CPI's Oceania Column Presents:

Market Studies Arrive in New Zealand: First Learnings from the Retail Fuel Sector Study

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I. Introduction

New Zealand has arrived late to the world of market studies. Legislation enabling the New Zealand Commerce Commission ("NZCC") to undertake market studies was not enacted until 2018.[2] A significant catalyst for this new regime was the Government's desire to examine retail fuel sector pricing. The Ministerial direction to undertake this market study came just two months after the legislation was passed.[3]

This paper:

- Commences with a brief outline of the new market studies regime; and
- Attempts to distil the key aspects of the NZCC's 589-page Market Study into the Retail Fuel Sector Final Report ("the Retail Fuel Sector Report").[4] The following discussion will focus on: the profitability assessment, the key competition and consumer information concerns considered in this study, and the NZCC's recommendations.

This review of the Retail Fuel Sector Report reflects that the new market studies powers have materially changed the landscape for competition law assessment in New Zealand. The following factors, which will be variously developed below, are likely to feature in future market studies:

- Such studies will likely be wide-ranging inquiries based upon broad terms of reference;
- A core part of these studies will likely be profitability assessments, given that a perception of excess profits will be a likely catalyst in selecting market study cases. The NZCC will make "pragmatic" use of the available evidence on profitability issues, including opinions expressed in internal company documents. Conclusions may be based on observations and inferences, rather than actual findings. In this context the assessment of normal levels of return will be based on the NZCC's approach to calculating the cost of capital, using the methodology that has been developed and applied to regulated entities under Part 4 of the Commerce Act 1986 (NZ) ("the Act");
- Competition analysis will also be central to market studies. In this context, conclusions are likely to be based on observations about what the evidence suggests or appears to support. Considerably more relaxed threshold standards apply in the market studies setting, compared with the traditional restrictive trade practices rules which apply under Part 2 of the Act. There is, for example, no requirement for the NZCC to establish that a substantial lessening of competition is likely under market studies. Throughout this study the NZCC made it clear that it would not undertake any such Part 2 inquiry in the market studies setting, and that there may be matters under review which, while compliant with these provisions of the Act, may nonetheless be subject to adverse assessment. Ultimately, this study reveals that adverse observations and conclusions may be based on low competition thresholds including, for example, whether any given matter may unnecessarily affect or impact, limit or soften competition; and
- Each market study will, upon completion, ultimately play out in the political arena.

II. The New Market Studies Regime in a Nutshell

The legal and institutional frameworks for market studies vary across jurisdictions.[5] The legislative framework in New Zealand is one of brevity and simplicity. Part 3A of the Act empowers the NZCC to carry out market studies and to prepare market study reports.[6]

The NZCC may commence a market study if it considers it to be in the public interest.[7] Similarly, the Minister may require the NZCC to undertake a market study, again based on unspecified public interest considerations.[8] Given the limited allocation of funding to this new power, it is likely that at current levels only one market study each year will be possible.[9] Depending upon how the political landscape unfolds, this may mean that the NZCC will be unlikely to commence any market study on its own initiative in the foreseeable future.

Prior to the commencement of any market study, the NZCC or Minister must prescribe terms of reference for the study.[10] The NZCC must undertake the market study in accordance with these terms of reference, but it may also exercise its discretion in relation to ancillary matters related to, but not expressly covered by, the terms of reference.[11]

The NZCC must produce a draft market study report and allow a reasonable time for public consultation on this before completing the report.[12] The NZCC may, but is not compelled to, make recommendations. These recommendations may, without limitation, include changes to legislation, changes to central or local government policies, changes to the policies or practices of organizations empowered with regulatory oversight and changes to information to be disclosed in relation to any given industry under consideration.[13]

Significantly section 51D(2) states that, to avoid doubt, a market study report is not a determination of the NZCC. Accordingly, appeal rights do not attach to these reports. However, they do remain open to judicial review challenge.

Finally, there is a requirement that the Minister must respond to the final market study report within a “reasonable time.”[14]

III. The Retail Fuel Sector Report

A. A New Framework

Part 3A places primacy on the terms of reference and this will likely mean that the scope of any market study will be broad. The wording of these terms is likely to involve a non-exclusive list of considerations which will enable the NZCC to take an expansive approach to matters to be covered by the inquiry, within reasonable boundaries as to relevance.

The terms of reference for this study were indeed broad.[15] The NZCC was directed to carry out a market study into “any factors that may affect competition for the supply of retail petrol (i.e. gasoline) or diesel used for land transportation throughout New Zealand.” Matters to be considered included, but were not restricted to, issues such as: the structure of the industry, the extent of competition, factors that may hinder competition, conditions for entry, whether wholesale and retail price offerings were consistent with those to be expected in “workably competitive markets”, and features of the markets which may not be in the long-term interests of consumers.

