



COVERSHEET

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

List of documents that have been proactively released

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

Information redacted

YES / NO

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Some information has been withheld for the following reasons:

- Confidentiality
- Constitutional conventions

In confidence

Office of the Minister of Energy and Resources
Chair, Cabinet Economic Development Committee

Response to the Commerce Commission's retail fuel market study: Fuel industry bill

Proposal

1. This paper seeks agreement to policy to regulate certain aspects of the petroleum fuels market in New Zealand, in response to the findings of the Commerce Commission's retail fuel market study, and approval to draft a fuel industry bill.

Executive Summary

2. On 5 December 2019, the Commerce Commission (the Commission) released its final report on the retail fuel market study. The Commission found that wholesale competition in New Zealand is limited by the lack of an active wholesale market. This has led to higher wholesale and retail fuel prices, and to fuel companies making persistently higher profits, than would be expected in a competitive market. The Commission recommended a number of regulatory interventions aimed at developing a more active wholesale market.
3. I consider that the Commission's study is robust, and that the issues it has identified need to be addressed in order to improve outcomes for consumers.
4. In response, I am proposing that pro-competitive regulation of fuel markets be introduced through a new Fuel Industry Bill. The Bill will:
 - 4.1. improve transparency of wholesale pricing;
 - 4.2. ensure contracts between wholesale suppliers and their customers support competition;
 - 4.3. allow for dispute resolution in relation to these matters;
 - 4.4. improve the information available to consumers at retail fuel outlets;
 - 4.5. monitor industry performance more effectively; and
 - 4.6. be enforceable by the Commission.
5. I expect that taken together, these changes will increase competition in the wholesale market, and over time lead to lower fuel prices for consumers.

Background

6. On 5 December 2019, the Commerce Commission (the Commission) released its final report on the retail fuel market study. The Commission found that fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market. The Commission also found that wholesale prices are higher than it would expect in a competitive market and that this flows through to consumers paying higher pump prices.
7. The main reason for this is the lack of an active wholesale market, which limits wholesale competition. Current wholesale market arrangements are driven by:
 - 7.1. significant cost advantages that the three major oil companies (BP, Mobil and Z Energy – the ‘majors’) enjoy over competitors through infrastructure sharing arrangements; and
 - 7.2. restrictive wholesale supply relationships, with any switching by wholesale dealers or distributors being rare¹.
8. The consequences of the lack of an active wholesale market are:
 - 8.1. independent importers face barriers to entry or expansion as there are few wholesale customers actively looking for new suppliers;
 - 8.2. competition between existing wholesale suppliers is reduced because many dealers and distributors face barriers to switching; and
 - 8.3. it is difficult for distributors and dealers to obtain competitive wholesale supply as they may lack bargaining power and transparent pricing information.
9. The Commission recommended a range of changes to address this and other issues. These included:
 - 9.1. introducing more transparent pricing at fuel storage terminals (with backstop regulatory powers if the regime does not deliver the expected outcomes);
 - 9.2. providing for terms in wholesale contracts that are fair and facilitate retail competition by allowing wholesale customers to switch suppliers more easily;
 - 9.3. encouraging the majors to review their shared infrastructure arrangements to improve industry understanding and to encourage investment in shared storage;
 - 9.4. enabling consumers to make more informed purchasing decisions through regulating the display of prices for premium petrol on price boards, monitoring the use of price discounting and investigating the introduction of fuel cap stickers specifying the recommended fuel grade for vehicles;
 - 9.5. regulating for the collection and disclosure of information to assist in market analysis; and

¹ *Distributors* purchase fuel at wholesale, and then either supply it to others, or retail that fuel under their own brand. Examples include Allied, NPD and Waitomo. *Dealers* are market participants who retail fuel under someone else’s brand.

- 9.6. changing current industry practices that may weaken competition in relation to the majors' joint shipping network and refinery allocation.
10. On 16 December 2019, Cabinet agreed in principle to responses to the Commission's recommendations subject to a further report back in February 2020 to seek final agreement to responses to recommendations in the Commission's final report, including further advice on proposed backstop regulatory powers and the financial implications of the proposals [CAB-19-MIN-0680 refers].
11. This paper seeks agreement to regulate certain aspects of the petroleum fuels market in New Zealand, and approval to draft a fuel industry bill to implement the recommendations.

Fuel Industry Bill

12. The Commission has undertaken a thorough study of the fuel industry. It has carefully considered the responses of market participants to its views about their profitability, and about the competitive dynamics of the market. I consider that its conclusions about the lack of an active wholesale market are robust, and need to be acted on quickly.
13. Regulatory intervention is required to implement the recommendations. While competition is emerging in fuel markets, it may not have much impact without changes to the regulatory environment. I propose that changes are made through a fuel industry bill.
14. Options for industry self-regulation are limited and unlikely to be effective given the features of the market identified by the Commission. During the market study, industry participants indicated that regulatory intervention would be required to implement the Commission's recommendations. They suggested that industry agreement on options was unrealistic and that joint negotiation about some relevant matters would expose them to liability under the Commerce Act (for anti-competitive collusion). Finally, given the oligopolistic structure of the industry, self-regulation may not lead to optimal outcomes for consumers.
15. The Commission recommended the enactment of a generic regulatory regime in the Commerce Act for the adoption and enforcement of voluntary and mandatory industry codes, which could apply to the fuel industry. These could apply to other industries, for example, following future market studies. However, this would require significant further consultation, as it could create a much wider scope for regulatory intervention across the economy.
16. By contrast, there has already been significant consultation over a number of years on the fuel industry. The industry was consulted extensively in relation to MBIE's Fuel Market Financial Performance Study, and in relation to the Commission's market study. Given that the issues identified by the Commission in this market study seem entrenched, and have a significant impact on consumers, I consider that it would be better to address them promptly through industry specific legislation.

