

Democrats Minority report

For decades the Australian Democrats have argued that a strong small business sector is essential to the economic and social health of Australia – that small business has a value of itself.

Our views on the *Petroleum Retail Legislation Repeal Bill* (the Bill) are necessarily coloured by that perspective. We strongly support the workings of a free and fair market, as evidenced by our work on corporations, trade practices and tax law, but we have long been concerned that a weak *Trade Practices Act* (TPA) does not deliver sufficiently fair competition for small business with sufficiently adequate protections from predatory pricing and the abuse of market power.

In that respect we set great store on the recommendations of the Majority, which we support, in the Senate Economics Reference Committee Report of March 2004 on: *The effectiveness of the Trade Practices Act 1974 in protecting small business*. If those 17 recommendations were implemented, that cover the misuse of market power, unconscionable conduct, collective bargaining, creeping acquisitions, divestiture, and the powers and resources of the Australian Competition and Consumer Commission (ACCC) – then fair and free competition would be greatly strengthened in Australia. Further, there would then be less of a case for industry-specific regulation if the general law was so strengthened.

The Democrats have opposed the earlier version of this Bill, arguing that stronger TPA powers are first required to address the abuse of market power and to introduce the threat of divestiture on over-mighty corporations. We said then that TPA reform was a precondition to considering whether this industry regulation could be lifted or modified.

As Democrat Senator Murray said in 2003¹:

Workplace, tax, corporations, finance and trade practices laws are the main laws affecting the functioning of the market and the regulation of the behaviour of corporations. In matters of competition and consumer interest, all over the world the law restrains great commercial power because of the known abuse of power that often accompanies it. When it comes to the size and behaviour of corporations, the Trade Practices Act 1974 is Australia's prime protective device. Yet the act is weaker and deficient in its protective capabilities in comparison to countries like the United Kingdom and the United States.

...I have said before that big business roars approval at the dynamism of the American market but fiercely condemns a major contributor to that dynamism—that is, the effects of antitrust or divestiture laws. We need those regulatory tools in Australia. Balanced divestiture laws are the corollary of balanced merger laws. We

¹ Hansard Adjournment 13 August 2003

do not have effective divestiture laws. It is a strange and illogical policy that can prevent mergers to maintain effective competition but cannot require divestiture also to maintain effective competition.

...In Australia, many markets are experiencing oligopolisation—a concentration of power in the hands of a small number of competitors. This is partly a natural result of economies of scale: the big get bigger and as they do they develop the ability to operate more cheaply and efficiently. Over time, the smaller players are forced out of the market. That is the way of the market, and it is valuable while it promotes efficiency, innovation and competition—but only up to a point.

Eventually, the destruction of competitors results in the destruction of competition, or the predatory intimidation of competitors reduces effective competition. Where that has occurred or will occur, the state must intervene to save the market from eating itself. By its very nature, the power to order divestiture should be regarded as largely a reserve power. As international precedents indicate, it would be seldom employed. It should be used rarely and used responsibly. Its great virtue is as a cautionary power, making oligopolies careful of abusing their market power. It would be used only where necessary to maintain or restore competition.

The Australian Democrats accept that there is a need to update the regulation governing the petroleum sector in response to the significant structural changes that have recently occurred in the sector, particularly the entrance of Woolworth's Coles and other supermarket chains into the petroleum retail market.

The Bills Digest notes that key stakeholders in the industry are concerned about 2 key issues:

- Commission agency arrangements covered by Oilcode.
- No industry specific restrictions on pricing behaviour.

We agree that the new regulations are likely to offer significant improvements in the transparency in the wholesale pricing of fuel and allowing access for small businesses to the terminal gate price. However, differential pricing will still apply based on volumes as the market dictates. That is, a large chain such as the Coles-Myer controlled Shell franchises can be expected to receive a superior price to an independent since they are likely to purchase far greater volume.

