

# REVIEW OF JULY 2015 FUEL PRICING ARRANGEMENTS



**Internal Review by the Cook Islands Price Tribunal**  
*with assistance from the Secretariat of the Pacific Community*

August 2016



# Acknowledgements

On behalf of the Cook Islands Price Tribunal, we would like to acknowledge the many contributors to this review.

We would like to thank members of the public, both on Rarotonga and Pa Enea, for taking time to respond to our surveys and expressing areas of concern regarding fuel prices in the Cook Islands. Their contribution provided us with valuable insight of the issues facing households and families, particularly in the Pa Enea.

We would also like to thank Retailers, both on Rarotonga and Pa Enea, especially those businesses that willingly shared details of their costs and operations to help determine fair prices for consumers. We would also like to thank those Retailers that agreed to participate in the Retailer Focus Group and provided their valuable contribution.

Fundamental to the review was the involvement of key importers and wholesalers. We acknowledge their active participation in the review process ensuring that robust discussions and exchange of opinions took place.

A special acknowledgement must be made to Welfare Director Ngatuaine Maui and her team of Pa Enea Welfare Officers who ably facilitated the dissemination and collection of questionnaires which ensured direct and representative feedback from people residing in Pa Enea, a vulnerable group whose views are often overlooked.

Finally, our appreciation goes to the Secretariat of the Pacific Community, and in particular to Mr Alan Bartmanovich, Petroleum Advisor, for his unwavering support, wealth of technical expertise and personal courage, on occasion, which demonstrated professional integrity, personal commitment and inspired the work of the Cook Islands Price Tribunal.

Tatiana Burn  
President of Price Tribunal



# Executive Summary

1. The Cook Islands *Control of Prices Act 1966* establishes the Cook Islands Price Tribunal to keep under review trade practices and the prices of goods and services. In early 2015, the Price Tribunal commenced a review of the pricing arrangements on fuel products imported into the Cook Islands. On 15 July 2015, the new fuel price arrangements were introduced. These arrangements introduced a single price set for each fuel product for Rarotonga on a bi-monthly basis and streamlined operational cost allowances.
2. At part of the new pricing arrangements, a follow up review was planned to commence in February 2016 allowing for a number of months for implementation. The key objective of the review was to assess whether the initial objectives identified for the new pricing arrangements were met and to look at sustainability over the medium term.
3. The methodology for the review included collection of both qualitative and quantitative information using a range of data collection methods. Consultations and feedback was provided by importers and wholesalers, retailers, Government agencies and members of the public on Rarotonga and Pa Enua. The review also balanced the qualitative data collected against quantitative data received from Secretariat of the Pacific Community regarding international price movements as well as benchmarking these movements against local prices.
4. Based on retrospective data analysis of prices for the last 2 years, it is clear that the new arrangements offer reduced prices to consumers compared with the actual historical prices due to dual impacts arising from reductions in global prices and structural reductions introduced by the Price Tribunal in the pricing methodology.
5. The new arrangements tightened up the operating allowances which has had a direct price reduction for all fuel products but especially in LPG and therefore contributes directly to consumer protection. Regular price monitoring on Rarotonga has helped to ensure full compliance of the new pricing arrangements. While full compliance has been achieved on Rarotonga, the widespread non-compliance of price orders in the Pa Enua indicates that the new arrangements have not increased consumer protection for people on those islands.
6. There has been an increase in competitive forces in the market reflected by better individual supply contract arrangements by importers and the new arrangements have contributed to a greater level playing field. The new arrangements reduced operational allowances placing greater pressure in companies to improve operational costs, seek better supply and contract arrangements and to seek greater efficiencies within their business and between wholesalers and retailers. The new arrangements also introduced comparative benchmark pricing of global and regional prices against prices set in each Price Order through a theoretical pricing template.
7. The new pricing model was broadly accepted as being an effective model by stakeholders that reduced prices and provided increased clarity to the market. Some aspects of the model will no longer be relevant beyond the end of 2017. These relate to phasing out of minimum wholesale prices and extending the current maximum wholesale pricing methodology used for LPG to petrol and diesel pricing.

8. The theoretical template analysis adopted by the Price Tribunal shows that there are still considerable inefficiencies existing in the current supply arrangements which result in premiums of up to 30 cents per litre for petrol and diesel.
9. The review findings demonstrated that the new pricing arrangements have provided an improvement against the previous arrangements which had effectively supported a price taker model and full cost recovery for importers with very little scope for efficiency incentives. From a consumer's perspective, in addition to some pricing gains, there is now greater clarity on how prices are determined and when prices will take effect. Pricing ambiguities have been removed and bench mark comparisons have been introduced. These all represent significant improvements and greater transparency of process and outcomes relative to the previous arrangements.
10. The review identified areas of potential gains that could be achieved to improve prices and transparency further, particularly, the need to review pricing arrangements in Pa Enua and in Aitutaki. A number of administrative improvements were also identified to improve the efficiency of the functioning of the Price Tribunal.
11. The review found that there has been a significant increase in the release of information from the Price Tribunal, both in terms of frequency and quality. The importers, including the NZ suppliers that were consulted, noted that there was a high level of communication on the new arrangements with the Price Tribunal. There seemed to be more effective communication with Rarotonga retailers who demonstrated more awareness of the new pricing arrangements compared to Pa Enua retailers where they indicated limited understanding of the new pricing mechanism, and its underpinning principles.
12. The review has identified 9 short-medium term recommendations:
  - i. Maintaining current pricing arrangements with some adjustments
  - ii. Reviewing all costs of supply of fuel to all Pa Enua
  - iii. Reviewing current Aitutaki Pricing Arrangements against the new pricing arrangements
  - iv. Improving compliance processes on Rarotonga through introduction of a targeted wholesale pricing compliance process from now until November 2017
  - v. Improving efficiency of internal processing of price orders and related documentation supplied by importers
  - vi. Improving communication strategies with stakeholders
  - vii. Ensuring retailers and importers are kept informed of their legal obligations to comply with Price Orders as they are issued and the penalties for failure to comply
  - viii. Ensuring all issues relation to compliance of dangerous goods standards are referred the Labour Division of the Ministry of Internal Affairs for follow up.
  - ix. Ongoing training and collaboration with regional counterparts.
13. The review also identified 3 long term recommendations:
  - i. Review of pricing arrangements mid November 2017 due to the expiration of the Government Funded Profit Guarantee
  - ii. Review applicability of alternative pricing models to the Cook Islands, as is used in other Pacific Islands Countries, such as Fiji and American Samoa
  - iii. Consider expanding price regulation review to other critical areas negatively affecting Cook Islands consumers such as electricity and telecommunications.

