

## **SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT LEGISLATION COMMITTEE**

**MARCH 1999**

### **PETROLEUM LEGISLATION REPEAL BILL 1998**

## **AUSTRALIAN DEMOCRATS MINORITY REPORT**

### **Failings of the Petroleum Industry**

1.1 The petroleum industry in total – exploration, production, and manufacturing, wholesaling and retailing – is an industry where there are major barriers to entry and exit. Barriers to entry range from the extraordinary investment and expertise required at the exploration, production and manufacturing end, to the planning difficulties surrounding retail siting. Barriers to exit particularly apply at the retail end where franchise contracts and a shrinking service station sector can often make a profitable exit difficult.

1.2 It is an industry which has always been characterised by the dominance of the transnational majors, who have always striven to maintain their captancy of every level of the supply chain to the customer. Consequently the petroleum industry has not seen the emergence of strong countervailing contenders for captancy of, for instance, the wholesale channel or the retail channel.

1.3 It is the Australian Democrats' view that the industry exhibits fatal flaws, which materially affect investment, profitability, pricing and competition. These flaws include major inadequacies in refinery performance, the oligopolisation of supply, and a heavy concentration of direct and indirect market power by the majors at every level in the chain of supply.

1. Much attention has rightly been paid by the Government, the ACCC, and concerned groups to pricing, to restrictive practices and to market manipulation. Market power, horizontal concentration, vertical integration, ties, and so on affect pricing. Those market flaws also affect profitability and the return on capital, because those with power are able to materially influence and affect where profits are made and taken. For all these reasons market regulation has been essential. That it has only partially succeeded does not mean that it is time to give up. If we are to envisage an industry with much enhanced pricing, competitive and profitability prospects we need to attend to the structures of the industry at every level.

1.4 Existing trade practices legislation provides sufficient powers for the Australian Competition and Consumer Commission to police and prevent mergers or an unacceptable level of market power at the exploration, production and manufacturing level. New law and regulation is most required at the wholesale and retail level.

1.5 To restrain the power of majors in the wholesale area, specific legislation is required to prevent dominance, control or predatory manipulation of the sector. Indeed, the wholesale sector should be entirely independent of the majors, in our belief.

### **Access to supplies**

2.1 Choice at service stations is severely limited. Service stations can be few and far between, especially in country areas, and will usually be tied to one supplier. It is unconscionable that a restrictive site practice, often because of planning considerations, should result in a local monopoly to a particular supplier. Imagine the uproar if consumer sectors with similar site restrictions, such as liquor stores or pharmacies, could sell only one supplier's products. It should be an essential part of competition policy that choice of product is available. All petrol retailers must have the ability to access competitive wholesale prices from alternative suppliers.

2.2 First in this matter of choice is the ability to buy at the best price, through the wholesalers of petroleum products. Access to the oil majors' terminals must be genuinely improved, and enforced by the ACCC. It is not just a question of a *more* open market, as conceded by Caltex Australia in its submission to the Committee:

Open access is all about making sure the market works more openly and efficiently.<sup>1</sup>

but a *genuinely* open market.

2.3 It is suggested that the agreement by the four oil companies to provide open access to terminals for bulk purchases will strengthen competition and bring retail prices down. The problem is that with so many franchisees tied to exclusive supply agreements, which in essence are restrictive trade contracts, the vast bulk of service station proprietors will still not be able to pick and choose from whom they purchase their fuel. Consequently that much desired competitive wholesale environment will be significantly constrained, unless those restrictive trade contracts are overturned by statute.

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1 Caltex Australia Limited, Submission No. 18, page 13.

2.4 The submission to the Committee by the Service Station Association makes the plea that:

The combination of being unable to take advantage of cheaper wholesale prices from alternative suppliers because of the exclusive tie, coupled with the wholesale price disadvantage from their landlord oil company is by far the greatest problem that besets franchisees in the petroleum retail industry.<sup>2</sup>

2.6 It is imperative that franchisees be able to shop around for the cheapest wholesale fuel price and the cheapest prices for other supplies. The law needs to provide for the extent to which franchisees may break their 100% tie agreements with their oil major franchisers. However any law change also needs to continue to allow service stations access to the undoubted advantages of franchise arrangements.

2.7 Retailers need to be able to counter these restrictive trade practices and shop for the best prices and service. In our view, no retailer should be required, by verbal or written agreement, to sell more than two-thirds of its total sales as the franchisor's products. The difficulty is, for this to occur, franchisors will need to be given access to franchisees' records to ensure that the franchisee is not in breach of this limit.

2.8 The prime argument by oil companies against allowing franchisees to obtain supplies from other suppliers is that the majors do not receive a commercial rate of return from leasing service stations. They maintain that the higher price that they receive from the franchisee for supplies compensates for this. Even if this view of a poor rate of return by the majors in a market they control could be believed, this is not a transparent method of conducting business and does not justify a restrictive trade practice. It can also be readily addressed by majors getting out of the landlord business.

