

## **Market study into the retail fuel sector**

### **Invitation to comment on preliminary issues**

Date: 31 January 2019

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## Introduction

### Purpose of this paper

1. The Minister of Commerce and Consumer Affairs (Minister) has asked us to carry out a market study into retail fuel (study) under Part 3A of the Commerce Act 1986 (Act). This study provides an opportunity to consider and evaluate whether competition in the retail fuel market is promoting outcomes that benefit New Zealand consumers over the long-term.
2. This paper:
  - 2.1 sets out our proposed scope of the study, based on the terms of reference provided by the Minister; and
  - 2.2 seeks responses from all interested parties, including industry participants and consumers, on preliminary issues we may explore during our study.
3. The issues we are seeking views on are based on our initial assessment of the terms of reference for the study issued by the Minister and are not exhaustive. Interested parties are welcome to raise other issues not identified in this paper that they consider to be relevant to the study.
4. This paper contains our preliminary assessment of issues relevant to the study, based on available information. We will consider responses to this paper and note that the issues we focus on and investigate may change as our study progresses. We may not necessarily address all issues outlined in this paper in our final report.

### What is a market study?

5. A market study, referred to as a “competition study” in Part 3A of the Act, is a study of factors that may affect whether competition works well for consumers in a market.<sup>1</sup>
6. Market studies allow us to examine whether markets are working well for consumers and how they could work better. By gathering and analysing information on markets we can identify whether there are features preventing markets from working well. We can then consider how competition in a market can be improved using proportionate means.
7. Further guidance on our approach to undertaking market studies can be found in our [Draft Market Studies Guidelines](#).<sup>2</sup>

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<sup>1</sup> Section 48.

<sup>2</sup> Commerce Commission “Draft Market Studies Guidelines” (12 December 2018).

### Our process for the retail fuel market study

8. Our process for this study is set out in our [Statement of Process](#) paper dated 12 December 2018.<sup>3</sup> This paper outlines the process we intend to follow over the course of the study and how interested parties can remain informed and contribute to the study.
9. **Attachment A** provides a summary of our intended timetable and indicative dates over the course of the study, including key opportunities for you to contribute and remain informed.

### Invitation to comment on this paper

10. We invite interested parties to respond to the questions raised in this paper. A list of the questions is included in **Attachment B** for ease of reference. We do not expect that interested parties will respond to all questions raised, but rather address the issues that relate to their business operations or experience.
11. We also invite submissions on any other issues that parties consider should be addressed during this study, having regard to the terms of reference issued by the Minister.
12. Written submissions on this paper are due no later than **5pm, 21 February 2019**. Submissions should be addressed to:  
  
Keston Ruxton  
  
c/o marketstudies.submissions@comcom.govt.nz
13. Further details on the process for making a submission are included in paragraphs 93 to 98 below.

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<sup>3</sup> Commerce Commission “Market Study into the Retail Fuel Sector – Statement of Process: Our intended process and how you can contribute” (12 December 2018).

### **The retail fuel market study**

14. The Minister has required us to carry out a market study into retail fuel used for land transport throughout New Zealand under Part 3A of the Act.
15. The Minister considered it would be in the public interest to require a study into retail fuel markets, given such things as:<sup>4</sup>
  - 15.1 the more than doubling of petrol and diesel importer margins over the past decade which could not be explained by any significant increase in capital expenditure;
  - 15.2 the size of the market (around 6 billion litres of petrol and diesel are consumed for land transport use annually); and
  - 15.3 the inability of previous studies to definitively conclude whether or not there is a competition problem in the market.

### **The terms of reference for the study**

16. The Minister has issued terms of reference for the study. We must carry out the study in accordance with the terms of reference. We may also exercise our discretion in relation to any ancillary matters that are related to, but not explicitly covered by, the terms of reference.<sup>5</sup>
17. The terms of reference for the study are set out in the box below.<sup>6</sup>

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<sup>4</sup> "Initiation of the first market study to be carried out by the Commerce Commission" (December 2018) at [5]. This is available at: <https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/market-studies/>.

<sup>5</sup> Section 51A(4).

<sup>6</sup> The terms of reference are available at: <https://gazette.govt.nz/notice/id/2018-go6158>.

### **Terms of reference for competition study into retail fuel market**

I, Kris Faafoi, Minister of Commerce and Consumer Affairs, pursuant to section 51(1) in Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply of retail petrol and diesel used for land transport throughout New Zealand.

Matters to be considered in the study include, but are not restricted to:

1. the structure of the industry;
2. the extent of competition at the refinery, wholesale and retail levels, including the role of imports;
3. any factors that may hinder competition between industry participants;
4. the conditions for entry by potential competitors, including independent suppliers, and/or the conditions for expansion;
5. whether wholesale and retail price and service offerings of petrol and diesel are consistent with those expected in workably competitive markets; and
6. features of retail petrol and diesel markets that are not in the long-term interests of consumers.

The Commerce Commission must make its final report for this study publicly available by 5 December 2019.

### **Recent analysis of competition in New Zealand fuel markets**

18. Different aspects of competition in the New Zealand fuel industry have been analysed before.<sup>7</sup> These analyses included:
  - 18.1 A review of the factors impacting on competitiveness in the New Zealand petrol market in 2008 conducted by the then Ministry of Economic Development. This included an assessment by Hale & Twomey of whether the results of an Australian review of the petrol industry were applicable to New

<sup>7</sup> A more detailed list of previous fuel industry studies relating to New Zealand can be found at: NZIER, Grant Thornton, Cognitus Economic Insight "New Zealand fuel market financial performance study" (prepared for the Ministry of Business, Innovation and Employment, 29 May 2017) at 23 (The 2017 Fuel Study). This is available at: <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-generation-and-markets/liquid-fuel-market/fuel-market-financial-performance-study-2017/>.

Zealand.<sup>8</sup> Hale & Twomey’s report found that the New Zealand petrol market was fundamentally competitive.

18.2 Our investigation into the Z/Chevron merger (“the Z/Chevron merger investigation”).

18.2.1 In 2015, Z made an application to acquire Chevron (which supplied service stations, including those operating under the Caltex banner) under S66(1) of the Commerce Act 1986. We gave clearance to the acquisition in 2016, subject to the divestment of 19 service stations and one truck stop.<sup>9</sup> We assessed whether the removal of Chevron from the market would be likely to substantially lessen competition in a market at any level of the fuel supply chain in New Zealand.

18.2.2 We undertook this assessment by asking what was likely to occur in the future with and without the acquisition. This means that the central question in that investigation was whether Chevron’s exit from the relevant markets would be a change that would substantially lessen competition in any relevant markets. Our study into retail fuel considers different questions to those asked in the Z/Chevron merger investigation. Our study focuses on overall competitiveness rather than any change to competitiveness resulting from a specific business acquisition. This means that while our study will draw on some of the understanding of the fuel industry gained in the Z/Chevron merger investigation, its focus is different.

18.3 The New Zealand fuel market financial performance study carried out in 2017 by Cognitus Economic Insight, Grant Thornton and NZIER, on behalf of MBIE (the 2017 Fuel Study). This included an analysis of whether prices were reasonable. The study’s overall conclusion was that “we cannot definitely say that fuel prices in New Zealand are reasonable, but we have reason to believe that they might not be”.<sup>10</sup> The study identified limits in time available for the study and the ability to obtain data as factors that prevented it from reaching more definitive conclusions.

