



MTA Submission

Further comment to Commerce Commission on Market Study into the Retail Fuel Sector

11 October 2019

Dear Sir / Madam

Submission:

Further comment to Commerce Commission on Market Study into the Retail Fuel Sector

This submission is from:

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Attn: Keston Ruxton

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Thank you for the opportunity for MTA to provide comment to the Commerce Commission on the Market Study into the Retail Fuel Sector regarding the views of and its effect on the automotive industry.

Yours sincerely,



Greig Epps
Advocacy & Strategy Manager

MTA Further Comment on Retail Fuel Market Study

Thank you for the opportunity to provide further comment on the Market study into the retail fuel sector following the Consultation Conference from 24-27 September 2019 (“**the Conference**”). This submission responds to issues arising from the open parts of the Consultation Conference, and submissions made by other parties regarding the 20 August 2019 Draft Report (“**the Draft Report**”).

I. Overview:

1. MTA reiterates its earlier comments, and its continued broad support for the way in which the Commission has identified that the primary issues impacting on consumer prices relate to contractual constraints and other constraints in the wholesale market. In addition to its earlier submissions, *MTA supports:*
 - 1.1 *various possible reform options which the Commission has “floated”, including the more recent suggestion that aspects of the “grey list” approach to unfair contract terms might be useful in terms of dealing with contractual issues (“b to B”) in this market; and*
 - 1.2 *indications that reform or improvement in this area could involve appropriate light-handed regulation, a market regulator and/or processes (not just a voluntary fuel firm code), or even (at least) some sort of ombudsman role.*
2. MTA has several comments following on from the Conference, which are outlined below, but which can be briefly summarised as follows:
 - 2.1 ***MTA has not heard any new information to sway its view that Commission’s Draft Report has properly identified the key issues in this market, being:***
 - 2.1.1 *there are significant issues regarding market contract terms and market structures/arrangements impacting on the independent fuel retailer operating in a vertically integrated oligopoly dominated by large fuel firms;*
 - 2.1.2 *other similar markets (electricity, natural gas, telecoms) have appropriate arrangements in place, which is a strong indicator that something more is required in the fuel market; and*
 - 2.1.3 *the one-sided contract terms that are prevalent in this market arise in the context of significant power imbalances between fuel firm wholesalers/ independent resellers and independent retailers (and resellers dealing with wholesalers).*
 - 2.2 ***Critically, improvements need to extend to retailer contract terms and access for retailers (and resellers), particularly independents, to the wholesale market:***

- 2.2.1 While the pressures of running a small business have minimised the levels of independent retailer participation¹ in the Commission's process, *access for independents to a wholesale market should still be addressed*; and
- 2.2.2 *otherwise any reforms will:*
- (a) *be less effective;*
 - (b) *further concentrate market power in (vertically integrated) wholesalers/resellers; and*
 - (c) *reduce (independent) retailer numbers/competition; and*
- 2.2.3 *this market study process should not be dominated by the views presented by well-resourced market participant fuel firms, and progress should not be slowed by their differing views about profitability/margin etc.*
- 2.2.4 *Discounting and the widespread use of fuel brand loyalty cards is still a significant issue* insofar as it provides a smokescreen that conceals a lack of workable competition in aspects of the market. Issues relating to the use of these loyalty cards outside the commercial fleet operation level have been raised with MTA in confidence but due to confidentiality clauses within supply agreements, further details are unable to be disclosed in this submission.
- 2.2.5 MTA notes the recent announcement by Government of its response to the Electricity Price Review, and particularly its comments on the use of prompt payment discounts:
- The Review found that prompt payment discounts (PPDs) are excessively high and not cost reflective. They cause additional hardship for those that can least afford it, and they contribute to customer confusion when comparing prices. As such, the Review recommended PPDs be prohibited but reasonable late payment fees be allowed.²
- 2.2.6 A similar analogy can be made with fuel brand loyalty cards where consumers who don't have the relevant card can't access any promotional discount or if they do, the retailer pays the advertised discount out of their retail margin (rather than the cost landing with the loyalty card promoter).

