

MARKET STUDY INTO THE RETAIL FUEL SECTOR: Z ENERGY'S RESPONSE TO INVITATION TO COMMENT ON PRELIMINARY ISSUES

- 1 This submission sets out Z's response to the Commerce Commission's preliminary issues paper on its retail fuel market study.¹
- 2 Z notes the short timeframe for responding to the preliminary issues paper; there is likely to be further information relating to the questions in the preliminary issues paper that Z may wish to present as the market study progresses.
- 3 This version of the submission is public. Confidential and commercially sensitive information has been redacted. Release of the redacted information would be likely unreasonably to prejudice Z's commercial position. Please contact us if you receive a request for the information.

Questions on our approach to the study

Q1 Do you have any comments on our proposed approach to the study, including the scope and areas we intend to consider? Are there any additional areas relevant to the terms of reference that should be considered and may not be captured by our approach? If so, please explain.

- 4 Z generally supports the scope of the market study, as set out in the preliminary issues paper.
- 5 Z does have a comment on the scope as described in paragraph 23 of the preliminary issues paper, where the Commission states:

We also note that retail fuel prices are affected by several factors including international crude oil prices, movements in the NZ dollar against other currencies (especially the US dollar), and the level of taxes and levies on fuel. We do not intend to focus on these factors directly. These factors are outside the scope of our mandate under the terms of reference, and Part 3A of the Act, which requires us to study any factors that may affect competition.

- 6 The only caveat to paragraph 23 is the statement, "we acknowledge that international crude prices and exchange rate movements can affect the extent to which parties compete in the hedging market".²
- 7 Z agrees that oil prices, exchange rates and taxes and levies are outside the direct scope of the market study. However, those factors do influence retail fuel supply and demand, and therefore market outcomes. For example, the imposition of the regional fuel tax in Auckland has caused significant changes in demand at certain sites as consumers have decreased their purchases in response to higher headline prices, while high oil prices and adverse exchange rate fluctuations can impact fuel suppliers' costs and risk profiles and so influence the way they price. Z submits these factors should not be excluded from consideration to the extent they affect retail competition.

¹ Commerce Commission, "Market study into the retail fuel sector: invitation to comment on preliminary issues", 31 January 2019.

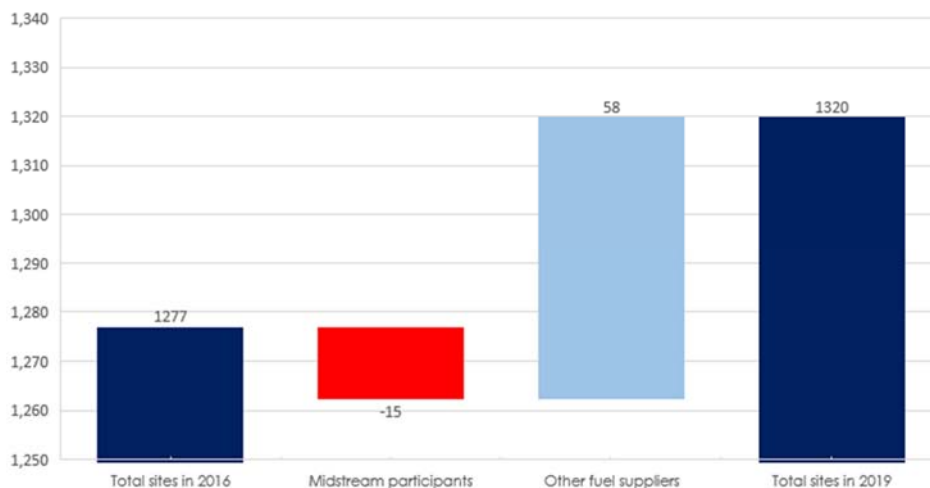
² Preliminary issues paper, footnote 11.

Questions on trends in market structure

Q2 What could explain the fall in retail sites that carry the brands of the major fuel firms and the increase in the number of retail sites that carry their own brand (e.g. Allied, NPD, Waitomo, Gull, RD Petroleum) as observed in Figure 1?

- 8 As the Commission acknowledges (and as Z also identified in the context of the Z/Chevron process), there has been a marked rise in the number of sites branded by suppliers independent of the three participants in the “midstream” supply infrastructure, Z (including the Caltex brand), Mobil and BP.
- 9 That rise in the number of Gull and distributor sites has continued beyond the data shown in Figure 1 in the preliminary issues paper. See Figure 1 below, which shows:
- 9.1 The total number of sites in New Zealand as at 1 January 2016.
- 9.2 The change in the number of sites under the midstream participants’ brands.
- 9.3 The change in the number of sites under other suppliers’ brands.
- 9.4 The total number of sites as at 1 January 2019.

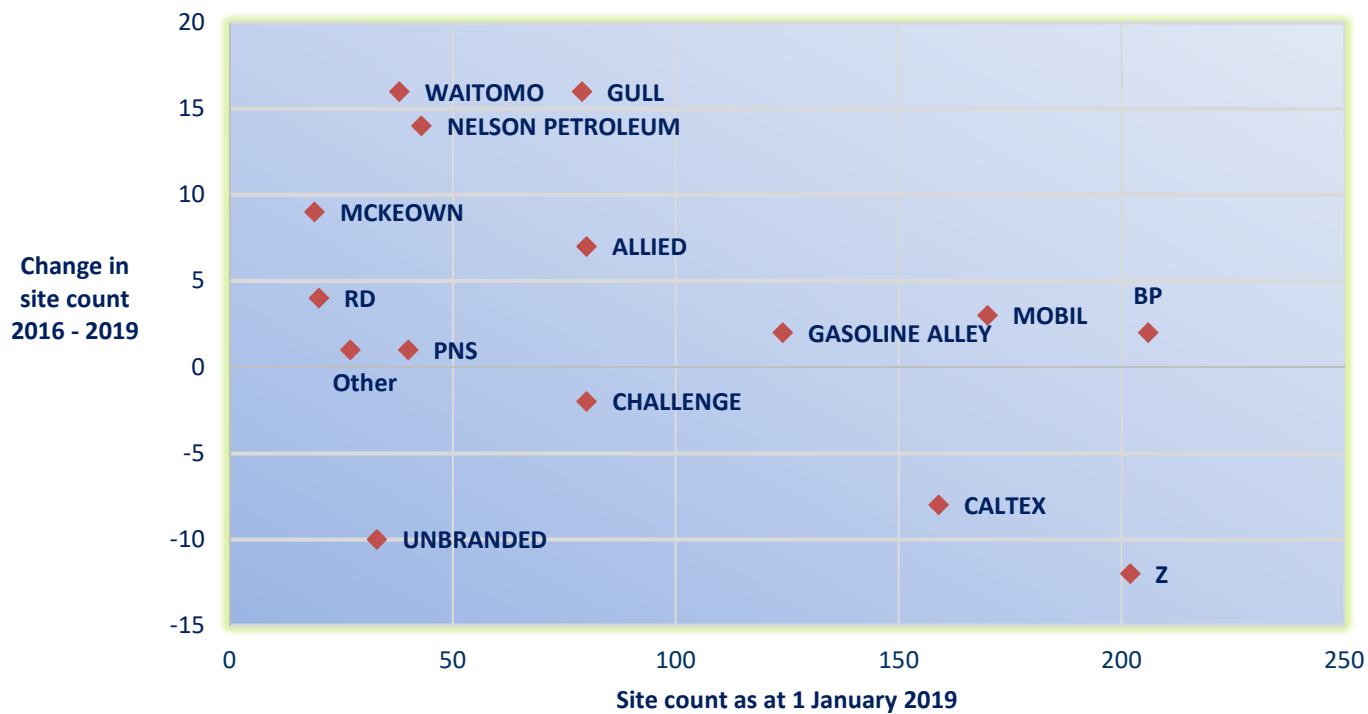
Figure 1³



³ Source: Z analysis based on data from Informed Sources.

- 10 Figure 2 below shows the total site count, by brand, and the change in site count for each brand between 1 January 2016 and 1 January 2019.

