COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Retail Fuel Market Study

DRAFT REPORT

Wellington

20 August 2019

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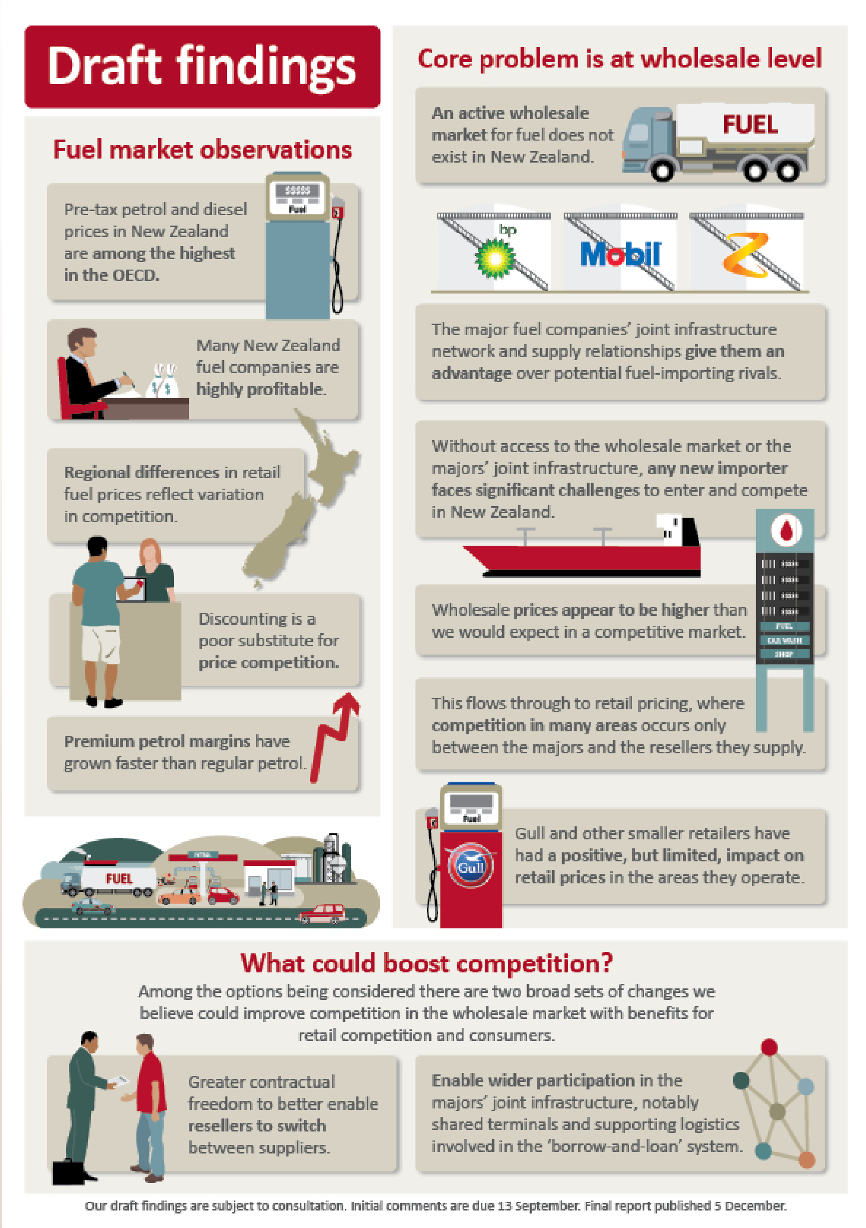
Chair

Draft findings

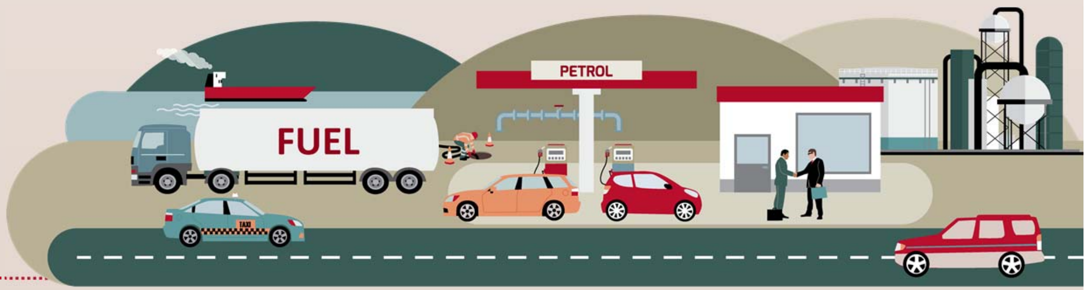


The purpose of the study

- Our draft report addresses two related issues:
  - Is competition working well?
    - Are we seeing outcomes that suggest the market might not be working well?
    - Are there factors that appear to be affecting competition in the market?
  - What options are there for making competition work better?
- Our findings on these issues are preliminary, and may change as a result of consultation

