



COVERSHEET

Minister	Hon Dr Megan Woods	Portfolio	Energy and Resources
Title of Cabinet paper	Regulatory Backstop under the Fuel Industry Act 2020	Date to be published	9 November 2022

List of documents that have been proactively released

Date	Title	Author
August 2022	Regulatory Backstop under the Fuel Industry Act 2020	Office of the Minister of Energy and Resources
3 August 2022	Regulatory Backstop under the Fuel Industry Act 2020 DEV-22-MIN-0170 Minute	Cabinet Office
29 August 2022	Supplementary Analysis Report: Regulatory Backstop under the Fuel Industry Act 2020	MBIE

Information redacted

YES / NO

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Some information has been withheld for the reasons of Commercial information, Confidential advice to Government, and Privacy of natural persons.

[In Confidence]

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

Regulatory backstop under the Fuel Industry Act 2020

Proposal

- 1 This paper seeks policy agreement to develop a regulatory backstop under the Fuel Industry Act 2020 (the Act), to promote wholesale competition in engine fuel markets which flows through to a more competitive retail market for the long-term benefit of consumers.

Relation to government priorities

- 2 In the last term the Government made a commitment to fairer fuel prices for consumers. The passing of the Act in August 2020, which gave effect to the Commerce Commission's (the Commission) recommendations from the retail fuel market study final report 2019 (the market study), was a critical step towards achieving this.
- 3 A regulatory backstop to the Act is a recommendation from the Commission's final report that has not yet been implemented.

Executive Summary

- 4 The Commission's market study found that price competition in fuel markets is not working as well as it could be. In response, the Act was passed in 2020 to promote competition in engine fuel markets for the long-term benefit of end users of engine fuel products.
- 5 The Act introduced interventions following the Commission's recommendations, including a terminal gate pricing (TGP) regime which helps to create a wholesale spot market to encourage new entry and expansion in new areas by existing players. The development of a regulatory backstop is a recommendation that is outstanding from the Commission's market study.
- 6 I recommend the development of a regulatory backstop to the Act that will enable the Commission to price regulate TGPs at certain terminals if TGPs are persistently higher than would be expected in a competitive market. This will better facilitate competition in wholesale fuel markets by disincentivising wholesale suppliers from offering non-competitive TGPs.

Better promoting wholesale competition will flow through to a more competitive retail market for the long-term benefit of consumers

Background

The Commission's market study found that price competition in fuel markets is not working as well as it could be

- 7 The Commission found that an active wholesale fuel market does not exist in New Zealand.
- 8 In response, the Act was passed in 2020. The purpose of the Act is to promote competition in engine fuel markets for the long-term benefit of end users of engine fuel products. The Act introduced the following interventions following the Commission's recommendations:
 - 8.1 Provisions that aim to reduce restrictive or dependent wholesale supply relationships between major suppliers (BP, Mobil and Z Energy) and their wholesale customers.
 - 8.2 A TGP regime to create a wholesale spot market to encourage new entry and expansion in new areas by existing players.
 - 8.3 Consumer information requirements which require retail sites to display fuel prices on boards to improve information for consumers to compare prices.
 - 8.4 Requirements for certain fuel companies to disclose information to the Ministry of Business, Innovation and Employment (MBIE) or the Commission to improve the monitoring of the market.
 - 8.5 A dispute resolution scheme for disputes between wholesale suppliers and resellers under the Act.
- 9 The Commission also recommended the development of a regulatory backstop to help promote wholesale competition in engine fuel markets by incentivising the wholesale suppliers to offer competitive TGPs. However, due to the significant design requirements, the Government agreed in February 2020 to defer the implementation of a backstop regime and to officials continuing to develop the regime to be implemented at a future point [DEV-20-MIN-0008 refers].
- 10 The development of a regulatory backstop was consulted on in March 2020 in the Consultation Paper: *Regulations under a Fuel Industry Bill and other matters* (Consultation paper). The Consultation paper outlined options for the design of the regulatory backstop.

Fuel margins have recently spiked

- 11 MBIE conduct weekly monitoring of importer margins for the previous week's data. The importer margin is the gross margin available to cover domestic transportation, distribution and retailing costs in New Zealand, as well as profit margins. This means

that importer margins are a useful indicator but not a complete measure of profitability.

