



## COVERSHEET

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

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
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

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

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

# Supplementary Analysis Report: Regulatory backstop under the Fuel Industry Act 2020

## Coversheet

Purpose of Document	
Decision sought:	Supplementary analysis provided to the Minister of Energy and Resources following Cabinet decisions DEV-22-MIN-01710, CAB-22-MIN-0300.
Advising agencies:	Ministry of Business, Innovation and Employment (MBIE)
Proposing Ministers:	Energy and Resources
Date finalised:	29 August 2022
Problem Definition	
<p>The Fuel Industry Act 2020 (the Act) introduced measures aimed to address New Zealand’s inactive wholesale fuel market. Despite this, there are risks that wholesale suppliers do not offer competitive prices at the terminal gate and the terminal gate pricing (TGP) regime is used as a vehicle for coordination which would undermine the effectiveness of these measures.</p>	
Executive Summary	
<p><i>Background</i></p> <p>In 2019 the Commerce Commission (the Commission) published its retail fuel market study final report 2019 (the market study). The market study found that price competition in fuel markets is not working as well as it could be, the main issue being that an active wholesale fuel market does not exist in New Zealand. This creates the following key issues for consumers:</p> <ul style="list-style-type: none"><li>• Fuel companies make persistently higher profits than would be expected in a competitive market.</li><li>• Regional differences in retail fuel prices are not explained by cost differences.</li><li>• Discounting practices are used to avoid competing on board prices.</li><li>• Premium petrol margins do not reflect actual cost differences in supply.</li><li>• Competition is less intense than could be expected in both retail and wholesale fuel markets.</li></ul> <p>The Act introduced a range of interventions to the fuel market to tackle these issues based on the Commission’s recommendations. This included a TGP regime which helps to create a wholesale spot market to encourage new entry and expansion in new areas by existing</p>	

players. The Commission also recommended the introduction of a regulatory backstop to the TGP regime.

Due to timing constraints, in February 2020 Cabinet agreed to defer a backstop regulatory regime and that officials were to continue developing this to be implemented at a future date [DEV-20-MIN-0008 Minute].

In March 2020 MBIE released a Consultation paper: Regulations under a Fuel Industry Bill and other matters (the Consultation paper). The Consultation paper sought views on the problem that a regulatory backstop seeks to address, the threshold and process for triggering the regulatory backstop and how should price regulation apply. Submissions on the Consultation paper have informed the proposals in this paper.

#### *Proposed response*

Officials 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. This recommendation requires legislative changes to the Act.

The preferred design of the regulatory backstop is as follows:

- The Commission provides a recommendation to the Minister after considering whether TGPs are persistently higher than would be expected in a workably competitive market.
- No pricing principle prescribed in the legislation.
- The Commission sets the pricing principle or methodology, and wholesale suppliers must apply it and may face a pecuniary penalty if it is not applied as specified.
- Only civil enforcement tools.

Given the intense scrutiny of the fuel market in recent years, we anticipate that the Government will want to act swiftly to enact a regulatory backstop to help promote wholesale competition. An amendment to the Act to introduce a regulatory backstop could come into force mid-2023.

### **Limitations and Constraints on Analysis**

#### ***Range of options considered***

The range of options considered is based on the market study and submissions on the Consultation paper. Some of the options are more specific than those consulted on but still incorporate stakeholder views.

#### ***Quality of data used for impact analysis***

This RIS relies upon the Commission's analysis in the market study, which is informed by submissions from interested parties to the Commission as part of that study, MBIE's consultation with stakeholders and analysis of subsequent market developments. The sources used did not include quantitative assessments of the costs and benefits of the options. While we have made use of multiple sources wherever possible, particular reliance has been placed on the Commission's findings and analysis given the Commission's rigorous testing process. Where possible we have updated the analysis with more recent market data.

## Responsible Manager(s) (completed by relevant manager)

Authorised by:

Privacy of natural persons

Osmond Borthwick  
Manager, Energy Markets Policy  
Building, Resources and Markets  
Ministry of Business, Innovation & Employment

29 August 2022

## Quality Assurance (completed by QA panel)

Reviewing Agency: MBIE

Panel Assessment & Comment: The panel considers that the information and analysis summarised in the Supplementary Analysis Report **meets** the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

## Section 1: Diagnosing the policy problem

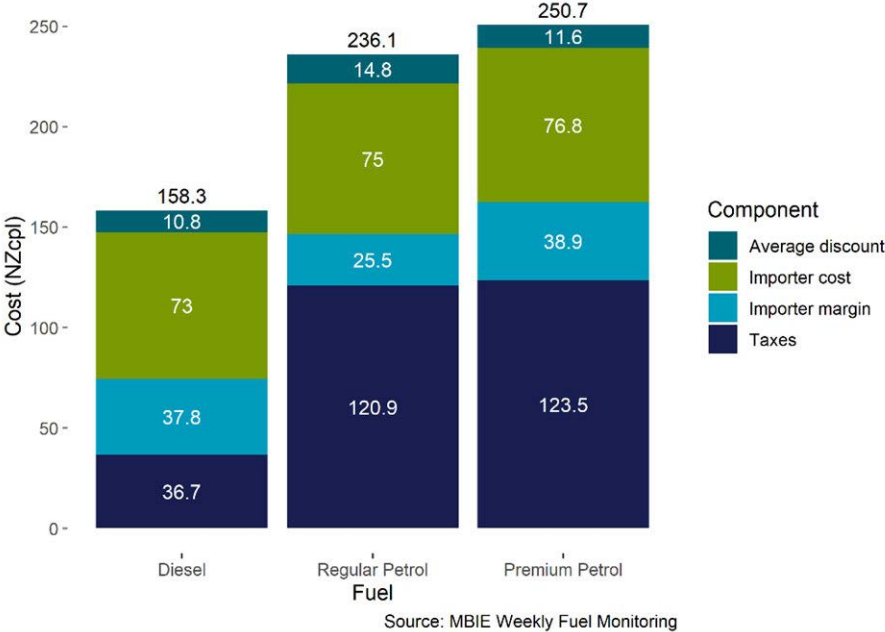
### Characteristics of the retail fuel market

1. About 2.9 billion litres of petrol and 3.8 billion litres of diesel are consumed annually in New Zealand. According to Bloomberg, in Q2 of 2020 New Zealanders spent more income on fuel each year than people in 53 other countries (out of a total of 61 countries), with the average New Zealand driver purchasing 675 litres of fuel a year, making up 2.26 percent of the typical salary.<sup>1</sup>
2. Currently fuel purchased at retail sites is split between petrol and diesel (about 55 percent and 45 percent respectively), although in most years these figures are more evenly split:
  - a. Households' light vehicles tend to consume petrol.
  - b. Premium petrol (95 or 98 octane) makes up about 25 percent of total petrol consumption.
  - c. Diesel is more likely to be used in heavier vehicles and in over 97 percent of trucks and buses. The number of diesel vehicles has increased steadily since 2000.
3. Figure 1 illustrates the components that make up fuel board prices across different types of fuel. This is representative of average prices over the 2021 calendar year.

---

<sup>1</sup> Bloomberg [Gasoline Prices by Country \(bloomberg.com\)](https://www.bloomberg.com). (Viewed on 23 May 2022).

**Figure 1: Components of the average board price of fuel (2021 calendar year)**



4. The importer margin represents the gross margin available to fuel importers to cover domestic transportation, distribution and retail costs in New Zealand, as well as profit margins.
5. Retail fuel prices can vary quite significantly over short periods of time. However, overall fuel expenditure tends to increase when prices go up because fuel consumption does not reduce significantly in response to price increases, both for short-term fluctuations and longer-term trends. Fuel is an essential purchase for many consumers.
6. Fuel company research suggests that between a quarter and a half of consumers may be relatively price sensitive and motivated to switch between brands – either looking out for the cheapest prices or actively searching for discounts between loyalty programmes. Other consumers are less price sensitive and value various non-price aspects of fuel offerings more highly than price.

**Industry structure**

7. There are currently five companies that import fuel into New Zealand: BP, Mobil, Z Energy, Timaru Oil Services Limited (TOSL) and Gull.
8. BP, Mobil, and Z Energy are regarded as ‘the majors’ in the New Zealand fuel industry. The majors import refined petrol and diesel, mostly from Singapore and South Korea, which generally arrives at ports in Mount Maunganui, Wellington and Lyttelton.
9. In 2020 a strategic review was commenced by the owners of the Marsden Point oil refinery (the Refinery) to identify the best way to realise the full value of the infrastructure. Following this, it made the decision to simplify and then cease refinery operations because of structural challenges to the competitiveness of the Refinery compared to newer Asian refineries, costs of energy and the global movement towards reducing carbon emissions.

