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6 January 2014

Mr Russell Keith
Clerk Assistant Committees
Fuel Price Disclosure Bill Scrutiny Committee
Legislative Assembly of the Northern Territory
la.committees@nt.gov.au

Dear Mr Keith

As you are aware, on 1 December 2014 Caltex made an interim submission into the Fuel Price Disclosure Bill Scrutiny Committee's inquiry into the draft NT Fuel Price Disclosure Bill 2014.

We kindly request the opportunity to provide a further submission that addresses specific proposals within the draft Bill. The supplementary submission is attached.

Please do not hesitate to contact me (ftopham@caltex.com.au; 0411 406 379) should you wish to discuss any aspects of this submission further.

Yours sincerely

Frank Topham
Head of Government Affairs

Supplementary Caltex submission into the Northern Territory Fuel Price Disclosure Bill Scrutiny Committee inquiry

1. *Executive summary*

The draft Northern Territory Fuel Price Disclosure Bill 2014 (the 'Bill') aims to better inform NT motorists of the price structure of fuel and promote price competition. The Bill proposes a statutory requirement that fuel retailers disclose their business costs and profits to the Commissioner for Consumer Affairs (the 'Commissioner') on a periodic basis. The Commissioner would in turn collate this information and publish it with the intent of satisfying the above aims of the Bill.

Caltex does not support the bill because we believe it would increase red tape and costs to fuel retailers, while not achieving its stated objectives. However, we support price transparency and believe there are better ways to achieve this than regulation.

The implication of the regulatory intervention provided for in the bill is that exposure of the workings of the market would in some way modify its operation, for example by reducing excessive profit margins applied to wholesale prices. In this submission, we discuss the nature of the market and why we believe such a perception of the nature of the market is not correct, and why the bill would not affect competition or prices. We propose an alternative approach to price transparency that would draw on largely existing information to inform motorists about the structure of prices.

In summary

- Competitive markets drive prices – not costs and profits; retail prices are not set as a mark-up on wholesale costs. It follows that monitoring of profits and costs does not help much in understanding the price structure of fuel. We suggest the ACCC should be asked to prepare a one-off report on the NT market that would include information on costs and profits, before the government considers any regulatory requirements.
- Data is already publicly available on the key structural components of fuel prices: retail prices, terminal gate prices, international prices and taxes. Motorists should be informed about this data rather than a regulatory requirement being imposed on retailers to submit data to the Commissioner.
- The focus on the retail market as the main source of higher prices is correct; wholesale prices have consistently tracked relevant international price benchmarks so are not the issue. However, higher retail prices and the stickiness of price movements are not the result of an absence of competition.
- Caltex sees no merit in a "price motivator exemption" mechanism and it would have no effect on prices.

2. *Competitive markets drive prices – not fuel costs and profits*

According to the select committee's terms of reference, the bill has "aims of better informing motorists of the price structure of fuel and promoting price competition".

The bill enables the Commissioner for Consumer Affairs to request certain information, which is defined in Section 3 of the bill:

a) The cost to a retailer of carrying on the business of fuel retailing
b) The profit derived by a fuel retailer from carrying on the business of retailing fuel
c) Other information about the way in which the price of fuel is determined by a fuel seller.

It is quite likely that members of the public see high retail petrol prices (relative to other locations in Australia) as the result of excessive mark-ups of wholesale costs by petrol retailers. However, this perception of the cost structure of the petrol market is incorrect: profit is an outcome of prices and costs, not an input to prices.

In other words, a petrol retailer will make a profit if the retail price of petrol exceeds the wholesale cost per litre, taking into account all capital and operating costs of the business. The price is determined by the competitive market, not by any particular mark-up the retailer would like to apply to costs.

A further implication is that more efficient, lower cost retailers will make more profit. Less efficient, higher cost retailers will make less. Higher profits are therefore a sign of efficiency, not greed, and lower profits are not a sign of virtue or fairness. However, the public may struggle to understand this concept and price disclosure that focuses on profits of individual retailers or even companies (aggregated across several service stations) may be misleading.

