. A variety of views were expressed, broadly: the producers and wholesalers considered that information currently available in the market was sufficient; independent resellers considered TGP should extend to autogas with discounting off published prices prohibited; and the RACV argued for the extension of TGP to autogas.

Analysis by CAV suggests that there is some transparency at a high level through the very strong correlation over time between the international 'Saudi Aramco Contract' benchmark price ('SACP') and Melbourne autogas retail prices. Thus, over time the SACP offers an independent 'guide' to retail price movements. In relation to notional industry margins (average retail prices less the SACP) LPG autogas exhibits marked fluctuations, but where sharp rises occur they are not sustained over time. Over the same period as the reference period for the TGP assessment (August 2000 to December 2002) autogas NIMs declined slightly, in contrast to the rise in petrol margins. Combined with a less concentrated market structure than petrol or bottled LPG markets, the existence of two major suppliers that are not integrated forward into retailing (BHP and Esso) and the likely entry of additional primary suppliers, these factors suggest that a legislated requirement for terminal gate pricing is not warranted at this point in time.

CAV understands that at least one substantial wholesaler of autogas is proposing to shortly begin publishing its wholesale prices for non-contract sales, by region. This initiative will introduce further transparency into the autogas market and provide resellers and consumers with an indicative wholesale price level between the SACP international benchmark and retail prices. Competitive pressures may result in other wholesalers following the initiative and increasing transparency and price information in the market in general.

⁷⁶ While proposals to implement ESC recommendations regarding industry disclosure of prices and costs and periodic monitoring and publication of information are currently being developed, there is no evidence as yet of any substantial change in the market position of producers and marketers or of any improvement in price transparency in the bottled LPG market.

Appendix A

Glossary

ACCC	Australian Competition and Consumer Commission.
Act	<i>Petroleum Products (Terminal Gate Pricing) Act 2000</i> , Act No 71/2000, Victoria.
Active Declared Suppliers	The Declared Suppliers actually posting terminal gate prices during the first twelve months of operation of the Act, that is BP Australia Limited, Caltex Australia Petroleum, The Shell Company of Australia, Mobil Oil Australia, and Trafigura Fuels Australia.
ADO	Automotive distillate oil or diesel.
AFRA	The Average Freight Rate Assessment for medium range vessels, as determined on the first day of each month by the London Tanker Brokers, plus a reasonable allowance for a clean-ship premium as determined by a Declared Supplier.
AIP	Australian Institute of Petroleum.
APADA	Australian Petroleum Agents and Distributors Association
Benchmark TGP	The value calculated for each Declared Product by Economic & Energy Analysis Pty Limited on behalf of Consumer Affairs Victoria in accordance with the determinations made for the Act to allow comparisons with the posted TGP values of Active Declared Suppliers. The Benchmark TGP is the sum of the LIPP, excise, a nominal terminal margin allowance and GST.
BP	BP Australia Limited, ABN 53 004 085 616.
CAV	Consumer Affairs Victoria. The Victorian Government Agency administering and monitoring the operation of the Act.
Caltex	Caltex Australia Petroleum Pty Ltd, ABN 17 000 032 128.
Declared Products	The petroleum products declared for the purposes of the Act by the Governor in Council. These products are petrol- lead replacement- at 96 RON; petrol- unleaded regular- 91 to 93 RON; petrol- unleaded premium- 95 to 98 RON; and automotive distillate.
Declared Supplier	The suppliers declared for the purposed of the Act by the Governor in Council. These include BP Australia Limited, Caltex Australia Petroleum, The Shell Company of Australia, Mobil Oil Australia, Trafigura Fuels Australia and Tri-State Petroleum.
ESC	Essential Service Commission in Victoria.
Franchise Act	Petroleum Retail Marketing Franchise Act 1980.
Gross Industry Margin	The difference between the retail price and the total of LIPP, excise and GST.

