Commerce Commission Retail Fuel Market Study

BP New Zealand– submissions on issues raised at the Commerce Commission's Fuel Study Conference of 24 – 26 September

1. Introduction and Executive summary

1.1 This document sets out BP New Zealand (**BPNZ**)'s responses to key matters discussed at the Conference of 24-27 September (the **Conference**) and raised in submissions on the Draft Report, and contains information and evidence to support BPNZ's responses.

1.2 This submission is set out, for convenience, using the chapter headings from the Draft Report (reflecting also the various topics canvassed at the conference). BPNZ's primary focus in this submission is on the Options for recommendations in chapter 8.

1.3 BPNZ is happy to provide more detail to the Commission on any of the points raised.

1.4 This response and all associated documents are highly commercially sensitive. In particular, related documents include detailed financial, commercial and strategy information that would not be available publicly. Accordingly, BPNZ requests that all material is kept in the strictest confidence by the Commission and that the Commission informs BPNZ of any requests for this information from any third party and gives it (and any contractual counterparties) the opportunity to submit on the request.

2. Chapter 2: Characteristics of the New Zealand retail fuel markets

2.1 As set out at para 2.2 of BPNZ's Submission of 13 September (**Submission**), and as raised at the Conference, BPNZ considers that the price board components graphic in Figure 2.2 of the Draft Report is inaccurate. It understates importers' costs, particularly in relation to 95 octane and 98 octane fuels. The graphs do not appear to take into account the costs of product quality adjustments (**PQA**s).

2.2 During the conference, the Commission requested further detail on PQAs and their movements over time.

2.3 By way of background, petrol is a blended fuel incorporating a number of variables including different napthas and aromatics, each with different octane, density, and evaporation curves.[1] Parcels of 92, 95 and 97 Octane petrol are traded through Platts (setting the MOPS92, MOPS95 and MOPS97 benchmark markers respectively). However, the quality parameters for these parcels are quite wide. PQAs adjust the price for fuels which have requirements above that of the benchmark grade (i.e. have more restrictive limits on the blending variables than those applying to parcels traded on Platts).

2.4 The level of the PQA premium is affected by the number of producers that are able to supply the relevant specification. There are relatively few suppliers in the region that can produce petrol to New Zealand's tight specifications (referred to as boutique grades). This increases the PQA that New Zealand acquirers pay for petrol compared to other countries.

[1] By contrast, diesel properties often relate to the crude oil they are derived from and the relative density of the diesel.

2.5 Specifically in relation to BPNZ's supply of 98 octane petrol:

[redacted]

2.6 The analysis above provides further support for BPNZ's submission that Figure 2.2 in the Commission's Draft Report is inaccurate. It also illustrates that the Commission has not properly taken into account product cost increases when seeking to assess changes in margins for fuel products over time or when seeking to make international comparisons.

2.7 Aside from the points above, BPNZ considers that the points raised in its submission on the Draft Report (the **BPNZ Submission**) stand and do not require further elaboration following the Conference.

3. Chapter 3: Outcomes in retail fuel markets

3.1 BPNZ considers that the issue of profitability was thoroughly canvassed at the Conference. BPNZ considers that the points raised by participants and, in particular the expert economists, were highly relevant and should be accounted for in the Commission's final report. BPNZ requests that if the Commission disagrees with any points made by CRA in its report (the **CRA Submission**), or at the Conference that are material to the Commission's profitability analysis that it be given further opportunity to comment.

3.2 The Commission noted a concern at the Conference that, while submitters raised a number of problems with the Commission's profitability analysis, submitters did not raise constructive solutions. In BPNZ's view this is due to the sheer difficulty of assessing whether firms in a competitive market are making "excess profits", particularly in the timeframes provided for. As noted, using a variety of techniques, each with their own limitations, does not assist to increase the level of certainty in the outcome.

3.3 Instead, BPNZ considers (as per the BPNZ Submission) that the most instructive information is how market participants are reacting to market conditions. New entry and expansion is expected when margins are stronger. This is exactly what the market is experiencing, both at the wholesale and retail levels. This is already setting margins on a downward trajectory and consumers are enjoying a highly competitive retail market.

3.4 Aside from the points above, BPNZ considers that the points raised in the BPNZ Submission stand and do not require further elaboration following the Conference.

4. **Chapter 4: Structural and regulatory conditions of entry and expansion**

4.1 BPNZ considers that the points raised in the BPNZ Submission stand and do not require further elaboration following the Conference.