17. A more generic regime could be considered in the future drawing on experience with the fuel-specific regime, should similar remedies be warranted in other sectors/markets.

Legislative Scheme for the Bill

18. The Bill will provide for the following matters, with some details set out in the regulations:
 - 18.1. a terminal gate pricing (TGP) regime which requires wholesale suppliers of fuel in relation to a terminal to publicly post a price at which they will sell specified fuel (e.g. diesel, regular 91, premium 95) to wholesale customers at that storage terminal on a spot basis;
 - 18.2. a regime governing contractual terms between wholesale suppliers and their wholesale customers (this excludes commercial customers like Fonterra);
 - 18.3. mediation and arbitration procedures in relation to disputes about these matters;
 - 18.4. prohibitions on or requirements for the display of price information at retail fuel sites;
 - 18.5. requirements for certain fuel industry participants to collect and disclose certain information, to enable monitoring of the market and assessment of the regulatory regime;
 - 18.6. the Bill will also provide for regulation making powers for the terminal gate pricing regime, the contractual terms regime, mediation and arbitration procedures, the display of price information and the market monitoring regime;
 - 18.7. powers for the Commission to enforce the new requirements and carry out any new functions; and
 - 18.8. civil pecuniary penalties based on those in the Commerce Act (with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case).
19. The rationale for each proposal is set out below.

Purpose of the Bill

20. The key problem identified by the Commission is the lack of a competitive wholesale fuel market. Remedying this problem would create scope for more competition and lead to lower prices at the retail level.
21. The measures in the Bill will increase the ability and incentive for dealers and distributors to switch more frequently, increase rivalry between majors and other importers, and make entry easier at the wholesale level. Other measures in the Bill will also support the development of competition. I therefore propose to make the purpose of the Bill to promote competition in fuel markets for the long term benefit of end-users of fuel products.
22. Cabinet may wish to consider broadening the scope of the Bill, to include climate change issues related to the fuel industry. This would require a change to the above

purpose statement, to broaden its focus beyond competition. Including fresh substantive elements in the Bill now would delay the passage of the Bill. Further stakeholder consultation, consideration by coalition partners, Ministers and the Government, and additional PCO drafting would require an additional 2-3 months. I note that the current timing and priority of this Bill has been driven by the need to respond urgently to the competition issues raised by the Commission in its market studies.

Key features of the Bill

Terminal gate pricing

23. I propose that an enforceable TGP regime be put in place in New Zealand. The TGP regime requires wholesale suppliers to set and publish a price at which they will sell fuel to wholesale customers at storage terminals on a spot basis. There is a TGP regime in place in Australia, although I am proposing some features which would depart from the Australian approach.
24. Wholesale suppliers would be required to supply specified fuel products at the terminal gate spot price to fuel retailers or wholesalers upon request (a “must supply” obligation), unless there were reasonable grounds to refuse. This would still allow wholesale suppliers to refuse to supply, for example on the grounds of poor credit, or health and safety reasons, the quantity demanded being below a de minimis amount, or reasons of force majeure.
25. Wholesale suppliers would also be able to refuse to supply fuel at the spot price if that fuel is required to meet their own or contracted fuel supply obligations, for example in situations of tight fuel supply at a terminal. These situations are not unusual in New Zealand. This could mean that spot supply at the TGP was frequently unavailable, if suppliers could rely on this excuse without limitation.
26. However, I propose that this would not be a reasonable excuse for a wholesale supplier unless it had made a minimum amount of specified fuel available to fuel retailers or wholesalers at the terminal gate price. The Commission suggests the minimum amount should be 30,000 to 35,000 litres (i.e. a tanker load) per week or month – the detail will be prescribed in regulations. Once a supplier has made this minimum amount available for spot supply at the TGP price, then it could rely on the reasonable excuse that it required the fuel for its own needs (or its contracted customers). The minimum would be available from each supplier per terminal where the supplier has the right to draw fuel, not to each customer who seeks supply.
27. This obligation prevents suppliers undermining the advantages of price transparency and competition by refusing to supply fuel to competitors, but caps their exposure to a reasonable amount. Feedback from suppliers is that supplying this minimum amount would not have a significant impact on their operations.
28. As mentioned above, the details of the TGP regime will be set out in regulations. However, the TGP regime will apply to all wholesale suppliers who have a right to draw fuel from a terminal or a similar facility in New Zealand. This would include not merely the three major suppliers (BP, Mobil and Z Energy) but also Gull and any new entrant with storage terminals. Gull and Timaru Oil Services (TOSL – a new entrant in the market) have indicated that they are comfortable with this approach. The

wholesale suppliers would be required to publicly post TGPs for specified fuel products at each terminal or facility at which they had rights to draw fuel. The regulations will specify which fuel products are covered by the regime, such as whether it should extend to premium 98 octane petrol, which is a niche product.