- 12 MBIE have also been monitoring the pass through of the fuel excise duty announced by Government on 14 March 2022. This includes a time series that shows how fuel margins have changed since the Russia-Ukraine invasion and a traffic light that allocates the industry a green, yellow or red rating based on changes in margins.
- 13 The traffic light has been predominately green since 20 March 2022. This indicated that, as would be expected in a competitive market, the pass through of the fuel excise reduction observed after the reduction had not been clawed back from consumers.
- 14 For the weeks ending 10 and 17 July 2022, the traffic light turned red for a range of fuel types. This was caused by spikes in margins which have been driven higher by the Russia-Ukraine invasion, and which are a cause for concern for consumers who have been facing historically high pump prices since late 2021:
 - 14.1 For the week ending Friday 8 July 2022, importer margins increased by 43.5 per cent for regular petrol, 32.4 per cent for diesel and 30.9 per cent for premium petrol, compared to the previous week.
 - 14.2 For the week ending Friday 15 July 2022, importer margins further increased by 26.89 per cent for regular petrol, 7.82 per cent for diesel and 21.47 per cent for premium petrol, compared to the previous week. This brought margins to the highest rates since MBIE's monitoring began in 2004: 61.1cents per litre (cpl) for regular petrol; 70.5 cpl for diesel; and 73 cpl for premium petrol.

Further improvements to information disclosed

- 15 Fuel companies often raise the issue that MBIE's importer margins do not account for operational costs, and that reported margins are therefore higher than the margins reported by individual companies.
- 16 This point was considered during the development of the information disclosure regulations under the Act, leading to a requirement for disclosure of some operational costs (domestic shipping and transport costs) from 1 September 2023 onwards.
- 17 These new requirements will go some way to unpacking the costs that importers' gross margins must cover. However, further disclosure of operational costs, and specifying a methodology as to how common costs must be allocated, should help to show whether increases in margins are because of increased operational costs.
- 18 The existing disclosure requirements do not require fuel companies to disclose information relating to the valuation of their assets. Further information on asset values could better enable monitoring of fuel companies' returns on assets over time.
- 19 I propose to report back to Cabinet how existing information disclosure requirements could be further refined, including methodologies that could be prescribed to outline how operational costs (such as domestic transport, salaries, rent and asset maintenance), are to be allocated and how assets are to be valued.

Overtime I expect the Fuel Industry Act 2020 will facilitate a more active wholesale fuel market

20 The two key interventions introduced in the Act to achieve a more competitive wholesale market, which should flow through to a competitive retail market, are fixed wholesale contract terms and TGP provisions.

21 The impact of the Act has been difficult to measure, because external shocks have had a much greater impact, such as lower fuel volumes because of Covid-19 restrictions and increased costs caused by the Russia-Ukraine conflict.

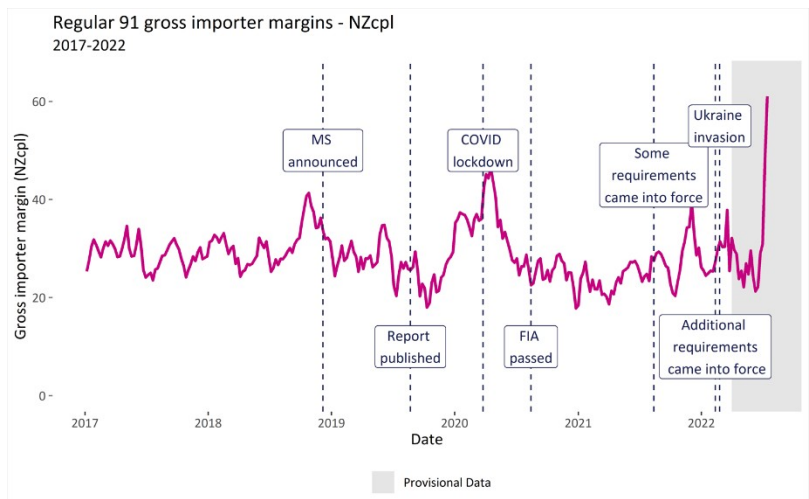
22 The TGP regime allows resellers the ability to access fuel from the majors’ terminals at a wholesale spot price, which has supported expansion into new areas by low-priced retailers such as Gull, NPD and Waitomo. Gull has said that without the Act it would not be able to competitively source fuel to operate its South Island outlets and provide competitive tension there.

