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Economic Development, Science, and Innovation Committee  
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## Submission on the Fuel Industry Amendment Bill 2020

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### Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy advocacy organisation. We enable collaboration across the energy sector and with government, through and beyond New Zealand's transition to net zero carbon emissions in 2050.
2. This document constitutes our submission to the Economic Development, Science, and Innovation (**the Committee**) on the Fuel Industry Amendment Bill (**the Bill**), which introduces a price regulation power as a regulatory backstop to the Terminal Gate Pricing (**TGP**) regime.

### Key points and recommendations

#### *Key points*

- We do not believe a backstop price control mechanism is required and oppose the proposal. The proposal addresses a risk that we view as low, and that is already managed adequately under the status quo. The proposal also brings significant risk of undermining further investment in critical fuel supply infrastructure.
- We expect the recent fuel industry reforms (e.g., the TGP regime) will achieve their intended policy objectives by enhancing competitive incentives in the sector.
- On the basis the proposal is implemented, the proposed design of the backstop mechanism generally strikes a balance between the need for certainty and timeliness on one hand, while also retaining sufficient flexibility to consider the circumstances of a given supplier on a case-by-case basis.
- We suggest the maximum ten-year duration for price controls is onerous, given it significantly increases regulatory risk for suppliers and could undermine investment in sufficient supply and storage infrastructure. We suggest this maximum duration should be shortened.



## Submission

### ***We do not believe a backstop price control mechanism is required***

3. In establishing a backstop price control mechanism, it would need to be shown that:
  - a. there is a problem, or a risk of a problem, that is sufficiently significant;
  - b. status quo settings (e.g., section 36 of the Commerce Act) are insufficient to address this problem/risk; and
  - c. the benefits of establishing a dedicated mechanism, and of its potential use, outweigh the corresponding costs.
4. We address each of these in turn below, with our conclusion being that the backstop price control mechanism is not required.

#### *We assess the risk of anti-competitive behaviour enabled by TGP transparency as low*

5. We do not consider a backstop price control mechanism is required, provided the recent reforms to the fuel industry achieve their intended policy outcome. At this early stage there is no evidence of a significant problem, with importer margins having dropped since the fuel market study, and the new wholesale contract term and TGP provisions need time to bed in. The new information gathering regime will, over time, enable more meaningful assessment of the effectiveness of recent market changes. We also note the sector has undergone significant disruptions and changes in recent years (particularly with the Refinery's shift to an import-only terminal).
6. We assess the risk of a future problem (i.e., anti-competitive behaviour enabled by TGP transparency) as low, on the basis that TGPs will be generally competitively constrained. Any anti-competitive behaviour by a wholesaler is likely to be temporary, as it will trigger a competitive response from other participants in the same market.
7. We further note the Australian Competition and Consumer Commission (ACCC), which was also quoted in MBIE's Supplementary Analysis Report, reached a similar view on the Australian TGP regime (which now has well-evidenced positive impacts on competition in that wholesale market):<sup>1</sup>

*"While there is currently no evidence of this occurring, there is a risk that published TGPs could be used as a price signal among wholesalers [...] the number of sales*

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1 ACCC submission on the 2015 review of the Oilcode, available at: <https://www.accc.gov.au/system/files/Oilcode%20review%202015%20-%20ACCC%20submission%20-%2013%20October%202015.pdf>

*actually made at the published TGP continues to be low. Most fuel retailers value supply certainty and therefore enter into long-term supply arrangements [...] on balance, the ACCC recommends that the obligation to publish TGPs be retained as it may provide petrol retailers with increased transparency of the wholesale price of petrol."*

*Status quo application of Section 36 of the Commerce Act is sufficient to manage this risk and disincentivise this behaviour*

8. The Commerce Act 1986 provisions already discourage terminal owners from posting non-competitive TGPs. This is particularly the case now that Section 36 has been updated to explicitly prohibit the exercise of market power through conduct that has the purpose, or has/is likely to have the effect, of substantially lessening competition in the market. In our view the updates to Section 36 addressed its most relevant shortcomings, in that it was costly and complex to enforce, and was unpredictable in terms of its application to business conduct.
9. MBIE's Supplementary Analysis Report argues that a regulatory backstop power for the fuel wholesale market is preferable to the status quo because it could:
  - a. deal with issues in a more forward-looking manner by setting regulated TGPs for a given terminal; and
  - b. set a lower intervention threshold than the existing Section 36 test, allowing for more timely intervention.
10. We suggest that the intervention threshold *should* be high. Intervening to impose price controls is a significant measure, the threat of which imposes significant risk on market participants. Due time and care should be taken to establish wrongdoing and to consider the costs and benefits of intervention.
11. We believe the existing Section 36 powers provide sufficiently strong incentive against anti-competitive behaviour.

*The mechanism will undermine investment incentives*

12. The proposal introduces further significant regulatory uncertainty into a market that has already navigated significant change and disruption over the past few years. The prospect of such an intervention will inevitably soften investment, as this poses another risk to wholesalers against returns on further investment in fuel infrastructure.
13. The mechanism also brings elevated risks of misallocation of resources and unintended consequences. These are difficult costs to quantify, but critically important to consider, nonetheless.

14. Finally, the impacts of the measure go beyond the fuel sector, as it creates an elevated risk of similar mechanisms being introduced in other sectors.
15. Based on the above, we do not believe the high threshold for introducing a threat of price regulation has been met.

### ***Specific comments on the Bill***

#### *Threshold and process for triggering the regulatory backstop*

16. The threshold for intervention proposed in the Bill is appropriate – this being a recommendation by the Commission to the Minister based on an assessment of whether TGPs are persistently higher than expected in a workably competitive market. The alternatives – which would use a binary benchmark price – would be overly simplistic and in effect apply price control from the outset.
17. The flexibility this approach confers to the Commission means it is harder for wholesale suppliers to judge whether they meet, or are likely to meet, the threshold for intervention. This will in turn impact incentives to invest and maintain sufficient storage and distribution infrastructure. On balance, though, this approach is preferable to alternatives as it enables a longer-term view and consideration of the specific circumstances of a given terminal and supplier.
18. Critically, the decision to recommend price regulation must involve assessment of the benefits and costs of regulation. This means it is not sufficient to demonstrate the presence of market power – this needs to have been exercised in a way that has resulted in adverse outcomes, and the benefits of rectifying this through price regulation need to demonstrably outweigh the costs.

#### *Pricing model used under the backstop regime*

19. We support the Bill's approach of not prescribing a pricing principle ahead of time, because if price regulation is implemented this should be set with specific regard to the circumstances of the terminal supplier on a case-by-case basis. Not prescribing a pricing principle does introduce more regulatory uncertainty (because suppliers cannot be sure ahead of time specifically how price regulation will be implemented), but we support this on balance because it also means the most discretion for suppliers in meeting it and provides the most flexibility to consider case-specific factors.

#### *Potential duration of price controls*

20. The maximum duration of price controls – set at ten years – is onerous. Once price controls for a particular terminal are introduced, they can be revoked only after another inquiry by the Commission. This creates a relatively high threshold for

removal. The prospect of up to ten years of price control at a terminal creates a significant disincentive to anti-competitive behaviour – by design – but with a corresponding chilling effect on investment.

21. We recommend the Committee consider shortening the maximum duration for price controls set out in the Bill.