

P.M.A.A.

SUBMISSION

TO THE

**SENATE LEGAL AND CONSTITUTIONAL
REFERENCES COMMITTEE**

**FOR THE COMMITTEE'S INQUIRY INTO
THE TRADE PRACTICES ACT 1974**

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PMAA

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Table of contents

Introduction	page 4
Executive Summary	page 5
The Small Business experience with the ACCC	page 7
Australian Independents in fuel retailing	page 8
Competition	page 9
The Oil Companies' Multi-Site Franchise System	page 10
National Champions	page 13
Report on investigations in the USA	page 15
USA Fair Marketing Laws	page 17
Conclusion	page 22

Introduction

The Independent Petroleum Marketers Association of Australia (PMAA) is a national group that represents the interests of independent operators of retail fuel and convenience stores outlets throughout Australia.

The PMAA was formed in 2000 by independent Service Station operators as a result of growing disquiet in the industry as to the motives and actions of the major oil companies in Australia. The PMAA represents approximately four thousand independent operators who control some 50% of retail outlets and 25% of the total retail sales volume.

The objectives of the PMAA are to bring about and monitor fair trading practices within the retail petroleum industry.

The Association, through its members, has compiled information and reported to Government authorities on such matters as allegations of discriminatory pricing, predatory pricing and abuse of market power by the oil majors.

The PMAA as a group is also very concerned with quality control and temperature correction in bulk petroleum product supplies.

On behalf of the independent petroleum operators of Australia, the PMAA makes its submission, to the Senate Legal and Constitutional References Committee for the Committee's Inquiry into the Trade Practices Act 1974,

Signed: Arthur Nestor, Secretary

Petroleum Marketers Association of Australia.

Executive Summary

The Petroleum Marketers Association of Australia (PMAA) emphasise that Section 46 should incorporate an 'effect' test, as opposed to the current and out-dated, 'proving a proscribed purpose'. The PMAA takes the view regarding a breach of Section 46, that to prove a proscribed purpose at law is difficult, costly and mainly unsuccessful in the courts.

The major oil companies realize this and will continue to pursue policies that will allow them to abuse market power to gain market share and drive out real competition.

The retail petroleum industry is unique in that it is the only industry where small business participants *must* directly compete with their own petroleum suppliers.

As a result, manipulation and predatory behaviour in this unique industry is a reality. It is only within this industry that the discount prices available for retail petroleum purchases from the oil companies' chains are truly predatory to the wholesale cost prices for the same product available from the same oil companies to the independents operators.

The Trade Practices Laws should be tightened to prevent these practices being continued. We recommend that the petroleum industry being unique, require its own laws that are over and above that which are required to balance the power between any other industry.

The PMAA strongly supports the view that a simple 'effect ' test should be in place that will indicate 'abuse of market power'. Such an indication should warrant the '*reversal of onus of proof*' proposal. The regulatory authorities should be empowered to more easily intervene and have the parties "show cause" why they should not be proceeded against.

Under our proposed system of law, this view provides scope that appeals to the basic fundamental principles of natural justice.

The major oil companies in Australia operate under directives from their multi national parent companies. The prevalence of global corporate corruption necessitates a requirement for assiduous anti-competitive deterrents. These deterrents must be of a severity that eschews the oil companies from current and any further abuse of market power.

The existing laws in Australia are ineffective and inefficient; therefore, it is crucial that the Trade Practices Act be heavily reinforced. As Australia is part of a global economy, it is imperative that our laws are juxtaposed with those of similar cross border economies. (i.e. – USA and New Zealand).

As the Oil industry impinges on the lives of all Australians both domestically and commercially; we should be better protected by our Government. Our Trade Practices Laws should reflect that importance, to ensure that the Australian community is not held to ransom by any vested interest sector and that the Australian people are protected against voracious commercial behaviour. Therefore; we believe the Australian community deserves the protection of a specialist ‘watch-dog’ acting under Restrictive Trade Practices Law. Such a ‘watch-dog’ could be a Petroleum Industry Ombudsman or a specialist petroleum industry Commissioner acting under the auspices of the ACCC.

