

# The Supply of Petrol

A report on the supply in the United Kingdom  
of petrol by wholesale



THE MONOPOLIES AND MERGERS COMMISSION

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A report on the supply in the United  
Kingdom of petrol by wholesale

**Presented to Parliament by the Secretary of State for  
Trade and Industry by Command of Her Majesty  
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<sup>1</sup>These members formed the group which was responsible for this report (see Appendix 1.1, paragraph 2).

## **Note by the Department of Trade and Industry**

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests. The omission is indicated by a note in the text.

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# 1 Summary

## **Introduction**

1.1. This is the third report on petrol by the Commission in the last 25 years.<sup>1</sup> The reference reflects both the importance of the industry and public concern over some of its features, in particular the extent of vertical control. We have examined the industry carefully and found that much of the concern is misplaced. In sum, this is a competitive market.

### *The market*

1.2. Petrol accounts for 3 per cent of consumer expenditure and is one of the main costs of motoring. About 30 billion litres were sold last year through some 20,000 retail outlets, ranging from remote rural sites selling less than 15,000 litres a year through a single pump to motorway sites selling more than 15 million litres a year.

1.3. There are over 70 petrol wholesalers, ranging from subsidiaries of major international companies to firms with a single road tanker supplying a handful of sites. Most of the larger wholesalers are involved in oil exploration and production and its refining into a range of products including petrol. We looked primarily at the activities of the 14 principal wholesalers, each with more than 1 per cent of the market.<sup>2</sup>

1.4. These wholesalers supply petrol to retail sites they own, which can be directly managed, licensed or tenanted, and to independent retailers, who include large retailers with chains of sites and supermarkets.

### *The issues*

1.5. We examined public interest issues under several main heads:

- the level of prices;
- profits;
- agreements between wholesalers, including exchange agreements;
- wholesaler agreements with retailers, including exclusive supply arrangements;
- wholesaler ownership of retail sites;
- wholesaler control over prices; and
- barriers to entry.

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<sup>1</sup>A note on the conduct of the inquiry, including the terms of reference, is at Appendix 1.1.

<sup>2</sup>Esso, Shell, BP, Texaco, Mobil, Conoco, Total, Petrofina, Gulf, Amoco, Murco, Burmah, Elf and Kuwait.

### *Petrol prices*

1.6. There are well-established international markets for trading in crude oil, and, to a lesser extent, in petrol. The principal petrol market for North-West Europe is the Rotterdam market.

1.7. We found that neither the general level of United Kingdom pump prices, excluding duty and VAT, nor trends in these prices appear unreasonable by comparison with Rotterdam petrol prices, European pump prices, or movements in consumer prices in the United Kingdom. We also found that, allowing for inflation and after deducting duty and VAT, the level of United Kingdom retail petrol prices was lower than at the time of the MMC's last report.

1.8. It was put to us that wholesalers tended to implement price increases more quickly than price decreases. On the contrary we found that, when Rotterdam petrol prices increased, United Kingdom wholesalers delayed price rises, to avoid losing market share, but that then pump prices went up sharply. When Rotterdam prices fell, United Kingdom prices tended to fall after a shorter delay but in small steps and with less publicity.

1.9. The principal wholesalers tend to increase prices almost simultaneously and by roughly the same amount. It was put to us that this was the result of collusion. This pattern of price changes is, however, a response to commercial pressures that are common to all and we found no evidence to suggest collusion among any wholesalers to fix pump prices.

### *Profits*

1.10. We noted that United Kingdom refiners buy the bulk of their crude oil from third parties and accepted that it was reasonable for them to use international market prices to value transfers to their refineries of the crude oil that they themselves produce. We, therefore, confined our examination to the downstream sector refining, wholesaling and retailing.

1.11. We looked at profitability of downstream operations as a whole for the 14 principal wholesalers over the six years 1983 to 1988 and found it below the average level of profitability in United Kingdom industry over the period, as reported by the Bank of England. Although there are difficulties in analysing financial results of integrated companies, and for a 'joint product' for which prices are highly volatile, we approached these problems from a number of angles and we are satisfied that our findings form a firm base for our conclusions.

1.12. Because petrol is a joint product and has to be produced with other petroleum products in the same process, it is not possible to decide how much of the total cost of production relates to petrol and how much to the other products. The appropriate valuation of individual petroleum products is, therefore, on the basis of market prices. Although petrol is less widely traded on the Rotterdam market than crude oil, the market is active enough for quoted Rotterdam prices to be used as the best available estimate of an open market price for valuing transfers of petrol within an integrated company from the refinery to its wholesale operation. This basis was, therefore, used for assessing the wholesalers' refining and wholesaling results.

