



COVERSHEET

Minister	Hon Dr Megan Woods	Portfolio	Energy and Resources
Title of Cabinet paper	Response to Commerce Commission's Retail Fuel Market Study	Date to be published	27 February 2020

List of documents that have been proactively released

Date	Title	Author
16 December 2019	Response to Commerce Commission's Retail Fuel Market Study	Office of the Minister of Energy and Resources
16 December 2019	Response to Commerce Commission's Retail Fuel Market Study CAB-19-MIN-0680	Cabinet Office
16 December 2019	Annex One Regulatory Impact Statement for the Government response to Commerce Commission Retail Fuel Sector Market Study – High Level Decisions	MBIE

Information redacted

YES / NO

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

In Confidence

Office of the Minister of Energy and Resources

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet

Response to Commerce Commission's Retail Fuel Market Study

Proposal

1. This paper seeks agreement to a Government response to the recommendations of the Commerce Commission's (the Commission) Retail Fuel Market Study and outlines a timeframe for progressing the response.

Executive Summary

2. The Commission's final report on the Retail Fuel Market Study has found that fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market, leading to consumers paying higher pump prices for petrol and diesel than they should.
3. The Commission has recommended a range of changes to address this issue. This paper seeks agreement in principle to a response to the Commission's recommendations, subject to preparation of a Regulatory Impact Statement. In particular, to:
 - 3.1. make changes to wholesale market arrangements to introduce transparent wholesale pricing at fuel terminals and to require terms in wholesale contracts that are fair and facilitate retail competition; and
 - 3.2. improve the ability of consumers to make more informed purchasing decisions through regulating the display of premium prices on price boards and monitoring use of price discounting.
4. We propose to further investigate some recommendations, including the need for backstop regulatory powers to support transparent wholesale pricing, and the introduction of fuel cap stickers specifying the fuel grade for vehicles.
5. We propose to develop a fuel industry bill, to enable the development of an industry code to address recommendations that require regulatory intervention.
6. The Commission also makes a number of recommendations to industry. The Minister of Energy and Resources will be writing to industry to ask them to address recommendations including reviewing their shared infrastructure arrangements to improve industry understanding and to encourage investment in shared storage, and changing current industry practices that may weaken competition in relation to the major suppliers' joint shipping network and refinery allocation.

7. We seek agreement for the Minister of Energy and Resources to report back to Cabinet in February to seek final agreement to the responses to the recommendations in the Commission's final report and approval to draft legislation.

Background

8. On 3 December 2018, the Minister of Commerce and Consumer Affairs wrote to the Commission to require it to carry out a market study (referred to as 'competition study' in the Commerce Act) into any factors that may affect competition for the supply of retail petrol and diesel used for land transport throughout New Zealand.
9. The Commission's final report on the *Market study into the retail fuel sector* has now been released. The Commission has found that fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market. The Commission has also found that wholesale prices are higher than it would expect in a competitive market and that this flows through to consumers paying higher pump prices. In particular, the Commission noted in its findings that:
 - 9.1. While retail fuel margins have stabilised since 2017, these remain high, and are unlikely to return to competitive levels without intervention.
 - 9.2. The core problem is limited competition at the wholesale level – there are barriers to entry and limited options for dealers and distributors to switch suppliers.
 - 9.3. On the retail market side, there is some evidence of regional price differences that are not explained by differences in costs to supply, and that margins for premium petrol have been growing faster than for other fuels.
 - 9.4. Discount and loyalty schemes avoid direct competition on fuel prices.
10. The Commission has undertaken a robust process. The Commission has gathered evidence from a wide range of stakeholders including the fuel industry, industry groups, consumer groups and everyday consumers. The Commission sought submissions on an issues paper and on a draft report. Following release of the draft report in August 2019, the Commission held a consultation conference on the report, and sought cross-submissions on the draft report.

