Coversheet: Government response to Commerce Commission Retail Fuel Sector Market Study – High Level Decisions

Advising agencies	Ministry of Business, Innovation and Employment
Decision sought	Agree in principle to the regulatory proposals recommended by the Commerce Commission, subject to further work on the detail of those proposals.
Proposing Ministers	Energy and Resources, Commerce and Consumer Affairs

Section A: Summary problem and proposed approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
An active wholesale market for petrol and diesel does not exist in New Zealand. Competition largely occurs in retail fuel markets and this is less intense than could be expected, particularly for premium petrol. The result is consumers paying higher pump prices. This is likely to persist without Government intervention.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
Government intervention will facilitate a more active wholesale market for petrol and diesel, thereby allowing for increased price competition. Backstop regulatory powers and an enhanced fuel monitoring regime will provide incentives for fuel companies to compete more vigorously. The benefits of this competition will flow through to retail markets in lower prices. Better information for consumers about premium fuel prices will facilitate more informed purchasing decisions.

Section B: Summary impacts: benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The main beneficiaries will be New Zealand households and businesses that use petrol and diesel for land transport. The benefits will be in the nature of lower fuel prices, likely more convenient locations for filling up, and more innovative fuel service offerings that meet the needs of consumers.

Where do the costs fall?
The costs primarily fall on: • Importers, distributors and retailers of petrol and diesel. There will be moderate transitional compliance costs as these companies move to the new regulatory regime (e.g. renegotiating contracts, amending price boards) and low to moderate ongoing

compliance costs in participating in the terminal gate pricing regime and complying with new recordkeeping and disclosure obligations. These costs will likely ultimately be passed on to consumers. • The regulator or regulators responsible for enforcement of the Industry Code, adjudication of disputes, monitoring the terminal gate pricing regime, and monitoring information disclosure.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
• The terminal gate price regime may impose additional costs (e.g. stock holding, investment, increased shipping frequency, or shortages for own-supply) which could lead to higher retail prices if wholesale competition does not increase. Moderate impact. This is minimised by proposals to closely monitor the terminal gate price regime and to adjust the Industry Code on a timely basis if required. • Increased transparency of fuel pricing may facilitate collusion. Moderate to high impact. This risk will be minimised by the enhanced fuel monitoring regime to enable the regulator to identify potential competition issues. Further regulatory intervention may be required if collusion is identified. • Reduced profitability of the major fuel companies may lead to reduced incentives to invest and rationalisation of fuel supply in high cost regions. Moderate to low impact. This is minimised by the preferred options focusing on promoting competition rather than more heavy-handed options for price control or structural separation.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
The proposals are consistent with the Government's expectations.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
Overall we have a high level of confidence in the evidence base for the nature and extent of the problem. The Ministry has been monitoring weekly retail petrol and diesel prices since 2008. A 2017 Fuel Market Financial Performance Study commissioned by the Ministry concluded that it had reason to believe that fuel prices may be unreasonable. The Commerce Commission has undertaken an in-depth market study into the retail fuel sector and concluded that competition is not as effective as it could be. The regulatory proposals were recommended by the Commerce Commission following consultation on its draft report for the retail fuel sector. This consultation included two rounds of submissions and a conference. We propose to undertake further work and consultation on the preferred proposals in the course of developing the new Bill and regulations for an Industry Code.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Treasury and MBIE
Quality Assurance Assessment:
Partially meets
Reviewer Comments and Recommendations:
A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury and Ministry of Business, Innovation, and Employment (MBIE) has reviewed the 'Government response to Commerce Commission Retail Fuel Sector Market Study – High Level Decisions' Regulatory Impact Assessment (RIA) produced by MBIE in December 2019. The Panel considers that the RIA **partially meets** the Quality Assurance criteria. While the RIA has been prepared under significant time constraints, MBIE has clearly and completely described the status quo and the problem definition. The RIA outlines a range of options based on the recommendations in the Final Report of the Retail Fuel Sector Market Study by the Commerce Commission, and recognises the interrelationships between the options. It clearly identifies the main beneficiaries and who will likely bear the associated costs. However, the cost-benefit analysis and criteria for the comparison of options are not sufficiently developed to demonstrate how the package can effectively address the problems and help achieve the objectives. This RIA is prepared for policy proposals seeking in-principle decision by the Cabinet in December 2019. MBIE intends to continue to work on the quantitative assessments of the costs and benefits of the options and refine the proposals. A full RIA will be prepared before the final policy decision-making by the Cabinet in February 2019.

Impact Statement: Government response to Commerce Commission Retail Fuel Sector Market Study – High Level Decisions

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment (**MBIE**) is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing in-principle policy decisions to be taken by Cabinet.

Key Limitations or Constraints on Analysis
Range of options considered The range of options considered is based on the Commerce Commission's (**the Commission**) analysis in its Final Report for the Market Study into the Retail Fuel Sector (**the Final Report**) and our analysis following the 2017 Fuel Market Financial Performance Study. Other options are discarded as they have not been subject to the same level of analysis or testing, and are unlikely to do so within the proposed legislative timeframes. Some of these options could be considered in the future if monitoring and evaluation of the options under consideration reveals that further regulation is desirable. ***Quality of data used for impact analysis*** This RIS relies upon the Commission's analysis in the Final Report, the submissions from interested parties to the Commission as part of that study, and other anecdotal evidence. The sources used did not include much quantitative assessments of the costs and benefits of the options. We intend to continue to work on this analysis of options prior to the final decision-making by Cabinet. ***Consultation and testing*** The RIS has been prepared under significant time constraints, and as such, MBIE has not tested its analysis with interested parties. We intend to further refine the proposals and our analysis as we carry out further work on the details and consult as part of informing further decisions by Cabinet and developing the new Bill and proposed Industry Code.

Responsible Manager:
Authorised by: Osmond Borthwick Special Advisor, Energy Markets Policy Building, Resources and Markets Ministry of Business, Innovation & Employment 11 December 2019

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Characteristics of the retail fuel market

The Commission's Final Report includes a comprehensive overview of the characteristics of New Zealand retail fuel markets.

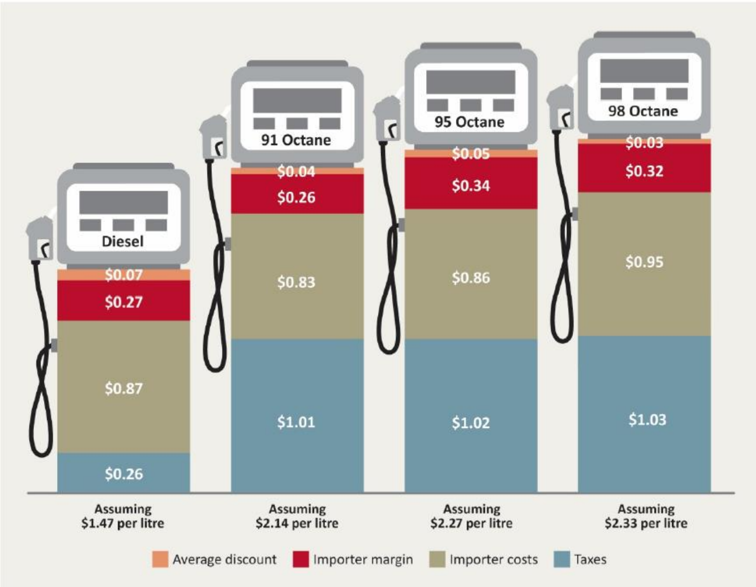
About 3.2 billion litres of petrol and 3.6 billion litres of diesel are consumed annually in New Zealand. According to Bloomberg, New Zealanders spend more income on fuel each year than people in 55 other countries (out of a total of 61 countries) with the average New Zealand driver purchasing 673 litres of fuel a year, making up 2.5 percent of the typical salary.[1]

Currently fuel purchased at retail sites is evenly split between petrol and diesel (about 54 percent and 46 percent respectively):

- Households' light vehicles tend to consume petrol
- Premium petrol (95 or 98 octane) makes up about 23 percent of total petrol consumption
- Diesel is more likely to be used in heavier vehicles and in over 97 percent of trucks and buses. The number of diesel vehicles has increased steadily since 2000.

Figure 1 illustrates the components that make up fuel board prices, across different types of fuel. This is representative of average prices over the 2018 calendar year.

Figure 1: Components of the average board price of fuel (2018 calendar year)



Source: Commerce Commission analysis of the Singapore benchmark cost index data and retail sales data.

The importer margin represents the gross margin available to fuel importers to cover domestic importation, distribution and retailing costs in New Zealand, as well as profit margins. The importer margin on premium fuels is higher than on regular petrol and diesel (at

[1] Bloomberg https://www.bloomberg.com/graphics/gas-prices/#20191:New-Zealand:NZD:l. (Viewed on 9 July 2019).

$0.32cpl), but as a percentage of the price, the importer margin on diesel is the highest (at 18.3 percent).

Retail fuel prices can vary quite significantly over short periods of time. However, overall fuel expenditure tends to increase when prices go up because fuel consumption does not reduce significantly in response to price increases, both for short-term fluctuations and longer term trends. This reflects that fuel is an essential purchase for many consumers.

Fuel company research suggests that between a quarter and a half of consumers may be relatively price sensitive and motivated to switch between brands – either looking out for the cheapest prices or actively searching for discounts between loyalty programmes. Up to half of consumers are less price sensitive and value various non-price aspects of fuel offerings more highly than price. In particular:

- convenience of location (ie proximity to consumers when they need to fill up and ease of accessibility such as from a main road)
- forecourt features (eg availability of attendants or canopies)
- shop features, including the variety and quality of food and drink choices
- ease of purchase
- attractiveness of the loyalty programme on offer
- branding and connection with the brand.

Discount and loyalty programme offerings are widespread. It is common for consumers to participate in multiple programmes.

Industry structure

There are currently four companies that import fuel into New Zealand: BP, Mobil, Z Energy, and Gull.

BP, Mobil, and Z Energy are regarded as 'the majors' in the New Zealand fuel industry. The majors import both crude oil to be refined at Marsden Point (New Zealand's sole refinery) or already refined petrol and diesel, mostly from Singapore and Korea, which generally arrives at ports in Mt Maunganui, Wellington and Lyttelton.

