Commercial In Confidence

Office of the Minister of Energy and Resources
Chair, Cabinet Economic Growth and Infrastructure Committee

Report back on the Fuel Market Financial Performance Study

Proposal

1 This Cabinet paper is my report back on the Fuel Market Financial Performance Study (the study). I propose that the Fuel Market Financial Performance Study report be publicly released, along with this Cabinet paper.

Executive summary

2 A trend of steadily rising importer petrol and diesel price margins since 2008 has raised questions about whether retail customers in New Zealand are paying reasonable prices for petrol and diesel. In addition to this, the emergence of significant retail fuel price variations between regions in New Zealand has been observed.

3 Due to these concerns, the Ministry of Business, Innovation and Employment (MBIE) commissioned a consortium of advisors to undertake the Fuel Market Financial Performance Study to determine whether consumers in New Zealand are paying reasonable prices for retail fuels, and what could be learnt about regional price differences in New Zealand.

4 The Fuel Market Financial Performance Study has concluded that "we cannot definitely say that fuel prices in New Zealand are reasonable, and we have reason to believe that they might not be."

5 The report confirms that there are outcomes in the market that may not be consistent with a workably competitive market. There appear to be aspects of the structure and conduct in the sector that, to varying degrees, could potentially be altered to produce materially better outcomes for consumers.

6 The report's main findings are:

6.1 As of quarter four 2016, New Zealand's pre-tax fuel price is the highest in the OECD;

6.2 Gross retail margins have increased significantly since 2011 (when the review period commenced). However, this does not appear to be matched by comparable levels of capital expenditure (one of the potential drivers of increased margins) made over the review period. The study also found that MBIE's method for calculating its weekly monitoring of importer margins is robust;

6.3 Where data on retail return on average capital employed (ROACE) was provided, these ROACEs had increased significantly. In some cases retail ROACEs had increased by over 100% through the period 2011 to 2016;

6.4 The analysis suggests that there may be cross-subsidisation between regions and business units, but this has not been confirmed beyond doubt;

6.4.1 Retail gross margins in the South Island (and Wellington) have increased at a faster rate than margins in the North Island (excluding Wellington). These differences are not explained by observable capital expenditure; and

6.4.2 Gross margins in the retail business units have been increasing, but have been flat or declining in the other business units (for example aviation marine, and the commercial sector).

7 The report makes clear that further analysis of the market is required before deciding what, if any, regulatory intervention is warranted. In particular, it recommends deeper analysis using different data (that companies in the industry should be able to provide on a consistent basis) and methodologies that are well-suited to addressing the study's questions.

8 However, despite the need for more analysis, the report also makes recommendations for options for improving market performance that should be subject to early policy development work:

8.1 The removal of Z Energy's Main Port Price (MPP), a national reference retail price[1], from its website;

8.2 The creation of a registry for the borrow and loan system[2] that limits each participant's visibility of other participants' market shares; and

8.3 Giving consideration to the creation of a liquid wholesale market for retail fuels.

9 I understand that Z Energy already intends to remove its MPP from its website. The industry could also voluntarily give effect to the other two recommendations. However, if voluntary implementation was not forthcoming, legislative change would be required to mandate any such change.

10 I intend to discuss the findings of the report with the industry. My expectation is that they will thoroughly investigate these recommendations. In parallel, I will commence my own assessment with my officials of these recommendations. I expect officials to report back to me by end November 2017.

11 With regard to the need for further analysis, once a market studies power is available to the Commerce Commission, I will ask the Minister of Commerce and Consumer Affairs to consider whether the Commerce Commission should undertake a further, competition-specific fuel market study using data which is comparable across companies. This decision to conduct a market study would be subject to ministerial and Cabinet consideration at that point in time.

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[1] The MPP is a national retail price for retail fuels in New Zealand. The Commerce Commission noted that "this is the price Z would like to achieve". Z Energy may be intending for the MPP to provide consumers with an indication of the current price of fuels, but it is possible that the MPP is also acting as a price signal to Z Energy's competitors. The MPP has recently become less reflective of Z Energy's prices across the country.

[2] The borrow and loan system allows the majors to use each other's terminal assets around the country, i.e. the majors can access products at any terminal (even if they don't own the terminal) without the companies having to buy this product from each other. This is intended to avoid duplication of assets, and thereby reduce costs for the companies and prices for consumers.