Independent Retail Site	A retail site or retail sites not branded as BP, Shell, Mobil or Caltex. For the purposes of this Report, the identification is based on branding only and not on ownership. Independent Retail Sites include those operated by the Woolworth group.
Informed Sources	Informed Sources (Australia) Pty Ltd.
Gross Industry Margin'	The difference between the retail price and the sum of LIPP, excise and GST.
Liberty	Liberty Oil Australia Pty Ltd.
LIPP	The Landed International Product Price as calculated in accordance with the determinations made by the Governor in Council in August 2001.
LRP	Lead Replacement Petrol at 96 RON.
LPG	Liquefied Petroleum Gas
Major or Refiner Marketer	Refers to the refining and related marketing operations of the organisations which operate refineries in Australia, that is BP, Shell, Mobil or Caltex.
Major Retail Site	A retail site or retail sites branded as BP, Shell, Mobil or Caltex. For the purposes of this Report, the identification is based only on branding and not on ownership.
Mobil	Mobil Oil Australia Pty Ltd, ABN 88 004 052 984.
MTBE	Methyl tertiary butyl ether.
Notional Industry Margin	The difference between the retail price and the LIPP.
Notional Terminal Margin	The difference between a Declared Suppliers' posted TGP (<i>post</i> -TGP period) and the LIPP.
Notional Wholesale Margin	The difference between a Declared Suppliers' 'wholesale' price (<i>pre</i> -TGP period) and the LIPP.
Platts Shipping	The "Platts Singapore Oilgram Report" for the journey from Singapore to Japan for 30 kt clean (product) tankers.
PMAA	Independent Petroleum Marketers Association of Australia.
PSA	Prices Surveillance Authority, a precursor organisation to the ACCC.
PSPASP	The Platts Singapore Products Assessment (Spot) Price (the Declared Supplier may use the mean of the quoted range), as set out in the Platts Singapore Products Assessment (Table 6) of "Platts Global Alert" published on subscription by Standard and Poors, a division of McGraw-Hill Companies for that class of product.
Ppm	Parts per million.
PULP	Premium Unleaded Petrol at 95 to 98 RON.

Quarter	The quarter since the introduction of the Act, that is Quarter 1 means the period of 1 August 2001 to 31 October 2001, Quarter 2 means 1 November to 31 January 2002 and so on. Quarter B refers to the first three months prior to the introduction of the Act (1 May 2001 to 31 July 2001) while quarter A refers to the three months before that.
Review period	The period of 1 August 2001 to 31 July 2002 being the period that corresponds to the first twelve months of operation of the Act.
RON	The Research Octane Number as determined by the method described in the test procedure which is designated in D2699-99 of the Standard Method for Research Octane Number of Spark-Ignition Engine Fuel published by the American Society for Testing and Standards.
Shell	Shell Company of Australia Limited, ABN 46 004 610 459.
Sites Act	Petroleum Retail Marketing Sites Act 1980
TGP	Terminal Gate Price or Terminal Gate Pricing, as the case may be.
Trafigura	Trafigura Fuels Australia Pty Limited, ABN 96 092 210127.
RULP	Regular Unleaded Petrol at 91 to 93 RON.
VACC	Victorian Automobile Chamber of Commerce.
Worldscale	The Worldscale 100 Freight Rate, (Singapore) to Melbourne, as set annually by the Worldscale Association (London) Ltd.
EEA	Economic & Energy Analysis Pty Limited.