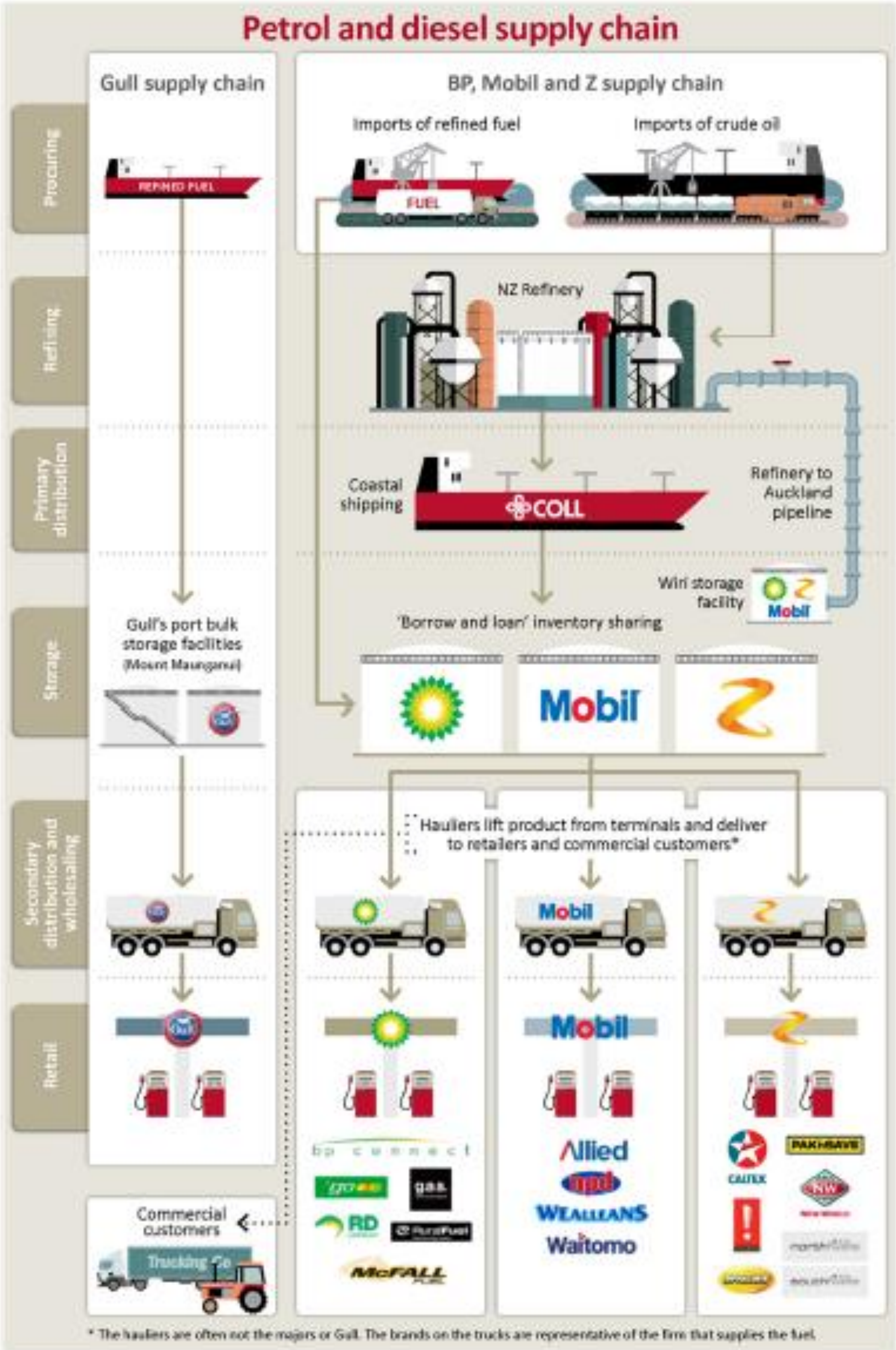
The majors jointly own or control the following infrastructure:

- the Marsden Point refinery, which produces approximately 58 percent of the petrol and 67 percent of the diesel used in New Zealand
- the pipeline infrastructure that carries the refinery's products to Auckland for storage and further transmission
- Coastal Oil Logistics Ltd, a shipping venture which transports refined fuel to other ports around New Zealand.

The majors also control the majority of New Zealand's existing fuel storage infrastructure around the country, and the stored fuel is then shared with the others through a system known as a "borrow and loan" arrangement.

New Zealand's only other importer, Gull, is not a party to any of the infrastructure sharing arrangements. Gull imports refined fuel to its Mt Maunganui terminal and from there trucks it to its North Island retail outlets. Figure 2 show the petrol and diesel supply chain.

Figure 2: The petrol and diesel supply chain



Source: the Commerce Commission final report on the retail fuel sector

New Zealand's fuel industry is essentially a vertically integrated oligopoly. Collectively, Z Energy, BP, Mobil and Gull control the supply of fuel to more than 1,300 retail sites under 20 different retail brands, either directly or indirectly through a distributor.

Many of the wholesale supply relationships that the majors have with distributors and dealers have been in place for decades and supply is typically on an exclusive basis. Each of the importers and distributors supply to retail sites that they own and operate and to franchisees (or in some cases, commissioned agents) that are dealer owned and operated.

The Commission estimates approximately 57 percent of retail fuel by volume is sold through importer owned and operated retail sites, and 27 percent of retail fuel by volume is sold through franchisees or commissioned agents that are importer-branded, dealer-owned retail sites.

Approximately 60 percent of retail sites carry brands outside of the majors. However, these sites account for approximately 20 percent of petrol volumes sold in 2018, and many are located outside of the major metropolitan areas.

Since 2016, there has been an increase in the number of retail sites with most of these sites being operated by non-majors. Along with Gull, brands distributing and retailing Mobil fuel (NPD, Waitomo, and Allied Petroleum) have particularly expanded. The number of sites operated by the majors has only marginally changed.

In addition, a new importer – Timaru Oil Services Ltd (**TOSL**) – is currently building a terminal storage at the Port of Timaru with the aim of commencing trading from 2020.

This growth in retail sites is occurring at a time when growth in total fuel demand has been slow. Over the past three years, national demand for petrol and diesel has been growing at an average rate of 3 percent and 13 percent respectively.

Future demand is more uncertain, due to changes in technology, such as increased vehicle efficiency and growth of demand for electric or hybrid vehicles. However, forecasts are that the demand for fuel is likely to remain reasonably flat over the next decade or more, but is likely to decline over a longer timeframe.

The counterfactual

The Commission has carried out an extensive analysis of the state of competition in retail fuel markets. It considers that price competition in fuel markets is not working as well as it could be. In summary, its reasons for this are:

- Fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market
- Regional differences in retail fuel prices reflect variations in local competition and not solely differences in cost of supply
- Discounts and loyalty schemes avoid direct competition on price
- Premium petrol margins have grown faster than regular petrol and do not reflect actual cost differences in supply
- Competition largely occurs in retail markets and this is less intense than could be expected.

These market outcomes are briefly explained below.

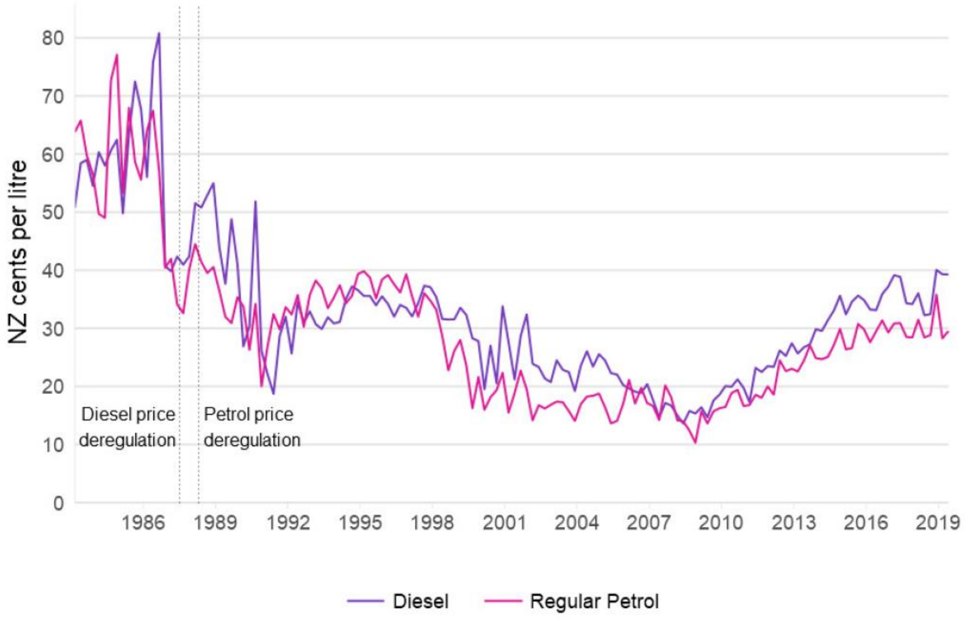
Persistently high profitability of fuel companies

The Commission has used a range of indicators to assess profitability of New Zealand fuel companies. Its results are outlined in its report as follows:

- Import margins have more than doubled since 2008 (refer Figure 3)
- Fuel company returns on new investment have averaged about 20 percent per annum over the past five years – well above the Commission's estimate of a reasonable return (6.9 to 8.6 percent) and the average historic returns made by international comparator companies

- New retail sites often exceed the company's own profitability expectations, with some achieving unusually fast pay back in investment for what are long-lived assets
- Ratios of fuel companies' market value (sale price or sharemarket value) to replacement cost (value of its assets) are approximately 1.5 to 1.8, meaning they are valued significantly higher than their replacement cost. The Commission would expect values closer to 1 in a workably competitive market.

Figure 3: Quarterly regular petrol and diesel importer margin (Real June 2019 prices)



Source: MBIE, copied from Commission Final Report

The Commission acknowledges that each of these measures of profitability has its limitations, but when considered together, they consistently indicate that fuel companies are earning higher profits that what the Commission estimates is a reasonable return.