12 The report also cautions against some regulatory interventions that are sometimes used in the fuel sector. For example, overseas studies find that – counterintuitively – increasing price transparency in retail fuel markets, such as through the use of apps, can actually cause prices to rise.

13 Increased price transparency for consumers can enable consumers to switch between competitors, but can also reduce incentives for companies to lower prices. Overseas studies have shown that the introduction of price transparency in retail fuel markets can lead to higher prices overall (this is detailed further in paragraph 67).

14 The inability to access detailed, comparable, data from all of the fuel companies has meant that the initial approach to the study – answering whether prices were reasonable through market-level analysis of ROACE – has not been achieved [EGI-17-MIN-0096 refers].

15 However, the study and report have taken us a meaningful step forward, confirming that with the upwards trend in importer margins, which are monitored by MBIE, we were right to be concerned.

Background

16 MBIE estimates importer margins (also referred to as gross distribution margins) as the difference between the landed cost of fuel and the retail price. The "landed cost" comprises an international benchmark price of fuel, adjusted for quality differences, and freight, insurance and wharf handling fees. Importer margins are a broad indicator of gross profit made on retail sales of petrol and diesel, out of which the suppliers must meet a range of costs (e.g. trucking and service station overheads) as well as a portion of corporate overheads, depreciation, interest, and income tax.

17 In September 2015, MBIE updated the method used to calculate importer margins by factoring in discounts (through loyalty schemes, shopper coupons and regional discounting). The margins calculated by MBIE have been independently reviewed by the Advisors and Hale and Twomey Limited, who found that MBIE's calculated margins identify a similar trend to that calculated by the Advisors' analysis and that differences in the absolute values can be attributed to MBIE's deliberate exclusion of certain expense items.

18 According to MBIE data, importer petrol margins increased by over 17 cents per litre from 2008 to 2016, while importer diesel margins increased by over 20 cents per litre. Each cent per litre equates to approximately $30 million per annum, meaning the additional cost to consumers is measured in the hundreds of millions of dollars per annum.

19 On 7 February 2017, Cabinet:

19.1 noted a briefing titled Fuel Market Financial Performance Study [briefing number 2215 16-17 refers] that raised questions as to whether consumers are being fairly treated and whether fuel company returns are reasonable;

19.2 noted MBIE intended to undertake a fuel market financial performance study; and

19.3 invited the Minister of Energy and Resources to report back to the Cabinet Economic Growth and Infrastructure Committee on the outcome of the study and the options for any further government action that may be required [CAB-17-MIN-0026 refers].

20 I publicly announced the Terms of Reference for the study on 24 February and undertook to report back to Cabinet in June 2017 on the findings. The Terms of Reference sought to answer two key questions:

20.1 Are retail consumers in New Zealand paying reasonable prices for petrol and diesel and why? At what level might prices be considered unreasonable?; and

20.2 What conclusions can be drawn about retail fuel price differences at a regional level?

21 MBIE engaged a consortium of the New Zealand Institute of Economic Research, Grant Thornton, and Cognitus Economic Insight (the **Advisors**) to lead the Study.

22 MBIE requested data from the four largest fuel suppliers (Z Energy, BP, Mobil and Gull) to assist the Advisors in responding to the Terms of Reference. Each company provided verbal and written undertakings to cooperate with the study. While most of the companies cooperated with most of MBIE's requests, not all the data provided was comparable across companies or provided in sufficient time to be incorporated into the Study. A market studies power with an information gathering power that could specify the form in which the data should be provided would help address this problem in future.

23 The scope of the study was subsequently amended to take into account the difficulties encountered in obtaining comparable data from all the companies and to produce the best possible report with the data available. The Cabinet Economic Growth and Infrastructure Committee, having been authorised by Cabinet to have Power to Act [CAB-17-MIN-0191], agreed to this variation on Wednesday 3 May 2017 [EGI-17-MIN-0096].

Findings regarding whether prices are reasonable

24 The report has concluded that "we cannot definitely say that fuel prices in New Zealand are reasonable, and we have reason to believe that they might not be."

25 Consistent with MBIE's advice, the report also confirms that there are outcomes in the market that may not be consistent with a workably competitive market. There appear to be aspects of the structure and conduct in the sector that, to varying degrees, could potentially be altered in cost-effective ways to produce materially better outcomes for consumers.