# Introduction

1. The Cook Islands *Control of Prices Act 1966* establishes the Cook Islands Price Tribunal to keep under review trade practices and the prices of goods and services, to institute proceedings for offences under the Act, and to take such other steps as in its opinion may be necessary to prevent the exploitation of the public. The Price Tribunal has the authority to exercise its functions, hold enquiries or conduct investigations as it sees fit.
2. Since 2011, the Cook Islands Price Tribunal has liberalised price control of a multitude of goods and services that had been the subject of controls for over forty years on the basis of sufficient retail competition. Price regulation however has remained in force on the following products: petrol (ULP), diesel (ADO), liquefied petroleum gas (LPG), (as well as bread) given their importance to the economy, the limited number of suppliers and the potential to exploit partial monopoly powers under those circumstances.
3. In early 2015, the Cook Islands Price Tribunal commenced a review of the pricing arrangements on fuel products imported into the Cook Islands which had allowed importers to operate on various company specific price templates since 2011. At that time, the Price Tribunal was issuing maximum wholesale and retail prices for road fuel products, ADO and ULP, and LPG products on a negotiated pricing structure for each importing company. These arrangements had developed due to the introduction of a profit guarantee in December 2009 for one of the importers arising from a failed plan to nationalise the fuel industry by Government in 2008 which led to material market distortions between suppliers of the same products.
4. The early 2015 review was assisted by the Petroleum Advisor of the Economic and Energy Division of the Secretariat of the Pacific Community, involved consultations with stakeholders and identified options to simplify the pricing arrangements. The key objectives of the early 2015 review was:
  - a. To reduce prices to consumers
  - b. To protect consumers
  - c. To ensure level playing field for importers
  - d. To encourage competition
  - e. To ensure wholesale efficiencies are passed on to the public
5. By mid-June 2015, the Price Tribunal had concluded its review. The new fuel price arrangements were introduced on 15 July 2015 and standardised the issuing of price orders for Rarotonga for every two months for each commodity as opposed to a review of prices on every shipment for each company with price orders set at the company level. Specific changes introduced were:
  - a. A single price template for petrol, diesel and LPG for Rarotonga
  - b. Set pricing on two month scheduling
  - c. Comparable treatment of all wholesalers reflecting the realities of the local market
  - d. Setting a minimum wholesale price to prevent predatory pricing
  - e. Setting a maximum wholesale price to prevent exploitation of consumers
  - f. Fixing the maximum retail margin to prevent exploitation of consumers

- g. Bench mark prices against Mean of Platts Singapore (MOPS) for fuel
  - h. Bench mark prices against Saudi Contract Pricing (SCP) for LPG
6. As part of the implementation strategy, it was planned that a review of the effectiveness of the new arrangements would be carried out in November 2015 to assess the impact of the two price orders issued in July 2015 and September 2015 on market prices, consumers, importers and retailers. Due to delays in commencing the new arrangements for LPG, the review was deferred to early 2016 instead.
  7. This report outlines the objectives of the review, the methodology used, key findings and recommendations for the pricing of the fuel commodities.

## Objectives

8. A review of the new pricing arrangements introduced in July 2015 was planned to assess the effectiveness of the new arrangements in achieving the original goals. The review was planned to occur after such time that a minimum of two price orders had been issued to enable identification of any implementation issues. There were, however, delays in the full rollout of the new pricing arrangements which required a necessary deferral of the planned review until early 2016.
9. The key objectives of the review of the new arrangements were:
  - a. To assess whether the initial objectives identified for the new pricing arrangements above were met and will they be sustainable over the medium term
  - b. To assess the effectiveness of the maximum and minimum pricing
  - c. To assess the effectiveness of the new pricing arrangements in bringing local market prices closer to global movements
  - d. To assess the efficacy of the new process – how the process meets the objectives, any gaps in process, administrative efficiency for all stakeholders (Tribunal, wholesalers, retailers), frequency
  - e. To assess the effectiveness of communication strategies in regards to public awareness
  - f. To identify any necessary improvements in the arrangements and process
10. Other matters that were considered relevant to the review was the sustainability of the current arrangements in the context of the end of the 8-year subsidy arrangements paid by Government to one of the importers (TOA Petroleum) and the effectiveness of the pricing arrangements in relation Pa Enea supply and potential applicability to Aitutaki pricing arrangements.



# Methodology

## **Data collection**

11. The methodology for the review included collection of both qualitative and quantitative information using a range of data collection methods:
  - a. Individual meetings were held with each of the major importers and wholesalers (Toa, Triad, Cook Islands Gas, Origin, Pacific Energy, Matson, Taio Shipping Ltd)
  - b. Written submissions from importers (Triad, Matson, Toa and Origin)
  - c. Individual meetings were held with a range of Government agencies (Te Aponga Uira, Crown Law, Cabinet, Emergency Management Cook Islands, Dangerous Goods Division of Internal Affairs)
  - d. A focus group discussion was held with Rarotonga based retailers
  - e. A survey was developed for Rarotonga based retailers
  - f. A survey was developed for Pa Enua retailers
  - g. A survey was developed for members of the general public in the Pa Enua
  - h. General public submissions
  - i. Data analysis of price movements locally, regionally and internationally.
  
12. Individual meetings with major importers and wholesalers had a structured approach around each of the objectives of the price review. This ensured a consistent approach to gather relevant issues faced by each company and government agencies.
  
13. The retailer focus group was the first time that this data collection method was used by the Price Tribunal. Discussion was held in a group setting and was focused on a set of 10 key areas, supported by a professional group moderator to enable free exchange of information from the perspective of retailers. Wholesalers were not present at this focus group discussion. The discussion was useful for both parties and led to some of key findings of this review.
  
14. Two separate surveys were designed. The first survey was designed to collect information from retailers on both Rarotonga and Pa Enua based on 11 questions to glean understanding of price control and the new pricing arrangements, how these arrangements affected retailers and issues that they may have experienced with these arrangements. The survey also collected specific information regarding volumes of commodity sold by each retailer.
  
15. The second key survey was designed to collect information from members of the general public in Pa Enua and was shorter based on 5 key questions around the understanding of the role of the Price Tribunal and the price control process as well as qualitative data on their perception regarding fairness and effectiveness of prices on their islands. The second survey was considered necessary to ensure representativeness of members of the public living in the Pa Enua, which is often challenging but the Price Tribunal considered their feedback would provide considerable value to the outcomes of the review. The work of the Welfare Director was critical to ensuring members of the public in the Pa Enua had all opportunities to respond and feel their feedback was valued.

16. To ensure general public awareness of the review and encourage responses from members of the public, a press releases on the review process, the purpose of the review and timelines was issued on 20 January 2016. A public notice was also issued on 25 January 2016 inviting submissions from the general public. Individual letters were sent to retailers on both Rarotonga and Pa Enua also inviting submissions.
17. The review also balanced the qualitative data collected against quantitative data received from SPC regarding international price movements as well as benchmarking these movements against local prices.

## **Data Analysis**

18. The qualitative information that was collected was analysed and assessed by stakeholder categories (e.g. importers/wholesalers, general public survey and responses, retailer focus group and survey responses) using a thematic approach against the criteria set out under the objectives of the review.
19. A thematic approach was used to analyse the collected data. The key areas identified were taken from the 5 objectives of the initial review which related to price reductions, consumer protection, level playing field, competition and supply efficiencies. These were then reduced to three key areas based on strong correlation. Additionally, 5 further areas were identified as the objectives of the current review. These were maximum and minimum pricing, effectiveness of new arrangements, efficacy of new process, effectiveness of communication strategies and necessary improvements.
20. The quantitative information was then used to provide a level of objectivity relating to the key issues identified in the qualitative information that was collected in the interviews and survey responses.
21. Issues of strengths and areas of challenges were identified and formed the basis of the key findings which guided the development of the final recommendations.
22. The review was not intended to be used to review the current operating allowances and margins as the review of annual accounts was considered a normal annual activity of the Price Tribunal and would continue to be managed as business as usual outside of this process.
23. Assistance was provided by the SPC Petroleum Advisor on key aspects of the review process.

