DOCTOR OF PHILOSOPHY

The regulation of fuel retailing activities and its contribution to a rural development policy
lessons from the UK and Australian jurisdictions

Nwaozuzu, Chijioke Ekezie

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Chijioke Ekezie Nwaozuzu

2010

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The Regulation of Fuel Retailing Activities and its Contribution to a Rural Development Policy: Lessons from the UK and Australian Jurisdictions

Chijioke Ekezie Nwaozuzu

019970202

A Thesis Submitted to the Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, in Fulfilment of the Award of the Degree, PhD

January 2010
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<tr>
<td>AA</td>
<td>Automobile Association</td>
</tr>
<tr>
<td>AAA</td>
<td>Australian Automobile Association</td>
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<tr>
<td>ABRD</td>
<td>Australian Bicentennial Road Development</td>
</tr>
<tr>
<td>ACCC</td>
<td>Australian Competition and Consumer Commission</td>
</tr>
<tr>
<td>AIP</td>
<td>Australian Institute of Petroleum</td>
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<td>ALGA</td>
<td>Australian Local Government Association</td>
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<tr>
<td>AMS</td>
<td>Aggregate Measure of Support</td>
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<td>APADA</td>
<td>Australian Petroleum Agents and Distributors Association</td>
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<td>ATO</td>
<td>Australian Taxation Office</td>
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<td>BIS</td>
<td>Department for Business, Innovation and Skills</td>
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<td>BFCS</td>
<td>Business Fuel Credit Scheme</td>
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<td>BP</td>
<td>British Petroleum</td>
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<td>BPR</td>
<td>Business Process Design</td>
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<td>BSOG</td>
<td>Bus Service Operators Grant</td>
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<td>CAP</td>
<td>Common Agricultural Policy</td>
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<tr>
<td>CC</td>
<td>Competition Commission</td>
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<tr>
<td>CEBR</td>
<td>Centre for Economics &amp; Business Research</td>
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<tr>
<td>CFI</td>
<td>Court of First Instance</td>
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<tr>
<td>CML</td>
<td>Coles Myer Limited</td>
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<td>CNG</td>
<td>Compressed Natural Gas</td>
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<td>CPRE</td>
<td>Council for the Protection of Rural England</td>
</tr>
<tr>
<td>cpl</td>
<td>cents per litre</td>
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<tr>
<td>CSIRO</td>
<td>Commonwealth Scientific and Industrial Research Organisation</td>
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<tr>
<td>DAFF</td>
<td>Department of Agriculture, Fisheries and Forestry</td>
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<td>Abbreviation</td>
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<td>DAFGS – Defra</td>
<td>Diesel &amp; Alternative Fuel Grants Scheme Department of Environment, Food and Rural Affairs</td>
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<td>Diesel Fuel Rebate Scheme</td>
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<td>Director-General</td>
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<td>EAFRD</td>
<td>European Agricultural Fund for Rural Development</td>
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<td>European Agricultural Guidance and Guarantee Fund</td>
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<td>FTAct</td>
<td>Fuel Tax Act</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>--------------</td>
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</tr>
<tr>
<td>FTA</td>
