APPENDIX 3.2
(referred to in paragraphs 3.23 and 8.144)

Overseas petrol markets

EUROPEAN COMMUNITY STATES

Belgium

1. Maximum petrol prices are set by a formula based on daily Platt's prices and exchange rates. Agreed wholesale and retail margins are allowed which differentiate between independent and wholesaler-owned outlets. The system is enforced through individual contracts between supplying companies and the Government. The extent to which actual pump prices are set at or below the controlled maximum varies regionally and is particularly influenced by hypermarkets.

Denmark

2. Until 1985 maximum prices were controlled by a Platt's-related formula imposed by the Monopolies Control Authority. These arrangements have been suspended but could be reimposed. Where retail promotions in the form of gifts operate there must also be a cash alternative.

France

3. Importing of crude oil and refined product is a state monopoly which is delegated to authorised companies. Authorisations to import refined products were extended from three to five years in 1987 and import licences have been more freely allocated. Limits on spot purchases have been removed. Regulations on site opening and closure have been relaxed. Until 1985 maximum pump prices were regulated by the Government and discounts were also controlled.

4. In 1983 hypermarkets started to exceed the allowed discount and legal action was taken. In 1985 the European Court of Justice ruled that the imposition of minimum pump prices was in contravention of the Treaty of Rome and these controls were then abolished. Hypermarket sales have grown substantially in recent years and now account for around 409 per cent of all sales. Price regulation was abolished in 1985 following an EC ruling that it was in contravention of the Treaty of Rome.

Federal Republic of Germany

5. No pricing controls exist, but the Federal Cartel Office monitors pricing as part of its overview of competition.

Greece

6. Petrol marketing companies are licensed by the Government and draw most of their supplies of petrol from two state-owned refineries. Wholesale prices for licensed marketing companies are set by the Government in relation to Mediterranean market prices. However, changes in prices resulting from this are usually offset by duty changes. As a result retail prices change infrequently. Maximum retail prices are set for urban areas with zonal mark-ups for rural areas. These mark-ups do not fully cover additional transport costs. Government subsidies are paid for supply to small islands.

Republic of Ireland

7. The Government requires importers to purchase 35 per cent of their petrol from the state-owned refinery. Limits are imposed on the number of retail outlets owned by wholesalers. This limit is 20 outlets or the number owned in 1972 whichever is higher. Price controls were abolished in 1986 but the Government has intervened since then to set maximum prices most recently in April 1989 when free gifts and stamps were prohibited.

Italy

8. There is a state monopoly on the import, manufacuture and distribution of oil products with licences issued to operating companies. The state-owned refinery and marketing companies supply about half of all retail petrol sales. Government price control links the Italian maximum price to the price in five other EC countries. Price changes resulting from this are often offset by changes in duty.

Netherlands

9. Price controls abolished in 1982 and scheduled prices are mostly linked to the Rotterdam spot price.

Portugal

10. Before 1986 all petrol was supplied from state-owned refineries. As part of the six- year transition following membership of the EC, import quotas have been granted to marketing companies. The state-owned distribution company at present accounts for about 65 per cent of retail outlets. Maximum prices are set by the Government for the whole country based on spot prices and prices in other EC countries. Changes in ex-refinery prices are usually offset by duty change so that retail prices remain stable.

Spain

11. A state monopoly controlled all refined products until recently. In 1986 import licences were granted to foreign operators on a quota basis and imports are expected to grow. Almost all retail outlets are supplied by the state monopoly at present but a `parallel network' of independent outlets is now planned which will sell imported petrol. Standard pump prices are set by the Government with no regional variation and no discounting. This is expected to be modified by 1991 to a maximum pricing system with discounting allowed. Offsetting duty adjustments are used to stabilise retail prices.