The Commission's recommendations

11. The Commission has made a number of recommendations aimed at addressing these findings and improving competition in the New Zealand retail fuel market. These recommendations relate to two main areas: improving wholesale competition for fuel and facilitating consumers to make informed choices.

Wholesale markets

12. The Commission has made a number of recommendations aimed at improving competition in the wholesale market. The Commission considers that limited competition in the wholesale market is due to:

- 12.1. longstanding and one-sided wholesale supply relationships favouring the major suppliers, with limited options for the distributors and dealers to switch suppliers; and
 - 12.2. the joint infrastructure network of the major suppliers, which gives them reach throughout New Zealand that competitors find difficult to match.
13. The Commission recommends:
- 13.1. introducing a more transparent wholesale pricing regime at fuel terminals (terminal gate pricing regime) that requires all firms supplying from a terminal to post a price and provide fuel at that price provided certain conditions have been met, and providing for a regulatory backstop power if a regime does not deliver competitive outcomes in a reasonable period of time;
 - 13.2. requiring terms in wholesale contracts that are fair and facilitate retail competition;
 - 13.3. that parties to the coastal shipping joint venture and inventory sharing ('borrow and loan') arrangements publish criteria for participation in the arrangements; and
 - 13.4. that parties to the 'borrow and loan' arrangements review aspects of these arrangements that may be disincentivising investment in shared storage.
14. The Commission recommended that a mandatory industry code with monitoring and enforcement powers should be used by Government as the mechanism for implementing the recommendations that require regulatory intervention. Such a code would require legislation to implement.
15. These changes would improve competition in the wholesale market, which should flow through to a more competitive retail environment. Brands like Waitomo and NPD should be able to access fuel more cheaply and in more places, and in turn should be able to offer cheaper fuel to consumers.

Retail markets

16. On the retail side, the Commission has also made a number of recommendations for improving the ability of consumers to make more informed purchasing decisions through:
- 16.1. regulating to require retail sites to display premium petrol prices on price boards to enable consumers to compare the prices of premium fuels before they fill up;
 - 16.2. monitoring use of price discounting, and of the display of discounted prices on price boards; and
 - 16.3. investigating the introduction of fuel cap stickers specifying fuel grade for vehicles.

Other recommendations

17. Additionally, to support its primary recommendations, the Commission recommended:
 - 17.1. regulating to require certain information to be collected and retained in New Zealand for a period of time to assist meaningful market analysis; and
 - 17.2. changes to current practices (such as sharing of information) in relation to the major suppliers' joint shipping network and refinery capacity allocation.

Government response to Commission's recommendations

18. The table in Annex One provides a full outline of the Commission's recommendations and a proposed high level Government response to each of the recommendations.
19. We seek your agreement in principle to the proposed responses, subject to preparation of a regulatory impact statement. A draft regulatory impact statement, setting out initial analysis for the recommended response, is included with this paper. We note that some recommendations will require further investigation before recommending a final response.
20. The table of proposed responses accepts the majority of the Commission's recommendations. Cumulatively this suite of measures will promote greater competition and better outcomes for consumers.
21. We propose to implement the recommendations that require regulatory intervention through a fuel industry bill. We anticipate the bill could provide for:
 - 21.1. Regulation-making powers to enable development of an industry code (the Code) to:
 - 21.1.1. provide for pricing transparency at fuel terminals;
 - 21.1.2. provide for fair and competitive terms in contracts;
 - 21.1.3. require the disclosure of information for monitoring; and
 - 21.1.4. require retail fuel outlets to display pricing information in a way that assists consumer choice.
 - 21.2. Powers for the Commission to enforce the regulations using their investigative powers and ability to accept undertakings.
 - 21.3. A dispute resolution mechanism to address disputes between fuel industry participants in relation to matters covered by the Code.
 - 21.4. Offences and penalties for breach of regulations and the Code.
 - 21.5. A review mechanism to ensure that the Code is working effectively and the ability to address any shortcomings.