Figure 2⁴



- 11 The change in site count over this period by island is as follows:
- 11.1 22 new sites in the North Island (a 2.5% increase). 39% of all sites in the North Island are now independent brands (i.e. not Z, Caltex, Mobil or BP).
- 11.2 21 new sites in the South Island (a 5.4% increase). 55% of all sites in the South Island are now independent brands.
- 12 Alongside the more than 6% net increase in site numbers since 2016 there has been only a [REDACTED]. This disparity between site and volume growth is likely to be contributing to the arresting of the margin growth trend discussed in response to question 4 below. [REDACTED]
- 13 The following paragraphs expand on the features of and reasons for this trend, from Z's perspective.
- 14 Z identified in the context of the Z/Chevron clearance process⁵ that distributors are becoming more significant players in retail markets in part because of the growing use and acceptance of unmanned facilities, which are lower cost. Some of these investments arose out of a distinctive business model, which combined rural distributor runs with retail site delivery using the same truck, at low marginal cost.
- 15 Low-cost, unmanned sites remain a significant component of competition, but since the time of Z's submission, Gull and some distributors have increasingly expanded

⁴ Source: Z analysis based on data from Informed Sources.

⁵ [REDACTED]

across the full range of service differentiation, from unmanned sites to full-service sites with convenience store offerings (see e.g. NPD Moorhouse, Rolleston and Queenstown).

- 16 Distributors have also expanded beyond the regions with which they were traditionally associated. For example:
- 16.1 NPD has a significant presence in Christchurch, as well as sites as far south as Invercargill.⁶
- 16.2 Hamilton-based Waitomo has recently announced plans to build a site in each of Wellington (in early 2019) and Christchurch (during 2019).⁷
- 16.3 Gull hopes to have a site operating in Wellington within a year.⁸
- 17 Z's experience is that distributors can be very competitive in their pursuit of new sites, e.g. [REDACTED]
- 18 The increase in the number of Gull and distributor sites appears to reflect a view about the opportunities in, and outlook for the industry (see Z's response to question 14 below). As noted above, the pace of capacity expansion has greatly exceeded that of volumes.
- 19 The increased and increasing retail presence of Gull and distributors also suggests a level of confidence about the competitiveness and reliability of the wholesale terms they are able to secure (see further Z's response to questions 3, 7 and 31-36).
- 20 These trends may in part be a competitive response to margins in the industry recovering over the last several years to a point where profitable entry appears possible. Prior to the start of this trend (from Z's perspective, around FY2008/09) margins were very low, market participants were seeking to exit and were unable to adequately fund maintenance of assets and attract investor capital – the number of sites in the industry had approximately halved between 1976 and 2008.⁹ But given the low barriers to retail entry (including the ready availability of sites and ease of set-up) and availability of competitive wholesale terms (including the ability to access wholesale supply without making any commitment to supply chain infrastructure beyond secondary distribution),¹⁰ Gull and other wholesale players have been able to respond to a perceived opportunity quickly and on a material scale. The rise in overall capacity, and Gull and distributor sites in particular, has occurred most markedly in the North Island, although more recently increasingly in the South Island as identified at paragraph 11 above. Given the lower and more dispersed population in the South Island, the perceived return opportunity may have arisen at a higher margin level.
- 21 Finally, it is important not to overstate the homogeneity of the midstream participants' approaches to new site investment and, as noted above, while their

⁶ See <https://npd.co.nz/npd-retail-network/> (accessed 14 February 2019).

⁷ See <http://www.waitomogroup.co.nz/> (accessed 14 February 2019).

⁸ Katarina Williams, "Gull New Zealand plans expansion into Wellington region", stuff.co.nz, 4 October 2018 (<https://www.stuff.co.nz/motoring/news/107588748/gull-new-zealand-plans-expansion-into-wellington-region> (accessed 14 February 2019)).

⁹ Z Energy "Submission to MBIE on Fuel Market Performance Study" (4 May 2017) at page 3.

¹⁰ See Z's response to questions 17-28, and 31-36.

new investment has been outstripped by that of Gull and distributors, their site numbers have not generally declined. Specifically:

21.1 [REDACTED]

21.2 Z observes that BP appears to be continuing to invest materially in its Connect network, which are its full service, company-owned sites.

21.3 Mobil has also had a net increase in its site numbers since 2016, although Z has not observed as much focus on new site investment by Mobil as it has for BP.

Q3 *How is the market structure, including ownership arrangements throughout the supply chain, affecting competition in the retail fuel market? How are recent changes to the market structure affecting competition in the retail fuel market?*

22 The retail market is fundamentally competitive. This is illustrated by the trends considered in response to question 2 above – capacity and margins have ebbed and flowed over time, but there is a diverse group of players, which have been able to respond to a perceived opportunity quickly and on a material scale.

23 In the retail market, the midstream participants compete alongside Gull and a number of distributors. The terms of wholesale supply do not appear to limit the latter's ability to exercise a material competitive constraint in retail markets. Specifically, based on their behaviour in the market, distributors appear to have a high degree of independence, with considerable freedom on:

23.1 [REDACTED]

23.2 Where they locate their sites (e.g. Waitomo has a site in Foxton, less than 3km from a site branded Mobil, Waitomo's wholesale fuel supplier).

24 Independent players (including players other than the owned or dealer sites of the midstream participants i.e. Gull and distributors) competitively constrain the midstream participants, particularly at a local site level.¹¹ Consistent with the trend in the growth of their site numbers, the effect of these players on competition has grown materially even since the Commission granted clearance for Z to acquire Chevron.¹²

25 For example, NPD opened a site in Invercargill in March 2016. [REDACTED]

Figure 3: [REDACTED]

26 Essentially, the market structure in which the three midstream participants maintain the national supply chain and make available fuel on a wholesale basis ex-terminals has resulted in a diverse, vibrant and competitive retail market (see the response to question 34 below). The three midstream participants, and their wholesale customers, present a wide range of offering, from premium full service to primarily price-driven unmanned sites.

¹¹ [REDACTED]

¹² Commerce Commission, *Z Energy Limited and Chevron New Zealand* [2016] NZCC 10.

- 27 The key recent change in market structure is the acquisition by Z of Chevron; Caltex Australia has also acquired Gull. Neither of these has had a material impact on retail competition. [REDACTED]

Figure 4: [REDACTED]¹³

Figure 5: [REDACTED]¹⁴

- 28 Z considers it is too early to understand the full impact of Caltex Australia's acquisition of Gull. For now, there is no noticeable difference in how Gull participates in the retail fuel market as a result of the acquisition. That is because Z understands Mobil has continued to supply Gull and only recently has Caltex Australia taken over that function. Z addresses the incentives of key market players, including Mobil and Caltex Australia, below in response to question 15.

¹³ [REDACTED]

¹⁴ [REDACTED]

Questions on trends in gross margins and regional pricing

Q4 *What factors could be contributing to an observed rise in gross margins?*

- 29 This question makes assumptions that are worth discussing at the outset:
- 29.1 [REDACTED]
- 29.2 Z indicated during the Z/Chevron clearance process that competitors' unilateral responses to Z's disruptive retail competitive conduct were continuing to evolve over time in a manner that suggests competitive retail markets. At that time (early 2016), this dynamic had already had consequences for Z's volume and market share,¹⁵ but profits as well as margins had been exceeding forecasts. [REDACTED]¹⁶
- 29.3 Z's margin increases need to be viewed in context. Z considers that at the outset of the trend margins were unsustainably low as they were inadequate to fund maintenance of assets and attract investor capital – see further below.
- 30 It is important to note that Z's margin growth has reflected the following:¹⁷
- 30.1 When it was formed in 2010 Z adopted a strategy of improving its margins through a high value offer. Z invested in the supply chain and its customer proposition as unilateral attempts to improve returns, which Z executed by developing a disruptive competitive strategy grounded in extensive customer research.
- 30.2 That strategy triggered a series of responses that have increased choice in the market and placed increasing pressure on margins [REDACTED]. Competitors' unilateral responses to Z's disruptive conduct, which by Z's observation have continued to vary by brand and over time and to which Z has in turn considered itself compelled to respond. Competitors' strategies are continuing to evolve over time in a manner that suggests competitive retail markets and they include:
- (a) Greater focus on "off price board" discounting strategies through loyalty programmes, such as AA Smartfuel and Mobil Smiles. The offers these loyalty programmes entail themselves also continue to evolve over time. Furthermore, some distributors are offering "off price board discounting" without a loyalty programme such as NPD giving customers a 15cpl discount for presenting a SuperGold card, and certain independents choosing to redeem supermarket docketts.
 - (b) Expansion of "on price board" discounting practices to grow share, with the "main port price" dynamic increasingly being superseded by more localised competition e.g. [REDACTED].
 - (c) Increased new-to-industry sites, including unmanned sites (see data above).

