



**AIP Submission to
The Victorian Economic, Education, Jobs & Skills Committee
Inquiry into fuel prices in regional Victoria**

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KEY MESSAGES

- The Australian liquid fuels market broadly, and the Victorian market specifically, is highly competitive and transparent, with pricing information at the wholesale and retail levels freely and widely published on a daily basis.
- According to the ACCC, wholesale petrol prices are dominated by refined international benchmark prices and Australian Government taxes. The wholesale “Terminal Gate Price” (TGP) typically represents around 95% of the retail price.
- Regional Victorian retail prices are not exposed to the highs and lows of the price cycles evident in Melbourne and appear to be much more stable.
- AIP’s published average Victorian regional price series provides consumers with the capacity to compare the average regional price (i.e. the average price across a range of representative towns in regional Victoria) with the average price in metropolitan Melbourne.
- Based on this data, average Victorian regional retail prices are now closer to average Melbourne metropolitan prices than they have been for many years. In the year to date in 2017, the daily average regional retail petrol price has been lower than the average Melbourne retail price for more than 50 percent of the time.
- There will, however, always be differences across towns and across retail sites within towns due to a range of local area competition and business factors.
- Consumers have a range of services available to them to identify the lowest retail price in their local area to assist them in their purchasing decisions.
- Given the market realities, the ever-increasing provision of transparent pricing information and the innovation by direct industry participants and third-party providers, there is little evidence to support Government intervention in the fuel market.

1. BACKGROUND

About AIP

The Australian Institute of Petroleum (AIP) was established in 1976 as a non-profit making industry association. AIP's mission is to promote and assist in the development of a sustainable, internationally competitive petroleum products industry, operating efficiently, economically and safely, and in harmony with the environment and community standards. AIP provides a wide range of factual information and industry data to assist policy makers, analysts and the community in understanding the key market and industry factors influencing Australia's downstream petroleum sector. AIP is represented on key advisory bodies including the ATO Petroleum Corporate Consultation Forum (PCCF), the Fuel Standards Consultative Committee (FSCC), the National Oil Supplies Emergency Committee (NOSEC) and National Plan Strategic Industry Advisory Forum (NPSIAF) and AIP sponsors or manages important industry environmental and health programs. The Australian Marine Oil Spill Centre (AMOSC) is a wholly owned AIP subsidiary.

AIP presents this Submission to the Department on behalf of AIP's core member companies:

- BP Australia Pty Ltd
- Caltex Australia Limited
- Mobil Oil Australia Pty Ltd
- Viva Energy Australia Pty Ltd.

About AIP Member Companies

AIP member companies operate across all or some of the liquid fuels supply chain including crude and petroleum product imports, refinery operations, fuel storage, terminal and distribution networks, marketing and retail. Underpinning this supply chain is considerable industry investment in supply infrastructure, and a requirement for significant ongoing investment in maintaining existing capacity. Over the last decade, AIP member companies have invested over \$10 billion to maintain the reliability and efficiency of fuel supply meeting Australian quality standards.

Moreover, AIP member companies deliver the majority of bulk fuel supply to the Australian market.

- In relation to conventional petroleum fuels, AIP member companies operate all major petroleum refineries in Australia and supply around 90 percent of the transport fuel market with bulk petroleum fuels.
- In relation to gaseous fuels, AIP member companies are the major suppliers of bulk LPG to the domestic market, representing around two thirds of the market.
- In relation to biofuels, AIP member companies are the largest suppliers of ethanol and biodiesel blend fuels to the Australian market.

The Australian petroleum industry is also a significant contributor to the domestic economy providing direct and indirect economic benefits from its own activities and underpins the competitiveness of key export industries like mining, agriculture and manufacturing. In addition, as a technologically advanced industry, the refining industry employs and trains many highly skilled technical staff and also attracts international expertise into the Australian workforce.

Given their significant role and investment, AIP member companies have a very strong interest in consultations relating to government policy proposals impacting on the downstream petroleum industry, including issues relating to fuel pricing.

Should you require additional information, the relevant contact details are:

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2. INTRODUCTION

AIP welcomes the opportunity to provide input into the Victorian Economic, Education, Jobs & Skills Committee's Inquiry into Fuel Prices in Regional Victoria.

AIP has been actively engaged in fuel pricing transparency and related policy issues for many years.

Victorian consumers are benefiting from the direct link between domestic fuel prices and competitively priced fuels from the Asian market.

AIP considers the Victorian market to be highly competitive. Indeed, average regional prices have become more closely aligned with the average prices in metropolitan Melbourne in recent years.

AIP also considers the Victorian fuels market to be highly transparent along the entire supply chain. The retail fuels market has become increasingly transparent due to a range of initiatives by AIP and the ACCC. These include:

- detailed weekly pricing data provided on the AIP website,
- ACCC price monitoring,
- ACCC quarterly and annual reports and Regional Market Studies, and
- price reporting on television and in print media.

This information has empowered consumers through a better understanding of daily pricing as well as retail price cycles. Price cycles occur as a result of the pricing policies of fuel retailers. This allows consumers to take advantage of the bottom of the cycle to buy cheaper fuel which is often sold at or below the wholesale cost price.

There is an expanding range of third party services and IT applications that builds on this information by providing real time and personalised price comparisons. These include commercial applications such as MotorMouth and GasBuddy.

Given the constant evolution and innovation of the various commercial offerings, government intervention, such as in New South Wales, is unwarranted and simply imposes significant costs on the industry without commensurate consumer benefit beyond that already freely available in the market place.

The display of highly visible price boards at service station sites also enables consumers to make quick price comparisons on the road if they are not using information technology. The recent changes made by the Victorian Government in this area were supported by AIP and Member Companies.

Given this competitive landscape and increasing market and price transparency, AIP believes that any government policy change or initiative to support market transparency needs to be:

- based on a demonstrated market failure
- based on sound evidence
- cognisant of current market circumstances and other policy and regulatory settings
- recognise free market outcomes/services achieving the same policy goals at no cost to industry or taxpayers
- transparent, with clear and credible objectives.

AIP and Member Companies are very concerned about the increasing burden of red tape and costs of doing business, as they strive to remain competitive in a challenging market environment. Unjustified regulation that imposes costs on business is strongly opposed by AIP and its members.

Any regulation must also be mindful of not encroaching into areas of legitimate and pro-competitive business operation, nor stifling business differentiation and innovation.

AIP believes that appropriate levels of transparency - both in terms of market operation and in pricing - is the best way to ensure consumers are best equipped to make informed purchasing decisions.

In this context, this submission:

- outlines how fuel prices are determined in Australia and identifies the relevant pricing benchmarks/markers
- examines the drivers for regional price differences in Victoria and why they differ to metro sites
- discusses appropriate arrangements for market and price transparency to assist consumers.

3. AUSTRALIAN LIQUID FUELS SUPPLY AND DEMAND

In 2016–17, Australia's domestic refineries supplied around 43 percent of total petroleum products required by Australia's major industries and the fuel distribution network of around 7,000 service stations. The reliability of the fuel supply chain is robust given the unique logistic and geographic challenges in Australia.

Australian petroleum refineries are highly capital intensive, technically sophisticated facilities that employ a wide range of highly skilled personnel and provide significant economic and other benefits to key Australian industries.

The Australian oil refining industry produces a range of petroleum products comprising:

- petrol (44%)
- diesel (35%)
- jet fuel (14%)
- fuel oil (3%)
- LPG (3%)
- other products (1%).

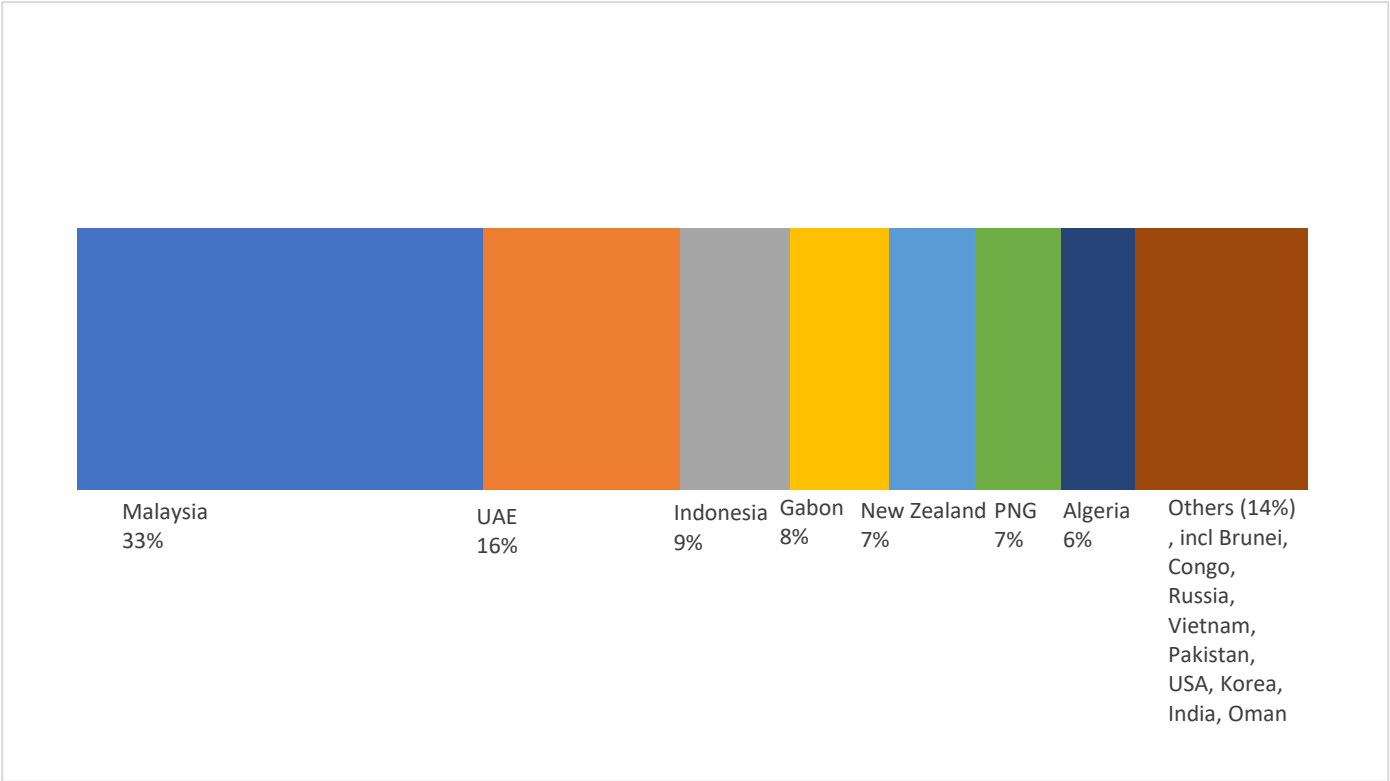
It also produces a substantial volume of chemical feedstock.