Recommendations for industry

22. We note that a number of the recommendations relate to actions to be undertaken by industry, particularly parties to the shared infrastructure arrangements.
23. The Minister of Commerce and Consumer Affairs has already written a letter to participants in the retail fuel industry to encourage them to put premium prices on price boards at their sites now, ahead of new regulations. A number have already responded that they are working towards this.
24. We propose that the Minister of Energy of Resources writes to industry before the end of 2019 to ask them to consider and address the other matters that the Commission raised in relation to shared infrastructure arrangements and capacity allocation for Refining NZ.

Timeline

25. On 2 December 2019, Cabinet invited the Minister of Commerce and Consumer Affairs to ensure that a proposed fuel sector industry bill is progressed with the view to its enactment in 2020 [CAB-19-MIN-0640 refers]
26. We note that the Commission's report indicates high margins and profits have persisted for a long time, and we consider that consumers should be able to expect prompt action on a significant area of personal expenditure. An indicative timeline for passage of a fuel industry bill by June 2020 would include the following components:

Timeline	Activity
December 2019/January 2020	Engagement with industry stakeholders, developing policy responses for matters requiring further investigation
February 2020	Consideration by Cabinet for final agreement to policy response and approval to draft
March 2020	Drafting of Bill, iterative drafting process, refining of policy detail with MBIE, peer review and proof reading
April 2020	Bill of Rights Act vetting of Bill, coalition consultation, brief targeted consultation
May 2020	Consideration by Cabinet Legislation Committee for approval for introduction Mid-May: First reading and referral to Select Committee
June 2020	Mid-June: Select Committee report back. Late-June: Bill passes through remaining stages.

27. There are risks to legislative design with such a short timeframe for this legislation. Only very limited targeted consultation could be undertaken after the policy decisions had been made. Passage of legislation in this timeframe would require a shortened Select Committee process of one month.
28. Because of the compressed period for consultation, we note that it may only be possible to finalise regulations after primary legislation is passed. The regulations involve a greater level of technical detail and complexity, which will require additional time for consultation and for Parliamentary Counsel Office drafting. Development of

regulations for an industry code to implement terminal gate pricing and changes to wholesale contracts will be prioritised.

Next steps

29. As noted above, the Minister of Energy and Resources proposes to write to industry before the end of 2019 to ask them to consider and address the matters that the Commission raised in relation to shared infrastructure arrangements and capacity allocation for Refining NZ.
30. As a fuel industry bill would sit in the Energy and Resources portfolio, we propose that the Minister of Energy and Resources report back to Cabinet in February 2020 to seek final policy approvals for the decisions outlined in Annex One and for approval to draft a fuel industry bill.

Consultation

31. The Treasury and the Ministry of Transport were consulted on the proposals in this paper. The Department of Prime Minister and Cabinet was informed.

Financial Implications

32. The proposals in this paper have financial implications, including the potential for expanded enforcement functions for the Commission, an expanded role for MBIE in monitoring fuel markets, and costs for dispute resolution services. Some of these costs may be recoverable, but this is yet to be determined. We will provide detail of financial implications and funding sought when final policy approvals are sought in February 2020.

Legislative Implications

33. Legislation will be required to implement the proposals in this paper. A legislation bid for a fuel industry bill has been prepared to be included in the 2020 Legislation Programme, with a priority of Category 3 (to be passed in the year if possible) sought.
34. Following discussion at Cabinet on 2 December, we now propose that this bill is sought to be Category 2 (must be passed in the year). The Commission's final report notes that high margins and profits have persisted for a long time, and consumers should be able to expect prompt action on a significant area of personal expenditure.
35. The Bill will include a provision that the Act should be binding on the Crown.

Impact Analysis

36. 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.

37. 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.
38. 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.