26 Key findings regarding whether prices are reasonable are summarised below.

Gross retail margins[3] have increased significantly over the period under review

27 An observed increase in margins in the absence of any change in underlying cost structures or demand conditions can be evidence of prices being or becoming unreasonable.

28 The major fuel companies provided sufficient information to enable comparable gross margins to be calculated for the industry. The report confirms what MBIE had claimed at the outset of the study – average retail gross margins have significantly increased over the period from 2013-2017. On a cents per litre basis, average retail gross margins have increased from approximately 13.0 cents per litre in financial year (FY) 2013 to 21.3 cents per litre in FY2017.

29 However, from gross margins alone it cannot be deduced whether prices are reasonable. Increases in margins could be a result of either (or both) increases in prices or volumes, or reductions in costs (e.g. due to efficiency gains or reductions in the cost of imported product). In addition to this, if an operator were investing significantly in assets (e.g. to increase storage capacity) then they would likely require higher returns to justify the investment, or margins could have been recovering from unsustainable levels (although the magnitude of the increase makes this an incomplete explanation).

Increases in gross margins do not appear to be due to capital expenditure made by the majors over the period under review

30 The Advisors' review of financial information did not identify capital expenditure made by the majors over the period under review which would explain such an increase in gross margins. This suggests that rising margins are not due to fuel companies significantly investing in new or upgraded assets.

31 The report identifies three possible reasons for rising margins:

31.1 A weakening of competitive intensity (e.g. a change in Z Energy's pricing strategy after it acquired Shell in 2010 – prior to this Shell had tended to be slow to follow competitors' price increases and quick to lower the price);

31.2 A shift towards greater product differentiation and price discrimination – offering increasingly differentiated product offerings (e.g. better quality forecourts) segments the retail fuel market and enables companies to discriminate between customer types; and

31.3 A rise in independent retailers, with possible inefficiencies in how they set prices.

32 In regard to the third possible explanation, MBIE notes that competition from independents appears to restrain prices in the North Island, rather than serving to increase them.

33 The report also identifies features of the market that the authors argue may allow margins to rise more or for longer than they should:

[3] Gross retail margins defined here are different to the importer margins calculated by MBIE. Gross retail margins for this Study are defined as profit after discounts, transfer price, storage and handling and logistics cost.

33.1 Vertically integrated companies (i.e. the same company owning operations at refining, wholesaling and retailing) giving firms the opportunity to limit competition;

33.2 Refinery arrangements (Part 1) – the refinery is run to tight capacity, its output is fully committed to the majors (meaning that there is no spare capacity for potential new entrants), and even if it were not any firm wishing to gain access to its output would need to commit to a full bundle of products (i.e. jet fuel and not just petrol and diesel); and

33.3 The independents' limited sources of product – New Zealand lacks liquid regional wholesale markets through which independent suppliers can reliably access fuels. This reliance potentially limits their ability to compete head-to-head with the majors, dampening the downward pressure they can exert on margins.

34 MBIE notes there may be features of the market that inhibit retail competition, but is mindful that the report also states that these features must be assessed against a viable counterfactual. MBIE considers that a counterfactual may not be possible for all of the aspects of the refinery arrangements mentioned above. For example, running the refinery with excess capacity is unlikely to be either efficient or profitable, making it an unsuitable counterfactual.

35 MBIE agrees that liquid regional wholesale markets through which independent suppliers can reliably access fuels could potentially enhance competition. However, none of the independents spoken to during the course of this inquiry cited this as an impediment to competing with the majors that supply them.

36 Finally, the report tentatively identifies three possible reasons for why fuel margins are simply higher than they need to be (i.e. higher than they might be in a market where certain features were not present):

36.1 Z Energy's publication of its MPP – this potentially serves as a retail pricing signal that can dampen competition;

36.2 Information exchange between the majors – the majors share terminal facilities under a 'borrow and loan' arrangement, through which the Advisors understand that the majors share information, allowing them to monitor each other's market shares. Such information sharing is often a cause for concern to competition authorities because it might help to support coordination among firms, leading to higher prices;

36.3 Refinery arrangements (Part 2) – the ownership arrangements of the refinery may be affecting how the majors price across various industry levels (although the impact of this is unknown).