10. The Refinery used to supply about 65 to 70 per cent of New Zealand's total demand for refined fuels, and most of its jet fuel. The fuels produced by the Refinery were supplied through pipelines and through coastal tankers commissioned by Coastal Oil Logistics Limited (COLL), a joint venture between Z Energy, BP and Mobil. The balance was imported mainly from refineries in Singapore and South Korea. The Government is separately considering policy options to address the security of supply risks associated with this change.
11. The Refinery has shut down permanently and became a fuel import terminal from 1 April 2022. As a result, New Zealand now fully relies on imports of refined fuel products. All the refined fuel products are delivered by international tankers to ports across New Zealand, and there are no domestic coastal tankers for delivering fuel products between ports within New Zealand.
12. The majors control the majority of New Zealand's existing fuel storage infrastructure. Historically, the stored fuel has been shared with the other majors through a system known as a "borrow and loan" arrangement. Under this arrangement, each of the majors could source fuel from the terminals of the other two without a specific commercial transaction, so long as the national balances across all terminals remained consistent between the majors. Although there was no financial transaction at a terminal for the fuel, the owner of a terminal charged a throughput fee to the firm that draws down fuel from its terminal.
13. Following the Refinery's conversion to an import terminal, the COLL joint venture responsible for coastal fuel shipping was wound up on 31 July 2022. The borrow and loan arrangements have also ended. This means that from 1 August 2022 fuel importers have been responsible for their respective inventories at terminals and will no longer be able to source fuel from the terminals of the other two unless a bilateral agreement has been reached.
14. Gull and TOSL have not been party to any of the infrastructure sharing arrangements. Gull imports refined fuel to its Mount Maunganui terminal and from there trucks it to its retail outlets, or sources fuel from the majors' terminals on a commercial basis. TOSL imports refined fuels to its Timaru terminal. TOSL planned a further terminal in Mount Maunganui but resource consents were declined in 2021.
15. TOSL has only recently commenced operations and is yet to make a significant impact on the market. Commercial Information [REDACTED] Tasman Fuels, a company associated with TOSL, has also recently entered the retail market in Christchurch.
16. New Zealand's fuel industry is essentially a vertically integrated oligopoly. Collectively, Z Energy, BP, Mobil and Gull control the supply of fuel to more than 1,300 retail sites under 20 different retail brands, either directly or indirectly through a distributor.
17. Many of the wholesale supply relationships that the majors have with distributors and dealers have been in place for decades, and supply is typically on an exclusive basis. Each of the importers and distributors supply to retail sites that they own and operate and to franchisees (or in some cases, commissioned agents) that are dealer-owned and operated.

18. The Commission estimated that approximately 57 percent of retail fuel by volume is sold through importer-owned and -operated retail sites, and 27 percent of retail fuel by volume is sold through franchisees or commissioned agents that are importer-branded, dealer-owned retail sites.
19. Approximately 60 percent of retail sites carry brands outside of the majors. However, these sites account for approximately 20 percent of petrol volumes sold in 2018, and many are located outside of the major metropolitan areas.
20. Since 2016, there has been an increase in the number of retail sites, with few of these being operated by majors. Along with Gull, brands distributing and retailing fuel (NPD, Waitomo, and Allied Petroleum) have expanded. The number of sites operated by the majors has only marginally changed.
21. In the three years leading up to 2020 petrol demand had been largely stable, while diesel demand grew by 4 percent per year. Both petrol and diesel consumption fell in 2020 due to COVID-19 restrictions (petrol more than diesel). While diesel has recovered (2021 consumption was 2 percent higher than 2019) petrol consumption is still down 10 percent on 2019 consumption levels.
22. New Zealand petrol prices are significantly influenced by international prices and events. This became particularly evident during the Energy Crisis 2022 where the price of Dubai Crude increased from \$115 NZD from January 2022 to \$157 NZD in early May 2022. This was mainly caused by the invasion of Ukraine, subsequent sanctions and embargoes on Russia, and a lack of international refining capacity.
23. These increased costs were passed on to consumers at the pump, which caused the cost of regular 91 to rise above \$3.00 per litre around New Zealand. In response the Government reduced fuel excise duty by 25 cents per litre (plus any associated GST reduction) and Road User Charges until January 2023 as a temporary measure to reduce the pressure at the pump for consumers.
24. Future demand is uncertain due to changes in technology such as increased vehicle efficiency and growth of demand for electric or hybrid vehicles. However, forecasts show that the demand for fuel is likely to remain reasonably flat over the next decade, and (for petrol in particular) is likely to decline over a longer timeframe.
25. The Government's Emissions Reduction Plan was published 16 May 2022, which is intended to help New Zealand move away from fossil fuels and reduce exposure to volatile global fuel markets. The Government will help households reduce their transport emissions by improving access to affordable, sustainable transport options, including by:
  - a. Continuing the Clean Vehicle Discount to help New Zealanders purchase low- and zero-emission vehicles and reduce their fuel and vehicle maintenance costs.
  - b. Improving electric vehicle charging infrastructure across New Zealand to ensure that all New Zealanders can charge when they need to.
  - c. Making cleaner vehicles and low-emissions alternatives affordable for low-income households through a vehicle scrap-and-replace scheme.

- d. Improving travel choices and accessibility by providing people with more convenient, affordable and frequent buses and trains, as well as safer walkways and cycle lanes.
26. Actions such as these aim to put New Zealand on track to make zero-emissions vehicles 30 per cent of light vehicles (cars, vans, utes) and reduce the total kilometres light vehicles travel by 20 per cent by 2035.
27. The information about fuel markets is drawn from the market study, which was reported in December 2019, with updates where more recent data is available.

### **The Commission's market study**

28. The Commission found that price competition in fuel markets was not working as well as it could be. It found that:
- a. Fuel companies have been making persistently higher profits over the past decade than would be expected in a competitive market.
  - b. Regional differences in retail fuel prices reflect variations in local competition and not solely differences in cost of supply.
  - c. Discounts and loyalty schemes avoid direct competition on price.
  - d. Premium petrol margins have grown faster than regular petrol and do not reflect actual cost differences in supply.
  - e. Competition largely occurs in retail markets and this is less intense than could be expected.
29. The most significant problem that the Commission identified was that an active wholesale fuel market did not exist in New Zealand. There were two interrelated factors that the Commission considered limited wholesale competition:
- a. The majors' joint infrastructure network gave them an advantage over current and potential rival resellers, who are unable to acquire fuel from terminals throughout the country other than under contract with a major. As mentioned in paragraph 13 above, this joint infrastructure network wound down in August 2022. This creates new risks which are discussed further below.
  - b. Wholesale supply relationships, including restrictive contract terms, between the majors and their resellers reduce competition and limit resellers' ability to switch supplier. The restrictive contract terms have been addressed by the provisions of the Act.

### **Persistently high profits**

30. The Commission found that a range of factors suggested that the profitability to New Zealand fuel companies is high. These include the following observations from the 2019 study:
- a. Import margins had more than doubled since 2008.



- b. Fuel company returns on new investment averaged 20 percent per annum over the previous five years – well above the Commission’s estimate of a reasonable return (6.9 – 8.6 percent) and the average historic returns made by international comparator companies.
  - c. New retail sites often exceeded the company’s own profitability expectations, with some achieving pay back on investment that is unusually fast for long-lived assets.
  - d. Ratios of fuel firm’s market value (share price or sharemarket value) to replacement cost (value of its assets) were approximately 1.5 -1.8, meaning they were valued significantly higher than their physical costs to build. The Commission would expect ratios closer to 1 in a workably competitive market.
31. The Commission recognised that while any one measure of profitability will have its limitations, this range of measures consistently indicate that fuel companies had been achieving a level of profitability in New Zealand that was persistently higher than what the Commission estimated a reasonable return would be in a workably competitive market.
32. It was however noted that while most fuel companies in New Zealand are profitable, some retail sites owned by individual dealers are not and operate on relatively slim margins compared to the majors who supply them.

#### **Regional differences in retail fuel prices not explained by cost differences**

33. Analysis conducted for MBIE in 2017 showed that fuel prices in the South Island and the North Island were roughly similar up until about 2014. But in the subsequent next five years, a significant gap emerged between the (higher) prices paid in the South Island and Wellington, on the one hand, and the rest of the North Island, on the other.
34. At the time the Commission undertook the market study, there were material differences in retail fuel prices between regions and locations in New Zealand.
35. Some of the regional price differences could be explained by differences in taxes (with the regional fuel tax introduced in Auckland) and costs of supply based on such things as transport costs and lack of economies of scale (e.g., Westland). However, the Commission considered that differences in competitive pressures in the regions and locations may be a better explanation. The Commission found that the level of competitive pressure faced by the three majors differs considerably by region.
36. The Commission considered that prices in Wellington and the South Island may reduce in the future as comparatively low-priced retailers expand into these areas and if TOSL’s entry in Timaru is successful.

#### **Discounting is not a substitute for price competition**

37. Discount and loyalty programmes available in the retail fuel sector have become increasingly common. Many consumers are members of more than one loyalty programme. In 2018, more than 41 percent of petrol and diesel sales were made at a discount to the advertised pump price. This has almost doubled since 2011. The average size of the discounts offered has also increased from 2 cents to 11 cents per litre for petrol, and from 2 cents to 16 cents per litre for diesel over this period.

38. The Commission reported that discounting is a poor substitute for price competition and noted that discounts may shift consumers' attention away from the actual price they pay and more on the size of the discount or reward.
39. Some discounts and loyalty schemes have conditions, such as minimum or maximum qualifying purchases or rewards that must be used before they expire. This can make it difficult for consumers to compare post-discount or reward prices between retailers to determine which one is offering the lowest actual price. In such circumstances, consumers are less likely to switch in response to competitive fuel prices and retailers have weaker incentives to offer competitive fuel prices.
40. Despite these concerns, the Commission did not recommend regulation of the display of discounting information, noting that such practices were still evolving. The Act does not provide for such regulation.

#### **Increases in premium petrol margins are unrelated to costs**

41. Premium petrol margins have increased faster than regular petrol margins. Pre-tax premium petrol prices in New Zealand have moved from being in the bottom third of OECD countries in 2008 to the most expensive in 2017. While there are differences in how countries report fuel prices to the OECD, the methods used have not significantly altered since 2008, suggesting that New Zealand's dramatic move up the rankings is due to a real shift in our relative position.
42. There is no obvious reason why the underlying cost of supplying premium petrol to New Zealand, compared to other markets, would have changed so significantly over the last decade. The Commission did not find any corresponding increase in the costs of producing premium petrol that could explain the increasing gap in importer margins between regular and premium petrol.