Climate Implications of Policy Assessment

39. The Ministry for the Environment (MfE) has been consulted on this proposal and note that the CIPA requirements do not apply. Both MfE and the Ministry for Business, Innovation and Employment (MBIE) consider that the emissions impacts are unlikely to be significant. While a decrease in the price of petrol through improved competition may have an indirect impact of encouraging additional driving, we consider this effect will be small, as demand for fuel is relatively inelastic. MfE will work with MBIE to further assess the emissions impacts, if appropriate, before final Cabinet decisions in early 2020.

Human Rights

40. The proposals in this paper are not inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Publicity

41. A press release was issued on 5 December to indicate that Government accepted the Commission's findings and would be moving swiftly to respond to its recommendations.
42. We propose that the Minister of Commerce and Consumer Affairs makes a formal Government response to the Commission's market study after Cabinet decisions are made in February. This Cabinet paper, including the table of responses, will be proactively released at that time.

Proactive Release

43. We propose to proactively release this Cabinet paper and minute. We propose to delay the release time for a short time beyond 30 business days in order to align the release of the Cabinet paper and table of actions with Cabinet agreement to final policy decisions in February.

Recommendations

The Minister of Energy and Resources and the Minister of Commerce and Consumer Affairs recommend that the Committee:

1. **Note** the Commerce Commission (the Commission) has found that fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market, leading to consumers paying higher pump prices for petrol and diesel than they should
2. **Note** the Commission has recommended:
 - 2.1. making changes to wholesale market arrangements to introduce more transparent pricing at fuel terminals (with backstop regulatory powers if a regime does not deliver outcomes), and to provide for terms in wholesale contracts that are fair and facilitate retail competition;
 - 2.2. that parties to shared infrastructure arrangements review them to improve industry understanding and to encourage investment in shared storage;
 - 2.3. improving the ability of consumers to make more informed purchasing decisions through regulating the display of premium prices on price boards, monitoring use of price discounting and investigating the introduction of fuel cap stickers specifying the fuel grade for vehicles;
 - 2.4. regulating for collection and disclosure of information to assist in market analysis; and
 - 2.5. changing current industry practices that may weaken competition in relation to the major suppliers' joint shipping network and refinery allocation.
3. **Note** the proposed responses to the Commission's recommendations outlined in Annex One.
4. **Agree** in principle to the proposed responses in Annex One, subject to the preparation of a regulatory impact statement.
5. **Note** the Minister of Commerce and Consumer Affairs has written to participants in the retail fuel industry to encourage them to put premium prices on price boards at their sites now, ahead of new regulations to require this.
6. **Note** the Minister of Energy and Resources will write to fuel companies before the end of 2019 to ask them to address the recommendations from the Commission's study that are directed at them.
7. **Note** that on 2 December 2019, Cabinet invited the Minister of Commerce and Consumer Affairs to ensure that a proposed fuel sector industry bill is progressed with the view to its enactment in 2020 [CAB-19-MIN-0640 refers].

8. **Note** we propose an indicative timetable for passage of legislation by June 2020, as we consider that consumers should be able to expect prompt action on a significant area of personal expenditure, and based on this timeframe we propose a fuel industry bill that is category 2 (must be passed in the year).
9. **Agree** that the Minister of Energy and Resources report back to Cabinet in February to seek final agreement to the responses to the recommendations in the Commission's final report and approval to draft legislation.

Authorised for lodgement

Hon Dr Megan Woods

Minister of Energy and Resources

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

PROACTIVELY RELEASED

Annex one: Government Response to Commerce Commission’s final report on retail fuel