29. Along with the other changes I propose to make, I expect the introduction of a TGP regime to:
- 29.1. increase the ability of distributors and dealers to obtain competitive terms for their wholesale supply;
 - 29.2. reduce barriers to entry and expansion by providing a transparent and readily available way for firms to obtain supply from the existing network of terminals;
 - 29.3. provide greater pricing transparency for distributors, which will increase the likelihood of switching; and
 - 29.4. provide competitive benchmark information for industry and government and curb the incentive on majors to use their market power in regions where competition is weak.
30. The Commission has argued that this type of regulatory intervention is likely to be lower cost, and with a reduced risk of unintended adverse consequences, compared to regulated participation in infrastructure sharing arrangements or price control. I agree with this analysis.
31. I propose that a monitoring regime be put in place to test whether the TGP regime is supporting competitive markets, and to address the risk that transparency of pricing may encourage collusive behaviour. This will be part of the broader monitoring regime described below.
32. I propose that the terminal gate pricing regime should come into effect on a date appointed by order in council and no later than 12 months after the date of Royal Assent.
33. I propose to provide for civil pecuniary penalties for breaches of the requirements of the terminal gate pricing regime, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Regulatory backstop power

34. Transparency may not be enough to constrain market power. Some majors may be able to raise prices significantly above competitive levels at particular terminals, particularly at isolated terminals which cannot easily be supplied by truck from another location.
35. The Commission has suggested that a credible threat of further regulatory action should be available to provide incentives for the majors to offer competitive terminal gate spot prices.
36. Putting in place a backstop would require the development of a price control regime, which will require a significant amount of time to design and draft. Given the urgency of the problems identified by the Commission, I propose to defer implementation of a

backstop regime for the present time. Officials will continue to develop a backstop regime, and I propose to amend the legislation at a future point to incorporate this feature.

37. In the meantime I note that the greater transparency provided by the measures in this Bill, and the greater competitive pressure that will result from the package as a whole will make it more difficult to depart from competitive prices.

Fair and competitive terms in wholesale contracts

38. The Commission found that while wholesale supply agreements vary substantially across the sector, many contracts provide little in the way of forward-looking price transparency, and in most cases majors have the ability to unilaterally alter wholesale prices. In many cases prices are only revealed to distributors after delivery has occurred.
39. The Commission's analysis suggests that a clear transparent pricing provision is likely to:
- 39.1. improve the ability of distributors and dealers to compare the price they receive with offers from other suppliers (or, under a TGP regime, posted terminal gate spot prices); and
 - 39.2. improve the ability of distributors and dealers to explore or challenge the justification for any price increase that their supplier imposes.
40. I agree with this analysis and propose that the Bill require dealer and distributor wholesale supply contracts to include a transparent pricing methodology.
41. The major suppliers will be concerned that this represents a "soft" version of price control. However, the Commission recommended deeming a price set with reference to either the TGP or the Mean of Platts Singapore (MOPS – an accepted international benchmark price for fuels) to be using a transparent pricing methodology. Methodologies based on MOPS are often used by commercial customers of the fuel suppliers (Confidentiality [REDACTED]). Similarly, methodologies based on MOPS are used in a regulatory setting in a number of Pacific Island jurisdictions. I consider that using either the TGP or MOPS will provide more certainty to industry while also providing more transparency to wholesale customers. I propose to enable regulations to be set under the Bill that deem certain benchmarks of this kind to be transparent cost-based methodologies.
42. The Commission was also concerned with the unilateral ability of suppliers to change the pricing methodology in wholesale supply contracts with dealers and distributors. The unilateral ability to change prices leaves dealers and distributors bearing the risks associated with any increase in wholesale margin. I agree with the Commission's assessment and propose that the transparent pricing methodology in the contract cannot be changed unilaterally. I propose regulation making powers to provide for reasonable exceptions, such as when the other party has sufficient notice and the right to terminate the contract if it is unacceptable.

43. In line with the Commission's recommendation I propose that the Bill require dealer and distributor contracts to be written in clear and concise language.
44. The Commission considered that competition would be enhanced:
- 44.1. by the removal of unjustifiably long terms in wholesale supply agreements with distributors (e.g. exceeding five years, unless justified by financial or other support);
 - 44.2. if distributors had the option to obtain a significant part of their annual requirements from other sources beyond their traditional exclusive supplier (e.g. up to 20 per cent of supply); and
 - 44.3. if there was a generic prohibition of terms which limited the ability of the dealer or distributor to compete with the supplier or other parties that was not captured in the other wholesale contract term changes. This generic prohibition could be supported with a list of specific terms that could only be used in contracts where they are necessary to protect the commercial interests of the supplier, or meet the requirements of the law.
45. I agree that these contractual features limit the ability of distributors and dealers to compete and to switch providers. To remedy this, I propose that the Bill will contain provisions that enable these changes in wholesale supply contracts and which:
- 45.1. allow distributors to terminate their wholesale supply contract on reasonable notice if they are longer than a prescribed length, and provide for a regulation-making power to set the prescribed length, and provide for reasonable exceptions, such as when the contract duration, or any renewal, beyond the prescribed period is reasonably necessary to enable specific investment for the benefit of the distributor or the contract is non-exclusive and contains no minimum purchase requirements;
 - 45.2. prohibit any exclusivity provision in a distributor's wholesale supply contract applying to more than a prescribed share of the distributor's annual requirement, and provide for a regulation-making power to set the prescribed share. To increase certainty for suppliers, the Bill should also provide a regulation-making power to require distributors to give sufficient notice of their intention to take supply from another supplier, or to require them to provide reasonable forecasting; and
 - 45.3. prohibit terms which limit the ability of the dealer or distributor to compete with the supplier or other parties from being included in contracts, and provide for a regulation-making power to prescribe a list of terms that are likely to have such an effect. The regulations should provide for reasonable exceptions, for example when they are reasonably necessary in order to protect the commercial interests of the supplier or any other person.
46. Because these are significant interventions which affect existing contracts, I propose that the key elements be set out in the Bill itself. As noted above, some details will be set out in regulations.