The Small Business experience with ACCC

Small businesses are being disadvantaged by the difficulties that come across the ACCC in taking 'Section 46' cases. Small businesses are unlikely to have the necessary resources to initiate and run a 'Section 46' case. Small businesses rely on the ACCC to run such cases once possible breaches are brought to the attention of the ACCC. The difficulties the ACCC and private litigants have experienced with enforcing 'Section 46' have weakened the competitive process in various sectors of the economy, reducing the benefits of true competition to consumers.

The ACCC's experience has been that without "smoking gun" documents, proving a relevant *purpose* under Section 46 to the satisfaction of a Court, is an onerous forensic process. It is a frustrating process for small business where the regulator cannot apply a simple procedure, in order to determine whether there is a case or not.

The high profile media attention given to "smoking gun" documents has alerted the general community of such conduct. Firms with substantial market power also appear to be very much aware of the consequences of "smoking gun" documents being found in their internal records and such firms appear to be taking great care to avoid potentially incriminating documents being created and/or stored.

Albeit the rare find of such documents, how does one prove allegations of "smoking gun talk"?

The consequences of such talk could be dire for small business.

These allegations can only be proven in an outcome within the parameters of an appropriate "effect" test.

The PMAA takes the view that this submission is extremely serious.

Australian Independents in fuel retailing

As the Trade Practices Act currently stands, the future of independents in fuel retailing is indeed bleak. The PMAA believes that, if we are not careful, the concept of Australian's purchasing bulk fuel at competitive prices, will fail because the majors are getting so huge they no longer properly compete.

Small businesses are the engine room of growth for the economy. The loss of small independent businesses from any industry would be a loss to the community as a whole. For many years, governments have paid lip service to this 'engine room' of the Australian economy.

The law must be robust to deter anti-competitive behaviour & protect small business. In a world where corporate culture respects nothing but the bottom line, breaking the law can, in fact, be more profitable!

Therefore laws need to be sufficiently robust to prevent such behaviour.

For many years the small business sector has loudly expressed and echoed its discontent, however, as the red tape has grown, and the political promises have been broken, many businesses have simply given up complaining and have been lost to predatory behaviour.

If the Government fails to provide a process to hear and administer the concerns of small business, many will continue to simply disappear. Innovations and inventiveness will disappear, the potential of which will never be realised or recovered. With them will go job opportunities and national wealth.

This situation is detrimental to, and a tragedy in the making for the small business sector. But, just as importantly, is a tragedy for Australia as a whole.

Competition

Competition is the process by which market participants, in pursuing their own self-interest, attempt to outdo, outprice, outproduce and outmanoeuvre each other. Competition, as a market process, is of vital importance.

The process is maintained by diversity and independence. Having a diversity of independent interests keeps the competitive process alive and the competitive state healthy. This cannot be over emphasised.

A competitive market produces simultaneously the socially desirable attributes of efficiency and choice. In the motor fuel marketing context, choice among various motor fuel sources is an especially valued asset of competition where there are large and small firms competing.

The major oil companies through extensive vertical integration now dictate terms to participants in the retail petroleum industry in this country.

There is a plethora of unfair & discriminatory wholesale prices created by the Oil Companies.

Independents are the rank and file wholesale purchasers; with the Oil Companies deliberately showing preference towards to their own retail networks. The diversity of competitors will be at the sole discretion of the suppliers of petroleum product.

This is a deft and discriminatory marketing practice that can only be accurately described as a denial of natural justice.

This marketing practice creates confusion and disinformation, designed to complicate the definition of a 'level playing field'. The rivalry of competition

cannot exist fairly, when the umpire officiating at the starting line, is the Oil Company itself.

The Oil Companies' Multi-Site Franchise System

The multi-site franchisees have reduced the effective number of small business participants in the market place, thus reducing the degree of competition. They have removed a mix of different types of retailers essential to generating competition. The oil companies' claim is that by producing economies of scale, the Multi-site franchisees could increase competition for different brands. The PMAA would dispute this claim.

The Multi-site franchisee has little decision-making discretion and is more akin to an indirect form of vertical integration for the oil companies. The Multi-site franchisee does not receive the same wholesale price as independent retail marketers, instead is provided with retrospective rebates at a time and a level sustainable to put the competition out of business.

This practice is blatantly unfair and illegitimate.

Although the 'Petroleum Retail Marketing Franchise Act (1980)' prohibits price discrimination between oil majors and their own like-branded franchisees, there are loopholes, justified by a need to 'meet competition'.