37 MBIE considers that it is possible that information sharing (MPP and borrow and loan) could be facilitating tacit collusion among the majors. However, whether the borrow and loan arrangements provide information that would not otherwise be known to the majors is at this stage unclear. Likewise, it is not clear that the potential benefits of increased competition outweigh the costs of intervention. MBIE agrees with the advisors that this issue should be subject to further examination.

38 MBIE notes that the ownership arrangements of the refinery could affect how the majors price across various industry levels, but notes that the study was unable to find supporting evidence that this was occurring. The report itself is cautious about concluding that this is a cause of higher margins.

MBIE's method for calculating its weekly monitoring of importer margins is robust

39 As part of the study, the Advisors and Hale and Twomey Limited, a specialist New Zealand-based oil consultancy, reviewed MBIE's margin analysis. They concluded that differences between the importer margins calculated by MBIE, and what the major fuel companies claim their gross margins to be, can be put down to MBIE's deliberate exclusion of certain expense items. This confirms that the method underpinning MBIE's weekly monitoring of fuel margins can be trusted. Despite the difference in absolute terms, MBIE's calculated margins identify a similar trend to that calculated by the Advisors' analysis, which is based on margins supplied by the operators.

New Zealand's pre-tax fuel price is the highest in the OECD

40 New Zealand's pre-tax cost of petrol as of quarter 4 2016 was the highest in the OECD.

Findings regarding regional pricing and cross-subsidies

41 There is enough evidence to suggest that cross-subsidies are occurring between regions and business units. However, the Advisors have not been able to confirm this beyond all doubt. They note that further data and analysis would be required to be definitive.

Retail gross margins in the South Island (and Wellington) have increased at a faster rate than margins in the North Island (excluding Wellington)

42 Fuel prices were initially similar between the North Island and the South Island for the financial years 2013 through 2014. However, in financial year 2015 a significant variance in retail prices emerged.

43 Wellington prices in recent years are more consistent with the trends in the South Island compared with the rest of the North Island. The Wellington market shares a common characteristic to the South Island in that the three majors (Z Energy, BP and Mobil) own all terminal assets and supply all downstream petroleum products. In the rest of the North Island, Gull is able to supply its retail network from its own terminal assets at Mt Maunganui.

44 For financial year 2017 the average gross margin difference between the South Island (and Wellington) and the North Island (excluding Wellington) was 9.8 cents per litre.

North Island/South Island differences are not explained by capital expenditure

45 The Advisors reviewed the fuel market participants' assets from financial statements for the financial year 2015 through 2017 but were unable to identify any major capital expenditure projects that can explain the increase in margin in Wellington and the South Island.

46 The geographic spread of the population in the South Island results in additional transportation costs which could explain a higher cost base than in the North Island. However, the proportion of transportation costs in the overall cost does not explain the size of the variances identified (possibly one to two cents per litre at most). While population spread may result in an expectation of higher prices this does not explain increases in margins and in particular does not explain the reason for the margin divergence since the 2015 financial year.

The analysis suggests that there may be "cross-subsidisation" between regions and business units

47 The analysis suggests that there may be some regional subsidisation, with growth in Wellington and South Island margins compensating for lower margin growth rates in the North Island. However, the Advisors cannot conclusively state this.

48 The anecdotal evidence available to them includes the following:

48.1 They understand, but have not been able to independently verify, that a small number of locations are operated by at least some of the majors at negative margin – suggesting those sites are indeed cross-subsidised by others;

48.2 The way in which shipping costs are allocated by the majors under their joint venture in coastal shipping may be favouring the South Island (though the impact of this is small, likely to be less than one cent per litre); and

48.3 The price-setting process of at least some majors involves attempting to recover margin lost in areas facing more intense competition by increasing margin in other areas.

49 While they have not been able to access specific data to confirm this, margin shifting makes sense if firms are simultaneously coordinating in less-intensive competitive areas. That way lost volumes from increasing prices are possibly more than offset by softer price competition.

50 Margins in the South Island and Wellington are able to rise relative to the rest of New Zealand due to the inability of truly-independent rivals (i.e. those with their own product supply) to access terminals owned by the majors.

51 In addition, the report finds that gross margins for retail have been increasing while margins from other business units on average have been flat or declining.