47. The Commission was concerned that given the long-term nature of wholesale supply contracts, waiting until the expiry of current contracts to implement change could substantially delay improvements to wholesale competition. They have therefore recommended that there be a transition period, after which the changes to existing contracts must be in place, even if the contract term has some time to run.
48. I note that this, and other changes proposed above, will override existing bilateral contractual arrangements, which will create some concern among wholesale suppliers. However, the industry is currently characterised by long term, exclusive supply arrangements, which make it difficult for new entrants to establish distribution networks, and do not encourage existing wholesale suppliers to compete to retain customers. I consider that changes to these relationships will assist new entrants to compete effectively and prompt existing suppliers to be more competitive.
49. Commercial customers (such as Fonterra or Air New Zealand) are the subject of more competition between fuel suppliers and do not need to be included in the regime.
50. I propose that existing contracts must be amended by no later than 24 months after Royal Assent to reflect the requirements in 41.1 and 41.2 above. This will give time for regulations to be finalised, and for contracts to be renegotiated. Some suppliers have large numbers of contracts and will need some time to adjust their terms. New contracts should be required to reflect the new regime soon after it comes into force. I propose that these requirements come into effect for new contracts no later than 12 months after Royal assent, which will give time for the regulations to be completed and in force, and give time for industry to understand the requirements. In each case the actual commencement date will be set by Order in Council.
51. I propose to provide for civil pecuniary penalties for breaches of the regime governing contractual terms between wholesale suppliers and their customers, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case;

Restrictive covenants

52. The Commission is concerned about restrictive non-petroleum use covenants that could prevent future owners from being able to use properties as retail fuel sites, making it more costly and difficult for new retail fuel sites to be established.
53. I agree with the Commission and this potential anticompetitive use will be explored as part of the review by the Minister of Commerce and Consumer Affairs of section 36 of the Commerce Act and other matters.

Dispute Resolution

54. It is likely that the new regime will generate disputes between the parties. The Commission has recommended that the regime should include a dispute resolution scheme that is accessible, of appropriate scope, affordable, independent of industry participants and effective.
55. I agree that such a scheme would be appropriate, and that it would provide parties to a dispute a less costly way to resolve disputes than seeking Commission enforcement. I propose that the Bill should provide both wholesale fuel suppliers and customers with a right to access mediation and, if agreed, arbitration dispute

resolution schemes as set out in regulations. The details of the mediation and arbitration schemes, such as the circumstances the dispute resolution system must be used in, who must use them, the process the parties must follow, and who must provide the dispute resolution, will be set out in regulations.

Improving transparency at retail fuel outlets

56. The Commerce Commission recommended regulating the display of the price of premium petrol on price boards at retail outlets.
57. I agree that better display of information at retail outlets will assist consumers and promote competition. Premium petrol prices are seldom displayed on price boards, making it difficult for consumers to compare prices, and making it harder for them to identify the most competitive supplier. This may have contributed to the fuel suppliers' premium petrol margin increasing faster than regular petrol. The Commission's study notes that the extra margin fuel companies are earning on this product does not appear to reflect actual cost differences between premium and regular petrol.
58. In late 2019, my colleague, the Minister of Commerce and Consumer Affairs, wrote to retail fuel sellers to encourage them to put premium prices on price boards at their sites. The Commission indicated that, although this would come with a cost of around \$7,500 per site, display of premium prices on boards would be likely to increase competition for premium fuel.
59. I propose that the Bill provides for requirements for display of certain price information on fuel at retail fuel outlets, with specific details left to regulations. There should be scope for exceptions, for example where retail fuel outlets must comply with other requirements such as NZTA or local council rules for signage, or for very small retail outlets for which the cost may be prohibitive.
60. The Commission raised a number of concerns about the display of discount information at retail outlets. For example the Commission noted that retail price competition is increasingly focused on discount and loyalty programmes. This has the effect of avoiding direct price competition on board prices. They also note that these programmes make it hard for consumers to compare prices.
61. However, the Commission notes that discounted pricing has evolved over the course of its market study. While the Commission has some reservations about the way market practices are evolving, it does not recommend regulation at this time. It proposes to monitor complaints and consider whether enforcement action is required under consumer law in the future. It also recommends that officials monitor discounting, and whether it is impeding competition.
62. Given that the market is evolving, I consider that monitoring of discounting is an appropriate response. However, I propose that the regulation-making powers in the Bill can also prohibit the display of certain pricing information such as discounted pricing at retail fuel outlets. This will enable rapid action if necessary.
63. I propose that these requirements should come into effect on a date appointed by order in council and no later than 18 months after the date of Royal Assent.

64. I propose civil pecuniary penalties for breaches of the requirement for the display of certain prescribed information relating to the price of fuel at retail fuel outlets in the form and manner prescribed in regulations, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case

Improving information on when premium fuel should be used:

65. The Commission also recommended investigating the introduction of fuel cap stickers specifying the minimum octane level recommended by the manufacturers for a vehicle. I suggest that Government looks further into this recommendation before recommending regulatory change. While the cost of producing and attaching labels is unlikely to be a significant cost for sellers of vehicles, there are some challenges in getting the relevant information for all vehicles. More work should be done to assess the benefits of this recommendation before it is progressed.
66. Addressing this recommendation would not fit within the proposed scope of a fuel industry bill, as regulation in this area would apply to sellers of vehicles, rather than sellers of fuels, which would widen the scope of the bill significantly. If Government decides after further investigation to progress this recommendation, implementation could be through a consumer information standard under the Fair Trading Act 1986.