Through these loopholes, the oil majors' discrimination on wholesale pricing is creating their own national champions.

Apart from disadvantaging Australian small business in the petroleum retail sector, it has indeed forced a number from the industry. This practice contributes to the massive retail price destabilization in the form of daily and weekly price cycles. These cycles having fluctuations the like of which are

unheard of in any other country in the western world. Such practices confuse and anger the public and disguise the true nature and level of pricing.

Section 49(1) of the Trade Practices Act states ... 'To be unlawful the discrimination (between competitors) must be of such a magnitude or of such recurring or systematic nature that this has the effect of substantially lessening competition in certain markets.'

We believe that these price cycles are orchestrated, are recurring, are systematic and beyond the entire magnitude of profit to Australian small business.

Based on our extensive investigations and the information gathered, we believe that these price cycles are **rapacious, discriminatory** and **predatory**. Despite the oil companies' claims that it is 'competition' which is prohibiting them supplying independents at a competitive price, it quagmires their claims they would not be able to continue their system of price support to their franchised service stations if a new effects test were to be written into trade practices law because it would expose them to the threat of prosecution.

However, there is little difference between predatory conduct and vigorous competition. The PMAA notes that in the Queensland Wire section '46' case, the Court noted that

Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away.... these injuries are the inevitable consequence of the competition sec.46 is designed to foster.

While it is duly noted that competition by its nature is deliberate and ruthless, it is not considered competition, when the only competitor who has a chance of striking a winning blow is the one who is making the rules.

Since the introduction of the 'Petroleum Marketing Reforms' in August 1998, competition had been stifled with all power being in the hands of the oil majors. Without appropriate regulation and enforcement, small business has had to compete against their own fuel suppliers' powerful retail chains. The oil companies' powers of inflicting their will has never been so equally combined, with the eagerness to accomplish this end.

An analogy of the multi-site franchise system would be as though 40-100 small fuel retailers were price-fixing under the directive of an Oil Major. We believe this to be criminal in intent and purpose.

They have disciplined recalcitrant independent operators to charge more at retail and in doing so have totally annihilated the Australian entrepreneurial spirit.

An unadulterated or pristine mandated Terminal Gate Pricing System should be introduced. Such a system should apply to all suppliers of petroleum to service station operators and should dictate that the wholesale suppliers must sell to service station operators at the same price. Any charges for dispensing equipment, franchise fees, cartage, credit and branding fees should be clearly defined and printed on sale documentation; with secret rebates and discounts not being permitted.

National Champions

In 1993, after the recommendations of Senator Barney Cooney's committee, the merger law was tightened to permit mergers only if they do not substantially lessen competition. US economist Michael Porter argued persuasively before the Cooney committee that domestic firms do not have to be large in the domestic market to be internationally competitive. However, large local firms have called for an easing of the merger test to foster so-called national champions. National champions are large local firms said to have the size necessary to compete on global markets. However, the countries in which the oil companies originated from have created national champions.

We enclose this article from the *Melbourne Age* Sunday 1 July 2001. This article highlights our concerns at the extent to which Corporations may abuse their power especially with a weakened Trade Practices Act.

"Exxon a 'profit-driven' tiger" by Roger Franklin.

"When *Business Week* devoted a recent cover story to Exxon Mobil, Esso's United States parent, it wasn't the staggering size of the world's largest energy outfit that inspired the greatest awe.

True, the \$US17.7 billion (\$A34.7 billion) profit last year was pretty darn impressive. But, what really captured the magazine's imagination were the same things that have inspired juries to sock the oil company with some of the largest fines ever imposed in the United States: Exxon's immense power and its arrogant willingness to abuse it. It is an attitude that begins at the top, in the chairman Lee Raymond, whose desk is watched over by a wall-sized oil painting of an attacking tiger, the company's snarling

symbol. "If he gives his word, which he is reluctant to do, he will keep it," an executive who has negotiated with Mr Raymond told *Business Week*. "But he is very difficult to deal with."

How difficult?

The lawyers in the Alabama Attorney-General's department found out several years ago, when they informed Exxon that it owed the state \$US88 million in unpaid royalties on oil and gas extracted from beneath the Gulf of Mexico.

A pittance in comparison with the oil giant's cash flow, the company nevertheless decided to contest the demand in court. That turned out to be a bad move because the lawyers for the state gained access to mountains of confidential - and embarrassing - corporate documents.