This is different from disclosure of the aggregate level of profit across all retailers. However, the interpretation of aggregate profit is fraught with difficulty. For example, profit <u>per litre</u> in Darwin or other parts of the NT may be high relative to other states but throughput per site in the NT is much lower. In reality, the actual dollar return to investors may be comparable with other parts of Australia.

We do not have information on industry profitability in the NT but urge caution in any collection and interpretation of data. In addition, we would be strongly opposed to disclosure of site by site or corporate profitability data because of commercial confidentiality, the difficulty of analysis and the risk of misinterpretation of the data.

The bill appears to focus on the disclosure of retailers' costs and profits and may assume that these are the key determinants of fuel prices. It is notable that "information" is not explicitly defined to include retail prices and discounts, or wholesale prices.

In Caltex's view, the price structure of petrol is best understood, particularly on a short term basis, by knowledge of the retail price, any retail discounts, freight costs, terminal gate prices, and import prices. As freight costs (international and domestic), terminal costs and taxes do not vary greatly over time as a percentage of the price of fuel, an ongoing understanding of price structure can be gained from three pieces of data: retail prices, terminal gate prices and international prices (converted to Australian cents per litre). Costs and profits could provide additional insights on an annual basis, as in ACCC price monitoring reports, but such information is difficult to collect (e.g. due to varying business structures and accounting definitions), analyse and interpret. The same comments apply to diesel and LPG.

We recommend the NT government does not seek to assess costs and profits through its own agencies and departments but could call on the ACCC to carry out such an assessment using its expertise and price monitoring powers. The results of such an assessment would be valid in general for several years. However, we also note the enormous complexity of generating meaningful cost and profit data due to the variety of business models, so that such an exercise may fail to provide much or any useful information.

As confirmed in the ACCC's *Monitoring of the Australian petroleum industry report 2014*, market forces drive Australian fuel prices and 'movements in retail petrol prices are primarily due to changes in the international price of refined petrol and the AUD-USD exchange rate'. The relevant international fuel price benchmark for Australia is Singapore Mogas 95 Unleaded petrol (also known as MOPS). There are similar benchmarks for diesel (MOPS gas oil 0.001% sulphur) and LPG (Saudi Aramco Contract Price).

Because MOPS is quoted in US dollars, the weaker Australian dollar has led to higher MOPS prices in Australian cents per litre (cpl), offsetting the major drop in crude oil prices experienced in the second half of 2014. This in part explains why consumers may not feel that Australian retailers have dropped prices in line with crude prices. If the average USD-AUD exchange rate matched that of 2012-13, retail fuel prices would on average have been 10 cpl lower according to the ACCC. However, it is also true that Darwin retail prices took a considerable time to adjust to lower international prices. This relates the characteristics of competition in the Darwin market.

Regional locations, like Darwin and the Northern Territory, have market structures that typically result in higher retail fuel prices in those areas than much larger urban areas. Retail prices are generally higher in regional markets, in part attributed to higher wholesale prices. Higher wholesale prices may reflect lower throughputs (hence higher unit costs for infrastructure) and less retail competition (so less downward pressure on wholesale prices).

Notwithstanding this, even though wholesale prices (in the form of terminal gate prices) in Darwin have been about 3 cpl higher than the national average for many years, the difference between them and the international benchmark (MOPS), has been fairly constant (see Figure 1). This suggests that wholesale costs are only a minor factor explaining the difference between NT and other Australian retail prices. In addition, it is clear that wholesale prices (relative to international prices) did not play a role in the higher retail prices experienced in 2014.