#### **Retail price competition is less intense than could be expected**

43. Approximately 84 percent of retail fuel is sold through importer-owned and -operated retail sites or through importer-branded, dealer-owned retail sites. While there are over 20 brands of retail fuel, each brand is closely tied to one of the importers through typically exclusive and stable contracts.
44. The entry of an independent importer, Gull, had a significant impact on retail prices and margins. In 2015-2016, the price difference between areas where Gull was represented and non-Gull regions were between 10 and 30 cents per litre.
45. While there has been a growth in the number of retail sites, particularly by the non-majors, the impact on price competition is localised. The non-majors primarily operate in low-cost unmanned sites in secondary locations, away from central metropolitan areas. Often the best sites have already been secured by existing suppliers.
46. Retail competition is also marked by differentiation in service offerings, such as whether it is manned or unmanned, includes a convenience store, takeaway food, barista coffee, toilets a car wash, and the ease of access and convenience of location. This product differentiation, coupled with the growth of discounts and loyalty programmes, weakens competition on price.

## Restrictive or dependent wholesale supply relationships

47. The Commission found that the wholesale market is characterised by stable and typically exclusive supply arrangements with distributors and dealers. Switching at the wholesale level is rare. Distributors and dealers rarely use the same competitive tendering processes used by larger commercial customers.
48. The Commission outlined that this reflects a combination of:
  - a. Non-contractual features, which result in the resellers being dependent on their existing suppliers.
  - b. Restrictive contract terms that make switching difficult.
49. The consequences of this were:
  - a. Independent importers face barriers to entry or expansion as there are few wholesale customers actively looking for new supply opportunities.
  - b. Competition between existing wholesale suppliers is reduced because many dealers and distributors face barriers to switching.
  - c. It is difficult for distributors and dealers to obtain competitive wholesale supply as they may lack bargaining power and transparent pricing information.
  - d. Wholesale prices appear higher than would be expected and this flows through to retail pricing.

## The Fuel Industry Act 2020

50. The Commission identified some retail market measures to address competition, however the most significant recommendations involved changes in the wholesale market. As a result, the Act was passed in 2020.
51. 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 introduces the following interventions:
  - a. Requirements and prohibitions that aim to reduce restrictive or dependent wholesale supply relationships.
  - b. TGP regime to create a wholesale spot market to reduce barriers to enter the wholesale market.
  - c. Consumer information requirements which require retail sites to display fuel prices on boards to improve information for consumers to compare prices.
  - d. Requirements for certain fuel companies to disclose information to MBIE or the Commission to improve the monitoring of the market (information disclosure regime).
  - e. A dispute resolution scheme for disputes between wholesale suppliers and resellers under the Act.

## How is the status quo expected to develop?

### The Fuel Industry Act is expected to facilitate a more active wholesale fuel market

52. The full provisions of the Act have only recently come into force, which gave sufficient time to develop regulations to support the new obligations (which came into effect 11 August 2021 and 11 February 2022) and to enable wholesale suppliers and resellers time to re-negotiate existing wholesale contracts to comply with the Act.
53. Overall, it is expected that the Act will:
  - a. Facilitate a more active and competitive wholesale market, which should flow through to a competitive retail market.
  - b. Ensure clear information is available to consumers to compare prices, leading to improved competition in retail markets.
  - c. Preserve incentives to innovate and to invest in markets for specified engine fuels.
54. The two main interventions introduced to achieve these outcomes are the fixed wholesale contract term and TGP provisions.
55. The fixed wholesale contract provisions aim to reduce restrictive or dependent wholesale supply relationships by providing that:
  - a. A wholesale supplier must ensure that the terms of its fixed wholesale contracts are expressed clearly, concisely, and in plain language and pricing methods are transparent.
  - b. A distributor may terminate a fixed wholesale contract at any time after it has been in force for longer than the maximum duration.
  - c. Provisions of fixed wholesale contracts have no effect to the extent that it requires the distributor to purchase more than a maximum amount.
  - d. A wholesale supplier must not enter into a fixed wholesale contract that contains a provision that is likely to limit the ability of the reseller to compete and is not reasonably necessary to protect the commercial interest of the supplier.
56. The TGP provisions provide that wholesale suppliers that sell from terminals must post a daily spot price. If requested, wholesale suppliers must supply the reseller with the requested amount at the TGP unless one of the specified reasonable grounds to refuse supply applies.<sup>2</sup>
57. The TGP regime aims to:

---

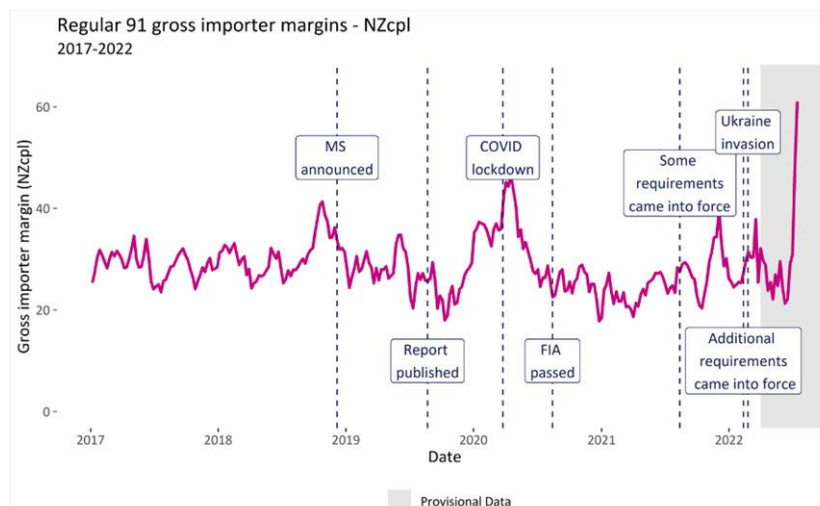
<sup>2</sup> Reasonable grounds to refuse to supply under the Act include: the amount of fuel requested is less than any minimum purchase amount, the wholesale supplier reasonably believes that the reseller will not comply with terms and conditions, abide by health and safety requirements, or pay for the requested amount or the wholesale supplier requires the requested amount to meet contractual obligations or to meet forecast demand.

- a. Enable the development of a liquid wholesale spot market to develop.
- b. Increase the ability for distributors and dealers to purchase fuel on competitive terms by providing greater transparency of wholesale fuel prices to inform bargaining and providing an ability to purchase some or all of their fuel through TGPs at terminal gates.
- c. Reduce barriers to entry and expansion for importers and distributors by providing a transparent and readily available way to obtain fuel supply through TGPs on a nationwide basis from the existing network of terminals or equivalent facilities.
- d. Provide competitive benchmark information for industry and the government and curb the incentive on wholesale suppliers to use their market power in regions where competition is weak.

### The full impact of the Fuel Industry Act 2020 will not be felt for some time

58. While there has been expansion by low-priced retailers, the impact has been difficult to gauge because of other developments with a much greater impact, such as diminished fuel volumes because of COVID-19 and increased costs because of the Russia-Ukraine conflict.
59. The TGP regime has created a wholesale spot market which allows resellers the ability to access fuel from the majors' terminals. This has supported the expansion and entry into new areas by low-priced retailers such as Gull, NPD, Waitomo and Tasman Fuels. 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.
60. Despite this, the tight relationships between the majors and wholesalers does not yet appear to have been significantly disrupted. Commercial Information  

However, the fixed wholesale contractual term interventions have not applied in full to existing contracts until 11 August 2022.
61. Information on gross margins is available through MBIE's long term data collection. The impact of the Act is hard to measure at this point, because of external shocks from COVID-19 and the Russia-Ukraine conflict. Since the introduction of the Act, there has been no clear upward or downward trend in importer margins:



62. Despite this 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.
63. 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.
64. As discussed above, future demand is uncertain due to changes in technology such as increased vehicle efficiency and growth of demand for electric or hybrid vehicles. However, forecasts show that the demand for fuel is likely to remain reasonably flat over the next decade, and (for petrol in particular) is likely to decline over a longer timeframe. Therefore, issues with the wholesale market are likely to persist for the foreseeable future.

### **There are risks to the success of the Fuel Industry Act 2020**

65. The market study outlined several risks that could prevent the implementation of a successful TGP regime, even if the fixed wholesale contract and TGP interventions were introduced:
  - a. The risk to supply during a port coordination event under the 'borrow and loan' arrangements.<sup>3</sup>
  - b. The risk that the TGP regime is used as a vehicle for coordination.
  - c. The risk that wholesale suppliers do not offer competitive TGPs due to market power at particular terminals.
66. The risks to supply during a port coordination event are mitigated by the Act requiring TGPs to be posted and outlining when the wholesale supplier has reasonable grounds to refuse supply under the regime.

### **What is the policy problem or opportunity?**

#### **The nature, scope, and scale of the problem**

67. 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 offer TGPs that incorporate a return on market power.
68. 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 regulated participation in infrastructure sharing arrangements (which ended in August 2022) or price control from the outset.

---

<sup>3</sup> Port coordination events were used to ration out available supply between the majors and their downstream partners, when terminals are forecast to run out of supply before the next shipment arrives.

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

69. 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 competitor 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 regimes attempt to reduce barriers to entry and expansion of the wholesale market.
70. The Australian Competition and Consumer Commission considered the risk of price coordination in Australia, but on balance supported the continuation of their TGP regime because of the benefits from increased transparency of wholesale prices.<sup>4</sup>
71. 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.