<td>Freight Transport Association</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GGAP</td>
<td>Greenhouse Gas Abatement Programme</td>
</tr>
<tr>
<td>GHG</td>
<td>Greenhouse Gases</td>
</tr>
<tr>
<td>GST</td>
<td>Goods and Services Tax</td>
</tr>
<tr>
<td>GVP</td>
<td>Gross Value of Production</td>
</tr>
<tr>
<td>GW</td>
<td>Giga-watts</td>
</tr>
<tr>
<td>HACC</td>
<td>State Home and Community Care Program</td>
</tr>
<tr>
<td>H &amp; I</td>
<td>Highlands and Islands</td>
</tr>
<tr>
<td>HIAG</td>
<td>Highlands &amp; Islands Action Group on Hydrocarbon Fuel Prices</td>
</tr>
<tr>
<td>HIAL</td>
<td>Highlands and Islands Airport Limited</td>
</tr>
<tr>
<td>IC</td>
<td>Industry Commission</td>
</tr>
<tr>
<td>IEA</td>
<td>International Energy Agency</td>
</tr>
<tr>
<td>IEEP</td>
<td>Institute for European Environmental Policy</td>
</tr>
<tr>
<td>IGA</td>
<td>Independent Grocers of Australia</td>
</tr>
<tr>
<td>IPPR</td>
<td>Institute for Public Policy Research</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>JV</td>
<td>Joint Venture</td>
</tr>
<tr>
<td>LAGs</td>
<td>Local Action Groups</td>
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<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
</tr>
<tr>
<td>LPG</td>
<td>Liquefied Petroleum Gas</td>
</tr>
<tr>
<td>MAV</td>
<td>Municipal Association of Victoria</td>
</tr>
<tr>
<td>MC</td>
<td>Monopolies Commission</td>
</tr>
<tr>
<td>ML</td>
<td>Million Litres</td>
</tr>
<tr>
<td>MTAA</td>
<td>Motor Trades Association of Australia</td>
</tr>
</tbody>
</table>
MW  Mega-watts
NCAs  National Competition Authorities
NGOs  Non-Governmental Organisations
NFU  National Farmers Union
NSW  New South Wales
OECD  Organization for Economic Co-operation and Development
OFT  Office of Fair Trading
PPFSS  Petroleum Products Freight Subsidy Scheme
PPSA  Petroleum Products Subsidy Act
ppl  pence per litre
ppm  parts per million
PRA  Petroleum Retailers Association
PSA  Price Surveillance Authority
PSAct  Price Surveillance Act
RBC  Rural Bus Challenge
RBSG  Rural Bus Subsidy Grant
R/D  Research & Development
RDOs  Regional Development Organisations
RDPE  Rural Development Programme for England
RFCS  Residential Fuel Credit Scheme
RHA  Road Hauliers Association
RIA  Regulatory Impact Assessment
RRP  Recommended Retail Prices
RRPGP  Renewable Remote Power Generation Programme
RSA  Regional Selective Assistance
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAPU</td>
<td>State Aid Policy Unit</td>
</tr>
<tr>
<td>SEADS</td>
<td>Scottish Executive Air Discount Scheme</td>
</tr>
<tr>
<td>SGA</td>
<td>States Grants Act</td>
</tr>
<tr>
<td>SGPPA</td>
<td>States Grants (Petroleum Products) Act</td>
</tr>
<tr>
<td>SME</td>
<td>Small &amp; Medium Scale Enterprises</td>
</tr>
<tr>
<td>SPFM</td>
<td>Scottish Public Finance Manual</td>
</tr>
<tr>
<td>SPS</td>
<td>Selective Price Support</td>
</tr>
<tr>
<td>SRDP</td>
<td>Scottish Rural Development Programme</td>
</tr>
<tr>
<td>SSA</td>
<td>Service Station Association</td>
</tr>
<tr>
<td>SSP</td>
<td>Scottish Socialist Party</td>
</tr>
<tr>
<td>STIGS</td>
<td>Scottish Transport Innovation Grant Scheme</td>
</tr>
<tr>
<td>SWOT</td>
<td>Strengths, Weaknesses, Opportunities and Threats</td>
</tr>
<tr>
<td>TGP</td>
<td>Terminal Gate Pricing</td>
</tr>
<tr>
<td>TIC</td>
<td>Trade &amp; Industry Committee</td>
</tr>
<tr>
<td>TPA</td>
<td>Trade Practices Act</td>
</tr>
<tr>
<td>TPC</td>
<td>Trade Practices Commission</td>
</tr>
<tr>
<td>ULSD</td>
<td>Ultra-Low Sulphur Diesel</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States of America</td>
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<tr>
<td>USDA</td>
<td>US Department of Agriculture</td>
</tr>
<tr>
<td>USO</td>
<td>Universal Service Obligation</td>
</tr>
<tr>
<td>VACC</td>
<td>Victorian Automobile Chamber of Commerce</td>
</tr>
<tr>
<td>WAG</td>
<td>Western Australian Government</td>
</tr>
<tr>
<td>WIC</td>
<td>Western Isles Council</td>
</tr>
<tr>
<td>WTO -</td>
<td>World Trade Organisation</td>
</tr>
</tbody>
</table>
DECLARATION