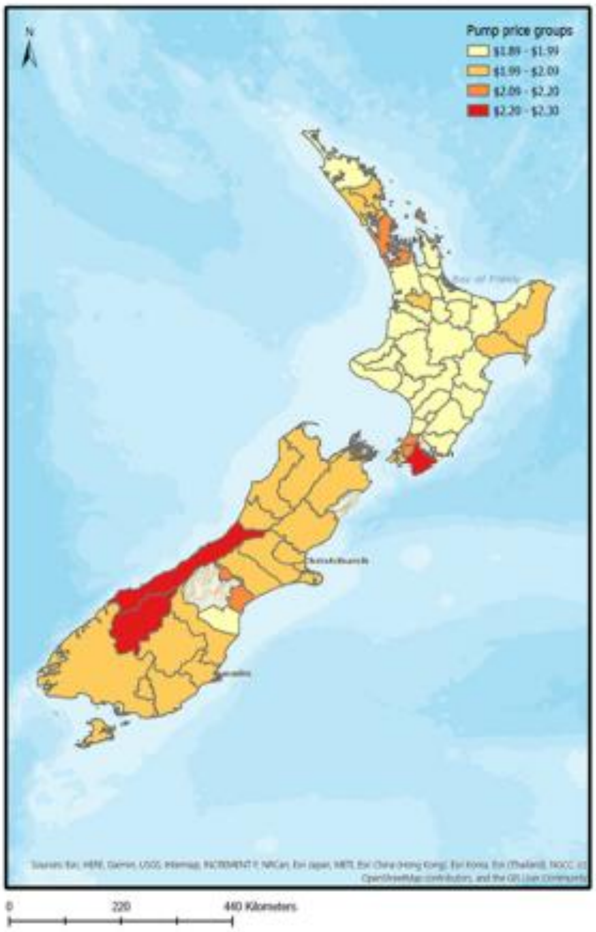
High profits on its own are not an indication that a market is not workably competitive, as it could be a reward for innovation and efficiency. Ordinarily high profits in competitive markets attract new entry and expansion by existing competitors. The Commission notes that, while there has been expansion particularly at the retail level, this does not appear to have materially reduced the profits observed across the fuel industry. While there are some indications that profitability may have peaked, expert commentators and the Commission consider that this period of excess returns has not ended as the underlying competition conditions have not changed.

Regional differences in retail fuel prices not explained by cost differences

There are material differences in retail fuel prices between regions and locations in New Zealand. Figure 4, taken from the Final Report, shows the average retail board prices across New Zealand for regular petrol (2019).

Some of the regional price differences can be explained by differences in taxes (with the regional fuel tax introduced in Auckland) and costs of supply, based on such things as transport costs and lack of economies of scale (eg Westland). However, differences in competitive pressures in the regions and locations may be a better explanation.

Figure 4: Average retail board prices across New Zealand for regular petrol (2019)



Source: The Commerce Commission final report on the retail fuel sector. Analysis of data provided by industry participants.

The three majors have fuel infrastructure that covers the span of New Zealand, including storage terminals at Wellington and South Island ports, and a shipping operation which facilitates the transport of fuel to these ports. This infrastructure allows the majors to serve retailers and stations across New Zealand.

Gull, on the other hand, has a single storage terminal at Mt Maunganui, and its geographical reach is limited to destinations which can feasibly be served by truck from that terminal. This has meant that, until very recently, Gull has not located sites south of Levin in the Manawatu region.

The cost of establishing new terminals is high, and to date Gull has not considered it economic to make the significant investment required to build terminals that would allow the company to expand further south. Part of this calculation is likely to be the additional costs and potentially lower profits involved in serving the smaller, more widely distributed population in these areas, compared to the more densely populated North.

In practice this means that while the three majors face competitive pressure from Gull (and its independent supply of imported refined fuel) across much of the North Island, this pressure is not present in the South Island and Wellington. Currently, the only competition the majors face in southern regions is from each other, and the other retail brands they themselves supply.

Analysis conducted for MBIE has shown that fuel prices in the South and the North Island were roughly similar up until about 2014. However, since then, a significant gap has emerged between the prices paid in the South Island and Wellington, on the one hand, and the rest of the North Island, on the other.

The Commission notes that prices in Wellington and the South Island may reduce in the future if comparatively low-priced retailers expand into those areas and TOSL's entry in Timaru is successful. However, restrictive terms in wholesale supply agreements for distributors and dealers in the South Island, and the limited wholesale supply options for distributors and dealers in the lower North Island, mean that this expansion and new entry may not have a material impact on retail prices without intervention.

Discounting is not a substitute for price competition

Discount and loyalty programmes available in the retail fuel sector have become increasingly common. Many consumers are members of more than one loyalty programme. In 2018, more than 41 percent of petrol and diesel sales were made at a discount to the advertised pump price. This has almost doubled since 2011. The average size of the discounts offered has also increased from 2 cents to 11 cents per litre for petrol and from 2 cents to 16 cents per litre for diesel over this period.

Discounts and loyalty schemes can benefit consumers if they result in lower prices or other benefits. Generally such schemes have the effect of discriminating between price sensitive customers who claim discounts and those that don't. With increasing use of digital technology, such discrimination is likely to become increasingly prevalent in markets. However, the Commission found evidence that discounts were correlated with higher board prices and have increased as margins have increased over the past decade. This suggests that discounting is a poor substitute for price competition.

The concern is that discounts may shift consumers' attention away from the actual price they pay and more on the size of the discount or reward. Some discounts and loyalty schemes have conditions, such as minimum or maximum qualifying purchases or when rewards must be used before they expire. This can make it difficult for consumers to compare post-discount or reward prices between retailers to determine which one is offering the lowest actual price. In such circumstances, consumers are less likely to switch in response to competitive fuel prices and retailers have weaker incentives to offer them.

Increases in premium petrol margins are unrelated to costs

As can be seen in Figure 1, premium (95 octane) petrol prices tend to be about 13 to 15 cents per litre above the price of regular (91 octane) petrol on average after accounting for discounts. The difference was about 7 to 8 cents in 2011. The premium petrol margin has increased faster than for regular petrol.

Pre-tax premium petrol prices in New Zealand have moved from being in the bottom third of OECD countries in 2008 to the most expensive in 2017. While there are differences in how countries report fuel prices to the OECD, the methods used have not significantly altered since 2008, suggesting that New Zealand's dramatic move up the rankings is due to a real shift in our relative position.

There is no obvious reason why the underlying cost of supplying premium petrol to New Zealand, compared to other markets, would have changed so significantly over the last decade. The Commission did not find any corresponding increase in the costs of producing premium petrol that could explain the increasing gap in importer margins between regular and premium petrol.

Retail price competition is less intense than could be expected

Approximately 84 percent of retail fuel is sold through importer owned and operated retail sites or through importer-branded, dealer-owned retail sites. While there are over 20 brands of retail fuel, each brand is closely tied to one of the four importers through typically exclusive and stable contracts.

The entry of an independent importer, Gull, has had a significant impact on retail prices and margins, and explains much of the difference between North Island and South Island and Wellington. In 2015-2016, the price difference between areas where Gull was represented and non-Gull regions were between 10 to 30 cents per litre.

While there has been a growth in the number of retail sites, particularly by the non-majors, the effectiveness of this on price competition is localised. The non-majors primarily operate in low-cost unmanned sites in secondary locations, away from central metropolitan areas. Often the best sites have already been secured by existing suppliers.

Gull and Waitomo are most likely to open new retails sites in close proximity to those of the majors, and this had a material impact on local prices in a third of cases analysed in the Commission's sample (50 new site openings over a five year period to February 2019). The new NPD retail sites in the South Island appear to have the greatest impact on majors' prices (after discounts). However, the Commission notes that this growth in retail sites is largely by distributors that source their supply from Mobil, and therefore, it is vulnerable to changes in strategy by one oil company.

Retail competition is also marked by differentiation in service offerings, such as whether it is manned or unmanned, includes a convenience store, takeaway food, barista coffee toilets and/or a car wash, and the ease of access and convenience of location. This product differentiation, coupled with the growth of discounts and loyalty programmes, weakens competition on price.

2.2 What regulatory systems are already in place?

Fuel markets in New Zealand are subject to generic competition and consumer protection legislation under the Commerce Act 1986, Fair Trading Act 1986 and Consumer Guarantees Act 1993. There is no sector-specific competition regime for fuel.

Competition regulatory system

The Commerce Act is part of the Competition Regulatory System. The purpose of the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand. The Act protects the process of competition, or if competition is limited, provides for regulation for outcomes that are consistent with competition. The main prohibitions applicable to the fuel sector relate to:

- anticompetitive agreements between parties, including cartel agreements that fix prices, restrict output or allocate markets (sections 27 and 30)
- anticompetitive mergers (section 47).

Of note, the Commission has considered cases in the fuel sector:

- Car wash cartel (1999) – the Commission successfully took action against an agreement between oil companies to jointly end a promotion which gave petrol customers a free car wash with every purchase over $20. While the companies had independently priced their fuel, the High Court held that the agreement amounted to price fixing as the car wash promotion was an inseparable part of the price of the petrol.
- Z-Energy's acquisition of the Challenge and Caltex businesses from Chevron New Zealand (2016). This merger reduced the number of importers from five to four. The Commission cleared the merger, subject to the divestment of 19 retail sites. The Commission's role was to assess the likely change in competition attributable to the proposed merger, and not whether fuel prices were too high or whether competition was already impaired.

The Commission's conclusions that competition is not as effective as it could be in the fuel sector, does not indicate that the Commerce Act is not fit for purpose. Rather the addition of the new market study power for the Commission in 2018 has given it an important new tool to promote competition. Under the market study power, the Commission can investigate any factors that may be impacting competition on a sector-wide basis, and identify options to improve competition, not just take enforcement action against anticompetitive conduct by any particular parties.

Consumer and commercial regulatory system

The Fair Trading Act and Consumer Guarantees Acts are part of the Consumer and Commercial Regulatory System, which aims to enable consumers and businesses to transact with confidence. The system helps consumers to:

- access and understand information to inform their purchasing decisions
- be protected from high levels of detriment from actions outside of their control
- access appropriate avenues for redress if their expectations are not me.

A few of the key provisions of the Fair Trading Act include:

- prohibitions against misleading and deceptive conduct
- prohibitions against false or misleading representations, including with respect to price
- specific prohibitions against advertising goods for supply at a price that the person does not intend to offer or offering gifts, prizes or free items in connection with the supply of any goods without the intention of provide these as offered
- restrictions on unfair contract terms in standard form consumer contracts.

