

29 May 2020

Janet Humphris
Principal Advisor
Ministry of Business, Innovation and Employment
By email to energymarkets@mbie.govt.nz

Dear Janet

Regulations under a Fuel Industry Bill and other matters

1. This is a submission by the Major Electricity Users' Group (MEUG) on the consultation paper "Regulations under a Fuel Industry Bill and other matters" published 17th March 2020.
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. MEUG makes 3 submissions. Each are discussed in the sections that follow:
 - Caution needed in considering regulations before a Bill is enacted.
 - Extension of the regime to other fuels by regulation sets a poor precedent.
 - Monitoring the retail fuel sector should start with existing public information.

Caution needed in considering regulations before a Bill is enacted

4. The proposed Fuel Industry Bill has yet to be tabled in Parliament. Submitters on this consultation paper and the Ministry therefore have uncertainty on what the final legislative scope for regulation making will be. It is not clear why there was a need for urgency for developing regulation making powers ahead of the details of the Bill being considered by a select committee and Parliament.
5. Anecdotally we understand some of the recommendations from the Commerce Commission are either being or may be voluntarily adopted by the retail fuel sector. Changes for the better maybe occurring irrespective of the Bill being enacted and new regulation making powers being put in place. MEUG suggests policy makers tread cautiously in implementing Cabinets decisions announced on 27th February on the proposed Fuel Industry Bill and regulation making powers.

Extension of the regime to other fuels by regulation sets a poor precedent

6. Paragraph 29 of the consultation paper notes:
 - The Fuel Industry Bill “will provide that the terminal gate pricing (TGP) regime applies to regular 91 petrol, premium 95 petrol, and regular diesel.” These products were considered in the Commerce Commission market study; and
 - The Commission’s market study did not cover other fuels such as aviation and marine fuels. Nevertheless, it is proposed the Bill will allow the Minister under regulations to add other fuels.
7. MEUG has concerns with the Minister having discretion to extend the TGP regime to fuels that were not considered in the market study. Parliament rather than the Minister should decide if regulation should be extended to other fuels and then only after appropriate analysis from the Commerce Commission.
8. To provide the ability for the Minister to extend regulations to other fuels will set a precedent. Sectors of the economy subject to future market study’s will be unsure if the announced scope set by the Minister will be abided by in subsequent decisions or those decisions will extend to products and services outside the scope of the market study.

Monitoring the retail fuel sector should start with existing public information

9. Table One (pp 44-45) of the consultation paper proposes information be collected for a range of wholesale and retail (at a regional level) revenues and volumes, TGP and retail prices, supply disruption statistics, wholesale contract information on counterparties and length of contracts, and details of importer costs for different grades of fuel. This information is to be collected at different frequencies (daily, weekly, or monthly) and disclosed monthly, quarterly, or annually. If this proposed collection of information is implemented, it will add costs to retailers that will be passed through to motorists. There will also be new regulatory and departmental administrative costs that either taxpayers will pay for, or motorists with an additional tax. MEUG does not believe it is necessary to collect and analyse the entire suite of information in Table One to have effective ongoing monitoring.
10. MEUG submits that the only information that should be collected and analysed to allow effective ongoing monitoring is the financial information set out in the last row of Table One, i.e. audited GAPP financial statements.
11. MEUG assumes the intention of the proposed regulation making powers to require information disclosure will apply to the 4 largest fuel retailers including Caltex/Gull. Two issues arise. First of the 4 largest retailers, only Z Energy is required to publish financial statements that comply with NZ GAPP. The other 3 retailers are classified as overseas companies and can file slimmed down statements that comply with other country’s GAPP requirements. Second if the intention is information requirements will also be required of other retailers then that raises the risk of creating a new cost barrier to new entrants.

