

**ASSCSA**

Australian Service Station  
and Convenience Store Association

***SUBMISSION BY THE***

***AUSTRALIAN SERVICE STATION AND  
CONVENIENCE STORE ASSOCIATION***

***TO THE***

***REVIEW OF THE TRADE PRACTICES ACT***

***15 July 2002***

## **1. Introduction**

The Australian Service Station and Convenience Store Association (ASSCSA) is the peak association which represents the national interests of approximately 8,000 service station operators. ASSCSA is an Allied Trade Association of MTAA and is governed by an Executive Committee composed of representatives of the Service Station (and Convenience Store) Divisions of the state and territory Member Associations of the MTAA Federation. The ASSCSA Executive Committee makes recommendations to the MTAA Board of Directors on matters related to the Australian retail petroleum trade.

The role of ASSCSA is to:

- encourage, promote and protect the interests of the retail service station operators in Australia and to conserve the interests of members;
- secure the protection of the rights and independence of resellers
- cultivate and obtain reciprocal relations with like associations, both nationally and internationally;
- establish and maintain contact with the legislatures of the Commonwealth and of the states and territories to promote, support and protect the interests of the Association; and
- conduct seminars, educational programs or other meetings for the purposes of improving the knowledge and understanding of service station operators of business, economic trade and related matters.

ASSCSA has played a pivotal role in the development of petroleum-related public policies in all levels of Australian government.

## **2. The Service Station Sector**

It is difficult to characterise the typical service station outlet. There are a variety of forms of ownership and operation of service stations. Many service stations carry the brand of one of the four oil majors (BP, Shell, Caltex/Ampol and Mobil); others carry the brand of secondary marketers, others carry the brand of a distributor and some carry their operators' own brand or no brand at all.

Fuel is retailed under a number of arrangements. In some cases the service stations are owned and operated by the oil majors, in some instances sites are operated by franchisees who either sell fuel on a commission agency basis for their franchisor or they purchase fuel from their franchisor and then retail it on their own behalf. Other sites are owned and operated by distributors or independent operators.

In addition, in the last eight to 10 years there has been a significant increase in multi-site franchise operations. Under a multi-site franchise arrangement one operator could operate between five and sixty retail outlets. The vast majority of Shell's retail network, for example, is operated by about half a dozen multi-site franchisees.

In addition a number of ancillary services are also provided by service station operators. Many service stations, particularly in metropolitan areas, now have large convenience stores on site, some sites include workshops, car washes, trailer hire, restaurants, 'fast food' outlets, ATMs and in the case of remote roadhouses, accommodation. In the case of the vast majority of sites, revenue from fuel sales represents the majority of site turnover; fuel however does not provide an equivalent share of site profits.

At the Commonwealth level, the retailing of fuel is governed, in addition to the *Trade Practices Act 1974*, by two Federal Acts; the *Petroleum Retail Marketing Franchise Act 1980* (the Franchise Act) and the *Petroleum Retail Marketing Sites Act 1980* (the Sites Act).

Briefly, the Franchise Act provides oil major franchisees certain rights and protections in their dealings with their franchisor and also provides for a minimum tenure period for those franchisees. The Sites Act limits the number of retail sites at which each of the four oil majors can retail fuel on their own behalf.

In 1970 there were an estimated 20,000 retail sites in Australia, in 1980 there were 12,500. Today it is estimated that there are just over 8,000 retail sites. In the early 1980s there were nine refining and marketing companies – we have four today. Since the 1980s there has been a similar substantial reduction in the number of distributors. The petroleum industry has thus gone through a period of enormous change and rationalisation over the past 20 to 30 years.

### **3. The Need for Reform of the Petroleum Sector**

One of the results of that rationalisation is that the industry has become much more concentrated and much more highly vertically integrated. The four oil majors own refineries, have equity interests in, and in some cases outright ownership of, distributors and they own and operate, directly, retail outlets which compete in the market against their own franchisees and others to whom they supply. This vertical integration provides the oil majors with significant market power and it is the use of that power which causes so many difficulties for resellers in the petroleum industry.