I hereby declare that I am the author of this thesis and unless otherwise stated, I have personally consulted all references cited. The work of which this thesis is a record has been done by me and has not been previously submitted or accepted in this or any other university for a higher degree.

Signed........
Date.................

Chijioke Nwaozuzu
ABSTRACT

Limited competition among the few fuel retailers in rural and remote locations results in fuel pricing problems, such as high rural fuel prices and rural-urban fuel price differentials. Thus, the regulation of fuel retailing activities in these locations is expected to resolve these problems, and thus contribute to a rural development policy. These problems are of concern to governments and rural communities, primarily because high fuel prices generate significant multiplier effects on the cost of rural living and economic activities. Therefore, the purpose of this study was to investigate the potential contribution of the regulation of fuel retailing activities to resolving these problems. The UK and Australian fuel retail sectors provided contrasting settings in which to conduct this investigation. Preliminary research outcome indicated that governments’ responses to these problems were generally in the form of regulatory support mechanisms and fuel subsidy schemes (a form of state aid).

The study focused on two research questions. The first question relates to whether the regulation of fuel retailing activities could resolve the fuel pricing problems in rural areas, and thereby contribute to a rural development policy. The second question deals with the necessity or otherwise of the use of state aid in resolving the problems of fuel retailing in rural and remote areas. This study investigated the research questions by adopting the qualitative comparative methodology, involving three actions. The first action entailed the use of a set of common comparators to examine fuel retail regulations in the two jurisdictions. The comparators consisted of the following regulations: sites, licence/franchise, retail/wholesale price, fuel tax. The second and third actions involved a comparison of state aid policies and trends in rural development policies in both jurisdictions.
The study revealed that these fuel retail regulatory measures have limited effectiveness in addressing the research problems. However, the author argues that regulation of fuel retailing is likely to contribute significantly to resolving the research problems within the context of an integrated approach to rural development. The author further argues that this approach could lead to a paradigm shift in the mix of fuels consumed in rural and remote locations, and hence cause a reduction in fuel prices as well as the rural-urban fuel price differentials.

The key recommendations flowing from this study was that the UK Government could take advantage of the various EU state aid provisions to promote a robust and integrated rural development policy. On the other hand, the Australian Government could consider developing a more formal and integrated approach to rural development policy, rather than its current ‘ad-hoc’ approach.
Chapter 1

INTRODUCTION

1.1 Introduction
Some market-oriented governments have been known to use regulatory support mechanisms in the form of statutes to promote the activities of independent fuel retailers regardless of whether they are based in urban or rural areas. Similarly, the use of subsidy schemes for fuels has been a popular tool for governments in addressing the special needs of rural populations. The vulnerability of such population groupings to probable predatory pricing practices from established fuel suppliers or limited competition among the few fuel retailers in such locations has encouraged the design of policy instruments to counteract the attendant fuel pricing problems.\(^1\) Some of these support measures have been used to cushion the effects of high fuel prices on rural inhabitants and businesses, or reduce the rural-urban fuel price differentials. Others have been directed at curtailing the market power of the oil majors. Yet questions may be raised about the long-term usefulness of such policies and their compatibility with the goals of a rural development policy.