5. **Chapter 5: Infrastructure sharing arrangements**

5.1 BPNZ appreciated the opportunity to canvas aspects of the infrastructure arrangements and cost differentials between different supply models. As discussed at the Conference, simply seeking to compare costs of different models by reference to trucking distances ignores a range of other key aspects of the supply chain that can affect costs (e.g. the benefits of operating a simple one or two terminal supply chain). In any event, market participants can, and do, obtain access to wholesale product at competitive prices outside of regions that they can service with their own infrastructure (or without owning any storage infrastructure at all).

5.2 In relation to incentives to invest in new terminal capacity, BPNZ disagrees with some of the views expressed that the B&L system adversely affects incentives to invest in new terminal capacity. As previously submitted, BPNZ has invested substantially in terminal capacity that has been included in the B&L system (and other capacity that sits outside B&L – e.g. for its 98 supply chain). Nevertheless, it does agree that total fuel demand is likely to fall over time in the face of new technology, such that future incentives to invest in terminal capacity may be much less important to the supply chain going forward. This does not mean there will be no future investment, but BPNZ does consider that it is unlikely there will be any significant investment in regional locations. This is because import volume will become a larger part of the non-Auckland supply chain and import freight optimisation will be a key driver of any future investment (for the existing wholesalers or for any future importers).

5.3 In relation to the Commission's initial proposal regarding third party access to COLL and the B&L system, BPNZ reiterates its earlier views that due to the complexity of the system (which is set up to efficiently move fuel from the refinery), this is highly unlikely to be attractive to any other fuel supplier. BPNZ notes that this appears to be a view shared by market participants appearing at the conference and accepted by the Commission. Further, this same complexity means there are risks of significant unintended consequences even if there was an appetite from new participants and BPNZ would suggest a considered approach if exploring this further.

5.4 Finally, BPNZ notes the reference in the Z submission to the possibility of RNZ changing to a merchant refinery model (although this was not raised at the conference). This would constitute a fundamental change to the industry and would have a large number of knock-on effects that would need to be addressed. Further, it is unlikely to materially affect the level of competition in retail fuel markets. BPNZ considers that this is ultimately a matter for RNZ and its shareholders.

5.5 Aside from the points above, BPNZ considers that the points raised in the BPNZ Submission stand and do not require further elaboration following the Conference.

6. **Chapter 6: Wholesale supply arrangements**

6.1 As discussed during the conference, BPNZ considers that resellers have a great deal of bargaining power in relation to contract negotiations with BPNZ. BPNZ has set out various examples of this in its Submission. Many of the contractual provisions that the Commission has raised concerns about do not appear to be relevant to BPNZ. However, we note the Commission's position that it has taken a more general industry view of the range of contracts and structures that exist. Therefore, to the extent that the Commission considers that it would assist resellers in their negotiations (and therefore improve the dynamics of the wholesale market), BPNZ is happy to consider approaches to address perceived concerns. This is set out in more detail in response to the Chapter 8 topics.

6.2 Aside from the point above, BPNZ considers that the points raised in its Submission stand and do not require further elaboration following the Conference.

7. **Chapter 7: The retail price and product offer**

7.1 The issue of display of premium fuels on main display signs was canvased at the Conference. There were a range of views, with Gull, Waitomo and BPNZ all opposing the view that displaying premium fuel should be made mandatory. Their views expressed at the conference were that firms should be free to make their own decisions as to what they do, and do not, place on their own signs (with the exception of Waitomo's views in relation to display of discount prices, which is addressed below).

7.2 BPNZ considers that this is a very important issue as regulation of main display signs could cause customer confusion, would add cost and could stifle competition for innovative products. This is set out further below in response to the Chapter 8 topics.

7.3 In relation to the ability of consumers to determine which fuel is appropriate for their vehicle, BPNZ supports any steps that could be taken towards the provision of a database to assist consumers in this regard, provided the database had been established by the best qualified party to co-ordinate light vehicle importers. Requiring car dealers and importers to ensure such information is placed on the inside of the fuel filler flap would be one approach.

7.4 For the record, BPNZ strongly disagrees with an assertion from Waitomo that BPNZ's display of its 91 price for AA Smartfuel customers on its main display sign could be misleading. BPNZ has been very careful to ensure the display is clear that it is available for AA Smartfuel customers. To the extent that a customer wanted to take advantage of that price, but was not currently an AA Smartfuel member, it is straightforward to sign up instore in order to take advantage of the discounted price.