Improving wholesale competition for fuel

Commerce Commission Recommendation	Government Response
<p>1 Institute a terminal gate pricing regime The Government should make regulations enabling a terminal gate pricing regime¹ as part of an enforceable industry code (similar to what exists in Australia). The terminal gate price would act as a benchmark for wholesale customers negotiating their wholesale supply agreements.</p> <p>The recommendation should be considered with recommendation five: To support a terminal gate pricing regime, the Government should also introduce backstop regulatory powers that could be invoked if the regime does not deliver competitive outcomes in a reasonable period of time.</p>	<p>AGREE A terminal gate pricing regime will increase wholesale price transparency and create the potential for a liquid wholesale spot market to develop. We will investigate the need for backstop regulatory powers to support the terminal gate pricing regime.</p>
<p>2 Change wholesale supply agreements The Government should make regulations that limit the use of certain terms in wholesale supply contracts. In particular:</p> <ul style="list-style-type: none"> • all wholesale contracts should be written in clear and concise language, and should include a transparent cost-based pricing methodology; • wholesale contracts should permit a distributor to take a prescribed minimum percentage of their fuel from other suppliers (eg. at least 20 per cent of supply); • distributors should not be committed to wholesale contracts exceeding a 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; and • other terms of wholesale fuel supply contracts should be regulated to prevent unjustifiable limitations on the ability of distributors and dealers to compete. 	<p>AGREE Greater contractual freedom and fair contract terms will facilitate wholesale competition, and in turn facilitate competition in the retail market.</p>
<p>3 Improve information on infrastructure sharing arrangements The parties to infrastructure sharing arrangements including the Coastal Oil Logistics Ltd joint venture and ‘borrow and loan’² inventory sharing arrangements should publish the existing process and criteria for third party participation in the infrastructure sharing arrangements.</p>	<p>NOTED The Government expects the parties to respond to these recommendations.</p>
<p>4 Review infrastructure sharing arrangements The parties should also review aspects of the ‘borrow and loan’ inventory sharing arrangements that may be disincentivising investment in shared storage. Regulation to enable participation in infrastructure sharing arrangements is not recommended at this time.</p>	<p>NOTED The Government expects the parties to respond to these recommendations.</p>

1 A terminal gate pricing regime requires all suppliers of fuel at storage terminals to set a spot price each day at which they will supply a minimum quantity of fuel on demand to buyers.

2 A ‘borrow and loan’ scheme allows major fuel suppliers to routinely access fuel at each other’s terminals.

5	Adopt an enforceable industry code of conduct Legislation should be introduced to create an enforceable mandatory industry code by regulations to give effect to the recommendations that require regulatory intervention.	AGREE A fuel industry bill will be introduced to the House in 2020.
---	--	---

Facilitating informed consumer choice

	Commerce Commission Recommendation	Government Response
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.	AGREE
7	Improve information on when premium fuel should be used The Government should make regulations to require fuel cap or fuel flap stickers specifying the minimum octane level required for a vehicle.	TO CONSIDER FURTHER
8	Monitor the display of discount pricing on price boards Regulation of display of discount pricing is not recommended at this time. The Government should monitor the display of discount pricing on price boards to assess whether this practice benefits consumers or limits competition. Fuel retailers are also encouraged to consider the potential for their discount and loyalty programmes to cause consumer detriment.	AGREE The Government expects the parties to respond to this part of the recommendation.

Improving monitoring of the fuel market

	Commerce Commission Recommendation	Government Response
9	Improve information and record keeping The Government should make regulations requiring improved, standardised information to be collected and retained in New Zealand for a certain period of time.	AGREE This will improve the timeliness, cost and accuracy of any future study or regulatory intervention in the fuel sector.

Other recommendations for the fuel industry

	Commerce Commission Recommendation	Government Response
10	Change the Coastal Oil Logistics Ltd joint venture to reduce the potential for coordination The Coastal Oil Logistics Ltd joint venture should review and change any information sharing arrangements that may lead to softening of competition.	NOTED The Government expects the parties to respond to this recommendation.
11	Change refinery capacity allocation Refining NZ's Technical Committee should review and change any information sharing arrangements and mechanisms for allocation of refinery capacity that may lead to softening of competition.	NOTED The Government expects the parties to respond to this recommendation.