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

72. The risk wholesale suppliers offering TGPs that incorporate a return on market power will be higher, the fewer the number of suppliers at a port.
73. We do not consider that the transformation of the Refinery to an import terminal will affect the risk of wholesale suppliers offering TGPs that incorporate a return on market power. Wholesale suppliers now source refined fuel from overseas markets to sell at terminals, but the risk remains that these wholesale suppliers could have market power at some terminals and do not offer competitive TGPs.
74. However, the Commission considered that in the absence of the borrow and loan arrangements a TGP regime on its own may be insufficient to constrain increases in price to raise profits at ports as the arrangements enabled the majors to cost-effectively compete nationally, including in areas where a particular major does not own terminal infrastructure. This is because the majors could supply cost-effectively into a region without owning a terminal there. Arguably, this enhanced competition in a region.
75. 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. The terminal owner could decide to deny access which would limit wholesale competition in that region.
76. 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 and whereby the supplier has market power. This market power and lack of threat of retaliation, could enable

---

<sup>4</sup> <https://www.accc.gov.au/system/files/Oilcode%20review%202015%20-%20ACCC%20submission%20-%202013%20October%202015.pdf>

the wholesale supplier to offer a TGP (and associated throughput fee) that is higher than would be expected in a workably competitive market.

77. 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 throughput fees to BP and Mobil because of BP and Mobil's ability to retaliate by increasing throughput fees in areas where Z Energy is dependent on them for product.
78. 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 to offer TGP that incorporates a return on market power which limits the effectiveness of the Act.

### **Failure to address these risks could mean poor outcomes for consumers persist in fuel markets**

79. Failure to address these residual risks could lead to many of the issues described above (see paragraph 28) persisting.
80. Threats to the success of the TGP regime are unlikely to be significantly eroded in the status quo as wholesale suppliers have commercial incentives to charge TGPs that incorporate a return on market power or to coordinate TGPs.
81. Charging excessive prices in competitive markets is unlikely to be sustainable, as firms would be driven out of the market by competitors that undercut the excessive prices. However, the Commission identified that the wholesale fuel market lacks competition and there are risks which would undermine the success of the TGP regime.

### **Stakeholders impacted by the problem**

82. The impacts of these issues persisting would be mainly felt by consumers who have been paying higher pump prices for fuel than could be expected in a competitive market. Individual consumers did not widely engage on the Consultation paper, although the New Zealand Automobile Association was supportive of the development of a regulatory backstop.
83. Wholesale suppliers and distributors are also impacted since a failure to address threats to the success of the TGP regime undermines the Act's attempts to:
  - a. Develop a liquid wholesale spot market.
  - b. Increase transparency of competitive wholesale fuel prices to inform bargaining and the ability to purchase some or all of their fuel through TGPs at competitive prices.
  - c. Reduce barriers to entry and expansion for importers and distributors by providing a transparent and readily available way to obtain fuel supply through TGPs on a nationwide basis from the existing network of terminals or equivalent facilities.



84. A wholesale supplier that purchases fuel from terminals for resale submitted on the Consultation paper that it does not support the development of a regulatory backstop, as it considered it should not be required if the Act and its intent is successful.
85. The interventions introduced by the Act are intended to promote competition in fuel markets for the long-term benefit of consumers. A backstop is complementary to the existing interventions and will help to ensure that the intent of the Act is met by mitigating the risks to the success of the TGP regime
86. A backstop regulatory regime would most directly impact wholesale suppliers that supply at terminals (currently Z Energy, BP, Mobil, Gull and TOSL). If a certain threshold were met, these are the fuel industry participants that could be subject to further regulation. Feedback from the Consultation paper showed that these stakeholders were generally not supportive of the development of a backstop regulatory regime. They raised concerns regarding the difficulty of designing such a regime, questioned the need for the backstop, and cautioned about the potential negative impact on incentives to invest.

#### **What objectives are sought in relation to the policy problem?**

87. The objective of a backstop regulatory regime is to promote wholesale competition which flows through to a more competitive retail market for the long-term benefit of consumers.
88. Increased competition should result in fuel prices that more closely reflect costs of supply and the limiting of excess profits by fuel companies. This could result in lower fuel prices and more innovative service offerings. This corresponds to the Government's commitment for fairer fuel prices for consumers.

## **Section 2: Deciding upon an option to address the policy problem**

#### **What criteria will be used to compare options to the status quo?**

89. The key criteria that apply to the options regarding a regulatory backstop are:
  - a. **Promotion of competition:** Incentivise wholesale suppliers at the terminal to offer competitive prices.
  - b. **Proportionate:** Intervention is no more than necessary to the risks identified.
  - c. **Flexible:** Intervention can be tailored to the specific wholesale supplier's circumstance.
  - d. **Timely:** Intervention is timely to minimise harmful impacts on the fuel market.
  - e. **Regulatory certainty:** Intervention has certain and predictable impacts and minimises impacts on wholesale supplier's incentives to maintain sufficient storage and distribution of fuel.

## What scope will options be considered within?

90. The Commission's market study informs the scope of the options, as it recommended that the Government develop a regulatory backstop to address the problems discussed above. Consistent with the Commission's recommendation, we do not consider that price regulation of TGPs from the outset is appropriate due to the cost involved in administering the regime and the impact it could have on wholesale suppliers' incentives to maintain sufficient storage and distribution of fuel.
91. In February 2020 Cabinet agreed to defer a backstop regulatory regime and that officials were to continue developing a backstop to be implemented at a future point [DEV-20-MIN-0008 Minute]. Despite this, Cabinet could decide not to develop a backstop if the status quo better meets the objective.
92. In March 2020 MBIE publicly released the Consultation paper, which sought views on the problem that a regulatory backstop seeks to address, the threshold and process for triggering the regulatory backstop and how should price regulation apply. A summary of the proposals contained in the Consultation paper are provided in Annex One.
93. Submissions on the Consultation paper have informed the scope and analysis of the proposals in this paper. Summary of the feedback received is provided in Annex Two. This feedback has also helped to shape the key criteria described above (particularly; proportionate, flexible, timely and regulatory certainty).
94. The status quo would involve relying on existing Commerce Act 1986 provisions (specifically sections 27, 30 and 36, and Part 4 inquiries) and the Act's wholesale market interventions (specifically Subpart 1 and 2 of Part 2). This option is evaluated below.
95. If it is established that the status quo is not satisfactory there are a range of options regarding the design of a regulatory backstop:
  - a. The threshold and process for triggering the regulatory backstop.
  - b. How price control regulation should apply.
  - c. What compliance and enforcement tools should be available in the event of non compliance.
96. The scope and the options described below are informed by existing backstop regimes for economic price regulation that are contained in the Commerce Act 1986, Telecommunications Act 2001 and Retail Payment System Act 2022.
97. Therefore, the overall options are:
  - a. **Option 1A:** Status quo – relying on existing Commerce Act 1986 and provisions under the Act to disincentivise wholesale suppliers from offering non-competitive TGPs.
  - b. **Option 1B (preferred):** Develop regulatory backstop – introduce a regulatory backstop to the Act which provides a credible threat of further regulation if wholesale suppliers offer non-competitive TGPs.

## 1. Status quo or develop a regulatory backstop

### Option 1A: Status quo

#### Sections 27, 30 and 36 of the Commerce Act 1986

98. Industry submitters on the Consultation paper commented that existing Commerce Act 1986 provisions should discourage terminal owners from posting non-competitive TGPs.
99. Section 27 of the Commerce Act 1986 prevent 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.
100. 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.
101. 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 tacitly coordinating prices without a contract, arrangement or understanding with competitors.
102. Since the Commission's recommendation in 2019 to introduce a regulatory backstop to the TGP regime, the Commerce Amendment Act 2022 updated section 36 of the Commerce Act 1986 by addressing the three main problems identified in the previous version:
  - a. It had the potential to fail to deter or penalise some forms of anti-competitive conduct.
  - b. It was costly and complex to enforce, which reduced the incentives for businesses to comply with the law.
  - c. It created some unpredictability as to its application to business conduct.
103. Section 36 of the Commerce Act 1986 makes it explicit that firms with a substantial degree of market power are prohibited from engaging in conduct that has the purpose or has or is likely to have the effect, of substantially lessening competition in the market.
104. 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 1986. In this situation, wholesale suppliers could face pecuniary penalties, damages, or exemplary damages.
105. Price regulated TGPs (or the threat of price regulated TGPs) would have the following benefits beyond the section 36 prohibition:
  - a. 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.

- b. Addresses the behaviour in a forward-looking manner by setting regulated TGPs, which would allow resellers to have access to terminals at competitive prices and reduce barriers to enter and expand in the wholesale market.

106. 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 by disincentivising wholesale suppliers from offering non-competitive TGPs. Plugging this gap would better deliver the objective which is to promote wholesale competition which flows through to a more competitive retail market for the long-term benefit of consumers.

#### Inquiry under Part 4 of the Commerce Act 1986

107. Part 4 allows the Commission to conduct an inquiry into particular goods or services if required to do so by the Minister, or on its own initiative. In conducting this inquiry, the Commission must:

- a. Consider whether the market has little or no competition and little or no likelihood of a substantial increase in competition, whether there is scope for the exercise of substantial market power, and whether the benefits of regulating materially exceed the costs.
- b. Consider whether the goods or services should be regulated and if so, how the goods or services should be regulated.
- c. Determine and apply input methodologies for the supply of the goods and services.
- d. Undertake a qualitative analysis of all material long-term efficient and distributional considerations, including material effects on allocative, productive, and dynamic efficiency, distributional and welfare consequences on suppliers and consumers, and assess the direct and indirect costs and risks of any type of regulation considered.
- e. When considering which type of regulation might be imposed, assess the benefits against the costs, and consider what would be the most cost-effective type of regulation.

108. If the recommendation to the Minister is that particular goods or services should be regulated, the recommendation must state how the goods or services must be specified, which type of regulation should apply, what input methodologies apply, and the material provisions for the regulation.