# Results and Findings

24. This section of the report assesses the extent that the objectives of the review were achieved based on the interviews with importers, wholesalers, retailers and other key stakeholders, the survey responses received by general members of the public from the Pa Enuu and other public submissions as well as the data analysis of local and global price movements.
25. The review objectives were:
- a. To assess how well the initial objectives of the new pricing arrangements were met
  - b. To assess the effectiveness of the new maximum and minimum pricing
  - c. To assess the effectiveness of the new price arrangements in bringing local market prices closer to global movements
  - d. To assess the efficacy of the administrative aspects of the pricing process
  - e. To assess the effectiveness of communication strategies in regards to public awareness
  - f. To identify any necessary improvements in the pricing arrangements and process

## **A. Initial objectives**

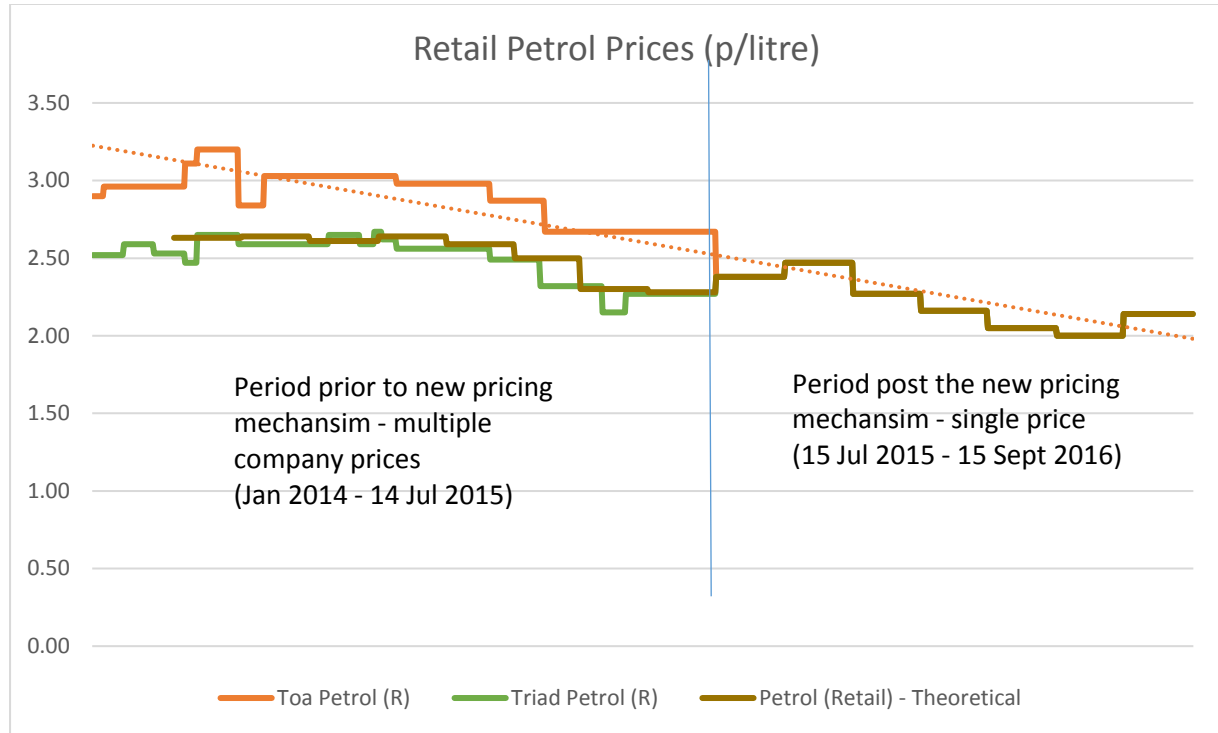
26. The initial objectives identified for the new pricing arrangements above were:
- a. Reduction in prices to consumers
  - b. Consumer protection/impact of wholesale efficiencies on the public
  - c. Level playing field for importers/competitive forces
  - d. Sustainability over the medium term

### ***Reduction in prices to consumers***

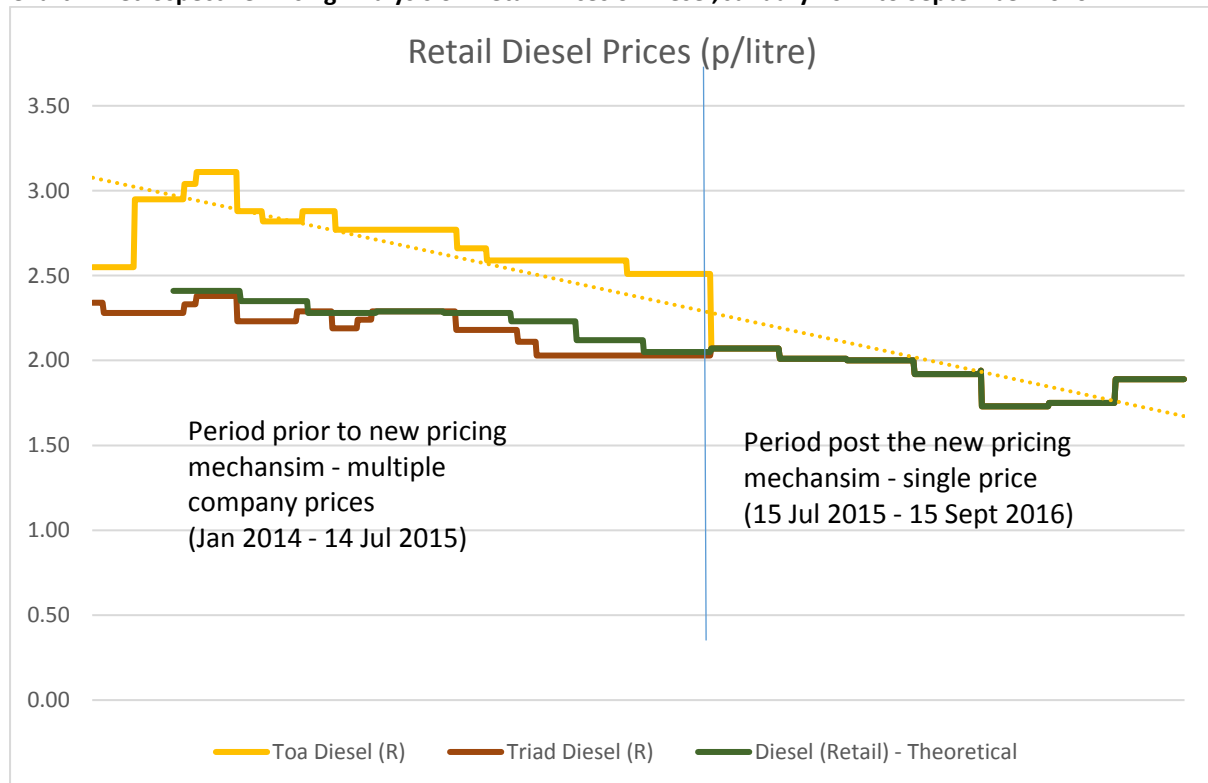
27. A comprehensive retrospective analysis of prices for the last 2 years was undertaken by the Price Tribunal. The purpose of that analysis was to see the impact of the new pricing arrangement in terms of each importer and to show impact of global prices and analyse how the new prices arrangements theoretically applied to the past period against the actual prices at the time.
28. Based on that retrospective analysis of prices for the last 2 years, it is clear that the new arrangements offer reduced prices to consumers compared with the actual historical prices due to dual impacts arising from reductions in global prices and structural reductions introduced by the Price Tribunal in the pricing methodology. New arrangements have affected one of the import companies substantially more than the other in relation to petrol and diesel prices (refer Charts 1 and 2).
29. LPG retails prices (refer Chart 3) reflect that under the new pricing arrangements, consumers would have faced substantially lower LPG prices if the new arrangements has been introduced in January 2014. The Chart demonstrates that since July 2015, there has been a significant drop in LPG prices for consumers. This is due to three factors: introduction of the new pricing arrangements, significant adjustments in profit margins for wholesalers and retailers, and reduced global prices in the period.

