



## COVERSHEET

<b>Minister</b>	Hon Dr Megan Woods	<b>Portfolio</b>	Energy and Resources
<b>Title of Cabinet paper</b>	Response to the Commerce Commission's Retail Fuel Market Study: Fuel industry bill	<b>Date to be published</b>	27 February 2020

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
12 February 2020	Response to the Commerce Commission's retail fuel market study: Fuel industry bill	Office of the Minister of Energy and Resources
12 February 2020	Response to the Commerce Commission's Retail Fuel Market Study: Proposed Fuel Industry Bill DEV-20-MIN-0008	Cabinet Office
12 February 2020	Annex One Regulatory Impact Statement for the Government Response to the Commerce Commission's retail fuel market study: Fuel industry bill	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.

Some information has been withheld for the following reasons:

- Commercial information

# Coversheet: Government response to Commerce Commission Retail Fuel Sector Market Study

Advising agencies	Ministry of Business, Innovation and Employment (MBIE)
Decision sought	Agree to a regulatory framework as the Government’s response to the Commerce Commission’s retail fuel sector market study report with the detail of the preferred proposals to subsequently be consulted on in the course of developing regulations.
Proposing Ministers	Energy and Resources, Commerce and Consumer Affairs

## Section A: Summary problem and proposed approach

<p><b>Problem Definition</b></p> <p><b>What problem or opportunity does this proposal seek to address? Why is Government intervention required?</b></p>
<p>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.</p>
<p><b>Proposed Approach</b></p> <p><b>How will Government intervention work to bring about the desired change? How is this the best option?</b></p>
<p>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.</p>

## Section B: Summary impacts: benefits and costs

<p><b>Who are the main expected beneficiaries and what is the nature of the expected benefit?</b></p>
<p>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.</p>
<p><b>Where do the costs fall?</b></p>
<p>The costs primarily fall on:</p> <ul style="list-style-type: none"> <li>• Importers, distributors and retailers of petrol and diesel. There will be moderate transitional compliance costs as these companies move to the new regulatory regime</li> </ul>

(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 regulations, 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 'must supply' obligation 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, such as initiating the regulatory backstop, 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. MBIE has been monitoring weekly retail petrol and diesel prices since 2008. A 2017 Fuel Market Financial Performance Study commissioned by MBIE 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. MBIE has also carried out targeted consultation with key stakeholders on the regulatory proposals following the release of the Commerce Commission's report. We will continue to engage with these stakeholders in the course of developing the new regulations to give effect to the detail of the regulatory proposals.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Treasury and MBIE
Quality Assurance Assessment:
The Quality Assurance Panel considers that the Regulatory Impact Assessment meets the Quality Assurance Criteria.
Reviewer Comments and Recommendations:
<p><i>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' Regulatory Impact Assessment (RIA) produced by MBIE in December 2019. The Panel considers that the RIA meets the Quality Assurance criteria.</i></p> <p><i>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.</i></p> <p><i>However, due to time constraints and the complexity of the design, a regulatory backstop regime as part of the terminal gate regime has not been considered at this time. MBIE will continue to develop it with a view that it should be considered by Ministers at a future date and added to the Fuel Industry Bill or Act.</i></p> <p><i>Further, as recognised in the RIA, this regime requires effective monitoring of industry practices to maintain incentives for competitive conduct and allow timely intervention if the regime is not working as intended. There are risks if there is no adequate level of resources from MBIE and the Commerce Commission to carry out these functions.</i></p>

# Impact Statement: Government response to Commerce Commission Retail Fuel Sector Market Study

## Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment ( <b>MBIE</b> ) 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 key policy decisions to be taken by Cabinet on the overall regulatory framework to be included in a new Fuel Industry Bill.

Key Limitations or Constraints on Analysis
<p><b>Range of options considered</b></p> <p>The range of options considered is based on the Commerce Commission’s (<b>the Commission</b>) analysis in its Final Report for the Market Study into the Retail Fuel Sector (<b>the Final Report</b>) 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.</p> <p><b>Quality of data used for impact analysis</b></p> <p>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, MBIE’s consultation with targeted stakeholders and other anecdotal evidence. The sources used did not include much quantitative assessments of the costs and benefits of the options. While we have made use of multiple evidence sources wherever possible, particular reliance has been placed on the Commission’s findings and analysis given the Commission’s rigorous testing process.</p> <p><b>Consultation and testing</b></p> <p>The RIS has been prepared under significant time constraints, and as such, MBIE has not been able to fully test its analysis and refinement of options with interested parties. Much of the detail of the regulatory proposals will be included in regulations empowered under the new Fuel Industry Bill. As such, we anticipate that there may be further refinements of the proposals through consultation during the legislative process and in the development of the regulations.</p>

**Responsible Manager:**

Authorised by:

Osmond Borthwick  
Special Advisor, Energy Markets Policy  
Building, Resources and Markets  
Ministry of Business, Innovation & Employment

31 January 2020

PROACTIVELY RELEASED

## 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.

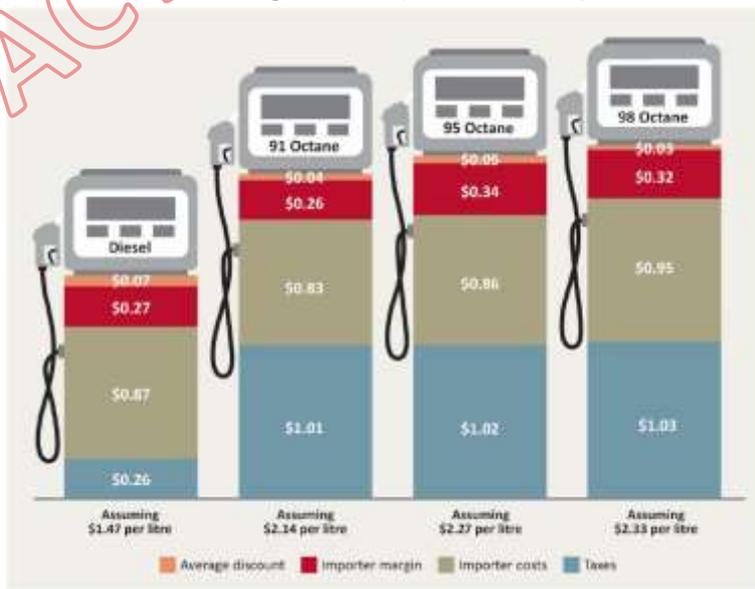
About 3.2 billion litres of petrol and 3.6 billion litres of diesel are consumed annually in New Zealand. According to Bloomberg, New Zealanders spend more income on fuel each year than people in 55 other countries (out of a total of 61 countries) with the average New Zealand driver purchasing 673 litres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

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

<sup>1</sup> Bloomberg <https://www.bloomberg.com/graphics/gas-prices/#20191:New-Zealand:NZD:I>. (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 Mount Maunganui, Wellington and Lyttelton.