The Fair Trading Act applies to the supply of retail fuel and any advertising, discounts or loyalty scheme associated with that supply. The provisions relating to unfair contract terms currently only apply to standard form consumer contracts, however an Amendment Bill is to be introduced to the House shortly which will address unfair commercial practices. This will amend the Fair Trading Act to introduce a new prohibition against unconscionable conduct and extend the restrictions on unfair contracts terms to standard form business contracts with a value below $250,000.

The Commission's concerns in the Final Report related to discount and loyalty schemes and how technology enables greater discrimination in service offerings between customers is a broad issue. The Australian Competition and Consumer Commission (**ACCC**) has recently released a report on the competition and consumer implications of customer loyalty schemes and we will continue to monitor this.

Energy markets regulatory system

MBIE is also responsible for the Energy Markets Regulatory System. This system provides for the effective and efficient operation of energy markets by regulating the allocation of, access to, and standards applying to energy resources and infrastructure in New Zealand.

The key objective of the energy markets regulatory system is, similar to the competition regulatory system, to promote competition and outcomes consistent with workably competitive markets. The system also has objectives relating to reliability and security of supply, access, energy efficiency and renewable energy.

As mentioned, the energy markets regulatory system does not include a sector-specific competition regime. Regulations relate to monitoring and enforcing petrol and diesel quality standards, and a regime for demand restraint in the event of supply shortages.

Following a 2008 New Zealand Petrol Review, MBIE monitors importer margins to promote transparency in retail petrol and diesel pricing. MBIE currently publishes weekly data on inputs into fuel costs, and consequent estimates of fuel importer margins. This data is then made public on MBIE's website, alongside historical data to provide context for the current information. Unlike in other energy sectors such as electricity and gas, there is no statutory requirement for fuel companies to provide MBIE with the data for this monitoring. While some companies do provide data voluntarily, the monitoring regime is largely based on a mixture of data from other sources, both international and domestic.

Fitness-for-purpose of the regulatory systems

MBIE has primary responsibility for maintaining, monitoring, evaluating and improving the three regulatory systems. MBIE is accountable to:

- the Minister of Commerce and Consumer Affairs for the competition and consumer and commercial regulatory system
- the Minister of Energy and Resources for the energy markets regulatory system.

Regulatory charters and systems assessments are publicly available on MBIE's website. The last regulatory system assessments were completed in June 2017, and these are expected to take place every five years. The 2017 system assessments found the regimes to be generally fit for purpose.

2.3 What is the policy problem or opportunity?

The core problem in the counterfactual is the inactive wholesale market

The Final Report concludes, and MBIE agrees, that the main cause of poor outcomes in the retail fuel sector is the lack of an active wholesale market.

The Commission outlines that without an effective wholesale market, competition is largely limited to retail markets, where strong price competition is less likely to occur because the markets are smaller, geographically scattered and retailers have differentiated their service offerings. The absence of wholesale competition increases the costs of fuel for retailers, which then places a floor under retail prices.

Resellers, predominately those supplied by Mobil, can and do offer petrol and diesel prices below the majors and Gull, primarily by offering low cost service offerings like unmanned, pay-at-the-pump sites. However, there is a limit to the price competition they can offer. This is dictated by the wholesale price they pay their suppliers and the individual strategies of the majors.

The Commission identifies two interrelated factors that limit wholesale competition and which are unlikely to change in the counterfactual. These are:

- The cost advantages that the majors have over rivals through their infrastructure sharing arrangements
- Restrictive or dependent wholesale supply relationships that limit competition.

These factors are discussed further below.

Cost advantage of infrastructure sharing arrangements

As mentioned above, the majors jointly own or control the following infrastructure:

- the Marsden Point refinery, which produces approximately 58 percent of the petrol, 85 percent of the jet fuel, and 67 percent of the diesel used in New Zealand.
- the pipeline infrastructure that carries the refinery's products to Auckland for storage and further transmission
- Coastal Oil Logistics Ltd, a shipping venture which transports refined fuel to other ports around New Zealand.

The majors also control the majority of New Zealand's existing fuel storage infrastructure around the country, and the stored fuel is then shared with the others through a system known as a "borrow and loan" arrangement. Figure 5 indicates the location of terminal storage throughout New Zealand.

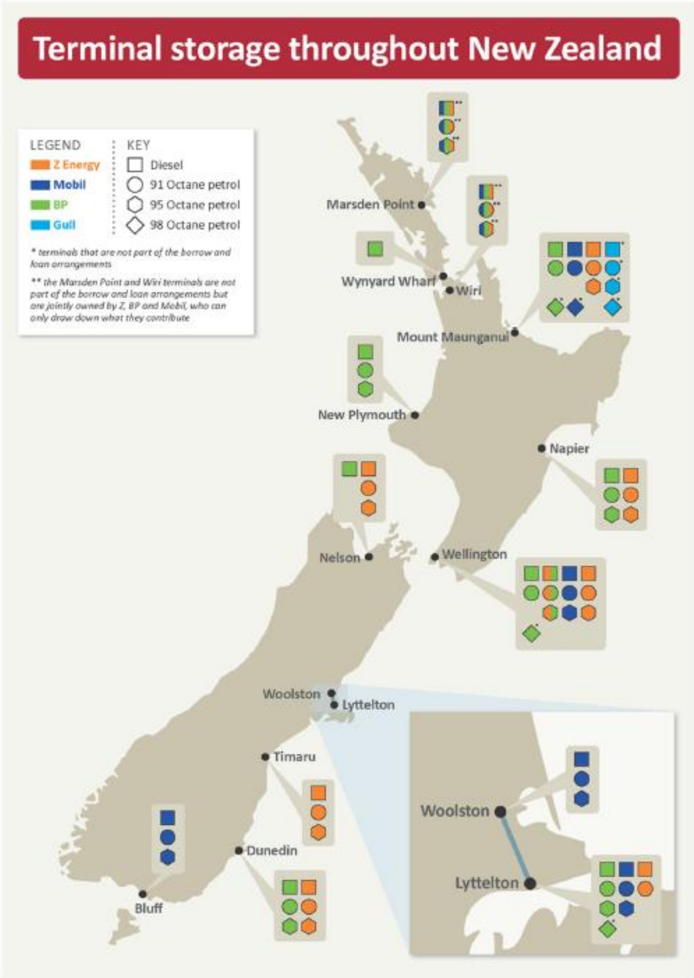
There are strong interrelationships between these infrastructure-sharing arrangements. The scheduling and shipping services provided by Coastal Oil Logistics are critical for the successful distribution of product from the refinery. The shared pipeline from the refinery to Auckland is also critical, given the limited storage capacity at Marsden Point and the need to safely and efficiently convey product to its largest customer base.

The borrow and loan arrangements also provide significant benefits to the majors by:

- avoiding duplication of terminal assets, particularly in relatively low volume and geographically dispersed areas

- enabling majors to compete nationally, particularly in areas where a major does not own its own terminal.
- constraining the exercise of market power in some regions, by the ability of each of the majors to retaliate to high fees for access at one terminal with higher fees at a terminal that it owns.

Figure 5: Terminal storage throughout New Zealand



Source: Commerce Commission analysis of industry participants' data.

In comparison, an existing or potential competitor must import refined fuel and establish a stand-alone supply chain, including owning or accessing independent storage terminals and using trucks for secondary distribution. The relative costs of this are discussed below.

New investment in terminals

The Commission concludes that new investment in terminal storage is possible and there are some indications of underinvestment given tight fuel supply and likely stable demand for fuel for at least the next decade. However, terminals require large capital investments, with high fixed and sunk costs. Access to suitable land at ports able to accommodate fuel tankers (given depth requirements) and the associated resource consents are also required. In addition, significant market share is required to support efficient terminal throughput rates. The Commission concludes that the scale of regional markets, the lack of suitable land and the high sunk costs, is likely to significantly limit the ability of new entrants to build and operate new terminals.

TOSL in Timaru will be an independently owned terminal planned to commence trading by mid-2020. Being in the middle of the South Island, TOSL has the potential to serve regions from Kaikoura to Bluff (including Queenstown). There is also speculation that its parent company, Pacific Energy, may build a new terminal in Tauranga. However, the success of TOSL (or any other new terminals) will depend on it having a sufficient fuel throughput to operate efficiently. This is linked to the discussion of costs of trucking and restrictive wholesale contracts below.

Costs of trucking

Fuel tanker trucks are used to transport fuel from storage terminals to retail sites and commercial customers by road. Despite road transport in New Zealand being generally competitive, the Commission finds that trucking costs over long distances can be significantly higher than transporting fuel via coastal shipping or pipelines.

The Commission has estimated trucking costs based on transporting fuel within one truck driving shift (a distance of up to 500 km). It estimates a range from 1.5 to 2.5 cents per litre for trucking 100 km to 7.5 to 8.5 cents per litre for trucking 500 km. In comparison, the costs of transporting fuel by pipeline and coastal shipping are relatively low:

- the fee for using the refinery to Auckland pipeline is in the order of 1 cent per litre and is calculated by reference to the cost of shipping refined fuel from Marsden Point to Auckland
- the cost of coastal shipping refined fuel from Marsden Point to ports throughout New Zealand varies by port and by fuel type, but the Commission estimates the average costs are within a range of 3 to 4 cents per litre (being the cost of trucking fuel up to 200 km).

Some industry participants have challenged the Commission's analysis. They argue that truck driving shifts are important to efficiently transport fuel. But it is not clear that this would be cheaper if the additional costs of overnight stops at a safe and secure place to park are factored in.

BP also submitted that it is important to focus on total supply costs, and a new entrant with a single terminal may be able to rely on simplicity and scale of importing which outweighs the higher trucking costs. This may be the case when serving regions close to the terminal, and Gull's distribution system seems to supports this. However, we agree with the Commission's analysis that any efficiencies gained by importing to a single terminal are likely to be outweighed by the costs of trucking fuel long distances.