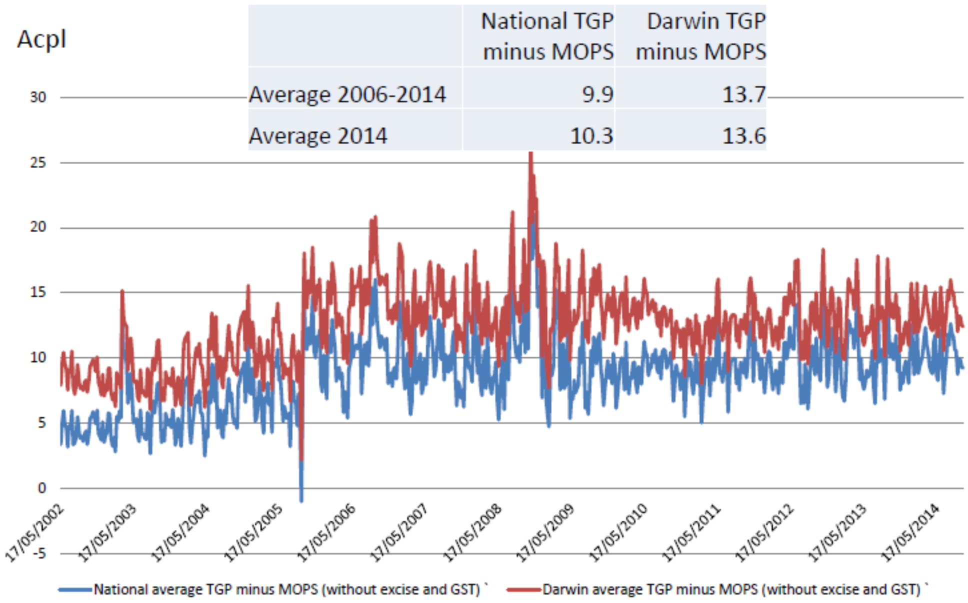


Figure 1 - Darwin TGP tracks national average TGP and national average TGP tracks MOPS 2006+

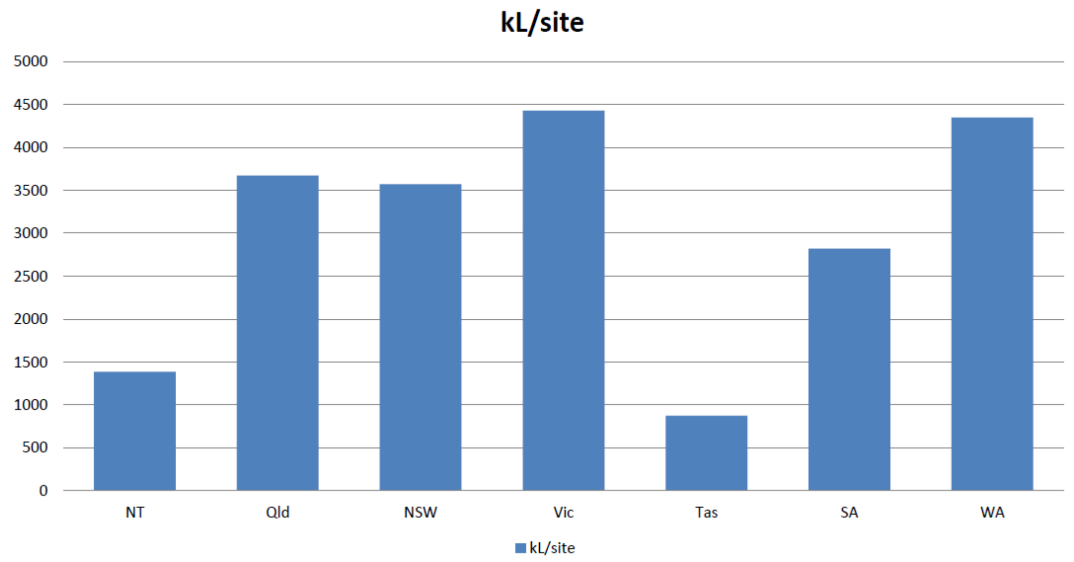
According to the ACCC's 2014 report, retail prices are generally higher in regional areas than in the five largest cities for a number of reasons, including

- A lower level of local competition, often reflecting the lower number of retail sites
- Lower volumes of fuel sold (which explains the lag of price movements between regional and city prices)
- Distance/location factors
- Lower convenience store sales.