Appendix B

Comparison of Victorian TGP Scheme with Proposed Commonwealth Scheme

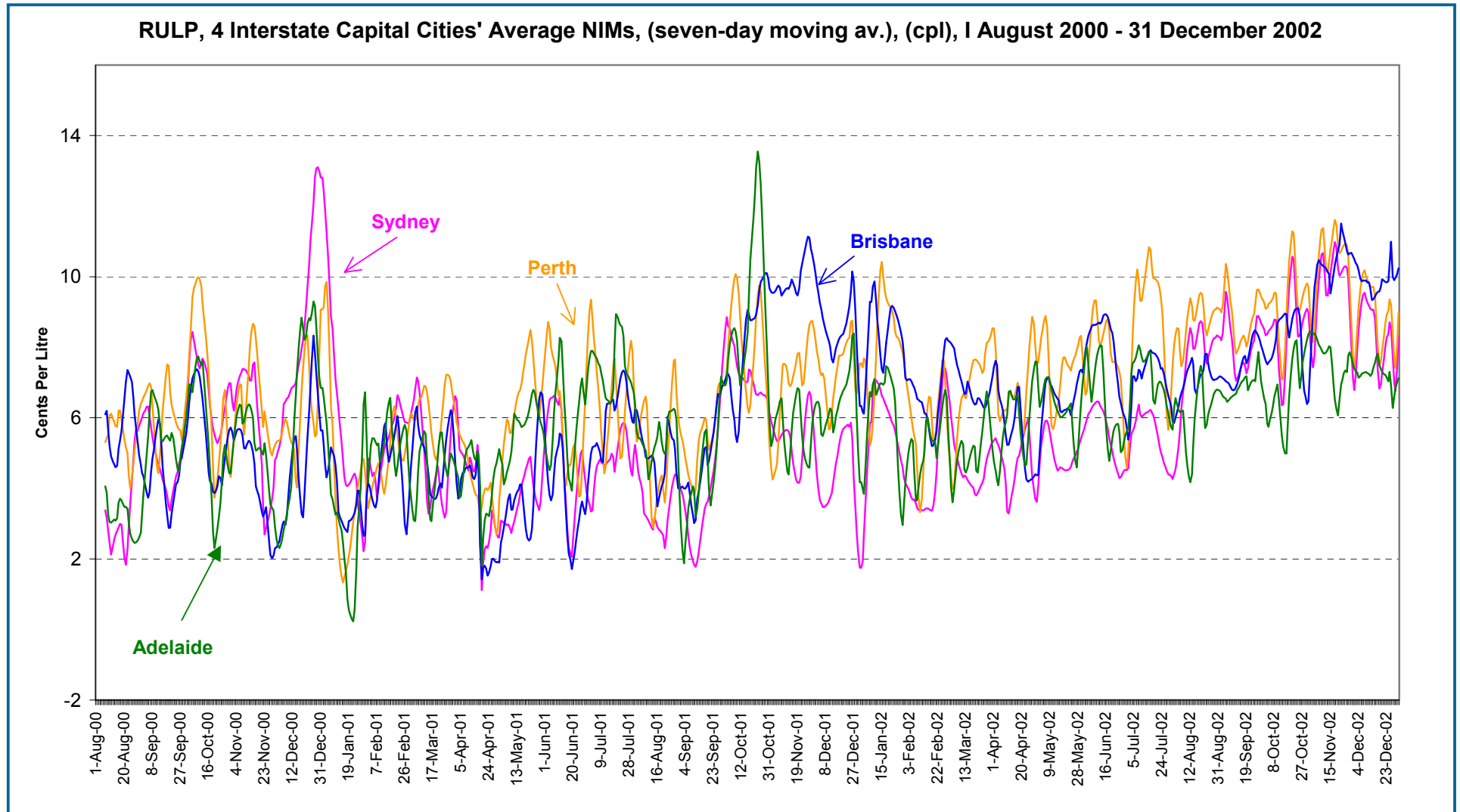
Requirement	Victorian Legislated TGP	Proposed National Scheme
Authority	<i>Petroleum Products (Terminal Gate Pricing) Act 2000</i> and accompanying Regulations, Orders in Council and Determination. Came into operation on 1 August 2001.	Proposed <i>Trade Practices Industry Codes – Oilcode) Regulations 2003</i> . Prescribed Code under the <i>Trade Practices Act 1974</i> . Proposed to come into operation end 2003.
Application	Victoria	Australia
Meaning of TGP	The primary wholesale price set by a Declared Supplier for Declared Fuel.	Defined as the price of a wholesale sale of Declared Fuel. It does not include ex-terminal charges.
TGP Formula	TGP must be determined using the prescribed formula where TGP = Landed international Product Price (LIPP) + excise and other taxes + a reasonable terminal operating margin + GST. LIPP = Relevant PSPASP/s + freight + insurance + wharfage.	TGP is the price for the wholesale sale of fuel; no method of determining the TGP is specified. A TGP must be set in cents per litre
Post-TGP Charges	Post terminal costs are not included in the calculation of the TGP. A Declared Supplier may only charge for the optional services specified in the Act including credit, transport, delivery, branding and equipment and for any return on investment in an owned or leased retail site.	Post terminal costs are not included in the calculation of the TGP. Additional services are not specified Distinction <ul style="list-style-type: none"> from the supplier, the supplier may provide and charge for additional services. may only provide and charge for additional services at the request of the customer. Spot and contract customers must be given the option of purchasing based on TGP or TGP plus or minus additional service charges or discounts.
Discounts & Rebates	Discounts and rebates allowed as deductions from the posted TGP applying to the sale of a load of fuel. Price support payments subsequent to the sale not restricted.	All discounting is permitted.
Declared Suppliers	Primary wholesalers (companies selling Declared Fuels from refinery-connected and seaboard terminals) including BP, Caltex, Mobil, Shell, Trafigura and Tri-State. (Specified in Order in Council).	All wholesale suppliers, that is wholesalers who supply declared fuel from a refinery or terminal.