1.13. We found that refining barely broke even, over the six years 1983 to 1988, and made losses in some years. In wholesaling, despite some significant cost reductions, total profits (ie on the wholesaling of all the petroleum products produced from the refinery) were positive but not unduly high. Profits were highly variable from year to year and for individual companies.

1.14. Any attempt to establish profits from wholesaling petrol alone requires decisions on allocation. We looked at the profitability of petrol wholesaling in several ways and found returns to be no more than moderate. From any viewpoint our results indicate little scope for price reductions.

### *Exchanges*

1.15. We examined the system under which wholesalers provide petrol at one location in exchange for a supply from a competitor of the same volume of petrol in a different part of the country. These arrangements, not widely known outside the industry until the Commons' Select Committee on Trade and Industry drew attention to them, at first sight involve a degree of co-operation which may appear anti-competitive.

1.16. We do not consider that the petrol exchanges encourage collusion; they do not require the exchange of commercial information or offset differences in costs of production between refineries. Exchanges enable wholesalers to supply parts of the country where transport costs might otherwise make it impossible to compete effectively. Consumers are not misled since the petrol supplied conforms to British Standard specifications and where a wholesaler uses special additives to distinguish its petrol these are added after the exchange. We did not, therefore, identify any adverse effects of the system of exchanges.

### *Solus ties*

1.17. We examined exclusive supply agreements (solus ties) between wholesalers and retailers. The principle of solus ties in selling petrol was accepted by our predecessors in 1965 and more recently by the EC Commission, and no one suggested to us that such ties should be abandoned. We saw no reason to dissent from the earlier assessment that they are not in principle against the public interest.

1.18. Arguments were put to us for both shorter and longer maximum periods for ties than the present five years. Longer ties give the wholesaler the security that may be needed if it is to underwrite major investment on the site. With shorter terms more agreements come up for renegotiation each year and provide greater scope for competition between wholesalers but at extra cost to them. We concluded that there were no compelling arguments for change in either direction.

### *Ownership and control of retail sites*

1.19. Wholesaler ownership of sites in effect applies an indefinite tie to those sites. In their 1979 report, the MMC noted that earlier concerns about the growth of wholesaler ownership had not been borne out. They concluded that the level of ownership then was not against the public interest. They saw dangers, however, if wholesaler-owned outlets were to provide a high proportion of sales in any major retail market. Since then the proportion of sites owned by wholesalers and of total volumes of petrol sold through them has risen slightly. The proportion of sales in conurbations through wholesaler-owned sites has also risen. However, the share of the five majors of total sales in the conurbations has fallen.

1.20. The proportion of total sites owned and volume supplied by the independent dealers has fallen slightly. However, the share of hypermarkets has grown substantially and new retail chains have been established.

1.21. There has also been a shift in forms of operation of wholesaler-owned sites towards greater control by the wholesaler, through greater use of licences or direct management, particularly on larger flagship sites. Wholesalers are using these sites to compete for market share with one another and with the independent retailers, including hypermarkets.

1.22. Many licensees complained to us that recent developments and the wholesalers' control over prices and methods of site operation had lessened competition at the retail level. This had prevented the licensee responding to local consumer needs or offering lower prices. It was also suggested that with margins closer to those of independent retailers, licensees and other operators of wholesaler-owned sites would be able to reduce prices.

1.23. The main reason why licensees and other operators of wholesaler-owned sites find it difficult to cut their prices is that their petrol margins are small, reflecting the higher wholesale prices they pay for petrol than independent retailers. These higher prices reflect a return on the wholesaler's considerable investment in the site. We also concluded that the wholesaler's control over the management of the site is part of the individual wholesaler's strategy to establish a distinctive and consistent brand image and used to promote rather than stifle competition. There was no reason to expect that greater freedom for site operators would lead to lower pump prices.

1.24. We found, therefore, that neither the level of wholesaler ownership nor changes in the ways in which sites are operated have adverse effects on competition in current circumstances.

### *Control of prices*

1.25. We examined the way retail prices are set. Pump prices can vary considerably from one site to another. Differences in quality of service offered (including convenience and location) account for some but not all these local differences. We found that each wholesaler has considerable influence over the pump prices at the sites it supplies, both through the wholesale price it sets and through the use of selective price support (SPS). The extent to which each can use this influence to keep prices up is limited by competition from other wholesalers and from hypermarkets and independent dealers.

1.26. We considered the argument that SPS was used as an anti-competitive weapon to discourage retailers from initiating price competition. The knowledge that SPS may be made available may in some circumstances inhibit price competition. We consider, however, that in current circumstances, SPS is used to promote competition. We find that regional price differences, which can vary significantly over time, result from variations in the level of local competition.

1.27. We examined petrol prices in the Highlands and Islands as an example of the problems of petrol prices in rural areas. We concluded that higher prices charged there were the result of higher costs of supply and less intense competition, at both wholesale and retail level, in this sparsely populated region. We found no evidence that wholesalers were making excessive profits from sales there.