7.5 Aside from the points above, BPNZ considers that the points raised in its Submission stand and do not require further elaboration following the Conference.

8. **Chapter 8: Options for recommendations**

8.1 As set out in its submission, BPNZ considers that it is very important to ensure that, before seeking to address perceived barriers to competition in fuel retail markets, such barriers are clearly defined and evidenced. BPNZ does not agree with many of the Commission's findings in its Draft Report and does not consider that material intervention is warranted. Furthermore, it is concerned that interventions have a substantial risk of unintended consequences.

8.2 Nevertheless, the Conference was useful in exploring some of the options that the Commission has considered and it was beneficial to hear various participants' views on these options. BPNZ would specifically like to cover issues relating to main display signs, terminal gate pricing (**TGP**), an Oil Code, options for categorising contractual terms in supply agreements, a disclosure regime, changes to RNZ capacity allocation and changes to information sharing mechanisms.

Main Display Signs

8.3 BPNZ is against regulation of what it displays on its main display sign. Such regulation is unnecessary. It also risks unintended consequences including causing customer confusion, raising retailers' costs and stifling innovation. In this regard, it was notable that Gull and Waitomo were both against such an imposition.

Main display sign regulation is unnecessary

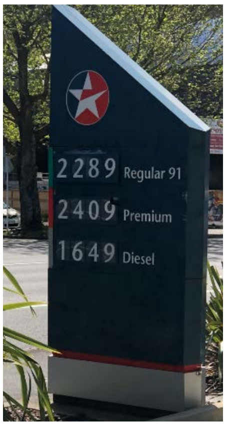
8.4 There is a limit to what can be feasibly displayed on the main display signs. BPNZ considers that the Commission's market study has not made out any compelling rationale to regulate prices to be displayed on the main site display sign. The primary concern expressed by some market participants is that not displaying premium fuel prices on the main display sign decreases competitive intensity of these products. BPNZ considers that this is not the case.

8.5 Firstly, scoping the size of the alleged issue (if there was one, which is denied) is important. Premium fuel makes up a low proportion of fuel sales. Only [redacted] of BPNZ's forecourt sales are of premium fuel. By far the largest proportion of sales are of 91 fuel at the AA Smartfuel discounted price, followed by diesel.

8.6 The main display sign is used for sharing information other than the price of its most popular fuel grades including, for example, the availability of particular services (e.g. ATMs) and products (Wild Bean Cafe and Krispy Kreme etc.). In fact, as discussed at the confidential session, [redacted]

8.7 Furthermore:

(a) some retailers choose to display the price of premium fuels on price boards, as will others where they too see value in doing so. See below an October 2019 example from Caltex in Auckland;



(b) the price of premium fuel is displayed at the pump. Customers can (and do) look at this price and can drive away if they consider that a more competitive option is available elsewhere. Over time, an uncompetitive price would result in substantial decrease in volume;

(c) in addition to the pump display, consumers are increasingly assessing the price of fuel and making a purchasing decision "before leaving home". This is facilitated by the use of apps such as Gaspy, the use of which is becoming ubiquitous.

Mandated display of premium fuel prices may cause confusion

8.8 As set out at the conference, BPNZ is concerned that mandatory display of premium fuel prices on the main display sign may not provide transparency to customers through easy price comparisons due to the greater degree of differentiation of premium fuels compared to 91:

(a) BPNZ offers two premium fuels – 95 and Ultimate 98 (which is part of a completely different supply chain to 91 and 95);

(b) other suppliers (such as Z) only supply one grade of premium fuel, being 95;

(c) Gull offers a 98 fuel with 10% ethanol, a high performance "E85" fuel with ethanol for FlexFuel capable vehicles and at some sites a Premium 95;

(d) Mobil offers two premium fuels – Supreme 95 and Supreme+ 98.

(e) NPD offers a premium fuel with additives – 100 Plus High Octane Petrol

8.9 More so than 91 fuels, these premium fuels are differentiated with ethanol blends, a much greater degree of additivisation and other characteristics. Seeking to display that level of information on main display signs would be difficult and costly (see further below). It is also likely to cause customer confusion, because different sites carry different products. While it is useful for customers comparing 91 prices between outlets to have price displayed on the main display signs, this would be much less useful where one outlet is offering a 95 product, one a 98 product with substantial additivisation and another an ethanol blended product.