Over the past decade there has been a number of attempts by Federal Governments (both Coalition and Labor) to reform the petroleum industry; in particular the retail sector. Those 'reform' proposals have largely focussed on the issue of whether the two, now somewhat dated, petroleum specific, Federal Acts, the Franchise Act and the Sites Act, should be repealed and replaced with an industry code of conduct. Generally speaking that proposition has been favoured by the Government and the oil majors, but not, at least in its totality, by service station operators.

However, ASSCSA does agree that there is a need for reform of the petroleum industry; not just at retail, but also at the refining and wholesale levels. Australia's refineries are small by Asian and world standards. That, ASSCSA believes, puts pressure on the refiners and ultimately those pressures are reflected in the companies' relationships with their resellers and their activities in the market place. The structural issues in the refining sector need to be addressed so that the benefits of that can flow to resellers and consumers.

ASSCSA believes that vertical integration of the oil industry is neither desirable in the national interest nor a desirable outcome for consumers. Increased vertical integration will inevitably lead to opportunities to abuse market power most particularly by selling, particularly in the short term, at unreasonably low prices.

Relationships, between service station operators and their suppliers (in particular, the four oil majors) have always been characterised by an imbalance of market power. Even though the four refiners have a substantial involvement at retail, exert significant control over both retail pricing and margins and the activities of resellers, resellers themselves see their interests as being quite different to those of their suppliers. It must be remembered that most resellers, even oil company commission agents, have invested in their sites/business activities. That investment can be anything from ownership of the site, tanks, pumps, fuel and other stock to just the ownership of shop stock and the purchase of a franchise arrangement (whether a Franchise Act franchise or simply a 'shop' franchise).

In all cases, resellers have capital at risk, expect to earn a return on that investment and in most cases see themselves as small business operators. Some of them are happy to have commission agency arrangements on fuel; others prefer the more traditional arrangement where the service station operator purchases fuel from the supplier and then retails it on his/her own behalf. It is also true that most resellers have considerable difficulty with the manner in which the oil majors, their suppliers in the main, manipulate wholesale and retail pricing and seek to secure control over their businesses.

The oil companies control pricing – both wholesale and retail (and thus all margins), compete in the market directly against their own franchisees and branded operators, arbitrarily offer and remove price support, change terms and conditions of aspects of the contractual relationship without consultation, all of which basically gives the oil company total control over an operator's business. It is very difficult to debate an issue or to be in dispute with a company that controls your livelihood. It can't be proposed that because a service station operator runs a business under the banner of an oil major, the interests of the operator and the oil major will coincide. The very nature of the contractual arrangements suggest that they will more often collide.

Securing the protection of the rights and independence of resellers has always been one of the major priorities for ASSCSA and MTAA. The rights and independence of resellers need to be protected because every day in every market the actions of the oil companies affects their businesses. While other sectors of retail have protections provided by either tenancy laws, the Franchising Code of Conduct, the NSW Industrial Relations Act (s106) or sections 51AA and 51AC of the Trade Practices Act such protections have historically, largely proved inadequate in dealing with relationships in the oil industry.

#### **4. Why the TPA Review is Important to Reform of the Petroleum Industry**

ASSCSA believes that the question of reform of the petroleum industry cannot be addressed in isolation from any review and consideration of amendments to the restrictive trade practices provisions of the Trade Practices Act 1974.

Central to the current Review of the TPA and also to reform of the petroleum industry is the need to redress some of the imbalance of market power that exists within the oil industry.

Much of the behaviour of the oil majors which has and continues to be of concern to service station operators has been detailed in the submissions by ASSCSA/MTAA (copies of which are available on request) to the many inquiries into the petroleum industry over the past decade and are not repeated here. However, while ASSCSA believes strongly that certain behaviour (such as the right to unilaterally vary franchise and other agreements, the presentation to service station operators of 'take it or leave it' type contracts and the selling of fuel by suppliers at unreasonably low prices) should be proscribed at law, it is because the suppliers have such market power that such behaviour is possible. ASSCSA believes therefore that there needs also to be a strengthening of the provision in the Trade Practices Act dealing with misuse of market power. Prohibiting the conduct would address only part of the issue; the question of how the market power is used and the potential for it to be misused must also be considered.