In 2016–17, Australia consumed 58,400 ML (mega litres) of petroleum products - or around 160 ML per day- a 9.1 percent increase since 2010-11. Australian refineries produced 25,000 ML of petroleum products, of which around 4.7 percent was exported (excluding LPG). Net imports from over 20 countries accounted for 57 percent (or 33,400 ML) of total consumption, as highlighted in the following chart. A proportion of this imported volume was supplied to northern and north-western areas of Australia where it is more economic to supply directly from Asia due to domestic refinery locations and local terminal configuration. Numerous import terminals are located around Australia providing ready access to the Australian market. The bulk of imported fuel came from refiners and regional suppliers in South Korea, Singapore and Japan and imports from India are increasing.

While Australia has its own indigenous crude oil production, this has been declining and around 76 percent was exported in 2016–17. These crudes are largely unsuitable for Australian refineries to manage their product slate, while the locations of Australian refineries also contribute to the quantity of exports. Crude oils required to meet the product demand mix in Australian refineries were imported from over 15 countries, but mainly from the Asia-Pacific region (64 percent) including New Zealand and PNG. The remaining third of crude oil imports was sourced from the Africa (18 percent), the Middle East (16 percent), and others (2 percent).

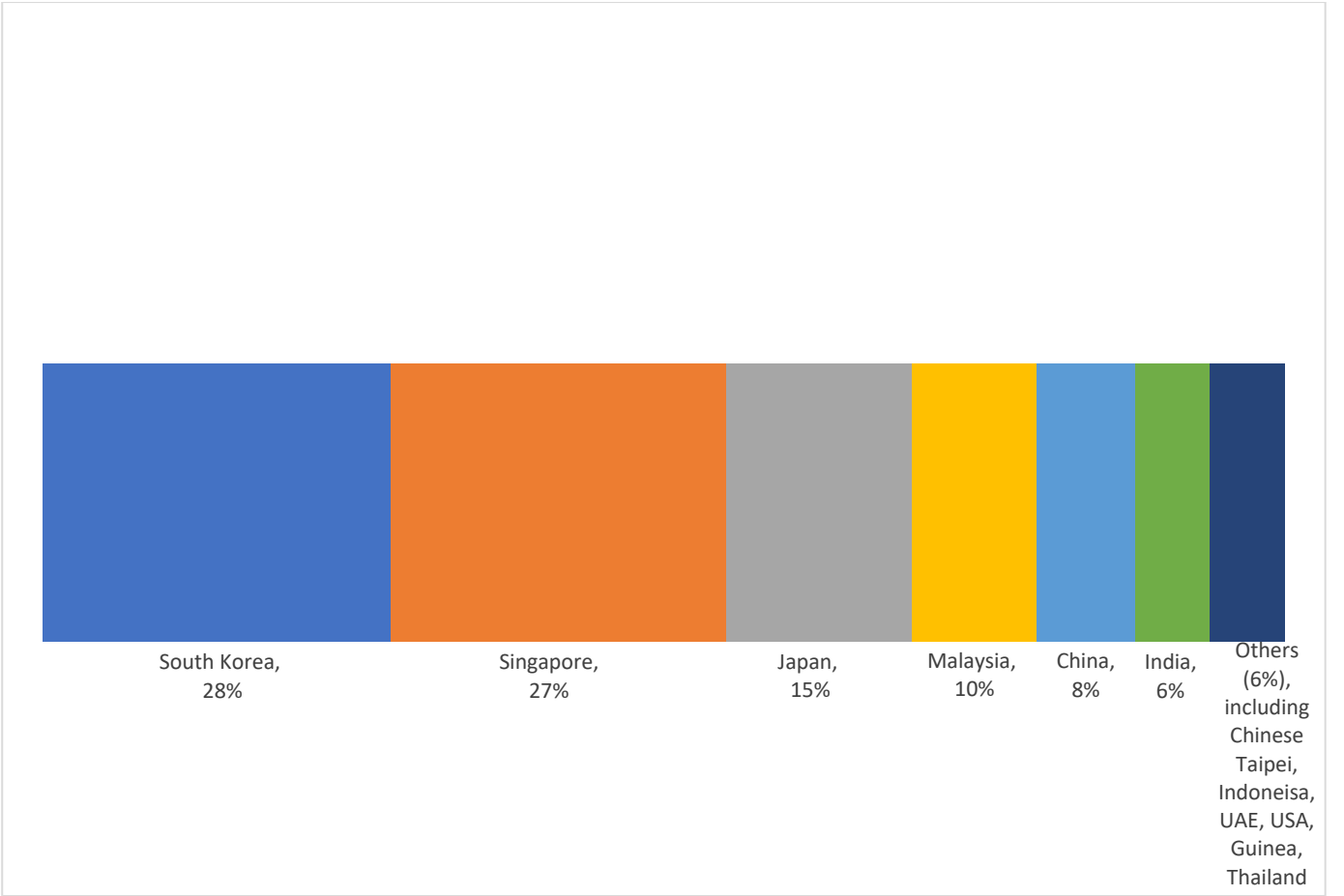


Chart 1: Imports of Crude Oil, 2016-17



Source: Australian Petroleum Statistics

Chart 2: Imports of Petroleum Products, 2016-17



Source: Australian Petroleum Statistics

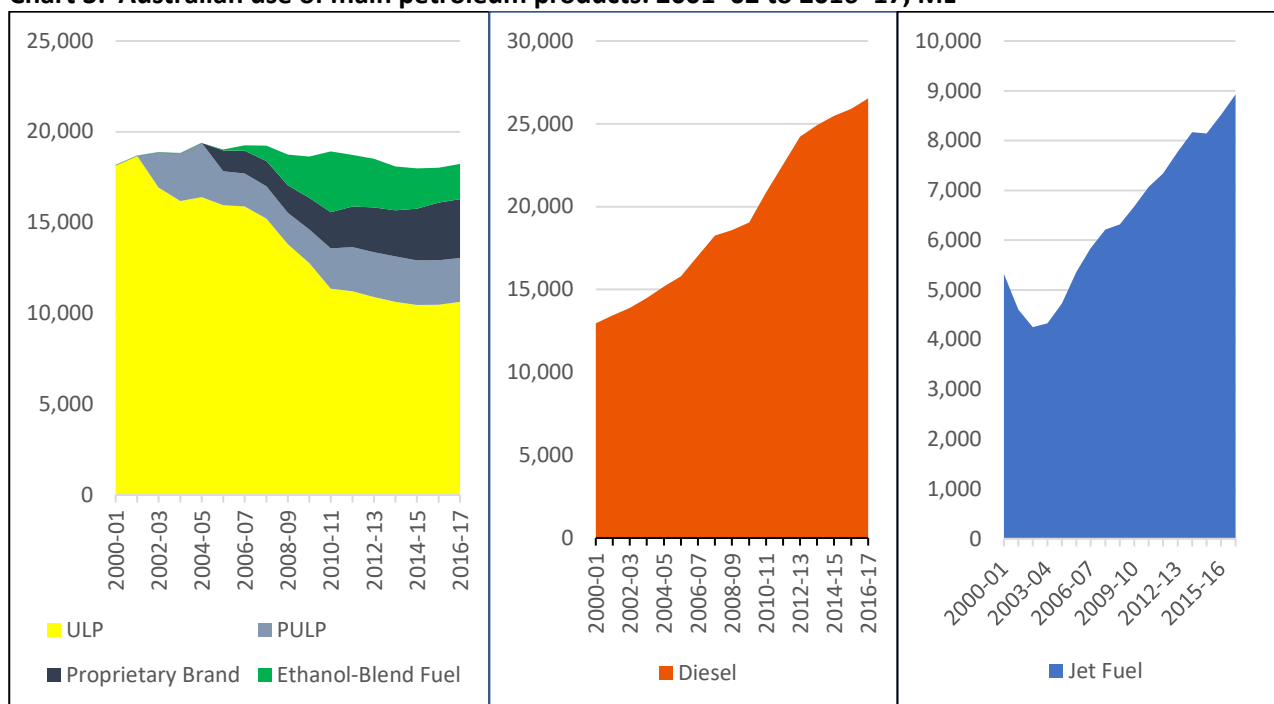
Changing Australian demand for petroleum products

Over the past decade, Australian use of petroleum products has increased by around 2 percent per year. Petrol, diesel and jet fuel use now comprise 92 percent of the total petroleum product demand.