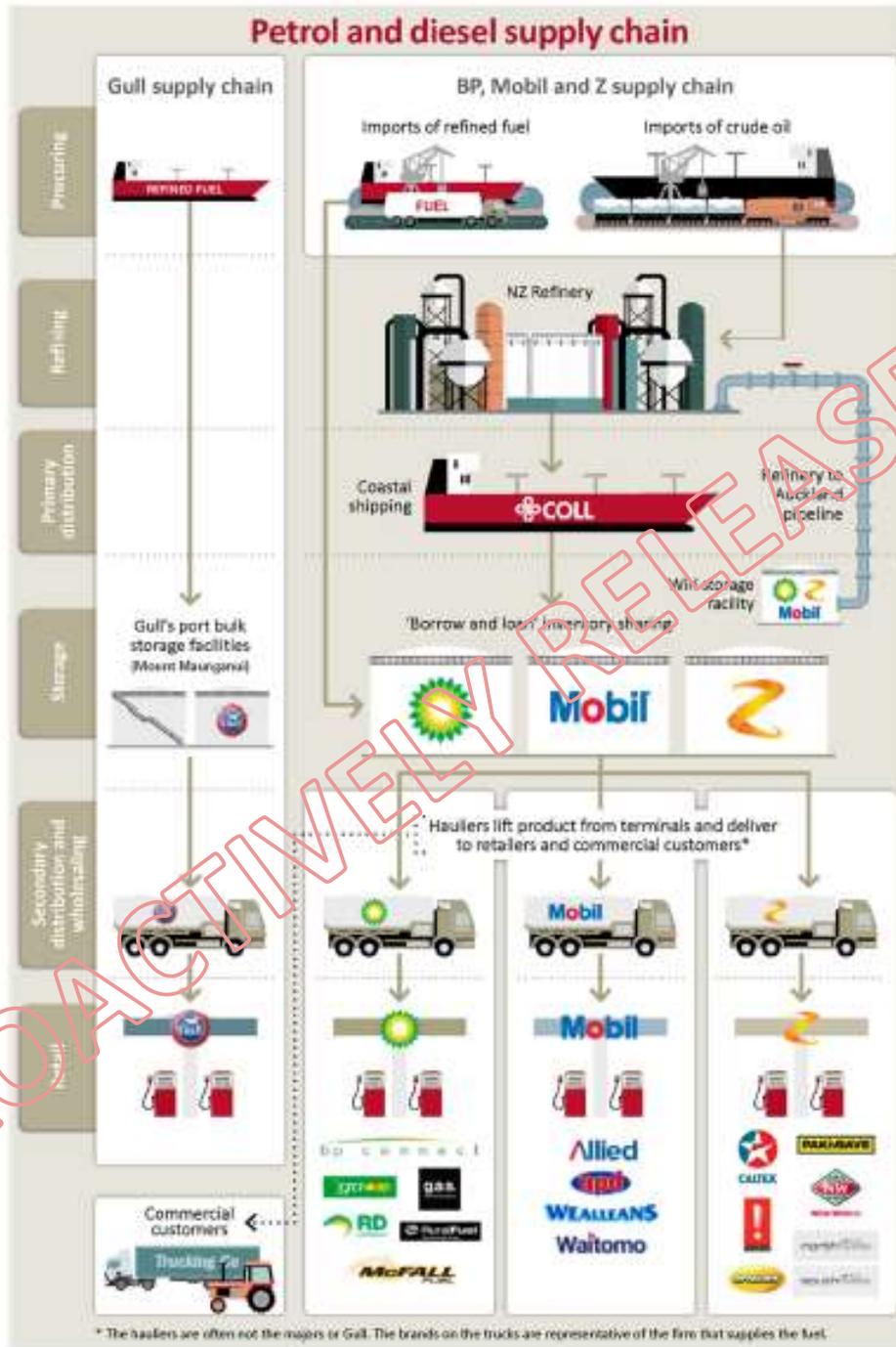
The majors jointly own or control the following infrastructure:

- 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 Mount 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 mid-2020. A further terminal is planned in Mount Maunganui.

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 (for petrol in particular) 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**

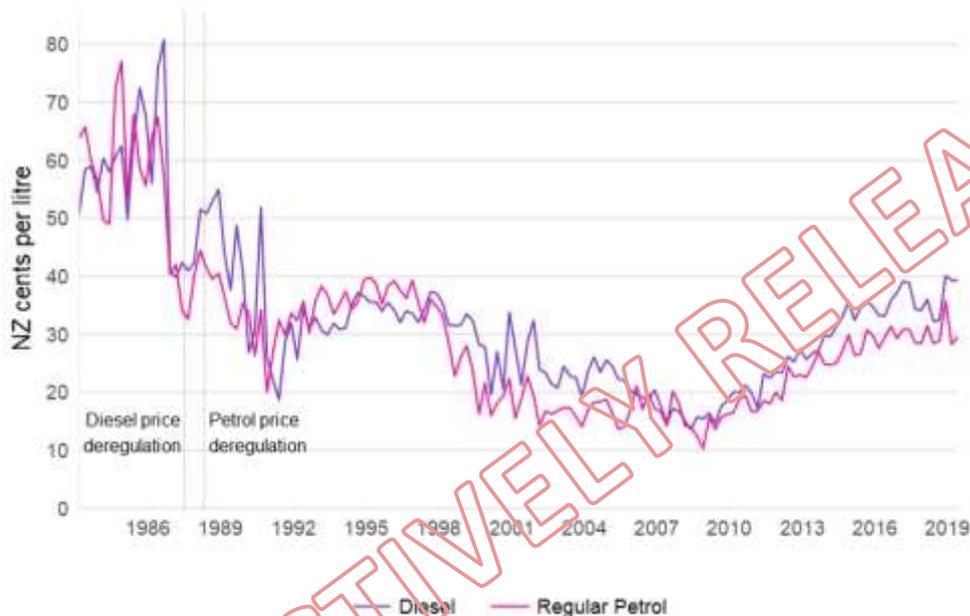
The Commission has used a range of indicators to assess profitability of New Zealand fuel companies. Its results are outlined in its report as follows:

- 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 than 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 (eg Z Energy's recent earnings downgrade), 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 Mount Maunganui, and its geographical reach has been limited, until very recently, to destinations which can feasibly be served by truck from that terminal. For example, prices are generally higher in Wellington than Masterton, although it is more expensive to truck fuel to Masterton from Wellington. The price difference is likely to be partly explained by Gull having a service station in Masterton, but not in Wellington (until this year).

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 (until recently) Wellington. Currently, the only competition the majors face in southern regions is from each other, and the other retail brands they themselves supply. The Commission notes that the opening of NPD sites, which only operate in the South Island, appears to have had the greatest impact on reducing the majors' prices.

Analysis conducted for MBIE has shown that fuel prices in the South and the North Island

were roughly similar up until about 2014. However, over the next five years, a significant gap 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 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 retail 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 met.

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. Some inputs are provided by Statistics NZ, which it collects as part of its consumer price index (CPI) statistical series. 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.

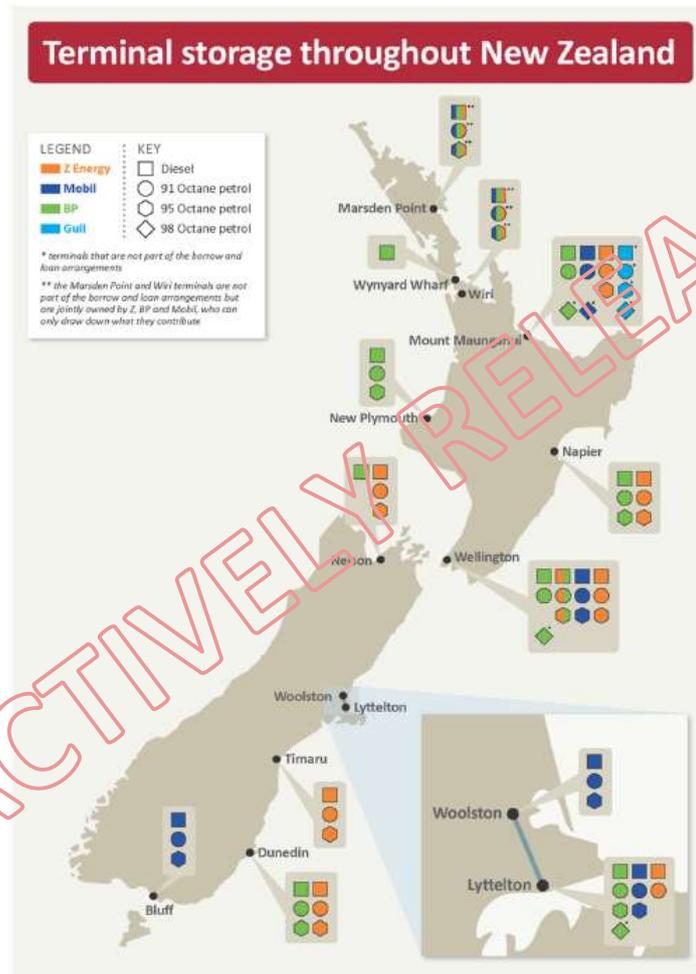
There are strong interrelationships between these infrastructure-sharing arrangements. The scheduling and shipping services provided by Coastal Oil Logistics are critical for the successful distribution of product from the refinery. The shared pipeline from the refinery to Auckland is also critical, 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 are also plans for its parent company, Pacific Energy, to 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 support 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.<sup>2</sup>

#### **Restrictive or dependent wholesale supply relationships**

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

<sup>2</sup> 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 influence 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 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 than 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.