Fuel is important to consumers

- Roughly 3.2 billion litres of petrol and 3.6 billion litres of diesel are consumed annually in New Zealand
- Fuel purchased at service stations and truck stops accounts for about 98% of the petrol and 73% of the diesel consumed annually, at a cost of more than $10 billion
- In the March 2019 quarter, NZ had the third highest pre-tax petrol prices and diesel prices in the OECD



Supply chain - historical origins

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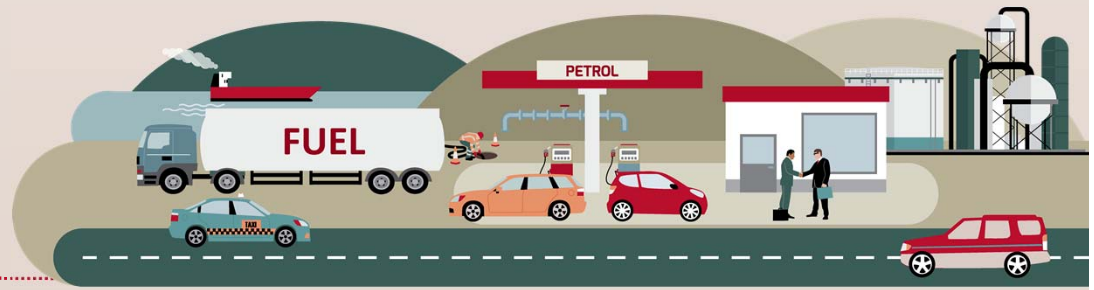
- Prior to deregulation in 1988, fuel importers set up joint infrastructure arrangements (refinery, shipping, pipeline, terminal access)

- Major fuel firms entered the retail market post-deregulation, buying retail sites and entering into long-term supply contracts with independent retailers

- They became effectively vertically integrated, with continued cost and logistical benefits of their infrastructure sharing agreements