Since 2000–01:

- Diesel use has increased by 105 percent due largely to growth in mining industry activities in Australia and growth in sales of vehicles with new generation diesel technology engines
- Jet fuel use has increased by 68 percent due to growth in air travel for business and leisure
- Petrol use has remained flat as vehicle fuel efficiency has continued to improve. Use of regular unleaded petrol (ULP) has declined by more than 40 percent as consumers chose new vehicles that recommend the use of higher octane fuels. The demand for ethanol blend petrol peaked at 18 percent of petrol use in 2010–11, largely as a consumer response to the ethanol fuel mandate in NSW, but has subsequently declined to less than 11 percent of total petrol use.

Chart 3: Australian use of main petroleum products: 2001–02 to 2016–17, ML



Source: Australian Petroleum Statistics (various publications)

As shown in the Charts 4 and 5, there are also significant variations in petroleum product use across the Australian states and territories, which reflect a range of differing factors. These include the main economic activities and resources in jurisdictions, their population base and dispersion, the age and structure of vehicle fleets, and their infrastructure capacity and performance (e.g. airports). For example, there is higher diesel use in the mining States of WA, NT and QLD, higher jet fuel use in major airport centres, and higher use of premium gasoline in NSW as a consumer preference response to that government's ethanol mandate policy.

Chart 4: Total Petroleum Products Demand, by State 2016-17

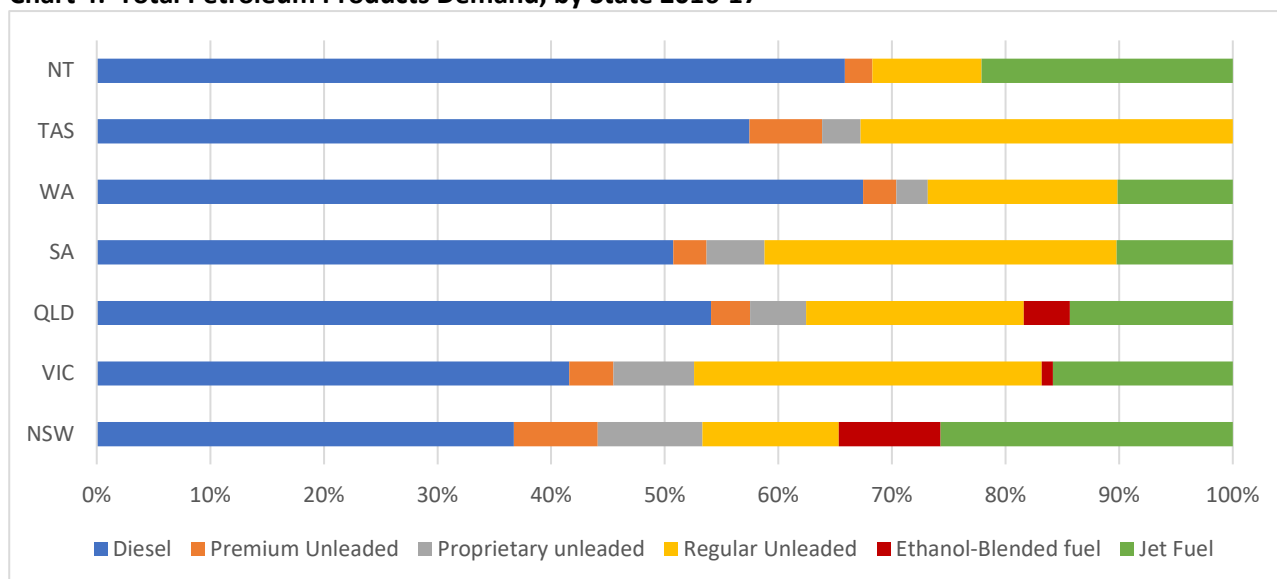
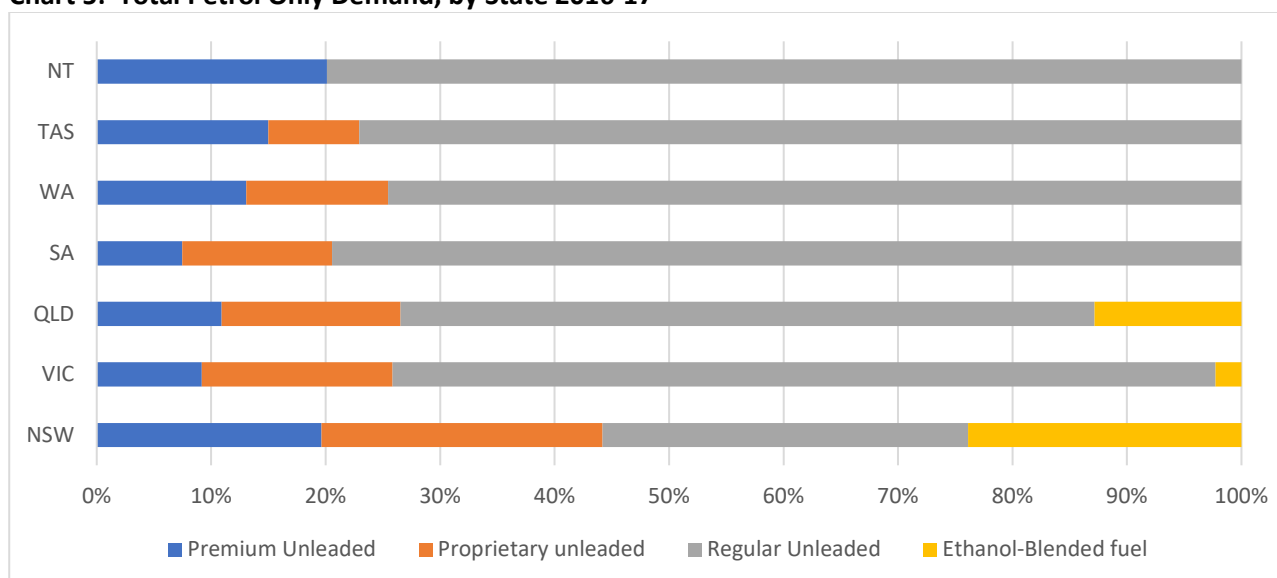


Chart 5: Total Petrol Only Demand, by State 2016-17

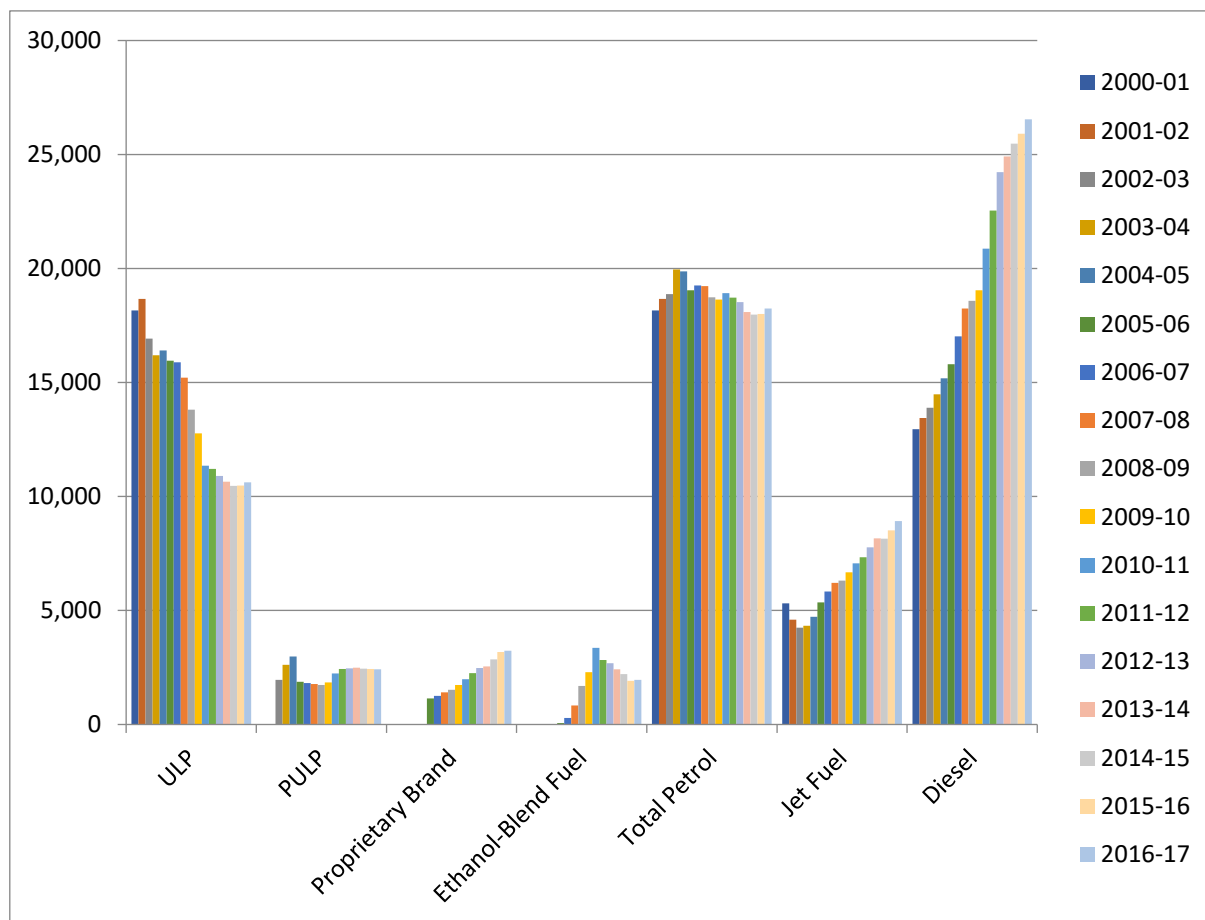


Source: Australian Petroleum Statistics (various publications)

These changes in production and demand patterns mean that there is a substantially different supply profile for each type of fuel. Overall, the Chart 6 on petroleum demand shows that imports of diesel and jet fuel have increased substantially over the last decade and imports now constitute the majority of supply. However, petrol is still largely supplied from Australian oil refineries with the import proportion at around 35 percent of the total.