Requirement	Victorian Legislated TGP	Proposed National Scheme
Declared Fuels	<ul style="list-style-type: none"> ■ Leaded Petrol - 96 RON ■ Lead Replacement Petrol 96 RON ■ Regular Unleaded Petrol 91 to 93 RON ■ Premium Unleaded Petrol - 95 to 98 RON ■ Automotive Distillate 	<ul style="list-style-type: none"> ■ Unleaded Petrol including unleaded petrol and a blend of another product ■ Premium Unleaded Petrol ■ Diesel other than proprietary diesel
Facilities where TGP applies	Seaboard and refinery connected terminals owned or operated in Victoria by the Declared Suppliers.	Wholesale facilities including seaboard and refinery connected terminals.
Types of Sales	<p>All wholesale sales including contract and spot sales.</p> <p>Declared Suppliers are not required to set a TGP for retail sales (sales to personal or business end users).</p>	<p>All wholesale sales including contract and spot sales.</p> <p>Excludes retail sales.</p>
Customers	Resellers including wholesalers, distributors and retailers.	Distributors and retailers including franchisees.
Temperature of posted TGP	Not specified	15 Degrees Celsius
Publication of TGPs	TGPs posted daily on Declared Suppliers' web site along with name of the relevant terminal.	<p>TGPs must be:</p> <ul style="list-style-type: none"> ■ posted daily on Wholesale Suppliers' web site; or ■ if web publication not possible by telephone or facsimile.
TGP Adjustment Period	Set and posted once every 24 hours. Not to be adjusted more than once every 24 hours.	No period specified. A TGP may change during the day.
Disclosure of Price Information	<ul style="list-style-type: none"> ■ prescribed post terminal charges must be disclosed on the invoice accompany the sale of a load of Declared Fuel. ■ return on investment in an owned or leased retail site must be disclosed on request. 	<ul style="list-style-type: none"> ■ documentation must identify the product, the volume, the total price and the price of the additional charges. ■ documentation must identify the supplier, the customer, the date of the transaction, the product, the volume, the posted TGP at the time of the transaction, the total price, the description and price of any additional services, the amount and application of any discounts.
Notification of Product Shortfall	A written notification must be provided to CAV when a Declared Supplier has insufficient stock of Declared Fuels to supply its contracted customers.	Not applicable.

Requirement	Victorian Legislated TGP	Proposed National Scheme
Selling below TGP- retail sales	Legislation is silent, therefore, not restricted.	<p>Allows a retail site that is owned, leased or operated by a refiner/marketer to set a retail price which is below the posted TGP:</p> <ul style="list-style-type: none"> price being offered by an unrelated site in the same market; and include a discount provided by the refiner/marketer or associated business <p>Refiner/marketer - wholesale supplier that manufactures fuel</p> <p>Market as defined in s.4E of the TPA</p>
Refusal to supply	<p>A Declared Supplier must supply to all customers except in the prescribed circumstances including:</p> <ul style="list-style-type: none"> product shortage which has been notified to CAV; customer is unable to tender the required price; load is less than 35,000 litres; unsafe or illegal to supply the requested fuel; and terminal scheduling. 	<p>A Declared Supplier must supply to all customers except in the prescribed circumstances including:</p> <ul style="list-style-type: none"> Declared Supplier does not have sufficient stock; Reasonably believes that the customer is unable to pay for the supply; unsafe load; and for a spot sale where the Wholesale supplier advertises a minimum amount and the amount sought is less than the minimum amount.
Vehicle and driver safety standards	Not applicable.	Wholesale suppliers and customers who operate road vehicles are responsible for the suitability and safety of vehicles and the competence of drivers.