Record keeping and disclosure of information for monitoring

67. The Commission is of the view that there could be long-term benefits derived from regulations that require certain information to be collected and retained in New Zealand for a period of time to assist meaningful market analysis. There will likely be a continuing public interest in the effectiveness of competition in the sector. If higher quality information is held by the industry or government, this will likely improve the timeliness, cost and accuracy of any future study or regulatory intervention.
68. I agree with this analysis. One of the reasons that multiple studies have been required to reach a view on key industry performance metrics such as profitability is that the necessary information has not been available or easily obtainable.
69. I propose that a record keeping and information disclosure scheme be put in place to help to determine whether the outcome of increased competition for the long term benefit of end-users is being achieved. I agree with the Commission's recommendations to require companies involved in the fuel industry to collect and retain information.
70. I propose that a record keeping and information disclosure regime be included in the Bill, with the detail to be specified in regulations. The detail would include:
- 70.1. to whom the obligation to collect/disclose information applies;
 - 70.2. the specific information to be collected/disclosed;
 - 70.3. how long information must be held for/when disclosure must take place; and
 - 70.4. the form in which information must be held in/disclosed.
71. I propose that the purpose of this information monitoring regime is to enable monitoring of the performance of the market, monitoring and enforcement of the TGP regime and assessment of the regulatory regime.

72. The information would be required to be disclosed periodically and/or on request to the Minister of Energy and Resources and/or the Commerce Commission to enable monitoring of the performance of the market and assessment of the regulatory regime, and to the Commerce Commission in relation to enforcement of the regime. I propose that MBIE and the Commerce Commission be able to share the information collected for the purposes of market monitoring and assessment of the regulatory regime. These agencies should also be able to publish analyses and summary information, subject to appropriate protections being in place for commercially sensitive data.
73. I propose that these requirements should come into effect on a date appointed by order in council and no later than 18 months after the date of Royal Assent.
74. I propose civil pecuniary penalties for breaches of the obligations to collect and disclose information with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Recommendations to industry

75. A number of the Commission's recommendations related to actions to be undertaken by industry, particularly parties to the shared infrastructure arrangements. I have written to fuel companies asking them to consider and address the Commission's recommendations in relation to shared infrastructure arrangements and capacity allocation for Refining New Zealand. An initial report back to me is due by 30 March.
76. The Commission has recommended Government monitor whether the changes have been made within an appropriate period after the publication of this report, and if not, consider whether regulatory intervention is required. Although it is not clear whether the industry will be able to reach agreement on changes to these arrangements, I do not propose to set up a formal regulatory backstop to address these matters at this stage. More consideration will be necessary of the appropriate regulatory model, as it affects not merely the fuel suppliers, but Refining NZ, the owner of the Marsden Point refinery.

Monitoring and enforcement regime

77. The Commission has recommended that the new regime be implemented through an enforceable code. This is the model that is in place in Australia, where a TGP regime is implemented through the Oil Code.
78. I propose to put in place an enforceable regime which will be similar in effect.
79. I propose that the Commission should enforce the regime. The Australian Competition and Consumer Commission performs a similar function in relation to the TGP regime in Australia. The Commerce Commission also has experience in dealing with unfair contract terms.
80. I propose that the Bill outlines sanctions for contraventions – for example, for failure to post a terminal gate spot price as required by the regulations. Non-compliance should be subject to civil pecuniary penalties similar to the Commerce Act, given the economic nature of the regime. The maximum pecuniary penalties would be

\$500,000 for an individual and \$5 million for any other person such as a body corporate, which may be imposed by the court on application of the Commission.

81. In relation to conduct that contravenes or may contravene the Act, I propose that the Bill would provide that the court may also:

81.1. grant injunctions on application of the Commission;

81.2. make compliance orders, such as in relation to display of the price information of fuel at retail fuel outlets; and

81.3. make other orders in relation to contracts containing contravening terms or provisions, including varying the contract, cancelling the contract, requiring any person who is a party to the contract to make restitution or pay compensation to some other person who is a party to the contract.

82. I propose that the Commission should be able to use the same enforcement powers and provisions as it has under the Commerce Act when carrying out its functions under this Act. This will ensure a common enforcement approach by the Commission across each of its sector-specific competition regimes (e.g. the Telecommunications Act and Dairy Industry Restructuring Act). These powers and provisions would include:

82.1. the key investigate powers (e.g. the power to demand information, documents and summons witnesses, the power to search, the power to take evidence, and the power to impose confidentiality orders in sections 98, 98A, 99G, 99 and 100) with the associated protections (e.g. proceedings privileged under section 106);

82.2. the ability to accept enforceable undertakings in relation to enforcement of the Act (e.g. sections 74A to 74C);

82.3. the general provisions relating to how the Commission operates (e.g. sitting in divisions, ability to state case for court, and service of notices in sections 15 to 17, 101 and 102); and

82.4. that it would be an offence to obstruct the Commission (section 103).

Consultation

83. The Ministry of Transport, the Ministry of Justice, the Ministry for the Environment and the Treasury were consulted on this paper. The Department of Prime Minister and Cabinet were informed.


84. We undertook targeted engagement with key stakeholders on the proposals in this paper including major fuel suppliers, Gull, Timaru Oil Service Limited (TOSL), distributors, the AA and the Motor Trades Association.

85. Additionally, consultation will be undertaken on regulations as these are developed.

Financial Implications

86. The Bill will require the Commission and MBIE to perform some new functions. This will require additional funding.

87. Constitutional conventions



88. Constitutional conventions



89. Constitutional conventions



Legislative Implications

90. Legislation is required to implement these proposals. A Fuel Industry Bill is currently proposed in the Legislation programme with a priority 2: to be passed in the year.