The substantial portion of Australian refining supply of petrol to the Australian market underlines the importance of the Australian petrol market to the continued viability of the Australian refining sector. It also emphasises the importance of Australian refineries to the ongoing Australian liquid fuel supply reliability, especially for petrol.

Chart 6: Australian petroleum products demand: 2000-01 to 2016-17

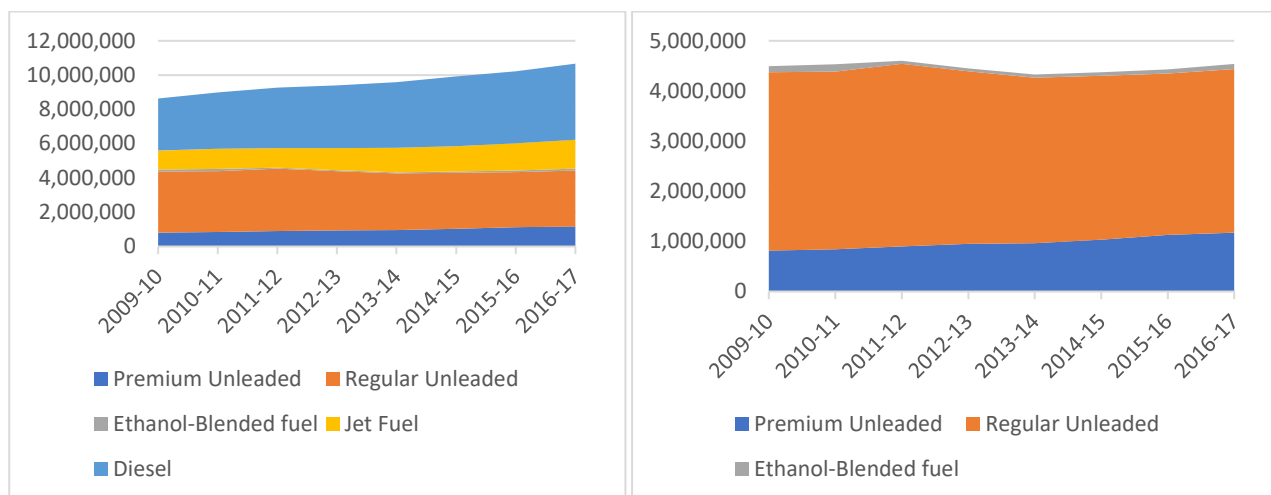


Source: Australian Petroleum Statistics (various publications)

Victorian Fuel Demand

Demand for total petroleum products in Victoria has increased 23.6 percent since 2009-10, largely due to significant growth in both diesel and jet fuel demand. However, total gasoline use has been largely flat, although there has been growth in premium fuel demand displacing regular unleaded. This is shown in Chart 7.

Chart 7: Total Victorian Petroleum Products Demand and Total Victorian Gasoline Demand, 2009-10 to 2016-17



Source: Australian Petroleum Statistics (various publications)

4. HOW ARE FUEL PRICES DETERMINED?

Fuel prices around the world are largely determined by regional markets and the benchmark prices and government taxes applying in those markets.

There are three distinct points throughout the supply chain for fuels which ultimately determines the final prices paid by consumers at the pump. At each of these market sectors, prices are fully transparent and freely and widely published on a daily basis. These sectors are:

- international market - the relevant Australian petrol benchmark price is Singapore MOPS95 unleaded and the relevant diesel benchmark is Singapore Gasoil 10ppm sulfur
- wholesale market - the Terminal Gate Prices in each capital city are published by all major fuel wholesalers and AIP and updated each weekday
- retail market - extensive pricing data is available from a range of sources, including AIP and third-party providers, as well as highly visible price boards at each retail site.

Collectively, these represent a “fuel price build” for the final price ultimately paid by consumers at retail sites.

These markets are discussed in the following sections.

International Market

The price of fuel in Australia is largely dependent on world market prices, with these world market prices reflecting the market supply and demand.

Crude oil, petrol, diesel and jet fuel are bought and sold within their own specific trading markets. As they are different products – with their own unique physical characteristics, uses, and demand and supply factors – they are priced and traded separately.

Each market is regionally based. There are linkages and transactions between regional markets to balance global demand and supply.

Prices in regional markets can be volatile and can move in different directions from each other. This can be due to the impact of factors and events unique to one market or all markets globally. Australia’s regional market for petroleum products is the Asia Pacific market.

Price benchmarks or ‘markers’ for crude oil and petroleum products are highly transparent providing convenient indicators of what is happening with prices in specific markets. Information on changes in the prices of these markers is extensively reported on a daily basis.

Australia’s benchmark prices, including Tapis and Dated Brent crude oil, MOPS95 petrol and Gasoil 10ppm sulphur diesel, are quoted daily by the independent monitoring agencies, Platts and Argus, based on transactions in the Singapore market on a given day.

Supplies of crude oil and petroleum product are sold internationally and domestically through a variety of term contract arrangements and in spot transactions. Crude oil and petroleum products are also traded on futures markets like NYMEX and ICE.

The link between international and Australian prices

There is a close relationship between international fuel prices and Australian wholesale and retail fuel prices.

To meet Australian demand, around 55% of petroleum products are imported, mostly from Asia. Singapore is the regional refining, distribution and trading centre and among the world's largest.

Singapore prices are the key pricing benchmarks for Australia because they represent the competitive alternative for supply to Australia. Benchmark prices are adjusted by a negotiated quality premium that reflects Australian fuel standards.

Growth in demand for fuel in Australia is likely to continue to be largely met by imports, further strengthening the price relationship with Asian fuel prices.

Australian refiners are compelled to price their local manufactured fuel products to be competitive with fuel imports from Asia —called 'import parity' pricing.

If Australian fuel prices were below Singapore prices, Australian fuel suppliers would have no commercial incentive to import the fuel needed here because sales of that fuel would incur losses. In addition, Australian refiners would have an incentive to export production.

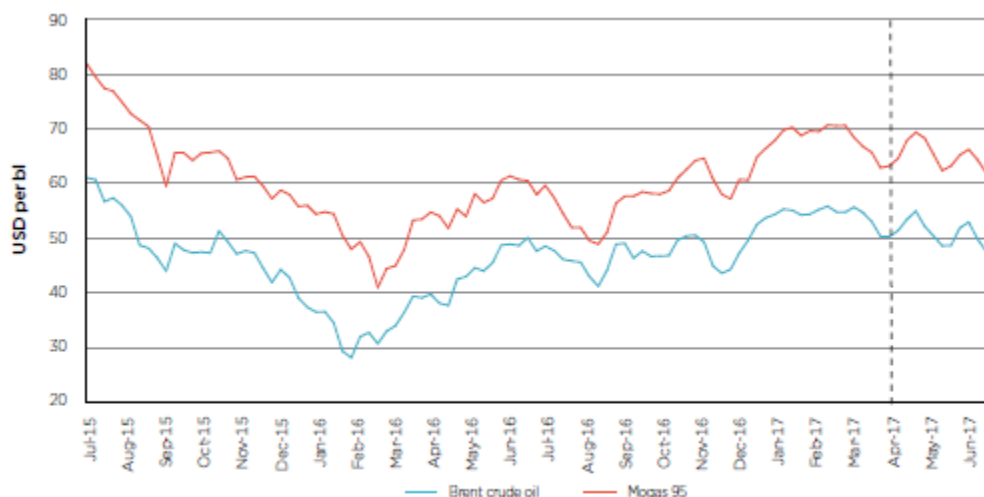
As the Singapore benchmark prices for fuel are quoted in US\$ per barrel terms, their price in Australian dollar terms also reflects movements in the US\$/A\$ exchange rate. This means that exchange rate movements can offset or magnify changes in Singapore fuel prices.

The Singapore market price for fuel plus shipping costs, Australian taxes and the impact of the exchange rate is called the refined product cost and represents around 85 to 90 per cent of the retail price of fuel in Australia.

Overall market and fuel price transparency in Australia is assisted by data published by AIP and member companies. The ACCC also formally monitors fuel prices in Australia and publishes a report quarterly.

The ACCC, in its most recent report¹, has highlighted the strong correlation in price movements between the international crude price and the price of refined petroleum, concluding "Mogas 95 prices moved in a similar manner to Brent crude oil prices over the two-year period". This is shown in the Chart below.

Chart 8: Weekly average Brent Crude Oil and Mogas 95 prices: July 2015 to June 2017



Source: ACCC calculations based on Platts data.

¹ ACCC (2017), *Report on the Australian petroleum market – June quarter 2017*, p34

Wholesale Market

Australian wholesale fuel prices are closely linked to international prices through Import Parity Pricing (IPP).