19. We refer to some of these analyses in the sections below. Our study may consider the information from these analyses where we consider it relevant, along with information from international studies on the sector and any other studies relating to the New Zealand fuel sector.

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<sup>8</sup> Hale & Twomey “2007 ACCC report into Australian petrol prices: Review of applicability to the New Zealand petrol market” (prepared for the Ministry of Economic Development, July 2008) (Hale & Twomey).

<sup>9</sup> *Z Energy Limited and Chevron New Zealand* [2016] NZCC 10 (Z/Chevron merger investigation). This is available at: <https://comcom.govt.nz/case-register/case-register-entries/z-energy-limited>.

<sup>10</sup> The 2017 Fuel Study at i.



## **Our proposed approach to the retail fuel study**

20. This section seeks views on our proposed approach to the study, including:
- 20.1 the high-level scope of our study; and
  - 20.2 what we intend to focus on when undertaking our competition assessment.

### **The scope of our retail fuel study**

21. In line with the terms of reference, we intend to focus on competition in the market(s) for the supply of petrol and diesel to retail customers. In doing so, we propose to consider:
- 21.1 the extent of competition and the factors that are affecting competition in retail fuel markets throughout New Zealand; and
  - 21.2 the supply chain for retail fuel throughout New Zealand. This includes the importing, refining, distributing, storing, transporting and sale of fuel to retail customers.
22. We do not intend to focus on the supply of other types of petroleum products such as jet fuel, bitumen and marine fuel. We will also not be focusing on the supply of petrol and diesel to customers via commercial contracts. However, we may consider these markets where they provide insight into understanding how competition operates in the retail petrol or diesel markets.
23. We also note that retail fuel prices are affected by several factors including international crude oil prices, movements in the value of 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.<sup>11</sup>

### **What we intend to focus on**

24. Our competition assessment of the retail fuel markets will focus on:
- 24.1 the competitive outcomes in retail fuel markets; and
  - 24.2 what factors are affecting competition in retail fuel markets.
25. Regarding the competitive outcomes in retail fuel markets, we will consider:
- 25.1 the price, choice, quality and innovation of product and service offerings;

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<sup>11</sup> We acknowledge that international crude oil prices and exchange rate movements can affect the extent to which parties compete in the hedging market.

- 25.2 the margins and profits industry participants are earning; and
  - 25.3 other outcomes that are not consistent with those expected in a workably competitive market.
26. Factors which may affect the functioning of New Zealand's retail fuel markets, which we intend to consider, are listed below.
- 26.1 **Market structure**, including:
    - 26.1.1 concentration levels and potential constraints on entry and expansion;
    - 26.1.2 horizontal and vertical integration, and other relationships present in the supply chain; and
    - 26.1.3 the overall structure of, and arrangements within, the industry.
  - 26.2 **Firm conduct**, including:
    - 26.2.1 how fuel suppliers set prices for fuel, and other terms and conditions;
    - 26.2.2 the operation of the refinery, including its operation as a tolling facility and the supply terms it has with the major fuel firms;
    - 26.2.3 the arrangements relating to the storage and distribution assets that major fuel firms share;
    - 26.2.4 supply arrangements between major fuel firms and downstream distributors and retailers;
    - 26.2.5 the information (such as prices, volumes and market shares) that market participants share;
    - 26.2.6 investment decisions, and capital and operating expenditure decisions; and
    - 26.2.7 the structure, price and innovation of retail offerings to consumers.
  - 26.3 **Consumer behaviour**, including preferences for different combinations of price and quality, geographic purchasing patterns, and factors influencing consumers' purchasing decisions, including information available.
27. Following our analysis, we may make recommendations if we consider there may be ways to achieve better outcomes for the long-term interest of New Zealand retail fuel consumers.

### 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.

### Preliminary issues we are seeking comments on

28. To undertake our assessment, we have identified several preliminary questions. These questions relate to:
- 28.1 trends affecting the fuel industry, including changes in market structure, prices and margins, and profitability; and
  - 28.2 the supply chain, including exploration and extraction of crude oil, refining, primary distribution, storage, secondary distribution, wholesale supply, and retail.

### Trends affecting the fuel industry

29. Our competition assessment will consider factors affecting retail fuel competition today and for the foreseeable future. We are concerned with issues affecting the long-term interests of consumers.
30. The discussion below outlines some recent industry trends. We invite comment on these recent trends and expectations about future trends.

#### *Trends in market structure*

31. There are currently three large integrated fuel firms which import and refine crude oil and supply a full range of products produced from that oil in New Zealand – Z Energy Limited (Z), BP Oil New Zealand Limited (BP) and Mobil Oil New Zealand Limited (Mobil). We refer to these firms as the “major fuel firms”.<sup>12</sup>
32. Z comprises the assets of two fuel firms that previously had interests throughout the supply chain: Shell New Zealand (Shell) and Chevron New Zealand (Chevron).
- 32.1 Z was formed following the purchase of Shell’s New Zealand downstream business by Infratil Limited and the Guardians of the New Zealand Superannuation Fund in 2010.<sup>13</sup> The new owners of Shell changed the strategy of the firm. The changes included:
    - 32.1.1 Shell being rebranded as Z Energy in 2011;

<sup>12</sup> BP New Zealand Holdings Limited is the parent company of BP. ExxonMobil New Zealand Holdings is the parent company of Mobil. BP’s ultimate parent is BP p.l.c. Mobil’s ultimate parent is Exxon Mobil Corporation.

<sup>13</sup> Z was listed on the New Zealand and Australian stock exchanges in 2013.

32.1.2 Z changing its stations to create a premium offer with services such as forecourt attendants, “hotel standard” toilets, and pay-at-pump;<sup>14</sup> and

32.1.3 Z engaging in a strategy to raise industry margins, including publicly stating the desire to raise margins.<sup>15</sup>

32.2 In 2015, Z acquired Chevron. This resulted in a reduction in the number of major fuel firms from four to three.

33. Gull New Zealand Limited (Gull) imports refined petrol and diesel and is the next largest supplier of retail fuel. Gull entered the market in 1998 and is now owned by Caltex Australia Limited.<sup>16</sup>
34. The major fuel firms individually and jointly own most of the infrastructure used to distribute, store and supply fuel to retail customers. This infrastructure includes coastal shipping vessels used to deliver products from the refinery to storage terminals at various ports and pipelines. We provide further detail on these aspects of the supply chain below.
35. The major fuel firms own and operate retail sites. In addition, they have sites that carry their brand but are owned by individual operators (dealer sites). The major fuel firms also supply retail networks which carry their own brand, including Allied, GAS, Challenge, NPD, Waitomo, and McKeown (resellers). These supply arrangements differ according to the extent of control by the major fuel firms over the retail offer and how the wholesale price is set.
36. The 2017 Fuel Study indicated that the major fuel firms have reduced the number of sites that carry their brand, while increasing the number of “independent” sites they supply (see Figure 1 below).
37. Overall, Figure 1 shows that there has been an increase in the total number of retail sites between 2012 and 2016.