A number of these factors apply to Darwin; without examination of these factors consumers' understanding of pricing structures would be distorted. A corollary is that a detailed understanding of the market is complex and requires careful examination and discussion; accordingly, any monitoring should be simple (as discussed below) and any more complex disclosure confined to a one-off report by the ACCC.

Another characteristic of the Darwin (and NT) fuel market is that it is heavily over-pumped i.e. the number of litres sold per site is substantially less than other cities and states.

Average site fuel volume in NT



For sites to have lower fuel prices, they must have higher fuel throughputs, which is difficult in such a market. One solution would be market rationalisation. However this could see larger companies and quality sites surviving, while smaller or less efficient operations are unable to survive in the market. While such rationalisation would be unlikely to decrease competition (there would still be many service stations), there would be an impact on business, including small businesses, and possibly a loss of convenience due to larger gaps between sites. Any rationalisation should be driven by consumers and market forces but if this does not occur then one consequence of a relatively large number of sites is higher prices.

As discussed above, it is clear that monitoring of price structure does not require information on profits; most of the understanding sought by the bill can be provided by aggregate information on

- Retail price (including supplementary information on shopper dockets and other discounts)
- Inland freight and distribution costs
- Terminal gate prices
- Terminalling costs
- Landed prices (into terminal)
- MOPS price
- Taxes (excise and GST).

Of these factors, only retail price, terminal gate price and MOPS change significantly over the course of a year. Annual averages for other structural components would suffice to understand the fuel price structure. Note that the above pricing factors are for petrol and diesel; a similar set applies to LPG.

The aim of 'promoting price competition' can be met by ensuring current retail prices are available to consumers so they can make more informed choices about where to purchase fuel (as discussed in the next section). Only retail prices should be published on a site by site basis; other structural indicators, as in the above list, should be aggregated for reasons of confidentiality (noting that TGPs are in fact published by each wholesale supplier but may not be directly comparable because of differing business models, hence the desirability of aggregation).

Fortunately, a lot of this data is already publically available from the Australian Institute of Petroleum (AIP) and ACCC reports into the petroleum sector, which from 17 December 2014 are required to be released quarterly rather than annually. This most recent Ministerial direction was also issued to provide the ACCC with the impetus to investigate specific issues or 'areas of market concern or heightened issues for the community'.

Given these recent developments, Caltex proposes that in the first instance, the NT government asks the ACCC to undertake a study of the NT fuel market.

3. Existing mechanisms for price monitoring and reporting should be used

The Bill allows the Commissioner to require retailers to provide information relating to fuel prices on a 'periodic', basis. The government's website relating to the bill says information will be required on a monthly basis, although it there is no indication whether the data would be monthly average, weekly average or on some other basis.

Caltex strongly supports price transparency. However, we do not support government monitoring of fuel prices where such information is, or could be, provided by the private sector at minimal or zero cost. For pragmatic reasons, we do support annual petrol price monitoring by the ACCC as key information in the ACCC's reports is not publicly available and for legal and competitive reasons could not be provided by the private sector.

Monitoring and reporting of fuel prices already occurs using well-established services such Informed Sources' 'Motormouth' website and phone app. Motormouth is used by the Automobile Association of the Northern Territory (AANT) to inform its 'Find My Fuel' website, AIP uses it to compile its 'Weekly Petrol Price Report', and until recently, the ACCC used the service to inform its reports and work. The ACCC now uses an alternative provider, Fueltrac, to provide pricing information to motorists.

In response to consumer demand, fuel retailers have developed phone applications, which provide consumers with near live petrol prices at their fingertips. Woolworths and United Petroleum have already developed such applications, bringing unprecedented convenience and transparency to the process of purchasing fuel. We expect the number of such apps to increase for reasons of brand competition (including fuels and convenience store offerings), although we have no specific information on this matter.