The IPP is the 'landed cost' of refined fuel to import terminals around Australia and includes:

- the refinery benchmark price for fuel (e.g. for petrol - MOPS95 petrol)
- the 'quality premium' for specific Australian fuel quality standards
- freight
- exchange rate
- wharfage, insurance and loss.

The ACCC has concluded that the IPP benchmark has a strong relationship with actual costs of fuel imports into Australia.

Previous ACCC analysis has shown that "the actual import costs paid by major fuel suppliers closely followed the IPP over the past three years, with the difference averaging around 2.6 cents per litre."

With imports providing the marginal source of supply and with prices set according to IPP, the ACCC considers Australian refiners (and suppliers) have little scope to pass on costs that are out of line with international markers.

Terminal Gate Prices (TGPs or spot wholesale prices) typically include the IPP as well as 'wholesaling costs' to store and handle the fuel once it arrives in Australia and prior to its distribution to the domestic market. TGPs also include taxes (fuel excise and GST) and a small wholesale profit margin.

Wholesale price transparency in the Australian market is assisted by the regulated publication of TGPs for petrol and diesel by all AIP members. The ACCC has concluded that "by virtue of its transparency and the fact that it represents a fuel-only charge, TGP is a useful benchmark for analysing wholesale prices".

ACCC analysis shows wholesale prices paid by customers vary slightly from TGP. In 2013-14, the average difference was 0.7 cent per litre. Differences are explained by volume discounts applying to contracted customers and large orders, or charges for additional services as part of the transaction like delivery costs and use of proprietary brands.

According to the ACCC, the average annual net profit for the wholesale sector over the last 12 years (to 2013-14) was 0.3 cents per litre for petrol and 1.7 cents per litre across all fuels.

The Singapore to wholesale price lag

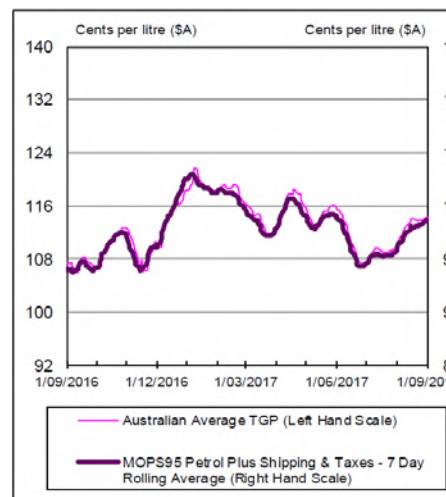
Generally, there is a time lag of one to two weeks between changes in international (Singapore) prices and changes in Australian wholesale prices.

Importantly, this time lag occurs whether prices are going up (when the lag slows price rises to consumers) or prices are going down (when the lag delays price falls).

The lag is a result of using a rolling average of Singapore prices as part of the wholesale pricing methodologies of companies — very similar to that used by the ACCC when wholesale prices were government regulated.

According to the ACCC, this time lag can be longer during times of significant volatility in international prices.

Chart 9



Source: AIP

The very close relationship between changes in MOPS95 Petrol and changes in Australian TGPs can be seen by applying a rolling average to the MOPS95 Petrol data, as shown in Chart 9. A 7-day rolling average is used to illustrate this.

Retail Market

Once fuel leaves the terminal gate (where TGPs apply), retail prices vary across metropolitan and regional areas, reflecting local area factors and competition.

In understanding movements in retail or pump prices, it is important to distinguish between the factors that contribute to the underlying price level and the factors that drive pump or retail price volatility around that underlying level. Ultimately, the market sets the retail price which can be achieved.

- The underlying price level is largely determined by the international influences noted above and the domestic competitive market.
- In contrast, retail price volatility is caused by the structure of the retail market and by variations in local area competitive factors (including price cycles).
- International and domestic factors can have different impacts. For example, there are often times when there are increasing or decreasing crude oil prices (reflecting international factors), but domestic petrol prices are moving in the opposite direction (reflecting domestic market factors including price cycles).

Within the competitive market framework, the underlying retail or pump price in Australia reflects the TGP and all the costs of getting the fuel from the refinery/terminal to the consumer. This includes:

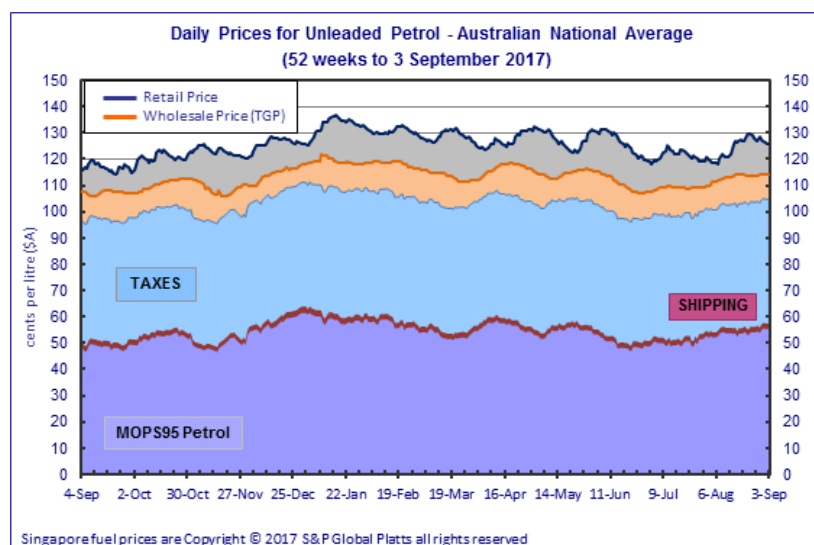
- transport costs,
- admin and marketing costs,
- service station running costs like wages, rent and utilities.

The TGP is typically around 95% of retail prices.

The ability to cover costs depends on local area competition. A small proportion of the pump price (3-5%) is received by fuel retailers to cover these costs and leave a small margin. ACCC analysis shows retail sector net profit on petrol over the last 12 years (to 2013-14) averaged 1.35 cents per litre.

This retail price build is illustrated below in Chart 10. It also demonstrates the close relationship between recent movements in national average ULP TGPs and national average ULP pump prices.

Chart 10:



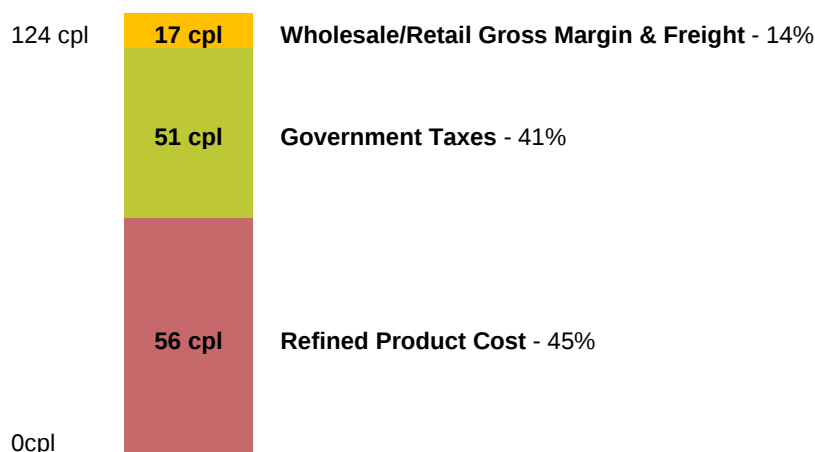
Source: AIP

The ACCC considers that Australian retail fuel prices are highly competitive. Retail fuel prices apply to almost half of the fuel sold in Australia. The remainder of sales are under competitive tenders to commercial, industrial and agricultural buyers.

The components of the national average retail petrol price highlight the small proportion of the final price received by fuel wholesalers and retailers. In 2016-17, the tax component (GST and fuel excise) of the final price of petrol averaged about 41 percent or 51 cents per litre.

According to the ACCC, “petrol industry costs are dominated by refined international benchmark prices and taxes”. AIP member companies typically make payments to the Australian Government (from fuel excise, GST on fuels and income tax) of over \$20 billion per annum.

According to AIP data, in 2016-17, with the National Average Fuel price of 124cpl, the retail price build was:



Price Cycles

Retail prices in many metropolitan areas typically follow a discounting cycle. These cycles occur as a result of the pricing policies of retailers and only retailers (i.e. they do not occur at the wholesale level). They also only tend to occur in Melbourne, Sydney, Brisbane, Adelaide and Perth, due to intense competition. For the same reason, they generally do not occur in the other capital cities, or in regional markets.

The price cycle is where petrol prices fall steadily often due to aggressive discounting by service stations in an attempt to attract customers. However, maximum discounts can only be sustained for short periods of time because at the bottom of the discount cycle, retail prices can be lower than the wholesale cost price of the fuel. Therefore, retail prices eventually cycle upwards to a level where some margin is available.

The ACCC notes that “price cycles are calculated from daily average prices in each city. This means that the actual increase in price at any individual retail site in that city can vary from the average price cycle increase in the city”².

It is also often claimed that retail petrol prices always increase before public holidays, and in particular ahead of long weekends. There is no evidence to support this claim. According to the ACCC, [they] “have examined petrol price increases before public holidays in each of the five largest cities since January 2007 and has consistently found that the average price cycle increase before public holidays was equal to or above the annual price increase just under half the time. Furthermore, there is little evidence that public holidays affect the timing of price cycle increases in any city”³.

² ACCC (2014), *Monitoring of the Australian Petroleum Industry, Report of the ACCC in the prices, costs and profits of unleaded petrol in Australia*, p87

³ *Ibid*, p87-88

Consumers clearly benefit by buying heavily discounted petrol at the low point in the cycle. The ACCC provides advice on low price days of the week and they estimate that 60% of petrol sales are below the average price of the cycle. The presence of a discounting cycle is a clear demonstration of vigorous competition.