What they found - in the words of Southern Methodist University Business School's John Slocum, who compiled a detailed study of Exxon's corporate culture - was a management philosophy that respects nothing but the bottom line.

"It is the ultimate cold, calculating, analytical and bureaucratic organization," Professor Slocum told *The Sunday Age* last week. "in Alabama, they did what they always do: conducted a cost-benefit analysis of what it would cost to honour the contract ... Obviously, ignoring it made greater financial sense at the time, so it appears they decided to withhold payments."

As documents submitted during the trial made clear, Exxon did indeed weigh right and wrong - and concluded that breaking the law was more profitable.

Even its chief in-house lawyer recommended withholding the royalties because, "Our exposure is 12 percent interest on underpayments. Plus the cost of litigation." In other words, the money to be made by breaking its word outweighed the potential fines.

What Exxon did not figure on was the sense of outrage that inflamed 12 Alabama jurors, who decided that such a flagrant disdain for honesty deserved special punishment.

In January, the panel brought down a \$US3.5 billion judgment against the company, with jury foreman Shae Fillingim later explaining that Exxon needed to be taught that the law applied to everyone, not just to the "little people".

A similar case unfolded last year in Miami, where a group of service station owners sued Exxon for price gouging. Once again, at least according to lawyer Eugene

Stearns, who won a \$US1 billion judgment in the case, the company chose to do wrong in pursuit of profit.

They "don't have much respect for the civil justice system. They fight over everything. They don't concede the obvious," said Stearns.

If that observation chills Melbourne lawyers preparing to sue Esso for the financial losses that followed the Longford explosion, the legal aftermath of the infamous Exxon Valdez oil spill in Alaska may well give them even more reason to expect a drawn-out legal battle.

Let this excerpt from an August, 1998, editorial in the *Anchorage Daily News* explain what happened in the wake of a 1994 jury decision that hit Exxon with \$US5 billion in punitive damages:

"Apparently delay pays," the paper wrote. "Exxon is earning \$US90, 000 an hour, about \$US2 million a day.... As it stands now, if the appeal lingers a couple more years, Exxon will have earned enough interest alone to pay the \$US5 billion, plus the accrued interest."

Report on Investigations in the USA

The oil companies are now demanding the repealing of the Sites Act and the repealing of the Petroleum Marketing Franchise Act. These demands have been pursued for some time. They claim certain efficiencies that flow from the desired vertical integration will benefit consumers. PMAA is concerned that addressing the current abuse of market power in Australia does not go as far to address certain findings with the proposed vertical integration currently in USA.

Since the same oil companies operate cross border with the vertical integrated format in the USA, this is of vital importance. We point out the findings of a recent report prepared by the Majority Staff of the Permanent Subcommittee on Investigations in the USA.

Findings

1. In the past three years there have been extraordinary spikes in the price of gasoline and the price of gasoline has increased significantly.

2. Spikes in the price of gasoline are harmful to consumers and the economy.
3. Over this same time period, the balance between supply and demand has become “tight”.
4. The mergers in the oil industry over the last few years and the closing of many refineries over the past twenty years have increased concentration in the refining industry. In some states, the refining and marketing industry for gasoline is highly concentrated; in many states it is at least moderately concentrated.
5. High concentration exacerbates the factors that allow price spikes and increases, a key one of which is the tightness of supply.
6. In concentrated markets refiners can affect the price of gasoline by their decisions on the amount of supply. In a number of instances, refiners have sought to increase prices by reducing supply.
7. Highly concentrated retail markets have higher retail prices.
8. Markets in which there is a high degree of vertical integration between refiners and marketers have higher wholesale and retail prices.
9. Oil companies do not set wholesale (rack) or retail prices based solely upon the cost to manufacture and sell gasoline; rather wholesale (rack) and retail prices are set on the basis of market conditions, including the prices of competitors.
10. Oil companies use zone pricing to charge different prices for gasoline to different station operators, some of which are in nearby geographic areas, in order to confine price competition to the smallest area possible and to maximize their prices and revenues at each retail outlet.
11. For the many stations owned or leased by the major oil companies, it is the major oil company rather than the local dealer that determines the competitive price position of the local station and that benefits from higher prices and profit margins.
12. The Wolverine Pipeline case illustrates how control over storage facilities and pipelines can be used to limit gasoline supplies and competition in a market.