23 Despite this, the tight relationships between the majors and wholesalers does not yet appear to have been significantly disrupted. Commercial Information

[Redacted]

However, the fixed wholesale contractual term interventions do not apply in full to existing contracts until 11 August 2022.

24 Information on gross margins is available through MBIE’s long term data collection. Since the introduction of the Act, there has been no clear upward or downward trend in importer margins. While some margins are currently higher or comparable to the levels at the time the market study was initiated, the pattern of margins since the passage of the Act has not been consistent:



25 As mentioned above, the impact of the Act is hard to measure at this point, because of external shocks from Covid-19 and the Russia-Ukraine conflict. However, there are some gaps in the regime, identified by the Commission at the time of its market study, that could compromise the effectiveness of the regime.

- 26 The information gathering regime, which has been designed to monitor the impact of the Act, has only recently come into force, and reporting and analysis of data is yet to commence. There is limited data to assess the impact of the Act as a result. Any such analysis will also be complicated by the above-mentioned shocks.

A regulatory backstop to promote wholesale competition in engine fuel markets

- 27 The market study outlined risks that could prevent the implementation of a successful TGP regime even if the fixed wholesale contract and TGP interventions were introduced. These risks include:

27.1 The TGP regime is used as a vehicle for coordination; and

27.2 Wholesale suppliers set TGPs that incorporates a return on market power.

- 28 These two risks are likely to manifest in the form of excessive TGP prices which deter market entry and expansion. Charging excessive prices in competitive markets is unlikely to be sustainable, as firms would be driven out of the market by competitors that undercut excessive prices. However, the Commission found that the wholesale fuel market lacks competition and there is a risk that wholesale suppliers do not offer competitive TGPs (because of coordination or market power at a particular terminal). A regulatory backstop would be a complementary intervention to the TGP and fixed wholesale provisions by helping to promote competition in wholesale fuel markets which flows through to a more competitive retail fuel market.

- 29 Failure to address these risks arising from what the Commission described as a “vertically integrated oligopoly” could mean poor outcomes for consumers persist in fuel markets. The existing interventions create greater transparency over wholesale prices and greater fairness in wholesale contracting, but this may not be enough to discipline anti-competitive pricing behaviour at terminals.

- 30 The Commission recommended a regulatory backstop to incentivise the majors to offer competitive TGPs which would mitigate the risks that the TGP is used as a vehicle for coordination and that wholesale suppliers do not offer competitive TGPs due to market power.

- 31 The Commission considered that this type of regulatory intervention is likely to be lower cost and with a reduced risk of unintended adverse consequences compared to requiring wider participation in infrastructure sharing arrangements (which are ending in August 2022) or wholesale price control from the outset.

Wholesale suppliers may not offer competitive terminal gate prices because of coordination

- 32 There is risk that the TGP regime is used as a vehicle for price coordination because of the greater price transparency. TGP information could assist wholesale suppliers to better monitor competitors’ prices and increase their ability to coordinate prices with those competitors, instead of competing on price. This could lead to higher TGPs being offered than would be expected in a competitive market and undermine the TGP regime’s objective of reducing barriers to entry and expansion of the wholesale market.

- 33 The Australian Competition and Consumer Commission considered the risk of price coordination but on balance supported the continuation of their TGP regime because of the benefits from increased transparency of wholesale prices.
- 34 On balance, the TGP regime was included in the Act despite the risk of coordination because it provided wholesale customers with greater transparency in the wholesale fuel market that was not functioning effectively. While this advantage is significant, it is important to balance the risk that it creates.
- 35 The Commission has recommended that a regulatory backstop should guard against this risk. This is because the regulatory backstop would provide a threat of further regulation, should wholesale suppliers not offer competitive TGPs as a result of price coordination. The information gathering regime will also enable the Commission to monitor whether coordination is taking place.