One of the difficulties with the current section 46 is the requirement to prove 'intent' and the ACCC and others have stated that that can be very difficult to do. Thus it is proposed that an 'effects' test should be included in s46. ASSCSA does not believe that the inclusion of an 'effects' test in s46 would have an adverse impact on small franchisees. Should the inclusion of an 'effects' test result in a more competitive and transparent wholesale pricing system then that may well benefit resellers and consumers.

One of the areas where the oil majors have the most market power is in relation to the wholesale and retail pricing of petrol. Imports of refined petrol by other than the oil majors represent a very small proportion, approximately three to four per cent, of Australia's total petrol consumption. Thus the wholesale fuel market is very much dominated by the four oil majors. Many of the non-oil major suppliers in fact source their fuel from various of the four majors.

In respect of wholesale pricing, service station operators are price-takers. Supply contracts, certainly franchise agreements, leave no room for any negotiation on price. The wholesale price paid for fuel is the price charged on the day of delivery. There is very little transparency in the wholesale pricing arrangements.

The difficulty for service station operators is not only the control that the oil majors have over wholesale pricing, but the near to universal control that they also have over retail prices. This retail price control is achieved in a number of ways.

First, the companies themselves set the retail price at a number of retail outlets. In many markets a 0.5 cents per litre difference in retail price as between one retail outlet and another can make a substantial difference to the volume of fuel sold by each site. Thus if a site at which an oil company directly sets the retail price posts a certain price, it is very difficult for other sites to post retail prices that vary from that oil company price; irrespective of what the wholesale price of the fuel might have been. Thus the matter of selling at unreasonably low prices becomes an issue for service station operators.

For example in Melbourne on Tuesday, 2 July 2002, the posted terminal gate price for one of the oil majors was 81.81 cents per litre (for unleaded petrol). At one of its company controlled sites, on the same day, the same oil major was selling unleaded petrol at retail for 81.5 cents per litre. How the oil company concerned can post a terminal gate price of 81.81 cents per litre and then retail below that is one of the great mysteries of the petroleum

industry. Does the company not incur any costs of land and buildings, in transporting fuel to the site, maintaining the tanks and pumps on the site, paying staff and so on?

Secondly, oil companies manipulate the retail prices of their franchisees through the provision and withdrawal of price support. Price support and its impact on the market is discussed in more detail in section six of this submission.

Finally, the emergence of multi-site franchise networks have also allowed the oil majors to gain control over retail pricing across broader geographic regions than was previously the case. In some multi-site franchise arrangements, the oil major retains ownership of the fuel until it is sold at retail and thus directly sets the retail price. At others, while the sites are nominally in the control of a franchisee, the companies through the price support mechanisms have quite some influence in the setting of retail prices at all of the sites in the particular multi-site network.

Thus reform of the retail sector of the petroleum industry needs to address service station operators concerns about vertical integration, market power and what we would call 'predatory pricing'. Those issues are perhaps best addressed, not through specific industry legislation, but through an amended and strengthened Trade Practices Act.

ASSCSA believes, as it has for quite some time, that relationships in the oil industry should be regulated by a specific mandated code of conduct. One of the public policy aims of such a code should be to avoid further increases in vertical integration and the market power of the oil majors. One of the aims of such a code should be to avoid further increases in vertical integration and the market power of the oil majors. The mandated code should, at the very minimum, address the following issues:

- minimum tenure for all resellers;
- direct company operation of sites;
- pre-contractual and on-going disclosure;
- assignment of franchise agreements;
- alternative dispute resolution;
- collective bargaining by like brand resellers;
- fuel losses;
- pricing policies and price support;
- termination and expiry of agreements;
- variation of agreements;
- environmental issues – particularly the remediation of sites
- business plans
- supplier obligations
- supplier fuel cards; and
- marketing and other cooperative funds.

## **5. The ASSCSA Charter of Fairness**

The Australian Service Station and Convenience Store Association earlier this year adopted a Charter of Fairness; some elements of which are relevant to this Review.

Many of the issues in the ASSCSA Charter of Fairness have been addressed in detail in the submission to this Review prepared by the Fair Trading Coalition. MTAA is a member of that Coalition.