8.10 BPNZ notes that Z was the only fuel retailer at the conference to support mandatory display of premium fuel pricing on main display signs. However, Z's premium fuel offer is limited to 95 and less differentiated than BPNZ, Gull and Mobil. (BPNZ understands that there is no suggestion that other fuels such as LPG or AdBlue would need to be added.)

Cost and feasibility

8.11 Adding premium fuel prices to main display signs would impose a substantial cost on fuel retailers, likely running into the tens of millions for the industry as a whole. This cost would be borne not only by the majors, but by a range of independent businesses. Costs would be even higher for those parties with multiple premium products, with the need to add several additional prices (particularly if discounted prices were also added) along with information about the product.

8.12 Furthermore, signage is limited by resource consents that are in place at each retail outlet. In general it is not possible to add greater area to a main display sign without seeking a new resource consent. Accordingly, an additional price would need to replace an existing display.

8.13 In some locations, no price display is allowed on main display signs. For example, NZTA rules prohibit display of any prices on main display signs at retail sites located on a motorway to avoid motorists being distracted. Having additional multiple prices displayed on a main display sign may also cause motorist distraction on non-motorway sites and could become a safety issue in the future.

Potential to stifle innovation

8.14 Another compelling reason not to regulate main display signs is the potential to stifle innovation. With demand for fuel expected to decline over coming years, BPNZ is actively considering new products that it could offer from its retail network and would be attractive to customers. Some possibilities include:

[redacted]

[redacted]

[redacted]

8.17 In summary, BPNZ considers that there must be an overwhelming benefit to customers before regulatory intervention in signage occurs. BPNZ considers that this has not been made out.

Terminal Gate Pricing

8.18 As set out at the conference, while BPNZ considers that the wholesale fuel market is already delivering highly competitive outcomes, it is willing to explore the imposition of a TGP mechanism. However, this needs to be carefully thought through to avoid unintended consequences and would have to be imposed by regulation to ensure its effective operation. BPNZ's views on the wholesale market are set out in its Submission and it does not repeat them here. Accordingly, the remainder of this section sets out some considerations around the implementation of a TGP.

Impact of a TGP

8.19 As discussed at the conference, neither BPNZ nor any other participant anticipates that the publication of a TGP will result in a highly liquid spot market for the acquisition of single deliveries of fuel. This is certainly not the case in Australia and, indeed, would be difficult to achieve given the nature of the fuel supply chain (where longer term contracts give much greater certainty of forecast demand allowing supply chain planning).

8.20 Rather, BPNZ understands that the TGP acts more as a reference price for parties in bilateral agreements or engaged in supply negotiations. Any TGP mechanism should be designed with this outcome in mind.

Implementation of TGP within the B&L system

8.21 BPNZ considers that the TGP needs to be established such that it is compatible with the ongoing efficient operation of the B&L system. While this needs to be worked through in much greater detail, at a high level BPNZ would expect to see the following principles:

(a) TGP applies to all owners of product in a terminal;

(b) TGP pricing will be set independently by each company

(c) Frequency of TGP updates should be at the discretion of the supplier;

(d) Suppliers must be able to refuse supply for the following conditions:

   (i) The customer cannot meet minimum credit worthiness or other financial suitability test (anti-money laundering, etc.) requirements – no requirement to do a cash transaction;

   (ii) A truck presented does not pass the suppliers reasonable requirements for safety;

   (iii) A driver/operator presented does not meet the reasonable requirements of the supplier from a competence/safe behaviour perspective;

   (iv) The supplier has reasonable grounds to believe it does not have sufficient stock to meet its own or its term contracted deliveries before the next replenishment.

Implementation more generally

8.22 BPNZ considers that the Australian TGP model set out in Part 2 of the Australian Oil Code (**Australian Oil Code**) (set out in Schedule 1 of the Competition and Consumer (Industry Codes—Oil) Regulations 2017) is a useful starting point should TGP be implemented in New Zealand.

8.23 Any TGP must be clear and must apply to all owners of diesel, 91 octane and or 95 octane fuel in terminals in New Zealand. TGP should not apply to 98 octane fuel for those parties who choose to supply it in order to differentiate their offer and supply an additional premium product to consumers. As set out above, BPNZ does this through a completely different supply chain than that used for diesel, 91 and 95 and BPNZ would not invest in this supply chain if it did not give it a point of difference against the competition.