2.3 **The Commission** should not *just* be focussed on whether it should go as far as Draft Report had suggested, it ***should (as signalled in the Draft Report) be***

¹ Contractual confidentiality and concerns about supply chain ramifications have also deterred small business participation in this process.

² Para 65 of the *Electricity Price Review: Government Response to Final Report*;

<https://www.mbie.govt.nz/assets/electricity-price-review-government-response-to-final-report.pdf>

considering whether the reforms floated in the Draft Report/at the Conference are enough or should go further.

II. MTA comments

3. ***(i) Despite contrary views expressed at the Conference, the key issues have properly been identified by the Commission in the Draft Report and should be addressed.***
4. *Three key factors reflect a lack of workable competition here:*
 - 4.1 *consumers are facing high fuel prices relative to consumers in other countries, which are not explicable solely by reference to geographical, economies of scale or tax-rate considerations;*
 - 4.2 *the supply chain is dominated (directly and indirectly) by vertically integrated majors, and by resellers (many themselves vertically integrated) that are themselves tied in directly to one or other major; and*
 - 4.3 *significant structural issues have been identified by the Commission relating to market contracting terms/arrangements and the lack of an active liquid wholesale market.*
5. *Other similar markets have arrangements in place, including some quite significant regulatory/access to infrastructure arrangements, that better ensure competition. Notably, other similar market environments (electricity, natural gas, telecoms) appear to benefit from regulator/regulatory inventions and/or more pro-competitive market arrangements. For example: access to lines/supply infrastructure is generally expected across natural gas and electricity markets; and regulatory regimes and oversight are in place through the Gas Industry Company for natural gas and the Electricity Authority for electricity.*
6. *There are significant “b to B” power imbalances in this market, which are self-evident from the one-sided terms that prevail. MTA sought to highlight that power imbalance during the Q&A in the Conference. It did not intend to suggest that its members were commercially naïve, but it did seek to make the point that in a vertically integrated oligopoly market they would almost universally be massively outgunned by well-resourced vertically integrated fuel firms – majors and super-majors (big oil companies), and also resellers³.*
 - 6.1 *The imbalance is clearest when an independent is dealing directly with a supermajor or major fuel supplier. But similar issues will arise when they deal with resellers which will generally be larger entities too and which will also only*

³ The current Rugby World Cup provides a perfect analogy. The so-called “minnows” – less experienced rugby playing nations – will still line up against the top tier sides, but they are usually out-played (with only rare exceptions of minnow success, like Japan v Ireland). The key differences here are that the rules of rugby are clear, and a visible referee oversees the interactions on the field. In contrast, in this unregulated market the big players set the rules.

be able to offer what their long-term contract with their supermajor wholesale supplier allows.

- 6.2 References by fuel firms in the public part of the Conference to *ad hoc* situations in which retailers have been able to secure a better deal should be considered in the context of a market reality (evident from the available standard trading terms) that most retailers *don't* secure better deals. Of course, some retailers and resellers try to push back to seek to negotiate contract terms. But the prevalent one-sided contract terms that the Commission has identified reflect that retailers generally make little impact on “take it or leave it” terms offered by fuel firms.
7. *This also affects participation in the market study.* Independent retailers are wholly dependent on the fuel firms for supply, with contracts that tie them in long term to their current supplier and which require confidentiality. Their resources will not match fuel firms. Understandably many perceive there is little to be gained from raising their heads above the parapet.
 - 7.1 During the Conference, the Commission appeared to seek views on whether supply contracts were fair. The only responses possible were from fuel firms present who issue those supply contracts. The less well-resourced counterparties, particularly independent retailers, were conspicuously absent from the room and the discussion could not properly accommodate their views on whether terms affecting them were fair. The reasons for independents' lack of involvement are largely out of the Commission's control. But the limited range of responses, and the absence of in-person independent retailer voices is notable (other than the limited representation that MTA can provide)⁴.
 - 7.2 Although some independent resellers were (courageously) more active, they will have needed to choose their words carefully in the presence of their much larger fuel firm suppliers at the Conference, and others have not participated.
8. *Fuel firms' perspectives are only part of the picture:* In that context the significant input from fuel firm perspectives, and comparative silence from independent retailers, should not discourage the Commission from following through on its own assessment.
 - 8.1 The Conference provided an *opportunity* for the vertically integrated fuel firms (the majors and some other substantial reseller entities with long term contracts with majors) to be heard, but (for the reasons noted) the process has not heard (much) from smaller independent retailers or many reseller entities. Nevertheless, MTA encourages the Commission to follow through on its findings so far as they relate to market issues adversely impacting on those entities' access to and participation in the wholesale market.