¹⁵ [REDACTED]

¹⁶ [REDACTED]

¹⁷ See also [REDACTED].

- (d) Increased focus on retail fuel by distributors to complement and grow their existing commercial business (such as NPD, Allied, Waitomo and McKeown), and also in the form of full-service retail sites.

30.3 [REDACTED].¹⁸

OECD Comparison

- 31 The Commission notes in the preliminary issues paper that, according to MBIE data, New Zealand's pre-tax fuel prices are now among the highest in the OECD, and that New Zealand has gone from having one of the lowest pre-tax prices in the OECD in 2008, to having the second-highest pre-tax price for premium petrol in 2017.¹⁹
- 32 Z has identified a number of methodological issues with this data (including, for example, regarding the appropriateness and comparability of using "premium" petrol as the basis for the analysis).
- 33 But even if based on robust methods the finding remained true, in Z's view that may well not indicate any lack of competitiveness in New Zealand retail fuel markets. In other words, there may well be good reasons for New Zealand's pre-tax fuel prices to be relatively high among OECD countries. While Z has not been able to calculate alternative data, it comments on these reasons below.
- 34 First, as noted above, margins (and prices) in 2008 were not at a level that would support a sustainable and resilient industry and so an increase since then should not be considered adverse, in itself.
- 35 Secondly, certain costs may be higher. New Zealand, being a small country (small volumes) distant from the main ports where refined petrol is sourced (e.g., Singapore) would likely have a high import parity price. Even though Australia is also distant from Singapore (although not as far), the much larger population means that Australia will likely be able to take advantage of economies of scale in shipping by transporting oil and refined petroleum in large ships relative to those that would be used for New Zealand.
- 36 Finally, New Zealand has fuel specifications that are stringent and that make New Zealand fuel relatively difficult to blend. The specifications target minimum performance and reducing fuel's environmental impact. While other countries do have tight specifications, they are generally not as constrained as many of those in New Zealand. For example, while Australian specifications are in many respects similar to New Zealand's, Australia is significantly more lenient in relation to sulphur levels.

Q5 *Could an observed rise in gross margins, or differences in gross margins between regions, be explained by capital expenditure or other costs?*

- 37 [REDACTED]

¹⁸ [REDACTED]

¹⁹ Preliminary issues paper, paragraph 41.

38 During the FY11-15 period, which was a period of rising margins, Z was implementing its new retail strategy, which involved major capital investment. As such, capital expenditure and other costs partly explain the trend. In summary, Z:²⁰

[REDACTED]

39 Z is no longer contributing significant new capital expenditure in the retail sector (as set out above in response to question 2). That said, Z has a significant amount of capital invested in the midstream supply chain, [REDACTED]. In addition, while Z is not opening significant numbers of sites, it does continue to invest in material new retail innovations such as Z Fastlane (see further below at paragraph 165).

40 Z made, and continues to make, these investments to compete by differentiating its offer. Z's adoption of its retail strategy and competitors' responses have taken place in a competitive context in which Z remains under continued pressure to adapt and evolve. [REDACTED]²¹

Q6 What factors contributed to observed differences in gross margins between the South Island and Wellington on the one hand, and the rest of the North Island on the other? Is this trend continuing?

41 Competitors' responses to market conditions have been varied.²² Up until recently, including at the time of Z's acquisition of Chevron, competition manifested in a different way in the North compared with the South Island partly because the midstream participants were the key players in the latter. That is, there tended to be less on board price competition in the South Island and more off board price competition.²³

42 The midstream participants incur significant cost owning, operating and maintaining the midstream infrastructure (this is discussed in more detail in response to questions 17 to 28 below). In that context, there is an economic imperative to ensure utilisation and unit cost efficiencies by defending market share. This means that in practice it is difficult to command a market premium because raising price delivers an opportunity to competitors to grow their volume share and improve their economics. Correspondingly, it is difficult to grow market share by discounting on the price board as competitors will match price to defend share and preserve supply chain economics. So, price competition where only the midstream participants are present tends to occur more by way of off-board promotions, discounts and loyalty offers than price board discounting (e.g. for particular periods and/or locations), because such activity is inherently more difficult for competitors to monitor and directly counteract (this dynamic is discussed in further detail in response to questions 12 and 13).

43 This trend has not continued, in part due to the growth in the South Island of distributors, with their localised strategies and lack of midstream investment burden. As a consequence, the competitive dynamic in the South Island has now begun to more closely mimic the North Island, with significant on-board price

²⁰ [REDACTED]

²¹ [REDACTED]

²² See, for example [REDACTED]

²³ See also Z Energy, Clearance application, paragraph 47-58.

competition in addition to off-board loyalty and promotion activity (see the responses to questions 12 and 13 below).

- 44 There remain some fundamental differences between the North and South Islands which can be expected to result in ongoing differences in market outcomes. In particular, the South Island has a smaller, and more widely spread, population than the North Island. For example, Gull has previously indicated it “could not afford” to build a terminal in the South Island, identifying the low population as the reason;²⁴ the perceived inability to generate sufficient returns to justify this investment (which Gull was able to make at Mt Maunganui) suggests that prices remained competitive in the South Island. Timaru Oil Services Limited (**TOSL**) has perceived a market opportunity based on its return expectations and the evidence suggests has been able to act on that opportunity without delay or hindrance.

Q7 Can the various suppliers of retail fuel increase output in the short term? Are there any constraints that reduce their ability and incentive to expand output/sales in a timely manner?

- 45 Yes. From Z’s perspective, there do not appear to be material contractual restrictions on any party’s ability to obtain volume. [REDACTED]²⁵ [REDACTED]²⁶
- 46 Additionally, Z does not know of any structural reason why either a midstream participant or an independent could not obtain additional volume at short notice:
- 46.1 Importantly, there is no material “new” volume in the industry. Volumes have been essentially flat for several years (see paragraph 12 above), and Z expects them to continue to be flat or to decline over time (see Z’s response to question 14 below). As a result, there is sufficient volume in the system to accommodate market share (or single major contract) “wins” and “losses”.
- 46.2 In any event, imports remain a major source of fuel in addition to locally-refined product (see also Z’s responses to the supply chain questions below), and imports can be increased at short notice (three months in the ordinary course, and potentially more quickly but at a premium price and subject to product availability).

²⁴ Rachel Clayton, “Gull NZ says lack of petrol terminal access blocks it from lowering South Island prices”, stuff.co.nz, 6 July 2017, <https://www.stuff.co.nz/business/94430296/gull-nz-says-lack-of-petrol-terminal-access-blocks-it-from-lowering-south-island-prices> (accessed 19 February 2019).

²⁵ [REDACTED]

²⁶ [REDACTED]

Questions on trends in profits

Q8 *Is an observed rise in gross margins leading to an increase in the level of profits being achieved by the fuel firms?*

- 47 Selling product at higher gross margin does not necessarily mean higher net margins and hence a positive impact on profitability. In addition, as noted above, Z's margin increases have corresponded with volume decline. Nevertheless, Z's gross margins generally grew during the period FY2009 to FY2016 and the net result, including having regard to the other factors that impact profitability, was that Z's profitability also generally improved. See, for example, [REDACTED].²⁷
- 48 However, more recently, [REDACTED] see Figure 6 below [REDACTED]²⁸ [REDACTED]²⁹ [REDACTED].³⁰ This outcome reflects increased competitive pressure across Z's business, but particularly in retail fuel, as well as the cost of issues relating to a longer than planned RNZ shutdown. As described in more detail above (see paragraph 30.2), a competitive response to higher margins was expected and has occurred.

Figure 6:³¹



²⁷ [REDACTED]

²⁸ [REDACTED]

²⁹ [REDACTED]

³⁰ [REDACTED]

³¹ Source: public announcements.

Q9 Is "return on average capital employed" (ROACE) a reasonable method to assess the reasonableness of prices (the approach taken by the 2017 Fuel Study)?