Appendix C

Interstate Notional Industry Margins



Appendix D

Crude oil pricing and refining margins

All crude oil and refined petroleum products are traded internationally in United States dollars, irrespective of source. Crude oil prices quoted on world markets are influenced by the crude specification (for example light, heavy, sulphur content etc), demand (such as the Northern Hemisphere stockpiling for winter) and supply factors (such as OPEC quotas and the recent Venezuelan strike). Markets are very sophisticated, with electronic trading, futures and margin trading and arbitrage influences.

Media in Australia tend to refer to movements in world crude oil prices when reporting on domestic petrol and diesel prices. However, the domestic pricing of petrol and diesel has traditionally been linked to the refined product price, not the crude oil price.

The Prices Surveillance Authority (PSA) and, subsequently, the ACCC used the refined product prices for petrol and diesel (gasoil) quoted on the Singapore spot market, as the basis for determining maximum wholesale price caps. Following deregulation of wholesale fuel prices in 1998, refiners and importers continued the link with the Singapore refined product prices, which are also the bases for TGPs set by Declared Suppliers under the Act.

While in the longer term, the trend in world crude oil prices influences individual refined product prices, the link is not necessarily a direct one in the shorter term. Prices for refined petrol and diesel are initially influenced by individual demand and supply factors, which can be seasonal, economic or political in nature. For example, world petrol prices usually rise in the lead-up to a Northern Hemisphere summer when vehicle travel increases; at the same time diesel prices will be falling away from a winter heating demand peak (sometimes irrespective of crude oil price movements).

An indicator of refining company performance is the 'Refining (or Refiner) Margin'. This is the \$US margin between prices of individual products refined from a barrel of crude and the quoted price of that barrel of crude. Individual product refining margins can vary substantially, one from the other, at any one time. For instance, the price of 95 ROM unleaded motor spirit might exceed the crude oil price by \$US1.50 bbl while, at the same time, the margin for diesel might be \$US3.80 bbl.

Singapore refinery output is geared mainly to the production of diesel. This means that from time to time the margin for petrol can approach or fall below zero as the market offloads excess petrol stock. This impacts on the profitability of Australian refiners as production is more heavily weighted to petrol refining and performance is assessed by reference to the refining margin available above crude oil prices. While Australian refiners continue to accept the parity link they point to low petrol refining margins as constraining their profit from time to time.

In December 2001, Caltex reported that it 'had been savaged by falling refining margins to \$US1.45 in the first half of that year'.⁷⁷ A study of Singapore prices in 2001 showed that in the period just before the introduction of TGP, spot 95 RON motor spirit prices fell below the Malaysian Tapis crude price. In August 2002, Caltex announced that refiner margins had improved from the 2001 average of \$US1.61 bbl to \$US2.60 bbl.⁷⁸

⁷⁷ Herald Sun Newspaper, 7 December 2001, *Caltex Sinks Lower*.

⁷⁸ The Australian Newspaper, 8 August 2002, *"We made a motser but don't blame us"*.

Appendix E

Petroleum Produces Terminal Gate Pricing Reference Group

Membership

Ongoing participants–

- Australian Institute of Petroleum
- Australian Petroleum Agents & Distributors Association
- Australian Liquefied Petroleum Gas Association
- Victorian Automobile Chamber of Commerce
- RACV
- Petroleum Marketers Association of Australia
- BP Australia Limited
- Caltex Australia Petroleum Limited
- The Shell Oil Company of Australia Limited
- Mobil Oil Australia Pty Ltd
- Trafigura Fuels Australia Pty Ltd
- Tri-State Petroleum Victoria Pty Ltd
- Liberty Oil Pty Ltd
- Elgas Limited
- Independent Gas
- Consumer Affairs Victoria

Other participants–

- Motor Traders' Association of Australia
- Australian Competition & Consumer Commission

Terms of Reference

The role of the Reference Group –

- 1 To identify any issues which need to be considered and resolved to enable effective implementation of the Act.
- 2 To provide advice on a range of issues concerned with implementation of the Act and including –
 - The structure and operation of the industry as it relates to the Act.
 - Proposals concerning:
 - the declaration of suppliers and classes of petroleum products;

- the specification of landed international product price;
 - the publication of a terminal gate price;
 - the notification of a shortfall in the availability of petroleum products; and
 - record keeping requirements.
- The financial impact and other costs of regulations proposed under the Act.
 - Any other issues which arise during and following implementation of the Act.
- 3 To co-ordinate action as necessary across the industry participants to implement the Act.
- 4 To assist with the development of a strategy to inform industry and consumers about price setting and access arrangements under the Act.
- 5 To assist with the development and monitoring of criteria to evaluate the impact of the Act.