109. These requirements demonstrate that Part 4 inquiries are a significant undertaking, which require a large degree of resource and analysis. The market study has already identified issues with wholesale fuel markets, and it is unnecessary to replicate this analysis. Instead, it would be more effective to provide a credible threat and proportionate to introduce a tailored regulatory backstop for the specific circumstance.

## Subpart 1 and 2 of Part 2 of the Fuel Industry Act 2020

110. As mentioned above, the main interventions introduced by the Act to achieve a more competitive wholesale market (which should flow through to a competitive retail market) while preserving incentives to invest are the fixed wholesale contract term and TGP provisions.
111. The fixed wholesale contractual provisions aim to address the market study finding that many wholesale supply relationships include restrictive contract terms between the majors and their resellers which reduce competition and limit resellers' ability to switch supplier. Alongside the infrastructure sharing arrangements, these restrictive supply relationships have prevented rival firms from entering the market or competing more vigorously against the majors.
112. The fixed wholesale contractual provisions will enable resellers to switch suppliers or source fuel from multiple suppliers by:
  - a. Having terms expressed clearly, concisely, and in plain language including transparent pricing methods.
  - b. Allowing a distributor to terminate a fixed wholesale contract at any time after it has been in force for longer than the maximum duration.
  - c. Prohibiting provisions that require the distributor to purchase more than a maximum amount.
  - d. Prohibiting provisions that are likely to limit the ability of the reseller to compete and are not reasonably necessary to protect the commercial interest of the supplier.
113. Fixed wholesale contracts govern for a fixed period or amount of fuel, the wholesale price and other conditions for the wholesale supply of fuel. The TGP regime is a complementary intervention which enables resellers to access terminal infrastructure where they do not have an existing wholesale supply arrangement (such as a fixed wholesale contract) and enables more transparent wholesale pricing to inform bargaining.
114. Provided that competitive prices are offered through TGP, over time these measures will reduce barriers to entry and expansion for importers and distributors, increasing competition in wholesale markets. However, existing interventions (including the Act) do not prevent the charging of excessive TGPs.
115. As mentioned above charging excessive prices in competitive markets is unlikely to be sustainable, as firms would be driven out of the market by competitors that undercut the excessive prices. However, the Commission identified 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). 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.

## Option 1B: Develop regulatory backstop (preferred)

116. All industry participants that submitted on the Consultation paper did not support the development of a regulatory backstop. Many considered a backstop regulatory regime should not be required if the Act and its intent is successful and that existing competition law mitigates the risks to the success of the TGP regime.
117. We disagree as a regulatory backstop would plug a gap in the status quo which would better deliver the objective by:
- a. Better addressing incentives to coordinated action and to exercise market power at relatively isolated terminals as a tailored intervention which could be triggered by such conduct.
  - b. Addressing the behaviour in a forward-looking manner by setting regulated TGPs, which would allow resellers to have access to terminals at competitive prices and reduce barriers to enter and expand in the wholesale market.
  - c. Providing an avenue to address tacit price coordination whereby wholesale suppliers use the TGP to inform their pricing decisions and avoid competing on price in the absence of a contract, arrangement or understanding with competitors.
  - d. Introducing a relatively timely and cost-effective response compared to a section 36 investigation or Part 4 inquiry under the Commerce Act 1986.
  - e. Introducing 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.
118. Option 1B will disincentivise wholesale suppliers from offering non-competitive TGPs which would flow through to a competitive wholesale and retail fuel markets, which is in the long-term benefit of consumers.
119. An industry participant that submitted on the Consultation paper commented that there is proof in the Australian context that TGP regimes increase competition, without the need for further intervention. However, the Commission has noted that there is a lower risk of wholesales 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.
120. Another key concern raised by industry participants that submitted on the Consultation paper, is that a backstop regime should strike a balance that ensures that there are efficient investment signals so that suppliers have certainty. A regulatory backstop could disincentivise new entrants to the market or investment of current participants, which could impact storage and distribution of fuel to meet consumers' needs. This risk can be mitigated by introducing a backstop that is proportionate and no more than necessary to the risks identified and minimises impacts on wholesale suppliers' incentives to maintain sufficient storage and distribution of fuel. We consider that the harm to consumers of issues persisting in fuel markets warrants a credible threat of price control, despite the risk that such a threat may create some regulatory uncertainty.

## 2. Threshold and process for triggering a regulatory backstop

121. There are three feasible options to trigger a regulatory backstop:
- a. **Option 2A:** A recommendation to the Minister based on whether TGPs exceed a benchmark wholesale price at the terminal;
  - b. **Option 2B:** A recommendation to the Minister based on whether TGPs exceed a benchmark built up using publicly available cost data (such as Mean of Platts Singapore), other reasonable costs plus a reasonable margin; or
  - c. **Option 2C (preferred):** A recommendation to the Minister after considering whether TGPs are persistently higher than would be expected in a workably competitive market.
122. Under all three options, the Commission would be responsible for making a recommendation to the Minister. Stakeholders were supportive of this approach, which utilises the Commission's experience under existing regimes and prescribes a transparent and robust process.
123. Also consistent with other regimes, under all three options the Minister must consider the Commission's recommendation and may request further information or advice. If the Minister decides to accept the Commission's recommendation and considers that regulation is in the public interest, the Minister must make a recommendation to the Governor-General to make an Order in Council (OIC). The OIC would provide that one or more wholesale supplier is subject to regulated TGPs for a particular fuel type or fuel types at a particular terminal or terminals, for a specified time. Consistent with submitters views, the public benefit test allows the Minister to consider the wider costs and benefits of the regulation.

### **Option 2A: A recommendation to the Minister based on whether terminal gate prices exceed a benchmark wholesale price at the terminal**

124. Under option 2A, the Commission's recommendation to the Minister would be based on whether TGPs at the terminal exceed a benchmark wholesale price. A terminal, such as Mount Maunganui, could provide a reasonable benchmark.
125. Apart from the decision on what terminal constitutes a reasonable benchmark, this trigger is relatively objective and binary, which would provide a fairly quick avenue for intervention, which non-industry submitters on the on the Consultation paper generally favoured. Therefore, the main benefit of option 2A, is that the consideration of whether the trigger has been met could be done in a timely way. Timely intervention is important to minimise harmful impacts on the fuel market and regulatory certainty.
126. Some industry participants that submitted on the Consultation paper that this option would effectively impose price control from the outset as wholesale suppliers would have incentives to avoid triggering the threshold. Industry submitters also considered that the trigger would not effectively reflect the level of competition in wholesale fuel markets.
127. We agree that there is a risk that this approach is too simplistic and not proportionate as it does not allow for wider considerations that could impact wholesale prices at a

particular terminal. For example, a wholesale supplier may face specific costs at a terminal that are not reflected in the benchmark price. This could lead to a wholesale supplier exceeding the threshold despite competitive TGPs being offered.

128. Instead, a more subjective test could be more appropriate that allows the Commission to take into account the wholesale suppliers' circumstances. This could involve the consideration of whether TGP has exceeded a benchmark TGP, but not be solely based on this test.

**Option 2B: A recommendation to the Minister based on whether terminal gate prices exceed a benchmark built up using publicly available cost data, such as Mean of Platts Singapore, other reasonable costs plus a reasonable margin**

129. Under option 2B, the Commission's recommendation to the Minister would be based on whether TGPs at the terminal exceeded an estimate of costs built up from publicly available fuel cost data (such as Mean of Platts Singapore) (MOPS), other reasonable costs plus a reasonable margin.
130. MOPS is the average of Singapore fuel prices published by Platts and it would be up to the Commission to determine what other appropriate costs and reasonable margin are. Some of these would be publicly available.
131. Apart from the decision on what constitutes reasonable costs and a reasonable margin, this trigger is relatively objective and binary, which would provide a relatively quick avenue for intervention, which non-industry submitters on the Consultation paper generally favoured. Therefore, consistent with option 2A the main benefits of option 2B, is that the intervention can be triggered in a timely way to minimise harmful impacts on the fuel market.
132. Consistent with the above, some industry submitters on the Consultation paper commented that this option would effectively impose price control from the outset as wholesale suppliers avoid triggering the threshold. Industry submitters also considered that the trigger would not effectively reflect the level of competition in wholesale fuel markets.
133. Under this option and option 2C the Commission would have the ability to require information from wholesale suppliers to set the pricing principle or methodology. This would include information on wholesale supplier's costs to reflect any difference in cost associated with transporting fuel to the regulated terminal.
134. Despite this, a threshold based solely off this test is too simplistic and inflexible and does not take into account whether the excessive prices are persistent or a short-term feature of the market. We consider that a threshold could involve consideration of whether TGP exceed a cost built up, other reasonable costs plus a reasonable margin, but should not be solely based on this test.

**Option 2C (preferred): A recommendation to the Minister after considering whether terminal gate prices are persistently higher than would be expected in a workably competitive market**

135. This option has some similar features to an option proposed in the Consultation paper for a threshold based on a detailed assessment on whether the wholesale supplier



has substantial market power and taking into account the benefits and detriments of imposing the regulation.

136. Non-industry submitters favoured a quick means of intervention. We consider that a threshold based on whether TGPs are persistently higher than would be expected in a workably competitive market would provide for a timely intervention, while ensuring the threshold covers both the risks that could impact wholesale competition under the status quo (i.e., market power and coordination), as both would likely manifest in TGPs that are higher than would be expected in a workably competitive market. This test also directly links to the problem definition to minimise the risk of unintended consequences.
137. Under this option, the Commission could still consider MOPS and benchmark TGPs at other terminals, but the Commission would not be as constrained to considering one in making its recommendation. This would lead to a more proportionate recommendation.
138. Under this option the Commission would consider whether the excessive prices are persistent, as opposed to a short-term feature of the market. Wholesale suppliers do not immediately adjust prices to match shifts in costs, particularly in what is a fast-moving global market. Because of this, wholesale prices may not reflect changes in costs for in subsequent weeks. Taking a longer-term view on whether prices are excessive would lead to a more proportionate recommendation.

