

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Initiation of the first market study to be carried out by the Commerce Commission

Proposal

1. This paper outlines my intention to select retail fuel markets as the subject of the first Commerce Commission market study.

Executive Summary

2. The Commerce Amendment Act 2018 amended the Commerce Act 1986 (the Act) to give the Commerce Commission the ability to undertake market studies to determine whether there are any factors that may be impeding competition in a market. If so, the Commerce Commission may make recommendations as to how competition could be improved.
3. On 15 October 2018, I wrote to senior members of the Cabinet Economic Development Committee, as well as coalition party leaders, seeking views on potential markets to be subject to a study. Several worthy suggestions were received.
4. I consider that the best candidate for the first market study is New Zealand retail fuel markets. In particular, I propose that the study focus on factors that may affect competition for the supply of retail petrol and diesel used for land transport throughout New Zealand.
5. I consider it would be in the public interest to require a study into this market, given such things as:
 - 5.1. the more than doubling of petrol and diesel importer margins over the past decade;
 - 5.2. the size of the market (around 6 billion litres of petrol and diesel are consumed for land transport use annually); and
 - 5.3. the inability of previous studies to definitively conclude whether or not there is a competition problem in the market.
6. It is important that the Commerce Commission be given sufficient time to conduct a thorough analysis of the issues in the sector. As such, I propose that the Commission must make its final report on competition in the retail fuel sector publicly available by 5 December 2019. I note that the Commission is required to publish and consult on a draft of its competition report, which will provide a strong indication of the Commission's conclusions several months prior to this deadline.

Background

7. The Commerce Amendment Act 2018, which received Royal assent on 25 October 2018, amended the Commerce Act 1986 (the Act) to give the Commerce Commission the ability to undertake market studies into the supply and/or acquisition of goods or services. The purpose of a market study is to determine whether there are any factors that may be impeding competition in a market. If so, then the Commerce Commission may make recommendations as to how competition could be improved.
8. Under the amended Act, the Commerce Commission may conduct a study on its own initiative or at my request, as the Minister of Commerce and Consumer Affairs, if it is in the public interest to do so. In conducting a study, the Commerce Commission will have access to its existing information gathering powers under the Act. An 'average-sized' market study will take around a year to complete. The Commerce Commission is only resourced to carry out one such study at a time.
9. On 15 October 2018, I wrote to senior members of the Cabinet Economic Development Committee, as well as coalition party leaders, indicating my intention to require the Commerce Commission to commence a market study later this year, and seeking views on potential markets to be subject to a study.

Criteria for undertaking a market study

10. As noted above, under the Act, in requiring the Commission to carry out a market study, I must be satisfied that it would be in the public interest to do so. What is in the public interest is not defined, but it should be interpreted consistent with the purpose of the Act, which is to promote competition in markets for the long-term benefit of consumers within New Zealand.
11. I consider that it is likely to be in the public interest to carry out a market study if it promotes the purpose of the Act and some or all of the following (non-exhaustive) criteria are met:
 - 11.1. there are existing indications of competition problems in the market (such as high prices or low levels of innovation);
 - 11.2. the market is of strategic importance to the New Zealand economy or consumers;
 - 11.3. it is likely that there will be viable solutions to any issues that are found; and
 - 11.4. a formal Commerce Commission study would add value above work that could be done by other government agencies.

Market to be subject to a market study

12. I received several suggestions for possible markets to be subject to a market study, including:
 - 12.1. retail fuel markets (proposed by Rt Hon Jacinda Ardern and supported by the Green Party);
 - 12.2. the market for building materials (proposed jointly by Hon Phil Twyford and Hon Jenny Salesa, and by New Zealand First);
 - 12.3. supermarkets (proposed by the Green Party and by Fletcher Tabuteau MP); and
 - 12.4. banking (proposed by Rt Hon Winston Peters).
13. I consider that these proposals may be worthy candidates for a future market study by the Commerce Commission. However, in my view, there is a clear public interest at this time in carrying out a market study on New Zealand retail fuel markets.
14. In particular, with reference to the criteria outlined above, I consider that:
 - 14.1. the more than doubling of petrol and diesel importer margins over the past decade and the findings of a 2017 fuel market financial performance study that concluded “we cannot definitely say that fuel prices in New Zealand are reasonable, and we have reason to believe that they might not be”, provides an indication of a potential competition problem in the market;
 - 14.2. the market is of strategic importance to the New Zealand economy and consumers, with around 6 billion litres of petrol and diesel consumed for land transport use annually;
 - 14.3. similar international studies have identified policy responses to competition issues that were found, and as such, there are potential viable solutions to any issues that are found in the New Zealand market; and
 - 14.4. given the Commerce Commission’s information gathering powers, and the inability of previous New Zealand studies to reach definitive conclusions on whether there is a competition problem in the market without such powers, I consider that the Commerce Commission is the most suitable body to carry out this study.

