REVIEW OF THE COMPETITION PROVISIONS OF THE

THE TRADE PRACTICES ACT 1974

JUNE 2002

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SENATE LEGAL AND CONSTITUTIONAL

REFERENCES COMMITTEE

INQUIRY INTO WHETHER

THE TRADE PRACTICES ACT 1974

SHOULD BE AMENDED

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1 - INTRODUCTION

This submission is brief and concentrates on item (b) of the notice of the inquiry, namely whether the ACCC should be given the power to order divestiture in circumstances where ownership has the effect of substantially lessening competition. Further, it concentrates only on the Australian petroleum industry as an example: that is not to say that the writer believes that this industry is the only one where such a power might be applied, nor that it is an industry which might require its application earlier or more vigorously than any other, but it demonstrates the characteristics which warrant serious consideration of such a power being available.

The submission is made with a considerable feeling of reluctance from two perspectives: firstly as it would appear that the Federal Government and its agencies have learnt virtually nothing from the 50 plus inquiries into the Australian petroleum industry held since the Prices Justification Tribunal (PJT) was established in the early 1970s, and secondly and more importantly in the context of this inquiry, the Australian petroleum industry has failed to respond in a reasonable manner to the causes of the underlying problem.

Over 50 inquiries into the Australian petroleum industry have been held by:

. the PJT
. the Petroleum Products Pricing Authority (while this organisation did not actually hold a formal public inquiry, its activities were virtually a running inquiry during its existence before it became absorbed into the new PSA)
. the Prices Surveillance Authority (PSA)
. the Trade Practices Commission inquired into a number of aspects before its merger with the PSA to form the ACCC
. the Australian Competition and Consumer Commission (ACCC) including one currently into the reasons for fuel price variability
. the Industry Commission
. a Royal Commission
. each state and territory has held AT LEAST one inquiry
. a Senate Inquiry
. House of Representatives and political party inquiries
. Treasury is currently co-ordinating an inquiry nominally into fuel taxation.

It would appear that these have all been a waste of time.

The reasons for these inquiries include political expediency, on both sides of the political spectrum, but also fundamental considerations relating to pricing practices by the oil companies, and probably unconscionable activities in their relationships with their dealers and distributors.

2 - IS THE CURRENT DE-INTEGRATED APPROACH TO THE INDUSTRY APPROPRIATE?

As one of the main reasons for continuing political scrutiny of the petroleum industry is continuing concern over pricing disparities it is relevant to look at whether the structure of current and recent inquiry into the industry is appropriate.

For a considerable period petroleum industry inquiries in Australia have concentrated only on the "downstream" sector, that is the refineries, marketing and distribution, ignoring the "upstream", namely exploration and, in particular, production.

There is increasing day to day management and operational control of the local oil companies from London, Singapore, Houston or wherever, and the local oil companies continue to make the frequent comment that they have to acquire their crude supplies on the open market where they have no influence on prices: however, the record international group results published in the last few months indicate that the local oil companies' shareholders are quite content with high prices and follow them up whenever they can.

This suggests that perhaps a much broader look at the profitability and operational structure of the industry might now be appropriate, especially in the context of possible divestiture powers. Also in the context of the Inquiry the increasing ownership of, for example, the distributor network and its significant rationalisation over the last 10 to 15 years warrants examination, as does the multi-site franchise structure of service stations.

3 - CIRCUMSTANCES

The ACCC is currently conducting an inquiry into the reasons for variability in fuel prices, but in the view of this submission its proposals are questionable and have totally missed the point, despite the ACCC's extensive **corporate** knowledge of the industry. The WA and Victorian governments have introduced 24 hour pricing rules as the latest attempt to address the continuing aggravation, but these will do little more than give the major operators more opportunity to structure the market conditions to their advantage, a state which they have managed to achieve successfully for decades. It is the continuing questionable activities of the major oil companies that focuses attention on the need to strengthen the Trade Practices Act.