- 49 No. ROACE can be used to assess profitability at a given point in time, but not to draw inferences as to the reasonableness of the underlying prices that are a factor of that profitability. The challenges in doing so include:
- 49.1 Difficulties collecting data for and comparing the results of businesses of a fundamentally different scale and/or structure.
 - 49.2 Understanding the contributions of multiple product lines in the context of sophisticated and efficient pricing.
 - 49.3 Assessing a period that properly accounts for economic and investment cycles.
- 50 The best and probably only way to have confidence in prices being reasonable is to ensure that the underlying trading conditions facilitate robust competition. Reasonable prices should reflect incentives to innovate that are present in workably competitive markets and may vary depending on the competitive strategies of particular firms – for example, a premium retail offer as compared with a low cost unmanned retail offer. In this regard, the increased entry and flattening of margins is evidence that competition in retail fuel markets is working.

Questions on trends in discounts

Q10 Do you have any comments on the methodology or data utilised by MBIE to calculate a rise in retail price discounts?

51 In Z's view there are two key points:

51.1 Once they are adjusted to take account of actual costs, the *trends* MBIE identifies in relation to importer margin are usually broadly correct. However, particularly during certain periods when the data is provisional, the monitoring can become significantly inaccurate. The main reason for this is that the way MBIE takes account of discounting is fundamentally flawed. As a result, while Z agrees there has been a trend to increasing importer or gross margins over recent years (although that has now changed), MBIE's monitoring hasn't got it quite right. It is becoming increasingly difficult for MBIE to monitor given the increasing level of discounting.

51.2 In any event, importer or gross margin is not a particularly meaningful measure, and if monitoring is to take place it should focus on net or operating margin.

52 Each of these points is addressed in turn.

MBIE's importer margin monitoring shows margin trends generally correctly in the long run, but the calculated margin levels themselves can be very inaccurate

53 At times when the international oil market is moving quickly, MBIE's importer margin calculation can become significantly inaccurate. This is directionally resolved when the figures are corrected for actuals, and at that point the trend the data identifies typically becomes reasonably accurate, but not the margins themselves. It is problematic for Z when the calculation is incorrect because as a listed company Z has a set of stakeholders, including investors, who look at the data regularly.

54 The key reason for the inaccuracy is that MBIE's estimate of discounting is flawed. Z understands the estimate is arrived at as follows.

55 Statistics New Zealand sends out scouts to 130 sites across New Zealand to observe the price of fuel at those sites (Z does not know which sites are used). Statistics New Zealand then uses this data and what it considers to be a "national price" to estimate an average "board discount". Statistics New Zealand also estimates loyalty discounts, using some historical information it holds about actual loyalty discounts.

56 Z considers this an inadequate estimate of discounts for the following reasons:

56.1 Statistics New Zealand does not have information about site volumes, and accordingly is unable to accurately weight the discounting data.

56.2 130 sites out of 1320 may well not provide an accurate representation e.g. due to the local nature of board pricing.

56.3 Intra-week price movements are missed by the weekly price sampling. Given there are many such movements, such as discount days, they are a significant part of retail competition and accordingly this seriously impairs the data.

56.4 It is no longer appropriate to use a “national price” as a starting point – see above at paragraph 30.2(b) – given sites now tend to be priced locally e.g. [REDACTED].

56.5 The discounts available through loyalty programmes have increased significantly since the time of the data Statistics New Zealand holds, so the estimate based on these figures is materially inaccurate.

57 Z proposes that a better way of monitoring retail fuel margins would be to use actual sales data provided by industry participants. [REDACTED]

Any monitoring should focus on net margin

58 Z considers net margin is more appropriate and provides a better sense of the landscape than gross margin, and should be used if monitoring is to be carried out.

Q11 What are the likely explanations for the rise in discounting? Is there a relationship between the level of discounting and retail gross margins? If so, why?

59 The key reason for the rise in discounting is competition. There has been significant retail entry in recent years and that, coupled with flat overall volumes, has meant many sites’ volumes are decreasing and market participants are competing hard to retain volume levels. As noted above in response at paragraph 11, the growth in the number of sites has far exceeded volume growth.

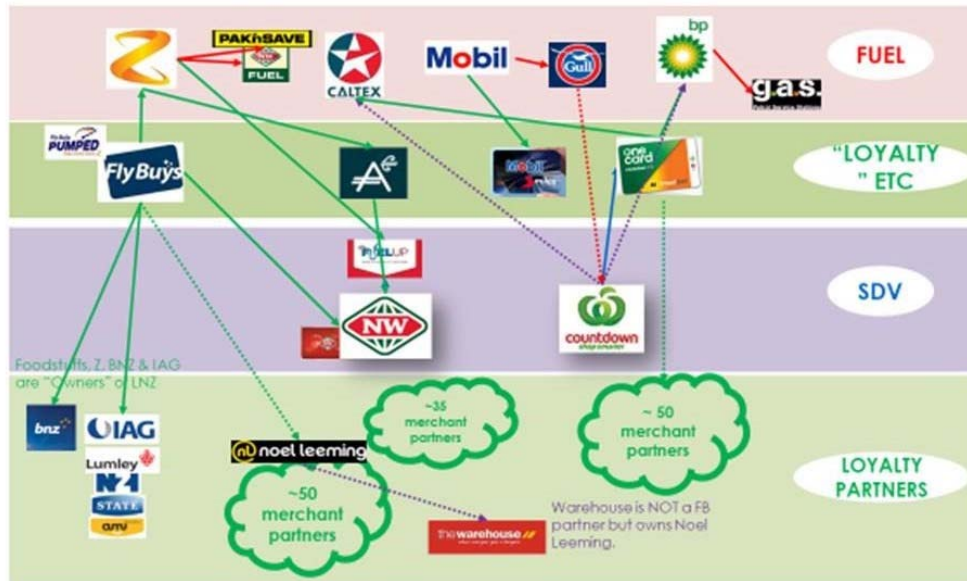
60 Discounting has increased and this has corresponded with a period in which gross margins are no longer increasing to the extent they were (see above in response to question 4).

Q12 What are the potential benefits and harms to consumers from the increased use of loyalty schemes and fuel discounts? For example, does this increase switching costs for consumers or make it easier for consumers to benefit from a lower price?

61 The increased use of loyalty schemes and discounts has resulted in substantial price and other benefits for consumers. Neither has increased customer switching costs in any material way.

62 Figure 7 below shows the current major loyalty relationships to the best of Z’s knowledge (e.g. Z does not know whether or not Gull continues to accept Countdown docketts). In addition to the schemes shown in Figure 7, other market participants run their own schemes that do not involve partners (e.g. NPD offers discounts to SuperGold Card holders, and Z understands some independents redeem supermarket docketts).

Figure 7



Notes:

- Lines in red indicate supply relationships (note that Z understands that since recently Gull has switched supplier to Caltex Australia; note also that G.A.S. does not have loyalty relationships); green and dotted lines indicate loyalty relationships.
- Solid green lines indicate direct relationships; dotted lines indicate relationships involving scheme redemption.
- "SDV" stands for supermarket discount vouchers (or, "dockets").

63 In terms of discounts, there are no barriers to switching between fuel suppliers and accordingly price discounts are straightforward to take advantage of. This is evidenced by the success of discounting in winning additional volume e.g. [REDACTED]. See Figure 8 below, which shows the customer and volume uplift experienced by Z sites on FlyBuys Pumped discount days:

Figure 8: [REDACTED]³²

64 Fuel loyalty schemes also have not increased switching costs. That is because:

- 64.1 There are no material barriers to entry to or exit from loyalty programmes; they are easy to join (they can typically be joined instantly, on site; joining does not require time or internet access). [REDACTED]
- 64.2 There are no volume or brand loyalty commitments and consumers can become a member of as many different schemes as they wish. For example, [REDACTED], and see also the survey results under Figure 9 below. FlyBuys Pumped does not require any minimum spend for a consumer to obtain a discount.
- 64.3 Loyalty schemes are not all about price and fuel discounts. Z customers are able to earn Airpoints dollars at Z, and obtain no fuel discount whilst doing so.

³² [REDACTED]

65 Again, the ease of switching and access to loyalty discounts is illustrated by the success of discounts and special offers made through those schemes in generating temporary volume swings e.g. as shown by Figure 8 above.

Figure 9: [REDACTED]³³

66 [REDACTED]

67 It is also worth noting that loyalty and other off board competitive activity is difficult for competitors to track e.g. it can be targeted at particular types or groups of customers; while promotions and loyalty offers can be broadly tracked it is very difficult to do so with accuracy, or to monitor their rate of redemption or impact on volume. Yet individual customers are easily able to keep informed about offers available to them, since such information is made available directly e.g. by email.

Q13 Do retail discounts differ by region? What are the main drivers of any regional differences in discounting?