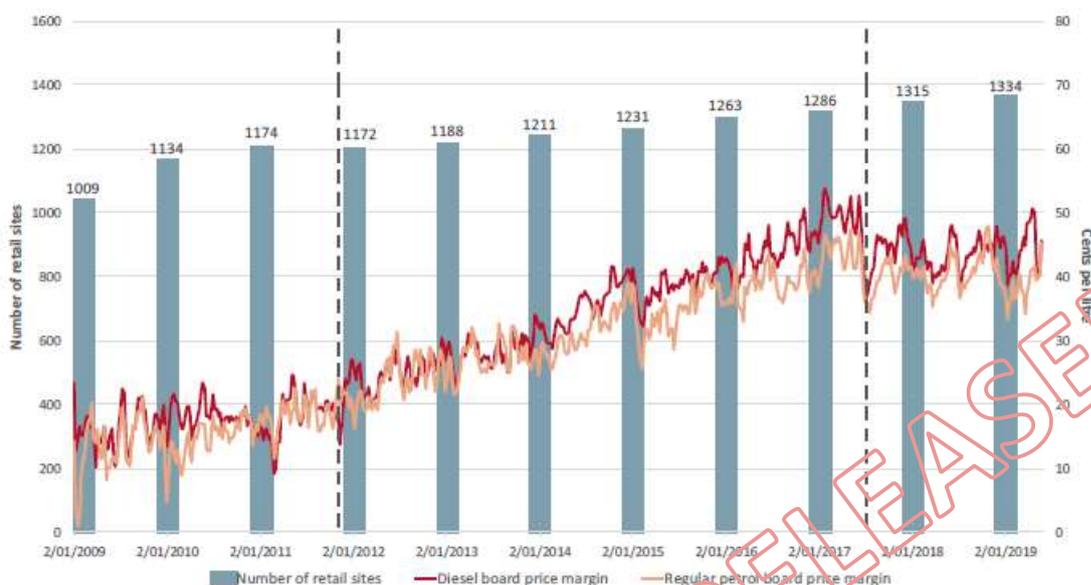
This is discussed further below.

### **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.<sup>6</sup>

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 coastal 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 of 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 percent 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 an overall framework for assessing the options and regulatory approach for the purposes of informing the Government response to Commission's Final Report and the development of a Fuel Industry Bill. The details of these proposals will be fleshed out further in the course of developing the associated regulations which will include much of the technical detail of the regime.

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

- A new Fair Trading Amendment Bill was introduced to the House on 17 December 2019 which contains 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 retail sites.

#### *Fuel companies*

- *Importers:* Z Energy, Mobil, and BP are the three 'majors' and Gull also imports fuel and operates retail sites. TOSL is anticipated to import (or provide for the import of) fuel once it commences operations.

- *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. For example, the MTA considers that some wholesale supply contracts held by its dealer members are unduly restrictive and impede fair competition. Gull, Gaspy, the MTA, the AA and Waitomo all welcome initiatives that increase competition in the wholesale fuel market. The AA considers that displaying the premium petrol price on price boards will improve price competition.

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. While disputing some of the Commission's findings (eg Z Energy disputes the assessment of industry profitability) both Mobil and Z Energy are supportive of measures that further strengthen competition and improve outcomes for consumers. BP does not consider that material intervention is warranted. All of the importers (including Gull) are concerned that the interventions have a risk of unintended consequences if not properly consulted.

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

### **Consultation**

The Commission conducted multiple rounds of consultation as part of its market study including hosting a consultation conference. The consultation was open to the wider public. MBIE carried out targeted consultation with key stakeholders seeking views on the Commission's Final Report to inform the advice on the Government response. There will be opportunities for further consultation through the legislative process and in developing the regulations.

## 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 in its Final Report:

##### *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 MBIE's assessment of these options for the purposes of informing the Government response to the Commission's Final Report and developing the necessary legislation and associated regulations to give it effect.

#### Options to improve wholesale competition for fuel

##### Option 1: Introduce a terminal gate pricing regime

The first option is to introduce a terminal gate pricing regime, drawing on a similar regime which operates in Australia through regulations providing for an Oil Code.

A terminal gate pricing regime would require wholesale suppliers (ie importers) to post a daily price at which they will sell fuel to wholesale customers at storage terminals on a spot basis. The terminal gate price would be quoted for fuel only and include no added services, such as delivery. Eligible wholesale customers would be able to drive up to the terminal and purchase fuel at the daily posted spot price. This will enable them to test the market or bridge supply arrangements until they can negotiate contracted supply. The posting of daily spot prices by the wholesale suppliers at each terminal would also improve price transparency and facilitate informed contracting arrangements (which are linked to Option 2).

The Australian regime requires that wholesale suppliers must not unreasonably refuse to

supply any wholesale customer who requests supply at the terminal gate (that is, a 'must supply' obligation). However, supply is not required if:

- There are reasonable grounds to believe the wholesale customer is unable to pay, or will not comply with relevant health and safety requirements
- The supplier does not have sufficient fuel supply to reasonably meet the wholesale customer's requirements
- The volume of fuel to be supplied is below a minimum amount.

A New Zealand terminal gate pricing regime would need to take into account the different characteristics of New Zealand fuel markets, such as the majors' infrastructure sharing arrangements at terminals and the frequency of port coordination events due to tight supply. These create some risks that would need to be addressed, being:

- The risk suppliers may refuse, or constructively refuse, to supply on a spot basis at the terminal during port coordination events when supply is constrained. This would undermine the benefits of regime, as any posted price would have no information value and any wholesale customer seeking to use spot supply to bridge supply contracts (eg a new entrant seeking new supply) would not have security of supply or leverage to negotiate a new contract.
- The risk that, irrespective of the supply situation, suppliers do not offer competitive terminal gate prices. For example, the supplier may be at a terminal in a relatively remote location which gives them a degree of market power, or the suppliers may coordinate in the setting of terminal gate prices.

To address the first risk, and taking into account New Zealand's unique market characteristics, under this option the terminal gate pricing regime would have the following features:

- Standard terms and conditions for terminal gate sales would 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 would apply to all wholesale suppliers who have a right to draw product from terminals or equivalent facilities (eg it would include terminals owned by non-majors, such as Gull)
- Suppliers would have an obligation to make a certain minimum volume of fuel available for spot sales (eg a tanker load per week or month).

The details of the terminal gate pricing regime would be consulted on as part of developing regulations. MBIE's preliminary view is that the specified minimum volume for spot sales would take priority over contracted and own supply in the event of a port coordination event or shortage (that is, a 'priority of supply' obligation). The regime would also require that the supplier could not discriminate between contracted and own supply in the event of a port coordination or shortage.

These obligations on suppliers under the terminal gate pricing regime would be enforceable by the Commission. In addition, an alternative dispute resolution process (eg mediation) would be set up under the proposed regulations to enable the suppliers and wholesale customers to resolve disputes (links to Option 5).

However, this terminal gate pricing regime on its own is insufficient to address the second risk, relating to the potential for terminal gate prices to be set at uncompetitive levels. The potential for a wholesale customer to purchase and truck supply from a neighbouring

terminal provides some constraint (if available), but this may not be sufficient to promote competitive terminal gate pricing within a reasonable period of time, particularly given the significant cost advantage that the majors enjoy through infrastructure sharing arrangements.

Consequently, the Commission also recommended that this option include:

- A monitoring regime to detect any risky behaviour at a terminal (covered in Option 9)
- A backstop regulatory regime that can be brought into force should competition not deliver competitive terminal gate prices within a reasonable period of time. The credible threat of further regulatory intervention should provide incentives for competitive prices.