Conclusion on cost advantages

The Commission concludes that the majors' infrastructure sharing arrangements provide a cost advantage compared to any rival importers that need to establish separate stand-alone supply chains. It also refers to a report by Hale & Twomey (2017) that showed that using the Marsden Point refinery and the subsequent distribution infrastructure via the pipeline to Auckland or the coastal shipping venture was more competitive (i.e. cheaper) than the option of importing product to the same locations for all years between 1997 and 2016, except for the period 2012-2014.[2]

Restrictive or dependent wholesale supply relationships

The Commission finds that the wholesale market is characterised by stable and typically

[2] Hale and Twomey, *Independent Review of the Refining NZ Processing Agreement*, April 2017

exclusive supply arrangements with distributors and dealers. Switching at the wholesale level is rare. Distributors and dealers rarely use the same competitive tendering processes used by larger commercial customers. The Commission outlines that this reflects a combination of:

- non-contractual features, which result in the resellers being dependent on their existing suppliers
- restrictive contract terms that make switching difficult.

Non-contractual features

The Commission outlines that a range of non-contractual features may influencing wholesale customers purchasing decisions:

- access to fuel card schemes – commercial fuel card holders are often valuable to retailers and, in turn, the distributors who supply them. The potential loss of fuel card volumes could act as a disincentive to switch to another supplier that does not have a similarly attractive fuel card scheme.
- the location of the distributors' retail sites – distributors often have retail sites that complement their long-standing supplier's retail network, rather than competing directly with them. The location of their retail sites may mean that they would not get a better wholesale price from an alternative supplier who they may then be competing against at the retail level.
- security of supply – supply risk associated with port coordination events or shortages may also be a factor influencing distributors purchasing decisions. For example, a distributor may be concerned that a major may prioritise supply to loyal distributors, particularly those that have retail sites that complementary to their own, rather than new wholesale customers.

Restrictive contract terms

There are terms in wholesale supply agreements between the importers and distributors or dealers that are overly restrictive and inconsistent with what would be expected in a workably competitive market. These agreements:

- are typically exclusive – exclusivity may be justified if it is required to protect the investments or intellectual property of the supplier, but without such justification, these terms may unreasonably impede competition
- commonly have long durations – many contracts were for terms of 10 to 15 years, and in some cases much longer, which is significantly longer than similar supply contracts with commercial customers
- sometimes tie wholesale prices to retail prices or are unclear on the methodology for calculating wholesale prices, and typically provide the majors with the ability to unilaterally change wholesale prices, making it difficult to compare offers between suppliers
- include other contract terms, such as 'first right of renewal' and restraint of trade provisions, which reduce the ability of the distributor or dealer to switch supplier.

Consequences of the lack of an active wholesale market

The combined effect of infrastructure sharing arrangements and restrictive supply relationships is to prevent rival fuel importers from entering the market or competing more vigorously against the majors.

Rival importers do not have the ability to match the majors' comparatively low cost of production and distribution, and on entering New Zealand would find it difficult to attract wholesale customers that are not contractually bound under existing restrictive arrangements. For example, Gull does not import fuel into the South Island and it is not party to any of the infrastructure sharing arrangements. Gull has recently opened its first South Island retail site and plans to open six more over the next two years. However, its ability to expand and compete in the South Island depends on it securing competitive wholesale supply arrangements.

Distributors and dealers lack transparent information about wholesale prices in order to negotiate competitive supply, and may become dependent on their suppliers. As part of the Commission's market study, almost all industry participants emphasised the value of freedom of contract and the ability to negotiate terms of supply that best meet their needs. However, some dealers, and most distributors, were concerned about feeling unable to negotiate terms that provided greater price transparency and better enabled them to assess supply options and switch supply if they chose to do so.

The consequences of this are:

- independent importers face barriers to entry or expansion as there are few wholesale customers actively looking for new supply opportunities
- competition between existing wholesale suppliers is reduced because many dealers and distributors face barriers to switching
- it is difficult for distributors and dealers to obtain competitive wholesale supply as they may lack bargaining power and transparent pricing information
- wholesale prices appear higher that would be expected and this flows through to retail pricing.

Weak incentives for the majors to compete with each other

The majors have limited incentives to compete strongly against each other on price at either the wholesale or retail level. The reasons for this are:

- the sector is vulnerable to coordinated conduct
- particular provisions of the infrastructure sharing arrangements may limit or soften competition.

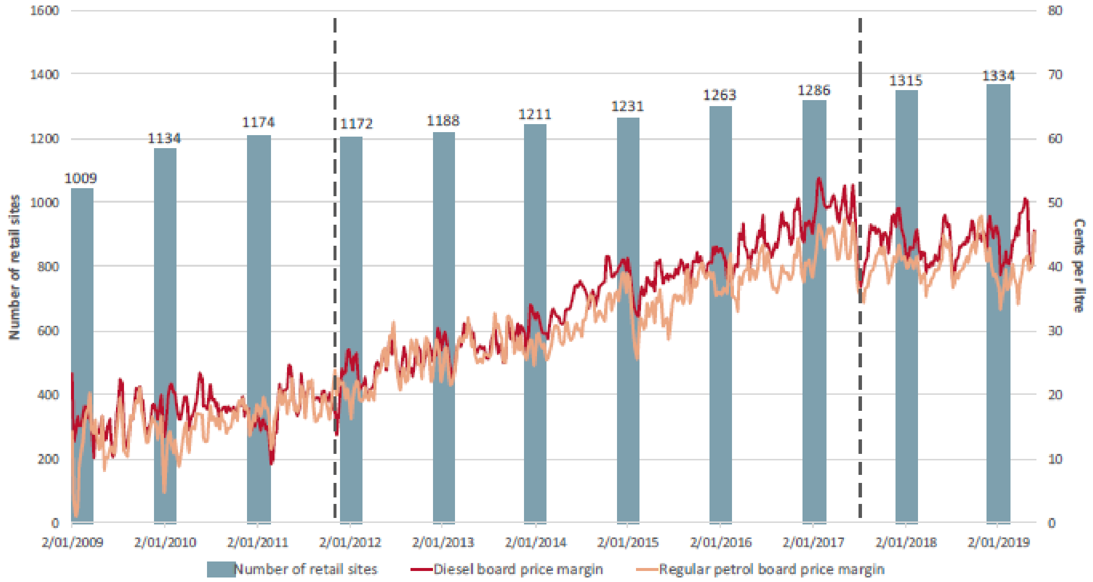
This is discussed further below.

Vulnerability to accommodating behaviour

The retail fuel market has a number of features that make it vulnerable to accommodating behaviour, such as fuel being a largely homogenous product, high levels of vertical and horizontal integration, and high barriers to entry at the wholesale level.

For example, after Shell exited the market in 2010, Z Energy publicly stated its intention to increase fuel margins which were widely considered to be unsustainable and insufficient to attract investment. Between 2012 and 2017, Z Energy published its Main Port Price (MPP) – the price that is used at most Z Energy's retail sites in the South Island and lower North Island. Figure 6 shows the average national board price margins of diesel and regular petrol respectively, and the number of retail sites, over the past decade. The time period during which Z Energy published the MPP is indicated by the black vertical lines. Z Energy ceased publishing the daily MPP in July 2017 following MBIE's review of the fuel industry.

Figure 6: Average weekly national board price margins and number of retail sites (Jan 2009 to May 2019)



Source: Commission analysis of MBIE data and information provided by industry participants.[6]

Despite an increase in the number of retail sites since 2012, it appears that average margins increased during the period when the daily MPP was published and have levelled off or decreased since publication ceased. There may be other explanations for this, but it would be consistent with an outcome where MPP was being used as a reference point for market prices.

Measures to improve competition at the wholesale and retail levels should reduce their vulnerability to accommodating behaviour. However, this should continue to be monitored.

Impact of infrastructure sharing arrangements

Infrastructure sharing arrangements may be weakening incentives for competition between the majors in a number of ways:

- The allocation of the refinery's capacity between the majors based on a three-year average of their retail market share by product may constrain their ability to cost-effectively increase supply in the short term. If a major wants to grow its market share, it would initially need to import more refined fuel to meet increased demand. This is likely to lead to a cost disadvantage in the short term, particularly in the Auckland market which received fuel directly from the refinery via the pipeline. This may reduce the ability and incentive to compete for new business, therefore softening competition between them.
- The borrow and loan arrangements and tight supply situation at certain ports may also limit competition between the majors at the wholesale level. First, the benefits of investing in a new terminal and expanding their capacity may not be fully captured by the party undertaking the investment, with some of the benefits shared by others who can withdraw product from the terminal. Second, the formulas used to ration fuel during port coordination events reduce the ability and incentive of the majors to compete for additional contracts because it reduces their ability to cost-effectively increase supply.
- The refinery arrangements could facilitate accommodating behaviour between the majors. In particular, the information exchange via the refinery's Technical Committee during the annual allocation procedure may provide a degree of transparency that could unnecessarily affect competition. This includes the majors sharing information on monthly

national volumes by various categories of retail fuel (including by customer type). While some coordination is desirable for the efficient operation of the refinery, these efficiencies should be able to be achieved through the exchange of less sensitive information.
- Similarly, information shared between the majors to enable the coastal shipping joint venture arrangements could facilitate accommodating behaviour. This information includes competitors' volumes and demand information. While some information sharing is necessary for the efficient operation of the coast shipping arrangements, these efficiencies could still be achieved with less risk for competition.

Consumers lack clear information to compare prices

When consumers have access to information about competing offers, they can make better decisions about their purchasing options. In the earlier part of this RIS, we outlined the Commission's findings that discount and loyalty schemes may focus consumers' attention on the size of the discounts and not necessarily the cheapest fuel available. These schemes may also make it more difficult to make choices between retailers.

With new technology, more information is being provided to consumers to inform them about fuel offers. This includes

- Real-time pricing through apps, such as Gaspy
- Price boards on the roadside of most retail sites with different strategies for displaying fuel prices and their discount or loyalty scheme offers.

Industry practices with display or information are evolving. There is a risk that some information on price boards or signs outside retail outlets that advertised discounts could risk misleading consumers, or at worst, act as a form of bait advertising. Alternatively, access to some real-time retail price information could be used by the industry to facilitate accommodating behaviour. These practices will continue to be monitored and further intervention could be considered in the future.

The Commission identified two particular areas where there were clear opportunities to improve the information to consumers:

- Many retail sites do not include the price of premium petrol on price boards. Consumers must drive on to the forecourt before they can see the price at the pump, at which point they may feel they have already made a commitment to purchase. The margins on premium petrol are higher and growing at a faster rate than other grades of fuel. Posting of premium petrol prices on price boards would make it easier for a driver to compare prices and make a decision about whether to purchase at the site.
- Some car owners may be filling up with premium petrol when regular would do. Approximately 23% of petrol sold is premium, and this is high relative to the models of cars on the road (eg many Japanese imported cars would run on regular petrol). Some car manufacturers provide this information to car owners, however potentially this could be improved.