The simplicity of the legislative regime, and the broad scope of this inquiry, are reflected in the limited framework discussion in the Retail Fuel Sector Report.[16] It is noted that there is connectivity between the terms of reference, the purpose statement and the definition of "competition" within the Act. Section 1A provides that the purpose of the Act is "to promote competition in markets for the long-term benefit of consumers within New Zealand", and the term "competition" is defined in section 3(1) to mean "workable or effective competition." Against this background, the NZCC emphasized at the outset that "one important outcome that can be expected over the long run in a workably competitive market is that firms will tend to earn normal rates of return and price will reflect efficient costs."[17] This consideration became a focal point for this inquiry.

Three other framework considerations are noteworthy in the context of this first market study. Firstly, considerably more relaxed competition threshold standards apply compared with traditional restrictive trade practices assessments under Part 2. The NZCC is not, for example, required to establish to the relevant standard of proof that a substantial lessening of competition is likely before it can make adverse observations in the market studies context. The NZCC is not under this market studies regime required to make any determination. It is empowered only to make recommendations. Accordingly, conclusions throughout the report reflect only observations of what the evidence suggests or appears to support.[18] These observations included adverse conclusions on the basis that matters under review may merely, for example, unnecessarily affect or impact, limit or soften competition.[19]

Secondly, and following on from this point, the NZCC made it clear that conclusions in the study would not be impacted by whether any given matter under review may comply with the restrictive trade practices provisions of the Act. The study variously observes that it made no inquiry into compliance with these provisions of the Act and that there may be matters under review which, while compliant with these provisions of the Act, may weaken competition.[20]

Finally, the focus on normal rates of return has a potential intersection with the regulatory control provisions of Part 4. Indeed, participants involved in this inquiry may at times have been left with the impression that this was predominantly a Part 4-type inquiry. However, in the course of the report the NZCC emphasizes that the profit assessment here is undertaken in a different context, being one which does not require comprehensive quantification of the level of excessive profits.[21] Nonetheless, there is a significant overlap with the development of profitability principles under Part 4, and the critical assessment of profitability in this study. The NZCC took the approach, as will be discussed further below, that the standard methodology used for estimating the cost of capital under Part 4 was appropriate for the current study to estimate what might be a normal level of return.[22]

B. Some Background Facts

Prior to 1988, the fuel market was subject to wholesale price regulation. This regulation was designed to provide the then four major importers (BP, Mobil, Shell and Caltex) with a 13 percent return. These importers were prohibited from having a retail presence and supplied fuel to independent retailers at regulated prices. These importers established various joint ventures to enhance efficiencies in their operations. These joint ventures included the construction of New Zealand's only refinery at Marsden Point (which is in the far north), the creation of a coastal shipping network to transport refined fuel, and shared storage terminals at regional ports throughout the country.

When the industry was deregulated in 1988, these major importers immediately entered the retail market. They achieved this by acquiring prominent sites and securing long-term contracts with independent retailers. The three remaining importers (BP, Mobil and a local company (called "Z"), which acquired Shell in 2010) supply more than 90 percent of retail fuel through the networks they own and retailers that carry their brands.[23] The only interruption to this vertically integrated market structure has been the emergence of Gull in 1999. Gull is an importer of refined fuel and has established its own storage terminal in Mount Maunganui (in the North Island). It distributes its fuel to 91 Gull retail sites throughout the North Island, one in the South Island, and has plans to open six more sites in the South Island over the next two years. The only other apparent challenger to the existing market structure is a new importer, Timaru Oil Services Limited ("TOSL"), which is building a new terminal in Timaru (in the South Island) with a planned commencement date in 2020.[24]

A brief outline of each of the functional levels of this market serves to introduce the key issues which were addressed in this inquiry.

Fuel is currently being imported by the three majors and Gull, as already outlined. BP, Mobil and Z each import crude oil to be refined at the New Zealand Refining Company ("NZRC") plant at Marsden Point. NZRC, which is 43 percent owned by the three majors (with the balance held by the public), produces approximately 58 percent of the petrol and 67 percent of the diesel fuel consumed in New Zealand.[25] The three majors also import refined fuel which is generally delivered to the ports at Mount Maunganui, Wellington and Lyttelton.