The Commission outlined two possible options for the design of a regulatory backstop for the terminal gate regime:

- 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 price or if 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 terminal or terminals where a major has market power, or competitive outcomes are not being observed. Options may include determining prices based on:
  - Mean of Platts Singapore<sup>3</sup> (or **MOPS**) plus a regulated margin, or
  - A benchmark terminal gate price, based on a demonstrably competitive price observed at another port (eg Mount Maunganui), adjusted to reflect any difference in cost associated with transporting fuel by the least cost means (eg shipping) to the regulated terminal.

MBIE considers that repeated instances of non-compliance by a supplier are best addressed through the enforcement of the regulations and therefore we have not considered the first option of a binding arbitration system further. However, we support the development of a backstop regulatory regime which would provide a basis for determining terminal gate prices if competitive outcomes are not being observed in a timely manner.

Developing this regulatory backstop is complex, and is likely to require a significant amount of time to design and draft. In particular, it would be necessary to have processes and thresholds for when a terminal or terminals may be subject to control, and if so, how that control would be applied and enforced. The design of this regulatory backstop could draw on lessons learned from other economic regulation, such as for specified airports under Part 4 of the Commerce Act or for raw milk supplied by Fonterra at the factory gate under the Dairy Industry Restructuring Act. However, it would need to be modified to fit the features of the fuel industry.

Given this complexity, MBIE proposes to continue to work on the regulatory backstop with a view that it should be considered by Ministers at a future date and added to the Fuel Industry Bill or Act. As Cabinet decisions are not being sought on the backstop at this time, it is not considered further.

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<sup>3</sup> The average price for a Singapore-based oil product, reported by the price assessment agency Platts. This is a widely used industry benchmark price.

### How would option 1 address the problem?

#### *Advantages*

A terminal gate pricing regime, coupled with the proposed changes to wholesale contracts in Option 2, is a key measure to address the problem of an inactive wholesale market. In particular, the terminal gate pricing regime goes some way to counter the significant cost advantages that the majors enjoy through infrastructure sharing arrangements by allowing other importers and distributors to access fuel from the existing network of terminals.

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 also provides access to supply to support new entry and expansion as a means to bridge supply arrangements. The 'priority to supply' (or non-discrimination) rules to be developed in regulations may also provide assurances of security of supply for wholesale customers that switch or have non-exclusive supply arrangements.

#### *Disadvantages*

The terminal gate price regime with the associated 'must supply' and 'priority to supply' obligations 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. However, the proposed volumes that a wholesale supplier could be obligated to supply are intended to be small (eg a tanker load per week or month) and this should not have a significant impact on stock holding costs. The proposed monitoring regime should also allow adjustments to the regulations on a timely basis if required. The rules for the 'must supply' obligation and prioritisation will be consulted on further in the development of regulations.

The increased transparency of terminal gate fuel prices may facilitate collusion. This risk will be minimised by the enhanced fuel monitoring regime to enable the regulator to identify potential competition issues. Further legislative intervention may be required if collusion is identified.

### How would option 1 achieve the objective?

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

- Creating the potential for a liquid wholesale spot market to develop
- Lowering barriers to entry and expansion for both importers and distributors by providing a readily available way to obtain supply from the existing network of terminals
- Providing greater pricing transparency for distributors and dealers, which should increase negotiating power and the likelihood of switching
- Providing competitive benchmark information for industry and government, which should curb the incentive on majors to use their market power in regions where competition is weak.

Increased wholesale market competition should lead to lower prices that will flow through to the retail market and consumers. 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 ability of the Commission to recommend further regulation if competition does not emerge in a timely manner.

## Option 2: Change wholesale supply contracts

The second option is to provide a regulation-making power in the Fuel Industry Bill that would allow regulations to be made which govern the contractual terms between wholesale suppliers, distributors and, as relevant, dealers. These requirements would apply to new contracts and, after a transitional period, all existing contracts.

The Commission identified three areas where contractual provisions in wholesale supply agreements may adversely affect competition:

- A lack of price transparency in wholesale supply agreements between suppliers and distributors and dealers, which makes it difficult to compare and negotiate wholesale prices, coupled with pricing terms that may provide suppliers with the ability to exert upwards pressure on retail prices
- Long-term exclusive contracts, which reduce contestability and limit the scope for entry into the wholesale market
- Other disincentives to switch suppliers, including restraints of trade, requirements to pay liquidated damages upon switching suppliers, rights of first refusal and renewal clauses at the supplier's option.

Under this option, the Fuel Industry Bill would:

- require contract terms to be written in clear and concise language;
- require prices to be set using a transparent pricing methodology set out in regulations and provide for a regulation-making power to prescribe acceptable methodologies;
- require certain terms to be included in contracts and provide for a regulation-making power to prescribe those particular terms, such as the ability for a distributor to terminate a contract on reasonable notice if the term is longer than a prescribed period;
- prohibit certain terms from being included in contracts and provides for a regulation-making power to prescribe those particular terms, such as terms that limit the ability of the dealer or distributor to compete with the supplier;
- provide a transitional period of at least one year to enable the affected parties to amend existing contracts to comply with the new provisions
- require the contract to provide for a dispute resolution process.

MBIE will carry out further consultation on the proposals for inclusion in the regulations. The Commission recommended the following options:

### *Transparency of pricing*

- That wholesale supply contracts set with reference to a terminal gate price of MOPS benchmark would be deemed to be using a transparent cost-based pricing methodology
- Prohibiting the unilateral variation of the pricing methodology, unless accompanied by sufficient notice and a right of the other party to terminate the contract in the event that the variation is unacceptable to it.

### *Long-term, minimum volumes and/or exclusive contracts*

- 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 (eg a maximum of five years) without a right to terminate on

notice, unless a longer term is reasonably necessary for relationship specific investment to occur or the contract is non-exclusive and contains no minimum purchase requirements.

#### *Other restrictive terms*

- All wholesale supply contracts should be regulated to prevent unjustifiable limitations on the ability of distributors and dealers to compete. One approach would be to include a prohibition on the inclusion or enforcement of terms that have that purpose or effect.
- A grey list may be outlined of terms that are likely to limit the ability of the distributor or dealer to compete.

The regulations would also include more detail about the alternative dispute resolution provisions whereby parties could resolve disputes, including in relation to price. For example, the Australian Oil Code has a voluntary mediation regime and the more recent Australian Dairy Industry Code has an additional non-binding arbitration regime.

#### **How would option 2 address the problem?**

##### *Advantages*

This option, coupled with the terminal gate pricing regime in Option 2, is a key measure to address restrictive or dependent wholesale supply arrangements which are impeding wholesale competition. 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. This will remove a barrier to entry and expansion by wholesale suppliers, both promoting competition between the majors and improving the conditions for entry by a new importer.

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.

##### *Disadvantages*

Requirements for existing contracts to be amended to provide for shorter contract length and non-exclusivity of supply, or to exclude restricted terms, may be seen to interfere with private contractual rights. There is a risk that these changes may increase uncertainty and risk for the wholesale supplier, and this risk could be reflected in higher fuel prices which would be passed on to consumers. MBIE will consult on whether additional measures should be included in the regulations to manage this risk. Such measures could include requirements for the distributor to give reasonable notice before switching all or part of purchase of fuel supply, and the merits of different options to limit unjustifiably restrictive contractual terms.

The requirement for wholesale supply contracts to include a transparent pricing methodology may be viewed as a 'soft' version of price control, particularly if it is required to be cost-based and backed up by a threat of further regulation. However, existing contracts of the fuel suppliers with commercial customers and distributors are often based on MOPS plus costs and a margin. Similar to Australia, it is expected that terminal gate pricing will also be used as a reference point in wholesale supply contracts. This change should not impose unreasonable costs, given the expected benefits outlined above.