Terminal gate prices for each wholesale supplier have been available online for many years. As discussed above, aggregate market data is also readily available, such as through the AIP website www.aip.com.au. AIP publishes weekly average price data for petrol and diesel for Darwin, Katherine, Alice Springs and Tennant Creek, daily average terminal gate prices, and charts of Singapore prices (MOPS) that are otherwise only available via subscription through Platts.

Given the variety of existing and low cost data available, Caltex believes the Bill's proposal to require the periodic provision of this information to the Commissioner as creating unnecessary red tape for business and adding little value for motorists. This is particularly true for smaller operators with fewer resources to compile and submit the requested information.

We suggest an alternative approach would be to ensure that any gaps in the existing data provided by the private sector are filled (which would be achieved through discussion, not regulation). There may also be some merit in the Consumer Affairs website providing general guidance to motorists on the availability of data (including links) and how to interpret the information (for example, a brief explanation of the meaning of MOPS and TGP and how this enables the fuel price structure to be determined). There would be no requirement for retailer provision of data.

4. The focus on the retail market to explain higher prices is appropriate

The Bill provides scope for requiring information from fuel suppliers that are not retailers i.e. wholesalers and resellers (distributors). This is not necessary as there is sufficient evidence to show that wholesale prices, which have consistently tracked international benchmark prices, do not contribute to periods of higher retail prices relative to international prices or other Australian cities.

Retail price control depends on the business model under which a service station operates, and the common assumption that an individual site's price is set by the company it is branded is not necessarily true. For example, although there are a number of Caltex-branded sites in the NT, only two sites in Darwin (Yarrawonga and Wishart diesel truck stop) and one site in Katherine are priced by Caltex. Any aggregation of information by brand would therefore not make sense given the varying underlying ownership and pricing structures of service stations.

Caltex has fairly accurate insight into the fuel industry and the Darwin market; Figure 2 is our estimate of the percentage of Darwin sites by company operation. As explained above, this is quite different from the distribution of sites by brand. Puma, United, Coles Express and Woolworths each control prices at a significant number of sites. Darwin does not lack competitors, so the reason for higher prices does not lie in the number or nature of competitors.

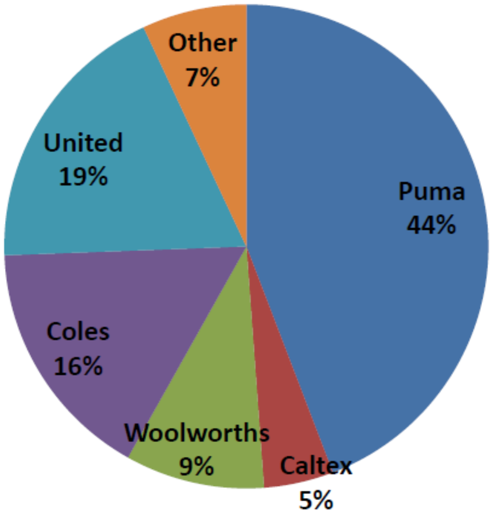


Figure 2 - Darwin sites by price control

Since 2011, there has been a noticeable divergence of wholesale and retail prices (see Figure 3). Based on our understanding of the petrol price structure in Darwin, and the fact that Darwin wholesale prices have consistently tracked relevant international benchmarks, it becomes apparent that this divergence is attributed to pricing at the retail level. This divergence has been attributed by AANT to acquisitions of the Ausfuel business. While this explanation seems plausible, we have no information to support or disprove this theory. However, it could well be that higher margins have been necessary to amortise the costs of acquisition of the Ausfuel business. We raise this point not because we have information on the matter but to caution against assumptions about the business drivers behind prices. This is a matter the ACCC could examine in a "deep dive" monitoring report.