OTHER

United States of America

Structure of the market

12. In early 1987 the United States refining industry had 115 companies operating some 224 refineries. The refineries ranged in size from about 25 million tonnes a year capacity to about 0.02 million tonnes. The largest United States petrol refiner had about 12 per cent of national refining capacity in 1986 and the largest five (Chevron, Exxon, Shell, Amoco and Texaco) owned about 37 per cent of capacity. Only about 5 per cent of United States petrol consumption is satisfied by imports of petrol. Fourteen of the United States suppliers are regarded there as large integrated refiners, ie each with a domestic refining capacity of more than 8.8 million tonnes a year, and themselves producing more than 30 per cent of the crude oil needed for their United States refineries.

13. With some 10,000 independent distributors, petrol wholesale supply in the United States is less concentrated than is refining. In 1989 the largest share of the petrol retail market was held by Shell with about 8.1 per cent. The combined share of the largest five (Shell, Amoco, Exxon, Chevron, and Mobil) was about 36 per cent.

14. With petrol sales of about 316 million tonnes in 1988, the United States market is about 14 times larger than the United Kingdom market. There are about 160,000 petrol retail outlets in all; of these there were about 117,000 which derived 50 per cent or more of their revenue from petrol sales. The breakdown of these 160,000 outlets was as follows:

	%
Refiner-owned and operated	6
Refiner-owned, dealer-operated	33
Wholesaler-owned and operated	17
Wholesaler-owned, dealer-operated	10
Independently owned	26
Convenience stores, etc	8
	100

Wholesaler-operated stations account for about 17 per cent of the volume of petrol sales (compared with 15 per cent in the United Kingdom). This share is more than double what it was in 1972.

Price and allocation controls

15. Petrol sales and prices were regulated by the United States Department of Energy between 1971 and January 1981. The federal price regulations required refiners, wholesalers and retailers to limit their prices to those in May 1973 plus allowable increased costs. In particular, a firm was deemed to recover from all of its customers each month the maximum amount of increased costs which it recovered from any one class of purchaser in that month. This `equal application rule' (removed in November 1980) penalised suppliers etc who reduced prices to any one customer or group of customer, and so it greatly discouraged the temporary competitive allowances (city by city, or even dealer by dealer) which had been a feature of the market before the controls. The federal sales regulations required suppliers to offer petrol to firms which had bought from them during a previous base period, but the purchaser was not obliged to buy. Together with the price controls, these regulations are now thought to have benefited independent wholesalers, which were more profitable than they would otherwise have been, and discouraged retailers, especially smaller ones, from improving their efficiency.

Petroleum Marketing Practices Act

16. Apart from general anti-trust legislation, the only current federal legislation affecting petrol sales is the Petroleum Marketing Practices Act (PMPA) of 1978. The PMPA prohibits branded suppliers (ie refiners, and other wholesalers which sell under a refiner's trade mark) from terminating or failing to renew a supply contract with any wholesaler or retailer of that brand except under four circumstances:

(a) certain operational failures by the retailer (eg bad debts, lower volumes than agreed, poor site cleanliness);

(b) failure of the parties, after good faith negotiations, to agree on renewal terms;

(c) retail location has become uneconomic to supply, or is to be converted to other uses; and

(d) supplier is withdrawing from the entire market locality.

The PMPA does not allow cancellation or non-renewal for the purposes of, for example, converting a site from tenant to agent or salary-operated, but does allow the supplier quite wide discretion in determining, for example, retailer opening hours, minimum gallonages, rental or other charges. A retailer can seek civil action in the courts if, in his view, his supplier fails to abide by the terms of the PMPA.

Divorcement

17. Under legislation enacted in certain States, refiners and other wholesalers may retain ownership of petrol retail outlets, but they are prohibited from operating them directly (ie through their own employees, or contract management). The sites can be leased to independent dealers or operated by lessee dealers (equivalent to tenants in the United Kingdom). Exclusive supply arrangements are unaffected.