There is a related risk that if many contracts adopt a terminal gate pricing methodology in their contracts that this could facilitate coordination on price and/or disincentivise a reduction

in the spot terminal gate price. This should be minimised by the other measures to promote competition in the wholesale market and the proposed enhanced monitoring regime (ie Option 9).

#### **How would option 2 achieve the objective?**

The removal of overly restrictive contractual terms will improve the ability of importers to compete and for distributors and dealers to obtain competitive terms for wholesale supply. 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.

As the Commission outlined, there is no guarantee that a competitive wholesale market will develop rapidly if these changes are made, particularly given the stable co-existence that has been in place for some time. However, the Commission considers, and MBIE agrees, that there appear to be significant economic incentives for some distributors to switch, at least some of their volumes, and this could be expected to lead to more competition over time. Increased wholesale competition will lead to lower retail prices to consumers. In the course of targeted consultation, we were advised by some stakeholders that they saw opportunities to compete for supply through these changes.

#### **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. This would improve transparency about how new importers can participate in the infrastructure sharing arrangements, if desired. To effectively promote competition, the access terms would be expected to be non-discriminatory.

This is a non-regulatory option. 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, where a new importer may have new infrastructure that could be included in these infrastructure sharing arrangements and improve the coverage or efficiency of the system, this should not be discouraged.

#### **How would option 3 address the problem?**

##### *Advantages*

This option is also designed to address the barrier to new entry for new importers that exists through the significant cost advantage that the majors share through their participation in infrastructure sharing arrangements. This option would make transparent how new importers may participate in those arrangements.

##### *Disadvantages*

Given the voluntary nature of this option, the costs are likely to be low and outweighed by the perceived benefits to the industry.

#### **How would option 3 achieve the objective?**

MBIE anticipates 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.

Facilitating wider participation for independent importers in the majors' shared infrastructure, notably port terminals and the associated logistics in the borrow and loan scheme has the potential to promote wholesale competition.

#### **Option 4: Review infrastructure sharing arrangements**

This option is for the majors to be invited to review the current rules or features of the borrow and loan scheme with a particular focus on addressing any measures that may disincentivise investment. This option is a non-regulatory proposal.

The borrow and loan scheme is a key element of the majors' infrastructure sharing arrangements. Under this scheme each major allows the other majors to draw down fuel from all or any of that major's terminals or infrastructure, as long as the other majors match it with an equivalent amount of fuel but not necessarily at the same place. This arrangement allows the majors to draw fuel from one another's terminals without having to buy or sell that product. Instead the majors have a series of bilateral arrangements setting 'throughput fees' that must be paid to the terminal owner for access to their terminal.

The Commission outlines that the borrow and loan scheme between the majors currently appears to be deterring investment in terminal infrastructure and causing some tension between the majors. For example **Commercial Information**

The reasons for this tension and potential disincentives for investment in terminal infrastructure include:

- 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.

The proposed terminal gate pricing regime could also impact on incentives to invest in terminal storage due to it giving wholesale customers rights to access fuel supply from all terminals. Therefore, it is desirable that the majors look at this in association with the introduction of that regime.

#### **How would option 4 address the problem?**

##### *Advantages*

This option seeks to address one of the drivers for dependent wholesale supply arrangements with distributors and dealers, being tight supply, and for weakened incentives

for competition between the majors.

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. The new terminal storage coming on stream in Timaru, Lyttleton (with investment by Mobil) and Mount Maunganui, coupled with longer term trend for reduced demand for petrol, will improve resilience, but the Commission considers that further investment is possible.

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.

#### *Disadvantages*

This option is voluntary. The costs of this option are likely to be low and outweighed by the perceived benefit to the industry. There does seem to be some tension between the majors with the current borrow and loan scheme, as evidenced by Z Energy's proposal to withdraw its Whakatū/Nelson terminal. There is the potential for the arrangements to further unwind and be replaced by bilateral arrangements. The implications of this for competition and fuel pricing could be monitored through the new regime outlined in Option 9.

#### **How would option 4 achieve the objective?**

This option would promote competition in the wholesale market by reducing the costs of 'just in time' supply chain which focuses the industry on security of supply, potentially at the expense of competition. Improved resilience in the supply chain would also be beneficial to consumers.

#### **Option 5: Adopt an enforceable industry code of conduct**

The Commission recommends that Options 1 and 2 should be given effect in a mandatory industry code, similar to the Australian Oil Code (recommendation 5 in the Final Report).

This option, consistent with the Commission's recommendation, would have the following features:

- The industry code should apply to all relevant participants, and clearly identify who the participants are
- The industry 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 industry 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
- A suitable transition period would be set for the new provisions relating to changing wholesale supply contracts to come into force to allow the industry to amend existing contracts

- There should be periodic reviews of the effectiveness of the industry 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.

MBIE considers 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 Fuel Industry Bill which would provide for the making of regulations to deal with matters such as terminal gate pricing. In particular:

- The terminal gate pricing regime and changes to wholesale contracts (Options 1 and 2) would be subject to an alternative dispute resolution procedure, the details of which will be consulted on as part of developing regulations.
- The Commission would be responsible for investigations and enforcement of the legislation and associated regulations. It would be able to draw on its investigative powers under the Commerce Act and the ability to accept enforceable undertakings in relation to enforcement matters.
- A transitional period of at least one year is proposed before the proposed changes to wholesale supply contracts would come into force in relation to existing contracts (as outlined in Option 2).

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

This option would provide for regulations to be made requiring retail sites to display premium petrol prices (95 and 98 octane, as relevant) on price boards to enable consumers to better compare available prices.

Currently the industry practice is to only display prices for regular 91 octane petrol and diesel. However, the industry confirms that 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 they make the decision to drive onto the forecourt, where the price is displayed at the pump.

#### How would option 6 address the problem?

##### *Advantages*

This option seeks to address the problem that consumers lack clear information to compare prices. The price of premium petrol is typically not advertised on roadside price boards. This is likely to be a contributing factor to unexplained higher margins for premium petrol. While premium petrol prices by geographic location are available on price comparison apps, such as Gaspy, MBIE considers that this does not appear to have the same impact on consumer purchasing decisions as roadside price boards.

A 2016 survey by AA found that 81 per cent of respondents would like to see premium prices being displayed at retail sites on roadside price boards. Premium petrol makes up approximately a quarter of total petrol consumption.

##### *Disadvantages*

Putting prices of premium fuel on roadside price boards will impose costs. The Commission estimates this would be in the order of \$7,500 per site. It is possible that resource consents might be needed for some older sites adding additional costs, but the New Zealand Transport Authority (NZTA) thinks that only a few sites would be affected. The cost of posting premium fuel prices might be particularly burdensome for small retail sites that sell low volumes. The case for exceptions from this obligation could be considered in the course of consulting in developing regulations.

There is a small risk that a requirement to display premium petrol prices on roadside price boards would impact on driver safety if reading the additional information is a distraction from driving. For this reason, roadside signage on state highways is regulated by the NZTA and for other roads by local authorities through District Plans. However, there is an increasing industry practice of putting company branding and special offers on signage. A requirement to display premium petrol prices may lead to some of the other discretionary information being removed from price boards. It is also expected that most drivers only focus on information that is of interest so any additional distraction may be minimal.

#### **How would option 6 achieve the objective?**

Transparency of premium petrol prices will make it easier for consumers to compare prices and shop around. This is likely to promote competition.

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

This option would provide for regulations to be made requiring importers of new or used vehicles to ensure that a sticker is on the fuel cap specifying the fuel grade recommended for that vehicle. This could be checked at the time of initial registration of the vehicle in New Zealand, with the information about fuel grades also being recorded on the motor vehicle register. The intention of this option is to ensure that consumers are better informed about which fuel grade is suitable for their vehicle and that they pay no more, or no less, than what is required.

For the purposes of this RIS, it is assumed that this option would not apply to the large stock of aged vehicles already in New Zealand given the difficulties in obtaining the information. The MTA estimates that information about the fuel grade for the vehicle should be available for around 90 per cent of vehicles in New Zealand, but MBIE considers there could be difficulties in ensuring its accuracy. In the future however, as this existing stock declines, consideration could be given to making a fuel cap sticker specifying the fuel grade for the vehicle a requirement of any warrant of fitness check for all vehicles.