Wholesale suppliers may offer terminal gate prices that incorporate a return on market power

- 36 The risk that wholesale suppliers offer TGPs that incorporate a return on market power will be higher, the fewer the number of suppliers at a port.
- 37 An industry submitter commented that there is proof in the Australian context that TGP regimes increase competition, without the need for further intervention. However, the Commission noted in its market study that there is a lower risk of wholesale suppliers not offering competitive TGPs in Australia as it has a better developed wholesale market, and a greater level of terminal competition at most Australian ports.
- 38 Since the Commission’s market study and the development of the Act, the fuel industry has undergone significant change:
- 38.1 The transformation of the Marsden Point refinery to an import terminal from April 2022.
- 38.2 The transition away from joint shipping arrangements and the “borrow and loan” infrastructure sharing arrangements in August 2022.
- 39 I do not consider that the transformation of the Marsden Point refinery to an import terminal will affect the risk of wholesale suppliers offering TGPs that incorporate a return on market power. From April 2022, wholesale suppliers have been sourcing refined fuel from overseas markets to sell at terminals, but the risk remains that these wholesale suppliers could have market power at terminals they own or operate, and do not offer competitive TGPs.
- 40 In its market study, the Commission considered that a TGP regime on its own may be insufficient to constrain increases in price to raise profits at terminals. The ‘borrow and loan’ infrastructure sharing arrangements, which were in place at the time of the market study, helped the majors to cost-effectively compete nationally, including in regions where a particular major did not own terminal infrastructure. Arguably, this enhanced competition in a region. These arrangements, which were linked to the Refinery model, are about to lapse.

- 41 For example, no major apart from Mobil currently owns terminal infrastructure in the Southland region, but all compete in this area by accessing Mobil's Bluff terminal under the infrastructure sharing arrangements. The terminal owner could decide to deny access which would limit wholesale competition in that region.
- 42 The Commission identified that the risk to competition of the borrow and loan arrangements breaking down is particularly high at relatively isolated terminals, which cannot easily be supplied by truck from another location allowing the supplier to exercise market power. This market power and lack of threat of retaliation, could enable the wholesale supplier to offer a TGP (and associated throughput fee) that is higher than would be expected in a competitive market.
- 43 Less isolated terminals may be less able to exercise market power. For example, Z Energy has previously said that it would be unable to unilaterally raise fees to BP and Mobil because of BP and Mobil's ability to retaliate by increasing fees in areas where Z Energy is dependent on them for product.
- 44 A fourth party seeking access would not have the same ability to retaliate without its own terminal infrastructure that other wholesale suppliers wish to access. This may provide some incentives for the majors not to offer competitive TGPs, which would limit the effectiveness of the TGP provisions in the Act.

Existing Commerce Act 1986 provisions do not address these risks

- 45 I have considered whether sections 27, 30 and 36 and Part 4 inquires under the Commerce Act 1986 could be relied on to address the risks outlined above.
- 46 Section 27 of the Commerce Act 1986 prevents persons from entering into or giving effect to a contract, arrangement or arriving at an understanding that has the purpose, or has or is likely to have the effect of substantially lessening competition in a market.
- 47 Section 30 of the Commerce Act 1986 prevents persons from entering into or giving effect to a contract, arrangement or arriving at an understanding that contains a cartel provision, such as a provision that has the purpose, effect, or likely effect, of fixing prices between competitors.
- 48 Coordinated behaviour in the wholesale fuel market is unlikely to breach sections 27 or 30 as wholesale suppliers could use their competitors' TGP's to inform their own pricing decisions by tacitly coordinating prices without a contract, arrangement or understanding with competitors.
- 49 Section 36 of the Commerce Act 1986 makes it explicit that firms with a substantial degree of market power are prohibited from taking advantage of that power for specific the purposes outlined.
- 50 A wholesale supplier with a substantial degree of market power offering non-competitive TGPs could be found to be in breach of section 36 of the Commerce Act. In this situation, wholesale suppliers could face pecuniary penalties, damages, or exemplary damages.
- 51 Price regulated TGPs (or the threat of price regulated TGPs) would have the following benefits beyond the section 36 prohibition:

- 51.1 A greater incentive to offer competitive TGPs as a lower threshold for intervention could be prescribed which provides a more credible threat of regulation (compared to the section 36 test which will likely not capture this pricing behaviour in the absence of other anti-competitive conduct). This threshold would also allow for more timely intervention and would be better tailored for the fuel market that has more than one firm with market power;
- 51.2 It also provides the potential to address the behaviour in a forward-looking manner by setting regulated TGPs, rather than responding to anti-competitive behaviour after the event.
- 52 Part 4 of the Commerce Act 1986 allows the Commission to conduct inquiries into particular goods or services and recommend regulation. Because of the procedural requirements these inquiries are a significant undertaking, which require a large degree of resource and analysis.
- 53 The market study has already identified issues with wholesale fuel markets, including the scope for market power to be exercised at terminals notwithstanding the other measures introduced by the Act, and it is unnecessary to replicate this analysis. Instead, it would be more effective and proportionate to provide a more credible threat by introducing a regulatory backstop for the specific circumstance.
- 54 There is a gap that exists as competition could be better facilitated in wholesale fuel markets by introducing a regulatory backstop to the TGP regime to incentivise wholesale suppliers to offer competitive TGPs. Plugging this gap would better promote wholesale competition which flows through to a more competitive retail market for the long-term benefit of consumers
- 55 This type of intervention is not necessary in competitive markets since charging excessive prices would not be sustainable as firms would be driven out of the market by competitors that undercut the excessive prices. However, the Commission found that the wholesale fuel market lacks competition and there is a risk that wholesale suppliers offer excessive TGPs (because of coordination or market power at a particular terminal).

The design of a regulatory backstop

- 56 I have considered a range of options regarding the design of a regulatory backstop:
- 56.1 The threshold and process for triggering the regulatory backstop.
- 56.2 How price control regulation should apply.
- 56.3 The compliance and enforcement tools that should be available.
- 57 In reaching my recommendations, I have drawn on backstop regimes for economic price regulation that are contained in the Commerce Act 1986, Telecommunications Act 2001 and Retail Payment System Act 2022.
- 58 Consistent with these regimes, I recommend that the Commission should be responsible for recommending whether price regulation should be imposed on one or more wholesale suppliers TGPs for a particular fuel type or fuel types at a particular

terminal or terminals, and for how long. Industry and non-industry submitters are supportive of this approach which utilises the Commission's expertise.

The threshold and process for triggering the regulatory backstop

I recommend that the Commission should be able to make a recommendation to the Minister after it considers whether terminal gate prices are persistently higher than would be expected in a workably competitive market

- 59 I recommend that the Act should allow the Commission to investigate, either on its own initiative or if requested by the Minister, whether one or more wholesale suppliers' TGPs at a particular terminal or terminals are persistently higher than would be expected in a workably competitive market. This would allow the Commission to be informed by its monitoring of fuel markets or respond to concerns that have been identified by MBIE through its monitoring.
- 60 Following such an investigation the Commission would be able to make a recommendation to the Minister responsible for the administration of the Act as to whether one or more wholesale suppliers' TGPs should be subject to price regulation at a particular terminal or terminals, for a specified time.
- 61 The Commission would be able make this recommendation to the Minister only after consulting with interested persons. It is important that interested persons have an opportunity to provide views on a draft recommendation, which will enable a more robust recommendation.
- 62 Requiring the Commission to consider whether TGPs are persistently higher than would be expected in a workably competitive market should cover both the problems that could impact wholesale competition (i.e., market power and coordination), as both would likely manifest in wholesale TGPs that are higher than would be expected in a workably competitive market.
- 63 After receiving a recommendation from the Commission, the Minister may request further information or advice or request the Commission reconsider any matter. The Minister may only make a recommendation to the Governor-General to make an Order in Council (OIC) if the Minister receives a recommendation from the Commission to regulate one or more wholesale supplier and considers that regulation is in the public interest. The OIC would provide that one or more wholesale supplier is subject to regulated TGPs for the specified fuel type or types, at a particular terminal or terminals, for a specified time.
- 64 As an alternative to requiring the Commission to consider whether TGPs are persistently higher than would be expected in a workably competitive market, I have considered whether the decision to regulate should instead be based on a clear threshold such as whether TGPs exceed:
- 64.1 A benchmark price at another terminal, which faces competition;
- 64.2 A benchmark built up from a widely accepted indicator of a competitively priced input (such as the Mean of Platts Singapore (MOPS)), to which would be added other appropriate costs plus a reasonable margin.

- 65 MOPS is the average of Singapore fuel prices published by the firm Platts.
- 66 Industry submitters commented that these options would effectively impose price control from the outset as wholesale suppliers would seek to avoid triggering the threshold. I consider that these approaches are too simplistic and inflexible and do not allow for wider considerations that could impact TGPs.
- 67 It is also important to build flexibility into the fuel backstop regime as the fuel industry has been undergoing significant change over the past couple of years such as transformation of the Marsden Point refinery to an import terminal from April 2022 and the expected decarbonisation of the transport fleet.