⁴ MTA's participation is limited not only by the contractual restrictions on businesses that might wish to share examples of unfair conditions. As a trade association, under the Commerce Act, MTA must be careful not to act as a *de facto* bargaining agent for its members in discussing supply chain arrangements and pricing mechanisms used by members and their counterparties.

8.2 Also, MTA encourages the Commission not to be swayed by differing fuel firm perspectives on measuring profits/margins, and (apart from reiterating its earlier comments that some of the models considered are ill-fitting for smaller independent businesses) leaves it to the Commission to determine how profitability is measured within the different business operating models, to the extent that is necessary. However, MTA maintains that irrespective of those issues, and for the reasons already identified, a substantive response is clearly appropriate.

8.2.1 MTA carried out an exercise, albeit limited, to try and establish a view on profitability at the independent retailer level. Given the wide range of business operating models and the size and shape of resources applied in these small businesses meant that a single method of profit measurement was near impossible at that level. What measurements we were able to apply, and other recent anecdotal accounts, did return profitability levels vastly lower than the figures quoted in the draft report clearly showing that at the independent retail level, these businesses are not achieving anything like the profits attributed to the fuel firms and in many cases finding it difficult to make ends meet.

9. ***(ii) Improvement needs to include improving the access of retailers (and resellers), particularly independents, to the wholesale market.***

10. *The recommendations the Commission appears to be considering with respect to impediments to other wholesaler/reseller participation in a wholesale fuel market need to be mirrored (as appropriate) with respect to retailers' supply arrangements with wholesalers/resellers.*

10.1 MTA maintains that it is not enough to focus on constraints that impact on market participants' ability to *participate in* the wholesale market, *it is also necessary to unravel constraints that prevent independent retailers/resellers (particularly independent retailers) from accessing that market.* It says retailers' ability to access the wholesale market is critical to competition for the supply of retail petrol and that is in the long-term interests of consumers⁵.

10.2 MTA maintains that unless similar changes are made to ensure that retailers are no longer so constrained by one-sided contract terms/market conditions and can access wholesale markets:

10.2.1 *there will be relatively few existing retail sites truly open to competition from wholesale/resale suppliers – just occasional ad hoc end of contract term negotiations, with the incumbent supplier in the box seat;*

10.2.2 *prices will continue to be largely dictated to independent retailers by their (generally vertically integrated/long term) suppliers – both by the price at which they supply fuel to independents and their retail sale prices (net*

⁵ From the Terms of Reference, page 9, Draft Report.

of their wholesaler/reseller margin – which may capture (all) available profits) in competition with the independents; and

10.2.3 *independent retailers will continue be constrained in their ability to engage with a wholesale market to seek better “buy” prices (stimulating wholesalers/reseller sale price competition), which could otherwise impact positively on retail competition and consumer prices.*