Retail Margins

There are a range of factors influencing retail margins at a given site, including those outlined above. The ACCC uses a metric called Gross Indicative Retail Differences, or GIRDs. These are calculated by subtracting average terminal gate prices from average retail petrol prices.

The ACCC notes that:

TGPs are the prices at which petrol can be purchased from wholesalers in the spot market and are posted on a regular basis on the websites of the major wholesalers. Not all wholesale transactions are at TGPs – some will be higher prices and some will be at lower prices, depending on the specific commercial arrangements. However, TGPs can be regarded as indicative wholesale prices. Furthermore, TGPs reflect the price of petrol only, and exclude other retail operating costs (such as branding, transportation, labour etc.).

As a result, GIRD's should be treated only as a useful approximate benchmark for the difference between wholesale and retail prices. They should not be confused with actual retail profits.⁴

When used in isolation, a calculation based on GIRDs could lead to a distorted perception of the downstream petroleum market, as this metric does not reflect the profitability of retail fuel sales, nor does it take into account the investment made by market participants across all aspects of the supply chain. In many cases, companies operating in the market ensure ongoing preventative maintenance and infrastructure upgrades in order to be more efficient, and to ensure customer, community and staff safety. These costs must also be considered when assessing margins as companies require adequate return on capital.

For example, one AIP member has observed significant increases in operating costs over the past five years, including:

- Utilities (gas and electricity), increased by more than 20% and growing
- Repairs and maintenance costs, increased by around 10%
- Salaries and wages, increased at around 5%
- Rental costs, increased at an average of around 15%

The costs, among others, are integral factors that affect decisions about fuel prices.

Companies operating retail sites are also subject to significant regulatory costs, which has grown markedly in recent years. This fact has been recognised by the ACCC, noting that Government intervention and therefore cost increases has been most significant in NSW.

Diesel Prices

For all intents and purposes, diesel prices are determined in a manner consistent with the methodology used to determine petrol prices, as outlined above.

Like petrol, the price of diesel is internationally based. For Australian diesel, the regional market is Asia-Pacific. The Singapore benchmark price of diesel (Gasoil, 10ppm sulfur diesel) is the current diesel price

⁴ ACCC (2014), *Op. Cit.*, p61

benchmark for Australia. The Singapore diesel price can be significantly higher or lower to the price paid, again reflecting supply and demand pressures.

Diesel is the dominant fuel in Asia and in recent years there has been a significant increase in demand, particularly as a result of the economic and industrial growth in China and India. Australian demand growth has also been strong on the back of our growing economy and the higher demand from industry - particularly as a result of the mining and commodity boom. This demand profile was highlighted in the previous chapter.

The international price for diesel is also affected by the demand for other petroleum products. This is because diesel is one of the middle distillates, which also includes kerosene, jet fuel and heating oil. If Asian refiners produce more kerosene or jet fuel as a result of increased demand, they will produce less diesel and this has an impact on supply availability and price. There is also a seasonal shift of refining production from petrol in the northern summer towards distillate (including heating oil) in the northern winter that affects relative prices of these products.

Australian wholesale prices for diesel are also determined in a manner consistent with the petrol wholesale price. That is, the TGP is closely linked to the Singapore price, using the IPP “landed cost”, plus taxes. Again, 95% of the wholesale cost of diesel consist of the diesel price, plus shipping and taxes, with the remaining 5% being accounted for by insurance, local wharfage and terminal costs, and a small wholesale marketing margin (where competitively possible). The Diesel TGP also exhibits the same short lag of 1-2 weeks between changes in Singapore prices and Australian wholesale prices.

The diesel retail price methodology is also consistent with that evident in the petrol market. Historically, diesel and petrol prices have followed each other. However, a gap can open up for periods as a result of changes in the relativity between international diesel and petrol prices.

In addition to the international factors influencing Australian wholesale prices, diesel pump prices here are affected by domestic market factors.

- Only around 25% of the diesel used in Australia is sold through retail outlets and much of that is sold to account customers. Most diesel is sold in bulk to commercial/industrial customers (e.g. mining and transport companies) on long term contract.
- In the Australian retail market, there is very little diesel sold to private customers.
- Hence retail diesel prices, unlike petrol prices, are not subject to aggressive price discounting. At service stations, retailers concentrate on petrol discounting to drive overall fuel sales volumes and associated convenience store sales.

It remains the case, however, that the TGP is typically around 95% of the retail price. Similarly, the factors influencing the differences between metro and regional prices (discussed in Chapter 5) also apply to diesel.

LPG Prices

AIP is not in a position to provide comment on LPG pricing and methodology, other than to note it exhibits significantly different market characteristics and therefore pricing methodology differs markedly to traditional liquid transport fuels. AIP suggests the committee talk with the relevant industry body and suppliers operating in the LPG market.

5. REGIONAL RETAIL FUEL PRICING

Key Features of Regional Fuel Markets

Regional fuel sites generally differ from the majority of sites in metro areas. Some of the key features of the retail market in regional Australia typically include the following.

- Lower fuel turnover and hence lower profits from fuel sales (regional service stations typically see one tanker per 2-3 weeks vs one or more tankers per day at metro sites).
- The viability or feasibility of service station expansion can be constrained by aging capital or by State/Territory government regulations.
 - Regional service stations tend to be older established businesses, typically without the capital backing for site upgrades (e.g. for new storage tanks, extra pumps, new forecourt, modern and expanded convenience store)
 - Site and/or service expansion can also be constrained by State/Territory government regulations and environmental expenditure requirements (e.g. to prevent leaks from underground storage tanks – most ‘at risk’ sites are in regional Australia where single skin tanks are more prevalent).
- The average customer base per service station is around 2,000 people in regional Australia and in many towns the customer base is between a quarter or half of this number. In comparison, metro service stations typically have an average customer base of around 4,000 to 5,000 people.
- Most major towns and cities have at least one supermarket alliance service station
- Generally, the more successful service stations in regional Australia are supermarkets and locally based independently owned chains (of either major oil company branded or independently branded retailers) who are often involved in fuel distribution as well.

Regional fuel prices are typically more stable in regional areas because of a general absence of discounting (i.e. the discounting price cycle discussed in Chapter 4).

As noted by the ACCC in its most recent quarterly report⁵:

“Movements in retail petrol prices in regional locations are largely driven by changes in international refined petrol prices and the AUD–USD exchange rate, as they are in the five largest cities. However, prices are generally higher in regional locations. A number of factors may contribute to these higher prices:

- *a lower level of local competition;*
- *lower volumes of fuel sold;*
- *distance/ location factors; and lower convenience store sales.*

The influence of these factors varies significantly from location to location. This means that there may be substantial differences in prices between specific regional locations”.

It is important to note that the retail fuels market is not a single, homogenous market where the price paid at the pump is consistent across all sites, regardless of location be they metro or regional. Rather, each local retail market is heavily influenced by a multitude of local factors. These differences predominantly explain the different prices paid by consumers.

These retail markets tend to be small, such as the sites operating within metro suburbs or local regions/town centres. As such, prices can vary significantly between sites considered “within driving distance”. These local markets will also seek to vary the demand requirements of that particular local market which can also have an influence on price. An example may be where a local market has greater

⁵ ACCC (2017), Ibid., p21

demand for diesel products or premium fuels and as such sites are configured to better meet this customer demand.

How to analyse regional fuel prices

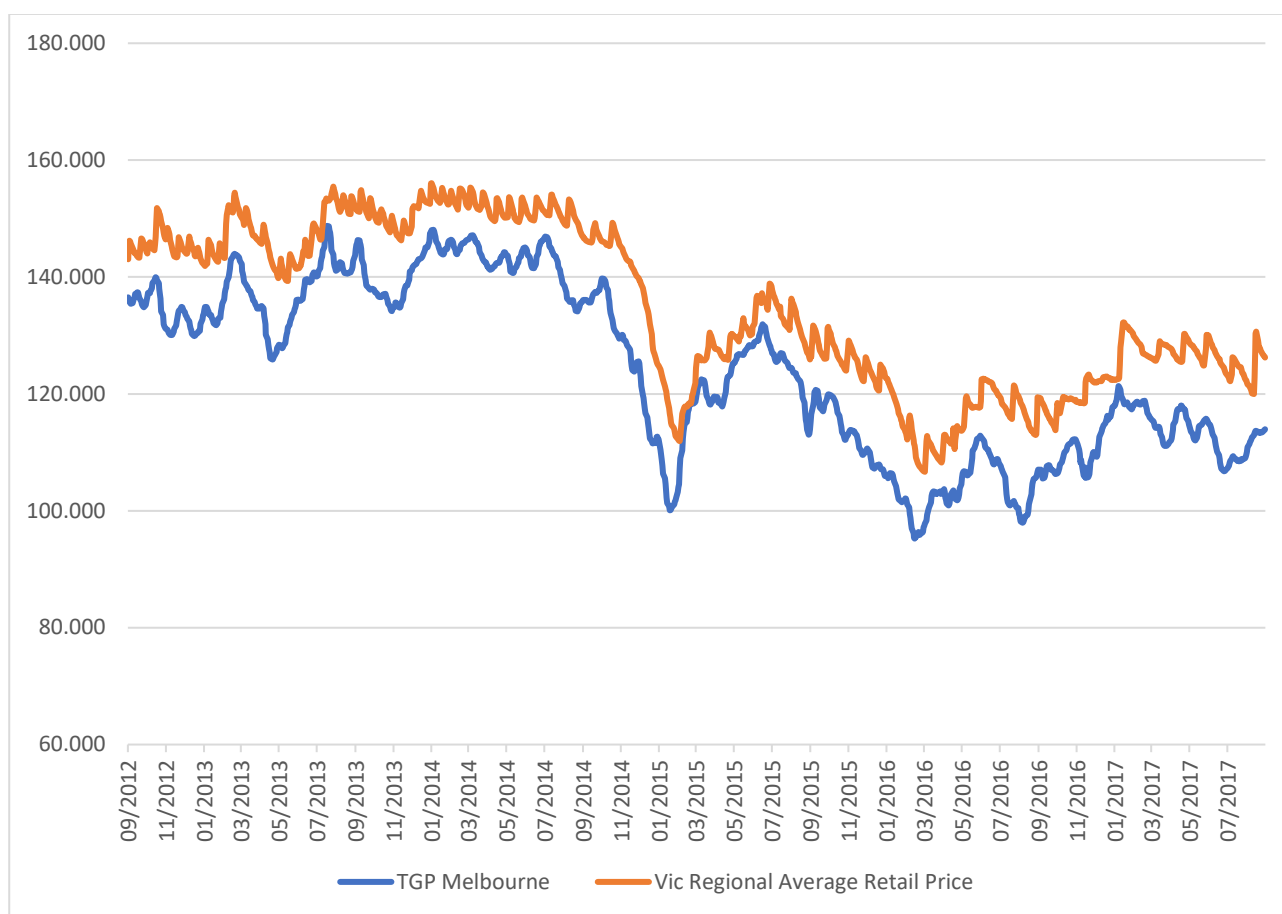
In analysing fuel price trends in any location, the two key factors are:

- The relevant benchmark price to compare local price trends to
- How local market prices actually compare to the benchmark price

Benchmark Price

For regional retail prices, extensive analysis confirms that retail petrol prices generally have a very strong link with the relevant terminal gate price in the State. In the case of Victoria, this is the Melbourne TGP. This strong correlation is shown in the following chart for prices over the past 5 years.

Chart 12: Melbourne TGP Price and Average Victorian Regional Retail ULP Price, Weekday, Sept 2012-Sept 2017



For regional retail prices, this link between TGP and retail prices is stronger than any apparent link to the retail petrol price in the closest capital city. This link is much stronger than any relationship to an average of a range of capital city prices (including cities at opposite sides/ends of the country).

This strong link to TPGs rather than capital city retail prices also makes sense on business/commercial grounds. The cost structure of an individual regional site, and its product offering, is likely to have a greater influence on price determination than any competitive pressure from capital cities. This is because:

- regional sites typically have different business drivers/model/owners compared to capital cities

- regional centres typically have a lower number of retail sites, a lower customer base and therefore lower sales of fuel and store products
- there is typically no retail discounting cycle in regional centres.

Price Comparison

AIP analysis of regional retail prices and TGPs for the nearest capital city confirms that there is a very strong relationship between these prices when appropriately lagged. The lag between the TGP price and the regional retail price is also shown in Chart 12.

The lag is explained by regional sites having significantly different fuel purchasing and supply patterns to capital city sites, and reflects:

- the time taken for a regional site to turn over its fuel stock:
 - for example, regional service stations typically see 1 tanker per 1-3 weeks versus one or more tankers per day at some major capital city sites
 - Thus, at any time, some regional sites might still be recovering the cost of fuel paid for weeks ago
- The nature of the supply chain servicing a regional centre. For example, for some regional service stations:
 - Storage, handling costs and lags may be significant where fuel must be stored in regional depots and double-handled, rather than being delivered from an import/refinery terminal. For regional centres with multiple handling/steps/parties in the supply chain before final retail delivery, a lag-on-lag effect would likely be present
 - Their fuel supply might not be sourced from the supplier with closest proximity (e.g. they may have secured a competitive supply contract from a more distant supplier).

Therefore, a robust assessment of petrol price trends in any regional centre should be grounded in these market and operational realities. For example, this would involve, for each region/site, taking proper account in any analysis of:

1. the price lag from the relevant TGP
2. local area factors and competition (population, number of sites, etc)
3. the supply chain for individual regions and for service stations sites within them
4. the business drivers and models of individual service stations

Given the above factors, which will be different for each regional area and service station, it is not surprising that analysis confirms different lags for each regional centre.

In 2015, AIP conducted detailed econometric analysis of 170 locations across Australia that showed that:

- the daily average of TGPs for the closest capital city is the best price benchmark for regional retail centres in that state
- calculating a price differential in any regional location should best take account of the appropriate lag applying for that location to ensure the community and other stakeholders are provided with an accurate reading of the 'price differential' compared to the most relevant price benchmark.

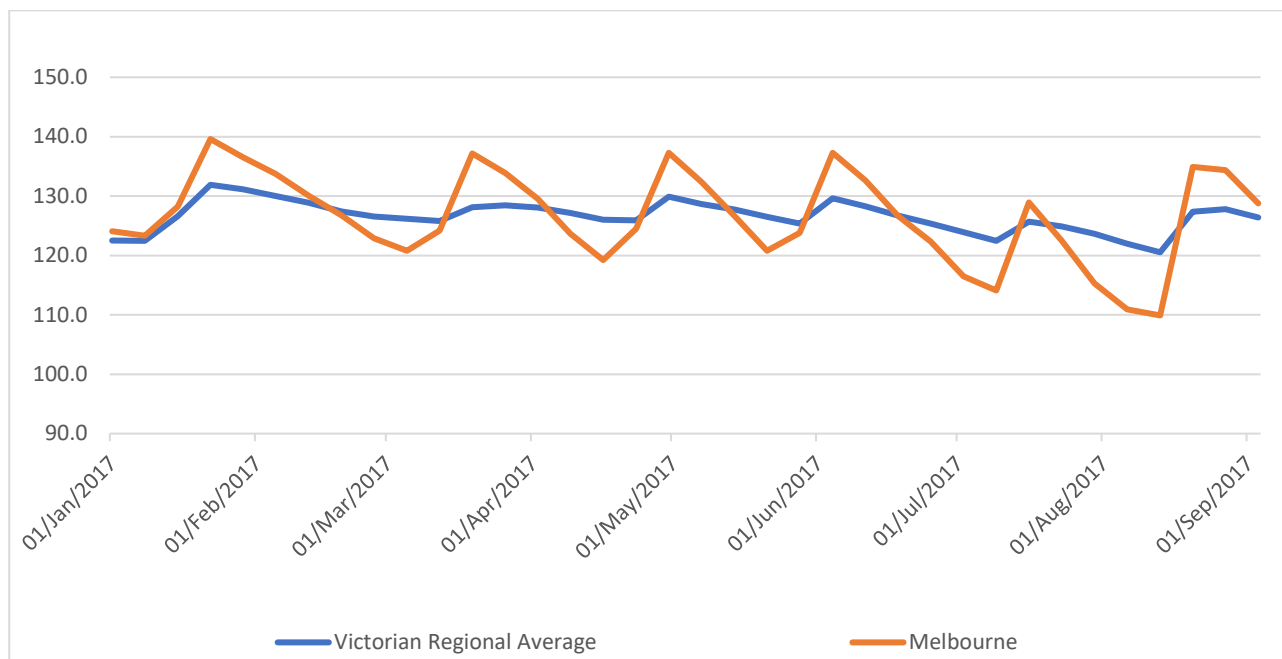
For Victoria, the research showed that the price lag from the TGP for metropolitan Melbourne was 4 days. The regional price lag for different towns ranged from 5 days through to 26 days, with the average price lag being 15 days.

Regional Victorian Retail Pricing

As previously noted, variations in Victorian regional prices are influenced by local market factors. However, it remains the case that the vast majority of the price build at the pump is made up of both international and wholesale prices, along with the taxes paid under Australia's fuel excise and GST arrangements.

The other fundamental difference relates to the absence of price cycles in Regional Victoria, which results in more stable pricing at regional sites. This is shown in Chart 13.

Chart 13: Average Fuel Price: Victorian Regional vs Melbourne Metro, 2017



In practice, this means that regional Victorians while not able to enjoy the benefits of deeply discounted fuel, are also not subject to the higher price evident at the top of the cycle.

AIP analysis has found that the number of days where the average retail price paid across regional Victoria is higher than the average retail price in Melbourne, is roughly equal to the number of days where the average regional price is in fact lower.

This ratio between the times where the average regional price is lower in metro areas against regional areas has significantly improved in favour of regional areas over the past two years and substantially over the past five years. This holds true whether measured on a daily or a weekly basis.

Indeed, there have been more days in 2017 where the average daily price has been lower on average for regional Victoria than for Melbourne on average.

Table 1: Number of days with cheapest average fuel price – Melbourne Metro vs Victorian Regional

	Daily Average Retail Price		
	2017 (to 3 Sept)	Over 2 Years, Sept 2015 to Sept 2017	Over 5 Years, Sept 2012 to Sept 2017
Number of days where Vic Regional average retail price lowest	128	351	654
Number of days where Melbourne Metro average retail price lowest	118	383	1175
% where regional average price is less than Melbourne	52%	48%	36%

Table 2: Number of weeks with cheapest average fuel price – Melbourne Metro vs Victorian Regional

	Weekly Average Retail Price		
	2017 (to 3 Sept)	Over 2 Years, Sept 2015 to Sept 2017	Over 5 Years, Sept 2012 to Sept 2017
Number of days where Vic Regional average retail price lowest	18	48	88
Number of days where Melbourne Metro average retail price lowest	18	57	174
% where regional average price is less than Melbourne	50%	46%	34%

Again, it must be emphasised that it is important to take into consideration local factors and there will be pricing differences not only against Melbourne metro prices, but across regional Victoria and between towns. However, it is also reasonable to conclude on the basis of this evidence that Victorian regional pricing outcomes, on average, are reasonable, that the city-country price differential has improved in recent years, and that many regional fuel customers have paid a lower price on average around half of the time compared to Melbourne consumers.