### 3. How price control regulation should apply: Pricing principle options

139. Under all options, and consistent with the threshold and process, the Commission should be responsible for setting the price regulation. This would utilise the Commission's experience under existing regimes.
140. It is also appropriate for the Commission to be a decision maker, as it is likely that there is an imbalance in power between the wholesale suppliers at the terminal and firms purchasing the fuel. Most stakeholders that submitted on the Consultation paper also favoured the Commission being the decision maker.
141. There are three levels of prescription that are generally used to regulate prices under existing backstop regimes:
  - a. **Pricing principle:** The regulated price must be (by the regulated firm) consistent with high level pricing principles. For example, the Telecommunications Act 2001 provides an initial pricing principle which is the benchmark against prices in comparable countries.
  - b. **Pricing methodology:** More detailed requirements set by the Commission as to how the components of the regulated price must be calculated by the regulated firm, while applying any applicable pricing principles. For example, methodologies for calculating costs, margins etc.
  - c. **Pricing decision:** The Commission sets the regulated price that the regulated entity can charge customers.

## **We no longer consider enforceable undertakings are a feasible option**

142. In the Consultation paper, we asked for submitters views on having enforceable undertakings as a feature of the regime in terms of reaching a pricing decision (or agreement). Enforceable undertakings are an agreement where one party agrees to undertake a particular action, which can be enforced by the Court.
143. One industry submitter favoured enforceable undertakings, as they considered it would:
- a. Be lower cost to apply and enforce and provide a quick means of intervention.
  - b. Allow for flexibility for difference circumstances, per wholesale supplier, rather than setting a universal methodology.
144. We no longer consider that an option that incorporates the ability for the wholesale supplier to offer an enforceable undertaking to the Commission as an alternative to a regulated price is feasible, for the following reasons:
- a. In the absence of an ability for the Commission to unilaterally set the price regulation, it may not be effective as the Commission and wholesale supplier may not be able to reach an agreement.
  - b. As the Commission would still require the ability to unilaterally set the price regulation for the option to be effective, the ability to enter enforceable undertakings could unnecessarily complicate the regulatory design.
  - c. The benefits of an enforceable undertaking approach (flexible and low cost) can be built into the other options.

## **There are three options regarding a pricing principle**

145. If an OIC is made specifying that one or more wholesale supplier for a particular fuel type or fuel types supplying at a particular terminal or terminals is subject to price regulation, for a specified time, there are three options regarding a pricing principle:
- a. **Option 3A:** Benchmark pricing principle prescribed;
  - b. **Option 3B:** MOPS plus a regulated margin principle prescribed; or
  - c. **Option 3C (preferred):** No pricing principle prescribed.
146. Options 3A and 3B are similar to the telecommunications service model which was proposed in the Consultation paper. The Telecommunications Act 2001 sets out pricing principles for regulated fuel products and a process for the Commission to make determinations as to how those pricing principles would apply.

## **Option 3A: Benchmark pricing principle prescribed**

147. Under option 3A, the Commission would be required to set regulated prices consistent with the following pricing principle:

- a. The methodology and price must be set by benchmarking against competitive TGPs observed at another terminal and reflect any costs associated with transporting fuel to the regulated terminal.
148. Consistent with option 2A above, a terminal such as Mount Maunganui could provide a reasonable benchmark.
149. This option would provide the Commission with less room to adapt the pricing methodology and any pricing decision for the wholesale supplier's specific circumstance.
150. It is also uncertain which terminal (and if any) would be an appropriate benchmark as the TGP regime only came into effect on 11 August 2021, and the monitoring regime on 11 February 2022.

**Option 3B: A benchmark built up using publicly available cost data, such as Mean of Platts Singapore plus a regulated margin and any appropriate costs principle prescribed**

151. Under option 3B, the Act would specify the following pricing principle that the Commission must follow when setting a pricing methodology:
- a. The methodology and price must be set consistent with a benchmark built up using publicly available cost data, (such as MOPS) plus a regulated margin and reflect any appropriate costs associated with the terminal subject to regulation.
152. Under this option, the Commission's role would be relatively limited to setting the methodology for the regulated margin and appropriate costs.
153. One submitter on the Consultation paper considered that it would not be possible to create a MOPS-based pricing model as each importer has different supply chain models. However, under this option and option 3C the Commission would have the ability to require information from wholesale suppliers to set the pricing methodology and to make any pricing decision.
154. This would include information on the wholesale supplier's costs to reflect any difference in cost associated with transporting fuel to the regulated terminal. This may require difficult judgements to be made about allocation of common and shared costs to particular terminals. Despite this, a MOPS-based pricing build up would still restrict the extent to which the price could be tailored to the wholesale supplier.

**Option 3C (preferred): No pricing principle prescribed**

155. Option 3C is the preferred option, which would allow the Commission to choose the most appropriate pricing principle or methodology for the one or more wholesale supplier without being constrained. This approach is consistent with the option 1 (the Part 4 Individual Price Path Model) and option 3 (the raw milk model) as proposed in the Consultation paper, as neither of these regimes have a pricing principles prescribed in the primary legislation that governs these regimes.
156. This approach would also be similar to the Retail Payment System Act 2022, which does not provide pricing principles but instead allows the Commission to set pricing principles and/or pricing method requirements for designated networks. Flexibility has

been built into this regime to enable it to adapt with the evolving retail payment system. This flexibility is traded against increased regulatory uncertainty for regulated parties.

157. The Retail Payment System Act 2022 model was not proposed as an option in the Consultation paper as it came into force in 2022, which was after the Consultation paper was released in 2020.
158. 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 Refinery to an import terminal from April 2022, and changes to policy settings. For example, in late 2021 the Government announced a biofuels mandate which will take effect from 2023. It is currently uncertain whether (and if so, how) wholesale suppliers will adjust its pricing practices as a result.

#### 4. How price control regulation should apply: Pricing decision options

159. There are two options for how the regime could allow the Commission to make a pricing decision:
  - a. **Option 4A:** (Part 4 model) The Commission sets the methodology and makes a pricing decision before it comes into force; or
  - b. **Option 4B (preferred):** (Retail payment systems model) The Commission sets the pricing principle or methodology, and wholesale suppliers may face a pecuniary penalty if it is breached.
160. The retail payment systems model is similar to the raw milk model which was proposed in the Consultation paper. We have referred to the retail payment system model in this paper as it has most recently been developed and is more widely recognised.
161. The Consultation paper also proposed that an arbitrator could be the decision maker in some circumstances. Submitters generally favoured the Commission being the decision maker for the pricing decision. We agree that the Commission would be best placed to set the price or determine any dispute regarding the application of the pricing principle or methodology.

#### **Option 4A: (Part 4 model) The Commission sets the methodology and makes a pricing decision before it comes into force**

162. Option 4A would see the Commission set both the methodology and make a pricing decision before the price must be applied by one or more wholesale supplier supplying at a terminal. This is the approach used when the Commission sets price-quality paths for regulated electricity, gas and telecommunications companies.
163. Unlike regulated electricity, gas and telecommunications markets, the methodology and pricing decision could only apply to the wholesale suppliers that are subject to the regulation, as opposed to all suppliers of a regulated service.
164. An argument could be made that it is not necessary to have a separate principle or methodology, and pricing decision as it could only apply to one wholesale supplier so may not materially differ. However, it is appropriate for the Commission to set a

pricing principle or methodology that will allow the regulated prices to move with costs fluctuations.

**Option 4B (preferred): (Retail payment systems model) The Commission sets the pricing principle or methodology, and wholesale suppliers may face a pecuniary penalty if it is breached**

165. Option 4C would see the Commission set a or pricing principle or methodology which would then be up to the regulated wholesale supplier to apply to TGPs. If a customer disputes how the pricing principle or methodology has been applied in reaching a TGP, it may inform the Commission. The Commission could also investigate the application of the pricing principle and methodology on its own accord.
166. If the Commission decides that the pricing decision or methodology has been incorrectly applied, it could apply to the Court to impose a pecuniary penalty.

**5. Compliance and enforcement tools**

167. 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 will include civil pecuniary penalties for non-compliance which would be enforceable by the Commission. Despite this, the Act could be amended to include criminal enforcement tools.
168. Consistent with other similar regimes we propose the following options for compliance and enforcement tools:
- a. **Option 5A:** Civil and criminal enforcement tools; or
  - b. **Option 5B (preferred):** Only civil enforcement tools.

**Option 5A: Civil and criminal enforcement tools**

169. Option 5A is modelled of the Commerce Act 1986 and Telecommunications Act 2001 equivalent provisions, which provide the following compliance and enforcement tools in relation to price-quality paths:
- a. The Court may, on application by the Commission, order a person to pay a pecuniary penalty that must not exceed \$500,000 in the case of an individual, or \$5,000,000 in any other case.
  - b. In addition to an order to pay a pecuniary penalty, the Court may, on application by the Commission, order a person to pay compensation to an aggrieved person.
  - c. Criminal liability for a person that knowingly and intentionally contravenes a price-quality requirement or injunction. A person that commits this offence is liable for a fine not exceeding \$200,000 in the case of an individual, or \$1,000,000 in any other case.
  - d. The court may grant an injunction or make an order if the price-quality path is, or is likely to be contravened.