18. Divorcement legislation is currently in effect in five United States States and the District of Columbia (DC):

– *Maryland:* enacted 1974, but challenged in courts, and finally became effective in July 1979. No producer or refiner may operate service stations using company employees, a subsidiary company, a commission agent, or under a fee contract. Refiner-owned stations must be dealer-operated. Affected companies had one year's grace to find dealers or sell affected outlets.

– *Delaware:* enacted 1974, and prohibited manufacturers of petroleum products from opening new retail petrol outlets operated by its employees, by a subsidiary company or by commission agents.

– *District of Columbia:* enacted 1977, and prohibited producers, refiners or manufacturers of motor fuels from opening new retail service stations operated by their employees, commission agents, subsidiary companies or by contract operators after April 1977, and from continuing to operate service stations in the prohibited manner from the beginning of 1981.

– *Connecticut:* enacted 1979, and prohibited producers and refiners from operating new service stations (as in DC) after 1 July, and after 1 July 1980 can only operate service stations through dealers.

– *Virginia:* enacted 1979, and prohibited refiners from directly managing retail outlets which are within 1½ miles of dealer-operated sites. Grandfather clause, as in Delaware.

– *Nevada:* enacted 1987, and prohibited large integrated refiners from opening new employee-operated service stations after 1 July 1987, and from operating no more than 15 service stations in this manner after 1 July 1988.

– *Florida:* enacted in 1974, but invalidated by courts, and finally repealed in 1985.

Divorcement legislation has been consistently opposed by both the Federal Trade Commission and the United States Department of Energy. Relevant divorcement bills have been introduced in many other States, as well as at the federal level, but so far only those mentioned above have been enacted. Divestment as such has not been a feature of policy discussions in the United States except in so far as divorcement has led to divestment where site owners have not found suitable dealers to operate the affected sites, or have simply chosen to sell off the affected sites rather than have them operated by dealers.

19. Proponents of divorcement argue that permitting refiners to act as both suppliers to and competitors of lessee dealers is unfair and anti-competitive. Earlier arguments focused on the issue of subsidisation or predatory conduct, ie that integrated oil companies were using profits from other segments of their operations to subsidise their directly-managed retail chains, and so drive lessee dealers out of business. The argument has now shifted to that of the `price squeeze', ie that refiners set retail prices at their managed outlets and also set buying prices for lessee dealers whose margins are squeezed between the two.

20. Opponents of divorcement argue that there is no hard evidence of discriminatory practice in favour of managed outlets, and that the decline of dealer outlets is the result of normal economic and social trends. They say that if such cases could be proved they could be dealt with under existing anti-trust legislation. Removing company-operated outlets would have the effect of removing one distinct form of competition in the market-place, thus presenting fewer choices to consumers, and reducing wholesalers' incentives to invest in and experiment with new retailing ideas and techniques.

21. The State of Maryland maintains that the effects of divorcement there have been beneficial:

(a) stability in the market-placedealers have more security and therefore more incentives to invest;

(b) no wholesalers withdrew from the market as a result of it;

(c) dealer margins in Baltimore were the lowest in any major United States city; and

(d) the lowest retail prices of 63 cities in July 1984 were in a city in each of three divorcement States.

Other studies have suggested that retail prices are higher in Maryland as a result of divorcement, and that divorced outlets are less efficient than they would have been. For example, research by Messrs Barron and Umbeck (published in the Journal of Law and Economics, October 1984) concluded that at divorced petrol stations petrol prices rose relative to those of competitors' and hours of opening fell. In a research note dated January 1988, Professor Sorensen (of Florida State University) concluded that divorcement in Maryland had raised prices and lowered consumer welfare. He calculated, for example, that prices in Baltimore rose by 3 cents per gallon more than in the USA generally following divorcement.

22. Any assessment of the impact of divorcement in Maryland is complicated by the ending of national and retail price margin controls at about the same time as divorcement in Maryland became effective, thus making before-and-after comparisons particularly problematical.