This will have the effect of increasing the barriers to entry in the market and could lead to an increase in the concentration of industry participants and a commensurate reduction in outlet choice for consumers. We are concerned that the result will be a significant reduction in the number of franchisees and small business operators', except perhaps for uneconomical regional/rural sites. This is evidenced in part by BP who have recently begun buying back their franchise network in anticipation of this Bill, according to the Service Stations Association (SSA).

The Motor Trades Association of Australia (MTAA) the SSA and others had concerns about the impact of the legislation and oil code, on independent retailers. The MTAA argued that it would be important for an effective regulatory framework to be in place

to deal with issues relating to the misuse of market power, and that the TPA needs to be strengthened:

MTAA therefore believes that it is important that there is an effective regulatory framework in place to deal with issues relating to the misuse of market power. In that regard, MTAA is concerned that despite the issue being mentioned as an element of the reform process in the 2002 Downstream Petroleum Industry Framework, the proposed reforms do not adequately address the concerns that service station operators have in relation to anti-competitive behaviour in the retail petroleum sector; in particular, predatory pricing, the misuse of financial power and the misuse of market power in one market to gain substantial power and reduce competition in another market. MTAA strongly believes that the *Trade Practices Act 1974* needs to be strengthened to address those concerns.

In that regard, the Association is aware that the Australian Government has foreshadowed amendments to section 46 of the *Trade Practices Act* which it proposes will address the issue of predatory pricing. MTAA notes however that at the briefing on section 46 organised by the Department of Industry, Tourism and Resources for Oilcode stakeholders and held on 27 April 2005, the Department's own legal adviser confirmed MTAA's view that the *Trade Practices Act* does not adequately address predatory pricing and that the Government's proposed amendments will not resolve that issue. In MTAA's view, the significant structural changes which have occurred in the retail petroleum sector over the last decade, including the growing market power of Coles and Woolworths and the trend toward vertical integration, mean that it is imperative that any reform package for the sector includes appropriate amendments to Part IV of the *Trade Practices Act* which will ensure that the Act deals effectively with all types of anti-competitive behaviour, including predatory pricing. The Government's petroleum sector reforms as currently proposed do not include such amendments and as a result the Association cannot support the repeal of the two petroleum sector-specific Acts.²

As noted in the Bills Digest, the Chief Executive Officer of the SSA, Mr Ron Bowden, has predicted that between 1000 and 1500 service stations would close and another 200 franchisees would leave the industry in the next two years. Mr Bowden also predicted that, in the longer term, the Government's proposals would increase concentration in the industry and that market power would be in the hands of a few large companies, which would lead to higher prices. Mr Bowden also claimed that the repeal of the Acts would affect the oil majors differentially. With respect to independents, they may find that both their fuel sales volumes and convenience store sales will increase.³

² Motor Trades Association of Australia, *Submission 4*, p. 4.

³ Bills Digest No. 116, p. 4.

Mr Cassidy for the ACCC told the Committee that section 46 of the TPA was unlikely to address the concerns of predatory pricing raised by the MTAA and others, because section 46 relates to horizontal conduct, whereas the situation outlined by the MTAA and others relates to vertical conduct:

Section 46 is in a sense about so-called horizontal conduct—a firm with market power seeking to damage and eliminate one or more of its competitors. The Oilcode, the franchising code and indeed part IVA and part IVB of the act, which are about unconscionable conduct in the industry code divisions, are really about what we would call vertical conduct—that is to say, how a supplier treats those they are supplying to or how someone purchasing treats their supplier. Inevitably in those arrangements the supplier or the buyer is, if you like, the more dominant party and then you have got the individual firm in the middle who perhaps has the lesser economic power. Really what this is about is, as I say, that sort of vertical relationship rather than what we would see as being the more horizontal competitor type relationship that section 46 seeks to address.⁴

Mr Cassidy for the ACCC also suggested that the perceived threat to small business/independent retailers would not necessarily come from the changes to the regulations but from broader issues:

Whether over time what you might call the stand-alone petrol retail outlets will be squeezed out by the integrated outlets is a much broader issue. Again, this goes to the economics of petrol retailing and perhaps a structural change that has been going on in that sector for at least the last 20 years.⁵

Mr Cassidy also noted that under the current regime the industry is very competitive, and that the increase of integrated service stations, and shopper dockets makes it a difficult environment for stand-alone small petrol retailers who rely predominately on the margins from the sale of petrol:

Senator WATSON—In terms of the small independents limited access to a range of supply as compared with previously, can you see the small independents going broke if they are trying to compete with the Coles-Woolworths price, unless they can offer something additional like extra services or something? If they just compete on price, I can see them going broke.

Mr Cassidy—Unfortunately, I think there is an element of truth in what you say. I would not characterise it just as being Coles-Woolworths because there is now quite a number of these arrangements around: Metcash, Foodland and Dimmeys. There are quite a number of arrangements where, if you like, people can basically acquire discounted petrol as a result of the other purchases they

⁴ Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 20.

⁵ Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 20.

have made in one form or another. I think those sorts of arrangements obviously do make it difficult for small independents and also for, in a similar vein, what I refer to as the integrated service station operations, which not only have petrol but have fast food, groceries and whatever else. Similarly, they also make it a difficult and competitive environment for the small petrol retailer who is predominantly just relying on the margin he gets on the sale of petrol. On the other hand, the economics of the retail part of the petroleum industry operate on very fine margins. It is a very competitive industry.

Mr Cassidy also went on to say:

I think the question starts from a proposition that the Sites Act has had an impact in restricting the acquisition of sites by the oil majors. I do not know that we would necessarily support that proposition. We think that the use of multifranchising arrangements has probably largely stepped around the Sites Act anyway. What I was getting to is that I think there is a fundamental driving force in petroleum retailing which means that the future is going to be with larger, integrated sites rather than with the smaller, stand-alone traditional petrol retailer. There will be areas where the traditional petrol retailer will continue to survive, perhaps where the competitive pressures are not as great. They would be, I expect, particularly in country and rural areas, but once you get to areas where there is high-volume demand then, as I say, I think the future of petrol retailing is with large integrated sites which are really more about retailing, of which petrol is just one commodity, rather than a dedicated retail petrol site as we have known it.⁶

The Democrats imagine that the idea that there are broader issues is little comfort to stand-alone retailers.

The Bills Digest also considered that under the current regime the market would continue to retract:

Failure to pass the legislation would mean the continuation of the legal status quo. However, the industry's structure would be likely to continue to evolve with more reductions in service station numbers, and further development of the industry outside the coverage of the Franchise and Sites Acts.

The Democrats remain concerned that the contraction of the market will be to a large degree, a result of anticompetitive behaviour - a firm or firms with market power seeking to damage and eliminate one or more of its competitors.

That means section 46 changes matter greatly in competition between independent retailers and the supermarket oligopolists, which confirms our view of the importance of strengthening Section 46 of the TPA.

⁶ Mr Cassidy, ACCC, Committee Hansard, May 8 2006, p 23.

While broader issues may indeed be affecting the ability of small business to stay within the industry, our reading of the submissions to this Inquiry suggested that the changes to regulation may exacerbate the problems. The question before us is whether measures can be put in place to ensure small retailers and independents are not unfairly pressured or priced out of the market. We think the Government has a prime responsibility to ensure competition in this industry, as all others, is fair and equitable.

One of the most important things the government can do in this area is implement the 17 recommendations in the Senate inquiry *The effectiveness of the Trade Practices Act 1974 in protecting small business*.

It is the Democrats view that this bill should be postponed until the signalled changes to the TPA are before the parliament, so that we and the industry can be assured that predatory pricing issues and other competition matters can be adequately dealt with by the ACCC regulator.

Senator Lyn Allison

Senator Andrew Murray