How price control regulation should apply

- 68 If the Minister decides to price regulate a wholesale supplier or group of wholesale suppliers TGPs, the Commission should be responsible for setting and enforcing the price regulation. This would utilise the Commission's experience under existing regimes, including the existing provisions under the Act.
- 69 It is also appropriate for the Commission to be the decision maker as there is likely to be an imbalance in power between the wholesale suppliers at the terminal and firms purchasing the fuel. Most submitters also favoured the Commission being the decision maker.

I recommend not prescribing a pricing principle in the Fuel Industry Act 2020

- 70 Under some existing price regulation regimes, the regulated price must be set consistent with prescribed pricing principles in the primary act. For example, the Telecommunications Act 2001 provides an initial pricing principle which requires regulated prices to be set by benchmarking against prices in comparable countries.
- 71 I have considered two options for pricing principles that could be prescribed in the Act:
- 71.1 Benchmark pricing; or
 - 71.2 A benchmark cost build up (such as MOPS) plus a regulated margin.
- 72 Instead, I recommend having no pricing principles prescribed in the Act, which would allow the Commission to choose the most appropriate pricing principle or methodology for one or more wholesale suppliers after it has consulted with interested persons. The wholesale suppliers could have some discretion as to how to apply the pricing principle or the methodology. Although this would create some uncertainty, it would be the most proportionate and flexible option.
- 73 As mentioned above, I consider it is important to build flexibility into the fuel backstop regime. This approach would also be similar to the Retail Payment System Act 2022.

Compliance and enforcement

- 74 The regime will require compliance and enforcement tools that could be used by the Commission in the event of non-compliance. The Consultation paper did not seek views on compliance and enforcement tools as the Government had already agreed that the Fuel Industry Bill would include civil pecuniary penalties, injunctions and Court orders.
- 75 I recommend extending these existing enforcement provisions in the Act to a breach or proceedings relating to a potential breach of a pricing principle or methodology.
- 76 If a reseller disputes whether a wholesale supplier has complied with the pricing principle or methodology has been applied in setting a TGP, it may inform the Commission. The Commission could also investigate the application of the pricing principle or methodology on its own accord.
- 77 If the Commission considers that a wholesale supplier has not complied with the pricing principle or methodology, it could apply to the High Court to impose a pecuniary penalty, consistent with those provided for under section 30(3) of the Act.
- 78 This approach allows for timely intervention as it allows the pricing principle or methodology to come into force once determined by the Commission. Non-industry submitters commented that they favour timely interventions as it does not allow the problem to persist longer than necessary.
- 79 I have considered whether it is necessary and desirable to also include criminal enforcement tools for non-compliance with the backstop regime, as provided for in the Commerce Act 1986 and Telecommunications Act 2001.
- 80 The Legislation Design and Advisory Committee (LDAC) considers that criminal offences should only be included in legislation if they are necessary to achieve a significant policy objective, which is likely to be the avoidance of harm to society or to particular classes of people.
- 81 I do not consider it is necessary to introduce criminal enforcement in respect of non-compliance with pricing principle or methodology at this stage, as there is currently no evidence that the civil methods would be inadequate, and the conduct does not clearly meet the factors that LDAC guidance outlines as relevant.

Application of existing Commerce Act 1986 provisions

- 82 The Act incorporates certain Commerce Act 1986 provisions to assist with general administration. I propose that these are extended to include the following provisions with appropriate modifications:
- 82.1 Section 17, that assent to a determination may be done by Commissioners in writing signed or in writing generally.
- 82.2 Section 26, that the Commission is to have regard to economic policies of Government.
- 82.3 Section 53ZD, the power for the Commission to require information.

- 82.4 Sections 99B to 99P, assistance to overseas regulators.
- 82.5 Section 103, an offence to fail to comply with information gathering powers, or to obstruct the Commission. Section 103 is already incorporated into the Act, insofar as it relates to a breach of the information gathering and search powers in sections 98 and 98A of the Commerce Act 1986. Section 42 of the Act should be extended to cover a breach of information gathering powers in the modified version of section 53ZD that is proposed above.
- 82.6 Section 104, how to determine a decision given by the Commission.
- 83 These provisions will enable the Commission to effectively carry out new functions and powers proposed in this paper.