Appendix F

Comments on draft recommendations and CAV response

Specific comments by those stakeholders providing written comments on the June 2003 draft recommendations are summarised below.

1 *Revoke declarations of independent terminal operators*

BP	<ul style="list-style-type: none"> ■ ■ ■ level playing field. ■
Mobil	<ul style="list-style-type: none"> ■ Oppose recommendation. ■ Purpose of Act is to require determination of terminal gate prices and the Hastings terminal is a major import facility for Victoria, therefore encompassed within the intent of the Act. ■ Revocation is discriminatory against suppliers remaining declared. ■ Do not accept that Trafigura has been disadvantaged.
Trafigura	<ul style="list-style-type: none"> ■
RACV	<ul style="list-style-type: none"> ■ Oppose recommendation. ■ Total transparency is purpose of Act and treating any wholesaler differently defeats this purpose. ■ Treating independent terminal operators as "a special case" sends the wrong signals to any potential new entrants.

CAV considers there is sufficient difference between the Major and non-Major market participants (and that BP is fundamentally distinguishable from Trafigura) to treat Trafigura and Tri-State differently to the Oil Majors without offending equity. See the discussion at Chapters 3, 6.2 and 10.2.1. While section 1 of the Act states that the purpose of the Act 'is to require determination of terminal gate prices...', the discretion as to the declaration of suppliers provided by section 4 and the broad definition of 'supplier' in section 3 clearly establishes wide discretion as to which businesses will be declared. 'Total transparency' is not the objective of the Act; rather it is to promote greater transparency in wholesale pricing than existed prior to the legislation. The permitting of discounting off the published TGP and the absence of a requirement to publish actual transaction prices indicates that the Act was not intended to force 'total' or absolute price transparency. See Chapter 4 for a discussion of the objectives of the Act.

2 *Allow flexibility in 'freight' component of LIPP*

BP	<ul style="list-style-type: none"> ■ ■ components of cost of product.
Mobil	<ul style="list-style-type: none"> ■ Support recommendation.

CAV considers the definition of TGP in the scheme strikes a reasonable balance between providing an objective reference point or benchmark for customers of Declared Suppliers and consumers to assess published prices on the one hand; and allowing Declared Suppliers flexibility in setting the exact quantum of prices on the other. See chapter 6.5 for a discussion of the components of the TGP formula.

3 *TGP to be a 'temperature corrected' price*

Mobil	<ul style="list-style-type: none"> ■ Mobil's TGPs already consistent with temperature correction ('TC'). ■ TC is a trade measurement issue and no reason for the Act to be amended to specify TGP to be temperature corrected
RACV	<ul style="list-style-type: none"> ■ TGP price which many customers will continue to buy at."

As TGP pre-dates TC, CAV considers that temperature corrected TGPs are necessary to improve transparency and consistency and to ensure that the published TGP is identical to the actual price at which a litre of fuel is sold to a reseller. See sections 6.5.4 and 10.2.3 for a discussion of the issues arising with regard to TGP and TC.

4 *Remove requirement to notify 'supply shortfalls'*

Mobil	<ul style="list-style-type: none"> ■ Support recommendation.
-------	---

No response from CAV is required.

5 *Continue monitoring of Declared Suppliers*

Mobil	<ul style="list-style-type: none"> ■ No need for CAV to monitor as Mobil is committed to compliance.
-------	---

While not doubting Mobil's commitment to compliance with the scheme's requirements, CAV needs to independently monitor compliance with the scheme and its impact on the market more generally in order to responsibly administer the legislation. Monitoring may also lead to an assessment that the legislation is no longer warranted.

6 *Clarify certain provisions of the legislation*

Mobil	<ul style="list-style-type: none"> ■ No objection.
-------	---

No response from CAV is required.