The fundamental point of the problem has been missed by these two states and the ACCC. The "variability" in the price is not the real problem for governments: it is the gap between some areas and others, mainly the metropolitan areas and country or regional areas, which is the bone of contention. The average metropolitan motorist who "misses out" on the trough in the cycle is merely miffed: the country motorist is the one who is furious and bleating to his politician and/or local newspaper (who fan the flames of the controversy of course to their own advantage) about the often very significant gap.

Added to this of course is the inability (for which read: lack of interest) of the country resident to grasp the fact of the need to remunerate capital invested in country areas to service those areas, both in an absolute sense (the fact that a facility is there), and also in the sense that there are quite different patterns of use compared with the metropolitan areas. Again, politicians and newspapers have little interest in understanding the facts if those facts do not support their

particular barrows. But that is not to say that nothing can, or should, be done to narrow the "gap" and this submission (and other submissions by the writer) puts forward a view as to how such a narrowing could occur, and why, in the absence of a considered and reasonable response by the oil companies, the strengthening of the Trade Practices Act to provide for a divestiture power should occur.

The ACCC discusses a "trade-off" issue in its paper (namely, a lower level of price fluctuations for higher average prices) showing just how much the ACCC is now mis-reading the "community" and failing to understand the oil company processes that have led to the aggravation.

While the consumer is worked up by journalists and responding politicians, at the same time the industry participants, especially the oil companies, have not acted in such a way as to endear them to the public or governments.

The ACCC's focus on how to limit "price fluctuations" simply means that the fundamental cause of the problem has been missed. The key is to narrow the gap between capital cities and the regions by addressing the oil company practices, and this the oil companies do not want: this will inevitably reduce fluctuations as such wide market price moves would become economically untenable.

The ACCC again demonstrates its failure to understand, and misses the opportunity to properly address, the situation with its comments on the diesel market. The diesel market is quite different from that for motor spirit and there is relatively little retail automotive diesel fuel sold. But the experience of the diesel market, where non-service station buyers are able to negotiate their prices, terms and conditions, highlights the key to addressing the retail motor spirit market's "problem". Rather than merely stating that "price fluctuations for diesel are not an issue" the ACCC should have explored this further.

A so-called solution has been bandied around for several years, namely "terminal gate pricing", TGP, but no agreement has been reached on what it is or should be. This is amply demonstrated by the variations found in the WA and Victorian "versions", though these are no doubt fuelled by the usual "each state knows better than anybody else" attitude. But there seems to be little sense in trying to ensure that all buyers in one sector of the petroleum market buy at the same price, and then hoping that competition will sort out the problem "at the pump". Behind this so-called "transparent" TGP price the manipulations in the various relationships would continue; the ACCC alludes to this situation in its paper, but does not pursue the aspect in depth. In any case it would (and should) be expected that larger users would demand better prices.

The ACCC's proposal to prohibit supply contracts and bulk discounts is precisely the wrong thing to attempt: what is needed is the right to negotiate contracts freely, see below 4 - Recommendation. It is the continued absence of the implementation of this right and the practices that take place that support the need to have a divestiture power available.

There are a number of points that continue to be trotted out on the regulatory framework of the industry that need to be clarified, if not rejected. The Senate Inquiry must look into the background for the need for the two main Acts to have been introduced in the early 1980s and the later introduction and subsequent failure of the OilCode (the industry code of practice

addressing disputes over agreements and contracts) to understand why this industry provides good evidence in support of the strengthening of the Trade Practices Act.

. The Petroleum Marketing Sites Act has been by-passed by multi-site franchises, and has evidently not been monitored by the Federal Government for several years. It is supposed to limit the number of sites the oil companies can actually operate themselves (not the number they can own which is often stated). However, the companies (logically) retained the best sites for their own operation so that the proportion of sales made through their own operated sites is far higher than the proportion of site numbers they operate.

. The Petroleum Marketing Franchise Act has been described by the oil companies as guaranteeing 9 year tenure for operators: it does not. An oil company (i) can make a "fair and reasonable offer" to an operator at any time if it needs to address the site in relation to its network, (ii) can change the terms of its relationship at each 3 year "rest", and (iii) can terminate the arrangement at any time if it is closing the site for "non-petroleum use". Not exactly much of a restriction, as clearly demonstrated by the (continuing) rationalisation of site numbers.