NZRC operates on a toll manufacturing basis, which means that each of the three majors retain title to their fuel throughout the refinery process. Access to the refinery is governed by processing agreements between the refinery and the three majors. Refinery capacity is allocated between the majors based on their retail market share by product over the previous three years.[26] Some 52 percent of the fuel refined at Marsden Point is distributed by pipeline to a storage terminal in nearby Wiri, Auckland. This Wiri storage terminal is jointly owned by the majors. Access to this pipeline is also covered in the access arrangements to the refinery. Users of the pipeline are allocated capacity based on the previous year's market share sales into the Auckland and Waikato markets.[27]

The remaining fuel refined at Marsden Point is distributed by Coastal Oil Logistics Limited ("COLL") which is a joint venture company owned by the majors. COLL distributes fuel to storage terminals owned by the majors at ten ports around New Zealand. COLL is also responsible for the scheduling of shipments and has oversight of capacity utilization at each terminal to ensure no shortages occur at any given terminal. In this context, COLL is also responsible for the administration of the borrow and loan arrangements under which the majors have agreed to the shared use of their various terminals.[28]

Turning to storage of fuel in the various terminals at the ten ports throughout New Zealand, there has been significant rationalization to avoid the previous duplication of storage terminals. The majors do not own storage facilities at each of these ports. For example, Mobil and Z have no storage presence in New Plymouth, BP and Z have no presence in Bluff and Mobil has no presence in Nelson. These infrastructural options have been made possible because of borrow and loan agreements between the majors. Under these agreements the majors can draw down fuel from anywhere in the system provided they match off-take with the addition of an equivalent amount of fuel elsewhere in the system. There is no sale or purchase of the fuel. Only a throughput fee is charged, as set by each terminal owner. As already mentioned, COLL has oversight of the workings of these arrangements. At times there may need to be rationing of the fuel where, for example, fuel stocks are estimated to be below three days' cover before the next date of shipment. This is known as "a co-ordination event."[29] Fuel is delivered from the storage terminals to retailers through a competitive road transportation sector.[30]

Apparently, each of the infrastructure sharing arrangements relating to access to the refinery, the COLL joint venture and the borrow and loan agreements is open to participation by third parties. However, these access terms are contained in confidential agreements between the majors and are untested.[31]

Turning finally to the retail market, there are some 1,351 retail sites throughout New Zealand ranging from full-service outlets through to unmanned stations. There are three categories of retail sites. Firstly, each of the majors and Gull supply their own branded sites which they own and operate themselves or through an agent. They set the prices at these sites. The NZCC estimated that these sites accounted for approximately 57 percent of the retail market.[32] Secondly the majors and Gull supply dealer-owned sites which carry their brand name. These individual owners generally tend to set their retail prices and have long-term wholesale supply contracts with the importer who supplies them. The NZCC estimated that this category of retail sites accounted for 27 percent of the market.[33] The remaining category of the retail market supplied by the majors comprises distributors (who on-sell to commercial customers or sell under their own brand)[34] and independently branded retail sites owned by independent retailers (like Foodstuffs). This means that at present only 16 percent of the retail market can be potentially regarded as contestable to new wholesale supply arrangements.[35]

C. The Profitability Focus

The Minister gave as one of the public interest factors for his direction to undertake the study the observation that there had been more than a doubling of petrol and diesel importer margins over the past decade.[36] The NZCC also observed that New Zealand's pre-tax fuel prices are currently amongst the highest in the OECD and have trended upward and departed from other OECD countries since about 2010.[37] These factors, combined with the framework question arising from the terms of reference as to whether the fuel market is workably competitive, based on normal rates of return over time, meant that profitability assessments were inevitably going to be employed to draw insights into the level of competition.

Acknowledging the limits on the use of profitability as a measure of competitiveness in certain cases,[38] the NZCC utilized a range of forward-looking and backward-looking indicators to assess whether, in the round, these suggested that the firms' profits were persistently in excess of a normal return. In summary, there were five key reasons for the NZCC's conclusion that the profits and returns being achieved or anticipated were materially above normal rates of return, and that this had appeared to have persisted for most of the last decade and seemed likely to continue under current policy settings.[39]

Firstly, the NZCC observed that the business cases used by the industry for new or rebuilt retail sites expected returns on average more than double the NZCC's estimate of the cost of capital required to fund these new investments. These projects expected a weighted average internal rate of return of 20 percent, compared with the NZCC's cost of capital range for a New Zealand fuel company of 6.9 to 8.6 percent. The NZCC noted that these forecasts may not be unduly optimistic given available information on the actual performance of some new sites. The NZCC also observed that these high returns were being projected in a market where retail capacity has been growing faster than demand.[40]

Secondly, the NZCC estimated so-called “Tobin’s q” values (i.e. the ratio between certain assets’ market value and their replacement value) for three of the retail fuel firms based on recent acquisition values of these companies. These estimates suggested a market value for these businesses of about 1.5 to 2.0 times the estimated current cost of replacing each of the firm’s assets.[41]

Thirdly, estimates of the returns on the average capital employed for the New Zealand fuel firms reflected numbers significantly in advance of the top of the NZCC’s estimated cost of capital range of 8.6 percent.[42]

Fourthly, importer margins were reviewed for the 2008-18 decade. The NZCC did not assert that these margins were a measure of profitability. However, it was suggested the growth of these margins over this time, compared with the previous decade, was an indicator of profitability. Importer margins were found to have increased from an average of 10.7 cents per liter for petrol in 2008 to 30.8 cents per liter in 2018. For diesel, the average import margin increased from 12.5 cents per liter in 2008 to 34.8 cents per liter in 2018.[43]

Finally, a survey of the market participants’ internal documents revealed that margins were thought to be favorable in absolute terms and at a level that posed the risk of attracting new entry to the retail market.