170. The Legislation Design and Advisory Committee (LDAC) considers that criminal offences should only be included in legislation only 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. LDAC further outlines that the following factors, not all of which must be present, may be relevant in determining whether conduct should be criminalised:
- a. The conduct involves physical or emotional harm.
  - b. The conduct involves serious harm to the environment, threats to law and order, fraud, bribery or corruption, or substantial damage to property rights or the economy.
  - c. The conduct, if continued unchecked, would cause significant harm to individual or public interests such that public opinion would support the use of the criminal law.
  - d. The conduct is morally blameworthy, having regard to the required intent and the harm that may result.
  - e. The harm to public or private interests that would result from the conduct is foreseeable and avoidable by the offender (e.g., it involves an element of intent, premeditation, dishonesty, or recklessness in the knowledge that the harms above may eventuate).
171. Breaching a regulated wholesale price regime does not involve physical or emotional harm.
172. Despite the New Zealand public generally having a high interest in engine fuel prices, the implications of a breach of the regulated price regime would be confined to the geographic area(s) serviced by the terminal(s). Therefore, it is unlikely b – d above apply.
173. In terms of whether the conduct is foreseeable and avoidable by the offender, we consider that the pecuniary penalties within the Act already cover off these factors. They apply to persons who have attempted, aided, abetted, counselled, procured, induced, attempted to induce, been in anyway a party to or conspired to contravene any of the provisions.

**Option 5B (preferred): Only civil enforcement tools**

174. The Act already provides the following compliance and enforcement tools for the TGP, wholesale contractual terms, consumer information and information disclosure requirements:
- a. The Court may, on application of the Commission, order a person to pay to the Crown a pecuniary penalty exceed \$500,000 in the case of an individual, or \$5,000,000 in any other case.
  - b. In addition to an order to pay a pecuniary penalty, the Court may, on application by the Commission, order a person to pay compensation to an aggrieved person.
  - c. The court may grant injunctions restraining or requiring a person's conduct.

175. The Act also allows for injunctions and Court orders.
176. The Retail Payment Systems Act 2022 has similar provisions for contraventions of a network standard.
177. These compliance and enforcement tools could be extended to a breach, or proceedings relating to a potential breach of a pricing principle or methodology.

## How do the options compare to the status quo/counterfactual?

### Key for qualitative judgements:

- ++ much better than doing nothing/the status quo/counterfactual
- + better than doing nothing/ he status quo/counterfactual
- 0 about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

	Option 1A: Status quo	Option 1B: Backstop (preferred)	Option 2A: Benchmarking threshold	Option 2B: MOPS threshold	Option 2C: TGP test (preferred)	Option 3A: Benchmark principle	Option 3B: MOPS principle	Option 3C: No principle (preferred)
Promotion of competition	0	++	++	++	+	++	++	++
Proportionate	0	++	-	0	++	0	+	++
Flexible	0	+	-	0	++	-	0	++
Timely	0	+	++	++	+	++	++	+
Regulatory certainty	0	-	++	++	+	+	+	0
Overall assessment	0	5	4	6	7	4	6	7



	Option 4A: Part 4 model	Option 4B: Retail payment systems model (preferred)	Option 5A: Civil and criminal enforcement tools	Option 5B: Only civil enforcement tools (preferred)
Promotion of competition	++	++	++	++
Proportionate	+	+	+	++
Flexible	+	++	++	++
Timely	0	++	++	++
Regulatory certainty	++	+	++	++
Overall assessment	6	8	9	10

## What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

178. MBIE recommends that the following combination of options is likely to best address the problem, meet the policy objectives and deliver the highest net benefits.

### 1. Status quo or develop a regulatory backstop

#### Option 1B: Option Develop regulatory backstop

179. A regulatory backstop would plug a gap in the status quo and address the problem by providing a credible threat of further regulation which will disincentivise wholesale suppliers from offering non-competitive TGPs. This would flow through to more competitive wholesale and retail fuel markets, which is in the long-term benefit of consumers.
180. Industry participants that submitted on the Consultation paper did not support the development of a regulatory backstop and cautioned about the negative impact on incentives to invest. We favour an approach that is no more than necessary to the risks identified and minimises regulatory uncertainty which could impact wholesale supplier's incentives to maintain sufficient storage and distribution of fuel.
181. Despite this, developing a regulatory backstop to the TGP regime is proportionate to the problem since the Commission's market study identified significant shortcomings in the wholesale fuel market, which flow through to higher pump prices than would be expected in a competitive market.
182. The Commerce Act 1986 contains existing provisions that prevent certain anticompetitive conduct or allow the Commission to recommend regulating particular goods or services and the Act introduced interventions to the fuel market that are mainly aimed at increasing competition in wholesale fuel markets, which flows through to more competitive retail fuel markets.
183. However, a regulatory backstop would plug a gap in the status quo which would better deliver the objective by:
- a. Better addressing incentives to coordinated action and to exercise market power by wholesale suppliers at relatively isolated terminals as a tailored intervention could be triggered by such conduct.
  - b. Addressing the behaviour in a forward-looking manner by setting regulated TGPs, which would allow resellers to have access to terminals at competitive prices and reduce barriers to enter and expand in the wholesale market.
  - c. Providing an avenue to address tacit price coordination whereby wholesale suppliers use the TGP to inform their pricing decisions and avoid competing on price in the absence of a contract, arrangement or understanding with competitors.
  - d. Introducing a relatively timely and cost-effective response compared to a section 36 investigation and Part 4 inquiry under the Commerce Act 1986.

- e. Introducing 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.
184. Whether a backstop is flexible and allows for timely intervention, largely depends on the design of the backstop. However, compared to the status quo the intervention can be tailored to a specific wholesale supplier's circumstance and to minimise harmful impacts on the fuel market.
185. Introducing a regulatory backstop will increase regulatory uncertainty for wholesale suppliers supplying at terminals as it increases the risk that they could be partly price regulated through the TGP regime. This could impact wholesale supplier's incentives to maintain sufficient storage and distribution of fuel. However, this risk is less prominent than if it were decided to price regulate TGPs in the outset. Instead, we consider the threat of further regulation appropriately balances this risk and the benefits a backstop will provide in terms of increasing competition.
186. Developing a regulatory backstop to the Act is MBIE's preferred option.

## 2. Threshold and process for triggering a regulatory backstop

### **Option 2C: A recommendation to the Minister after considering whether terminal gate prices are persistently higher than would be expected in a workably competitive market**

187. Such a recommendation could promote competition to a lesser extent than the other options as this threshold is more subjective than the other options. This would make it more difficult for wholesale suppliers to judge whether they are likely to meet the threshold for intervention. This could make the backstop less effective in disincentivising wholesale suppliers from offering non-competitive TGPs. This uncertainty could also impact wholesale suppliers' incentives to maintain sufficient storage and distribution of fuel.
188. Requiring the Commission to consider whether prices 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). Both would likely manifest in TGPs that are higher than would be expected in a workably competitive market.
189. Option 2B would be more flexible than option 2A as, although cost information such as MOPS would be prescribed in the Act as a key consideration, the Commission could take into account other reasonable costs (instead of reliance on benchmarking). This increased flexibility also makes option 2B more proportionate compared to option 2A.
190. Option 2C allows for a more targeted assessment of this problem than option 2A and 2B which should allow for a more proportionate and flexible assessment based on the particular wholesale supplier's' circumstances.
191. Option 2C is also more proportionate than the other options as the Commission would consider whether the excessive prices are persistent, as opposed to a short-term feature of the market. Taking a longer-term view on whether prices are excessive would lead to a more proportionate recommendation.

192. Because of the increased flexibility of option 2C, it could also take longer for regulatory intervention to be imposed, compromising the timeliness.
193. A recommendation based on whether wholesale prices at the terminal are persistently higher than would be expected in a competitive market is MBIE's preferred option for a threshold and process for triggering a regulatory backstop as it most effectively balances the assessment criteria.

### 3. How price control regulation should apply: Pricing principle options

#### Option 3C: No pricing principle prescribed

194. Having no pricing principles prescribed would allow the Commission to choose the most appropriate pricing principle or methodology for one or more wholesale supplier without constraint.
195. All options regarding the specific design of a backstop (options 3 – 5) promote competition to the same extent as the decision would have been made to price regulate a wholesale supplier at one or more terminal.
196. Not prescribing a pricing principle is the most proportionate and flexible option as a pricing principle or methodology could be set specific to a wholesale supplier's circumstances. Industry submitters favoured flexible methods that could be tailored to the wholesale supplier. However, not prescribing a pricing principle also provides less certainty and could take more time for a methodology to be set. This increased uncertainty could impact wholesale supplier's incentives to maintain sufficient storage and distribution of fuel.
197. Option 3B would also be more flexible than option 3A as, although cost information such as MOPS would form part of the price, the regulated margin could be specifically tailored to a wholesale supplier (instead of reliance on benchmarking). This increased flexibility also makes option 3B more proportionate compared to option 3A.
198. Not prescribing a pricing principle is MBIE's preferred option as it most effectively balances the assessment criteria

### 4. How price control regulation should apply: Pricing decision options

#### Option 4B: (Retail payment systems model) The Commission sets the methodology, or pricing principle and wholesale suppliers may face a pecuniary penalty if it is breached

199. Option 4B would see the Commission set the pricing principle or methodology, the regulated wholesale supplier would apply at the terminal. If a wholesale customer disputes how the pricing principle or methodology has been applied in reaching a TGP, it may inform the Commission. The Commission could also investigate the application of the pricing principle or methodology on its own accord.
200. All options regarding the specific design of a backstop (options 3 – 5) promote competition to the same extent as the decision would have been made to price regulate a wholesale supplier at a terminal(s).