Improved monitoring is desirable

The Commission notes that they encountered some constraints in obtaining the information they sought in conducting the market study, even with the power to compel the production of information.

This echoes the experience from previous attempts to analyse sector profitability. For example, the information sought is sometimes not available because it has never been collected, or has been destroyed/not retained; because it is held offshore and its production cannot legally be compelled in New Zealand; because it has been prepared in accordance with different standards, making it difficult to compare with others; or because it is held in systems that make it difficult to access at a reasonable cost.

MBIE's monitoring regime could also be improved. The availability of higher quality information than that currently available would allow for more timely, accurate and cost-effective analysis or intervention.

2.4 Are there any constraints on the scope for decision making?

The timing of decisions has been a constraint on the scope of analysis of options and decision-making. The Government has directed MBIE to have legislation prepared and passed by the middle of 2020. This has meant that MBIE is heavily reliant on the analysis carried out by, and recommended proposals of, the Commission in its Final Report. However, the Commission is an independent and expert competition body, so we are confident in the quality of its findings.

This RIS sets out a high-level framework for assessing the options and regulatory approach for the purposes of informing an 'in principle' agreement by Government to proceed on the basis of the preferred proposals. The details of these proposals will be fleshed out further as work proceeds, including as part of developing the necessary legislation and associated regulations for an Industry Code.

The proposals relating to restrictive contract terms have some interdependencies with other reforms underway.

- A new Fair Trading (Unfair Commercial Practices) Amendment Bill will be introduced to the House shortly which will provide new provisions dealing with unfair commercial contract terms. Those reforms are aimed at unconscionable conduct or unfair commercial contracts having a value of less than $250,000, which is unlikely to relate to most distributor or dealer fuel supply contracts.
- A current review of the Commerce Act is looking at strengthening deterrence to anticompetitive covenants on land. The Commission identified restrictive covenants as being a barrier to competition by preventing future use of desirable sites by other fuel retailers. This matter will be considered as part of that review.

2.5 What do stakeholders think?

Stakeholders

As part of the Commission’s market study many of the below stakeholders participated in consultation ahead of the final report being released, with the exception of the dealers and some of the distributors whom have fewer retails sites.

Fuel companies

- *Importers:* Z Energy, Mobil, and BP are the three ‘majors’ and Gull also imports fuel and operates retails sites.
- *Distributors:* Gasoline Alley, Allied Petroleum, Waitomo, NPD, RD Petroleum, Challenge, McKeown, South Fuels, and McFall.
- *Dealers:* Independent operators of retail sites that are branded under one of the importers’ or distributors’ brands.

Other fuel associated stakeholders

- Refining NZ – the operators of the Marsden Point refinery, which produces approximately 58 percent of the petrol and 67 percent of the diesel used in New Zealand.
- Motor Trade Association is the main automotive industry body in New Zealand whose members include fuel retailers (primarily dealers).

Consumer stakeholders

- Business NZ – New Zealand’s largest business advocacy body.
- Automobile Association (AA).
- Gaspy – an independent app that allows consumers to see fuel prices at retail outlets across the country.

Stakeholders views of the problem

The majority of stakeholders agree that New Zealanders are better off when markets work well and consumers and businesses are confident market participants. In particular Gull, the MTA and Gaspy share the Commission’s and MBIE’s view that the main cause of poor outcomes in the retail fuel sector is the lack of an active wholesale market in New Zealand. Gull, Gaspy, the MTA, the AA and Waitomo all welcome initiatives that increase competition in the wholesale fuel market.

The majority of the importers (Z Energy, Mobil and BP) consider that the New Zealand retail fuel market is workably competitive and already serves the consumers well. BP does not consider that material intervention is warranted and is concerned that interventions have a risk of unintended consequences.

A more detailed summary of stakeholders’ views can be found in 5.1.

Consultation

The Commission conducted multiple rounds of consultation as part of their market study including hosting a consultation conference. The consultation was open to the wider public. There will be opportunities for further consultation as MBIE develops the detail of the proposals and through the legislative process.

Section 3: Options identification

3.1 What options are available to address the problem?

Summary of options

To address the problems above, MBIE is considering the following options as recommended by the Commission:

Improving wholesale competition for fuel

- **Option 1**: Introduce a terminal gate pricing regime
- **Option 2**: Change wholesale supply contracts
- **Option 3**: Improve information on infrastructure sharing arrangements
- **Option 4**: Review infrastructure sharing arrangements
- **Option 5**: Adopt an enforceable industry code of conduct

Facilitating informed consumer choice

- **Option 6**: Improve transparency of premium fuel prices
- **Option 7**: Improve information on when premium fuel should be used
- **Option 8**: Monitor the display of discount pricing on price boards

Improving monitoring of the fuel market

- **Option 9**: Improve information and recordkeeping

Other recommendations for the fuel industry

- **Option 10**: Change the information sharing arrangements for the Coastal Oil Logistics Ltd joint venture and refinery capacity allocation to reduce the potential for coordination (relates to Commission recommendations 10 and 11).

The following section is a high level assessment of these options for the purposes of informing Cabinet's in-principle decisions. MBIE will continue to refine this analysis as it carries out further work prior to the final policy decisions.

Options to improve wholesale competition for fuel

Option 1: Introduce a terminal gate pricing regime

A terminal gate pricing regime requires wholesale suppliers to post a price at which they will sell fuel to wholesale customers at storage terminals on a spot basis. The terminal gate price is quoted for fuel only and includes no added services, such as delivery. A terminal gate pricing regime has been implemented in Australia through regulations providing for an Oil Code.

The Australian regime requires that wholesale suppliers must not unreasonably refuse to supply any customer who requests supply at the terminal gate. However, supply is not required if:

- There are reasonable grounds to believe the customer is unable to pay, or will not comply with relevant health and safety requirements
- The supplier does not have sufficient supplies to reasonably meet the customer's requirements.

A New Zealand terminal gate pricing regime would need to take into account the different characteristics of New Zealand fuel markets and, in particular, New Zealand's infrastructure sharing arrangements.

Some features that would be explored for a New Zealand terminal gate pricing regime include:

- Standard terms and conditions for terminal gate sales should be set, including credit and safety conditions, what taxes or costs can be included in a terminal gate price, and how terminal gate prices are published
- It should apply to all wholesale suppliers who have a right to draw product from terminals or equivalent facilities
- Unlike the Australian regime, a new requirement should be imposed on suppliers to make a certain minimum volume of fuel available for spot sales and such spot sales (and sales to distributors under term contracts) would take priority over own supply in the event of a port coordination event or shortage (a 'must supply' obligation).

A regulatory backstop would be developed that could be brought into force if the terminal gate pricing regime does not deliver competitive terminal gate pricing within a reasonable period of time.

Further work is required on the design of this regime, but it may be:

- A binding arbitration system that could provide for price or terms of supply to be set for a supplier who has unreasonably failed to comply with the terminal gate pricing regime. For example, this could apply if there were repeated instances of non-supply at a terminal gate or if terminal gate prices were consistently set well above cost at a terminal
- A default regulatory regime could be made available to price regulate a specific terminal or terminals where a wholesale supplier has market power, or competitive outcomes are not being observed. Options may include determining prices based on:
    - An industry benchmark, such as Mean of Platts Singapore (or MOPS) plus a regulated margin
    - A benchmark price, based on a demonstrably competitive price observed at another port, adjusted to reflect any difference in cost associated with transporting fuel to the regulated terminal.

How would this option address the problem?

A terminal gate pricing regime would improve access to pricing information for buyers in the wholesale market and allow them to switch fuel suppliers should they chose to. The ability of buyers to purchase from a different supplier at the terminal gate depending on price should improve competition and transparency of pricing in wholesale contracts.

Experience from Australia shows that very few actual sales occur at terminal gate prices. However, the terminal gate price provides a useful reference point that could act as a discipline on other bilateral negotiations. If combined with a "must supply" obligation of the kind described above it could also stimulate a spot market that would support new entry.

The regulatory backstop is desirable to guard against the risk that the majors post terminal gate prices that incorporate a return on market power. The risk of this will be higher, the fewer the number of suppliers at a port. Ideally the mere threat of a regulatory backstop would be sufficient to deter this behaviour.

How would this option achieve the objective?

A terminal gate pricing regime is likely to help improve competition by:

- Creating the potential for a liquid wholesale spot market to develop
- Lowering barriers to entry and expansion for both importers and distributors
- Providing greater pricing transparency for distributors
- Providing competitive benchmark information for industry and government.

The regime achieves the objectives in a proportionate manner and at least cost to industry and regulators. It is supported by the threat of more heavy-handed regulation through the regulatory backstop if competition does not emerge in a timely manner.

Option 2: Change wholesale supply contracts

Regulations would be made to limit the use of certain terms in wholesale supply contracts. In particular:

- All wholesale supply contracts should be written in clear and concise language, and should include a transparent cost-based pricing methodology.
- Wholesale supply contracts with distributors should permit the distributor to take a prescribed minimum percentage of their fuel from other suppliers (eg at least 20% of supply).
- Distributors should not be committed to wholesale supply contracts exceeding a prescribed maximum period (suggested not longer than five years) without a right to terminate on notice, unless a longer term is reasonably necessary for relationship specific investment to occur.
- All wholesale supply contracts should be regulated to prevent unjustifiable limitations on the ability of distributors and dealers to compete.

The regulations could prohibit certain terms in wholesale contracts or provide some minimum contractual terms that the wholesaler must agree to if an independent distributor or independent retailer requests to use it. These provisions could also include dispute resolution provisions whereby parties could resolve disputes, including in relation to price. A transitional period would be specified by which time existing contracts would be required to be renegotiated to be consistent with the new regime.

How would this option address the problem?

Limiting the use of restrictive terms in wholesale supply contracts will enable distributors and dealers more freedom to contract with wholesale suppliers and switch if desired. Greater transparency around the wholesale pricing and the use of cost-based pricing methodologies will improve the ability of distributors and dealers to both obtain better prices at the wholesale level, and compete with the majors at the retail level.

How would this option achieve the objective?