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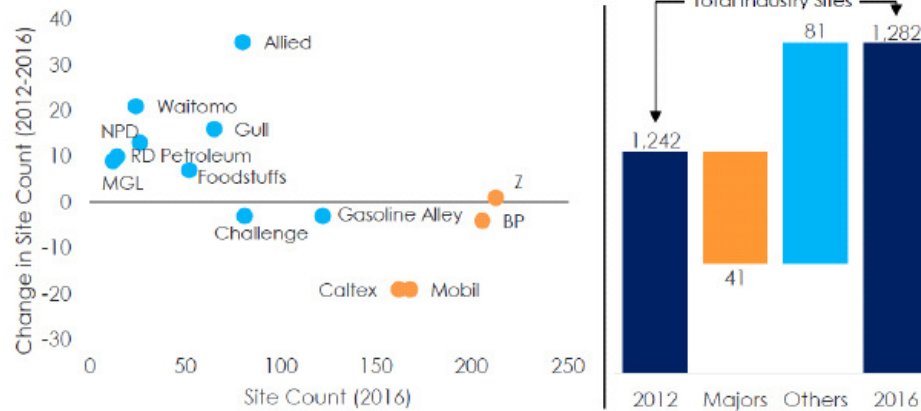
<sup>14</sup> Z/Chevron merger investigation at [170].

<sup>15</sup> Z/Chevron merger investigation at [110].

<sup>16</sup> In 2017, Caltex Australia Limited acquired Gull New Zealand Limited through CAL Group Holdings NZ Limited.

**Figure 1 – Rise in retail sites owned and operated outside the major fuel firms and Gull<sup>17</sup>**

Change in site share by brand (2012-16)



Source: Z Energy (used with permission).

**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 (eg, Allied, NPD, Waitomo, Gull, RD Petroleum) as observed in Figure 1?
- 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?

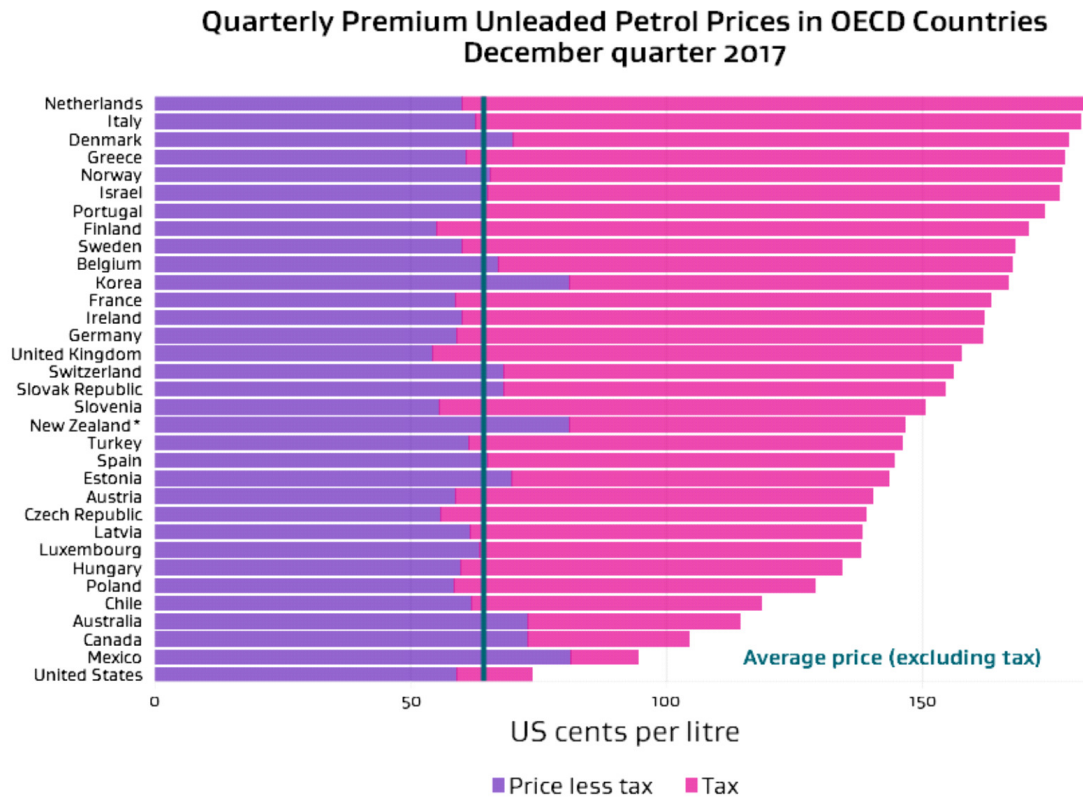
*Trends in prices and margins*

38. The overall trends appear to show that prices, margins and profits have been rising over the past decade.
39. There are four features we have noted here:
- 39.1 high pre-tax fuel prices, including when compared to other countries in the OECD;
  - 39.2 rising margins;
  - 39.3 regional price variations and the presence of Gull; and
  - 39.4 increase in loyalty schemes.
40. We describe each briefly below.

<sup>17</sup> The 2017 Fuel Study at 56.

41. According to MBIE data, New Zealand fuel pre-tax prices are now among the highest in the OECD. MBIE notes that New Zealand has gone from having one of the lowest pre-tax prices for premium petrol in the OECD in 2008, to having the second highest pre-tax price for premium petrol in 2017.<sup>18</sup>

**Figure 2 – OECD pre-tax fuel prices**



Source: International Energy Agency, Energy Prices and Taxes Q1 2018

42. The fuel industry has experienced rising margins over the past decade. Several studies have identified this trend.
- 42.1 In the Z/Chevron merger investigation, the Commission identified that retail fuel margins had risen since 2009.<sup>19</sup>
- 42.2 MBIE noted that, according to its data, importer margins have been trending upwards since 2008 and increased by over 18 cents per litre between 2008

<sup>18</sup> MBIE “Spotlight on Fuel” (2017). This is available at: <https://www.mbie.govt.nz/dmsdocument/3062-spotlight-on-fuel-pdf>.

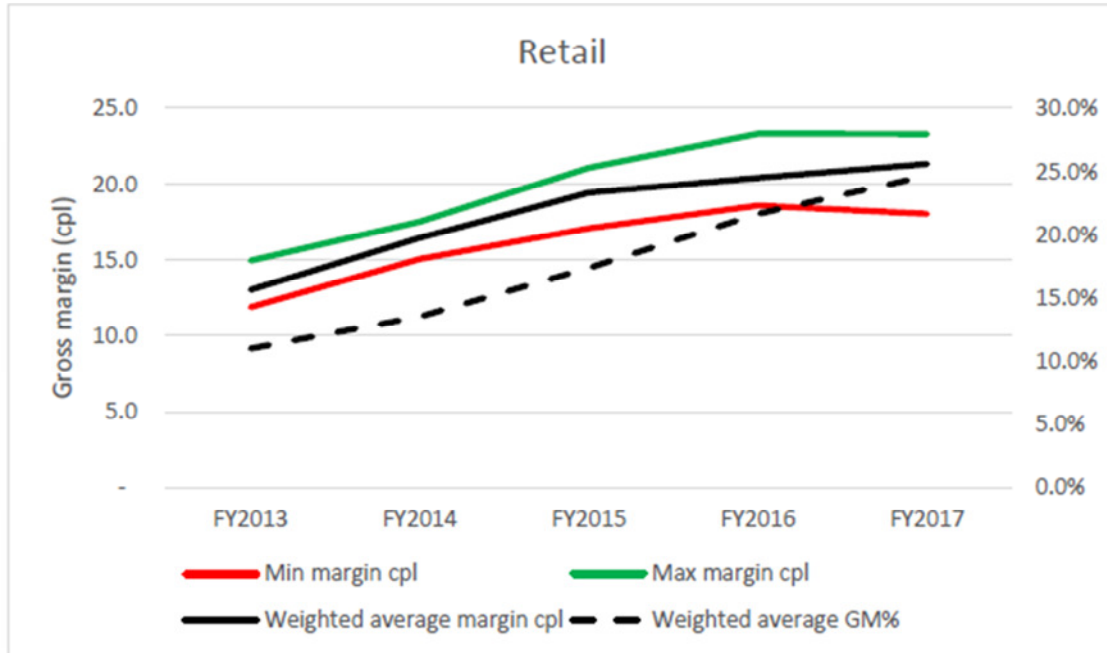
<sup>19</sup> Z/Chevron merger investigation at [211].