The UK and Australian fuel retail sectors provide contrasting settings in which to examine these regulatory measures, and what significance they might have for rural development. Each country has a slightly different legal regime and is at a different stage in the cycle of fuel retail trade liberalisation.\(^2\) Thus, this thesis examines whether the regulation of fuel retail activities could resolve the problems of high rural fuel prices and rural-urban price differentials, and thus contribute to a rural

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\(^1\) The nature and degree of these fuel pricing problems are clearly defined in Chapter 3.
\(^2\) Other countries that have tried petrol retail liberalisation would include US, and most West European countries, e.g. France, Germany, the Netherlands, Italy, etc. The reasons for choosing the two jurisdictions are contained in the heading, ‘Justification for the Choice of Countries’.
development policy; and whether state aid is essential in promoting fuel retailing activities in rural and remote areas.

This chapter sets out the justification for the study, the relevance of a rural development policy, and the relevance of independent fuel retailers in the context of rural development. The second part of this chapter deals with the analytical framework for the study, which includes a statement of the research problem, the research questions and hypotheses, the objectives and purposes, the methodology, and the thesis structure.

1.2 Justification for the study
Petroleum products, like education, training etc. are classified as ‘impure public goods’ or ‘special products’ because their supply has multiplier effects on the socio-economic and political life of a community. Although such goods and services do not have the basic characteristics of a ‘public good’ (e.g. roads, national defence, policing, etc.), they do however contain some ‘public good’ dimensions.³ ‘Impure public goods’ can be traded in the market but require periodic regulatory interventions because they may be subject to some degree of market failure, with disastrous consequences for society.

As a source of fuel, petroleum products have high energy content compared to gas and coal. Their fluidity creates economies of scale during storage. There are no adequate substitutes for petroleum fuels in transportation, and virtually none in the field of lubrication. These qualities have combined to make petroleum products the

fuels of choice in modern transportation.\textsuperscript{4} Therefore, any disruptions in fuel retailing activities within a given location will likely result in socially undesirable outcomes.

The economics of the petroleum retail trade creates an equally unique situation. The demand for the products is not price elastic i.e. an increase in price does not produce a corresponding decrease in demand (and vice-versa). Thus, petroleum fuels could be a source of potential abuse by governments (through taxation) or by fuel retailers (through high pump prices). These have severe potential implications for rural fuel consumers, cost of rural living, and a rural development policy.

No study has yet been carried out to determine the potential contribution of the regulation of fuel retailing activities to a rural development policy. Therefore, the result of this research could contribute to the current debate on approaches to a rural development policy. The research outcomes could be of interest to the myriad of government ministries/agencies, local governments, and local associations that articulate and coordinate rural development policies. The research findings could also be of interest to most developing countries as they pursue a strategy of even development.

1.3 Does a rural development policy matter?
A vital insight into the OECD indicators describing rural areas of member countries is the diversity within and between rural areas. Rural areas are not uniform and have been categorised by various agencies and individuals. For instance, Sharp identified

three types of rural areas in England as follows: 5 (a) remote areas with scattered populations and access difficulties; (b) areas strongly under the influence of towns and cities; and (c) areas of rapid change, e.g. mining closures. The 1996 Scottish Rural Life Update Report identifies five distinctive area types: remote rural, less remote rural, mixed urban/rural, remote settlement dominated, and prosperous high growth. 6 Also, according to the OECD rural typology, there are three types of rural regions: predominantly rural, significantly rural, and predominantly urbanised. 7

The implication is that articulating effective rural development policies is not an easy task, as ‘one size fits all’ rural policies cannot be effective. 8 Another major challenge stems from the disparity between the structure needed for the formulation and implementation of territorial policies (i.e. horizontal, multi-sectoral, and collaborative) and the structure of government policies in member states (i.e. vertical, sectoral, and hierarchical). Yet a diverse group of ministries must be involved (as well as the private sector), if rural development policies are to be effectively conceived and implemented.