Not surprisingly, these conclusions were vigorously opposed by the three majors. For example, it was not accepted that the analysis of estimated returns on average capital employed could support meaningful conclusions on the level of prices and margins. The time frame used by the NZCC for the assessment of persistent profits was not accepted as appropriate, and there was criticism of the failure to attempt forward-looking forecasts, particularly given recent market developments. The NZCC accepted that margins and profits had peaked, but also considered that future trajectories looked to be stable. In contrast, the majors warned against the time-selective use of data which they considered did not adequately take account of the potential disruption which they saw to be on the horizon. Further, there were divergent views on the comparator companies used for the set of the asset beta and so on.[44]

Significantly, the NZCC’s profitability conclusions are not based on actual findings of excess profits. The NZCC noted that there could be an attraction in undertaking a Part 4-type approach to reach conclusions on profitability. Under this approach specified methodologies would enable the reliable set of asset values, and methodologies would be prescribed to account for the allocation of shared and common costs and assets. Further, there would be detailed rules for reporting performance information including revenues, capex and expenses. However, the NZCC took the position that it would not be possible to achieve this task within the study’s timeframe, and that such an approach would involve disproportionate costs. Accordingly, it opted for a “pragmatic” approach based on the available information.[45] The end result is that the profit assessment has been made on the basis only of observations and inferences drawn from available information.

D. Competition and Consumer Information Concerns

1. Infrastructure Sharing Arrangements

The NZCC's assessment of the infrastructure sharing arrangements was inevitably an important part of the study. These upstream arrangements clearly impact the level of retail competition. The NZCC did not assess the legality of these arrangements. Rather, it expressed views on the benefits and potential detriments of these arrangements.

The benefits are obvious enough. The arrangements enable the lower cost supply of fuel around New Zealand, compared with the scenario of separate standalone supply chains. These result in cost savings of potential benefit to consumers. Furthermore, the borrow and loan agreements enable the majors to compete cost-effectively in regions where they do not have terminal infrastructure.[46]

The NZCC's assessment of the detriments was more controversial. The conclusion was reached that the borrow and loan agreements may be deterring necessary investment in terminal infrastructure, to the detriment of the competitive process. Four theoretical reasons were advanced. Firstly, it was suggested that the party undertaking the investment may not fully capture the benefits of the investment. Secondly, the costs of failing to maintain the terminals may not be fully borne by the terminal owner, but rather may result in all the majors incurring additional shipping and trucking costs. Thirdly, the rules with respect to allocations during co-ordination events may discourage incremental investment in terminals. Finally, and relatedly, these allocation rules may insulate majors from the risk of losing customers, given that competitors could not obtain fuel beyond the allocated amount unless costly alternative bridging arrangements were made for the supply of fuel.[47]

The three majors disputed these conclusions on the basis of evidence of recent investments in the upgrade of terminals and decreasing trends in co-ordination events. Further, and perhaps most significantly, the point was made that significant investment in new infrastructure is now unlikely in any event given the long-term forecasts for fuel demand and the recent entry of TSOL in Timaru (and possibly also in Mount Maunganui).[48]

There were two other ways that the NZCC thought that the infrastructure sharing arrangements may limit or soften competition between the majors. Firstly, there was concern that the allocation at the refinery, based on a three-year market share average, may limit competition because this would result in a significant lag before greater market share would translate into greater refinery allocation. A major wanting to increase market share would over this three-year period need to rely on imported fuel to meet increased demand. This would likely be at a cost disadvantage over this time, particularly in the Auckland region where the other majors would have the benefit of delivery of fuel by the pipeline.[49]

The second concern related to the borrow and loan arrangements requiring that information on past and future demand be shared between the majors. This gave rise to concerns about disclosure of likely strategies which would aid in facilitating accommodating behavior. The NZCC recognized that much of the information being shared was necessary to ensure the efficient operation of the shipping schedules and shared industry storage. Further, it was accepted that this information sharing would not necessarily be illegal under the Act. Nonetheless, concerns remained about the potential that these arrangements may have for accommodating behavior between the majors, and the extent to which this may limit or soften competition.[50]