and 2017, equating to an additional average cost per motorist of close to \$150 per year over that period.<sup>20</sup>

- 42.3 The 2017 Fuel Study found that, consistent with MBIE’s published importer margin monitoring, retail gross margins had increased between FY2013 and FY2017 (see Figure 3 below).<sup>21</sup>

**Figure 3 – Retail gross margin<sup>22</sup>**

Retail margin, cents per litre and average GM%



Source: data provided by majors.

43. These observations contrast with the previous major public review of the downstream fuel sector in 2008 by Hale and Twomey. Importer margins were at historic lows in 2008 and Hale & Twomey concluded that the New Zealand petrol market was fundamentally competitive.<sup>23</sup> This 2008 review was undertaken in the

<sup>20</sup> MBIE “Spotlight on Fuel” (2017). MBIE describes the importer margin as a calculation of the gross profit made on retail sales of petrol and diesel.

<sup>21</sup> The 2017 Fuel Study at ii-iii. The 2017 Fuel Study describes the “gross margin” as the difference between the price consumers pay at the pump and the cost of the refined product including logistics, storage and handling costs to the retail station.

<sup>22</sup> The 2017 Fuel Study at 37. We assume that “GM%” represents the gross margin expressed as a percentage.

<sup>23</sup> Hale & Twomey at i.

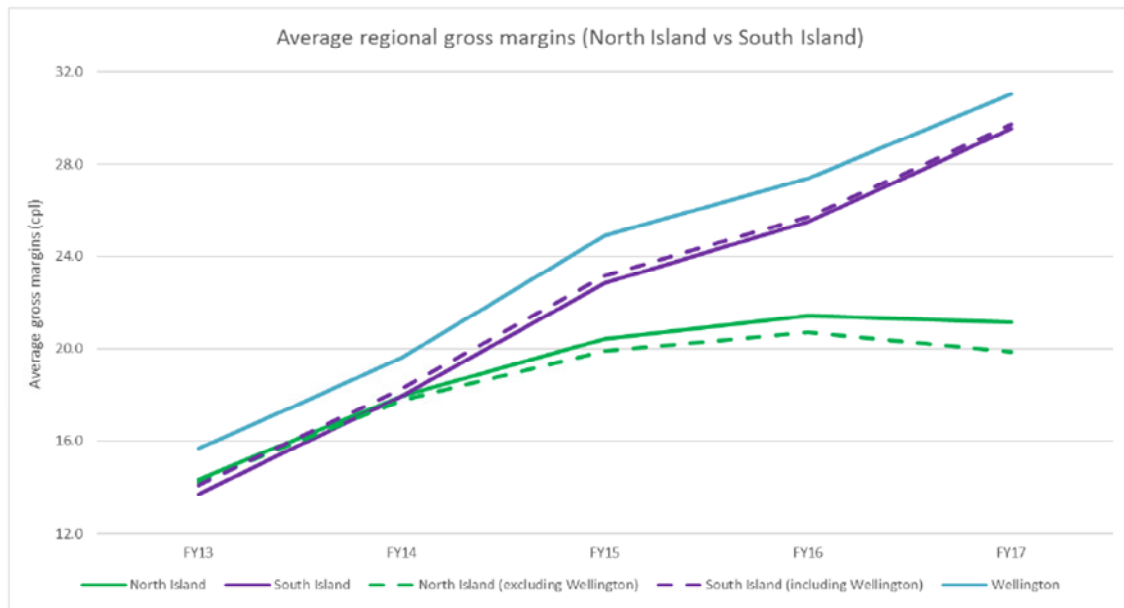
context of rapidly rising crude oil prices, resulting in petrol prices reaching a then historic high of \$2.19 per litre.<sup>24</sup>

44. Prices and margins appear to be higher in Wellington and the South Island than the rest of the country.

44.1 In the Z/Chevron investigation, the Commission identified that prices in Wellington and the South Island tended to be higher than in the upper North Island.<sup>25</sup>

44.2 Similarly, the 2017 Fuel Study identified that regional gross margins have increased at a faster rate in Wellington and the South Island than margins in the North Island (see Figure 4 below).

**Figure 4 – Average regional gross margins<sup>26</sup>**



45. The Z/Chevron merger investigation noted that there are some cost differences in supplying retail sites between those regions. However, these differences were not sufficient to fully explain the difference in prices observed.<sup>27</sup> The authors of the 2017 Fuel Study noted they were “unable to identify any major capital expenditure

<sup>24</sup> MBIE “Report back on the findings and recommendations of the Fuel Market Financial Performance Study” (November 2017) at [31].

<sup>25</sup> Z/Chevron merger investigation at [61].

<sup>26</sup> The 2017 Fuel Study at 39.

<sup>27</sup> Z/Chevron merger investigation at [219].



projects that can be linked to the increase in margin in Wellington and the South Island.”<sup>28</sup>

46. The presence of Gull has been considered one potential explanation for the regional variations in prices and margins.
  - 46.1 The Z/Chevron investigation observed that Gull “competes aggressively on price”<sup>29</sup> and that the regions where there were higher prices tended to be where Gull was not present.<sup>30</sup>
  - 46.2 The 2017 Fuel Study identified that Gull had aggressively expanded since it first entered the fuel industry and its rivals had reduced prices where it had entered.<sup>31</sup> It noted that in regions where Gull does not operate – notably the South Island and Wellington – retail gross margins have grown more strongly, and to higher levels, than in the rest of the country.<sup>32</sup>
47. A final factor relevant to price and margins trends is that there appears to have been an increase in use of loyalty schemes, including loyalty cards and discount vouchers.
48. Loyalty cards include Flybuys, AA Smartfuel and Mobil Smiles. These offer a discount when presented at a participating fuel retail site. Customers of Foodstuffs supermarkets (Pak ‘N Save and New World) can get a discount voucher that can be used at Foodstuffs and Z retail sites, while customers of Countdown can get a discount at participating AA Smartfuel partner sites (BP and Caltex) using their Onecard.<sup>33</sup>
49. Loyalty and discount programmes vary in size and the location that they can be redeemed. In some instances, fuel discounts may only be redeemable in certain geographic locations or at certain fuel sites. This may depend on the size of the discount, and the issuer, among other factors.
50. Those customers that do not have a loyalty card or discount voucher pay the posted board price.
51. MBIE data (see Figure 5 below) shows that there has been an increase in the size of these discounts.

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<sup>28</sup> The 2017 Fuel Study at 39.

<sup>29</sup> Z/Chevron merger investigation at [170].

<sup>30</sup> Z/Chevron merger investigation at [218].

<sup>31</sup> The 2017 Fuel Study at 62.