This option would be outside the scope of the proposed new Fuel Industry Bill, as it would regulate vehicle importers rather than fuel suppliers. However, it could be given effect as a Consumer Information Standard under the Fair Trading Act.

Separately, the Commission outlines a concern expressed by some industry stakeholders that consumers may misunderstand the benefits of premium petrol, or that retailers may be overstating the benefits of premium petrol to 'upsell' to some consumers. This option is not designed to address this concern. The Commission advises that all claims about the benefits of premium petrol must be able to be substantiated or risk breaching the Fair Trading Act.

MBIE also notes that, in 2018, Europe introduced new labelling requirements for newly

manufactured vehicles to ensure that consumers select the correct fuel grade for their vehicle. This coincided with its promotion for the use of a new alternative fuel with a higher ethanol blend that has lower greenhouse emissions, and an intention to inform consumers of the compatibility of new biofuels with their vehicle. New fuel labelling requirements for environmental purposes is outside the scope of the Commission's market study.

#### **How would option 7 address the problem?**

##### *Advantages*

This option relates to the problem that consumers lack clear information to make fuel purchasing decisions. 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.

The advantage of the fuel cap sticker is that it ensures 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.

##### *Disadvantages*

This option may be costly to bring into effect due to the difficulties in obtaining accurate information for used vehicle imports. Information about the correct fuel is most readily available for new vehicle imports from the car manufacturer. This information is either in the car manual, already on a fuel cap sticker, or available in industry databases such as the 'Red Book'. In the case of used vehicle imports, the availability of this information will likely depend on the age of the vehicle and the car manufacturer. Further work would be required to assess this matter.

#### **How would option 7 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**

This option is for MBIE and the Commission to monitor evolving industry practices for displaying discount pricing for fuel on price boards and whether this is causing consumer detriment or impeding competition. In the interim, the new Fuel Industry Bill will empower the making of regulations to restrict the display of discount pricing for fuel on price boards, so that new regulations may be introduced if required in the future. The Commission recommends that the case for regulation could be considered when the new regulatory scheme is first reviewed.

The Commission outlines that 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 and in many cases these discounts include minimum or maximum purchase terms. The impact of this practice on consumers is unclear.

A focus on discounting, and the desire of consumers to obtain a perceived 'bargain', can distort consumer purchasing decisions. Consumers may focus on the amount of the discount and not the base price. In addition, loyalty programmes that offer non-fuel price rewards,

such as airpoints, make it difficult for consumers to compare fuel prices. Moreover, some displays of discount pricing could be misleading, such as if the purchase terms are not clearly displayed so as to confuse the consumer as to their entitlement to the discount or if the 'discount price' is actually the everyday price.

An industry-wide focus on discounting can also impact on competition, particularly if it causes other firms to increase undiscounted prices and institute their own discount programmes, or if of smaller low-cost firms that do not operate a loyalty programme are disadvantaged due to consumers' misperception of the value of the competitors' discounts.

MBIE was advised that the particularly harmful Australian practice which led to the some Australian States banning the display of discounted practices does not occur in New Zealand. That particular practice involved retailers only displaying the discounted price on roadside price boards, when this price was subject to purchase terms and not available for all full sales or consumers. To our knowledge, any display of discounted prices in New Zealand also includes the display of the undiscounted price.

The Commission also notes that the practice of displaying discounted prices may also cease if premium petrol prices are required to be displayed on price boards, as per Option 7. Therefore, monitoring of evolving industry practices is considered a proportionate response at this time.

#### **How would option 8 address the problem?**

##### *Advantages*

This option relates to the problem of consumers lacking clear information to make informed purchasing decisions. Monitoring of industry practices would address an information gap and inform officials as to whether the practice of displaying discount pricing is causing consumer detriment or impeding competition. Introducing new regulation-making powers in the new Fuel Industry Bill to restrict harmful display practices will enable the Government to act in a timely manner if detriment is found. Monitoring may also lead to the Commission taking enforcement action under the Fair Trading Act in the case of particularly misleading practices.

##### *Disadvantages*

There may be some uncertainty for fuel retailers as to the standard they will be assessed under the monitoring regime before officials recommend that further regulation is desirable. This risk can be addressed by an open review process before any recommendation would be made for further regulation.

#### **How would option 8 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 the new Fuel Industry Bill to enable the making of 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 which may be

undertaken from time to time, as desirable.

- 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 details of the requirements for collection of information, recordkeeping, and disclosure would be specified in the regulations. MBIE will consult further with stakeholders on the details of these requirements. The type of information that could be collected and retained could include:

- Terminal gate pricing regime information, such as:
  - Daily terminal gate prices for each grade of fuel at each terminal from each supplier who can supply fuel from that terminal
  - Daily volumes of each grade of fuel sold, separated out by spot sales and contract sales
  - For those contract sales, the wholesale prices charged for each grade of fuel at each terminal (by customer)
  - All instances of requested terminal gate supply that was not supplied, including the date on which this occurred, the name of the company seeking fuel, and the reason for non-supply
- Daily retail volumes and revenues on a per fuel type, per site basis
- Additional wholesale supply information including
  - Monthly volumes and revenues, per fuel type, on a per customer basis
  - Annually, a list of contracted customers, including any details of the contract start and finish date, and any exclusivity requirement
- Standalone accounts for the New Zealand business, prepared in accordance with generally accepted accounting practices, and
- Cost information

The monitoring regime would be undertaken by MBIE and the Commission, depending on the purpose for its collection and which agency is best placed to carry out that function. The relevant agency or agencies will prepare and publish summary and analysis of the disclosed information, subject to confidentiality requirements and minimising the risk of facilitating coordination between the companies. The new Fuel Industry Bill would also allow the Commission and MBIE to share information in order to assist them carry out their functions. The new Fuel Industry Bill and associated regulations would set out prohibitions for the companies providing false information or failure to collect, retain or disclose the specified information.

#### **How would option 9 address the problem?**

##### *Advantages*

A statutory regime for recordkeeping and information disclosure will ensure that sufficient information is available in a standard form to enable comparison and analysis. This information is important to enable effective monitoring of the performance of the new regime.

##### *Disadvantages*

New recordkeeping and disclosure obligations will impose additional costs on the industry. This will be taken into account as part of consultation in developing the new regulations to give effect to the detail of the proposal.

### How option 9 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 weak competition

This option relates to recommendations 10 and 11 in the Commission's Final Report. The Commission recommends that the majors review:

- the commercial information that is shared for the purposes of administering the coastal shipping joint venture and Marsden Point refinery to ensure that only the minimum information necessary to achieve the objectives of the arrangements is shared, and that the information is not used for other purposes, such as to facilitate accommodating behaviour in the retail fuel market.
- The mechanism that is used for allocating processing capacity at the Marsden Point refinery to ensure that it does not discourage competition between the majors. The current mechanism is based on average market share over the past three years. As a consequence, a major with a growing market share is likely to face a significant delay before it obtains increased refinery processing capacity (at a cost advantage relative to importing refined fuel) to supply that market share.

This proposal is also a non-regulatory option, but the Commission recommended that the Government should monitor whether the industry makes the desired changes within a reasonable time, and if not, consider whether further regulatory intervention is required.

MBIE proposes that the new Fuel Industry Bill should not include any formal regulation making powers for this purpose at this time. The majors have expressed a willingness to undertake this review. In addition, considerable further work would be required to design an appropriate regulatory backstop given that it would apply to Refinery NZ and Coastal Oil Logistics. If necessary, the case for further regulation could be considered in the future.

### How would option 10 address the problem?

#### *Advantages*

This option seeks to address some of the problem related to weak incentives for the majors to compete against each other. It would guard against sensitive information being used to facilitate accommodating behaviour in downstream fuel markets. It would also 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.