30. The analysis of the pricing trend also shows better alignment of local prices with global price movements. In addition, the theoretical template, designed as part of the new pricing arrangements, also confirms that the local prices better reflect global price movements, particularly for LPG.

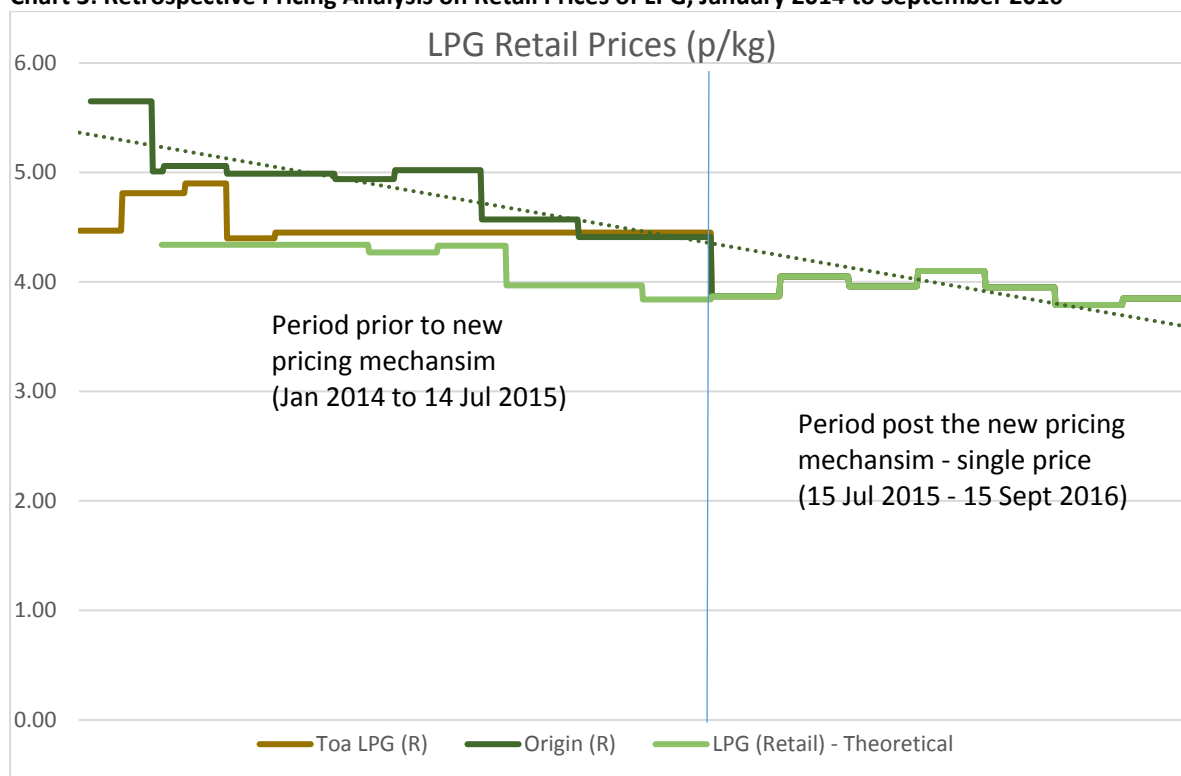
**Chart 1: Retrospective Pricing Analysis on Retail Prices of Petrol, January 2014 to September 2016**



**Chart 2: Retrospective Pricing Analysis on Retail Prices of Diesel, January 2014 to September 2016**



**Chart 3: Retrospective Pricing Analysis on Retail Prices of LPG, January 2014 to September 2016**



31. Despite this evidence supporting real reductions to consumers, survey responses from Pa Enea general public confirmed that they had not seen any price reductions since the introduction of the new arrangements and that they believed the prices charged in the Pa Enea were not fair, were too expensive and unaffordable given the high costs that they face. One respondent noted that they had no choice but to pay the prices charged. Many noted the high freight costs that added to the costs in general.

32. Further, survey responses from Pa Enea retailers confirmed that, while they were aware of the purpose of price control and their obligations, they priced above the price orders as they felt the prices set did not cover their actual cost of business. Some retailers also felt too much emphasis was placed on consumer interests over retailer interests in the Pa Enea. A number of retailers also claimed that they had never received the most recent price order that had been issued at the time.

33. There were a number of observations that Government ought to look into regulating shipping services to Pa Enea, as costs of shipping are too high. A local shipping company expressed concern with high prices and low income capacity and often dealt with unregistered businesses in the Pa Enea and often is placed in the situation of being a default creditor to allow those business to continue to import products.

***Consumer Protection/Impact of wholesale efficiencies on the public***

34. For the purpose of this report, consumer protection has been defined primarily as ensuring consumers are charged the lowest price by ensuring wholesale efficiencies are passed on to the public while still providing a fair profit to businesses. The new arrangements tightened up the

operating allowances which has had a direct price reduction for all fuel products but especially in LPG.

35. More regular price monitoring on Rarotonga has helped to ensure full compliance of the new pricing arrangements providing systematic consumer protection so consumers do not have to pay more than the maximum prices charged.
36. While full compliance has been achieved on Rarotonga and provides the public a level of assurance for consumer protection, the widespread non-compliance of price orders in the Pa Enea indicates that the new arrangements have not increased consumer protection for people on those islands. As noted above, general survey respondents noted that they had no choice but to pay the high costs charged in the Pa Enea.
37. One Pa Enea retailer felt that the pricing arrangements favoured the consumer far more than the retailer and there needed to be greater consideration given to the real costs of business in the Pa Enea.
38. In discussion with retailers, one retailer believed that issuing of price orders once every two months by product, as opposed to company-specific, has reduced confusion faced by consumers on why there were different prices for the same products. The changes have helped give the consumer increased clarity of fuel prices, thereby adding to consumer protection.
39. A common theme expressed by Pa Enea respondents and those dealing with Pa Enea supply was that greater consumer protection was needed in the Pa Enea who continue to face high costs largely driven by high freight costs. A common suggestion made was to consider a government subsidy on Pa Enea freight. An example suggested by a local shipping company was to have one price for fuel across the Cook Islands based on Rarotonga's price and for Government to fully subsidise the shipping component and all other delivery charges to the Pa Enea. Another suggestion was for Government to directly supply fuel in the Pa Enea and eliminate local business competition for example through Island Councils as monopoly suppliers given the small scale operations in the Pa Enea.
40. A critical aspect of the new price arrangements was adopting the lowest landed cost of LPG on Rarotonga for both the maximum and minimum prices due to the material differences in costs between the 2 LPG importers to ensure consumer protection in not having to pay an unreasonably high cost for LPG relative to the lowest available price. This aspect of the new price arrangements was legally challenged in Court. The Court declined to issue an interim injunction preventing the implementation of the Tribunal's new pricing template for LPG.
41. The court case and subsequent representations from the company that challenged the Price Tribunal's decision-making powers has indicated that they remain concerned that the Price Tribunal does not take into account their specific arrangements, and so they believe that the arrangements are unfair for their company. In terms of the new price arrangements, this has been the most significant issue that the Price Tribunal has had to manage in implementing the new arrangements.
42. There remains an issue in the new pricing arrangements relating to the maximum and minimum price setting of petrol and diesel and whether greater price reductions should be achieved for

consumers. Under the new arrangements, the maximum price for petrol and diesel is set based on the higher of the two weighted average costs of the two import companies, not the lowest as is done for LPG. This feature is deliberate recognising that the company with the lower price is also propped up by a Government funded profit guarantee which is set to expire in December 2017. It is very likely that maximum and minimum pricing will cease to be a feature of the pricing arrangements at this time and that, similar to LPG, the lowest weighted average cost of fuel landed in Rarotonga will be used to set the maximum prices for petrol and diesel. This will ensure consumers are being charged the lowest price.