<sup>32</sup> The 2017 Fuel Study at 62.

<sup>33</sup> The providers of these supermarket contracts change from time to time. For example, prior to Z entering the contract with Foodstuffs in 2017, Mobil had a contract to supply fuel to Foodstuffs service stations.

**Figure 5 – Rise in retail price discounts (2010 – 2018)<sup>34</sup>**



Source: Ministry of Business, Innovation and Employment - 2018

### *Trends in profits*

52. The 2017 Fuel Study attempted to assess whether the higher prices and margins meant firms were earning excessive profits. It sought to analyse the level of returns that the fuel firms were earning on their assets, known as “return on average capital employed” (ROACE).<sup>35</sup>
53. The 2017 Fuel Study was limited in its ability to obtain the necessary information to conduct the analysis.<sup>36</sup> However, it observed that where retail ROACEs had been provided, these ROACEs had increased significantly over the period under review and in some cases had increased by over 100% through the period 2012 to 2017.

### *Other trends*

54. In the future, customers may not have the same demand for fuel. For example, electric vehicles are available for sale in New Zealand. At present, these account for a

<sup>34</sup> Figure 5 illustrates average retail price discounts. MBIE notes that the estimated discount is calculated as the difference between the quarterly average main port price, and the quarterly average retail price series produced by Statistics New Zealand. <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/weekly-fuel-price-monitoring/#what-is-the-discounted-price>.

<sup>35</sup> The 2017 Fuel Study at 35.

<sup>36</sup> The 2017 Fuel Study at 41.

small proportion of cars in New Zealand.<sup>37</sup> However, a significant increase in the use of such vehicles could reduce demand for fuel over the longer term.

**Questions on trends in gross margins and regional pricing**

- Q4 What factors could be contributing to an observed rise in gross margins?
- Q5 Could an observed rise in gross margins, or differences in gross margins between regions, be explained by capital expenditure or other costs?
- 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?
- 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?

**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?
- 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)?

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

**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.

<sup>37</sup> Damien O’Carroll “Lowest price to highest: every Electric Vehicle you can buy in NZ” (10 October 2018) Stuff <https://www.stuff.co.nz/motoring/107675892/lowest-price-to-highest-every-electric-vehicle-you-can-buy-in-nz>.

## The supply chain

### *Exploration and extraction of crude oil*

55. The first stage in the supply of fuel is the exploration and extraction of crude oil. None of the major fuel firms are involved in these operations in New Zealand. However, the wider corporate groups to which Mobil and BP belong have exploration and extraction operations in other countries.
56. Shell and Chevron were involved in exploration and extraction of crude oil (through their global parents). However, Z did not purchase Shell and Chevron's exploration assets and it is not involved in exploration or extraction of crude oil.

### **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?
- 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?

### *Refining crude oil into petroleum products*

57. Crude oil is refined into petroleum products such as petrol, diesel, aviation fuel and marine fuel. The New Zealand Refining Company (NZRC) owns and operates New Zealand's only oil refinery at Marsden Point. NZRC is a listed company. Its shareholders include Mobil, Z and BP.<sup>38</sup>
58. NZRC operates on a toll manufacturing basis. Currently, only the major fuel firms use the oil refinery at Marsden Point. These firms purchase crude oil on global markets and then deliver the crude oil to the refinery. Each fuel firm retains ownership of the crude oil and the resulting output, and NZRC charges a fee for converting the crude into refined petroleum products. NZRC has a processing agreement with each of the major fuel firms for the right to a certain proportion of the refinery's capacity.
59. Each fuel firm is allocated capacity at the refinery in proportion to its respective aggregated three-year rolling average market share of downstream refined products. This means that a refinery user wishing to grow its downstream market share would initially need to do so through importing refined product. The fee that each refinery user pays is calculated based on (among other things) the difference between the benchmarked price of crude oil and refined fuel with a discount of around 30% to

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<sup>38</sup> Collectively, Mobil, Z and BP have about a 43% stake in the NZRC.

each refinery user. The aim of this calculation is to incentivise refinery users to maximise the use of the refinery.<sup>39</sup>

60. Even at full capacity, the oil refinery cannot meet all of New Zealand’s demand. For example, it produces around 58% of petrol and 67% of diesel consumed in New Zealand.<sup>40</sup> The shortfall is made up by imports of refined fuel. Generally, imported fuel arrives at three ports in New Zealand: Mt Maunganui, Wellington and Lyttelton. The fuel firms purchase this fuel on global markets.
61. The 2017 Fuel Study considered that the agreements regarding governance and operation of the refinery might raise entry barriers.<sup>41</sup> In particular:
- 61.1 the agreements might prevent rivals accessing the refinery’s capacity; and
  - 61.2 firms maintain ownership in all outputs, which may deter rivals as they would need to establish distribution arrangements for all petroleum products (not just retail petrol and diesel).<sup>42</sup>
62. The 2017 Fuel Study also noted that the major fuel firms’ part ownership of the refinery may affect how they price across the industry.<sup>43</sup>

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

*Primary distribution of fuel*

63. Refined fuel is distributed around New Zealand through “primary” distribution assets, including pipelines, storage terminals and coastal shipping assets. Most of the primary distribution assets (except for storage terminals) are jointly owned by the

<sup>39</sup> The 30% that the user retains is designed to reflect the costs that are incurred by the major fuel firms rather than the refinery, such as the cost of coastal shipping and working capital associated with stockholding crude oil.

<sup>40</sup> Refining NZ [www.refiningnz.com](http://www.refiningnz.com).

<sup>41</sup> See for example: The 2017 Fuel Study at 50-51.

<sup>42</sup> Fuel firms cannot choose to have a barrel of crude processed into only one or two petroleum products. Instead, each barrel of crude refined by NZRC at Marsden Point produces a mix of different refined products, including petrol, diesel, aviation fuel and other products. This is known as the “butchery principle”.

<sup>43</sup> The 2017 Fuel Study at vi.

major fuel firms. An exception is the Refinery to Auckland Pipeline (RAP) which is owned by NZRC. Users of the RAP are allocated capacity based on a 1-year market share of downstream refined products in the Auckland market.

64. Around 37% of fuel that NZRC refines is delivered to the Wiri terminal via the RAP.<sup>44</sup> This is used to supply petrol stations in Auckland and surrounding areas. The remaining fuel is distributed to terminals at the main ports throughout New Zealand using coastal shipping.
65. The logistics of supplying the terminals are organised by Coastal Oil Logistics Limited (COLL), which is jointly owned by the major fuel firms. This includes scheduling coastal shipping to transport fuel domestically refined at Marsden Point to terminals throughout New Zealand and scheduling imports to ensure import deliveries do not conflict with coastal shipping deliveries of domestically refined fuel. The major fuel firms rely on these distribution assets to supply fuel to downstream markets, including retail fuel. The access to this infrastructure is administered by COLL, which is governed by rules established by the major oil firms. These rules may affect the degree to which these major oil firms can alter their usage of this infrastructure/capacity.
66. New Zealand's fuel market is characterised by shared infrastructure owned and operated by the major fuel firms. This was noted in the Z/Chevron investigation as a factor that can lead to some similarity in wholesale costs. It was also noted that the major fuel firms share many wholesale costs through their joint ventures in primary distribution. Structural links and similar cost structures were identified as features in the Z/Chevron investigation that may make price coordination easier.<sup>45</sup>
67. Gull has its own terminal in Mt Maunganui. Gull imports fuel directly to this terminal and then supplies its retail sites by road transport from that terminal.