52 The reason for the margin differential between retail and other customers is most likely due to buying power combined with capital investment. It is likely that large wholesale customers are provided with higher discounts than retail customers given that long-term contracts are in place and significantly higher volumes are acquired. In addition, some wholesale customers have their own storage facilities or lower quality requirements in respect of distribution (for instance more unmanned sites) and therefore this means the operators have invested less in distribution assets.

The report's recommendations

53 The report emphasises that there is not enough evidence to suggest that regulation is the answer. The report's main recommendation is that given the importance of the industry, and the potential materiality of the issues, there is merit in deeper inquiry using different data and methodologies that are well-suited to addressing the study's questions (specifically, prices and quantities of different fuel types, by station and with details of station characteristics). Companies in the industry should be able to provide these data on a consistent basis, and at a level of detail fine enough that analysis can be undertaken in specific markets (e.g. cities or regions).

54 These data would open up the possibility of other types of analysis that should give:

54.1 A clearer indication of the nature and extent of any problems in fuel sector competition in specific markets;

54.2 An ability to gauge the impact on retail fuel margins in those markets of possible remedial changes to industry arrangements (i.e. through policy simulations); and

54.3 A better idea of whether the benefits of any possible remedial changes outweigh their costs.

55 In short, with better access to data of these types, it should be possible to provide more definitive and evidence-based responses to the study's questions. In turn this will provide better information about the causes of regional price differences.

56 The report recommends some aspects of the industry be subject to early policy development work. Specifically, the report recommends further examination of:

56.1 The removal of Z Energy's MPP from its website;

56.2 The creation of a registry for the borrow and loan system that limits the visibility of other participant's market shares; and

56.3 Giving consideration to the creation of a liquid wholesale market for retail fuels. The Advisors acknowledge that this would require careful planning and assessment but recommend that such planning and assessment commence now.

57 MBIE understands that Z Energy intends to remove the MPP from its website once this fuel market financial performance study is completed. MBIE supports this action.

58 As stated above, it is currently unclear whether the high transaction costs involved in intervening in the borrow and loan system would outweigh the benefits. MBIE notes that further analysis of these costs and benefits would need to be undertaken before regulatory intervention might be proposed.

59 I intend to ask that industry provide MBIE with a formal response to this recommendation by 30 September 2017, with MBIE due to provide details of their analysis to me by end November 2017.

60 MBIE notes that, as stated by the Advisors, the creation of a liquid wholesale market for retail fuels would require further assessment to ensure that it would be of benefit to consumers. This further assessment would be best undertaken alongside any future investigation of the downstream fuel market.

61 There is a range of potential interventions potentially available to create a liquid wholesale market. These include:

61.1 Forced divestment of terminal assets;

61.2 Requirements on terminal owners to make some part of their terminal capacity (either at each terminal, or just for selected terminals) available to others at regulated access prices;

61.3 Information disclosure requirements at terminals (similar to what is required in Australia), requiring terminal owners to post wholesale prices at terminal gates. Under this option, terminal owners can decline to supply if capacity is needed for the owners' own requirements;

61.4 Requirements on fuel suppliers to post wholesale prices for forward delivery at each terminal.

62 I consider that an assessment of options for Government to intervene in the creation of a liquid wholesale market needs to be carefully and fully considered, and is best undertaken as part of a future market study undertaken by the Commerce Commission.

63 Industry is nonetheless encouraged to investigate what practical steps they could take to improve liquidity now. I expect that industry will also provide MBIE with a response to this recommendation by 30 September 2017, and I will ask MBIE to provide me with an initial assessment of this recommendation by end November 2017.

64 The report cautions against some regulatory interventions that are sometimes used in the fuel sector. For instance:

64.1 Divorcement laws forcing refiners to exit their ownership of retailers – overseas studies find that find that retail prices rise as a result, because some of the efficiency gains from vertical integration are lost, even if greater retail competition emerges;

64.2 Increasing price transparency – overseas studies find that prices can actually rise because the information becomes available to the suppliers, who can use it to respond more effectively to their competitors' prices (this initially counterintuitive result has been found in a number of overseas studies of fuel markets); and

64.3 Mandatory provision of consistent and comparable financial data – this is likely to be expensive, contentious and time-consuming to operate.

65 MBIE agrees with the Advisors' cautious approach to regulatory intervention. Any proposals to intervene need to be supported by a robust regulatory impact assessment.