Rural development policy is concerned with thinly populated areas and small towns. These areas face major challenges created by the globalisation of both production and demand of goods and services; rapid changes in technologies, information flows, and the composition of markets; and the need to enhance and safeguard environmental

8 See id., p. 23.
conditions. Yet economically viable and environmentally healthy rural areas are an indispensable part of a strategy for balanced national development.

Rural development as defined by the OECD rural development programme is a societal goal, but not a social (transfer) programme. In other words, rural people who fall below social norms of well-being established by individual countries may be targets of policies and programmes aimed at improving their condition. These policies and programmes are not executed because they are rural peoples, but because they are citizens of the nation state (same partners in the social contract). Prior to the 1990s, governments sought to overcome the disadvantages of distance and low density through transfer payments or through regulatory measures that necessitated businesses to provide uniform levels of service. These approaches have been costly for both private businesses and governments and seem unattractive for the future because social transfer programmes cannot operate indefinitely. The measures that are promising for the future seem to be those that seek to create the basic conditions necessary for broadening and building an indigenous economic base, stimulating entrepreneurship, and improving the skills for rural residents with the support of all levels of government and related government agencies. However, the specific social policies and programmes and their implementation strategies are likely to differ between urban and rural residents.

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10 See OECD Documents; supra note 7, at p. 25.
There is also a growing importance of environmental concerns for rural areas. These concerns relate to issues of sustainable development. Since the 1990s the environmental debate has been intense, particularly after the Rio Declaration on Environment and Development in 1992. Bartels argues that these areas do not always capture the ‘fair’ return from society’s use of their environmental, cultural, and historical resources. With growing income levels, demand for these resources is increasing. However, the trade-off that rural areas face between economic development and environmental preservation is difficult to resolve (i.e. the need to meet the goal of sustainable economic development). The author argues in part that to resolve this difficulty could require cooperative action within communities by businesses, local organisations, and various levels of government. Coordinated investments from public and private sources might be needed to improve human capital, upgrade rural infrastructure, and modernise rural transport, energy, and information technology services.

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Among the OECD member states, rural areas comprise 90% of the land mass and almost one-third of the population. Therefore, rural areas are expected to contribute to national economic growth, if the overall economy is to effectively exploit its full potential. Such a prospect bodes well both for rural inhabitants and for other citizens, including tourists. For this reason, rural development is considered an important and integral part of policy agendas among OECD countries.

Prior to the 1990s, rural development was mainly a question of agriculture and its development, or a matter of securing wildlife, environmental, or recreational issues. More recently, rural areas have been put on the political agenda for all OECD and EU countries for a number of reasons. Firstly, it has become clear to many governments that agricultural activities can no longer employ all the people live in rural locations or who may wish to relocate to these areas. Moreover, far-reaching structural rationalisation of the agricultural sector is taking place in most OECD countries, especially EU countries, and this is expected to have a significant effect on the culture of agricultural society. Tangiv argues that there are large numbers of people interested in living in rural areas, and this, coupled with the concept of democracy and the associated issue of decentralisation, has resulted in the current focus on the development of rural areas. Particularly, EU policies on rural development through Agenda 2000, Common Agricultural Policy (CAP), and the EU Leader

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13 See id., p. 9. OECD member countries include United Kingdom, Australia, United States, Austria, Belgium, Canada, Denmark, France, Germany, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, Japan, Finland, New Zealand, Mexico, Czech Republic.
16 Agenda 2000 is an EU action programme aimed at strengthening community policies and preparing the EU for enlargement. The actions include a reform of the CAP, and increasing the effectiveness of
Programme\(^{18}\) have played a decisive role in focusing the rural development agenda in many EU countries and in some OECD member states. Government policymakers in Australia, in line with neoliberal rationalities, have also taken the view that ‘rural adjustment’ as recognised in Europe will ultimately be beneficial in effect when efficient firms replace lost production from failed farms.\(^{19}\) This new policy direction is in line with the new round of WTO trade talks in 2000 (Uruguay Round Agriculture Agreement URAA), which emphasised market competitiveness, reductions in domestic support, elimination of export subsidies, and increased market access.\(^{20}\)