Supply chain has not materially changed

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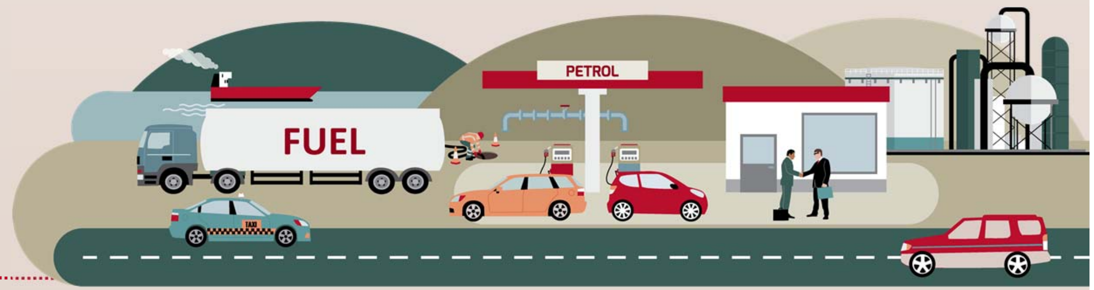
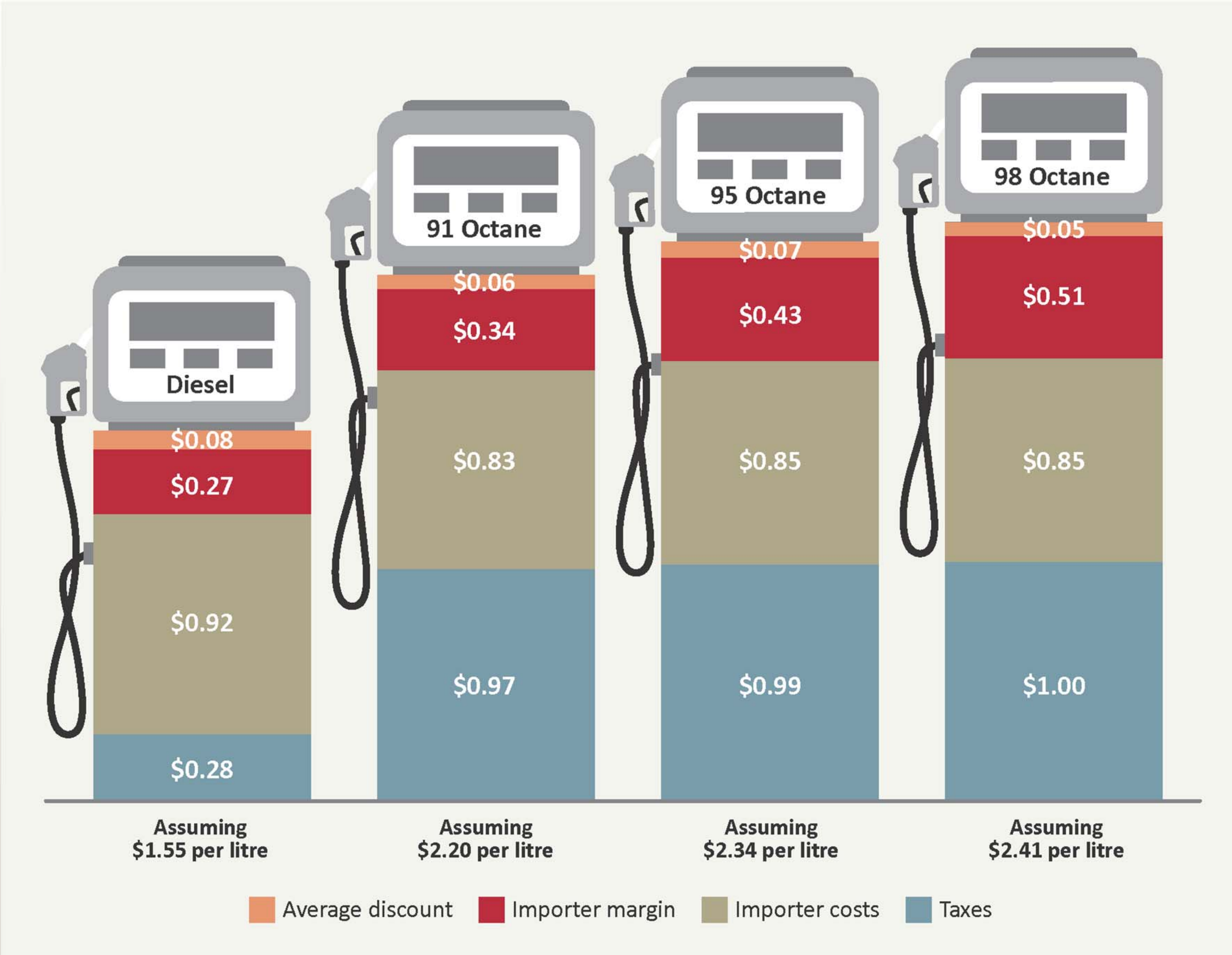
- Z Energy, BP and Mobil together control 90% of the fuel supplied to New Zealanders
- Gull imports via Mt Maunganui and does not share the majors' infrastructure network
- Collectively, all four importers control the supply of fuel to more than 1,300 retail sites under 20 different retail brands