Financial Implications

- 84 The Commission receives funds from the Enforcement of General Market Regulation appropriation to carry out its activities in relation to consumer and competition regulation. This includes a category that is limited to legislation regulating the fuel industry. It is anticipated that an amendment bill to the Act to give effect to these policy proposals should come into effect mid-2023 and additional funding of approximately Confidential advice to Government will be required.
- 85 MBIE will also incur increased costs of approximately Confidential advice to Government associated with increased monitoring activities relating to these policy proposals from 2023 onwards.
- 86 Additional funding to give effect to the proposals will be sought in Budget 2023.

Legislative Implications

- 87 A Fuel Industry Amendment Bill (the Bill) would be required to implement the policy proposals contained in this paper.
- 88 Confidential advice to Government
- 89 The Act binds the Crown and I do not propose to change this.

Impact Analysis

Regulatory Impact Statement

- 90 Cabinet's impact analysis requirements apply to this proposal, but there is no accompanying Regulatory Impact Statement and the Treasury has not exempted the proposal from the impact analysis requirements. Therefore, it does not meet Cabinet's requirements for regulatory proposals.
- 91 A Regulatory Impact Statement has been completed but the quality assurance rating has not yet been confirmed by the quality assurance panel. On behalf of respective Ministers, the Treasury's Regulatory Impact Analysis team and the Ministry of Business, Innovation and Employment have agreed that supplementary analysis will be provided to me in August 2022.

Climate Implications of Policy Assessment

- 92 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the emissions impact is indirect and not able to be accurately quantified.
- 93 An assessment of climate implications was carried out in February 2020 when Cabinet agreed to implement a new regulatory regime for the fuel industry [CAB-20-MIN-0031 refers]. Initial analysis of greenhouse gas (GHG) emissions impacts showed 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.
- 94 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 programme is being progressed to reduce the emissions of light vehicles imported into New Zealand. These vehicle initiatives will complement the wider Fuel Industry reforms by encouraging a shift to lower emission vehicles despite an expected fall in fuel prices.

Population Implications

- 95 A backstop regulatory regime would most directly impact wholesale suppliers that supply at terminals (currently Z Energy, BP, Mobil, Gull and TOSL), rather than a distinct population group. If a certain threshold were met these are the fuel industry participants that could be subject to further regulation.
- 96 The impacts of the competitive issues persisting in engine fuel markets that a backstop would address, would be mainly felt by consumers who have been paying higher pump prices for fuel than expected in a competitive market.

Human Rights

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

Consultation

- 98 In March 2020 MBIE released the Consultation paper which sought views on the possible design of a regulatory backstop, to be added to the Act at a later date.
- 99 Industry stakeholders were generally hostile to the development of a backstop regulatory regime, raising concerns regarding the difficulty to design it, questioning the need for the backstop and cautioning the potential impact on incentives to invest. Despite these concerns, I consider it is important to progress this proposal to fully give effect to the recommendations made by the Commission in its market study.
- 100 Individual consumers did not widely engage with the Consultation paper; however, the New Zealand Automobile Association was supportive of the development of a regulatory backstop.

101 The Commerce Commission, Ministry of Transport, Ministry of Justice and the Treasury have been consulted.

Communications

102 I will release a press release announcing this work following Cabinet approval.

Proactive Release

103 This paper will be published on MBIE's web site within 30 business days of final Cabinet decisions, subject to withholdings as appropriate under the Official Information Act 1982.

Recommendations

The Minister for Energy and Resources recommends that the Cabinet Economic Development Committee:

- 1 **Note** that in the Commerce Commission's (the Commission) retail fuel market study final report 2019 (market study), it recommended the development of a regulatory backstop to the wholesale fuel market;
- 2 **Note** that due to the significant design requirements, in February 2020 the Government agreed to defer the implementation of a backstop regime and that officials continue to develop the regime to be implemented at a future point [DEV-20-MIN-0008 refers];
- 3 **Note** that the Fuel Industry Act (the Act) was passed in 2020 to give effect to the Commission's recommendations from the market study, but a regulatory backstop to the Act has not yet been implemented;

Further improvements to information disclosed

- 4 **Agree** for the Minister of Energy and Resources to report back to Cabinet on how existing information disclosure requirements could be further refined, including methodologies that must be applied in recording information such as how common costs are to be allocated and how assets are to be valued.