43. The principle of adopting the lowest landed costs have been successfully used in other Pacific jurisdictions, including Fiji. The Price Tribunal considers that there is value in assessing the applicability of these alternative approaches to the Cook Islands market, taking into consideration necessary adjustments for the size of the Cook Islands market.
44. In reviewing landed costs of fuel products on Rarotonga, it became clear in discussion with an external supplier to one of the importers that while their cost price for one product had been experiencing reductions in line with global prices to the local importer, cost reductions were not being reflected in invoices issued to the local company. This is an area of concern indicating potential collusion between an importer and external supplier and will need to be monitored. This indicates importance of global price benchmarking to ensure that consumers are being offered fair and reasonable prices.

#### ***Level playing field/Competitive forces***

45. Overall, there has been an increase in competitive forces in the market reflected by better individual supply contract arrangements by importers, and better prices, and the new arrangements have also contributed to a greater level playing field than previously. The new arrangements reduced operational allowances placing greater pressure in companies to improve operational costs, seek better supply and contract arrangements and to seek greater efficiencies within their business and between wholesalers and retailers. The new arrangements also introduced comparative benchmark pricing of global and regional prices against prices set in each Price Order through a theoretical pricing template.
46. The theoretical pricing process determines the comparative benchmark prices and involves:
  - a. Analysing Mean of Platt's Singapore pricing for MOGAS, GASOIL and Freight World scale and Saudi Aramco LPG prices for Propane and Butane. These prices are supplied independently to the Price Tribunal by the Secretariat of the Pacific Community (SPC) on a monthly basis.
  - b. The Price Tribunal records average weekly fluctuations in exchange rates between NZD and USD, FJD and USD, and FJD and NZD over the 2 month period that the Price Order relates to.
  - c. The Price Tribunal inserts relevant global pricing and exchange rate data into the theoretical template which was developed with the assistance of SPC.
  - d. The theoretical pricing template is based on the best possible theoretical supply arrangements to the Cook Islands from Singapore and Fiji. This supply model would provide the best case price scenario for the Cook Islands for petrol, diesel and LPG as it reflects the most efficient pricing for product and freight of those products. The

theoretical pricing template reflects all allowances approved by the Price Tribunal for importers to supply these products locally.

- e. The purpose of the theoretical template is to provide the Price Tribunal an independent benchmark on what local prices should be, providing some assurance of the fairness of local prices to consumers and importers.
  - f. The theoretical prices need to be understood, however, in the context of Rarotonga being a low volume market and impacts of actual contractual arrangements between importers with their suppliers.
47. Currently the theoretical template is used as a comparative tool only to show actual prices and best possible prices with the purpose of quantifying the scope of possible improvement in prices. The Price Tribunal is considering looking further into how the template could be better utilised as is done in other Pacific Islands Countries that use similar templates in setting actual pricing. The Price Tribunal would like to undertake this work before the end of 2017.
48. Retailers and consumers generally agreed that the new arrangements had provided a more level playing field for both importers and offered less confusion for consumers with a single market price for a defined period of time.
49. Interestingly, however, all importers complained about not being provided with a level playing field for various aspects of their business with claims of disadvantage relating to price, trading licence arrangements, dangerous goods compliance, differences in the quality of product, and inflexibility in supply contracts.
50. The issue of the Government funded profit guarantee to one of the companies was raised in the review as disadvantaging their competitors. While this is a real disadvantage, many of the companies that were interviewed had not been aware that the introduction of the minimum pricing was to mitigate potential predatory pricing by the company that had access to the Government funded profit guarantee.
51. One company considered that they had brought competition back because they started buying in bulk prior to the new pricing arrangements which forced its competitor to look for better supply deals.
52. Several companies raised the issue of non-compliance by the competitors with dangerous goods standards resulted in an environment where was no level playing field. Compliance with dangerous goods standards was also raised by a number of Pa Enea respondents. Suggestions were made by Pa Enea respondents that LPG bottles should be checked for compliance and that risk management training should be offered. There were also some concerns from the Pa Enea regarding the conditions of petrol pumps in the outer islands and some respondents noted potential contamination of fuel affecting quality.
53. One LPG retailer noted that with the introduction of the new pricing arrangements, that they had lost a significant level of market share due to competitive forces in the LPG market based both on price and service differentiation. Such a loss in sales places increased pressure on the company in this situation to take urgent steps to ensure their competitiveness in the market place.



54. There appears to be a general misunderstanding of the Price Tribunal role and competition. A number of the observations made in the interviews suggested that the respondents believed that the role of the Price Tribunal is to prevent monopolies. This issue was raised and discussed to some extent by the Chief Justice during the hearing of the interim injunction of the price order where it was noted that the overarching principle of the price tribunal, despite the trade practices section relating to competition, was ultimately about consumer protection not prevention of monopolies.
55. An external NZ supplier stated that they ensure that they look for the best competitive price for their Cook Islands importer and that they trust their suppliers and shop around for the best price. While positive statements, the Price Tribunal has not received evidence to substantiate these claims. In order to substantiate those claims better, the Price Tribunal has been able to use the theoretical price template to assess the extent that those prices reflect global realities. Based on that analysis, the NZ price remains higher than the best alternative price to the Cook Islands.
56. Retailers in Pa Enua however are to some extent disadvantaged by higher prices, lower volumes and high transportation costs and therefore could not see any improvements contributing to creating a level playing field. Pa Enua retailers have faced gradual rises in other costs including shipping, barge towage and other onshore distribution costs combined with lower volumes. Issues of contamination of fuel were also highlighted by retailers and members of the public in their survey responses.
57. Retailers on Rarotonga noted an issue of stock management and being stuck with a higher cost product on a falling price market and felt disadvantaged in not being able to sell at the old price until all old stock cleared. These sentiments are highlighted under falling prices, however, as prices have increased, no complaints were made and changes to prices were made immediately. All retailers noted that they were reliant on the distributors to change the price on the pumps.

#### ***Sustainability of the new pricing arrangements***

58. The new pricing model was broadly accepted as being an effective model by stakeholders that reduced prices and provided increased clarity to the market. Some aspects of the model will no longer be relevant beyond the end of 2017.
59. It is anticipated that the need for minimum wholesale pricing will no longer be necessary once the Government funded profit guarantee to one of the fuel importers expires at the end of 2017. It would be sufficient to only have maximum wholesale prices.
60. The other aspect that is expected to change is that the pricing methodology used for petrol and diesel, which currently adopts the highest weighted average landed costs between the importing companies, will transition to the LPG methodology, which uses the lowest weighted average landed costs between the importing companies as the best price set by the Price Tribunal.
61. These potential changes would need further consideration and would require another review which can take place prior to November 2017 when the Toa profit guarantee arrangements are expected to expire. Any changes arising from this review is likely to take effect in the January 2018 price order.