91. I propose to develop the regulations which contain much of the detail of this regime in parallel to the legislation. However, I do not expect these to be completed until after the legislation has been passed.

92. The Bill will bind the Crown.

Impact Analysis

93. A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury and Ministry of Business, Innovation, and Employment (MBIE) has reviewed the 'Government response to Commerce Commission Retail Fuel Sector Market Study' Regulatory Impact Assessment (RIA) produced by MBIE in December 2019. The Panel considers that the RIA meets the Quality Assurance criteria.

94. While the RIA has been prepared under significant time constraints, MBIE has clearly and completely described the status quo and the problem definition. The RIA outlines a range of options based on the recommendations in the Final Report of the Retail Fuel Sector Market Study by the Commerce Commission, and recognises the interrelationships between the options. It clearly identifies the main beneficiaries and who will likely bear the associated costs.

95. However, due to time constraints and the complexity of the design, a regulatory backstop regime as part of the terminal gate regime has not been considered at this

time. MBIE will continue to develop it with a view that it should be considered by Ministers at a future date and added to the Fuel Industry Bill or Act.

96. Further, as recognised in the RIA, this regime requires effective monitoring of industry practices to maintain incentives for competitive conduct and allow timely intervention if the regime is not working as intended. There are risks if there is not an adequate level of resources for MBIE and the Commerce Commission to carry out these functions.

Climate Implications of Policy Assessment

97. The Ministry for the Environment has been consulted and confirms that the CIPA requirements do not apply to this proposal. Initial analysis of GHG emissions impacts shows that the per annum impacts of these proposals will be below the CIPA threshold of 250,000 tonnes per annum. Analysis shows that emissions increases could range from between approximately 11 Kt CO₂ per annum for a price change of 1cpl (cents per litre) in the short run, through to approximately 219 Kt CO₂ per annum in the long run for a price change of 12cpl.
98. Although GHG and air pollutant emissions from transport can be expected to increase as a result of a fall in fuel prices, other initiatives are being advanced to drive emission reductions. In particular, the Clean Car Reforms are being progressed to reduce the emissions of light vehicles imported into New Zealand. It will be important to progress these vehicle initiatives as they will complement the reforms recommended in this paper by encouraging a shift to lower emission vehicles despite an expected fall in fuel prices.

Human Rights

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

Publicity

100. The cost of fuel is a matter of significant public interest. The Commerce Act also provides that the Minister of Commerce and Consumer Affairs must respond to the Commission's report within a reasonable time after the report is made publicly available.
101. I therefore intend to put out a press release jointly with Minister Faafoi setting out the Government's final response to the Commission's study. The press release should emphasise that work is still underway on developing the backstop option, to reinforce our continued commitment to this course of action.
102. While major suppliers have some reservations about the proposals, the interventions I have proposed have been signalled for some time and are unlikely to get a hostile reception.

Proactive Release

103. I propose to proactively release this Cabinet paper and minute within 30 business days, together with the Cabinet paper and minute outlining the initial response to the

Commerce Commission's retail fuel market study, considered on 16 December 2019 [CAB-19-MIN-0680 refers].

Next Steps

104. I propose to have a targeted consultation on a draft of the Bill with key stakeholders. I also propose to release a discussion document which sets out the policy details that will go into the regulations.

Recommendations

The Minister of Energy and Resources recommends that the Committee:

Create a new regulatory framework for the fuel industry

1. **note** that following a Market Study into retail fuel under the Commerce Act, the Commerce Commission has found that fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market, leading to consumers paying higher pump prices for petrol and diesel than they should.
2. **note** that on 2 December 2019, Cabinet invited the Minister of Commerce and Consumer Affairs to ensure that a proposed fuel sector industry bill is progressed with a view to its enactment in 2020 [CAB-19-MIN-0640 refers].
3. **note** that on 16 December 2019, Cabinet agreed in principle to responses to the Commission's Market Study and agreed that the Minister of Energy and Resources report back to Cabinet in February to seek final agreement to the responses to the recommendations in the Commission's final report and approval to draft legislation [CAB-19-MIN-680 refers].
4. **agree** that the Bill should promote competition in fuel markets for the long term benefit of end-users of fuel products.

Terminal gate pricing

5. **agree** that the Bill establish a terminal gate pricing regime applying to all wholesale suppliers who have a right to draw specified products (diesel, 91 and 95 octane plus any other fuel as specified in regulations) from terminals or equivalent facilities.
6. **agree** that the terminal gate pricing regime:
 - 6.1. require wholesale suppliers of specified fuel in relation to a storage terminal to publicly post a price at which they will sell that fuel to fuel retailers or wholesalers at storage terminals on a spot basis and provides for a regulation-making power to prescribe those requirements;
 - 6.2. require wholesale suppliers of specified fuel to supply a prescribed minimum of fuel product per week or per month to retailers or wholesalers of fuel products upon request unless there are reasonable grounds for refusal and provides for a regulation-making power to prescribe those requirements; and

- 6.3. provide for regulation-making powers to prescribe standard terms and conditions for sales, what constitutes reasonable grounds for refusal, which taxes or costs can be included in the terminal gate price, the prescribed minimum of fuel to be supplied, and requirements for publication of the terminal gate price.
7. **agree** that the terminal gate pricing regime should come into effect on a date appointed by order in council and no later than 12 months after the date of Royal Assent.
8. **agree** to provide for civil pecuniary penalties for breaches of the requirements of the terminal gate pricing regime, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Backstop regime for terminal gate pricing

9. **agree** to defer implementation of a backstop regime for the present time.
10. **agree** that officials continue to develop a backstop regime to be implemented at a future point.