2. Conditions of Entry and Expansion

It was common ground that a new entrant refinery is highly unlikely. Economies of scale are important for refineries. The NZCC cited an international study which concluded that NZRC's current annual throughput is approximately 55 percent of what may be regarded as minimum efficient scale.[51] A further reason that new entry is unlikely in this market is the presence of large sunk costs.[52]

This conclusion led the NZCC to focus on conditions of entry faced by importers of refined fuel. A range of deterrents to new entry were noted including: economies of scale in shipping fuel to New Zealand; access problems for standard cargoes to shallow regional ports; import cargoes may need to be unloaded across multiple ports due to depth or storage limitations; differences in fuel specifications may make it difficult to ship fuel to multiple countries; and New Zealand's distance from import refineries (in particular from Singapore and South Korea) may affect security of supply.[53]

Access to storage terminals is another entry consideration facing importers. The NZCC thought that new entry is possible at the terminal level, particularly at larger ports. Nonetheless, such entry was thought not to be without its challenges. Terminals require large capital investment (with high fixed and sunk costs), access to suitable land and resource consents are required and a significant market share is required to support efficient terminal throughput rates.[54]

Finally, the NZCC noted that the majors have significant existing cost advantages over new entrant importers. They have lower distribution costs through access to the pipeline to Wiri and shipping by COLL, and the borrow and loan arrangements at terminals throughout the country, as already outlined.[55]

Turning to the retail market, the NZCC outlined that entry is possible and is occurring here. However, such entry has only been observed largely for low cost unmanned sites and in secondary locations rather than prime metropolitan sites.[56]

These conditions of entry and expansion in the round sound to be somewhat overwhelming. However, some significant new entry has occurred, and is unfolding, albeit in the setting of current importer margins. Gull successfully commenced imports in 1999 and the impact of TOSL's entry is awaited.[57] However, the resultant competition from such entry has tended to be regional in scope, absent access by importers to terminals around the country under the borrow and loan arrangements.[58] This, in part, explains the regional differences in retail fuel prices.[59] Gull, in particular, has had a positive impact in the regions it operates where its sites have been located close to those of the majors.[60]

3. The (Missing) Competitive Wholesale Market

It will be apparent from the discussion above that the picture being painted by the NZCC was not one reflecting workable or effective competition in the wholesale and retail markets. The NZCC concluded that the most significant problem, and the cause for this outcome, was the absence of an active wholesale market as a result of the vertical integration and long-term exclusive wholesale supply agreements since deregulation. The NZCC's focus on this wholesale market dynamic reflected its view that effective competition in this wholesale market was important to strengthen competition in the retail market.[61]

Apart from wholesale competition being limited by the advantages conferred upon the majors under the joint infrastructure network, the NZCC explored in some detail the nature of the wholesale supply arrangements between the majors and dealers (selling under the brand of the supplier) and distributors (selling under their own retail brand). While it was accepted that restrictive contractual provisions may have pro-competitive effects where the majors supported dealers for establishment costs, pro-competitive rationales for such provisions were less likely for the supply of what are homogenous products to distributors.

The contractual arrangements which attracted scrutiny included long-term, minimum volume and exclusive supply contracts. Terms of these contracts (often 10-15 years) were not thought to be justified based on cost recovery. Other rights in favor of the majors gave control over retail distribution channels. In the transfer of ownership setting, these restrictions included first rights of refusal in favor of the majors and the ability to veto transfers. Further, some agreements included restraints of trade against dealers and distributors, and restrictive non-petroleum use covenants over the land.[62]

In the round these contracts were thought to create an imbalance of bargaining power and involve undue dependency with the result that a competitive wholesale market was being bypassed. A consequence of this is that some dealers and distributors are disincentivized or prevented from supporting new import entry to the market.[63]

Further NZCC concerns centered upon the majors having control over wholesale pricing. In particular, transparency and certainty of wholesale pricing to dealers and distributors is absent in many cases. The majors typically have the ability unilaterally to alter wholesale prices and some dealers and distributors only discover the wholesale price after the transfer of ownership when they are invoiced. While the reason for this is to enable the majors to accommodate price fluctuations caused by underlying oil prices, the end result is that this leaves dealers and distributors bearing the risks of increased costs, which costs may also include other increases such as the pursuit of higher wholesale margins. The consequence of these aspects of pricing power was seen by the NZCC to create a market whereby the majors could effectively create a price floor below which dealers and distributors could not reduce retail prices.[64]

Finally, the NZCC observed market outcomes which it believed reflected weak wholesale market competition. These included evidence of lack of switching by distributors and the rarity of competitive tendering or bidding for wholesale contracts.[65]

The centrality of these wholesale market concerns features, and is further discussed, in the NZCC recommendations section below.