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<sup>44</sup> Z/Chevron merger investigation at [23].

<sup>45</sup> Z/Chevron merger investigation at [54 and 57].

**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?
- Q21 What are the advantages and disadvantages of the current arrangements that govern COLL and the RAP for competition in the retail market?
- Q22 Are there efficiency gains from the shared infrastructure? If so, how are these being shared with consumers?

*Storing fuel – terminals and the borrow and loan system*

68. Refined products are delivered to, and stored in, terminals until dispensed for delivery to retail sites. In general, terminals are located at coastal ports. Mobil has an inland terminal at Woolston in Christchurch.<sup>46</sup>
69. Each of the major fuel firms own terminals at various ports, although not necessarily at every port or for every refined product. The major fuel firms have access to each other's terminals under the "borrow and loan system". Under the borrow and loan system most of the major fuel firms' terminals are designated as industry storage and the refined fuel within those terminals is jointly owned by the major fuel firms.<sup>47</sup> The firms charge each other a fee (known as a "throughput fee") to draw down fuel from a terminal they do not own. Throughput fees are charged on a cents per litre basis to the fuel firm who draws down the product.
70. The rules of the borrow and loan system, including both 'draw down' and 'top-up' provisions, may affect the degree to which major oil firms (or any resellers/distributors they supply) can alter the amount of fuel they draw down from a given terminal at any point in time.
71. Gull does not participate in the borrow and loan system (nor do any other fuel firms, aside from the major fuel firms).<sup>48</sup> Gull has its own terminal in Mt Maunganui which it uses to supply its retail sites. No other fuel retailers (aside from the major fuel firms and Gull) have their own terminals. The other fuel retailers instead obtain their fuel from the major fuel firms (or from distributors of the major fuel firms). These fuel retailers purchase fuel under long-term supply agreements.

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<sup>46</sup> The Woolston terminal services the Christchurch region and is connected to terminals at the port of Lyttelton via a Mobil owned pipeline over the Port Hills. Z/Chevron merger investigation at [73].

<sup>47</sup> There are some terminals, including the Wiri Terminal and Marsden Point terminals, that are owned by the major fuel firms that are not part of the borrow and loan system. Z/Chevron merger investigation at [62].

<sup>48</sup> Z/Chevron merger investigation at [64].

72. At present the major fuel firms own all petrol and diesel terminals in the South Island. However, a company called Timaru Oil Services has commenced earthworks on a new terminal in Timaru.<sup>49</sup>
73. The 2017 Fuel Study considered whether the borrow and loan arrangement might inhibit competition. It identified that the information shared by the major fuel firms through the borrow and loan system (which included information on volumes) would allow the firms to monitor each other's shares. It noted that such information sharing is often a cause for concern to competition authorities because it might help support coordination among firms, leading to higher prices.<sup>50</sup> Similarly, the Z/Chevron investigation identified that national volumes are likely to be transparent due to the borrow and loan scheme.<sup>51</sup>
74. In response to the 2017 Fuel Study, the major fuel firms submitted that the borrow and loan system created efficiencies and did not agree there was evidence of anti-competitive behaviour arising from it.<sup>52</sup> The major fuel firms did not support the 2017 Fuel Study's suggestion to further examine the creation of a registry for the borrow and loan scheme (to limit the visibility of other participants' market shares in the fuel industry).<sup>53</sup>
75. In particular, Z describes how the sharing of data allows for port fuel supply shortages to be managed through the port coordination management system, which rations fuel proportionate to a participant's market share. It noted that the entire supply chain is incentivised to ensure port stocks are suitably low to ensure maximum efficiency and lowest cost of the supply chain. Z suggested that one or more terminals in the South Island are being managed through port coordination management up to about half the time.<sup>54</sup> Port coordination may affect the ability of major oil firms (or any resellers/distributors they supply) to alter the amount, or proportion, of fuel they draw down from affected terminals.
76. The 2017 Fuel Study also identified that the major fuel firms controlled access to terminals in key ports such as Wellington and Lyttelton.<sup>55</sup> The 2017 Fuel Study considered the major fuel firms may have an incentive to maintain tight capacity throughout the supply chain, including at terminals. The study suggested that this limits access to other entrants and means that any entrants that can secure access to

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<sup>49</sup> See for example Chris Tobin "Earthworks start on \$30m fuel store" *The Courier* (online ed, Timaru, 16 September 2018).

<sup>50</sup> The 2017 Fuel Study at vi.

<sup>51</sup> Z/Chevron merger investigation at [174].

<sup>52</sup> See BP "Letter from BP to Office of Hon Judith Collins" (13 October 2017); Mobil "Re: Mobil Oil New Zealand response to Fuel Market Financial Performance Study" (13 September 2017); Z "Submission to MBIE on Fuel Market Performance Study" (13 October 2017).

<sup>53</sup> See BP "Letter from BP to Office of Hon Judith Collins" (13 October 2017); Mobil "Re: Mobil Oil New Zealand response to Fuel Market Financial Performance Study" (13 September 2017); Z "Submission to MBIE on Fuel Market Performance Study" (13 October 2017).

<sup>54</sup> Z "Submission to MBIE on Fuel Market Performance Study" (October 2017).

<sup>55</sup> The 2017 Fuel Study at 51-52.



capacity are limited in their ability to expand. This could make it harder for rivals to the major fuel firms to emerge.<sup>56</sup>

77. The 2017 Fuel Study noted that international studies have shown that regulations requiring integrated firms to divest ownership of facilities at a level of the supply chain are likely to result in higher prices.<sup>57</sup> However, the study made several proposals for improving access to terminals including:
- 77.1 a requirement for terminal owners to make some part of their terminal available to others at a regulated price;
  - 77.2 a requirement to post wholesale prices at terminal gates; and
  - 77.3 developing a liquid wholesale market.
78. Gull submitted that the “inclusion of Gull within [the borrow and loan] scheme can only enhance the benefits for the Kiwi motorists”;<sup>58</sup> Gull did not provide comments on the creation of a registry.
79. The major fuel firms did not consider it was necessary or desirable to create a liquid wholesale market.<sup>59</sup> Gull submitted that it had considered building a terminal in the South Island several times in the past ten years; however, it considered the value proposition in the South Island is not as attractive as the North Island, citing additional costs that would need to be recovered from motorists. Gull submitted that to improve competition it should be allowed access to fuel at import parity pricing plus a market-based terminal margin.<sup>60</sup>

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<sup>56</sup> The 2017 Fuel Study at 51-52.

<sup>57</sup> The 2017 Fuel Study at 52. Footnote 72 notes that these studies typically relate to vertical separation between refining and retailing, rather than terminaling from either. See Eckert (2013), Noel (2016), Borenstein and Bushnell (2005).

<sup>58</sup> Gull “Fuel Market Financial Performance Study” (October 2017).

<sup>59</sup> See “Letter from BP to Office of Hon Judith Collins” (13 October 2017); Mobil “Re: Mobil Oil New Zealand response to Fuel Market Financial Performance Study” (13 September 2017); Z “Submission to MBIE on Fuel Market Performance Study” (13 October 2017).

<sup>60</sup> Gull “Fuel Market Financial Performance Study” (October 2017).