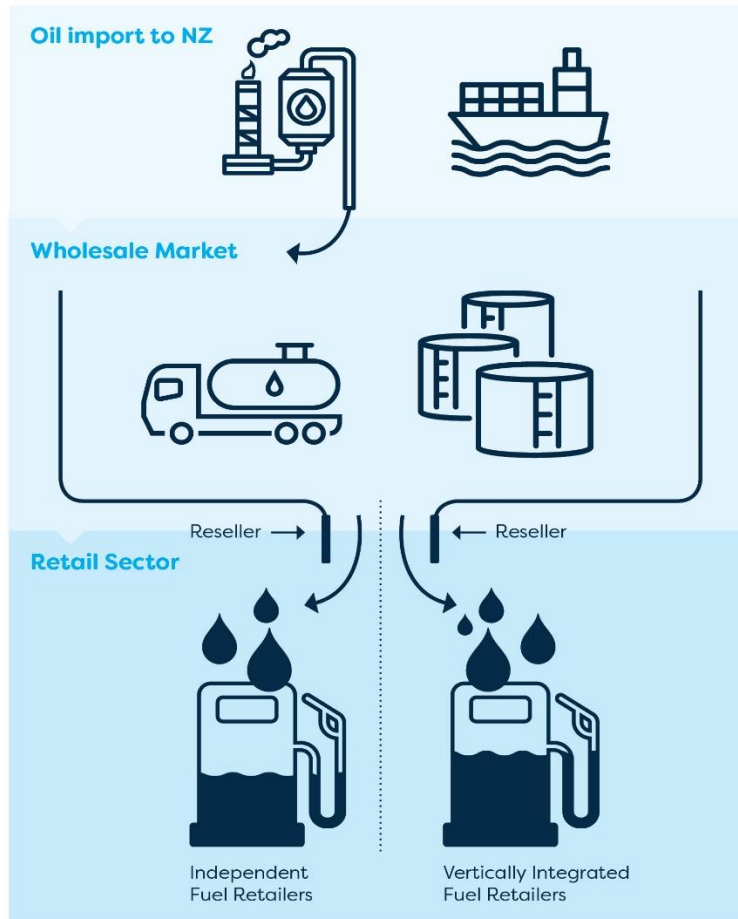
10.3 *As per our previous submissions, changes confined to wholesale/resale participants would be likely to:*

10.3.1 *concentrate market power amongst those wholesalers and retailers, meaning independent retailer continue to be contract terms and price takers, exposed to price squeeze effects and limiting their ability to compete at a retail level to whatever margin (if any) is left for them by their (generally) vertically integrated wholesaler/reseller; and*

10.3.2 *result in a perverse anticompetitive effect, and potentially a market squeeze, forcing independent retailers out of the retail market and reducing retailer numbers/competition (Refer Fig 1, page 9).*

11. *Discounting conceals market operations where there is a lack of workable competition.* MTA notes that the Commission has signalled that it might not deal with discounting, but MTA invites the Commission to at least deal with the impact of discounting to the extent that it clouds issues regarding the operation of this market. To the extent that fuel brand loyalty card discounts can be *imposed* by a wholesaler or reseller on a retailer (contractually or effectively through market forces that require retailers to use them when available), they enable unfair market terms to be imposed, at times eroding any commercial margin entirely or forcing trading at a loss. That could amount to a market squeeze, and pricing to independent retailers which is not sustainable long term - in effect reinforcing the market power of wholesalers/resellers and reducing any scope for effective independent retailer engagement with the wholesale market or retailer-retailer competition. These are real, current issues for independent retailers – during the recent round of consultations MTA is still hearing confidential accounts of “take it or leave it” terms being imposed on retailers and discounts being imposed on retailers which erode any remaining retailer margin on fuel sales.
12. ***(iii) The Commission should (as signalled) be grappling with whether the floated reforms go far enough and with other options that go further.***
13. *MTA is primarily concerned to ensure that, as noted above, any recommendations also extend to constraints on retailer engagement with the wholesale market.*