## The OilCode

3.1 The OilCode is still under negotiation. It is premature to ditch the Act while the OilCode remains undecided. Advice to the Committee indicated that a new OilCode and the Act could co-exist. It makes sense for it to do so, because of the legislative protections in place. Until such time as the Government, the ACCC, and industry representatives as a whole agree that the new OilCode is working well, the Australian Democrats believe that the *Petroleum Retail Marketing Franchise Act 1980* should co-exist with an agreed OilCode for at least 2 years. It is only when the OilCode has been operating for 2 years and there is a general consensus that it is strong enough to adequately protect individuals and allow for genuine competition in the petroleum industry that the Democrats will support the repeal of the *Petroleum Retail Marketing Franchise Act 1980*.

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2 Service Station Association, Submission No. 21, page. 13.

3.2 The Committee received submissions from numerous groups who commented on the OilCode. Those submissions almost unanimously advocated strengthening the OilCode. This was a position taken both by those in favour of and against repeal of the two Acts. The Motor Traders Association of Australia commented:

MTAA recommends that as a first step towards genuine reform the Government negotiate to obtain agreement for a mandatory OilCode to be tabled as a disallowable instrument in the Senate. MTAA recommends that the Senate only consider the repeal legislation once the code has been agreed to by all parties and come into force.<sup>3</sup>

3.3 The Australian Democrats agree that it is premature to present this legislation to the Senate before the new OilCode has been finalised. Evidence received comments that there are still some major sticking points with the MTAA.<sup>4</sup> As the principal representative of the retailers, who are the most burdened by restrictive trade practices in this industry, it is wise to continue to address these sticking points.

### **Competition in the industry**

4.1 The Australian Democrats have not seen any reliable evidence that the repeal of the *Petroleum Retail Marketing Franchise Act 1980* and the *Petroleum Retail Marketing Sites Act 1980* will result in a reduction in fuel prices in the country. It is not until we see evidence that that will occur that we will be prepared to support this bill.

4.2 The MTAA drew the Committee's attention to a letter from the ACCC to the government on 12 June 1998 which advised that it:

remains the view of the ACCC that deregulation now would most probably widen the country/city petrol price disparities in areas yet to experience independent entry by such as Woolworths or Liberty.<sup>5</sup>

4.3 It is at the retail end that the most fatal flaws in industry structure and practice are apparent. In the opinion of the Australian Democrats radical government action is necessary in this area. The actual and effective (up to two-thirds, so it is claimed) market shares of the majors in retail through direct and indirect control of the market, must be curtailed. To do this would require attention to at least a few key areas:

- there must be an absolute prohibition of the supplier or any interests associated with the supplier, being the landlord of the franchisee.
- as mentioned above, with regard to any goods supplied to service stations, no retailer should be required by verbal or written agreement to sell more than two-thirds of the franchisor's products. This should not of course prohibit the franchisee from voluntarily buying 100 per cent of some of the franchisor's products.

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3 Motor Trades Association of Australia, Submission No. 23, page 45.

4 Australian Petroleum Agents and Distributors Association, Submission No. 20, page 7.

5 Letter from the ACCC to Treasury, 12 June 1998; obtained by MTAA under the Freedom of Information Act; Submission No. 23, page 8.

- ultimately, oil companies should be required to divest themselves of all interests at the wholesale level of the industry. An independent wholesaling sector completely separate from the oil manufacturers and producers is crucial for competition development, particularly in rural areas.
- 4.4 The Australian Democrats have grave concerns that the repeal of the *Petroleum Retail Marketing Sites Act 1980* will result in increased vertical integration. Upon the repeal of that Act, it will be open to the oil majors to increase the numbers of sites directly owned and operated by the companies and to increase vertical integration. This is precisely the opposite of what should be occurring.

## **Conclusion**

- 5.1 The issues for the petroleum industry are vertical and horizontal integration, open access to terminals and protection of the rights of individual operators. The correct mix of regulation of each of these areas should result in increased competition and profitability, and better pricing practices. It would also result in a beneficial end to the market dominance of the oil majors in the wholesale and retail sectors.
- 5.2 The Australian Democrats agree with the majority report to the extent that it recommends the retention of the Franchise Act until the completion and tabling of the OilCode in the Parliament as a regulation pursuant to Part IVB of the *Trade Practices Act 1974*.
- 5.3 We agree that an appropriate access regime should be implemented. The description by the majority of the regime is an appropriate starting point for the development of an access regime.
- 5.4 The Australian Democrats do not agree with the majority in its recommendation that the Sites Act be repealed after two years unless the Senate passes a resolution adopting a recommendation of a committee of the Senate that the Act not be repealed. This is an unusual mechanism. The ordinary procedure would be for the Sites Act to be left in place and for the Senate to repeal that Act after two years (or any other period) if a Senate Committee recommended that that was appropriate.
- 5.5 The Australian Democrats agree that there should be a Parliamentary review of the access regime after 18 months of operation.

**Senator John Woodley**