**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?
- 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?
- 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?
- Q26 Are there examples of firms seeking to gain access to terminal capacity owned by other parties? If so, please provide details.
- Q27 Will the construction of the new Timaru terminal impact competition in the South Island? Why or why not?
- 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?

*Secondary distribution*

80. Secondary distribution refers to the road transport of fuel from terminals to retail sites. This activity is contracted out by major fuel firms to third party distributors and/or undertaken by resellers, such as Waitomo and NPD. Allied Petroleum has a nation-wide contract to distribute fuel for Mobil, as well as owning and operating retail outlets.
81. Transportation costs may differ between regions, which may contribute to geographic differences in retail fuel prices. The 2017 Fuel Study noted that the more geographically dispersed population in the South Island results in higher transport costs (in terms of cents per litre). However, it considered that this does not explain the observed increases in margins (or the reasons for higher margins in the South Island observed since 2015).<sup>61</sup>

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<sup>61</sup> The 2017 Fuel Study at 39.

**Questions on the supply chain: secondary distribution**

- Q29 Are there any features of secondary distribution that may affect competition in the retail markets?
- Q30 To what extent do differences in distribution costs contribute to the observed regional differences in fuel price?

*Wholesale supply*

82. The major fuel firms and Gull supply petrol and diesel to customers through retail sites.
83. There are a variety of arrangements through which fuel is supplied through retail sites. These include:
- 83.1 Retail sites that the major fuel firms and Gull own and operate. This includes BP Connect sites, most Z-branded sites, and most Mobil and Gull sites. The major fuel firms set prices directly at these sites.
- 83.2 Retail sites that are owned and operated outside the major fuel firms and Gull. The major fuel firms have supply agreements with these firms. These agreements will differ according to the extent of control over the retail offer and how the wholesale price is set. However, in all cases the owner of each site sets the retail price. Examples include:
- 83.2.1 Dealer sites that carry the brand of the major fuel firm (BP 2GO, Z, Caltex, Mobil) and Gull but are owned and operated by individual owners.<sup>62</sup>
- 83.2.2 Reseller sites with their own brands but which purchase fuel from one of the major fuel firms. This includes retail brands GAS and Challenge which have long-term supply agreements with a major fuel firm. This also includes reseller brands such as NPD, Waitomo, and McKeown, which are a mix of those owned by the reseller and other sites that are dealer sites.
- 83.3 Retail sites operated by a Foodstuffs supermarket branded, as either Pak'nSave or New World. As of September 2018, Z holds an exclusive contract with Foodstuffs to supply fuel to these sites. Z sets the board price and pays Foodstuffs a per litre commission, which Foodstuffs can use to give discounts to shoppers. Those stations and Z's own stations are where consumers can redeem the fuel discounts printed on their New World and Pak'nSave docketts.<sup>63</sup>

<sup>62</sup> This might be an individual owner or a company that owns several retail sites.

<sup>63</sup> Z <https://z.co.nz/about-z/news/general-news/kiwi-brands-unite-to-bring-fuel-discounts-to-customers/>.

84. As noted earlier, the trend has been towards a greater proportion of sites not directly owned and operated by the major fuel firms. Retail sites vertically-integrated within major fuel firms have been replaced with long-term supply agreements with individually-owned retail sites. These contracts may provide options for renewal and provide parties with the right of first refusal if the outlet is going to be sold. These provisions could impact the extent to which the major fuel firms compete to supply to dealer owned sites or resellers.
85. The 2017 Fuel Study raised concerns that these supply agreements might be introducing inefficiencies. It noted that the supply agreements did not include features to ensure individually-owned retail sites are a good substitute for vertically integrated operations (sites owned and operated by the major fuel companies).<sup>64</sup> The 2017 Fuel Study also queried whether the reliance on major fuel firms for the supply of fuel means that individually-owned stores are limited in their ability to compete against their suppliers.<sup>65</sup>

#### **Questions on the supply chain: wholesale supply**

- Q31 Are there aspects of wholesale supply agreements to other fuel firms (eg, resellers and dealer sites) that could impact on competition in retail fuel markets?
- Q32 What are the key factors affecting the terms on which suppliers are willing to offer wholesale fuel to other fuel firms (eg, resellers and dealer sites)? What is the effect of these factors on competition in retail fuel markets?
- Q33 Are there differences in the way that the major fuel firms supply fuel to other fuel firms (eg, resellers and dealer sites) in different regions that may affect retail competition?
- Q34 To what extent do the major fuel firms compete to win supply to other fuel firms (eg, resellers and dealer sites)?
- Q35 Do other fuel firms (eg, resellers and dealer sites) have sufficient information to compare offers between the major fuel firms? Are there examples of other fuel firms (eg, resellers and dealer sites) switching between the major fuel firms, and if so, what were the main factors incentivising them to switch?
- Q36 Are there any limits on the ability or incentive of other fuel firms (eg, resellers and dealer sites) to compete against the major fuel firm that supplies them?

#### *The nature of retail competition*

86. Retail fuel for a given octane rating is largely the same regardless of the petrol station from which it is purchased. However, there are some differences between

<sup>64</sup> The 2017 Fuel Study at 57.

<sup>65</sup> The 2017 Fuel Study at 69.

retail chains.<sup>66</sup> For example, some fuel firms add additives after the fuel has been dispensed from the terminal; some firms offer 98 octane as their premium fuel, others 95 octane; Gull offers 98 octane fuel with 10% bioethanol.

87. Retail sites differentiate themselves through their service offerings.<sup>67</sup> The types of station range between:
- 87.1 unmanned sites where customers fill their own tanks and pay using an unattended terminal; and
  - 87.2 “full service” sites with forecourt attendant, car wash and a café.
88. Retail sites list prices on boards displayed outside their sites. Prices offered tend to be higher at “full service” stations reflecting the greater range of services.<sup>68</sup> As noted earlier, there has been an increase in the use of loyalty cards and discounts.
89. The 2017 Fuel Study noted that fuel companies had been increasingly engaging in price discrimination over the study period (2011 – 2015), charging different customers different prices for the same product. It identified this to include loyalty cards and supermarket vouchers, and the bundling of other products and services with fuel offerings. It was not able to conclude whether the price discrimination was positive or negative overall for consumers. It noted the following points.
- 89.1 The increasing use of price discrimination may be adversely affecting those customers who pay board prices (which are likely to be higher with the presence of discounting). The authors identified that the use of loyalty cards and discount dockets allows retailers to screen price-sensitive customers from price-insensitive customers.<sup>69</sup>
  - 89.2 The study found that, over the period of the study, there had been an increase in the degree of service differentiation of retail sites. That is, more full-service stations and more low-cost unmanned stations. It found that the overall impact of the increased use of product differentiation was likely to have caused margins at full-service stations to rise; however, there could be efficiency benefits from the conduct, such as offering greater convenience to customers (eg, time savings from buying fuel with food and drink).<sup>70</sup>
90. Price discrimination may vary regionally. Customers’ purchasing patterns for fuel may differ between geographic locations (eg, urban versus rural areas, or lower versus higher income areas) but share similarities within a given location. The Z/Chevron investigation identified that a primary reason for a customer’s choice of a

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<sup>66</sup> Z/Chevron merger investigation at [169].

<sup>67</sup> Z/Chevron merger investigation at [170].

<sup>68</sup> Z/Chevron merger investigation at [171].

<sup>69</sup> The 2017 Fuel Study at 66-68.