Current Market State



Potential Market Response

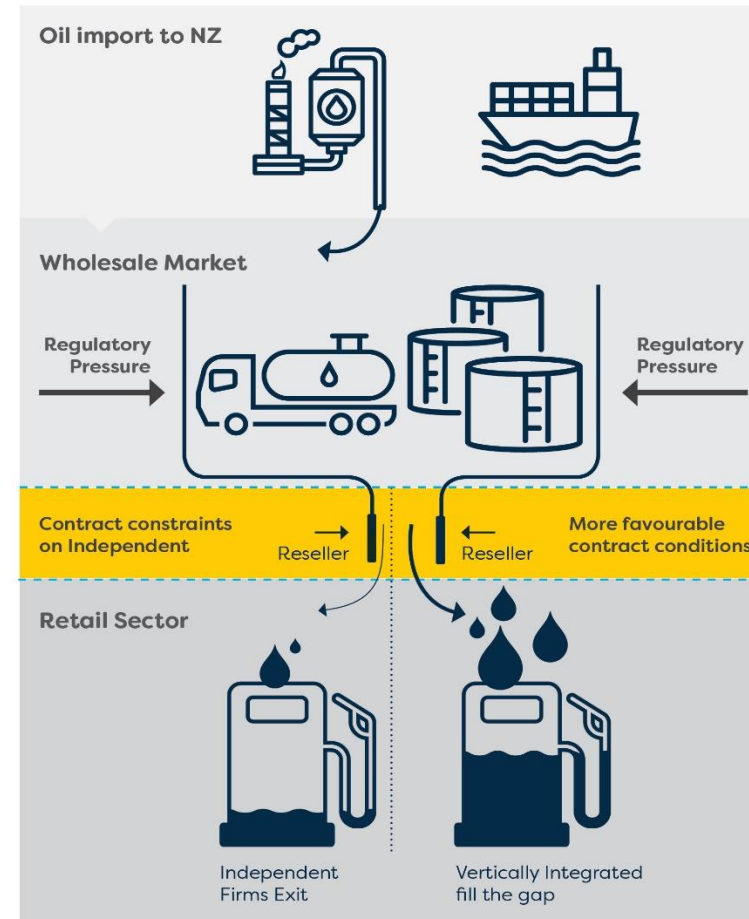


Figure 1 Potential market outcome if regulatory pressure only placed on wholesale segment.

14. *In addition, MTA urges the Commission to make recommendations regarding an approach styled on the “unfair contract terms” regime, with certain sorts of terms being identified in a grey list that might be presumed anti-competitive/unlawful except if specified exceptions apply.* That could cover elements like contract term/length, transparency/clarity around terms on offer and available in the market, limits on exclusivity arrangements etc.
- 14.1 As to contract length, MTA does not necessarily accept that the 7 years that Z Energy had suggested in open session is the right threshold level. The fuel firm information cited in the Draft Report suggests fuel firms’ start-up costs can be recovered in less than that time frame. MTA suggests that a shorter time frame might be preferable, but with a clarity that an exception could apply if both parties actively choose a longer time frame (moderating trading risks as they see fit).
- 14.2 Similarly, although MTA maintains that retailers too should have freedom from exclusivity provisions (i.e. an ability to choose to take some or all supply more directly through a wholesale market if they wish), again MTA maintains that they should be able to negotiate terms that reflect whether they want some freedom to take supply elsewhere or whether they want certainty over a longer term. So, again, a combination of a grey list exclusion and an exception provision would be appropriate.
- 14.3 This sort of grey list/exceptions regime should allow retailers to engage with more active/liquid wholesale market pricing and/or to contract on longer/fixed term basis (or some combination of the two). This would give all parties (including independent retailers/resellers) *options* to choose and negotiate arrangements depending on their business models and appetites for risk. Independent retailers need to be part of that negotiation in real terms (not just as terms/price takers) - in much the same way that an investor might choose to manage a portfolio, or a home-owner might opt for fixed, floating or a mixture of fixed/floating mortgage arrangements. The exceptions regime would need to be realistic too – something that could not be “played” by wholesalers/resellers simply requiring retailers to sign off a tick-box to say they agreed terms that were actually imposed on them.
15. Finally, reform or improvement in this area might involve appropriate light-handed regulation, a market regulator and/or processes (not just a voluntary fuel firm code), or even (at least) some sort of ombudsman role. That could be in combination with a grey list/exceptions approach⁶.

⁶ The Commission may wish to encourage MBIE to investigate establishing a franchise code (similar to the Oil Code in Australia) to complement its recent work on unfair business practices (unconscionable conduct and unfair “B2b” contract terms). The indicative scope of the unfair practices rules will not capture fuel supply arrangements (being over \$250,000 in a given year).

III. Next steps

16. We thank the Commission, again, for the opportunity to participate in this process and look forward to seeing the final report that may include recommendations to address factors that may hinder competition between industry participants.
17. Should you require any clarification in respect of any of these comments, please do not hesitate to get in touch.



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