AIP's average Victorian regional retail price is an average across a range of representative towns in regional Victoria. It provides consumers with a general guide to the difference in relative average prices between metropolitan Melbourne and regional Victoria. AIP recognises that pricing outcomes in specific towns can be different (either higher or lower) to the regional average price across a range of towns. This difference is due to the local market factors outlined above.

6. MARKET AND PRICE TRANSPARENCY

Providing transparency in the fuels market is important to dispel myths within the community that companies operating in the market are deliberately inflating prices or taking advantage of consumers. This transparency extends not simply to the publication of prices, but also to the market itself. Understanding how the market operates, and the factors influencing it, is critical to understanding retail prices.

There exists a number of key factors helping to facilitate this important transparency.

The Australian Competition and Consumer Commission (ACCC)

The ACCC plays an important, independent role in providing a range of functions relating to the fuels market, including increased market transparency. The ACCC also has enforcement functions to ensure necessary competitive factors exist and operate within the market.

This role is supported by AIP and member companies.

The ACCC has had a role in the fuels market since its inception in 1995. The ACCC formally monitors and reports the prices, costs and profits relating to the supply of fuel in the petroleum industry throughout Australia. The ACCC's monitoring role is by Ministerial direction under the Competition and Consumer Act 2010.

The ACCC financial reporting has covered the three major sectors of the downstream petroleum industry:

- total supply (refining and importing)
- wholesaling
- retailing across all major market operators.

For each sector, the ACCC reporting presents detailed cost, revenue and profitability data.

The extensive industry data required for these ACCC reports is supplied under legal requirement each year by AIP member companies and other major fuel suppliers operating in the Australian market.

The ACCC has not published financial performance data for the petroleum industry since the December 2014 ACCC Monitoring Report. In 2014, the Australian Government directed the ACCC to focus its attention on shorter, "consumer friendly" quarterly reports.

This analysis by the ACCC has provided Governments and the community with the necessary transparency on how fuel markets are structured and the factors influencing prices, including in regional markets. These factors were discussed in Chapters 4 and 5.

In acknowledging the highly competitive nature of the industry, as well as the wealth of information now available, the key focus of the ACCC has now moved towards consumer price discovery for retail prices in local areas, with ACCC Chairman Rod Sims recently highlighting in a speech that:

"...the current focus of the ACCC is to highlight to consumers the ability of technology to help them find where the cheapest petrol prices are, to encourage them to buy where petrol is cheapest, and to reward retailers which have the lowest prices".

Price Transparency

In its work in this area, the ACCC has noted that price cycles, although not evident in regional areas, are often confusing to consumers, and therefore provides information on its website about when to buy in cities.

However, the ACCC also believes that until recently a missing piece of the puzzle for consumers has been knowing where to buy. Fuel price transparency apps and websites allow consumers to work out where to buy when you might see very large differences in prices between retail sites.

There is currently a range of free information available to motorists in Victoria to support efficient fuel purchasing decisions.

These are discussed below.

Australian Institute of Petroleum (AIP) and Member Companies

AIP agrees with ACCC Report findings that effective access to *“information about current retail petrol prices enables motorists to shop around and purchase fuel at relatively lower priced retail sites. This promotes competitive market behaviour and rewards discounters, as more consumers will see which petrol retailers are discounting.”*

AIP and its member companies expend significant efforts and resources to increase market transparency, particularly through the free publication of comprehensive market prices data on a daily and weekly basis, and at jurisdictional, regional and town levels (on the AIP website at www.aip.com.au) and member company websites for terminal gate (wholesale) prices at terminals across the country. This represents a significant investment and commitment to market transparency by AIP and member companies.

AIP Member Companies have also provided comprehensive data to the ACCC for many years which has underpinned their monitoring and analysis role. Comprehensive industry data is also provided to relevant Australian Government agencies, including Treasury and the ABS. Data provided to the Department of Energy and Environment also assists in the preparation of the monthly Australian Petroleum Statistics publications. AIP anticipates that the robustness and coverage of this publication will soon improve as companies beyond the AIP membership will be included in the new mandatory reporting regime.

Fuel Price Boards

Highly visible price boards at retail sites allow customers to take advantage of low prices and retailers to observe price discounting by competitors. AIP does not believe that a clear and strong case has been made for governments regulating price boards in the Australian market. We consider that the general competition laws are adequate to deal with any unlawful price board conduct (e.g. false and misleading advertising) and consumers already have access to a wide and expanding range of timely fuel pricing information and technology services to make informed and efficient fuel purchasing decisions.

However, we acknowledge government’s desire to give consumers consistent information to make these decisions, but AIP believes that only a light touch, low cost and low impact regulation is justified. The minimum standard model applied in Victoria, South Australia and Queensland represents a pragmatic and proportional approach that helps to minimise the additional operating costs for most fuel retailers to comply whilst facilitating a move towards more consistent price board regulation across jurisdictions, which is particularly important to AIP members who operate across multiple jurisdictions in Australia.

This model requires price boards, where they exist, to display only undiscounted prices and for changes to price board and pump displays to be sequenced or simultaneous (consistent with longstanding industry practice). The advertisement of the actual discount offer, where they exist, is permitted under the model.

AIP sees no justification for moving away from this approach.

Fuel Price Applications

There is a range of independent third-party information available in Victoria to make efficient purchasing decisions which are published by commercial data providers through the internet and mobile phone applications (Apps) without charge to Victorian motorists or taxpayers.

These information services include the MotorMouth App, which provides comprehensive site-specific data across and within all Australian jurisdictions including Victoria. Prices are published in near real time within 15 minutes of the change in price.

Motorists can also obtain information about retail prices using the apps of the petrol retailers (such as Woolworths and 7-Eleven) as well as other crowdsourced general apps such as GasBuddy which have coverage throughout the State and nationally.

State motoring bodies also publish pricing data for their jurisdiction.

We also understand there are other Apps under development which are designed to take advantage of the ACCC Informed Sources undertaking which would also be available to consumers. So, the range of independent free services is growing every day with market and commercial opportunities, and through business innovation.

AIP does not see a clear market failure in relation to retail price transparency in Victoria to justify an additional system which imposes costs on businesses and taxpayers. Indeed, we are concerned that there is significant potential to stifle industry innovation and drive out third party participants should Government intervene to establish their own system.

Government Pricing Initiatives

New South Wales introduced its FuelCheck system in late 2016, as part of its reforms to its Biofuels Mandate. AIP consistently and strongly opposed the introduction of NSW FuelCheck on the basis that:

- the retail fuels market in NSW was already transparent and highly competitive, a view which has been consistently supported by the ACCC
- the market is continually evolving and responding to consumer needs
- FuelCheck would be a costly regulatory intervention for both industry and government
- A number of third party providers including MotorMouth and GasBuddy were already providing similar pricing data without the need for intervention or additional cost. FuelCheck has the capacity to put these innovative small business ventures at risk
- The system imposed significant additional corporate risk and had scope for unwarranted reputational damage
- There is evidence that similar regulatory interventions, both domestically and internationally, have resulted in increased prices paid by consumers.

There is no clear evidence currently available that the scheme has been effective, widely used by motorists, is meeting its policy objectives and has changed consumer and market behaviour. NSW Fair Trading Office has recently reported that on average there are around 13,000 users utilising FuelCheck each day, which is insignificant given the millions of NSW motorists.

In contrast, there is clear evidence that:

- NSW FuelCheck required significant investment from fuel retailers that required modifications to corporate pricing and reporting systems to meet the “real-time” requirement. This approach also imposed additional regulatory risk through the need to ensure instant alignment of the published fuel price on the board, the bowser and the electronic price board. This is especially challenging for those companies providing price updates in bulk for multiple sites. There were also significant industry concerns with the legislative language which raised a number of risks for price setters and site operators.

- NSW FuelCheck required a major Government investment in Information Technology Infrastructure. The most recent public estimates (Finance Services & Innovation Annual Report) indicate a spend to date of \$300,000. NSW initially went to tender, but rescinded the EOI 10 days later and awarded the work to the Government's own internal IT provider "OneGov".

Importantly, based on a very initial assessment by AIP member companies, we do not consider that the direct and identical application of the NSW scheme to Victoria will reduce compliance costs for Victorian retailers through implied economies of scale. It would require similar costly modifications to corporate pricing and reporting systems to meet the "real-time" requirement. We also note that the NSW FuelCheck scheme took an extended period to implement at both government and industry levels (including because of a range of practical and technical matters that needed to be resolved).

Unfortunately, the Northern Territory is pursuing a similar FuelCheck model to New South Wales which will add further costs to industry without clearly articulating the benefit to consumers.

In contrast, the Tasmanian Government has partnered with the RACT and third-party provider GasBuddy in a manner that does not require Government intervention, including the creation of unnecessary bureaucracy and infrastructure to support a Government owned and operated scheme.

Ultimately, while AIP supports activities to increase price transparency to assist consumer purchasing decisions, we do not see this as a direct role for Government. Rather, this section of the market is well serviced by third party providers and industry participants. It would be unfortunate if Government intervention lead to a stifling in innovation in this area, or worse still, drove these players out of the market.