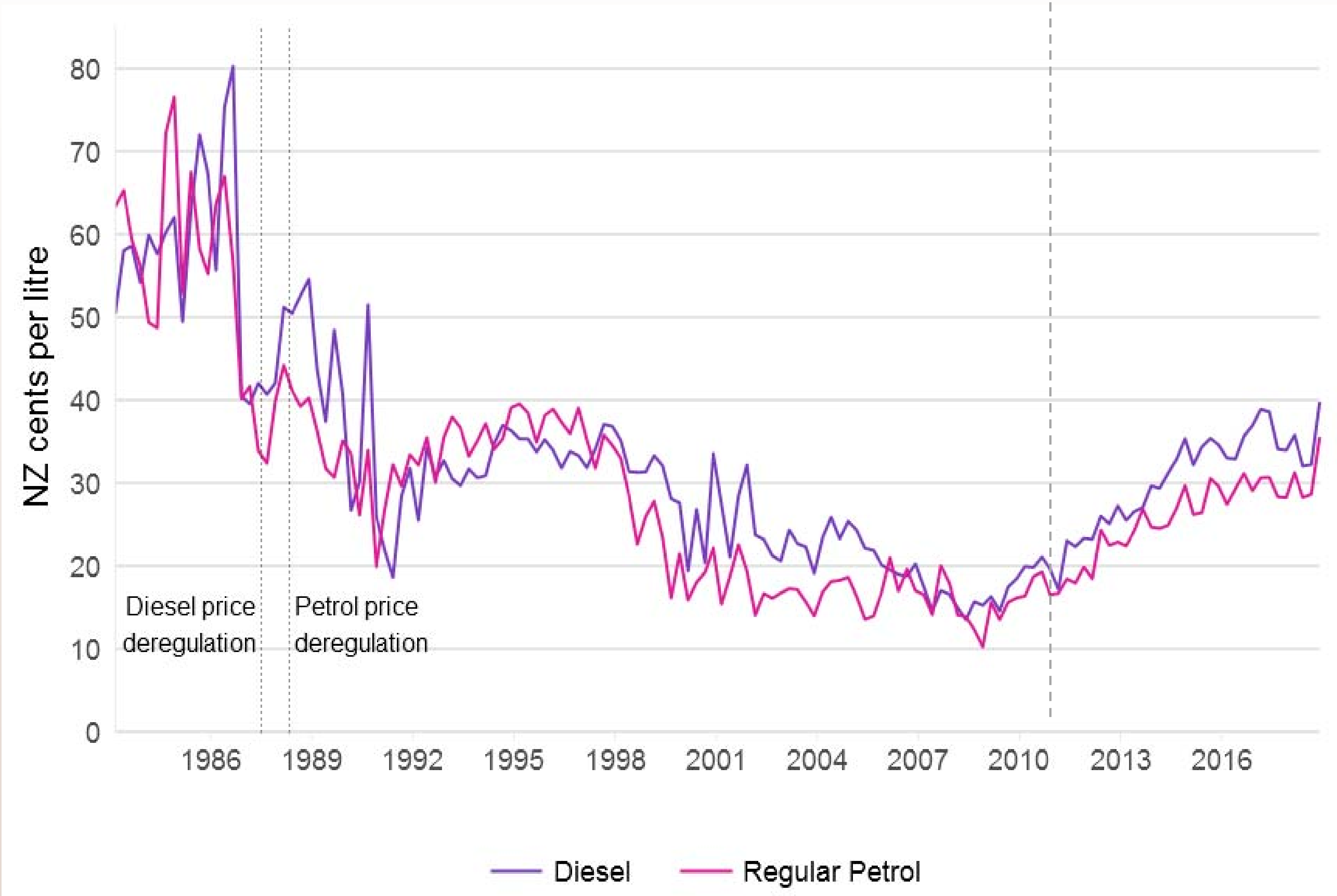


Retail price components



Estimated components of the board price of fuel (1 July 2018 – 31 December 2018)

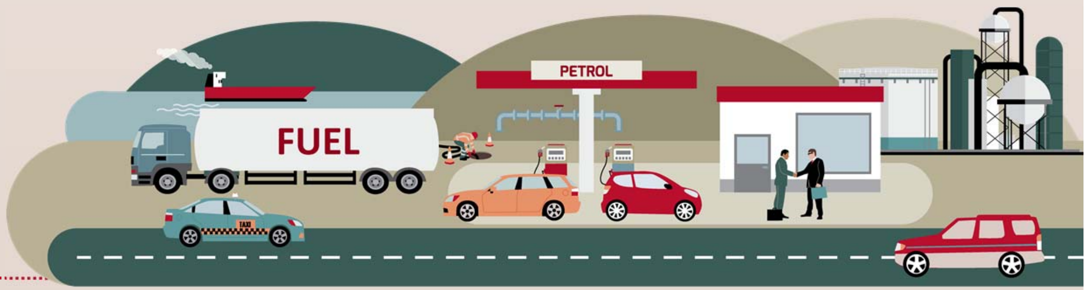
Margins have trended up this decade



Quarterly regular petrol and diesel importer margin (real Dec 2018 prices)

Profitability is the key factor

- Price at the pump is affected by a range of factors (global oil price, exchange rates, taxes etc)
- Longer term profitability can be an indicator that prices may be 'too high' and competition is not working as well as it could be



Fuel firms are highly profitable

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- A range of indicators suggest the profitability of New Zealand fuel companies is higher than normal competitive levels. These include:
  - Importer margins more than doubling since 2008
  - Fuel company returns on new investment are more than double our estimate of a reasonable return
  - New retail sites are typically achieving unusually fast pay back
  - Recent returns on capital (whole business) are higher than international peers and above normal returns

Further observations

- Regional differences in retail fuel prices
  - Variations not all explained by cost
  - Differences in competitive conditions affect price
- Discounting is a poor substitute for price competition
  - Takes focus off board price
  - Sorts consumers between those who get discount and who don't
- Premium petrol margins have grown faster than regular
  - 95 and 98 octane margins are currently 13–15cpl higher than 91 – margin was 7-8cpl in 2011
  - Extra margin does not reflect actual cost differences