12. In the Commerce Commission market study Ireland, Wallace & Associates (IWA) made several submissions demonstrating the use of publicly available audited information and a proven methodology that emulates the standard Commerce Commission approach to calculating economic profits. Economic profits are a necessity for effective investment and innovation in a sector. However, if there has been sustained excessive economic profits over several years then that is a good indicator that there is an underlying problem of non-transient market power in an industry.

13. The IWA submissions on the retail fuel market study are listed in the following table:

IWA submission to CC on Market study into the retail fuel sector:	Date
Invitation to comment on preliminary issues Commerce Commission New Zealand. A Submission on Question 9: “Trends in Profits” ¹	21 st February 2019
Invitation to comment on “Working paper on assessing profitability.” ²	7 th May 2019
Draft Report - dated 20 August 2019 , Submission. ³	13 th September 2019
Submission in response to: “Return on average capital employed OIA response document” and “Conference Consultation” held on 24 September 2019. ⁴	11 th October 2019

14. MEUG’s submissions to the Commerce Commission during the market study consistently noted the superior methodological, cost and time benefits of using the IWA approach as an initial screening tool to assess if at the aggregate industry level there has been sustained excessive economic profits.⁵ The Commission decided not to use our proposed approach. The reported cost of the Commerce Commission’s retail fuel market study cost of \$2.5m we think could have been radically reduced had they used the IWA approach as an initial screening and then a more targeted investigation.⁶

15. For the ongoing monitoring of the sector MEUG is concerned we will see a continuation of the high cost and untargeted approach of the market study. Hence MEUG recommends ongoing monitoring of the retail sector can be undertaken at an aggregate industry level using public information rather than regulating for detailed information. The option of using the Commission’s existing powers to require information then allows specific issues to be investigated should they arise.

¹ https://comcom.govt.nz/_data/assets/pdf_file/0015/127302/Ireland,-Wallace-and-Associates-Submission-on-preliminary-issues-paper-21-February-2019.pdf

² https://comcom.govt.nz/_data/assets/pdf_file/0028/168346/Ireland,-Wallace-and-Associates-Limited-Submission-on-assessing-profitability-07-May-2019.PDF

³ https://comcom.govt.nz/_data/assets/pdf_file/0027/174942/Ireland,-Wallace-and-Associates-Limited-Submission-on-Retail-Fuel-Draft-Report-13-September-2019.PDF

⁴ https://comcom.govt.nz/_data/assets/pdf_file/0022/190381/Ireland,-Wallace-and-Associates-Limited-Cross-submission-on-Retail-Fuel-Draft-Report-October-2019.PDF

⁵ For example, refer MEUG to Commerce Commission, Retail fuel study – post conference submission on draft report, 11th October 2019, paragraph 11, https://comcom.govt.nz/_data/assets/pdf_file/0023/190382/MEUG-Cross-submission-on-Retail-Fuel-Draft-Report-October-2019.PDF.

⁶ <https://www.stuff.co.nz/business/118156489/competition-watchdog-probed-by-mps-over-25m-cost-of-petrol-study>

16. The speed at which that aggregate sector level monitoring can be undertaken is illustrated by the submission of IWA to the Commerce Commission on 13th September 2019 analysing the most recent audited financial statements to show a large decline in 2019 in the aggregate economic profits of the 3-largest retailers in excess of WACC compared to the prior year (refer IWA submission to Commerce Commission, 13th September 2019, Table A, p9).
17. In contrast the Commission's market study approach was not as timely with the analysis using information up to and including 2018 only. MEUG believes the Commission appears not to have addressed the issues raised in submissions by IWA in September and October 2019 and hence failed to give sufficient weight to the more recent actual financial statement information that showed a decline in profitability in 2019. That begs the question of whether the decline in economic profits in 2019 was an aberration or a lag in the market re-balancing after two years of economic profits well in excess of WACC?
18. MEUG recommends the analysis by IWA should be updated using subsequent publicly available audited financial statements that have become available to assess if the declining trend in aggregate economic profits seen between 2018 and 2019 has carried over into 2020.

Yours sincerely



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