Wholesale contractual terms

11. **agree** that the Bill include a regime governing contractual terms in fuel supply contracts between wholesale suppliers and their distributors and dealers, as relevant, that:
 - 11.1. requires contract terms to be written in clear and concise language;
 - 11.2. requires contracts with dealers and distributors to contain transparent pricing methodologies, and provides for a regulation-making power to deem certain methodologies to be transparent pricing methodologies;
 - 11.3. prohibits the unilateral ability of one party to change the transparent pricing methodology, and provides for a regulation-making power to permit reasonable exceptions, such as when the other party has sufficient notice, and the right to terminate the contract if the change is unacceptable to it;
 - 11.4. allows distributors to terminate their wholesale supply contract on reasonable notice if they are longer than a prescribed length, and provide for a regulation-making power to set the prescribed length, and provide for reasonable exceptions, such as when the contract duration, or any renewal, beyond the prescribed period is reasonably necessary to enable specific investment for the benefit of the distributor or the contract is non-exclusive and contains no minimum purchase requirements;
 - 11.5. prohibits any exclusivity provision in a distributor's wholesale supply contract applying to more than a prescribed share of the distributor's annual requirement, and provide for a regulation-making power to set the prescribed share, and provide for distributors to give sufficient notice of their intention to take supply from another supplier, or to require them to provide reasonable forecasting; and

- 11.6.** prohibits terms which limit the ability of the dealer or distributor to compete with the supplier or other parties from being included in contracts, and provide for a regulation-making power to prescribe a list of terms that are likely to have such an effect and provide for reasonable exceptions, such as when they are reasonably necessary in order to protect the commercial interests of the supplier or any other person.
- 12.** **agree** that commercial customers will not be included in the regime.
- 13.** **agree** that the wholesale contractual terms regime should come into effect:
- 13.1.** for new contracts, on a date appointed by order in council and no later than 12 months after the date of Royal Assent; and
- 13.2.** for existing contracts, on a date appointed by order in council and no later than 24 months after the date of Royal Assent.
- 14.**
- 14.** **agree** to provide for civil pecuniary penalties for breaches of the requirements or prohibitions of the regime governing contractual terms between wholesale suppliers and their customers, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Dispute resolution

- 15.** **agree** that the Bill provide that industry participants have a right to access mediation and, if agreed, arbitration dispute resolution schemes as set out in regulations.
- 16.** **agree** that the Bill provide for a regulation making provision to prescribe the details of the mediation and arbitration dispute resolution schemes including, but not limited to, the circumstances the dispute resolution system must be used in, who must use them, the process the parties must follow, and who must provide the dispute resolution schemes.

Display of price information

- 17.** **agree** to include in the Bill a requirement for display of certain prescribed information relating to the price of fuel at retail fuel outlets, in the form and manner prescribed in regulations.
- 18.** **agree** that the Bill provides for regulation-making powers to:
- 18.1.** set out the specific requirements for display of information relating to the price of fuel (including setting out any requirements to prohibit the display of certain pricing information) and to prescribe the form and manner in which that information is to be provided; and
- 18.2.** allow exceptions to be made to prescribed requirements for display of information relating to the price of fuel, for example, for small sites below a defined annual sales volume.

19. **agree** that these requirements should come into effect on a date appointed by order in council and no later than 18 months after the date of Royal Assent.
20. **agree** to provide for civil pecuniary penalties for breaches of the requirement for the display of certain prescribed information relating to the price of fuel at retail fuel outlets in the form and manner prescribed in regulations, with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Record keeping and information disclosure

21. **agree** to include in the Bill a requirement for certain fuel industry participants to collect and disclose certain information periodically and/or on request to the Minister of Energy and Resources and/or the Commerce Commission, to enable monitoring of the market and assessment of the regulatory regime and to the Commerce Commission to enable enforcement of the regime.
22. **agree** to provide for regulation-making powers setting out the specifics of these obligations, including (but not limited to):
 - 22.1. to whom the obligation to collect/discard information applies;
 - 22.2. the specific information to be collected/disclosed;
 - 22.3. how long information must be held for/when disclosure must take place; and
 - 22.4. the form in which information must be held in/disclosed.
23. **agree** to provide for civil pecuniary penalties for breaches of the obligations to collect and disclose information with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.
24. **agree** to include in the Bill the ability for the Minister and Commerce Commission to share information for the purposes outlined in recommendation 22 above and to publish information disclosed, and analysis of this information, subject to appropriate protections.
25. **agree** that these requirements should come into effect on a date appointed by order in council and no later than 18 months after the date of Royal Assent.
26. **agree** to provide for civil pecuniary penalties for breaches of the obligations to collect and disclose information with maximum penalties of \$500,000 for an individual or \$5,000,000 in any other case.

Other recommendations

27. **agree** that the Commerce Commission will enforce contraventions of the Act drawing on its enforcement powers and the regime in the Commerce Act, including the power to demand information and accept enforceable undertakings, and the offence for obstructing the Commission.

28. **agree** that the court may make orders in relation to conduct that contravenes or may contravene the Act, including granting injunctions, requiring compliance with the Act, and other orders in relation to contracts, including compensation for affected parties.
29. **invite** the Minister for Commerce and Consumer Affairs to table the government responses set out at Annex A as the official government response to the Commission's Market Study on Retail Fuel as part of my announcement of the Government's decisions set out in this paper.

30. Constitutional conventions [Redacted]

31. Constitutional conventions [Redacted]

Constitutional conventions [Redacted]

32. Constitutional conventions [Redacted]

Constitutional conventions [Redacted]

Constitutional conventions

33. Constitutional conventions

34. **invite** the Minister of Energy and Resources to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations.