68 Retail discounts increasingly vary by region, as pricing generally takes place on a more localised basis than it did in the past (although national discounting practices remain e.g. through loyalty schemes and nationwide offers). The major driver of regional discounting is local competition, and attempts to drive greater, or protect existing, volume share. This reflects, at least in part, the increased role (and significant freedom) of suppliers other than the midstream participants.

69 [REDACTED]

³³ [REDACTED]

Questions on other trends

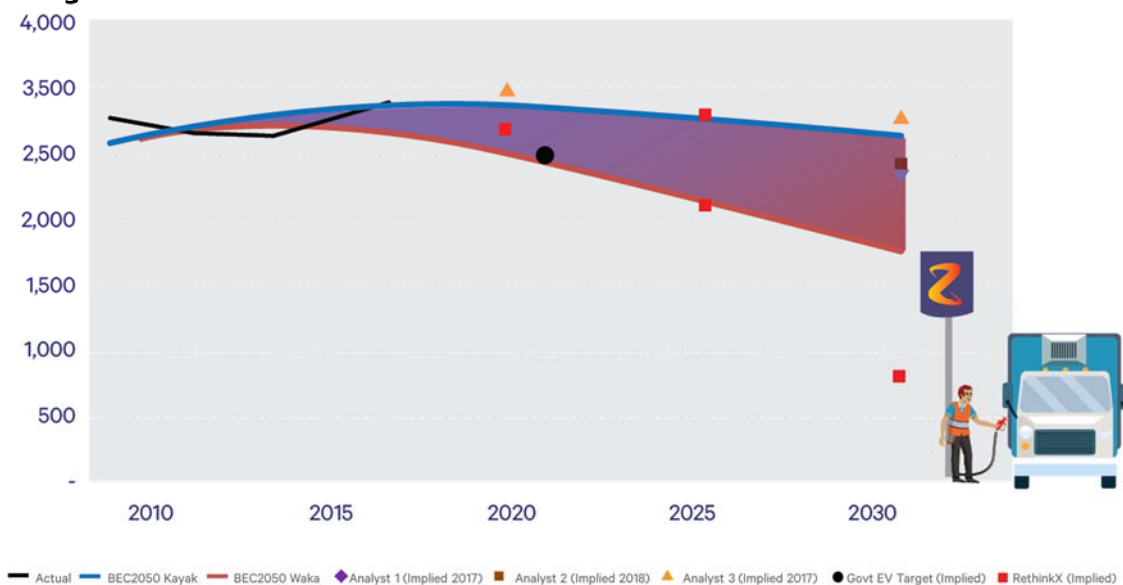
Q14 Are there other trends that are likely to affect competition for retail fuel in the foreseeable future? If so, please explain how.

70 Retail fuel is a “sunset” industry. Estimates of how quickly retail fuel will cease to be used vary widely. Z agrees there appear to be two main possibilities, described as a “kayak” and a “waka” scenario. These scenarios have been created by the Business Energy Council (of which Z is a member) and provide a set of bookends by which to look at the future of the retail fuel industry. In summary:³⁴

70.1 In the Waka scenario global leaders unanimously agree that climate change is the defining problem of our time and a comprehensive global deal on climate change is agreed based on strong emissions reduction commitments. In New Zealand, governance and decision-making become more hands-on with climate change mitigation strategies prioritised to meet New Zealand’s international obligations. Emissions from the energy sector are reduced accordingly.

70.2 In the Kayak scenario, consumers and suppliers determine outcomes through market forces, while government focuses on establishing strong competitive frameworks relying on the pursuit of least cost energy supply. A global deal on climate change is agreed but international commitments on reducing emissions are weak, lacking breadth and depth. Carbon markets develop but are fragmented across ad-hoc regional and national schemes. Consumer preferences for renewable-sourced energy and environmentally friendly goods and services go some way towards filling this void, which sees market-led action across a wider front where this is commercially viable.

**Figure 10: Industry demand for petrol fuels (mlpa):
Range of scenarios to 2030³⁵**



³⁴ See <https://www.bec.org.nz/our-work/deep-dives/deep-dive-energy-and-transport-emissions> (accessed 19 February 2019), and https://www.bec.org.nz/_data/assets/pdf_file/0014/110309/BEC-Report.pdf (accessed 19 February 2019).

³⁵ Source: ZEL 2018 Full Year Results FY2018.

- 71 Regardless of which outcome turns out to be correct, and the specific implications for retail fuel supply, Z considers it safe to assume that within 10 years there will be material changes to the industry. Competition-wise, this will play out by forcing some capacity and/or players from the industry, followed by further exit or adaptation by remaining participants.

- 72 Despite the uncertainty about when and how quickly this will happen, it is important to keep in mind this prospect for the industry, particularly when considering whether regulatory interventions might be required – even assuming such interventions would be pro-competitive in the short term (which is not necessarily the case), the cost and other burdens they impose might not be worthwhile given the broader direction of the industry.

Questions on the supply chain: exploration and extraction of crude oil

Q15 *Does the vertical integration of some fuel companies with exploration, extraction and refining functions outside of New Zealand affect how these companies compete to supply retail fuel markets in New Zealand?*

- 73 In Z's experience the different levels of integration are likely to affect how companies compete to supply retail fuel, as do the different methods of supply within New Zealand (e.g. distributors compared to the midstream participants).
- 74 Z is differently placed to BP and Mobil. Z is a New Zealand business, required by shareholders to earn profits in New Zealand only, and not vertically integrated upstream. In contrast, BP and Mobil are parts of global, vertically integrated firms, which may affect how they behave compared to Z. For example:
- 74.1 The New Zealand businesses of BP and Mobil may buy wholesale oil or fuel at different prices or on different terms from an affiliate (generally or at specific times), or be able to use that option to drive different prices or terms from unrelated sellers.
- 74.2 Regardless, different incentives may operate on the New Zealand management of BP and Mobil given their vertical integration compared to Z, with its local shareholder base only.
- 75 Z notes also that wholesale oil prices are very material – approximately [REDACTED]³⁶ of Z's costs are from crude oil or refined petroleum – and wholesale prices are highly volatile. In this context, even small differences in wholesale purchasing behaviours may have a large impact at the retail level.
- 76 Similarly, different transfer price dynamics may affect retail markets in New Zealand. Even if the fuel firms' transfer prices are essentially equivalent, it is very unlikely that any given moment in time their precise transfer prices are equal, given different upstream activity and timing considerations.
- 77 It is worth noting also that since the Commission last considered these issues in the Z/Chevron clearance process:
- 77.1 Gull has been acquired by Caltex Australia, which now supplies Gull with product for the New Zealand market (where previously Mobil supplied Gull out of the refinery or by importing). Caltex Australia also has retail operations in Australia, which may drive particular (and distinctive) incentives.
- 77.2 [REDACTED]
- 78 Finally, different business models and methods of supply in New Zealand are also likely to have an impact at the retail level. Distributors will be differently affected by changes in global pricing than their suppliers (and as discussed throughout, distributors are increasingly independent of their suppliers). As explained in more detail in response to question 31, distributors and dealers hold relatively small volumes at any one time, carrying less price exposure and risk than the midstream participants.

³⁶ [REDACTED]

Q16 The New Zealand operations of Shell and Chevron were separated from their global exploration and extraction operations, following Z's purchase. Has this affected competition for retail fuel?

79 See Z's response to question 15, above.

Questions on the supply chain: refining

Q17 Does the operation of the refinery as a tolling service (as opposed to a merchant refinery) adversely impact competition in the retail fuel markets?

- 80 The operation of the refinery as a tolling service has no meaningful impact on competition in retail fuel markets. Participants in the refinery compete directly with importers (and import themselves), and refined product is available to non-participants in all regions on highly competitive terms, as discussed in response to questions 3, 7 and 31-36.
- 81 There are advantages and disadvantages of a tolling service refinery and a merchant refinery, just as there are advantages and disadvantages of current participation in the refinery (discussed in response to question 18).
- 82 The real-world effects of a merchant refinery are untested in New Zealand. The points below reflect Z's assumptions about how a merchant refinery would operate.