13. If concentration in the oil industry continues to increase, higher prices can be expected.

The complete 400-page report by the Majority Staff of the Permanent Subcommittee on Investigations in the USA is available **on the Internet:**
www.senate.gov/~gov_affairs/042902gasreport.htm

The findings of that report may direct and influence the committee to implement laws necessary to address unforeseen marketing strategies currently not applied in Australia.

USA Fair Marketing Laws

The FAIR MARKETING LAWS incorporated in eleven states in the USA is as an indication that petroleum marketing is so concentrated and with limited suppliers, it requires its own laws.

We enclose the epitome of "an Economic Analysis of Motor Fuel Fair Marketing Laws". Prepared for the Petroleum Marketers Association of America by David R. Kamerschen, Ph.D. Professor of Economics, The University of Georgia February 1 2001.

In the context of the subjects in the proceeding executive summary, the following words and phrases have the following meanings;

- **Barriers to entry:** a barrier to entry is any factor that prevents long-run entry into a market.;
- **Contemporaneous recoupment:** The ability to recoup the lower profits or losses resulting from subsidised pricing at one level of activity or geographic area with larger profits generated from other activities or geographic areas during the same time period.
- **Downstream:** Downstream means that in a vertically structured industry, a later stage of production or distribution, such as distribution or retailing.

- **Dealer tank wagon price:** Dealer tank wagon price means the price charged to retail dealers by wholesalers or by refiners who sell directly to retail dealers. The dealer tank wagon price is generally higher than the terminal (rack) price charged to wholesalers.
- **Market:** A market is where buyers and sellers determine what they are willing to purchase and sell and on what terms. Thus, a market is the zone of consumer choice among closely substitutional goods.
- **Predation:** Predation is a generic concept that means a predator's sacrifice of short-run profits in an enterprise to gain greater long-run profits in such enterprise or related enterprises.
- **Predatory Pricing:** Predatory pricing is a strategy of charging a very low price with the objective of driving a competitor(s) out of the market, weakening the ability of competitors to compete, or disciplining competitors to charge higher prices.
- **Price Squeeze:** Price squeeze means a pricing policy by a vertically integrated firm or mass retailer where it sells motor fuel to itself at artificially low prices (below terminal price plus overhead) and charges low retail prices and as a result the competitors are squeezed if they stay competitive.
- **Retail outlet:** The retail outlet means a facility, including land and improvements, where petroleum products are offered for sale at retail to the motoring public.
- **Subsidised price:** A subsidised price is a price that fails to cover the raw product, plus certain direct costs associated with selling the product.
- **Terminal (rack) price:** The terminal or rack price means the price refiners charge independent wholesalers (or jobbers), consignees and their largest commercial end user customers. The wholesalers and consignees generally store the refined motor fuel in bulk storage facilities and distribute the motor fuel to retail dealers or commercial end users.
- **Upstream:** Upstream means in a vertically structured industry, an earlier stage of production or distribution, such as production or refining.
- **Vertically integrated oil company ("VIOC"):** Vertically integrated oil company means a firm that operates in all phases of the petroleum industry, from upstream exploration and production of crude oil to downstream refining and marketing.

"Executive Summary" – Fair Marketing Laws

Eleven states have motor fuel fair marketing laws that restrict among other things, selling motor fuel at retail below cost. Twenty-three other states have general sales below-cost laws that cover many more products other than gasoline.

The retail selling of gasoline below cost has been and continues to be a prevalent practice of vertically integrated oil companies (VIOCs") and large mass retailers. VIOCs operate at all levels of the petroleum industry, to include: (1) crude oil production, (2) transportation of the crude, (3) refining the crude into gasoline and other petroleum products, and (4) offer a wide variety of consumer products in numerous geographic areas, and some have recently added gasoline to their product offerings.

VIOCs and mass retailers "subsidise" or finance retail gasoline prices at below-cost levels with profits generated from other levels of operations, operations in other geographical areas; or in the case of mass retailers, profits from other higher profit non gasoline products. Because of their structure, subsidised or below-cost pricing can result in short-run profit maximisation. Additionally, by selling gasoline below cost, VIOCs and mass merchandisers gain an unfair advantage over independent gasoline retailers.