66 MBIE understands that interventions such as divorcement can have unintended consequences and costs for consumers.

67 MBIE agrees with the Advisors' caution regarding price transparency. Given that suppliers already have fairly good access to information about their competitors' prices, greater price transparency does provide consumers with some (limited) countervailing power. However, increased price transparency (particularly if it is digital) also enables companies to see each other's prices and react instantly. This reduces the incentive to lower prices to gain consumers (because prices will not differ for very long) and a greater ability to raise them to maximise profits. At least two separate overseas studies into increasing price transparency in retail fuel markets have found that the overall net effect is likely to harm rather than benefit consumers, while another has demonstrated collusive behaviour that was enabled by this transparency.[4]

68 MBIE agrees that the mandatory provision of consistent and comparable financial data would be expensive, contentious and time-consuming. For instance, the process the Commerce Commission and industry went through to set the input methodologies under Part 4 of the Commerce Act 1986 (which include information disclosure requirements) was a lengthy, contentious and costly process. However, these costs need to be weighed against the long run benefit for consumers. These cost-benefit assessments have not yet been made.

Limitations of the Study

69 While all of this takes us a step forward by confirming that there are problems in the market, it still leaves us with questions about what is really going on.

70 Most of the companies eventually cooperated with most of the requests made by MBIE and the Advisors. As the report states: "While the fuel companies and other participants were generous in providing information and explanations about their operations, some of this material took time to collate, and in some instances was provided very late into our review."

71 As a result, the study has been unable to answer the question regarding reasonableness of prices by analysing return on average capital employed (ROACE) [CAB-17-SUB-0191 refers].

72 While the study has not answered the core question of whether prices are reasonable, it does – as intended – take us a step forward in confirming that the examination of this sector is warranted.

Next steps

73 I understand that Z Energy already intends to remove its MPP from its website. The other two recommendations (8.2 and 8.3 above) could be voluntarily given effect by the industry. However, legislative change would be required to mandate this if it was not forthcoming.

74 I intend to discuss the findings of the report with the industry. My expectation is that they will thoroughly investigate these recommendations and provide a formal response to MBIE by 30 September 2017.

[4] Studies of retail fuel markets in Germany, Chile, and Australia (Perth).

75 In parallel, I will direct my officials to assess the report's findings, with particular emphasis on the recommendation to create a registry for the borrow and loan scheme. I expect officials to report back to me by 30 November 2017.

76 The report also recommended a further study using data that is comparable across the industry. To this end, I note that the Government has recently agreed to grant the Commerce Commission a market studies power [CAB-17-MIN-0274 refers]. Once this power comes into force, Cabinet would have the ability to require the industry to provide us with sufficient data (and in a timely manner) to enable us to conduct in-depth competition analysis of the market and identify areas where barriers to competition might exist (such as in the contracts that the Advisors were unable to review).

77 Should that be considered the appropriate next step following MBIE's further consideration and advice, I would ask the Minister of Commerce and Consumer Affairs to consider whether the Commerce Commission's market studies power should be used to undertake a further, competition-specific fuel market study using data which is comparable across companies. This decision to conduct a market study would be subject to further Cabinet consideration at that point in time.

78 In summary:

78.1 I intend to discuss the findings of the report with the industry;

78.2 I expect industry to provide MBIE with a formal response to the report's recommendations by 30 September 2017;

78.3 I will direct MBIE to assess the report's findings and recommendations, and expect officials to report back to me by 30 November 2017 (particularly with regard to the recommendation to create a registry for the borrow and loan system);

78.4 Should it be considered the appropriate next step following MBIE's further advice, I would ask the Minister of Commerce and Consumer Affairs to consider whether the Commerce Commission's market studies power should be used to undertake a further study of the fuel market; and

78.5 I will report to Cabinet on any further proposals or advice in regard to the fuel market, including the consideration to ask the Minister of Commerce and Consumer Affairs to consider a Commerce Commission market study.

Consultation

79 No public consultation has been undertaken on the proposals in this paper.

80 The major companies in the industry were extensively involved in providing and discussing the information used to develop the report. I plan to provide the major companies, as well as the Automobile Association, with an embargoed copy of the report following Cabinet and prior to public release.

81 The Treasury has been consulted and the Department of Prime Minister and Cabinet has been informed.

Financial implications

82 There are no budget implications arising from the proposals in this paper.

Human rights

83 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative implications

84 There are no direct legislative implications arising from the proposals in this paper. However, I intend to further investigate whether regulatory intervention is required to create a workably competitive market.