Enabling non-exclusive supply and shorter term contracts for distributors will lower barriers to entry and expansion by importers, and when coupled with the terminal gate pricing regime, would enable distributors and dealers to shop around for better deals.

Option 3: Improve information on infrastructure sharing arrangements

This option proposes that the majors be invited to publish their process and criteria for considering applications to participate in their infrastructure sharing arrangements, including the coastal shipping and pipeline distribution arrangements and borrow and loan scheme.

Rather than regulating to enable access seekers to participate in the majors' infrastructure sharing arrangements, non-regulatory options should be explored in the first instance. The infrastructure sharing arrangements are complex and provide efficiency benefits to the participants. Regulated access could impose significant costs on the parties and does not bring any significant benefits over and above the terminal gate pricing regime outlined in Option 1. However, there would be benefits in the parties being more transparent about how access seekers can participate in the infrastructure sharing arrangements. To effectively promote competition, the access terms would be expected to be non-discriminatory.

How would this option address the problem?

This option would make transparent how access seekers may participate in infrastructure sharing arrangements. We anticipate that the terminal gate pricing regime would be the primary mechanism that would facilitate access to a nationwide supply network. If an active wholesale market develops, many of the cost advantages of the shared infrastructure network would be passed on to purchasers at the terminal gate price. However, this option provides additional information for independent importers that could assist them in making decisions on developing a nationwide distribution network.

How would this option achieve the objective?

Facilitating wider participation for independent importers in the majors' shared infrastructure, notably port terminals and the associated logistics in the borrow and loan (B&L) system will promote competition. The proposal is voluntary for the parties and, therefore it is lower cost. Further regulation may be considered in the future if an active wholesale market does not develop in a timely manner.

Option 4: Review infrastructure sharing arrangements

The borrow and loan arrangements currently appear to be deterring investment in terminal infrastructure and causing some tension between the majors. The proposed terminal gate pricing regime will address most of the concerns relating to wholesale competition, but there are risks that that regime could impact on incentives to invest in terminal storage. Therefore, it is desirable that the majors look at this in association with the introduction of that regime.

This proposal is a non-regulatory option. The majors would be invited to consider whether current rules or features of the borrow or loan arrangements may disincentivise investment. In looking at this arrangements, the majors should note:

- That fact that not all benefits of investing in new terminals are captured by the party undertaking the investment
- That costs associated with failing to maintain terminals, such as increased shipping and/or trucking costs, are not fully borne by the terminal owner
- Rules which require majors to maintain stock in line with relative contributions to tankage rather than market shares, which may deter incremental investment in terminal infrastructure
- Rules which dictate that fuel is allocated according to port market shares during port coordination events, meaning majors may be insulated from the risk of losing customers during such events.

How would this option address the problem?

Current terminal storage leads to a 'just in time' supply chain that regularly leads to requirements for coordination between the majors in supply. The tight supply arrangements can undermine security of supply and create uncertainty for distributors considering switching suppliers or for the majors seeking new customers thereby impeding competition. Lack of resilience in the supply chain also imposes costs on consumers. This option would complement the proposal to explore a new terminal gate pricing regime in Option 1. It would guard against the risk that those arrangements may undermine incentives to invest in terminal storage.

How would this option achieve the objective?

This option would ensure that majors are rewarded for expanding market share through access to the more cost effective refinery fuel and infrastructure-sharing arrangements that are more reflective of their current market shares.

Option 5: Adopt an enforceable industry code of conduct

The Commission recommends that options 1 to 4 should be given effect in a mandatory industry code, similar to the Australian Oil Code (recommendation 5 in the Final Report).

This option would have the following features:

- The code should apply to all relevant participants, and clearly identify who the participants are
- The code should include a dispute resolution scheme that is accessible, of appropriate scope, affordable, independent of industry participants and effective.
- Monitoring of compliance with the code will be essential and would include:
    - Identifying an agency responsible for investigations and enforcement action
    - Imposition of sufficiently broad recordkeeping obligations (as outlined in option 9 below)
    - Ensuring the agency is adequately resourced and has appropriate information gathering powers
- Have a suitable transition period to allow the new provisions relating to changing wholesale supply contracts to come into force (as outlined in option 2)
- There should be periodic reviews of the effectiveness of the code, with the ability to amend it if any matters are not working well or new regulation is desirable. This is discussed further in Section 7 of the RIS.

We consider that the adoption of an enforceable industry code of conduct is the means by which the other options for mandatory regulation outlined in this RIS would be given effect. That is, the Government would introduce a new Bill which would provide for the making of regulations to make an industry code to deal with matters such as terminal gate pricing. As such this option does not stand-alone, and we have not separately considered its impact further.

Options to facilitate informed consumer choice

Option 6: Improve transparency of premium fuel prices

The Government should make regulations to require retail sites to display premium petrol prices on price boards to better enable consumers to compare available prices. Currently the industry practice is only to display prices for regular 91 octane petrol and diesel. However, consumers are very sensitive to slight changes in prices on price boards. Displaying the premium petrol price would allow consumers to make informed choices before the drive onto the forecourt.

How would this option address the problem?

A lack of transparency regarding the pricing of premium petrol has led to unexplained higher margins. In particular, the price of premium petrol is typically not advertised on roadside price boards, making it difficult for consumers to compare prices and weakening price competition.

How would this option achieve the objective?

Transparency of premium petrol prices will make it easier for consumers to compare prices and shop around.

Option 7: Improve information on when premium fuel should be used

The Government should require car manufacturers or importers to include a sticker on the fuel cap specifying the fuel grade for that vehicle. This will ensure that the information is readily available at the point that consumers intend to fill their vehicle with fuel. It ensures that all users of the car have easy access to the information.

How would this option address the problem?

This option would address the concern that some consumers are purchasing premium petrol when regular petrol would be sufficient for their car. In such cases, they are spending more than they need too. There may also be cases where consumers are purchasing regular petrol when their vehicle needs premium petrol. In such cases, they risk causing damage to their car. Better information would reduce these risks.

However, the regime may be difficult to easily bring into effect. Requirements could be made to apply to new imports, but considerable further work is required on how this option might apply to existing cars.

How would this option achieve the objective?

Some additional consumers would have easy access to information about the petrol grade suitable for their vehicle. However, MBIE is not sure that this option would promote competition or if this intervention is proportionate to the problem.

Option 8: Monitor the display of discount pricing on price boards

The display of prices on price boards that consumers can pay if they participate in a retailer's discount and loyalty programme is evolving. Some fuel retailers, including Z Energy and BP, are starting to display discounted prices along with minimum and maximum purchase terms. The impact of this practice on consumers is unclear. The practice may also cease if premium petrol prices are required to be displayed on price boards, as per Option 7.

This proposal is for MBIE and the Commission to monitor the development of this practice, and whether it is impeding competition. Regulation could be considered in the future if the practice is likely to lead to consumer harm.

How would this option address the problem?

This option would address an information gap and inform officials as to whether the practice of displaying discount pricing is causing consumer detriment or impeding competition. If detriment is found, the Commission make take enforcement action under the Fair Trading Act, or MBIE may recommend further regulator intervention.

How would this option achieve the objective?

This option would enable regulators and the government to act quickly if consumer detriment and impediments to competition are identified.

Options to improve monitoring of the fuel market

Option 9: Improve information and recordkeeping

This option is for regulations relating to information as follows:

- To require certain information to be collected by the fuel companies and retained in New Zealand for a period of time to assist meaningful market analysis.
- To require certain information to be disclosed to assist with monitoring the effectiveness of the terminal gate pricing regime and regulation of wholesale supply contracts.
- To require certain information to be disclosed to enhance MBIE's monitoring of importer margins and the competitiveness of the retail fuel sector.

The monitoring regime could be undertaken by MBIE or the Commission, depending on the purpose for its collection and which agency is best placed to carry out that function. There would be offences for providing false information or failure to collect, retain or disclose the specified information.

How would this option address the problem?

A statutory regime for recordkeeping and information disclosure will ensure that sufficient information is available in a standard form to enable comparison and analysis.

How this option would achieve the objective?

If higher quality information is held by the industry or government, this will likely improve the timeliness, cost and accuracy of any future study or regulation intervention. This fact of greater monitoring and transparency about the performance of the fuel sector should also act as a deterrent to some industry conduct that may harm competition and consumers.

Other options to reduce coordination in the fuel industry

Option 10: Review information sharing about the infrastructure sharing arrangements to reduce the potential for coordination

The infrastructure sharing arrangements require a high level of coordination to ensure their efficient operation. This option relates to recommendations 10 and 11 in the Commission's Final Report. It proposes that the majors review the arrangements for information sharing for operation of the Marsden Point refinery and coastal shipping joint venture to ensure that the minimum information necessary is shared to achieve the objectives of the arrangements, and that the information is not used for other purposes, such as to facilitate accommodating behaviour in the retail fuel market.

This proposal is also a non-regulatory option. The majors have expressed a willingness to undertake this review and so regulation is not considered necessary at this time.

How would this option address the problem?

This option would guard against sensitive information being used to facilitate accommodating behaviour in downstream retail fuel markets.

How would this option achieve the objective?

In reviewing the information shared, the majors would ensure that the shared infrastructure sharing arrangements continue to operate efficiently and effectively.

MBIE comment on options

The options identified have been recommended by the Commission after taking into account submissions received in the course of the Retail Fuel Market Study.

The options are interrelated:

- Options 1, 2, 3, 4, 5 and 10 work together to promote an active wholesale fuel market. An effective terminal gate pricing regime requires that distributors and dealers are not restrained by restrictive terms in wholesale supply contracts so that they can take advantage of increased transparency of wholesale fuel prices and opportunities to shop around. The regulatory backstop in Option 1 and the review of impacts of the infrastructure sharing arrangements on investment by the majors in Option 4 are both designed to mitigate some risks of the terminal gate pricing regime. The new monitoring regime in Option 10 ensures that officials are well informed about how the terminal gate pricing regime is working and are able to respond quickly to amend the Industry Code (as recommended in Option 5 if problems are identified.

- Options 6 and 8 work together to assess how price board displays impact on competition and consumer choice. Given that many of the fuel companies were concerned about limited space on price boards, a recommendation to introduce premium petrol prices on price boards may crowd out display of some discounted prices which are of concern.