62. The Price Tribunal notes that the current pricing arrangements are still based on reflecting the full costs of the products, shipping, operations and profit margins. It remains effectively a cost recovery model that suits the importers but does not necessarily result in the best prices for consumers as confirmed by the theoretical template adopted by the Price Tribunal.
63. The theoretical template is currently used as a theoretical tool only, demonstrating the best price that could be charged in the Cook Islands. The analysis has shown that there continues to be significant price premiums charged by importers which the Price Tribunal has only observed and analysed so far. The premiums for diesel and petrol are in the range of 30 cents per litre higher than what could be charged under an efficient national supply arrangement while LPG is in the range of 10 cents per kg.
64. The Price Tribunal has observed that these significant premiums result largely from the current market structure, however, there are aspects within the template that have not been tested robustly in relation to efficiency pressures on importers. The Price Tribunal has the power to review the existing premiums and place greater pressure on the importing companies for further efficiencies in these premiums and costs, as is done in other Pacific Islands countries.
65. The Price Tribunal understands that in some Pacific Island countries that the pricing is largely done on theoretical pricing templates and premiums agreed with importers, for example in Fiji and American Samoa. The Price Tribunal considers that the only way within its control to achieve further efficiencies is by reviewing the applicability of these pricing models in the Cook Islands context.
66. Any possible further changes to the price methodology could meet significant resistance from importers. However Price Tribunal believes the only way to achieve price improvements over longer term is to continuously review the arrangements.
67. Throughout the review, it was raised by a number of respondents that the Pa Enea supply arrangements were considerably disadvantaged by low volumes and highly individualised and disparate supply arrangements. A number raised the issue of cost of shipping, including one of the main shipping companies and its impact on prices in Pa Enea. Suggestions were made to move to a more economical way of shipping fuel to outer islands instead of sending small containers (200Ltre drums back and forth).
68. In the absence of Government intervention regarding shipping in the Pa Enea and supply rationalisation, it is unlikely that any substantial price improvements can be achieved in the short to medium term in the Pa Enea through the Price Tribunal activities.
69. The Price Tribunal also considered the applicability of the new pricing arrangements to Aitutaki as the pricing arrangements in Aitutaki were not changed. The pricing model used in Aitutaki remains to be the previous pricing model that allows different prices for each individual company for the same products. It therefore does not impose any efficiency incentives on the importers and just reflects cost recovery for them. Consumers are therefore disadvantaged by these arrangements. The Price Tribunal notes that a specific review must be undertaken to address these matters and consider the applicability of the Rarotonga new pricing arrangements to Aitutaki.

## **B. Impact of Maximum and Minimum pricing**

70. Under the new price arrangements, the Price Tribunal for first time introduced minimum wholesale pricing in addition to maximum wholesale pricing. The primary purpose was to ensure that the company that is operating under a Government funded profit guarantee is not tempted to charge prices below minimum wholesale prices, taking a loss, and claiming the losses back through the guarantee payments.
71. The Price Tribunal notes that even under the current arrangements, the only price that is readily available for verification is the retail price, however the Price Order sets the wholesale prices but there is no current mechanism in place to verify the compliance on wholesale prices. The only current avenue is on a complaints basis to the Price Tribunal at which stage the Price Tribunal can then exercise its legal powers to investigate. A more robust and systematic approach needs to be developed for ensuring compliance to the Price Orders specifically on wholesale prices. The Price Tribunal notes that this issue has arisen because of the new minimum wholesale pricing, and therefore, the approach to wholesale compliance is likely to be a temporary requirement until end of 2017 when there will no longer be a need for a minimum wholesale price.
72. When the new pricing arrangements were introduced, the Price Tribunal changed its retail pricing in the Price Order from setting maximum retail prices to setting instead maximum retail margins. One importer and one retailer suggested that the Price Order should reinstate the previous arrangements, to setting maximum retail prices as opposed to the maximum retail margins in the price orders sighting that setting the margin limits competitive forces between retailers and inflexibility with their relationship with their wholesaler. Price Tribunal had considered those suggestions at that time and felt that they had merit and returned to original system of setting maximum retail prices in the May 2016 Price Order 03/2016.
73. The feedback from Pa Enea showed that there was largely no positive impact on prices to consumers in the outer islands arising from the new arrangements, as Pa Enea retailers have not generally complied with the Price Orders, confirming that they are generally pricing based on their own cost recovery structures and personal judgments.
74. Another observation made by retailers on Rarotonga was that prices setting was a matter for distributors rather than retailers themselves. Their impression was that the retailer has no influence on the process and that they simply accept what the distributor sets the prices at, including the determination of the time and date of when the prices will change at the pump. Most retailers confirmed that they are pricing at the maximum as determined by the distributor. All understood what the maximum retail price is and that they cannot price above it.
75. In the focus group, retailers expressed that they did not really understand the principle of why minimum wholesale pricing was introduced and how it affects them. They also stated that their prices are usually set at the maximum prices. This purpose was explained to them.

### **C. Local Price Relativity to Global Movements**

76. Based on the retrospective analysis reflected in Charts 1 to 3, we observe that there is a clear impact of global price reductions in the local market compounded by structural changes made by the Price Tribunal in the new pricing template making the overall impact of price reductions more pronounced.
77. The theoretical template analysis adopted by the Price Tribunal shows that there are still considerable inefficiencies existing in the current supply arrangements which result in premiums of up to 30 cents per litre for petrol and diesel. In the course of the review, the Price Tribunal offered to share the information from the theoretical pricing template with all importers to demonstrate how far apart the actual prices that they were being charged against best possible prices that could be achieved.
78. Importers were open to receiving the theoretical template but wanted to know how it would be used by the Price Tribunal. Upon sharing, concerns were expressed by one of the importers that the Price Tribunal would consider setting prices based on the theoretical price template and considered that approach would be a considerable threat to their current arrangements and would be unfair.

### **D. Efficacy of New Pricing Process**

79. Overall, the new pricing arrangements have provided an improvement against the previous arrangements which had effectively supported a price taker model and full cost recovery for importers with very little scope for efficiency incentives. From a consumer's perspective, in addition to some pricing gains, there is now greater clarity on how prices are determined and when prices will take effect. Pricing ambiguities have been removed and bench mark comparisons have been introduced. These all represent significant improvements and greater transparency of process and outcomes relative to the previous arrangements.
80. There are however three areas of potential gain that can be achieved to improve prices and transparency further. These are review of pricing arrangements in Pa Enea, in Aitutaki and within current pricing model itself. These are areas that the Price Tribunal see where further efficiencies can be potentially gained and is likely to be focus of the Price Tribunal over the medium term.
81. Under the new pricing process, there is an expectation that importers continue to provide invoices and all supporting documentation to the Price Tribunal as each shipment received. Supporting documentation includes the material data safety sheet, customs clearance form and exchange rates where relevant. In addition, independent confirmation of discharge dates from the Ports Authority is collected by the Price Tribunal Secretariat as the relevant pricing period is based on shipments discharged in Port within that period, as opposed to date of purchase.
82. In review of this process, a number of issues were experienced in the efficiency of processing this information largely due to delays in receiving the invoices and supporting documentation. The submission of this information by importers has not occurred when shipments are received resulting in considerable administrative follow up by the Price Tribunal at the end of the 2 month period that the new price order applies as opposed to during that period. Delays in receiving

information, has placed increased time pressure on processing the new prices and the necessary in-depth analysis needed to issue the price order.