Secondly, the concept of globalisation introduces a steady process of adjustment in societies. However, that adjustment process is not uniform throughout national territories. Moreover, globalisation does not automatically generate uniform socio-economic and environmental benefits.\(^{21}\) Therefore, it is the responsibility of governments to enable all parts of their territory to be strong enough to adjust. Thirdly, the balanced development of national territories deals partly with the notion of economic equity designed to enable all citizens to benefit from growth, regardless

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17 The CAP was recently reformed in 2003 with the objective of weakening the link between subsidies and production. However, to prevent abandonment of production, member states were advised that they ‘may choose’ to maintain a limited link between subsidy and production, albeit under well defined conditions and limits. In place of the subsidies, ‘single farm payments’ were devised and linked to maintaining environmental, food safety and animal welfare standards. For more details see <http://ec.europa.eu/agriculture/capreform/index_en.htm>, last visited on 25 May 2009.

18 The LEADER programme is EU’s programme for community-led rural economic diversification, and funded through the EU Structural Funds. The programme was launched in 1999 and ran from 2001-6. LEADER+ Programme covered all of Northern Ireland, whereas LEADER II promoted community-led projects and initiatives in rural Scotland (Inverness, Nairn, etc).


21 For more details on uneven development and social change, see Hoggart; supra note 9, at pp. 185-227.
of where they live or work. This also is of political importance, because the harmonious development of an entire national territory is a basic condition for fostering social cohesion within a country, and consequently for its political stability.\textsuperscript{22}

In a nutshell, the significance of a rural development agenda is derived from the impact of globalisation on rural communities and the search for balanced development of national territories. Globalisation has placed certain rural areas in a precarious state, thereby requiring them to make far-reaching adjustments. For example the use of new technologies in agriculture, fisheries, forestry, etc. has led to the disappearance of a significant number of rural jobs.\textsuperscript{23} Manufacturing industries which could have acted as a source of new jobs are already experiencing an overall decline. Service activities are not well developed in most rural locations in the OECD member states. These factors put together have led to large-scale movements of local labour towards the urban cities. Thus, rural development is a question of designing multi-sectoral policies, requiring close cooperation between the various authorities involved.

Rural areas are generally viewed in many jurisdictions as economies specialising in traditional resource-based industries (agriculture, mineral extraction, forestry, fishing, etc.). However, in many areas there is considerable diversity of economic activity.

Rural areas are subject to the same forces that drive economic change in the national


\textsuperscript{23} See OECD Documents; \textit{supra} note 7, at p. 18.
economy, and so continuous pressures to improve the competitiveness of its products/services in order to compete in global markets will continue to increase the substitution of capital for labour in resource industries. Therefore, these industries will innovate with the help of new technologies (capital goods) and are not expected to provide major sources of new employment. Thus, specialisation in many rural economies has made them vulnerable to business cycles and resource depletion. Typical examples are the depletion of ground fish in Atlantic Canada that led to the collapse of the ground fish industry; and the closure of coal mines in parts of England and Wales which affected the sectoral-dependent rural economy.24

The decline in employment in traditional sectors in some rural areas has led to the call for active encouragement of diversification as an economic strategy. Nevertheless, traditional resource industries will perhaps remain the economic base of many rural areas in the future. Diversification strategies usually develop from within sectors and focus on creating new value-added opportunities within sectors.25 However, strategies that sustain sectoral dependence tend to create better economic stability on the condition that the new value-added base is less price-sensitive than the traditional production activity.

A comprehensive diversification strategy enhances the development of activities both related and unrelated to the existing dominant industry. However, in terms of competition in global markets (based on competitive advantage) diversification may not offer a viable alternative to further development of the existing resource base. The reason is that the small size and limited resource base of most rural areas makes it

24 See id., p. 49.
difficult for them to assemble a critical mass of skills and resources to be competitive in the global markets.