. The OilCode voluntary code of practice was introduced in the early 1990s with great fanfare about how it would bring in a new era of co-operation between the parties in the industry in addressing problems or misunderstandings in the operation of contracts, franchises and the like. It failed in the late 1990s as it only ever was able to successfully deal with the smaller, less important problems, and it can be argued due to bad faith in the negotiations in the mid 1990s during a review of the various subsidiary codes intended to amend them in the light of experience over the previous 3 or 4 years. The circumstances of its failure are instructive.

4 - RECOMMENDATION

This submission strongly supports the amendment of the Trade Practices Act to give the ACCC a divestiture power, with appropriate checks and balances, and appeal provisions.

The oil companies in Australia have argued long and hard for price deregulation and no doubt will continue to do so, but the petroleum industry in Australia (or anywhere else) does not warrant full deregulation due to the practices of the major participants in the pricing area, which in turn leads to the relationship problems exemplified by the two Acts and the OilCode mentioned above. That is not to say that, on average, prices being charged are excessive, but that the prices being charged in different regions are often unreasonably high or uneconomically low: this is the major problem/irritant. Various temporising measures put in place in WA and Victoria will not solve the problem.

To overcome and remove the problem is, in principle, quite simple, but in practice will require some radical changes both of attitude and structure, and if this cannot be voluntarily achieved, the amendment to the Act to provide for the divestiture power is essential.

What is needed is to arrive at the situation where ALL buyers have the right to NEGOTIATE FREELY their PRICES, TERMS and CONDITIONS. And all three are needed, not just prices.

If all buyers had this right the price differentials between the capital cities and regional areas would change significantly. Market prices in those different areas would never be identical, except in extreme competitive circumstances, due to the structure of the industry where in country areas the capital costs of the distributors, extra delivery costs and lower throughput costs will impact. It should be noted that the capital costs of distributors are frequently forgotten, even though currently there are a rapidly diminishing number of distributors, and an increasingly high proportion of high oil company equity (ownership) in them.

To arrive at this right of real negotiation regime may require the imposition of an environment akin to Part IIIA of the Trade Practices Act in which the goods and/or services are declared, allowing the calling in of an independent arbitrator in the situation where one party could claim that it was not allowed the benefit of real negotiation. Mere physical access to the petroleum terminals is not enough: the right to negotiate under the access regime is crucial.

This submission would envisage the ACCC providing such an independent arbitrator, but only where the arbitrator is appropriately experienced and qualified. It would be expected that the mere threat of an independent arbitrator being called in would lead to real negotiations, but in any case it would be likely that the arbitrator would only ever be called in once.

This submission would expect metro-regional price variations to narrow by around 5 cpl as a result of this recommendation, and inevitably capital city fluctuations would diminish also. Also, it is envisaged that some businesses would fall by the wayside as a result of different skills in negotiation: the submission does not advocate a "right to exist in business" simply by entering into an arrangement.

There are some problems in this proposal: current contracts would undoubtedly be an issue, but it is in the interests of all parties to enter into sensible negotiations to arrive at an outcome which would resolve the continuing aggravation which has led to more than 50 inquiries.

And if sensible negotiations do not allow the development of the "real negotiation regime" then serious consideration must be given to total segregation of the wholesaler- reseller structure, in other words no oil company involvement of any sort in the retail market. The Trade Practices Act must be amended to give the ACCC the power to order divestiture in certain circumstances.

5 - CONCLUSION

This submission has concentrated on what it regards as the fundamental circumstances that support the Trade Practices Act being amended to give the ACCC the power to order divestiture in circumstances where ownership has the effect of substantially lessening competition. Such an amendment may be viewed as radical: but unless a "radical" change is implemented, the full potential of the Trade Practices Act to improve commercial relationships to the benefit of the community will not be realised.

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