4. Consumer Information Concerns

The NZCC also considered a range of consumer information issues. For the most part, the only information that is available to consumers is the display on retailers' price boards of regular and diesel prices.

Making real time pricing information available has been mandated in some jurisdictions. This would in theory better enable consumers to make decisions on the best retail prices that are available. However, the NZCC had concerns about how many consumers may use this information. Apparently, only 5 percent of Australians use real time price comparison apps. Moreover, there were concerns that this price information would be of greater benefit to retailers, as it would better enable price monitoring and potentially increase the ability of competitors to co-ordinate. For these reasons the NZCC made no recommendations on real time pricing.[66]

The display of discounted prices was also considered but not recommended. The display of such prices could act as bait advertising as these prices would not be available to everyone. Further, a focus on discount levels, rather than actual prices, has the potential to act adversely on informed decision-making.[67]

One matter that did attract the NZCC's attention was the absence in most cases of the display of premium fuel prices on retailers' price boards. This makes it difficult for consumers to compare prices. The NZCC also observed that margins on premium fuel have been increasing over time at a greater rate than the margins for regular fuel. Different costs did not appear to explain this difference in margins between regular and premium fuels, being currently 8 to 10 cents per liter. The NZCC thought that the absence of transparent pricing may be a factor contributing to this trend. Accordingly, the NZCC recommended that these prices should be displayed on retailers' price boards.[68]

E. Bold (and Some Simple) Recommendations

Not surprisingly, the NZCC's recommendations were primarily directed at stimulating a competitive wholesale market. The wholesale market recommendations center upon a two-pronged approach. Regulation is recommended to provide for a Terminal Gate Price regime ("TGP regime") and regulation is also recommended to limit the use of certain terms in wholesale supply contracts.[69]

It is proposed that the TGP regime be based on the Australian precedent, with amendments to meet local conditions.[70] This regime requires that TGPs must: (a) be expressed in cents per temperature corrected liter, (b) be posted on a website or available through a phone service, (c) be posted each day and (d) not include any amount for an additional service. Wholesale suppliers must not unreasonably refuse to supply any customer who requests supply at the TGP. Refusal to supply is only justified where there are reasonable grounds to believe that customer is unable to pay or comply with relevant health and safety regulations, or where the wholesaler does not have sufficient supplies.

The NZCC favored this approach because of its potential to create a liquid wholesale spot market, although it did acknowledge that this may not happen in the short to medium term.[71] The TGP regime was also favored because it could help to reduce barriers to entry and expansion for vertically integrated import entrants and distributors, as these firms would be provided with the ability to obtain supply from the existing network of terminals. Another perceived benefit was increased price transparency for distributors as this would give them a benchmark to compare their prices against. Finally, the NZCC thought that TGPs would provide additional information to any monitoring agency and may, for example, reveal whether any increases in a TGP posted at a particular location is justified or involves the exercise of market power.

The NZCC did attempt to spell out some further detail for this regime, should it be adopted. The greater extent of supply constraints in New Zealand, compared with Australia, caused the NZCC to suggest that there be a "must supply obligation" at each terminal, up to certain limits. A TGP monitoring regime is also proposed to enable analysis of the competitiveness of this market. Finally, it was recommended that there be a backstop regulatory regime in place should competition not be delivered under this new regime. This could take the form of binding arbitration proceedings, or a default regulatory regime.

Industry participants, including the majors, have variously expressed support for the introduction of the TGP regime to New Zealand.[72] However, the devil will remain in the detail. Furthermore, the smallness of the New Zealand market, and the fewness of likely suppliers into this wholesale market, will be factors which may impact significantly on the potential competitiveness that will emerge. This is a bold recommendation and only time, potentially quite some time, will tell if the NZCC's confidence in this market solution is well-placed.

Turning to the wholesale supply agreements with distributors and dealers, regulation is proposed to correct the contractual imbalance.[73] Potentially under an enforceable industry code of conduct,[74] it is proposed that these contracts include a transparent pricing provision. This would enable the distributors and dealers to compare the prices they receive against, for example, the posted TGPs.

To overcome the impact of wholesale contracts with long-term, minimum volume and exclusive dealing restrictions certain changes are proposed. In relation to the distributors it is recommended that they be permitted to obtain a certain proportion of their supplies from another supplier, notwithstanding an exclusivity provision. Further, it is a recommended that distributors be given the right to terminate the contract after of a prescribed period of (say) five years. It was acknowledged that similar limitations may not be appropriate in the case of dealer contracts where there may be relationship-specific investments to justify such restrictions.

Finally, the recommendation is made that regulations be passed to prohibit unjustifiable limitations on the ability of distributors and dealers to compete. These limitations relate to restrictive contract matters discussed above, such as restrictions on the transfer of ownership, restraints of trade and restrictive non-petroleum use covenants.