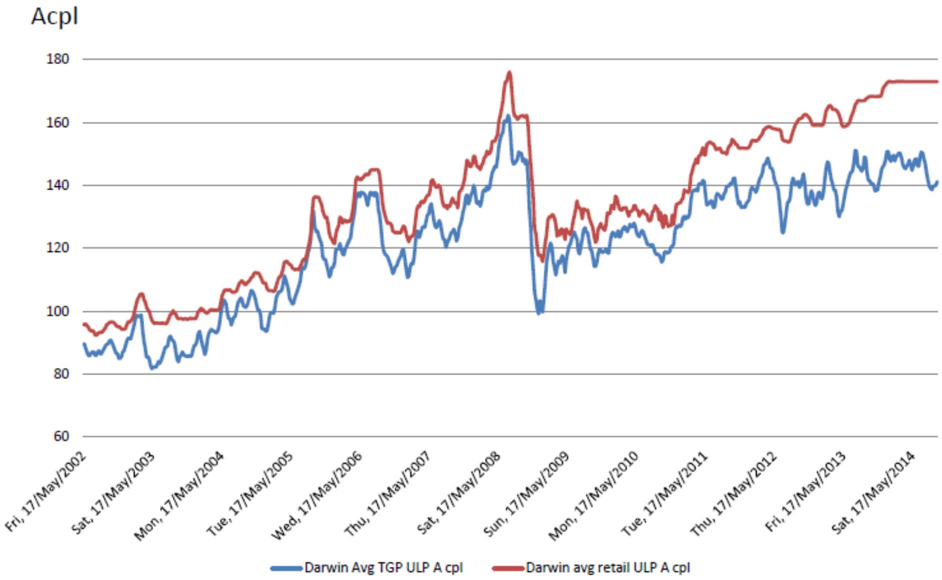


Figure 3 - Darwin ULP retail price versus TGP

Leaving aside the question of the margin increase since 2011, there are two other fundamental questions about Darwin prices:

- Why are nominal retail margins (the difference between aggregate retail prices and TGPs) higher than many other parts of Australia?
- Why retail prices were so slow to fall after June 2014 when international prices and TGPs fell sharply?

The answer to the first question is that, over the long term, higher Darwin retail margins probably reflect structural factors such as lower throughputs and higher operating costs (including rents and wages). The answer to the second question is that short term variations in retail margins (both downward and upwards) most likely reflect a 'stickiness' in prices that is observed to varying extents in many other non-metropolitan markets.

We note that the ACCC has expressed an interest in examining regional markets in more detail so may in the future be able to explain this in more detail. However, we are firmly convinced such market behaviour is the result of competition, not collusion, and the history of investigations into complaints about country prices bears this out.

5. Price motivator exemption will have no effect on prices or competition

The terms of reference require the Committee to "enquire into mechanisms for setting a price motivator exemption to be gazetted under the bill".

The concept appears to be that exemption from reporting would provide an incentive for a retailer to set prices below some threshold value. However, as discussed above, prices are determined by market forces and the costs for an individual retailer of not responding to the market would in almost every case exceed the administrative costs avoided by not reporting. There may also be a notion that retailers prepared to price under the threshold would avoid being "shamed" by disclosure of their presumably excessive profits. This would require public reporting of the profits of individual sites; however, such information would disclose commercially sensitive information and would most likely be impossible to calculate on a comparable basis across sites due to differing business models. Moreover, as discussed above, low profits are not a sign of virtue, more likely inefficiency; castigation of relatively high profits would unfairly penalise the reputation of more efficient sites.

A further consideration is that in any competitive market, service stations strongly in competition with each other (that is, within a few kilometres) will have similar prices. In a small market like Darwin, most prices are within one or two cents of each other. As a result, all sites would tend to be over or under an exemption threshold, so all competitors would face the same burden.

Caltex therefore sees no merit in an exemption mechanism, except perhaps to provide the Commissioner with an easy way to apply or remove the requirement for price disclosure. The mechanism would have no "price (discount) motivator" effect.