Briefly, ASSCSA supports:

- a strengthening of s46 of the Trade Practices Act to prevent the misuse of market power through the inclusion of an ‘effects’ test and giving the ACCC the power to issue ‘cease and desist’ orders;
- a legislated right for small businesses to collectively negotiate, subject to certain ‘safe harbour’ arrangements as described in the Fair Trading Coalition’s submission;
- a specific prohibition in the Trade Practices Act to proscribe selling at ‘unreasonably low prices’;
- the introduction of a mandatory (under the Trade Practices Act) code of conduct between all suppliers and resellers in the oil industry which provides resellers with certain rights and protections in their dealings with their suppliers;
- a strengthening of s51AC of the Trade Practices Act to proscribe ‘take it or leave it’ contracts and to prohibit the unilateral variation of franchise agreements and other documents by franchisors; and
- the need for a strong and effective competition regulator, the ACCC, but believes that the Commission should have a greater focus on the needs of small business and that there should be created within the Commission, a ‘small business as consumers’ division.

The ASSCSA Charter of Fairness is as follows:

<b>ASSCSA CHARTER OF FAIRNESS</b>	
1.	Strengthen the Trade Practices Act to give the ACCC greater power to prevent abuse of market power by big business and to allow small business the right of collective negotiation
2.	Prohibit the sale of fuel at unreasonably low prices
3.	Introduce a terminal gate pricing regime – where all costs incurred post the terminal gate are separately identified and charged
4.	Introduce a mandatory code of conduct for the oil industry
5.	Prohibit unilateral variation of franchise agreements by franchisors
6.	Outlaw ‘take it or leave it’ contracts
7.	Retention of the Petroleum Retail Marketing Sites Act 1980 until alternative regulatory arrangements, agreed to by ASSCSA/MTAA, are in place
8.	Review multi-site franchise arrangements
9.	Create a ‘small business as consumers’ division of the ACCC
10.	Appoint a Small Business Ombudsman

## **6. Examples of the ‘Misuse’ of Market Power**

### **\* *Tenure Arrangements***

Franchisees in the petroleum industry have tenure under the *Petroleum Retail Marketing Franchise Act 1980*. That Act provides that a minimum tenure of nine years (3+3+3 years) be provided to franchisees. However it is not unusual for the companies to enter into ‘hold-over’ arrangements with franchisees at the end of the franchise agreement tenure period. Franchisees continue to retail fuel, to pay royalties to their supplier, yet are expected to do so on the basis that they face a very uncertain future. Some franchisees have continued to operate under ‘hold-over’ arrangements for many months and some for several years, in the hope and expectation that the company will eventually provide them with a new agreement. Of course, those hopes and expectations are too often not met.

The point is not so much that the agreements should be renewed, but that the companies know the retailers are in an impossible situation in that the service station is their livelihood and that it is better to be in business than not. However, the companies have in the past manipulated that situation to their best advantage. They are aware that if they provide a new agreement then the retailer is entitled to a minimum of nine years and has certain statutory rights. If they don't provide an agreement, the retailer has no tenure and no rights; but the company continues to earn royalties and rental payments from the retailer.

\* ***Unilateral Changes to Agreements***

In late 1999 one of the oil majors advised its franchised dealers that it would be reducing the price support it offered its dealers. The company announced that from 10 December it would be reducing the minimum retail margin allowed dealers from 2.8 cents per litre to 2.0 cents per litre. That, for those dealers who are almost constantly in receipt of the maximum amount of price support, represents a drop in their gross income from petrol of almost 30 per cent. ASSCSA understands that the company did not consult in any meaningful manner with its dealers prior to announcing that change in price support levels. It was effectively a unilateral decision by the company concerned which franchisees could not object to, yet the financial impact on many of them was likely to be quite substantial.

Price support is considered by the oil companies to be of a 'discretionary' nature; a view which has in the past also been expressed by the ACCC. However, in reality price support is not just provided by the oil majors on an 'ad hoc' basis it is an essential part of the financial operation of franchisees' sites. Price support is required by dealers because the wholesale price at which they must buy their fuel is often nearly equal to, and in many instances higher than, the price at which they need to retail to ensure an adequate sales volume.