While the options are interrelated, further work is required to determine if the options should be implemented as a package or if implementation could be phased. For example, a regulatory backstop may not be required to be implemented at the same time as the introduction of a terminal gate pricing regime if the fuel companies are aware that such a regulatory backstop is a real possibility. MBIE is not convinced that Option 7 regarding introduction of mandatory fuel cap stickers in cars should be introduced.

The options are a mix of non-regulatory and regulatory proposals. The options are selected on the basis of being assumed to be proportionate to the problem identified and imposing low compliance and regulatory costs. Regulatory options are considered where voluntary action is unlikely to address the problem or achieve the objectives. For example, some proposals would require coordination between the majors which may put them at risk under the Commerce Act if carried out on a voluntary basis. In other cases, regulation is required as the private interests of the parties may not be aligned with the public interest.

Wherever possible the experience from other countries, particularly Australia, has been considered in the development of these options. For example, Australia has long experience with an Oil Code for a terminal gate pricing regime, which has been evaluated and found to be a successful low cost mechanism to facilitate competition in the wholesale fuel market.

Many Australian States have also introduced regulations requiring the display of premium petrol prices on price boards and banning discounted prices; however we are not aware of any evaluation of these reforms at this time. We will continue to draw from international experience as we carry out further work on the options.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

- *Comment on relationships between the criteria, for example where meeting one criterion can only be achieved at the expense of another (trade-offs)*

Our overall objective is to promote the efficient and effective operation of markets in the fuel sector through the promotion of competition for the long-term benefit of consumers.

To achieve this objective, we have identified some criteria:

1. Enable the competitive process to work well
2. Encourages efficient storage and distribution of fuel to meet consumers' needs
3. Enables consumers to make informed purchasing decisions
4. Regulatory options are proportionate to the harms identified
5. Minimise the risk of regulatory error.

3.3 What other options have been ruled out of scope, or not considered, and why?

A range of other regulatory interventions have not been considered.

As part of its Draft Report for the Retail Fuel Market Study, the Commission considered a range of more heavy-handed regulatory interventions that have been used overseas to promote competition in the fuel sector. Such options included:

- Forced divestment of terminal assets with regulated terms and conditions
- Requiring structural separation by vertically integrated suppliers of their wholesale and retail businesses
- Regulating access to the majors' shared infrastructure, such as the pipelines, coastal shipping and borrow and loan scheme
- Limiting the number of company-owned retail sites, such as up to 40 percent of total sites.

However, following consultation with stakeholders on the Draft Report, these options were discarded as the costs of intervention were likely to exceed the benefits. In particular, the Commission did not recommend regulating access to the shared infrastructure arrangements given the risk of unintended consequences and that distributors stated they were unlikely to seek to participate in these arrangements in the short to medium term. These options could be considered in a future review of the Oil Code if competition does not develop in a timely manner.

Oher options were discarded as they could have implications that were wider than the fuel sector and we have not fully considered the generic nature of the problem and its impacts. For example, one of the problems identified in the fuel sector is the risk of accommodating behaviour that weakens competition. Australia has amended its competition law to include a generic prohibition against concerted practices that substantially lessen competition. We will continue to assess the case for this generic intervention.

Other options were discarded as they could have unforeseen consequences. For example, the Commission considered the option of promoting real-time price disclosure to inform consumers' purchasing decisions. With consumers increasing use of technology and apps, a price comparison website could provide real-time information to assist consumers in finding the best deals. However, this option was not considered as international experience has shown that real-time price disclosure could be used by the industry to facilitate accommodating behaviour. The fuel sector appears to be particularly vulnerable to this practice. We will continue to monitor the voluntary use of these price comparison websites.

Section 4: Impact Analysis (indicative only)

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

MBIE will continue to assess the options and refine its impact analysis prior to final decision-making by Cabinet.

		Stimulate wholesale competition				Improve consumer information			Monitoring	
	No action	**Option 1**	**Option 2**	**Option 3**	**Option 4**	**Option 6**	**Option 7**	**Option 8**	**Option 9**	**Option 10**
		Terminal gate pricing	Limit restrictive contract terms	Publish access arrangements	Review infrastructure sharing	Display premium petrol prices	Require fuel stickers on caps	Monitor discounting practices	Enhance monitoring regime	Review information sharing
Promote competition	**0**	++	++	++	++	++	0	0	++	++
Efficient fuel supply chain	**0**	++	+	+	+	0	0	0	+	++
Consumers well informed	**0**	0	0	0	0	++	++	0	++	0
Proportionate regulation	**0**	++	+	+	++	++	0	0	++	+
Minimise regulatory error	**0**	+	+	+	++	+	+	0	++	++
Overall assessment	0	7	5	6	7	7	3	0	9	7

Key:

++ much better than doing nothing/the status quo

\+ better than doing nothing/the status quo

0 about the same as doing nothing/the status quo

\- worse than doing nothing/the status quo

\- - much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
We recommend that the options identified by the Commission should be approved in principle, subject to further work on the detail and reporting back. This package of measures is aimed at promoting competition in the wholesale fuel market by the most effective and low cost means. These measures are a significant improvement on the counterfactual. **Stakeholder views on options** The package of measures is generally supported by the fuel companies. The following themes have been gathered from the Commission's consultation process (detailed in 2.5). These opinions were taken into account by the Commission in their final recommendations. *Stimulate wholesale markets* • There is broad support for the introduction of a terminal gate pricing regime based on the Australian model. • There are mixed views on the need for changes to wholesale contract terms. The smaller industry participants welcome any changes that could give them greater ability to test the market ahead of signing any supply contracts. The majors disagree with the need for the full range of changes recommended by the Commission, and believe that the market is working well, but are willing to make some changes. • The few stakeholders that have commented on a regulatory backstop do not see the need for one. Mobil doesn't support the need for an Industry Code, viewing it as unfeasibly complex. However, this is a minority view and many participants support the development of an Industry Code. • Gull, the most likely benefactor of easier terms for access to the shared infrastructure, has indicated that it does not want to participate in the majors' borrow and loan arrangements, preferring the simplicity of the proposed terminal gate pricing regime. The majors have not directly expressed views on publishing the access criteria. *Limit coordination* • The majors dispute that there is a disincentive to invest in infrastructure. • There is general support from the majors to limit information sharing and change the refinery allocation mechanism. *Improve consumer information* • Many retail fuel market participants accept the premise for displaying premium fuel prices on price boards but note that the cost of making this change will likely be passed on to consumers. • There is broad support for some form of regulation to assist consumers to determine which fuel is appropriate for their vehicle. • Some stakeholders are concerned with discounted prices being shown on price boards and think that this practice should not be allowed due to it masking headline price competition.

5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Regulated parties	We expect the fuel companies to incur medium one-off costs in setting up the terminal gate pricing regime, renegotiating wholesale supply arrangements as required and changing price boards. Ongoing costs would be low.	Medium.	Low
Regulators	The regulator or regulator will incur medium costs from monitoring and enforcing the regime.	Medium	Low
Wider government	Fuel consumption may impose some environmental costs, but this would be limited due to fuel demand not being price sensitive.	Low	Low
Consumers	Some of the increased costs to regulated parties may be passed on to consumers in higher fuel prices. This is likely to be a small amount spread over a large number of customers.	Low	Low
Other parties	We do not foresee increased costs to other parties.	Low	Low
Total Monetised Cost	*Without accurate quantifiable evidence, it is not possible to provide an estimate*	*Unknown*	*Unknown*
Non-monetised costs	*We anticipate a medium increase in overall costs, mainly from compliance and enforcement.*	*Medium*	*Low*
Expected benefits of proposed approach, compared to taking no action			
Regulated parties	Regulated parties seeking to grow market share and compete may benefit from a more active	Medium	Low

	wholesale market.		
Regulators	The regulator will have better information to monitor the sector and greater ability to intervene to protect competition.	Medium	Low
Wider government	There are social benefits from improving affordability of essential items.	Low	Low
Consumers	Consumers benefit from stronger competition through lower prices, better services and more convenience.	Low	Low
Other parties	We are not aware of increased benefits to any other parties.	Low	Low
Total Monetised Benefit	*Without accurate quantifiable evidence, it is not possible to provide an estimate*	*Unknown*	*Unknown*
Non-monetised benefits	*We anticipate a medium level of benefits from increased competition and more transparency in the fuel sector over the longer term.*	*Medium*	*Medium*

5.3 What other impacts is this approach likely to have?

There are some potential risks and uncertainties with the proposed options. For example:

- The terminal gate price regime may impose additional costs (e.g. stock holding, investment, increased shipping frequency, or shortages for own-supply) which could lead to higher retail prices if wholesale competition does not increase. Moderate impact. This is minimised by proposals to closely monitor the terminal gate price regime and to adjust the Industry Code on a timely basis if required.
- Increased transparency of fuel pricing may facilitate collusion. Moderate to high impact. This risk will be minimised by the enhanced fuel monitoring regime to enable the regulator to identify potential competition issues. Further regulatory intervention may be required if collusion is identified.
- Reduced profitability of the major fuel companies may lead to reduced incentives to invest and rationalisation of fuel supply in high cost regions. Moderate to low impact. This is minimised by the preferred options focusing on promoting competition rather than more heavy-handed options for price control or structural separation.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

The preferred package of options for further work is compatible with the Government's 'Expectations for the design of regulatory systems'.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
The final package of regulatory proposals will be implemented either in primary legislation, through the introduction of a new Fuels Sector Bill, or in regulations made under that Bill. The Government has directed that the Bill will be passed by the middle of 2020, and the new regime would commence soon after. Appropriate transitional arrangements would be included where required. The choice of agency responsible for regulation is still to be determined. The Commission is a likely candidate for enforcement of the regulations, but there may be other agencies better suited to operate a dispute resolution scheme. MBIE is a likely candidate for the enhanced monitoring and information disclosure regime.

6.2 What are the implementation risks?
MBIE will engage further with stakeholders on the implementation risks as the detail of the proposals is developed.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
A key feature of the proposals is an enhanced regime for recordkeeping and information disclosure to enable regulators to monitor the effectiveness of the regime. It is envisaged that the Industry Code would be evaluated after it has been in effect for a period, such as two to three years.

7.2 When and how will the new arrangements be reviewed?
It is envisaged that the Industry Code would be evaluated after it has been in effect for a period, such as two to three years. However, the monitoring regime will identify issues and enable earlier amendment of the regime if required. Stakeholders will be able to raise concerns directly with MBIE or Ministers.