Regulatory impact analysis

85 No regulatory options are being proposed in this paper, and therefore no regulatory impact analysis has been conducted.

86 The interventions that the report has recommended would be subjected to further evaluation, including a regulatory impact analysis, before any regulatory options are proposed.

Publicity

87 Following Cabinet sign-off, I intend to release an embargoed version of the report to the industry participants that provided data for the study (Z Energy, BP, Mobil, and Gull), and the New Zealand Automobile Association.

88 I intend to announce the results of the study on 27 June 2017. The announcement will make reference to Minister Dean’s announcement regarding the decision to grant the Commerce Commission a market studies power.

89 This paper will be proactively released on MBIE’s website with the report, and MBIE will provide a summary of the report.

90 The report’s findings are likely to generate wide media and industry interest and discussion. To this end I have requested that the report’s authors be on hand to answer questions that the media might have regarding the report’s method and findings.

91 I am aware that some stakeholders are likely to disagree with aspects of the report – such as the finding that greater price transparency in this market is likely to be harmful to consumers. While this finding is counterintuitive I believe that it is evidence-based (as set out in paragraph 67).

Recommendations

The Minister of Energy and Resources recommends that the Committee:

1 **note** that on 7 February 2017 Cabinet invited the Minister of Energy and Resources to report back to the Cabinet Economic Growth and Infrastructure Committee on the outcome of the fuel market financial performance study and the options for any further government action that may be required [CAB-17-MIN-0026 refers];

2 **note** that the Terms of Reference for the Study were publicly announced on 24 February and sought to answer two key questions:

2.1 Are retail consumers in New Zealand paying reasonable prices for petrol and diesel and why? At what level might prices be considered unreasonable?; and

2.2 What conclusions can be drawn about retail fuel price differences at a regional level?

3 **note** that on 3 May 2017 the Cabinet Economic Growth and Infrastructure Committee, having been authorised by Cabinet to have Power to Act [CAB-17-MIN-0191], agreed to vary the scope of the study to take into account the difficulties encountered in obtaining comparable data from the companies involved in the study [EGI-17-MIN-0096];

4 **note** that the fuel market financial performance study has concluded that “we cannot definitely say that fuel prices in New Zealand are reasonable, and we have reason to believe that they might not be”;

5 **note** that the report confirms that there are outcomes in the market that may not be consistent with a workably competitive market and that this may mean consumers are paying unreasonable prices for fuel;

6 **note** that the report confirms that MBIE’s method for monitoring margins in the fuel industry has stood up to independent review and reaches results consistent with those calculated by the Study’s authors using data provided by the industry;

7 **note** that the report cites international evidence suggesting that greater price transparency in retail fuel markets can harm competition and raise prices;

8 **note** that the report recommends detailed examination of the costs and benefits of:

8.1 The creation of a registry for the borrow and loan system that limits the visibility of other participants’ market shares; and

8.2 Giving consideration to the creation of a liquid wholesale market for retail fuels;

9 **note** it is evident that further analysis of the market is required before deciding what, if any, regulation is warranted;

10 **note** that I intend to:

10.1 discuss the findings of the report with industry; and

10.2 commence my own assessment of whether or not the government should regulate aspects of the industry;

11 **note** that the Cabinet Economic Growth and Infrastructure Committee, having been authorised by Cabinet to have Power to Act [CAB-17-MIN-0191] agreed on Wednesday 3 May 2017 that to be successful, any review will need information gathering powers [EGI-17-MIN-0096];

12 **note** that I therefore intend to ask the Minister of Commerce and Consumer Affairs to consider a further competition-focused market study into the retail fuel market (once a market studies power is granted to the Commerce Commission);

13 **agree** to the public release of the Fuel Market Financial Performance Study report;

14 **agree** to the release of an embargoed copy of the Fuel Market Financial Study report to Z Energy, BP, Mobil, Gull, and the New Zealand Automobile Association, ahead of public release; and

15 **agree** to the proactive public release of this paper.

Authorised for lodgement

Hon Judith Collins
Minister of Energy and Resources

Annex 1

Advisors' report – Fuel Market Financial Performance Study

Annex 2

Original Terms of Reference

Annex 3

Revised project scope