Other policies

23. Open supply means permitting a dealer to buy petrol from a supplier other than his current branded supplier, ie the ending of exclusivity in supply. The case for open supply is that the dealer would be able to shop around for lower-priced supplies, and so put price pressure on his normal supplier. The dealer in turn may pass on the benefits of lower prices to consumers. Refiners with excess capacity, and independent wholesalers wishing to increase their market shares, may thus have an opportunity to expand their sales into sites currently supplied by others. On the other hand open supply may lessen the value of the brand, and the value of the dealers' exclusivity would be lost, thus reducing refiners' interests in them. It would undermine the refiners' distribution system, and increase demand uncertainties downstream. It may introduce quality control problems. In the settlement of a recent anti-trust case in the United States (Bogosian v Gulf, 1985) 13 refiners agreed to permit some form of open supply at their dealer stations for a period of five years (though the dealers would still have to install tanks and pumps to dispense the additional supplies), but while open supply has been proposed at both federal and state levels, it has not so far been enacted anywhere in the United States.

24. In the United States the Robinson-Patman Act prohibits price discrimination where its effect is substantially to lessen competition. The courts there have interpreted this widely, with the effect that almost any differences in prices to competing outlets are prohibited unless shown to be cost-related or merely to meet the competition. With particular reference to the petrol market, uniform pricing statutes have been enacted in Delaware, Maryland, DC and Rhode Island. The first three require that any temporary allowances given by a supplier be given uniformly to all outlets supplied by it in the State. In Rhode Island all price discrimination is banned. The effects of uniform pricing depend on how wide the geographic area is in which uniform discounts are required. The larger the area, the more outlets will be affected, and the less likely it is that a supplier will be willing to discount; the smaller the area, the more likely. Areas could be defined down to individual small towns, and the effects might then be quite small. The more outlets a particular wholesaler supplies in an `area' the less likely it is to discount, if the discount has to apply equally to them all. Opponents argue that uniform pricing introduces pricing rigidities, and can be difficult to enforce.

25. Legislation on minimum mark-up and below-cost sales exists in at least 28 States:

– Minimum mark-up: retailers are required to retail at a specific percentage above their supply price (statutory retail mark-ups average about 6 per cent, but range from 4 to 12 per cent). Wholesalers may be similarly required to take a fixed mark-up (commonly 2 per cent).

– Below-cost sales: retailers are prohibited from selling below their wholesale cost.

These restrictions are designed to prevent predatory pricing, and loss leading.

Canada

26. In 1986 the Canadian Restrictive Trade Practices Commission produced a wide-ranging examination of the Canadian petroleum industry, covering both upstream and downstream activities. The inquiry was triggered by a report in 1981 from the Director of Investigation and Research (a post broadly equivalent to that of the DGFT) that the oil companies had significantly overcharged the Canadian consumer over the period 1958 to 1973. The Commission rejected these findings as either not proven or irrelevant in the changed circumstances of the 1980s (when, besides structural changes, the role of the Canadian Government in regulating the upstream industry and imports has declined).

27. The main feature of interest identified in the retail market through to the 1980s was a decline in numbers of outlets by one-third over the decade, to 24,000 in 1980 (for a population of less than 25 million) and average throughput more than doubled. In the 1960s and 1970s independents took market share from the majors by offering lower pump prices. Majors retaliated by introducing second, lower-price brands. Price differentials have narrowed and there is some evidence that Canadian consumers are more sensitive to differentials than in the United Kingdom. Over the period self-service has been introduced, particularly at majors' redeveloped outlets, but still accounts for a smaller percentage of outlets than in the United Kingdom where most of the self-service outlets are owned and operated by the majors. Two provinces in the Atlantic region regulate or prohibit self-service.

28. Overall market shares have developed as follows:

(a) the individual shares of national majors have declined, but after ownership changes and the creation by acquisitions of a state-owned company Petro-canada, the four majors, Imperial (Exxon), Shell, Petro-canada and Texaco, in 1985 held nearly 70 per cent of the market;

(b) the independents' market share has increased somewhat, particularly in Western Canada; and

(c) the regional integrated companies have generally maintained their market shares.