35. **authorise** the Minister of Resources and Energy to make decisions, consistent with the proposals in these recommendations, on any issues that arise during the drafting process.

36. **authorise** the Minister of Energy and Resources to make decisions on minor and technical matters that may arise during the drafting process

37. **agree** to release a draft of the Bill for the purposes of targeted consultation with key stakeholders.

38. **agree** to defer consideration of improving information available to consumers on when premium fuel should be used in motor vehicles until further policy work has been undertaken.

39. **note** that the potential for restrictive covenants that prevent future owners from being able to use properties as retail fuel sites to be used for anticompetitive purposes is being explored as part of the review by the Minister of Commerce and Consumer Affairs of section 36 of the Commerce Act and other matters.

Authorised for lodgement

Hon Dr Megan Woods

Minister of Energy and Resources

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

Improving wholesale competition for fuel

Commerce Commission Recommendation	Government Response
<p>1 Institute a terminal gate pricing regime</p> <p>The Government should make regulations enabling a terminal gate pricing regime² as part of an enforceable industry code (similar to what exists in Australia). The terminal gate price would act as a benchmark for wholesale customers negotiating their wholesale supply agreements.</p> <p>The recommendation should be considered with recommendation five: To support a terminal gate pricing regime, the Government should also introduce backstop regulatory powers that could be invoked if the regime does not deliver competitive outcomes in a reasonable period of time.</p> <p>2 Change wholesale supply agreements</p> <p>The Government should make regulations that limit the use of certain terms in wholesale supply contracts. In particular:</p> <ul style="list-style-type: none"> • all wholesale contracts should be written in clear and concise language, and should include a transparent cost-based pricing methodology; • wholesale contracts should permit a distributor to take a prescribed minimum percentage of their fuel from other suppliers (e.g. at least 20 per cent of supply); • distributors should not be committed to wholesale contracts exceeding a maximum period (suggested not longer than five years) without a right to terminate on notice, unless a longer term is reasonably necessary for relationship specific investment to occur; and • other terms of wholesale fuel supply contracts should be regulated to prevent unjustifiable limitations on the ability of 	<p>AGREE</p> <p>The Government considers that a terminal gate pricing regime will increase wholesale price transparency and create the potential for a liquid wholesale spot market to develop.</p> <p>The Government will introduce legislation to enable such a regime.</p> <p>The Government supports introducing backstop regulatory powers. This will be added to the legislation at a future point.</p> <p>AGREE</p> <p>The Government considers that greater contractual freedom and fair contract terms will facilitate wholesale competition, and in turn facilitate competition in the retail market.</p> <p>The Government will introduce legislation to enable a regime which requires certain pro-competitive contractual terms to be included and certain anti-competitive terms to be excluded.</p>

² A terminal gate pricing regime requires all suppliers of fuel at storage terminals to set a spot price each day at which they will supply a minimum quantity of fuel on demand to buyers.

distributors and dealers to compete.

<p>3 Improve information on infrastructure sharing arrangements The parties to infrastructure sharing arrangements including the Coastal Oil Logistics Ltd joint venture and 'borrow and loan'³ inventory sharing arrangements should publish the existing process and criteria for third party participation in the infrastructure sharing arrangements.</p>	<p>NOTED The Government has written to parties and expects the parties to respond to these recommendations.</p>
<p>4 Review infrastructure sharing arrangements The parties should also review aspects of the 'borrow and loan' inventory sharing arrangements that may be disincentivising investment in shared storage. Regulation to enable participation in infrastructure sharing arrangements is not recommended at this time.</p>	<p>NOTED The Government has written to parties and expects the parties to respond to these recommendations.</p>
<p>5 Adopt an enforceable industry code of conduct Legislation should be introduced to create an enforceable mandatory industry code by regulations to give effect to the recommendations that require regulatory intervention.</p>	<p>AGREE The Government will introduce an enforceable regulatory regime.</p>

Facilitating informed consumer choice

	Commerce Commission Recommendation	Government Response
<p>6 Improve transparency of premium fuel prices The Government should make regulations to require retail sites to display premium petrol prices on price boards to better enable consumers to compare available prices.</p>	<p>AGREE The Government has written to participants in the retail fuel industry to encourage them to put premium prices on price boards at their sites now, ahead of regulations.</p>	
<p>7 Improve information on when premium fuel should be used The Government should make regulations to require fuel cap or fuel flap stickers specifying the minimum octane level required for a vehicle.</p>	<p>TO CONSIDER FURTHER While the cost of producing and attaching labels is unlikely to be a significant cost for sellers of vehicles, there are some challenges in getting the relevant information for all vehicles. The Government considers that further policy work needs to be undertaken before action is taken.</p>	
<p>8 Monitor the display of discount pricing on price boards</p>	<p>AGREE</p>	

3 A 'borrow and loan' scheme allows major fuel suppliers to routinely access fuel at each other's terminals.

<p>Regulation of display of discount pricing is not recommended at this time. The Government should monitor the display of discount pricing on price boards to assess whether this practice benefits consumers or limits competition.</p> <p>Fuel retailers are also encouraged to consider the potential for their discount and loyalty programmes to cause consumer detriment.</p>	<p>The Government considers monitoring to be the appropriate response at this time.</p> <p>Powers will be added to the legislation to make regulations to regulate or prohibit the display of discounted pricing at retail outlets if the need arises.</p> <p>The Government expects the parties to respond to the second part of the recommendation.</p>
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Improving monitoring of the fuel market

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

Other recommendations for the fuel industry

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