Terms of reference

15. In line with the requirement of the Act, I have prepared draft terms of reference for a study into retail fuel markets, and consulted on these with the Commerce Commission. The proposed terms of reference, taking into account this feedback, are attached as Annex 1.
16. To summarise, I intend that the study focuses on factors that may affect competition for the supply of retail petrol and diesel used for land transport throughout New Zealand.

17. Regarding timeframes for the study, I intend for the study to commence on 5 December 2018, and for the Commission to publish its final report on competition in the retail fuel sector by 5 December 2019. Obtaining complete and reliable information from industry participants will require a significant amount of time at the beginning of the study. While I understand that there is significant interest in a timely report into the competition matters in this sector, it is important that the Commission be given the time needed to undertake a thorough, robust study. I note that the Commission is required to publish and consult on a draft competition report, which will provide a strong indication of the Commission's conclusions several months prior to publication of the final report.
18. In developing the terms of reference for the study, I have made the following judgements:
 - 18.1. *The study should focus on retail petrol and diesel markets.* This means that markets such as the market for bitumen, commercial diesel, aviation fuel, and marine fuel will not form part of the study, unless competition in one of these markets is relevant to the retail petrol or diesel markets. Restricting the scope of the study will focus it on the areas with the largest direct impact on New Zealand consumers, and make the Commission's study more manageable.
 - 18.2. *The Commerce Commission should primarily focus on whether the market is competitive, rather than whether prices are 'fair'.* There is no single definition of what is fair or reasonable, and the Commission's expertise lies in competition analysis, not making value or equity judgements. However, the Commission's analysis will include such things as regional price differentials and its findings will provide a strong basis for the government to make fairness judgements.
 - 18.3. *The study should focus on understanding the problem and providing a strong evidence base to develop policy responses.* While the Commission may identify areas of concern and recommend options for further policy consideration, development of those options would be carried out by ministry officials and would be a decision for Ministers. I expect that the Commerce Commission will focus most of its effort on understanding the issues in the market. This will provide the government with a strong evidence base from which to develop policy options (if required).

Consultation

19. Senior members of the Cabinet Economic Development Committee were consulted on possible markets to be subject to a market study, along with coalition party leaders.
20. The Commerce Commission, Treasury and the Ministry of Transport have been consulted on this Cabinet paper and the draft terms of reference. The Department of Prime Minister and Cabinet has been informed. The Minister of Energy and Resources was consulted on the draft terms of reference.
21. The Commerce Commission is of the view that twelve months is required for the completion of a market study based on the proposed terms of reference.

Financial Implications

22. The Commerce Commission has a dedicated appropriation of \$1.5 million per annum to carry out market studies. The Commission is expected to meet the costs of this study from within this appropriation.

Legislative Implications

23. There are no legislative implications arising from this paper.

Human Rights

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

Publicity

25. I intend to issue a media statement announcing the initiation of the study into retail fuel markets. The finalised terms of reference must be published in the Gazette and will be posted on MBIE's website.

Proactive Release

26. MBIE will publish this Cabinet paper and the finalised terms of reference on its website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **note** that the Commerce Amendment Act 2018 gives the Commerce Commission the ability to undertake market studies;
2. **note** that I intend to require the Commerce Commission to undertake a study into competition in retail fuel markets, in line with the terms of reference set out in Annex 1;
3. **note** that I intend to require the Commerce Commission to publish its final report on competition in retail fuel markets by 5 December 2019;
4. **note** that the Commerce Commission will publish and consult on a draft report several months prior to the publication of the final report, which will provide a strong indication of the Commission's conclusions;
5. **note** that this Cabinet paper and the final terms of reference for the market study will be published on the MBIE website.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

Annex 1: Proposed terms of reference for a competition study into retail fuel markets

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

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

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

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