A regulatory backstop to promote wholesale competition in engine fuel markets

- 5 **Agree** that, subject to a supporting regulatory impact statement, a regulatory backstop to the wholesale fuel market should now be progressed by Government, with the objective of promoting wholesale competition in engine fuel markets which flows through to a more competitive retail market for the long-term benefit of consumers;

The threshold and process for triggering the regulatory backstop

- 6 **Agree** that the Commission should be responsible for recommending to the Minister responsible for the administration of the Act (the Minister) whether price regulation should be imposed on one or more wholesale suppliers' terminal gate prices (TGPs) for a particular fuel type or fuel types, at a particular terminal or terminals, for a specified time;

I N C O N F I D E N C E

- 7 **Agree** that the recommendation referred to in paragraph 6 above, can only be made after the Commission considers whether TGPs at the terminal or terminals owned or operated by wholesale suppliers have been persistently higher than would be expected in a workably competitive market;
- 8 **Agree** that a recommendation referred to in paragraph 6 can only be made by the Commission after it considers views from interested persons;
- 9 **Agree** that an investigation leading to a recommendation referred to in paragraph 6 may be commenced by the Commission on its own initiative, or at the request of the Minister;
- 10 **Agree** that if the Minister receives a recommendation referred to in paragraph 6, the Minister must consider the Commission's recommendation and may request further information or advice or request the Commission reconsider any matter;
- 11 **Agree** that if the Minister receives a recommendation from the Commission to regulate one or more wholesale supplier with the associated information referred to in paragraph 6 above, and if the Minister considers that regulation is in the public interest, the Minister may make a recommendation to the Governor-General to make an Order in Council which would provide that one or more wholesale supplier is subject to regulated TGPs for the specified fuel type or types, at a particular terminal or terminals, for a specified time;

How price control regulation should apply

- 12 **Agree** that if an Order in Council has been made that prescribes that one or more wholesale supplier is subject to regulated TGPs for specified fuel type or types, at a particular terminal or terminals, for a specified time, the Commission must set the pricing principle or methodology after it has consulted with interested persons;
- 13 **Agree** for the Commission to have discretion as to whether it prescribes a pricing principle or methodology, and the Commission may amend a pricing principle or methodology at any time after consulting with interested persons, and if the Commission considers that an amendment would better give effect to the purpose of the Act;
- 14 **Agree** that regulated TGPs must be set by a wholesale supplier for specified fuel type or types, at a particular terminal or terminals, for a specified time, consistent with the pricing principle or methodology determined by the Commission;

Compliance and enforcement

- 15 **Agree** to extend the existing injunction, Court order and High Court pecuniary penalty provisions, and associated provisions, with appropriate modifications, in the Act to a breach of a pricing principle or methodology by a wholesale supplier subject to regulated TGP;
- 16 **Agree** that the Commission may, of its own accord or in response to a complaint referred or made to it, investigate whether a pricing principle or methodology has been correctly applied by one or more wholesale supplier;

- 17 **Agree** that if the Commission finds that a wholesale supplier has not complied with a pricing principle or methodology in setting its TGPs, the Commission may apply to the Court to impose a pecuniary penalty, consistent with those provided for under section 30(3) of the Act;

Application of existing Commerce Act 1986 provisions

- 18 **Agree** to incorporate certain Commerce Act 1986 administrative and information requiring provisions into the Act with appropriate modification.

Other recommendations

- 19 **Agree** that new ongoing funding is required to implement these proposals which will be sought as part of Budget 2023;
- 20 **Invite** the Minister of Energy and Resources to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations;
- 21 **Note** that recommendations 5 to 18 will be given effect through the Fuel Industry Amendment Bill, Confidential advice to Government [REDACTED]
- 22 **Authorise** the Minister of Energy and Resources to make additional policy decisions, consistent with the proposals in these recommendations, on any issues that arise during the drafting process;
- 23 **Authorise** the Minister of Energy and Resources to make decisions on minor and technical matters that may arise during the drafting process.

Authorised for lodgement

Hon Dr Megan Woods

Minister of Energy and Resources