In many rural areas, tourism is seen to offer the potential as a new source of employment and its development is based on a holistic exploitation of local resources, scenic, cultural, or historic amenities, possibly in association with the traditional industry.\textsuperscript{26} Much of manufacturing activity has been linked to the traditional resource sectors. However, since the 1990s manufacturing activities (particularly in the older industrial economies) are increasingly being outsourced to developing economies, due to lower labour costs. As a result, rural areas in industrial economies can only adapt their economic base and remain competitive by developing new products and services in which to specialise, and to create niche markets in which they can secure competitive advantage. Therefore, rural areas can either be encouraged to seek new types of business enterprises not associated with their traditional sectoral dependence (diversification), or to pursue an economic strategy that is directly related to the major resource base (micro-specialisation).\textsuperscript{27}

In choosing between specialisation and diversification strategies for a given rural location, it is necessary to consider the significant differences among rural areas in relation to their population, economy and environment.\textsuperscript{28} A number of other points need to be considered. Firstly, a specialisation strategy is not possible for all rural areas because by its nature it requires a large initial capital outlay, high-skilled labour, and market access. These conditions tend to limit its application to areas where


\textsuperscript{27} For more details on rural development strategies, see Champetier, Y., \textit{Local Development Initiatives} pp. 53-58, in \textit{Rural Europe: Rural Development Policies for the 1990s} (1992).

\textsuperscript{28} See OECD Documents; \textit{supra} note 7, at pp. 56-58.
economic activities are already vigorous and to firms which already profit from a large accumulation of capital, land, and skilled labour. Therefore, specialisation is applicable to economically integrated areas but may not apply to remote areas.

Secondly, a diversification strategy may be resilient to market changes in the economy as a whole, but individual markets will often be volatile. Thirdly, in remote rural areas, a diversification strategy usually has a better chance of success in the medium/long-term than a specialisation strategy. This is because specialisation is too expensive for some areas and there is a risk involved in the shift of technology and labour. However, the establishment of networks between small and medium-size enterprises (SMEs) can be a success factor in remote areas because it makes it possible for these areas to be sufficiently competitive in order to respond to market changes and consumer demands.

Fourthly, new technological development will contribute positively to both development paths, although to varying degrees. For instance, biotechnology is useful in the development of high value-added agricultural products as in the case of specialisation, and also for developments in the food industries to aid their diversification.

Rural areas need economic incentives to enable them to decide which development path to follow, or whether this should be a combination of both. This is a source of challenge for policymakers at different levels who are directly responsible for designing rural development policies. Having established the relevance rural areas and a rural development policy, the role of government could be to create an
economic and social environment in which rural areas can take the initiative for their development. The decision as to which path rural areas should choose would depend on the best allocation of their resources (i.e. natural, human, cultural, environmental). However, neither a ‘single policy for all rural areas’ nor a ‘specific area for each policy’ could be applied with much success.

1.4 The importance of and threat to rural independent fuel retailers (UK and Australia)

The large number of UK independent fuel retailers in the past (i.e. between 1960 and 1990) made it difficult for the refiner wholesalers to abuse their market power. Since the mid-1990s, a significant reduction in the number of independent retailers deprived the market of an essential competitive counterweight. However, this balancing factor has been provided by the supermarkets who operate in urban areas and to some extent out-of-town locations, but not in rural and remote communities.