The fact is that many franchisees rely on that price support (and that it is necessary is because of the obscure pricing arrangements of the oil majors) and have often been told of the existence of price support in "glowing" terms prior to their entry into a franchise agreement. That that should be so is not surprising because the businesses would be plainly unviable but for such price support.

The oil majors may well be within their rights to alter price support arrangements, but what is often forgotten is the manner in which the existence of the price support has been conveyed to franchisees and how much that price support is relied upon by those franchisees (and the companies are aware of that). The unfairness and the misuse of market power arises when and because of the manner in which those arrangements are changed.

\* ***Oil Company Price Support Arrangements***

Price support or rebates is a sensitive issue in the oil industry. Essentially, such support or rebate is provided to resellers, generally franchisees, but not always, by the oil majors which essentially provides a maximum retail margin for resellers. However, price support is not necessarily provided all of the time, nor is it provided in all markets. The removal of price support is generally evidenced by a large upwards movement in the retail price of petrol.

The oil majors contend that they offer price support in order to assist their resellers in meeting 'competition' in the market.

While the exact mechanisms for price support or rebate arrangements may differ slightly between the oil majors the following applies:

- resellers pay the delivered price for fuel on the day they receive a delivery;
- their supplier, the oil major, will notify the reseller, generally electronically, of the maximum retail price at which the company will provide price support and from what time that support will be provided. The maximum retail price advised by the supplier is not always above the wholesale or buy price paid by the reseller;
- as long as the reseller does not set a retail price above the maximum price advised by the supplier then the reseller will in due course receive from the oil company a payment equating to the price support in cents per litre times the volume of fuel sold;
- if the reseller sets a retail price above the supplier 'suggested' maximum retail price then the reseller will not receive any price support. Of course, because the reseller has set a price above the rest of the market, the volume of fuel sold by that reseller is likely to fall significantly. Thus while the reseller may in fact earn a higher margin on the fuel sold, because the volume is affected, the reseller is likely to be worse off than if the instructions from the supplier about the maximum retail price had been followed;
- if a reseller chooses to set a retail price below the maximum price suggested by the oil major the reseller, may, but not in all cases, still receive price support, but its overall margin will be reduced – because the retail price is below the 'ideal' proposed by the supplier. Thus, the reseller is unlikely to be any better off. Volume may have increased, but the margin per litre will be lower;
- it is therefore generally not in resellers' interests, either in terms of the financial situation or in terms of their relations with their supplier to at any level other than that 'suggested' by their supplier. This effectively means that while it is not compulsory for resellers to 'accept' price support, the reality of the market is such that most do whenever it is 'offered'; and
- thus through the price support system the oil majors have secured control over the setting of virtually all retail prices; albeit indirectly.

## **7. The Two Great Myths of the Petroleum Sector**

### *Myth 1 – Predatory Pricing Does Not Exist in the Petroleum Industry*

It is possibly true that no charges alleging predatory pricing have ever been laid in the Australian petroleum industry. However, that is a result of the weakness of the law relating to the misuse of market power and unfair competition, rather than the alleged fact that predatory pricing does not occur.

ASSCSA believes that this is a matter about which the ACCC has collected much evidence from service station operators while at the same time assessing that as being insufficient to lay charges under the current s46 which requires evidence that a company intended to misuse its market power.

ASSCSA believes that the Review should seek to have private discussions with the appropriate enforcement officials of the ACCC to make its own judgement as to the existence or not of predatory pricing in the petroleum industry. Certainly it should not accept unsupported claims by major oil companies that predatory pricing does not exist.

### *Myth 2 – A Change to an ‘Effects’ Test Will Expose Price Support Systems to Potential Prosecution*

The second great myth is that a change to an ‘effects’ test would expose oil companies’ price support systems to potential prosecutions. No evidence or legal opinion has been advanced to support this entirely fanciful proposition and it should be treated as fanciful until such evidence by a reputable and independent Counsel is produced.

## **8. Fair Trading Coalition**

ASSCSA has sought to raise with the Review matters of specific concern to service station operators. As indicated above, some of those issues raised here have been addressed in quite some detail, though perhaps in a broader small business context, in the submission prepared to the Review by the Fair Trading Coalition (FTC). ASSCSA supports the submission made by the FTC and strongly believes that the matters canvassed therein should be given close and careful consideration by the Review.

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