Overview of each model in general terms

- 83 In general terms, under the current tolling model:³⁷
- 83.1 Participants (currently Z, BP and Mobil) import crude oil for refining subject to processing agreements. The refinery takes 70% of the "gross refining margin" (**GRM**) – the difference between the notional cost of importing and landing crude oil versus refined product. Cost dynamics mean this margin is not always positive; i.e. the refinery is not cost-competitive with imports at all times. The processing agreements set a fee floor to ensure the refinery is paid a minimum fee for all refining.
- 83.2 Each participant owns the oil (and hence the working capital) as it works its way through the refining process.
- 83.3 Each participant's allocation of access to the refinery's processing capacity is calculated by reference to a three-year rolling average of its downstream market share for each refined product (i.e. taking into account downstream sales of both locally-refined and imported refined product).
- 83.4 The refining process produces a range of products including petrol, diesel, jet fuel and fuel oils. Most refined products are transported from the refinery and delivered to Wiri through the refinery to Auckland Pipeline (**RAP**), which is owned and operated by the refinery, with most of the balance distributed around the country by coastal ship. A small proportion of product is lifted from the refinery itself (located at Marsden Point).
- 84 Under a merchant refinery model, Z assumes:
- 84.1 The refinery would take responsibility for sourcing and selecting crude oil and making optimisation decisions.³⁸ The refinery would be required to invest a substantial amount of working capital in the system.

³⁷ More detail is set out in Z's application to acquire Chevron, from paragraph 64.

³⁸ Decisions around crude selection and refinery operation can result in slightly different grades and proportions of products produced.

- 84.2 The refinery would earn 100% of the refining margin, but would also take on significant risk in competing directly with imported product.
- 84.3 The refinery would make product available to customers, perhaps at Marsden Point and Wiri (although that would need to be separately considered), assuming no more pipelines and terminals were developed.
- 84.4 The refinery would need to continue to sell the complete range of products, not only retail fuels. It has very limited ability to store product and “play” markets.

Advantages and disadvantages

- 85 There are advantages and disadvantages of either model, and these will be felt differently by different market participants, as follows:
 - 85.1 The refinery currently takes very little risk. Mechanisms in the processing agreements promise floors (regardless of GRM) and caps on processing fee and various other protections. When the refinery does not match the cost of imports, the three midstream participants absorb the downside (but cannot easily pass it on to consumers due to competition with imported product).
 - 85.2 Under a merchant refinery model the refinery would presumably take on 100% of the risk in competing with imports. That includes yield risk – the cost of replacement cargoes if the event of unexpected shutdowns or poor yields resulting in a shortfall of products compared to commitments. Currently Z, BP and Mobil shoulder the cost of supply shortages to the benefit of consumers. [REDACTED]
 - 85.3 A merchant refinery would likely require commitments from Z, BP and Mobil to operate successfully. The refinery would want to run at full capacity and therefore shift product regularly and at substantial volumes, which in practice may well require fixed term commitments from fuel suppliers. The refinery would also need to shift non-retail fuel products – crucial to make the economics of refining work. Only Z, BP and Mobil currently sell these products [REDACTED]
- 86 The refinery currently operates below and above the cost of the import alternative, depending on the costs of imported crude and refined product. This means there are different perspectives, at different times, held by the three midstream participants on whether it is worthwhile to participate in the refinery.

Impact on competition

87 The different models would have no material impact on downstream competition. They have advantages and disadvantages, and share risk in different ways, but either way the refinery must remain competitive with imports to survive. Refinery participants also make locally-refined product available to distributors on highly competitive terms and under pressure at the wholesale level from the cost of importing product (see the responses to questions 3, 7 and 31-36). [REDACTED]

Q18 Are there any features of the ownership, management, or supply/access arrangements relating to the refinery which may impact competition in the retail fuel markets?

88 No. Refined product owned by the participants competes at the pump with imported product and locally-refined product sold to dealers and distributors. Nothing in the refinery arrangements prevents, or reduces incentives for, retail competition.

89 The refinery operates below and above the cost of the import alternative depending on the costs of imported crude and refined products. Z, BP and Mobil's participation in the refinery is historical and reflects a substantial degree of investment in the refinery and associated supply chain, rather than being evidence that refining gives a competitive edge over importing product.

90 The refinery is simply one method of supply and imports or wholesale purchase are alternatives – all with their own advantages and disadvantages. Competition in fuel markets generally is characterised by competition between different service offerings, levels of supply chain investment and methods of supply.

91 [REDACTED] In fact:

91.1 New Zealand refined product is likely to be lowest cost for the participants at Auckland (other than Marsden Point itself), as refined product is delivered to Wiri via the RAP. However Gull and other independents are demonstrably price competitive in Auckland.

91.2 [REDACTED]

91.3 The refinery expanded as part of the Te Mahi Hou project prior to Z's acquisition of Chevron. [REDACTED]

91.4 Wholesale terms are highly competitive, as discussed above in response to questions 3, 7 and 31-36. Distributors are choosing to buy product from refinery participants (which in practice will be a mixture of locally-refined and imported product) rather than import themselves.

92 As to ownership specifically: ownership of the refinery has no impact on retail competition whatsoever or even firms' incentives to use the refinery. Participants' allocations are driven entirely by their processing agreements, not ownership shares. For example, participants' shares are significantly lower than their capacity allocation and together comprise only 43% of ownership in the New Zealand Refining Company Limited (**Refining NZ**) (Mobil: 17.2%; Z: 15.36%; BP: 10.1%). There is a recent trend of participants reducing their shares in the refinery.

Q19 Are these features restricting the ability and incentive for firms other than the major fuel firms to use the refinery?

- 93 The refinery model does restrict the ability and incentive for other firms to use the refinery, but this does not affect competitiveness in retail markets as discussed elsewhere (noting in particular the competitiveness of imports and availability of fuel on highly competitive wholesale terms).
- 94 Z, BP and Mobil are the only firms currently entitled to access processing capacity at the refinery. A third party may access processing capacity if there is spare capacity that is not wanted by any of the participants. The refinery is typically at full operating capacity (except during planned or unplanned shutdowns) and to date no third party has participated in the refinery.
- 95 More importantly, features of a refinery model in general restrict the likely willingness of other firms to participate. As explained above, refinery participants require a significant level of investment compared to importers and distributors, and must sell the full suite of refined products including non-retail fuels – unlikely to be an attractive proposition to many firms in the retail fuel market.

Investment costs

- 96 Refinery participants require substantially more working capital invested in crude and take on significant risk in relation to:
- 96.1 supply shortages, due to factors such as refinery shutdowns (a significant and costly problem in recent years) and poor refining yields; and
- 96.2 the competitiveness of the refinery with imported product.
- 97 Participation in the refinery also requires investment in a national supply chain. The advantages of the refinery only play out when participants have the ability to transport refined product nationally and store product locally ready for secondary distribution (trucking) or sale to distributors. The participants also take the burden of resilience, ensuring sufficient fuel is stored in New Zealand at all times.
- 98 This has involved investment in:
- 98.1 the refinery and RAP,³⁹ which Refining NZ owns;
- 98.2 primary distribution, through the Wiri terminal and truck loading facilities, Coastal Oil Logistics Limited⁴⁰ and the Wiri to Airport Pipeline; and
- 98.3 terminals located at ports around the country, which include storage facilities, pipelines and truck loading gantries.
- 99 This requires a high level of capital investment and adds significant pressure to move volumes given the high fixed costs for refinery participants. Firms with a certain business model are able to invest in this manner, while others will naturally prefer lower cost and lower risk import or resale models, and to be more targeted in relation to retail competition.

³⁹ Note that the RAP is an essential part of the refinery and not a flexible asset. Pumping imported product down the RAP de-optimises the refinery and isn't feasible given the cost it will impose on the refining model.

⁴⁰ (COLL), which transports product by ship to terminals around the country.

Other complexities

100 Other complexities with participation in the refinery include:

100.1 Crude – refinery participants must procure crude (and meet the associated working capital requirements) for refining. This process is substantially different to the business of selling fuel day-to-day.

100.2 Commercial markets – the need to move significant volumes from the refinery (given high fixed costs) mean participating in commercial fuel markets, not only retail markets, including selling fuel to distributors, dealer sites and commercial bulk fuel customers.

100.3 Non-retail fuel products – refinery participants must be able to take and sell non-retail fuel products produced in the refining process.

Questions on the supply chain: primary distribution

Q20 Are there any features of the ownership, management, or supply/access arrangements relating to COLL, the RAP, and/or the Wiri terminal which may impact competition in the retail fuel markets?