These proposed rewrites of the wholesale contracts appear to be readily achievable.

These two recommendations involve a significant degree of inter-dependency. For example, the success of the TGP regime may depend in part on long-term supply contract adjustments to overcome concerns that importers may have regarding access to retail space.

The remaining recommendations in the Retail Fuel Sector Report are relatively straight-forward and relate to the consumer information issues discussed above, and a range of miscellaneous matters.

The NZCC recommends that regulation be imposed to require the display of premium fuel prices on price boards[75] and to require a fuel cap or fuel flap sticker specifying the minimum octane level required for a vehicle.[76] No recommendations are made in respect of the display of discount pricing on price boards, but it is suggested that this practice should be subject to monitoring.[77]

Some miscellaneous recommendations complete the report. It is recommended that regulation be introduced to require certain information to be collected and retained in New Zealand to assist in enabling future market analysis.[78] Reductions in the level of information sharing through COLL are also thought desirable, to reduce the potential for co-ordination. Similar information sharing concerns attach to NZRC, with the majors sharing volume information in the course of the annual capacity allocation procedure. Also, the NZCC had raised with NZRC the prospect that allocation be based over a shorter time than the three years currently in use. NZRC has indicated support for a shorter time frame for allocation and agreed that some of its processes can be modified to reduce the current level of information sharing. Against this background, the NZCC was content just to recommend that these changes be monitored.[79]

IV. Where to Now?

The market study phase is complete, and this matter now returns to the political arena. The Minister soon after the release of the report announced that the Government is ready to act swiftly on the study, and that it was looking to enact laws to give effect to changes by mid-2020. Not surprisingly the Government is, it appears, looking pro-actively to take steps to bring petrol prices down in what is an election year.[80]

Will the Minister and his officials consider that the NZCC's recommendations will provide an adequate and sufficiently timely response? Will political expediency mean that more immediate regulatory impacts may be thought necessary? To what extent is industry offering up concessions to appease the Minister and his officials? For the moment, intrigue into these issues is all that we have. Meantime, speculation continues as to the next industry to be identified for market study scrutiny.

[1] Barrister, Auckland. Dr. Berry was Chairman of the New Zealand Commerce Commission from 2009-19. He participated in the preliminary issues and working papers in relation to this study. The substantive analysis into this study was undertaken following Dr. Berry's departure in May 2019. Comments and questions are welcome to mark.berry@mblaw.co.nz.

[2] Section 4 of the Commerce Amendment Act 2018 (NZ). The NZCC has for some time held market studies powers in respect of the consumer and telecommunications laws for which it also has responsibilities: see section 6 of the Fair Trading Act 1986 (NZ) and section 9A of the Telecommunications Act 2001 (NZ).

[3] Cabinet Paper, "Initiation of the first market study to be carried out by the Commerce Commission" (December 2018): https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/market-studies.

[4] NZCC, "Market Study into the Retail Fuel Sector Final Report", December 5, 2019: https://www.comcom.govt.nz/_data/assets/pdf_file/0028/193915/Retail-fuel-market-study-Final-report-5-December-2019.PDF.

[5] For an outline of the range of market study powers conferred on various competition authorities, see OECD, "Guide on Market Studies for Competition Authorities", *DAF/COMP/WD(2018) 26* (May 23, 2018), at 5-6.

[6] Section 49 of the Act. The legislation refers to "competition studies" rather than "market studies." For the sake of conformity with standard international terminology on this subject, this paper uses the term "market studies."

[7] Section 50 of the Act.

[8] Section 51 of the Act.

[9] $1.4 million was allocated to market studies for the first year of the new regime. The retail fuel sector study was the only market study undertaken over the 2018-19 year. See NZCC, Annual Report 2019, at 8: https://www.comcom.govt.nz/_data/assets/pdf_file/0028/192268/Commerce-Commission-Annual-Report-2019.pdf.

[10] Section 51A of the Act.

[11] Section 51A(4) of the Act.

[12] Section 51C of the Act.

[13] Section 51B of the Act.

[14] Section 51E of the Act.

[15] See Retail Fuel Sector Report, *supra* n 4, at 36.

[16] *Id*. at 37-39.

[17] *Id*. at 38 (citing *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289, at [18]-[22]).

[18] See, e.g. *id* at 99, 103, 108, 116, 259 and 262.

[19] See, e.g. *id* at 215, 219-20, 222, 243, 290, 326 and 355.

[20] See, e.g. *id* at 37, 223, 239, 242 and 251.

[21] *Id*. at 359.

[22] *Id*. at 382.

[23] *Id*. at 10.