83. Under the new process, it was envisaged that all documentation by the importers would be received as shipments arrived with all information collated by the first of the month for the new price order giving the Price Tribunal 15 days for analysis of the information received, benchmarking against the theoretical prices and finalising the new prices. During the review period, importer and retailers requested to provide them with prior notification of the new prices in order to make stock decisions. This was considered favourably by the Price Tribunal and the Price Tribunal endeavoured to meet this request with the March 2016 price order issued with 3 working day's notice and is now setting a target of one week's notice for price orders that have been issued after March 2016.
84. The consequence of providing one week's notice to importers and retailers coupled with the delays experienced in receiving the invoices and supporting documentation for the period in which the new price order applies, is that the Price Tribunal is operating under undue time constraint over that 15 day period and therefore unable to respond to other relevant issues that arise in that time. Tightening up of the process in relation to submission of information and returning to 3 day notice must be considered in order for the quality of the analysis and decisions taken is not undermined. Adherence to this process is a dual responsibility by both the Price Tribunal secretariat and the importers.
85. Another administrative aspect that was considered critical to the effectiveness of the new pricing process was to ensure that compliance against the orders was being achieved and checked on a regular basis. With the introduction of the first price order under the new arrangements in July 2015, it required the Price Tribunal to ensure daily monitoring of the new prices were in place. As the new arrangements became more familiar, there has been a general improvement in compliance. The days following the issue of new prices has shown that when prices fall, compliance is generally not immediate and has taken up to 10 working days in some cases to achieve. However, when prices rise, compliance has been immediate.
86. The Price Tribunal noted that there was a perception in the Pa Enea that price orders were not being issued for those islands which resulted in them being non-compliant. This is despite new processes that require the Price Tribunal Secretariat distributing price orders through the newspaper, directly to importers and retailers as well as Internal Affairs officers on each of the Pa Enea. This perception needs to be managed. Some Pa Enea retailers stated they were not compliant knowingly because their actual costs were higher than the maximum prices set. There were mixed responses from some Pa Enea retailers on their awareness of obligations under the Act.
87. Some retailers expressed that they do not control price changes at the pump and therefore did not feel responsible for being compliant with the price orders. The Price Tribunal consulted on a number of occasions with Crown Law regarding retailer obligations under the Act and subsequently issued advisory letters to retailers confirming that they are responsible to comply with Price Orders under the Act and non-compliance constitutes an offence under the Act. These letters helped to ensure compliance.

88. The most challenging aspect relating to compliance has been with LPG prices. With the introduction of the first price order under the new arrangements in July 2015, the new process was legally challenged by one of the importers. While that challenge was subsequently discontinued, there was a further challenge in achieving compliance on almost every price order especially when LPG price reductions have taken place. Various tactics have been taken by importers to challenge the new prices set therefore resulting in delays in compliance. However, it is noted that when the LPG prices have increased, there have been no issues with compliance.
89. Despite some of those difficulties, there is full compliance achieved on Rarotonga and regular monitoring has also been ensured. There are challenges in relation to regular monitoring in Aitutaki and also with both compliance and monitoring efforts in the Pa Enua.
90. On the issue of frequency of Price Orders, one importer suggested to return to the previous pricing system which required the issue of a new Price Order per shipment per company citing difficulties with operational processes under infrequent price orders, effective stock management and the uncertainty of pricing set by the Price Tribunal. In addition, they noted that having a lagged impact of 2 months pricing, instead of as shipments are received within the period, has the effect of preventing that company from selling at lower prices that they may be importing in real time indicating that this would result in consumer losses. However, from a systems point of view, the consumer is equally likely to benefit when the prices rise and the consumer is protected from that rise for the two month period.
91. The Price Tribunal considered this suggestion and concluded that the previous system did not allow the Price Tribunal to undertake any meaningful work relating to analysis and policy setting due to a high workload of processing each individual shipment for each company. As an example, in 2014 the Price Tribunal reviewed 75 invoices and shipments and issued 53 individual price orders for petrol, diesel and LPG. That work crowded out the more important tasks that the Tribunal needs to be undertaking in relation to effectiveness of prices, relegating the Price Tribunal to an administratively focused clerical office. Under the new arrangements, the Price Tribunal will still review 100% of shipments, however only 6 price orders will be issued. These price orders are supported by substantial analysis through actual and theoretical price analysis, improved communications to Government and the general public and a greater focus on compliance with Price Orders. This change has already proven that it allows the Price Tribunal to add value to the effectiveness of pricing arrangements and pursue policy improvements.
92. In the review, there were some requests made by importers to review the margins set in the new pricing template with the intention of increasing them further. This is due to some of the retailer margins being reduced at the time the new pricing template came in to effect. The Price Tribunal originally reviewed the margins when setting the new pricing mechanism. In setting up a single margin, some retailers were advantaged and some disadvantaged. There is currently no intention to return to individual margins for individual companies. The Price Tribunal will however continue to monitor the relevancy of margins annually on receipt of all companies audited financial accounts.
93. One area of that needs more attention is identifying effective mechanism to monitor compliance with the wholesale prices by importers to retailers. Currently, the only way the Price Tribunal is made aware of non-compliance is through complaints submitted to the Price Tribunal which are

then investigated. The Price Tribunal considers that the approach to wholesale price compliance needs to be more proactive rather than reactive.

94. In support of the new pricing arrangements, and in line with improving communication strategies, the Price Tribunal introduced regular ministerial briefing to accompany every price order as well as regular press releases to the media to inform the public of price changes and any other issues relating to fuel supply.
95. The new ministerial briefing provides a regular method of communication between the Price Tribunal and Minister which previously occurred on an ad-hoc basis. The brief provides the Minister with full information on local price movements, global price comparisons and other issues of importance for that period.

## **E. Effectiveness of Communication**

96. As part of the new arrangements, the Price Tribunal considered communication with stakeholders and the public an important aspect for the successful roll out of the arrangements. Overall, there has been a significant increase in the release of information from the Price Tribunal, both in terms of frequency and quality. The importers, including the NZ suppliers that were consulted, noted that there was a high level of communication on the new arrangements with the Price Tribunal.
97. There seemed to be more effective communication with Rarotonga retailers who demonstrated more awareness of the new pricing arrangements compared to Pa Enua retailers where they indicated limited understanding of the new pricing mechanism, and its underpinning principles
98. Rarotonga retailers requested earlier notification of upcoming price orders to better manage difficulties that they had experienced with stock control. As a result the Price Tribunal agreed to provide forewarning prior to the date of effect of new Price Orders.
99. Noting the issues raised throughout the review, the Price Tribunal is considering a number of effective communications methods to address issues of general understanding and improved compliance. These include a range of media strategies through radio, TV, newspaper, social media and Price Tribunal website, as well as using Maori notifications especially for Pa Enua.
100. It became clear that the channels of communication with Pa Enua needs to be clarified and reactivated to address the issues of non-awareness but also in order to establish appropriate pricing parameters for Pa Enua supply.
101. While there was direct contact between the Price Tribunal and importers, there was a reliance and expectation that the importers would communicate changes with their retailers directly. This expectation has generally not been met and allows for some scope of miscommunication of the intentions of the Price Tribunal with retailers. Given this, there is a need to establish new communication channels directly with retailers both in Pa Enua and Rarotonga.