The advantages of a voluntary option are that the majors would ensure that the shared infrastructure sharing arrangements continue to operate efficiently and effectively, and thus avoids the risk of regulatory error.

#### *Disadvantages*

As this option is voluntary, the costs of this option are likely to be low or less than any perceived benefits from this option for the industry. However, there is a risk that self-regulation will not be able to produce appropriate outcomes in a reasonable timeframe. This will be managed by monitoring the majors' efforts and, if necessary, further regulation could be considered in the future.

#### **How would option 10 achieve the objective?**

The option is intended to limit the potential for coordination between the majors and encourage competition.

## **MBIE comment on options**

#### **How has consultation affected these 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. MBIE will continue to consult with stakeholders in the course of developing the detail of the proposals to be included in regulation.

#### **Are these options mutually exclusive?**

Most of 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 review power by the Commission in Option 1 (sub-option 1B) 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 regulations (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, MBIE considers that implementation of some of the options can be phased. In particular, a formal regulatory backstop for the terminal gate pricing regime requires further work to ensure it is designed effectively. It is intended to be introduced at a future point, but its development will be clearly signalled so as to maintain incentives for competitive outcomes at the terminal gate. The enhanced monitoring regime will also inform regulators as to whether further regulation or amendment is desirable, such as to back up the proposals for industry to update information sharing and refinery allocation arrangements in Option 10. In addition, MBIE is not convinced that Option 7 regarding introduction of mandatory fuel cap stickers in cars should be introduced at this time.

#### **Have non-regulatory options been considered?**

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.

#### **Has relevant overseas experience been taken into account?**

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. Regulatory options are certain and predictable.

### **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 regulations if competition does not develop in a timely manner.

Other 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 as part of wider consideration of the efficacy of our competition regime.

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. MBIE will continue to monitor the voluntary use of these price comparison websites.

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## Section 4: Impact Analysis

		Stimulate wholesale competition				Improve consumer information			Monitoring	Other
	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
<b>Promote competition</b>	0	++ Lowers barriers to entry and expansion in wholesale market	++ Lowers barriers to entry and expansion in wholesale market	+ Informs new importers of one low cost means to expand distribution	++ Seeks to enhance majors' incentives to invest and compete	++ Promotes price competition by providing timely and comparable price information	0 N/A	+ Supports backstop regulatory power to give some disciplinary effect.	++ Supports threat of further regulation if competitive outcomes not observed	++ Seeks to reduce risk of weak competition between majors
<b>Efficient fuel supply chain</b>	0	++ Enables supply at spot price and access to nationwide supply network	++ Wholesale customers able to switch to most competitive supply	+ Enables new importers to join low cost distribution arrangements	++ Promotes resilience in supply chain and efficient allocation of costs	0 N/A	0 N/A	0 N/A	+ Summary and analysis may better inform investment and supply decisions by industry	++ Promotes efficient use of shared infrastructure by majors
<b>Consumers well informed</b>	0	0 N/A	0 N/A	0 N/A	0 N/A	++ Provides timely and comparable premium fuel prices	++ Provides clear and timely information on fuel grades	0 Some remaining risk consumers may be confused by price displays	++ Summary and analysis may better inform consumers to shop around	0 N/A
<b>Proportionate regulation</b>	0	++ Builds on existing industry practices	++ Supports contracting between parties	++ Relies on industry self-regulation	++ Relies on industry self-regulation	++ Exceptions for small volume retailers to be considered	0/+ Ease of availability of information required for compliance unclear	++ Backstop regulatory power able to be introduced if required	++ Information only collected or disclosed if required to support regime	+ Relies on industry self-regulation. Case for regulation in future to be

										determined.
<b>Certain and predictable regulation</b>	0	++ Largely based on known Australian regime	+ Improves transparency of pricing, but some uncertainty about contract terms	++ Majors control setting of arrangements. New importers better informed of process and conditions for joining	+ Majors encouraged to address tension in arrangements	++ Regulation is clear and on what must be displayed	+ Regulation is likely to be clear on requirements, but detail to be determined	+ If further regulation is appropriate, consultation would occur with interested parties.	++ Regulation is clear on what must be collected and disclosed.	++ Majors control setting of arrangements.
<b>Overall assessment</b>	0	8	7	6	7	8	3 or 4	4	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

PROACTIVELY RELEASED

## 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?

#### Preferred options

MBIE recommends the following options:

##### *Improving wholesale competition for fuel*

- **Option 1:** Introduce a terminal gate pricing regime (without a full regulatory backstop)
- **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 (being assessed as part of options 1 to 4)

##### *Facilitating informed consumer choice*

- **Option 6:** Improve transparency of premium fuel prices
- **Option 8:** Monitor the display of discount pricing on price boards (with a regulatory backstop)

##### *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 (without a regulatory backstop).

We do not recommend Option 7 relating to improving information on when premium fuel should be progressed at this time.

This package of preferred measures is aimed at promoting competition in the wholesale and retail fuel markets for the long term benefit of consumers. This is an incentive-based regime, based on a relatively light-handed package of measures that are backed up by a robust monitoring regime and the credible threat of further regulation if competitive outcomes do not arise in an appropriate time frame.

These measures are a significant improvement on the counterfactual. While there are indications that competition is improving, the Commission considers, and we agree, that there remain underlying impediments that mean that consumers are paying more for fuel than they could otherwise.

The preferred package of options would be given effect through different means as outlined in the Table 5.1 below.

**Table 5.1 Means to give effect to preferred proposals**

Option	Non-Regulatory	New Fuel Industry Bill	New Regulations	Other
1 Terminal Gate Pricing Regime		Overview of terminal gate pricing regime	Detail of terminal gate pricing regime requirements	Backstop regulatory regime to be developed and added to Bill/Act at future point
2 Wholesale supply contracts		Overview of wholesale supply contract requirements	Detail of wholesale supply contract requirements	
3 Disclose infrastructure sharing arrangements	Industry to report back to Minister on progress by 30 March			No backstop at this time. Will be monitored.
4 Review infrastructure sharing arrangements	Industry to report back to Minister on progress by 30 March			No backstop at this time. Will be monitored.
5 Adopt Enforceable Industry Code		Overview of alternative dispute resolution schemes and enforcement regime, including powers of regulators	Detail of alternative dispute resolution schemes	
6 Display premium petrol prices	Industry invited to display premium petrol on price boards	Power to make regulations for price board displays	Detail of requirements for display of premium petrol on price boards	
7 Fuel cap stickers on recommended fuel grades for vehicle				No action at this time. Could be made as a Consumer Information Standard under the Fair Trading Act, if desired, in future.
8 Monitor discount pricing practices	MBIE and Commerce Commission to monitor	Power to make regulations for display of discounted prices	No regulations at this time. Await outcome of monitoring	
9 Improve information and recordkeeping	MBIE to enhance reporting on premium petrol.	Overview of recordkeeping and reporting regime	Detail of requirements for recordkeeping and reporting	
10 Review of logistical information sharing arrangements	Industry to report back to Minister on progress by 30 March			No regulatory backstop at this time. Likely to be outside scope of Fuel Industry Bill. Will be monitored.

## Stakeholder views on options

The package of measures is generally supported by the fuel companies. The following themes have been gathered from MBIE's and the Commission's consultation processes (detailed in 2.5). These opinions were taken into account by the Commission in their final recommendations and by MBIE in providing advice to Ministers.

### Stimulate wholesale markets

- There is broad support for **Option 1**, being the introduction of a terminal gate pricing regime based on the Australian model. The majority view is that few spot sales will occur, but some distributors welcomed the option of being able to do so.
- Most concerns with **Option 1** were by importers relating to the new bespoke measure recommended by the Commission relating to a 'must supply' obligation and prioritising spot and contracted sales over own supply. If the volumes required to be supplied are small, such as within margins of forecasting error, most agreed it should be able to be managed without imposing significant additional stocking costs. MBIE will continue to consult with the industry on the details of the volumes and prioritisation rules as part of developing the regulations.
- The few stakeholders that commented on a regulatory backstop in **Option 1** do not see the need for one and consider that a robust industry monitoring regime is sufficient. Some majors consider that the focus on costs-based pricing may be a 'soft' form of price control.
- There are mixed views on the need for changes to wholesale contract terms as recommended in **Option 2**. The smaller industry participants welcome any changes that could give them greater ability to test the market ahead of signing any supply contracts and the MTA supports new restrictions on terms in existing contracts which they consider

to be unduly restrictive.