29. The report's conclusions and recommendations (and subsequent action by the Director) cover four areas of potential interest in our inquiry:

(a) company ownership (and management of retail outlets);

(b) obligation to supply;

(c) selective price support and price transparency; and

(d) restrictive covenants.

30. There is no comprehensive survey of company ownership and management of retail outlets in the report, although it is noted that almost all the majors' self-service outlets are operated directly by them. For those individual integrated majors for which figures are given, however, the proportion of sales rose between 1970 and 1980 from less than 10 per cent to between 20 and 50 per cent. Nor do any of the report's recommendations bear on the issue. However, in recently reviewing of the acquisition of Texaco Canada by Imperial (Exxon) the Director required divestment by the merged group of retail outlets in three major regions. In all cities where Imperial's post-merger share of volume is more than 30 per cent it is to divest to that level, either by sale of properties or release of independent dealers from contractual obligations, but if the independent's share of the market is less than 20 per cent Imperial has to divest to 25 per cent. In smaller communities numbers are to be controlled so that Imperial has no more than one in three outlets. In total 614 stations are to be divested.

31. The Commission decided to deal with concerns about the possible adverse effects of vertical integration combined with market power by a behavioural rather than a structural remedy, designed to deal with potential rather than actual detriments. It recommended that suppliers with high degrees of market power should not be entitled, without sufficient reason, to refuse supply, with provisions for rapid enforcement of redress. However, if a company has insufficient capacity to supply its own outlets and fulfil contractual obligations, there will be no obligation to supply these without contractual entitlement. In his application to the Competition Tribunal for a Consent Order on the Imperial Texaco merger the Director has required supply assurances to independents, against a background of his expectation that surplus refinery capacity in Canada will be reduced over the next few years.

32. The Commission examined the widespread use of selective price support. The Canadian system is very similar to that in the United Kingdom with the variant that, when support is necessary, to avoid problems with the restrictive practices legislation many companies switch to a consignment system, ie for that period the dealer becomes their agent. The Commission concluded that margin support systems, ie those systems that related the amount of support to particular retail prices (almost all those then operated), were contrary to the public interest. In 1986 a price support scheme of this nature that was being used by Sunoco was held to be illegal under the resale price maintenance legislation and the company abandoned its use of temporary allowances.

33. During the Commission's inquiry Canadian petroleum markets were deregulated and Imperial introduced a new rack-pricing system. Sales to other wholesalers were all to be at spot prices posted daily at such terminals, and sales to retailers were all to be at a dealer price, adjustable day to day and set individually for each of 100 zones. Payment would be at the price ruling on order or delivery and there would be no support, but if the dealer price turned out to be uncompetitive because of subsequent price falls, price for the next delivery would be adjusted. There would be no discounts to either class of customer. Other companies started to follow suit. The Commission concluded that a system that involved openly stated policies that confidential discounts would not be granted off published prices was against the public interest. The `no discount' feature was not necessary to operate the new policy and in an oligopolistic situation it had the effect of a horizontal agreement.

34. We understand that most of the major companies have now introduced zonal rack-pricing systems for their branded dealers but that larger independent customers are able to negotiate discounts from the published price. Since 1985 wholesale prices available to independents have been influenced by import alternatives in Eastern Canada. We understand that zones are fairly large, with only two or three major cities having more than one zone. Price support has largely been withdrawn and if a price war breaks out the posted price is normally the same for all dealers in the zone.

Australia

35. In Australia both the wholesaling and marketing of petrol are subject to Federal regulation. Since 1980 wholesale prices have been regulated first by the Petroleum Pricing Products Authority and since 1983 by the Price Surveillance Authority.