Core problem is wholesale market

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- An active wholesale market for fuel does not exist in New Zealand
- The major fuel companies' joint infrastructure network and supply relationships give them an advantage over potential fuel-importing rivals
- Without access to the wholesale market or the majors' joint infrastructure, any new importer faces significant challenges to enter and compete in New Zealand
- Wholesale prices appear to be higher than we would expect, which flows through to retail pricing where competition is limited

There are two key causes

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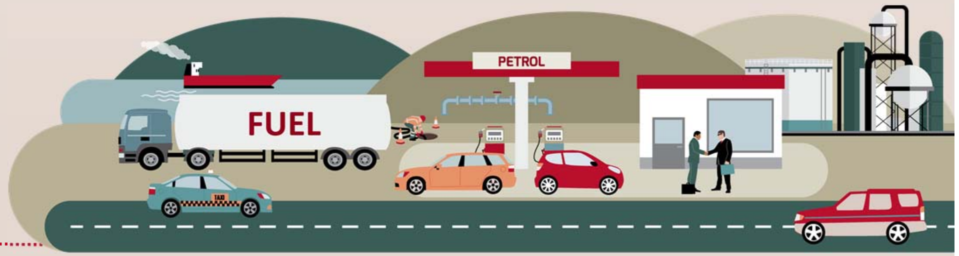
We consider there are two interrelated factors affecting wholesale competition:

1. Limited switching means no active wholesale market

- Distributors are dependent on their suppliers
- Supply contracts often include restrictive terms

2. Infrastructure sharing gives the majors a significant advantage

- Majors have lower costs of supply
- Raises costs to new entry



Market developments may help

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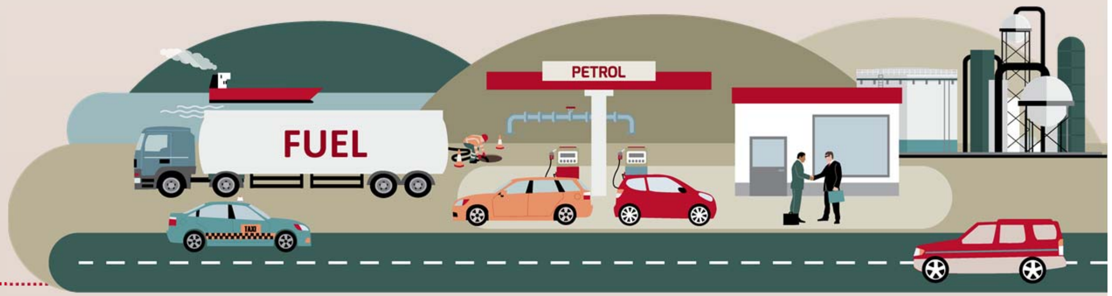
- Developments that could improve outcomes for consumers include:
  - the establishment of TOSL's new import terminal in Timaru
  - further expansion by retailers like Waitomo, NPD and Gull
- However, these do not address our concerns with the wholesale market



What could boost competition?

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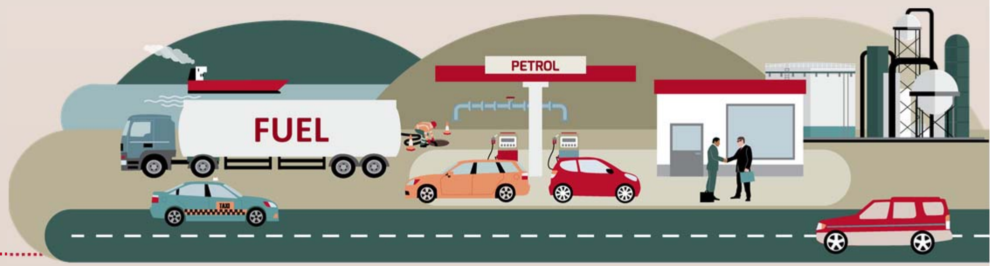
- We consider there are two broad sets of changes that could help create a competitive wholesale market:
  - Greater contractual freedom to make switching easier
  - Enable wider participation in the majors' shared infrastructure, notably the borrow-and-loan system
- Further options relating to information sharing and premium fuel are included in our report
- We will continue to develop our thinking on potential options as part of the consultation process



Consultation

Written comments on Draft Report due	Friday 13 September 2019 (4pm)
Consultation Conference	Tuesday 24 September – Friday 27 September 2019
Post-conference comments due	Friday 11 October 2019 (4pm)
Publishing date for Final Report	Thursday 5 December 2019

The Draft Report and further information:

www.comcom.govt.nz/fuel-market-study

If you would like contact us please email us at:

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