[24] There is also some speculation that Gull may look to expand into supplying jet fuel to Auckland Airport and that TOSL may build a further terminal in Port Tauranga: *id*. at 176.

[25] *Id*.

[26] *Id*. at 82.

[27] *Id*. at 85-87.

[28] *Id*. at 89.

[29] *Id*. at 89-94.

[30] *Id*. at 178-79.

[31] *Id*. at 197.

[32] *Id*. at 78.

[33] *Id*.

[34] A number of brands supplied by Mobil (NPD Limited, Waitomo Petroleum Limited and Allied Petroleum) have been most active in building new sites.

[35] *Id*. at 78-79 and 272.

[36] *Id*. at 36.

[37] *Id*. at 118-21.

[38] *Id*. at 361-65.

[39] See, *id*. at Attachments A to D for full commentary on the assessment of profitability. These profitability observations do not apply to some dealer-owned retail sites which were found to be operating on slim margins, reflecting relatively the high wholesale prices they pay for fuel: *id*. at 104.

[40] *Id*. at 105-07. There was evidence that Z had built 35 new retail sites, growing capacity 2 percent over a time when petrol sales had declined by 1.5 percent: *id*. at 18.

[41] *Id*. at 107-08.

[42] *Id*. at 108-09.

[43] *Id*. at 111-12.

[44] For full coverage of these and other opposing views, see *id*. at Attachments A to D.

[45] *Id*. at 368.

[46] *Id*. at 190-96.

[47] *Id*. at 210-12.

[48] *Id*. at 200-02. The NZCC found that the demand for petrol in New Zealand is likely to remain reasonably flat for the next decade or more before potentially declining as a result of improved fuel efficiency and the uptake of electric vehicles. The conclusion was reached that electric vehicles will not have a meaningful impact on fuel sales for at least ten years: *id*. at Attachment J.

[49] *Id*. at 215-19.

[50] *Id*. at 219-23. The NZCC also suggested that the retail market was vulnerable to accommodating behavior by reference to Z publishing its Main Port Price from 2012-17. Price transparency over this time resulted in leader-follower pricing. This was the period in which there was the most significant increase in margins. See, *id*. at 296-99.

[51] *Id*. at 155-56.

[52] *Id*. at 157-58.

[53] *Id*. at 160-68.

[54] *Id*. at 169-75.

[55] *Id*. 177-82.

[56] *Id*. at 182-87.

[57] Gull has achieved high returns on capital employed since its entry: *id*. at 109-10.

[58] *Id*. at 175-77.

[59] *Id*. at 126-35.

[60] The extent of this competition needs to be considered in the context of Gull being able to still maximize profits by offering prices below the majors' average retail prices: *id*. at 133,139 and 302.

[61] *Id*. at 234.

[62] *Id*. at 245-53.

[63] *Id*. at 239-44.

[64] *Id.* at 254-57.

[65] *Id*. at 258-60.

[66] *Id*. at 306-08.

[67] *Id*. at 309-10. There is extensive discussion on discounts and loyalty programs throughout the Retail Fuel Sector Report. The NZCC concludes that it is difficult to distinguish between discounting that is good for competition and that which is harmful. No recommendations were made in respect of discounts and loyalty programs. Rather, the focus here was on the best way that competition could be promoted on price boards at the retail level: *id*. at 274-87.

[68] *Id*. at 315 and 320-21. The NZCC also considered that there would be benefits in having more information available about what type of fuel consumers should use, with the suggestion that over time fuel caps or fuel flaps on vehicles should provide this information: *id*. at 319.

[69] The recommendations discuss other related matters which may impact on the wholesale market. These include requiring the parties to the COLL joint venture and the borrow and loan agreements to publish their existing process and criteria for applications to gain access to this infrastructure. No recommendation is made to regulate sharing arrangements at this time: *id*. at 344-45. No mention is made regarding NZRC's access

processes. It is also suggested that consideration be given to whether the borrow and loan arrangements may be disincentivizing investment in shared terminal capacity: *id*. at 345-46.

[70] *Id*. at 327-37.

[71] *Id*. at 330.

[72] *Id*. at 328.

[73] *Id*. at 338-44.

[74] The adoption of an enforceable industry code of conduct, possibly based on the Australian Oil Code under Part IVB of the Competition and Consumer Act 2010 (Cth), is also recommended: *id*. at 346-48.

[75] *Id*. at 348-49.

[76] *Id*. at 349-51.

[77] *Id*. at 352-53.

[78] *Id*. at 353-55.

[79] *Id*. at 355-57.

[80] See, e.g. Catherine Harris, Tom Pullar-Strecker and Collette Devlin, "Petrol could fall 18c a liter if retailers forced to show price", December 5, 2019: https://www/stuff.co.nz/business/117929994/petrol-companies-told-by-regulator-how-to-improve.