36. In 1980 two Federal Acts were passed dealing with the marketing of petrol. The Petrol Retail Marketing Franchise Act (PRMFA) gave lessees or franchisees in company-owned sites a minimum of nine years' tenure, and contained a further provision which allowed price discrimination to be actionable even if it did not meet the `substantially lessening competition' test required under the Trade Practices legislation. The Petroleum Retail Marketing Sites Act (PRMSA) forced Shell, BP and Ampol, the main owners of self-service stations, to cut their company-run numbers by half, although independents and lessees were allowed to operate self-service without restriction. In 1982 legislation was passed in Victoria giving dealers the right to purchase up to 50 per cent of their requirements from other than their landlords and to dispense the fuel from the landlords' tanks and equipment. Similar legislation was passed in Western Australia. However, we understand they have not been used with any success by resellers.

37. There have been a number of earlier examinations of the petroleum industry in Australia by Royal Commission and the Restrictive Practices Authorities. Since 1988 the Trade Practices Commission (TPC) has been again examining market practices and regulation in the industry. The inquiry was preceded by a number of complaints: from dealers that the current pricing system was unfair or discriminatory, particularly between lessees and independents supplied by the same company; that car owners inland pay higher prices than those on the coast; and about the cycle of competition in major cities where over two or three weeks a series of small competitive price cuts would be followed by one large simultaneous rise at the main outlets, often before a weekend or public holiday. Dealers have argued strongly in favour of visible rack pricing as practised in parts of the United States or Canada.

38. The TPC produced last October an interim study of the petroleum industry. The Commission considered that the current market system and industry structure provide the framework for a highly competitive retail market in most metropolitan areas. In spite of the closure of two refineries in recent years, the supply of petrol remained in excess of requirements. The number of oil companies had declined from nine to six in the last few years. While the number of service stations had declined substantially in the last decade, the rate of decline had recently slowed, due to the growth of independents and companies' difficulty in rationalising sites under the provisions of the PRMFA because of the tenure given to lessees. The Commission suggested guidelines to control price discrimination, equal access for wholesalers to refinery supplies, abolition of the 50 per cent rule on tied supplies (which was stated to be ineffective and not supportable by the Trade Practices Act), a Code of Conduct to `stand before' the PRMFA and a surveillance, not regulatory, role for the PSA. The Commission, however, rejected the concept of simple rack pricing (under which a dealer wagon price would be posted daily at each delivery terminal for cash sales to all classes of customer for delivered full tanker loads) as likely to lessen competition and lead to higher prices.

39. The Commission subsequently produced two further discussion papers, one setting out price discrimination guidelines, and the other setting out draft rules for the voluntary Code of Practice which would be designed to remove the need to pursue disputes under the PRMFA. The latter is now in operation. Under the price discrimination guidelines suppliers would post daily prices for three classes of customers/lessees and smaller independents selling under the suppliers' brand and distributors' unbranded independents, and would negotiate prices for larger chains of unbranded or own-brand independents which might be linked to a visible price. Independent dealers and distributors would be able to negotiate up front payments or other benefits. Any differences between these various prices, if challenged, would have to be justifiable by cost savings on volume, distribution, site investment, etc. It

appears that under such a pricing system the offering of selective price support could be challenged under the Trade Practices Act as unfairly discriminatory.

40. We understand that the six major oil companies introduced rack pricing for retailers over a six-month period starting October 1988. In addition, all majors have in the last few months introduced a rack-pricing system for distributors. Selective price support, we are informed, has been withdrawn from all resellers and distributors although we were told that some companies are giving financial concessions to retailers in difficult trading conditions. There has been much complaint from this section of the industry and as a result in June the Price Surveillance Authority was asked to inquire into petroleum product prices. Its report is due at the end of the year.

41. We understand that the Commission is still developing its thinking on price discrimination and will decide on the final form of any guideline after the PSA has delivered its report. The Commission has made clear, however, that it will test any industry agreement on a single price level rack-pricing system in the Restrictive Trade Practices Court, that price discrimination in breach of the Trade Practices Act will not be condoned and that it considers that the use of selective price support schemes is questionable.