101 No. As above, refinery participants also make locally-refined and imported product available to distributors on highly competitive terms and under pressure at the wholesale level from the cost of importing product, as discussed in response to questions 31-36. The midstream participants bear the cost and risk of the midstream infrastructure and national distribution.

102 Z notes in particular:

[REDACTED]

Q21 What are the advantages and disadvantages of the current arrangements that govern COLL and the RAP for competition in the retail market?

103 The primary advantage of the RAP and COLL arrangements is that they allow refinery participants and their distributor customers to benefit from the RAP and COLL without needlessly replicating the supply chain.

104 The result is cost savings via economies of scale and a lack of duplication. These savings allow locally-refined products to compete against imported products. Customers benefit from competition taking place nationwide (as opposed to e.g. only one supplier supplying fuel through Bluff) and also from the supply resilience that Z, BP and Mobil take on.

105 The disadvantage of the primary distribution arrangements is that they result in high fixed costs for the midstream participants and effectively tie the participants into national distribution. Importers and distributors have more flexibility about how and where they compete, whereas Z, BP and Mobil are committed to national coverage via COLL and their terminal networks, and volume pressure driven by investment in the supply chain as a whole.

106 Other advantages and disadvantages are covered in response to questions 23-28, being:

106.1 Advantage: COLL and the terminals network allow national coverage for all refinery participants and their wholesale customers, allowing brand competition nationally.

106.2 [REDACTED]

Q22 Are there efficiency gains from the shared infrastructure? If so, how are these being shared with consumers?

107 Z has explained in response to questions 20 and 21 above the cost savings associated with participating in the refinery and supply chain.

108 Significant retail competition, including from direct imports, incentivises these savings being shared with consumers.

Questions on the supply chain: terminals and the borrow and loan system

Q23 *Are there any features of the ownership, management, or supply/access arrangements relating to storage terminals (including the borrow and loan system) that may impact competition in the retail fuel markets?*

109 Arrangements relating to storage terminals do not restrict competition in retail fuel markets. The midstream participants supply fuel to distributors ex-gantry on competitive wholesale terms at all locations.

110 The operation of storage terminals and the borrow and loan arrangements may result in inefficiencies through an inappropriate distribution of costs, as follows:

110.1 For context:⁴¹

- (a) Z, BP and Mobil individually own terminals, but have arrangements allowing COLL to deliver to them on behalf of all three, and allowing all three to lift product from them (arrangements known as "borrow and loan"). The midstream participants charge per-litre throughput fees for liftings from their tanks.
- (b) Ownership of terminals included in this network of national storage involves a degree of risk – demand and liftings are subject to change; terminal owners take on the risk of their terminals becoming redundant or being bypassed due to market or competitor behaviour.
- (c) [REDACTED] Port coordination events allocate limited product based on stock in terminals but not terminal ownership.
- (d) [REDACTED]

110.2 [REDACTED]

110.3 [REDACTED]

Figure 11:⁴² [REDACTED]

110.4 [REDACTED]

111 This scenario results in some inefficiency. The midstream participants do not necessarily face the true terminal investment/storage cost of any increases in their market share. This may result in underinvestment in terminal infrastructure due to insufficient reward, [REDACTED].

112 [REDACTED]

113 That said, there are some efficiencies in the current arrangements. They prevent over-investment through duplication of terminal assets, and allow fuel firms to access national networks and compete in all regions rather than only those where they have terminal assets. [REDACTED]

⁴¹ These arrangements are also described in Z Energy, Clearance application, paragraph 107ff.

⁴² [REDACTED]

Q24 How has the level of capacity at terminals changed over time? Is it sufficient to meet current and future demand? Does the level of available terminal storage adversely impact competition, and if so, to what extent?

- 114 The level of available terminal storage does not adversely impact competition (except as described in response to question 23). Z, BP and Mobil access a national terminal network and those firms in turn sell to distributors ex-gantry at all locations on highly competitive terms.
- 115 Additions to terminal capacity, including Gull's terminal at Mount Maunganui and presumably Timaru Oil Services Limited's (**TOSL**) terminal soon opening at Timaru will impact wholesale competition, giving non-midstream participants more options for how, where and on what terms they acquire fuel.

Q25 Is the cost of building new terminals or accessing existing storage facilities a significant barrier to the expansion of existing participants or entry of prospective participants?

- 116 No. Firms can easily enter or expand in any region on the basis of competitive wholesale terms ex-gantry or investment in terminals.
- 117 Independents historically tended to focus on specific areas (although that is now changing) but they have access to fuel across the midstream participants' terminal networks (and in the alternative can build their own terminal). For example, Gull has announced that it is considering expanding to Wellington but would not enter the South Island because of expectations about returns (see the response to question 6 for more detail). Z expects that Gull would enter the South Island – through investment, TOSL's terminal or purchase ex-gantry – if returns expectations changed. [REDACTED]
- 118 Nor is the cost of building new terminals a significant barrier. Investment by third parties, such as Gull's import terminal at Mount Maunganui and TOSL's investment at Timaru illustrates this fact. The lack of investment in other regions outside of the midstream participants is evidence of competitive wholesale terms ex-gantry and the national coverage of the shared storage arrangements. For example, NPD and Allied compete vigorously in the Nelson region despite NPD and Mobil (their supplier) having no Nelson terminal.

Q26 Are there examples of firms seeking to gain access to terminal capacity owned by other parties? If so, please provide details.

- 119 Other than access through industry shared storage, Z and other midstream participants seek access to third parties' terminals from time to time. For example:
- 119.1 Z and BP lease some of Gull's storage at Mount Maunganui and include it in shared storage; and
- 119.2 the midstream participants access terminal assets that they own together with other midstream participants (e.g. all at Wiri, Z and BP and Wellington).
- 120 [REDACTED].
- 121 [REDACTED] distributors request wholesale supply ex-gantry and achieve highly competitive terms (discussed in more detail below). [REDACTED]

Q27 Will the construction of the new Timaru terminal impact competition in the South Island? Why or why not?

122 Z does not know TOSL's intentions for the terminal but:

122.1 Z assumes that TOSL will be looking for a reasonable degree of commercial return on its investment. Presumably it has expectations, if not firm commitments, about its ability to compete and generate returns.

122.2 Given the extra capacity being added, the terminal will almost certainly have an impact on competition in the South Island.

123 Extra capacity may increase competition in wholesale fuel markets, giving non-midstream participants more options for how, where and on what terms they acquire fuel.

Q28 How are retail fuel customers affected by port coordination events (rationing of fuel), particularly in areas of the South Island where these events occur relatively frequently?

124 From Z's perspective, there is very little impact on retail fuel customers when port coordination events occur in their regions.

125 Coordination events occur when stock levels are estimated to be below three days' stock as at the time the supply ship is due to arrive. Depending on where stock is in the supply chain, coordination events may have less or more potential to affect retail fuel customers.

126 Z goes to great lengths to ensure that port coordination events do not affect retail fuel customers e.g. by carrying out "bridging activity" such as moving product from neighbouring ports, and by reducing the number of days' cover at some retail sites. [REDACTED] Z expects that the number of coordination events will decrease if and when Mobil completes its terminal replacement at Lyttelton.

127 When a port coordination event does occur, Z, BP and Mobil are allocated the remaining stock based on the amount of stock they own nationally in the borrow and loan system.

128 Z aims to [REDACTED] Z observes that in some cases competitors' sites choose to fall dry reasonably frequently or for (what Z considers) reasonable periods of time.

129 Z achieves consistency of supply during coordination events by trucking additional fuel from alternative ports, resulting in minimal impact on Z's retail (and other) fuel customers. [REDACTED]

130 [REDACTED]

Questions on the supply chain: secondary distribution

Q29 Are there any features of secondary distribution that may affect competition in the retail markets?

- 131 No features of secondary distribution are likely to affect competition in retail markets. The major fuel firms contract independently for secondary distribution (usually trucking), as do most distributors.
- 132 Z notes also that distributors are able to buy fuel from the national terminal network maintained by the major fuel firms (and without the associated investment or risk). As such, distributors require no more secondary distribution than the midstream participants (e.g. having to truck fuel further because they and their supplier doesn't have a footprint at the nearest port).
- 133 In this sense, the nature of primary distribution and competitive wholesale terms (both discussed in other sections) facilitate competition; they allow retailers to enter any region, however remote, with similar secondary distribution costs (and no associated supply chain investment) to the midstream participants.

Q30 To what extent do differences in distribution costs contribute to the observed regional differences in fuel price?