<sup>70</sup> The 2017 Fuel Study at 66-68.

service station is location. This means that the markets that service stations fall within are localised but geographically differentiated.<sup>71</sup>

91. Previous analyses of retail fuel markets have identified features of the markets that might make it easier to engage in price coordination. For example, the Z/Chevron investigation identified factors which include the following.<sup>72</sup>
- 91.1 The retail fuel that firms sell is largely the same. There is differentiation in the service offering but in some local areas the degree of differentiation is low.
  - 91.2 There is transparency on board prices. This included Z listing its main port price on its website as a potential way to signal price changes. The 2017 Fuel Study also identified this as being of potential concern. Z no longer lists its main port price on its website. Nonetheless, Z (and other firms') board prices remain readily observable.
  - 91.3 Firms are regularly interacting as a result of the shared ownership infrastructure and operations by the major fuel firms.
  - 91.4 The lack of fully independent players aside from Gull.
  - 91.5 Consumers make small, regular purchases of a product.

**Questions on the supply chain: the nature of retail competition**

- Q37 Are there features of the retail fuel market that may inhibit the ability of consumers to obtain competitive offerings?
- Q38 What are the advantages and disadvantages of the increase in service differentiation in service stations, ranging from full service to unmanned?
- 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?

<sup>71</sup> Z/Chevron merger investigation at [130].

<sup>72</sup> Z/Chevron merger investigation at [168]-[203].

**Other issues**

92. The list of issues we are seeking views on is based on our initial assessment of the terms of reference for the study issued by the Minister and is not exhaustive. Interested parties are welcome to raise other issues and provide information that they consider to be relevant to the study, having regard to the terms of reference issued by the Minister.

**Questions on other issues**

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

### **Making a submission**

93. We invite interested parties to respond to the questions raised in this paper. A complete list of the questions is included in **Attachment B** for ease of reference. We do not expect that interested parties will respond to all issues raised, but rather address the issues that relate to their business operations or experience.
94. To inform our study, we encourage parties to provide comments that are supported by corroborating evidence. Less weight may be given to a statement or submission that cannot be supported by evidence, than a statement or submission that is supported by corroborating evidence.
95. Written submissions on this paper are due no later than **5pm, 21 February 2019**. Submissions on this paper should be addressed to:

Keston Ruxton

c/o marketstudies.submissions@comcom.govt.nz

### **Format for submissions**

96. Please include your company name or the name of the person submitting and “Submission on Market Study into the retail fuel sector – Invitation to comment on preliminary issues” in the subject line of your email. We prefer submissions in both a format suitable for word processing (such as a Microsoft Word doc), and a ‘locked’ format (such as a PDF) for publication on our website.

### **Disclosure of your submission**

97. We request confidential and public versions of submissions so that a public version may be published on our website.
98. We offer guidance below where interested parties wish to provide information in confidence.
- 98.1 Where confidential information is included in a submission, such information should be clearly marked.
- 98.2 Both confidential and public versions of submissions should be provided.
- 98.3 The responsibility for ensuring that confidential information is not included in a public version rests on the party providing the submission.



## Attachment A – Key process steps and how you can contribute

99. **Table 1** below sets out our intended timetable and indicative dates for our study, including key opportunities for you to contribute to our study.

**Table 1: Key process steps and how you can contribute**

Indicative dates	Key process steps	How you can contribute and remain informed
5 December 2018	Terms of reference for the study issued by the Minister and published in the Gazette.	
6 December 2018	Issued initial information requests to main parties.	
12 December 2018	Published Draft Market Studies Guidelines on our website. Published Process paper on our website.	<b>You are invited to submit</b> on the guidelines by <b>31 January 2019</b> by email to <a href="mailto:marketstudies.submissions@comcom.govt.nz">marketstudies.submissions@comcom.govt.nz</a>
31 January 2019	Publish Statement of Preliminary Issues on our website. This includes our proposed approach to responding to the terms of reference and preliminary issues we intend to consider as part of the study.	<b>You are invited to respond</b> to our proposed approach and preliminary issues. These submissions will help inform our analysis and draft report.
December 2018 – March 2019	Further information gathering and engagement with parties. Undertaking of analysis.	We will engage directly with parties.
February – July 2019	Testing information and analysis with stakeholders. Publish working paper(s) for stakeholder comment over this period. To include analysis on potential competition issues impacting outcomes in the retail fuel market.	We will provide updates on opportunities to contribute.
July – August 2019	Publish draft report on our website. This will include our findings on the factors affecting competition in the retail fuel market and may include any recommendations about changes to the market.	<b>You will be invited to comment</b> on our draft report. We will provide an update on submission opportunities, including details relating to any hearings.

September – November 2019	Consideration of responses to our draft report. We may hold hearings over this time.	We will provide updates on opportunities to contribute.
By 28 November 2019	Report back to the Minister on our findings.	
5 December 2019	Publish final report on our website.	
From December 2019 onwards	The Minister responds to our final report.	

100. These indicative process steps and dates may change. We anticipate providing further details on specific steps and key opportunities for you to contribute to our study as it progresses.

**Subscribe to our mailing list to remain informed about our study**

101. We will be providing updates on our study on our website at: <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-fuel>.
102. If you would like to be kept informed and receive updates on our study, please subscribe by emailing [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz).

## **Attachment B – Invitation to comment on preliminary issues: summary of questions**

### **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.

### **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 (eg, Allied, NPD, Waitomo, Gull, RD Petroleum) as observed in Figure 1?
- 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?

### **Questions on trends in gross margins and regional pricing**

- Q4 What factors could be contributing to an observed rise in gross margins?
- Q5 Could an observed rise in gross margins, or differences in gross margins between regions, be explained by capital expenditure or other costs?
- 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?
- 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?

### **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?
- 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)?

### **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?
- 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?

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?

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

**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.

**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?

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?

**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?

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?

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

**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?

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

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

- 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?
- 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?
- Q26 Are there examples of firms seeking to gain access to terminal capacity owned by other parties? If so, please provide details.
- Q27 Will the construction of the new Timaru terminal impact competition in the South Island? Why or why not?
- 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?

**Questions on the supply chain: secondary distribution**

- Q29 Are there any features of secondary distribution that may affect competition in the retail markets?
- Q30 To what extent do differences in distribution costs contribute to the observed regional differences in fuel price?

**Questions on the supply chain: wholesale supply**

- Q31 Are there aspects of wholesale supply agreements to other fuel firms (eg, resellers and dealer sites) that could impact on competition in the retail fuel markets?
- Q32 What are the key factors affecting the terms on which suppliers are willing to offer wholesale fuel to other fuel firms (eg, resellers and dealer sites)? What is the effect of these factors on competition in the retail fuel markets?
- Q33 Are there differences in the way that the major fuel firms supply fuel to other fuel firms (eg, resellers and dealer sites) in different regions that may affect retail competition?
- Q34 To what extent do the major fuel firms compete to win supply to other fuel firms (eg, resellers and dealer sites)?
- Q35 Do other fuel firms (eg, resellers and dealer sites) have sufficient information to compare offers between the major fuel firms? Are there examples of other fuel firms (eg, resellers and dealer sites) switching between the major fuel firms, and if so, what were the main factors incentivising them to switch?
- Q36 Are there any limits on the ability or incentive of other fuel firms (eg, resellers and dealer sites) to compete against the major fuel firm that supplies them?

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

**Questions on other issues**

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