Form of regulation

8.24 As discussed at the Conference, BPNZ considers that, in the event that it is determined that intervention in fuel markets would be beneficial to consumers, this should be implemented by way of an industry code, similar to the Australian Oil Code. This is because:

(a) competition law would prevent industry participants negotiating and agreeing rules that applied to how they run their businesses – development of an industry code must be done through a regulatory process;

(b) compliance must be equal across industry participants and the rules must be transparent for all parties.

8.25 BPNZ would not support the establishment of a new regulator to oversee an industry code. BPNZ would anticipate that it would largely be self-governing. However, BPNZ notes the ACCC's role in certain aspects of the Australian Oil Code and considers that the Commission could play a similar role.

8.26 Finally, BPNZ considers that the design of any regulation should take into account potential impacts on smaller players in the market (such as independent retailers) by avoiding unduly burdensome compliance and reporting obligations.

Grey list of contractual terms

8.27 BPNZ notes and agrees with the comments made at the Conference that a balance should be struck between protecting the interests of distributors and dealers on the one hand, and preserving their freedom to enter into contracts which they judge to be in their commercial interests.

8.28 BPNZ believes that a properly defined "Grey List" concept strikes an appropriate balance. Under this option:

(a) the Oil Code would specify a list of Grey List terms. These will need to be carefully determined, but in BPNZ's view should encompass:

(i) last rights of refusal;

(ii) exclusivity of more than 5 years;

(iii) a requirement distributors or dealers provide the fuel supplier with customer information at the end of a contract;

(iv) notice periods for distributors to terminate contracts (at the end of or outside of the initial contract term) of more than 6 months;

(v) territorial restrictions.

8.29 A contract containing Grey List terms

(a) would need to prominently and transparently disclose those terms, e.g. by way of a mandated form of contractual schedule, noting the Grey List term and the relevant clause reference(s) in the contract;

(b) would need to provide for the counterparty to certify they had sought legal advice prior to entering into the contract (or acknowledge that legal advice was recommended, and they had sufficient time to seek such advice);

(c) could not be executed within 10 working days of the mandated disclosure of the Grey List terms, so as to allow the counterparty sufficient time to consider the relevant issues.

8.30 To the extent that the Commission remained concerned about exclusive agreements between suppliers and resellers, the Commission could consider a regulation that prevents a supplier from refusing to supply a reseller solely on the basis the reseller is not willing to commit all of its volume to the supplier (provided that the proposed supply terms gave sufficient certainty around demand forecasts to enable the supplier to maintain reliable supply). However, as canvassed at the Conference, there are many reasons why exclusivity can have a strong efficiency rationale and can bring substantial benefits to the supplier and reseller. Accordingly, such regulation should leave open the ability for a supplier and reseller to agree exclusive supply if they both agree (which may be on different terms than a non-exclusive supply offer).

Disclosure regime not suitable

8.31 The Commission made reference to the disclosure regime in the Australian Oil Code as a possible option for ensuring contracting parties' interests are protected. BPNZ does not agree with some of the views shared at the Conference that dealers are not sophisticated parties who do not understand what they are signing up to. This is not BPNZ's experience of its negotiations with dealers.

8.32 Furthermore, BPNZ is informed that the disclosure regime under the Australian Oil Code is not an effective way of providing genuinely useful information to new business owners. The disclosure document is onerous to prepare and can run to 80 – 160 pages of generic information that does not relate to any particular business which an individual is looking at investing in. Accordingly, it is of limited utility for those it aims to protect. The view is that for individuals who are new to running a business, general advice on operating a business may be more useful, which is probably best provided by an independent party or government entity. BPNZ would not support the introduction of a disclosure regime along the lines of the current Australian Oil Code.

Amendments to refinery allocation mechanism

8.33 As set out in its Submission, BPNZ considers that changes to the capacity allocation mechanism at RNZ will have little impact on competition, because refinery users are effectively indifferent between imported and New Zealand-refined fuels. Nevertheless, BPNZ has no objection to moving to a shorter period. However, it is important that a mechanism is established to ensure market share figures (upon which capacity is allocated) are accurate, independently verified and there is sufficient time given to schedule crude deliveries.

Amendments to information sharing mechanisms

8.34 Again, BPNZ generally supports changes to the way in which necessary information exchange occurs. BPNZ considers that this is an area that can be led by the industry, e.g. through the COLL/Supply Manager forum.