# Recommendations

### ***Short-Medium term recommendations:***

1. Maintain current pricing arrangements with the following adjustments:
  - a. Adopting the lowest import landed cost price for ULP/ADO (as we do for LPG)
  - b. Removing minimum wholesale pricing when the Government funded profit guarantee expires
2. Review of all costs of supply of fuel to all Pa Enea and:
  - a. determine new pricing structure and
  - b. introduce an effective compliance process
  - c. identify broader issues relating to fuel supply to the outer islands for Government consideration.
3. Review current Aitutaki Pricing Arrangements against the new pricing arrangements that were introduced in Rarotonga and:
  - a. determine an appropriate pricing structure for Aitutaki
  - b. introduce an effective compliance process
4. Improve compliance process on Rarotonga through introduction of a targeted wholesale pricing compliance process from now until November 2017
5. Improve efficiency of internal processing of price orders and related documentation supplied by importers by:
  - a. ensuring that suppliers are instructed to submit all invoices and supporting documentation as they are received and no later than the first of the month that the price order is expected to be issued.
  - b. Ensure that the Price Tribunal Secretariat services are improved to enable effective and timely decision-making based on strengthened evidence based data
6. Improve communication strategies with stakeholders by:
  - a. Regular and timely communication with retailers and wholesalers on expected price changes
  - b. Communicating positive consumer impacts of the new pricing arrangements to the public
  - c. Improving targeted communications with Pa Enea Retailers to raise awareness of their obligations of the Act
  - d. Utilising all available communication channels between the Price Tribunal and Pa Enea including members of the public, retailers, welfare officers, island administration staff, island councils, and members of Parliament to ensure effective exchange of information on pricing.
7. Ensure that retailers and importers are kept informed of their legal obligations to comply with Price Orders as they are issued and the penalties for failure to comply:
  - a. Clarify responsibilities for price changes at the pump
  - b. Clarify relationship between retailer and supplier regarding responsibilities to the Price Tribunal and the general public to ensure no unreasonable shifting of obligations



8. Ensure that all issues relation to compliance of dangerous goods standards are referred the Labour Division of the Ministry of Internal Affairs for follow up.
9. Seek out ongoing training and collaboration with regional counterparts on best practice and trends on fuel pricing.

***Long Term Recommendations:***

10. Review of pricing arrangements mid November 2017 due to the expiration of the Government Funded Profit Guarantee
11. Review applicability of alternative pricing models to the Cook Islands, as is used in other Pacific Islands Countries, such as Fiji and American Samoa
12. Advise Minister on the need to review other critical areas negatively affecting Cook Islands consumers such as electricity and telecommunications given the positive outcomes of fuel price regulation

## Appendix 1 General Public - Submissions and Pa Enea Survey Responses

### Analysis of General Public responses

- a. Responses from survey developed for members of the general public in the Pa Enea (50 received from islands of Atiu (15), Mangaia (15), Manihiki (10), Mitiaro (4), Tongareva (6). No responses were received from members of the public from Rakahanga, Mauke, Pukapuka or Aitutaki.
- b. General public responses (3 received)

Fairness of prices	From individuals, they do not believe the prices are fair, it's too expensive and unaffordable/cost of living. One respondent noted that they have no choice but to pay the prices charged. High freight costs.
Understanding of PT	For individuals many seemed to understand the purpose of the Price Tribunal however the reality was that they never saw any changes to prices that continued to be the same over time. From retailers, it became clear that they do not use the price tribunal price but instead they price by adding all their actual costs noting high price of shipping and charging a 10% mark-up – this price falls far above the price tribunal.
Understanding of obligations	There is a general lack of awareness of price orders one example where this was evident was one retailer respondent in the North had indicated that the last price order received was in 2013, despite communications to the Internal Affairs officer on every price order in recent years. Another retailer in the South believed too much emphasis was placed on consumer interest over retailer interests. Almost all are aware that they are pricing above price orders and many were not aware of the obligations under the Act.
Effectiveness	For individuals, generally believed that current price control was not effective, some noted realities of doing business in the Pa Enea. A number noted that there was a need for regular checks and monitoring. A few suggestions put forward that Government should subsidise freight to bring down fuel (and other prices) or supply directly.
Other issues	DG Compliance issues was raised by a few respondents – LPG bottles should be checked and risk management training, some concerns of status of petrol pumps; some noted potential contamination of fuel affecting quality; one respondent noted the impact of VAT increase affecting standard of living; additionally a suggestion made to move to a more economical way of shipping fuel to outer islands instead of sending small containers (200Ltre drums back and forth), a bulk container could instead be sent and refuelling occur on island (Penrhyn); shortage of fuel noted by a few respondents and occasional missing drums;

## Appendix 2 Retailer Survey and Focus Group Responses – Pa Enuā and Rarotonga

Summary of Responses from Retailers based on:

- a. Survey responses from Rarotonga based retailers (3 out of 15 received)
- b. Survey responses from Pa Enuā retailers (8 from islands of Atiu (2), Manihiki (1), Mangaia (5))
- c. Focus group responses with Rarotonga retailers (4 out of 15 attended)

Understanding of new arrangements	Rarotonga retailers were more aware of the new pricing arrangements, however there was a general lack of understanding in the Pa Enuā as many had not seen or read anything. Rarotonga retailers saw price setting as an arrangement between the PT and importer rather than with the retailer.
Impact of new prices	Pa Enuā retailers generally were aware of Price Control and obligations but admitted to pricing above Price Orders as they felt they did not cover their cost of business. Some felt too much emphasis was placed on consumer interest over retailer interests. Many claimed that they have never received the most recent price order that had been issued at the time. In the focus group there was a general understanding that the new arrangements had provided a more level playing field for both importers and offered less confusion for consumers. Retailers noted an issue of stock management and being stuck with higher cost product on a falling price market and felt disadvantaged in not being able to sell at the old price until all old stock cleared. All retailers noted that they are reliant on the distributors to change the price on the pumps.
Compliance and awareness of obligations	Some Pa Enuā retailers claimed they did not receive price orders and therefore not compliant, some stated they were not compliant knowingly because costs were higher than the maximum prices set. All respondents from Rarotonga were compliant. Mixed responses on awareness of obligations under the Act. A number of Pa Enuā respondents noted issues of possible fuel contamination.
Max/min pricing	Pa Enuā retailers are generally pricing based on their own cost structure so do not use the maximum/minimum pricing; Raro respondents noted prices set by distributors – impression was no retailer influence on the process, they accept what the distributor sets it as (including the day when the prices change at the pump, including on the day that the prices are changed) In the focus group, retailers did not really understand the purpose of max/min pricing. Prices are usually set at the maximum prices. One retailer expressed that they are more interested in quality fuel so prices may be higher but that is due to superior fuel quality.
Improvements in communication and Monitoring	Communications in the media (radio, TV, Māori), visit retailers in Pa Enuā, improve monitoring; Many did not have an opinion on monitoring. One noted price monitoring is needed and a few thought it was a good idea
Cost drivers	Pa Enuā noted the following as costs that they face: Freight, labour, barge, transport from harbour, cost of fuel, evaporation, overheads, power. The largest area of concern was freight costs.
Supplier issues	Most noted no issues with their suppliers in the survey responses except for one retailer noting the delays in adjusting pump prices by suppliers and stock management. One Pa Enuā retailer noted issue with Taio shipping regarding costs of product.
Other matters	Safety equipment concerns, issues with notice of breach letters, Retail margin requests