- The majors disagree with the need for the full range of changes in **Option 2** recommended by the Commission, and believe that the market is working well, but are willing to make some changes. Concerns raised included potential increased costs and inefficiencies to the supply chain, such as if potentially 20 per cent of contracted supply shifted to a non-exclusive basis. At least one major supported shorter contract terms, such as 7 years. MBIE will continue to consult as part of developing the specific requirements for changes to wholesale contract terms in regulations.
- In terms of **Options 3 and 4**, the majors all supported the fact that the Commission has not recommended regulation of their infrastructure sharing arrangements. These arrangements are complex and linked to the efficient operation of the Marsden Point refinery.
- The majors have not directly expressed views on publishing the access criteria in **Option 3**. 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.
- At least one major is supportive of reviews of the infrastructure sharing arrangements in **Option 4** to be led by the majors, but others are non-committal until they have seen the detail. Some majors dispute that there is a disincentive to invest in infrastructure.
- Mobil doesn't support the need for an Industry Code as recommended in **Option 5**, which it associates with an enforced schedule of contractual terms and requirements for cost-based pricing, viewing it as unfeasibly complex. However, this is a minority view and many participants support the development of some form of regulations or Industry Code.

### Improve consumer information

- For **Option 6**, 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. Most participants are getting this underway following a request from the Minister of Commerce and Consumer Affairs. The AA considers that this change will have significant benefits for consumers.
- There is broad support for some form of regulation to assist consumers to determine which fuel is appropriate for their vehicle in **Option 7**. However, a representative of vehicle importers thought that support would be conditional on some other party providing the information on the recommended fuel grade for each used vehicle to importers, given the difficulties in obtaining this information. The AA warned of the technical complexities of determining the correct fuel grade for each vehicle and that it was not aware of significant consumer calls for this intervention.
- For **Option 8**, 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. MBIE will monitor this evolving industry practice and the backstop regulatory power will enable timely intervention if required.

### Improved monitoring of regime

- Those industry participants that commented did not oppose an enhanced monitoring regime as recommended in **Option 9**.

### Other recommendations to the industry

- There is general support from the majors to limit information sharing and change the

refinery allocation mechanism as outlined in **Option 10**. In particular, Coastal Oil Logistics Limited has a review already underway as to its information requirements for scheduling and logistics purposes.

## 5.2 Summary table of costs and benefits of the preferred approach

<b>Affected parties</b> (identify)	<b>Comment:</b> <i>nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks</i>	<b>Impact</b> <i>\$m present value, for monetised impacts; high, medium or low for non-monetised impacts</i>	<b>Evidence certainty</b> (High, medium or low)
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### 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 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
<b>Total Monetised Cost</b>	<i>Without accurate quantifiable evidence, it is not possible to provide an estimate.</i>	<i>Unknown</i>	<i>Unknown</i>
<b>Non-monetised costs</b>	<i>We anticipate a medium increase in overall costs, mainly from compliance and enforcement.</i>	<i>Medium</i>	<i>Low</i>

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 wholesale market.	Medium	Low
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
<b>Total Monetised Benefit</b>	<i>Without accurate quantifiable evidence, it is not possible to provide an estimate</i>	<i>Unknown</i>	<i>Unknown</i>
<b>Non-monetised benefits</b>	<i>We anticipate a medium level of benefits from increased competition and more transparency in the fuel sector over the longer term.</i>	<i>Medium</i>	<i>Medium</i>

### 5.3 What other impacts is this approach likely to have?

There are some potential other impacts with the proposed options. For example:

- 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.
- Lower fuel prices may increase demand for fuel and detrimentally impact on the environment. Low impact. Initial analysis of emissions impacts shows that the per annum impacts of the preferred proposals will be below the CIPA threshold of 250,000 tonnes per annum. Analysis shows that emissions impacts could range from between approximately 11 Kt CO<sub>2</sub> per annum for a price change of 1cpl (cents per litre) in the short run, through to approximately 219 Kt CO<sub>2</sub> per annum in the long run for a price change of 12cpl.

### 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 preferred package of regulatory proposals will be implemented through the introduction of a new Fuel Industry Bill, which will have the purpose of promoting competition in fuel markets for the long-term benefit of end users. The detail of the proposals will be included in regulations that will be developed in parallel to the passage of the Bill, and come into effect after the Bill is enacted.

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 to enable the regulators and companies to prepare for the new requirements. MBIE will continue to work on developing the regulatory backstop, and this will be added at a future date.

MBIE and the Commission will have new or enhanced functions under the regime. The Commission will be responsible for enforcement of the new Act and associated regulations, and the Bill will incorporate the Commission's investigative powers from the Commerce Act for this purpose. We envisage that the Commission will also have a new function of receiving some of the information to be disclosed by the industry under regulations, and summarising and analysing that information on a regular basis to enable an assessment of the performance of the regime. This will be finalised in the regulations.

MBIE's current monitoring function is also likely to be enhanced, with it envisaged to receive a wider range of information from the industry as will be specified under new regulations. The new Fuel Industry Bill will also provide for MBIE and the Commission to share confidential information related to the carrying out of their functions.

The regulations will also provide for alternative dispute resolution for the industry to resolve disputes about the application of the terminal gate pricing regime and the changes to wholesale supply contracts. We intend that existing mediators or arbitrators with suitable qualifications and experience will carry out this function, and the parties to the dispute may appoint the mediator (or arbitrator, as relevant) in the first instance.

The new functions for the Commission will not be able to be met within existing baselines. MBIE is currently working with the Commission to establish what funding would be required to enable it to carry out these new functions. The proposed alternative dispute resolution scheme will be funded by the parties to the dispute.

### 6.2 What are the implementation risks?

There are some implementation risks from the speed with which the new regulatory proposals are being developed and are proposed to be implemented. MBIE will seek to manage this risk by continuing to engage with the industry in developing the detail of the regulatory proposals and to recommend appropriate transitional periods to provide sufficient notice for when the obligations come into effect.

There are also risks if the regulators are not adequately resourced to carry out the new functions, such as monitoring and enforcement. This regime requires effective monitoring

of industry practices to maintain incentives for competitive conduct and allow timely intervention if the regime is not working as intended.

## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

A key feature of the preferred proposals is an enhanced regime for recordkeeping and information disclosure to enable MBIE and the Commission to monitor the effectiveness of the regime and to regularly publish summaries and analysis of the results. The anticipated impacts of the new arrangements will be identified by this means.

MBIE considered the option of specifying a statutory date by which the Act must be reviewed, but has decided against this. Information necessary to carry out a full evaluation of the impact of these proposals may not be available for some time. The regular summary and analysis proposed as part of the monitoring regime is seen as an effective means to identify any issues arising on a timely basis for more targeted reviews. MBIE will also carry out periodic reviews of the regime as part of its general Regulatory Stewardship responsibilities.

In terms of the non-regulatory proposals, the Ministers of Energy and Resources and Commerce and Consumer Affairs have written to the fuel companies setting out their expectations and deadlines for the industry to respond. The companies are due to respond by 30 March 2020 on progress. MBIE will monitor this and seek further information from the industry as appropriate.

MBIE will also coordinate with the Commission on plans to monitor industry practice with loyalty programmes and advertising or displays of discounted prices.

### 7.2 When and how will the new arrangements be reviewed?

There are no plans to conduct a formal review of the regulations within a specific timeframe. However, it is envisaged that the regulations would be reviewed on a periodic basis, the first being after it has been in effect for a suitable period (eg two to three years). The monitoring regime will also identify issues and enable earlier amendment of the regime if required. Stakeholders will be able to raise concerns directly with MBIE or Ministers.