This, in turn, can lead to dominance by VIOCs and mass retailers in local retail markets and a decline in the independent sector's ability to compete effectively. The end result is a lessening of competition, which leads to higher prices and fewer choices for consumers.

A fundamental economic principle is that more competitors in a market will result in more competition. More competition results in long-term lower prices and more choices for consumers. Fair marketing laws preserve the diversity of competition in retail motor fuel marketing by protecting the independent marketing sector from the

economic harm caused by below-cost selling. Motor fuel fair marketing laws are good for competitors, competition and consumers.

Federal and state regulatory policies have recognised the importance of maintaining the competitive viability of the independent marketing sector. A recent economic study of California's high gasoline prices has found that the lack of a strong independent marketing sector in California is one of the primary reasons for California's high retail prices. The FTC, in its review of recent VIOC mergers, has identified the problem of major branded VIOC market dominance and the historical role independent distributors have played in keeping retail gasoline markets "honest."

Fair marketing laws have been effective in maintaining the viability of independent gasoline retailers in many but not all fair marketing states. The fact that fair marketing laws may have worked better in some states than others does not support the claim that such laws have been regulatory failures. For example, Florida is one of the states with a motor fuel fair marketing law. From 1993 to 2000, the percentage of decline in the number of gasoline retail outlets in Florida (6.8 percent) is less than half of the percentage of decline in both the United States as a whole (15.2 percent) and in Georgia (13.6 percent), a neighbouring state without a fair marketing law.

Fair marketing laws are a less restrictive solution to the anti competitive problems caused by subsidised pricing than retail divorcement. Prohibiting VIOCs from engaging in retail gasoline sales lessens the number of competitors and lessens competition. Allowing VIOCs to compete at the retail level is better for competition as long as they play by the rules. Also, retail divorcement fails to solve the price subsidisation problem caused by mass retailers.

None of the economic studies done to date have resulted in any statistically reliable finding that fair marketing laws have raised retail gasoline prices over time. The studies cited by critics of fair marketing laws are incomplete as to: (1) the design of the statistical models used, (2) the time period covered by the study and (3) the empirical data gathered. Especially troublesome is the use by the studies of gasoline retail profit margins as a surrogate value for retail prices. Retail prices over time are

the most accurate data to use if the objective of the study is to measure the casual effect (if any) of fair marketing laws on retail gasoline prices.

The retail margin data used in all the studies to date do not truly reflect the actual retail margin. Rather, the data in the studies include both the profit earned by the entity selling or transferring the gasoline to the retail outlet (i.e., jobber, distributor or refiner) plus the profit margin earned by the retail seller of the gasoline. For states with a fair marketing law that only restricts the retail selling of gasoline below cost, combining the profit margin from the wholesale sale and retail sale leads to erroneous results.

No governmental regulation in the marketplace comes without some cost. In the case of fair marketing laws, the "cost" is the elimination of short-term, subsidised retail gasoline prices for some consumers. The benefits are preserving a strong, independent marketing sector that results in more competitors and more vigorous competition in the long run. In my view, the balance tips in favour of the fair marketing laws, and the ultimate winners are all consumers.

Motor Fuel Fair Marketing Laws serve as a law that is good for competitors, competition and consumers in the USA.

Conclusion

The Petroleum retailers are small business operators and owners who have high regard for the integrity of their industry in respect of competition and environmental standards. They fully endorse the clean fuel initiatives.

The findings of this inquiry should reflect the stance of all Australians, not just the multi national corporate companies who choose to operate in Australia as part of their global market place.

Small business in the retail fuel industry must be allowed conditions which enable them to continue to serve their customer base without continued threat to their livelihoods from an unjust and unfairly weighted system.

There are some fifteen hundred service station sites in non-metropolitan and a similar numbers in metropolitan areas of Australia, mostly owned and managed by small business. There must be a process in law to protect these entities from abuse of market power by voracious multi national oil majors (who are on record as saying that they want to see an end to the ‘mum and dad operators’ in the industry, only to have corporate competition).

We need an Act that will adequately protect the balance of power between large and small business.

We finally impress upon the committee the words of our Prime Minister, *‘As in the past, the key to Australia’s Future is the spirit and attitude of its people. With choice, incentive, opportunity and a fair go, there is nothing they cannot aspire to achieve.’*

This is maintained.