### *Entry*

1.28. We examined a number of potential constraints on entry to the wholesale market. Some arise from legislative and administrative requirements, including planning and safety regulations and the strategic stock requirement, and others from factors affecting the cost and availability of retail sites. We concluded that they have not prevented entry or expansion into the market at various levels over recent years. We saw no grounds for suggesting modification to present arrangements on any of these matters. There appears, however, to be widespread misunderstanding of the way the strategic stock requirement operates. We suggest that more information should be made available on the working of the scheme to those who may be affected by it.

### *Supply of petrol*

1.29. Over the period since the last MMC report the industry has been dealing with a surplus of refining capacity and this has contributed to the competitive state of the industry. There are signs that the process of rationalisation has now reached a stage when supply and demand are more closely in balance.

## **Conclusions**

1.31. We were required to consider whether a monopoly situation, under the terms of the Act, exists in the wholesale supply of petrol and whether any of the facts found in our inquiry operate or may be expected to operate against the public interest.

### *The monopoly situation*

1.30. We found that a monopoly situation exists in favour of 69 wholesalers,<sup>1</sup> including the 14 principal wholesalers listed in the note to paragraph 1.3.

### *The state of competition*

1.32. We considered the public interest issues in the light of the findings set out above and concluded that the wholesale petrol market is competitive. In most areas of the country, consumers have available in their neighbourhood a range of petrol prices and standards of service from which to choose. Pump prices are highly visible, being clearly displayed outside outlets, enabling the motorist to be aware of relative prices and make a choice. We did not find either the general level of United Kingdom pump prices, after tax, or recent trends in their prices, unreasonable when measured against Rotterdam petrol prices, the general trend of consumer prices or European pump prices.

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<sup>1</sup>The 69 wholesalers are listed in Appendix 8.1.

1.33. The companies' profits in their downstream operations as a whole have been low and on their wholesale operations, including petrol, have been no more than moderate. The reality of competition is shown by the level and volatility of profits over the period we have studied.

1.34. Since the 1979 report there has been a reduction in concentration. The aggregate market share of the five majors has declined, with shifts in market share between them, while that of the mini-majors has increased. Two wholesalers with significant overseas oil interests have recently entered the United Kingdom market, as have a number of smaller wholesalers. Although there has been an increase in the proportion of sites owned by the wholesalers and the proportion of total sales through these outlets, the 14 principal wholesalers compete effectively on price, facilities and service, with different marketing and operating strategies. Competition for market share has led to higher site standards with improved access, layout, longer opening hours and other on-site facilities such as shops and car washes. The hypermarkets are strong and growing competitors (particularly on price), as are the independent chains of retailers. Each year a substantial number of independent solus contracts come up for renewal or replacement, and the principal wholesalers compete strongly for these. This helps ensure the strength of independent retailers. All these factors have combined to keep prices and service competitive.

1.35. We concluded that none of the facts found operates at present against the public interest.

### *The future outlook*

1.36. We are required to consider not only whether any facts found in our inquiry operate against the public interest, but whether they may be expected to do so in future. We would be concerned by significant changes in the forces which we have identified as encouraging competition; in particular by an adverse change in supply conditions for petrol; a further significant increase in wholesaler ownership of sites or in the volume of petrol sold through those sites, with a corresponding reduction in the role of the independents; a significant reduction in either the number of wholesalers or their geographic coverage, or both, particularly among the 14 principal wholesalers; and anti-competitive changes in the use of SPS, either by wholesalers failing to respond to local price competition or by their using SPS as a pricing weapon to deter price cutting in local markets by rendering such operations unprofitable.

1.37. We have considered the likelihood of such adverse developments. Members varied in the weight they attached to possible shortages of refining capacity, developments in wholesaler ownership and pricing policies and the effect that these might have on entry to the market. Having regard to the current competitive state of the industry we decided that the likelihood of such developments, taken individually or together, was not sufficient for us to conclude that the facts found may be expected to operate against the public interest.

### *Monitoring the industry*

1.38. We recognised, however, that conditions could change for the worse in a number of ways, some of which we have already outlined. Although members varied in their assessment of the likelihood of adverse developments, all agreed that the importance of the industry and the potentially serious consequences of a decline in competition were such that continued monitoring of the industry was necessary.

1.39. The Office of Fair Trading (OFT) already keeps the competitive situation in the industry under review, and following the 1979 report has also collected annual information on the extent of wholesaler ownership of sites. We consider this collection of information should be expanded to enable the OFT to review the competitive state of the industry on a regular basis. We outline the indicators we think should be monitored and sources for the information needed. Should the results of monitoring give cause for concern we envisage a further reference to the Commission.