- 134 [REDACTED]
- 135 Haulage costs vary by location of delivery, depending primarily on distances.
[REDACTED]
- 136 Local competition, not secondary transport cost, is the primary driver of fuel prices at any given location. See more detail (including on the changing nature of competition in the South Island) in response to question 6.

Questions on the supply chain: wholesale supply

Q31 Are there aspects of wholesale supply agreements to other fuel firms (eg, distributors and dealer sites) that could impact on competition in the retail fuel markets?

- 137 Distributors and dealer sites appear to have highly competitive wholesale terms. They compete aggressively in retail fuel markets and appear to have very competitive wholesale prices, geographic freedom (in the case of distributors) and the ability to compete against their supplier's brand and its other distributors (see the response to questions 3, 7 and 36). These aspects of wholesale supply arrangements are all likely to impact competition in retail fuel markets.
- 138 Distributors and dealer sites also appear unconstrained in the volumes they take (see also question 7 above). Distributors' recent expansions in footprint and number of sites imply that they can take however much fuel they require. Z's view is that Mobil's recent increase in volume is largely driven by increases in volumes supplied to its distributors. [REDACTED]
- 139 Conversely, location or region are not significant factors in wholesale supply arrangements. Z observes that distributors are increasingly fluid in the regions they compete in, and do not appear to be constrained to particular regions via their wholesale supply arrangements. [REDACTED]
- 140 Distributors and dealers also have very little price exposure compared to their suppliers, due to the small volumes they hold at any one time. They carry less risk than the midstream participants, who hold significant volumes of crude and refined product throughout the supply chain, and can quickly pass drops in fuel prices to customers via competition at the pump.

Q32 What are the key factors affecting the terms on which suppliers are willing to offer wholesale fuel to other fuel firms (eg, distributors and dealer sites)? What is the effect of these factors on competition in the retail fuel markets?

- 141 In general, the commitment to the refinery and national supply infrastructure particularly incentivise the midstream participants to place large parcels of volume via wholesale contracts. [REDACTED]
- 142 A key factor for Z in this respect is also [REDACTED].
- 143 The cost of alternative supply to the distributors (specifically, direct imports) is a further factor. Participants in the refinery (Z, BP and Mobil) will need to offer wholesale terms that are cheaper than the cost of direct imports. Direct importing has always been available to market participants but the advent of TOSL's investment, depending on how it is used, may make it more immediate.
- 144 In the last few years, these factors have resulted in:
- 144.1 Supply to distributors being highly cost competitive (Z has [REDACTED]).
- 144.2 A changing dynamic between dealers and distributors ([REDACTED]), and the midstream participants. Mobil-supplied distributors in particular appear to have materially expanded their propositions e.g. Waitomo moving to the South Island, although Z does not know whether this reflects a formal change in terms or whether those distributors have simply taken advantage of a perceived market opportunity.

144.3 [REDACTED] (see the response to question 34).

144.4 A relatively larger proportion of sites being run by non-major brands, as discussed in more detail in response to question 2.

144.5 Strong price competition, including between distributors and their suppliers' brands, as discussed in more detail in response to question 36.

Q33 Are there differences in the way that the major fuel firms supply fuel to other fuel firms (eg, distributors and dealer sites) in different regions that may affect retail competition?

145 No. In Z's case:

[REDACTED]

146 Z also observes that distributors supplied by other midstream participants appear able to operate in any region, as evidenced by expansion of many distributors beyond their previously traditional borders (e.g. most recently NPD's expansion into Christchurch, and Waitomo's new sites planned in Wellington and Christchurch). See also question 2 above.

Q34 To what extent do the major fuel firms compete to win supply to other fuel firms (eg, distributors and dealer sites)?

147 The major fuel firms compete vigorously to win supply arrangements with dealers and distributors. All have high fixed cost bases, investment in the supply chain and processing agreements with the refinery, maximising their incentive to move volumes even on marginal terms (noting, as explained in response to question 15, that there are key differences between the midstream participants too). In their bids for wholesale supply, the midstream participants are also always competing against the prospect of direct import entry.

148 In Z's case:

[REDACTED]

149 [REDACTED] some degree of competition for individual sites does occur.

150 Z notes also, as explained in response to question 32, that [REDACTED].

Q35 Do other fuel firms (eg, distributors and dealer sites) have sufficient information to compare offers between the major fuel firms? Are there examples of other fuel firms (eg, distributors and dealer sites) switching between the major fuel firms, and if so, what were the main factors incentivising them to switch?

151 Distributors and dealer sites have a high degree of visibility about offers and likely pricing between the major fuel firms. Z's experience is that distributors are free to shop around – and do – by approaching multiple suppliers.

152 [REDACTED], but Z's experience is that all distributors test the market; [REDACTED].

153 [REDACTED]

154 As discussed above, individual dealers switch supplier from time to time and are likely increasingly able to test the market, for example [REDACTED].

Q36 Are there any limits on the ability or incentive of other fuel firms (eg, distributors and dealer sites) to compete against the major fuel firm that supplies them?

155 No. There appear to be no restrictions on distributors' ability or willingness to compete against their suppliers' brands.

156 [REDACTED]⁴³

157 In fact there are numerous examples of distributors competing in this way, including for example Waitomo competing less than 3km from a Mobil site in Foxton and NPD competing against Mobil in multiple areas following its recent and substantial expansion into Christchurch.

158 Nor do there appear to be any restrictions on distributors' geographic footprints or maximum volumes. Distributors continue to expand beyond their traditional regions, competing with their suppliers and overlapping with other distributors contracted with the same supplier. Waitomo recently announced expansion into Wellington and a first Christchurch site. NPD recently expanded into Christchurch.

159 Finally, there are no significant restrictions outside their supply arrangements that limit the ability of distributors to expand and compete. There are no obvious limits on site locations – [REDACTED]. Nor do there appear to be any capital barriers to distributors expanding and competing with midstream participants; [REDACTED] and there is a clear trend towards more distributor sites in recent years.

160 As for incentive, distributors have no reduced incentive whatsoever to compete against their suppliers, and in Z's experience distributors are not discouraged from growing volume [REDACTED]. Distributors are incentivised to capture all sales they can, including from their suppliers' brands, and act accordingly.

⁴³ [REDACTED]

Questions on the supply chain: the nature of retail competition

Q37 Are there features of the retail fuel markets that may inhibit the ability of consumers to obtain competitive offerings?

- 161 No – see in particular Z’s response to questions 2-13 above. There is a wide range of customer choice in relation to discounting and loyalty schemes, and no material barriers to switching.
- 162 The rise in the significance of independent players has broadened the competitive offering available to consumers, without any corresponding downside in consumers’ ability to take advantage of their choices.
- 163 Price transparency for consumers is high, despite the range of offers available in the market (see the response to questions 12-13 above). For example, the Gaspy app, which has an install base of approximately 480,000 users,⁴⁴ provides information on the lowest board price offers in a given area. Members of loyalty schemes generally directly receive information on the offers available to them.

Q38 What are the advantages and disadvantages of the increase in service differentiation in service stations, ranging from full service to unmanned?

- 164 The diversity of service offering in the market has increased choice for consumers. Consumers may now choose a full premium service offering, with a variety of convenience-enhancing aspects such as forecourt concierge and Pay at Pump. Unmanned, heavily price competitive offers cater to customers for whom price is the primary consideration.
- 165 Additionally, the increase in service differentiation has driven ongoing innovation by those suppliers wishing to command a premium. Given the degree of choice available, including in the form of low-cost unmanned offerings, consumers have no need to pay for any service they do not value. This has led to premium suppliers such as Z and BP working to innovate in ways that customers will value, to the benefit of competition and consumers. Recent examples include Z’s Fastlane, which is an app to which a customer can add vehicle number plate, fuel preference, loyalty card and payment details. When the customer uses a Fastlane a camera recognises the number plate and the customer is able to re-fuel and drive away without making an on-site payment. BP has launched BP Me, which is also an app that allows customers to pay from their vehicle.

Q39 Are there currently any factors limiting the ability or incentive of retail customers to compare the offers they receive at different service stations and decide which offers best meet their needs?

- 166 No – see in particular the answers to questions 12 and 13 above.

⁴⁴ Source: App Annie analytics.

Questions on other issues

Q40 *Are there any other issues not raised in this paper that could impact competition in the retail fuel markets?*

167 No response.