201. Option 4A provides the most regulatory certainty as the regulated price would be set in advance, but this would also provide wholesale suppliers the least amount of discretion in setting the regulated price. This makes option 4A less timely and flexible than the other option.
202. Options 4B is more flexible than option 4A as it does not require the regulated price to be set in advance of it coming into effect. Having a pricing principle or methodology would allow for fluctuations in the regulated price, such as international product costs.
203. Options 4B is also more timely as it allows the principle or methodology to come into force in the absence of a separate pricing decision. Non-industry submitters on the Consultation paper favoured the quickest means of intervention.
204. Option 4B is MBIE's preferred option as it most effectively balances the assessment criteria.

## **5. Compliance and enforcement tools**

### **Option 5B: Only civil enforcement tools.**

205. Option 5B would see only civil enforcement tools being made available to the Commission for non-compliance with the backstop regime.
206. All options regarding the specific design of a backstop (options 3 – 5) promote competition to the same extent as the decision would have been made to price regulate a wholesale supplier at a terminal(s).
207. Both civil and criminal enforcement tools would improve regulatory certainty, as they would provide a clear framework for non-compliance with the backstop regime. Both options also provide for the same degree of timeliness and flexibility, as the intervention would have been in place for a compliance issue to occur.
208. However, it is not necessary to introduce criminal enforcement 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. For these reasons, option 5B is more proportionate and is MBIE's preferred option as it only utilises civil enforcement tools which is consistent with existing penalties under the Act.

## What are the marginal costs and benefits of the option?

209. The table below presents costs and benefits of the preferred option as a package, compared to taking no action at all under the counterfactual.
210. In the absence of reliable quantitative information, non-monetised costs and benefits impacts have been identified by the Commission's market study and taking into account submissions received on the Consultation paper.

Affected groups	Comment	Impact	Evidence Certainty
<b>Additional costs of the preferred option compared to taking no action</b>			
Regulated groups (wholesale suppliers that supply at terminals)	One off-cost to review pricing practices to ensure TGPs being offered are competitive. Ongoing increased risk of further regulation, and compliance costs if price regulation is imposed.	Medium.	Low.
Regulators	One-off cost when the Minister requests a recommendation and to set regulated TGPs (if required). Ongoing increased monitoring costs and compliance and enforcement costs if price regulation is imposed.	Medium.	Low.
Fuel industry participants that do not supply at the terminal	Some of the increased risk could be passed to wholesale consumers in the form of higher wholesale prices.	Low.	Low.
Consumers	Some of the increased risk could be passed to end-users through higher retail prices and/or supply impacts caused by regulatory uncertainty impacting incentives to maintain sufficient storage and distribution of fuel.	Low.	Low.
<b>Total monetised costs</b>	<i>Without accurate quantifiable evidence,</i>	<i>Unknown.</i>	<i>Unknown.</i>

	<i>it is not possible to provide an estimate.</i>		
<b>Non-monetised costs</b>	<i>We anticipate a medium increase in overall costs, mainly from ongoing increased risk of further regulation and increased compliance for wholesale suppliers that supply at terminals, and one-off costs for the regulator if the Minister requests a recommendation and in setting wholesale prices (if required).</i>	<i>Medium.</i>	<i>Low.</i>
<b>Additional benefits of the preferred option compared to taking no action</b>			
Regulated groups	Clear incentive and consequences for failure to offer competitive TGPs.	Low.	Low.
Regulators	Ongoing benefit of having a fit-for-purpose tool designed to address the particular risk of wholesale suppliers offering non-competitive TGPs.	Medium.	Low.
Fuel industry participants that do not supply at the terminal	Ongoing benefit of increased transparency of competitive TGPs to inform bargaining, the ability to purchase fuel through the TGP regime at competitive prices and reduced barriers to wholesale entry and expansion.	High.	Low.
Consumers	A more competitive wholesale market flowing through to a more competitive retail market compared to the status quo.	High.	Low.
<b>Total monetised benefits</b>	<i>Without accurate quantifiable evidence, it is not possible to provide an estimate.</i>	<i>Unknown.</i>	<i>Unknown.</i>

<b>Non-monetised benefits</b>	<i>We anticipate a high level of benefits from increased wholesale competition in the fuel sector over the long term, which should flow through to a more competitive retail market compared to the status quo.</i>	<i>High.</i>	<i>Low.</i>
-------------------------------	---	--------------	-------------

## Section 3: Delivering an option

### How will the new arrangements be implemented?

211. MBIE will be the agency responsible for advising the Minister as to whether to request a recommendation from the Commission and to provide any further supporting material the Minister may need. MBIE is already responsible for providing advice to the Minister regarding engine fuel markets. No changes are necessary to implement a regulatory backstop regime at MBIE, subject to increased funding to carry out these activities.
212. The Commission is responsible for enforcement of the Act and, as outlined in the options above, we consider a backstop regime is best administered by the Commission which is consistent with other price regulation regimes. The Commission has been involved in the policy development and provided input regarding the proposed design of the backstop regime. This has been informed by the Commission’s existing responsibilities for economic regulation under existing regimes.
213. The Commission has recently constructed a new team that is dedicated to carry out the new functions and powers under the Act. This team is well placed to implement a backstop regime, subject to increased funding to carry out these activities. 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.
214. 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. Additional funding to give effect to the proposals will be sought in Budget 2023.
215. It is also proposed that the Act is extended to incorporate certain Commerce Act 1986 administrative and information requiring provisions to assist with the implementation of a proposed backstop regime.
216. Given the intense scrutiny of the fuel market in recent years, we anticipate that the Government will want to act swiftly to enact a regulatory backstop and help promote



wholesale competition. An amendment to give effect to this could come into force mid-2023.

217. A regulatory backstop within the Act would only have direct impacts on wholesale suppliers that supply at terminals (BP, Mobil, Z Energy and TOSL) who could become price regulated parties. As this is a relatively discrete group, direct communications with fuel companies by MBIE and the Commission will be sufficient to keep these parties informed of their obligations.

### **How will the new arrangements be monitored, evaluated, and reviewed?**

218. The impact of the new regime will be monitored by MBIE and the Commission as part of its existing monitoring functions. The Fuel Industry Amendment Regulations 2021 require fuel companies to disclose information to the Commission regarding the wholesale fuel market (prices, revenues, volume, and contractual information). This information will enable the Commission to monitor the wholesale fuel market, and whether the Act is promoting competition for the benefit of end-users.
219. It is also envisaged that the regulations under the Act would be reviewed on a periodic basis, the first being after it has been in effect for a suitable period (e.g., two to three years). Any such review could also identify any shortcomings in the backstop regime.
220. Stakeholders will also be able to raise concerns directly with the Commission, MBIE or Ministers.

## Annex One: Summary of proposals contained in the Consultation paper

Problem definition	Threshold and process	Design of price control
<p>If wholesale suppliers do not offer competitive TGPs it will undermine the effectiveness of the TGP regime. For example, a wholesale supplier may supply at a terminal in a relatively remote location which gives them a degree of market power, or wholesale suppliers with rights to sell specified fuel products at that terminal may coordinate TGPs.</p> <p>Existing statutory provisions under the Commerce Act 1986 are insufficient to provide disciplines on the conduct of wholesale suppliers in these situations.</p>	<p>Option 1 –Clear test: Discretion for regulation to be imposed at a terminal or equivalent facility if TGPs repeatedly exceed a measure of supply (benchmark or cost based) and the decision-maker is satisfied that regulation would be in the public interest.</p> <p>Option 2 – Detailed assessment: Whether the wholesale supplier or suppliers at the terminal or equivalent facility have ‘substantial market power’ and taking into account the benefits and detriments of imposing regulation.</p>	<p>Option 1 - Part 4 Individual Price Path Model: The regulatory regime could link to generic regulatory control provisions in Part 4 of the Commerce Act 1986.</p> <p>Option 2 - Designated telecommunications service model: The regulatory regime could set out an initial and final pricing principle for regulated fuel products, and a process for the Commission to make determinations as to how those pricing principles would apply.</p> <p>Option 3 - The raw milk model: The regulatory regime could set out a regulated pricing methodology for how the TGP must be determined. Once an OIC has been made declaring a terminal subject to regulation, regulated wholesale suppliers at that terminal would be required to apply that methodology when calculating the TGPs.</p> <p>The Commission should be the body charged with making a determination on regulated prices. However, in some cases, an arbitrator may be able to carry out this function.</p> <p>Enforceable undertaking could be explored as an instrument for regulation.</p>

## Annex Two: Summary of feedback provided on the Consultation paper

Problem definition	Threshold and process	Design of price control
<p>Price intervention should not be considered when there is proof in a very similar market [Australia] that TGP achieves the objective of increasing competition.</p> <p>Existing provisions in the Commerce Act 1986 address the problem.</p> <p>A backstop regime should strike a balance that ensures that there are efficient investment signals so that suppliers have certainty, and it avoids imposing a low margin environment which would erode the appeal of the market to any potential entrant.</p> <p>There is a risk that one or more of the major fuel companies will seek to set a TGP that is influenced by its own financial arrangements for current and forward prices.</p>	<p>A clear, transparent and robust process must be followed if backstop regulation is to be triggered.</p> <p>Analysis undertaken by the Commission should inform the decision as to whether to price regulate TGPs.</p> <p>The trigger should allow for the consideration of cost and benefits of regulation, which ensures regulation is not imposed merely because of the existence of market power</p> <p>The trigger should not be a blunt tool, otherwise it would not effectively reflect competition but would instead effectively impose price control from the outset.</p> <p>The quickest means of intervention should be progressed.</p>	<p>The Commission should be responsible for setting regulated prices.</p> <p>The lowest cost and most flexible methods of price control should be preferred, for example enforceable undertakings.</p>