Rural communities, and activities that take place within these locations, are particularly dependent on private transport, partly because of the nature of rural living but also because of the lack of public transport serving these less populated regions. Therefore, rural fuel outlets often serve as centres for services other than fuel sales, e.g. vehicle sales and servicing, village shops, post-offices, taxi services, video shops, etc. While these ancillary services provide employment for rural residents, they also help to retain skills within rural areas.29

Rural activities that are also affected either by higher fuel prices and fuel price differentials between urban and rural areas, and/or high closure rates, include: farming

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and compost makers; rail and marine transport; manufacturing companies; rural hospitals, nursing homes, homes for the elderly, and other medical institutions; forestry; mining; construction, quarrying, and dredging companies; brewing and distilleries; local government road construction and maintenance; commercial electricity generation for remote communities, etc.\(^{30}\)

When rural garages are forced to close in large numbers, not only will rural communities lose an important amenity, but there will also be consequences on commercial activities in and around these locations, as well as environmental consequences. It is likely to trigger the dreaded rural–urban migration, with consequences for rural commercial activities, and also neglect and under-development of a large expanse of land and resources.

The Rural Development Commission (UK) has identified a significant loss of business for rural garages since the mid-1990s, especially for those in more accessible areas, owing to the combined attractions (or convenient convergence) of bulk grocery shopping and cheaper fuels which tend to draw customers from those rural communities to supermarkets (see Table 1.1). The current intensity in price competition has further exacerbated this trend. Consequently, those rural areas closest to urban areas where fuel is cheaper tend to feel most effects of price competition from supermarkets and high-volume urban sites.\(^{31}\)

Generally, independent fuel retailers in rural areas face severe disadvantages compared to their urban counterparts. Due to the higher distribution costs, the


\(^{31}\) See Parliamentary Trade & Industry Committee Report; *supra* note 29, at p. xvii.
wholesale price of fuels is higher. It was estimated in 1995 that the cost of distributing fuels to the Highlands and Islands in the UK was about 16.6% higher than to Scotland’s urban areas.\textsuperscript{32} Another issue concerns turnover, which is typically lower for rural areas; and as a result the independent fuel retailers operating there cannot benefit from bulk-buying discounts and other financial assistance offered by the oil companies to larger and more profitable sites. As a result, larger wholesalers discontinued direct supplies to rural outlets not only because of their low-volume sites but also considering the difficult terrain and extended distribution networks required to supply these sites. The smaller wholesalers who took over the function of supplying these sites are unable to offer the price support necessary for them to compete against the cheaper urban sites.\textsuperscript{33} Consequently, rural pump prices tend to be significantly higher and occasionally force residents to drive several miles to find cheaper fuel.

Table 1.1 Retailer groups – ownership, percentage volume and average throughput, 2006

<table>
<thead>
<tr>
<th>Groups</th>
<th>No. of Sites</th>
<th>% of Sites</th>
<th>% Volume</th>
<th>Avg. Volume (ml)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major oil companies</td>
<td>5,431</td>
<td>61.5</td>
<td>57.6</td>
<td>3.8</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>1,175</td>
<td>12.0</td>
<td>31.4</td>
<td>9.5</td>
</tr>
<tr>
<td>Branded minors</td>
<td>1,620</td>
<td>13.5</td>
<td>7.9</td>
<td>1.7</td>
</tr>
<tr>
<td>Other minor brands</td>
<td>464</td>
<td>1.4</td>
<td>1.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Unbranded</td>
<td>1,089</td>
<td>11.2</td>
<td>2.2</td>
<td>0.7</td>
</tr>
<tr>
<td>UK Total</td>
<td>9,779</td>
<td>100</td>
<td>100</td>
<td>3.6 (Avg.)</td>
</tr>
</tbody>
</table>

Source: Catalist (UK Petrol Retail Consultants)

\textsuperscript{32} See \textit{id.}, xviii.
\textsuperscript{33} See \textit{id.}, xviii.
The Petrol Retailers Association (PRA) is of the view that it is not socially and environmentally acceptable for motorists to drive 30–40 miles for each fill-up. The PRA Chairman was recently quoted as saying for example that ‘the average distance that someone in Scotland has to drive to find an open forecourt is now seven miles’.  

Furthermore, the Office of Fair Trading (OFT) UK survey of 1998 recognised that the number of independent fuel retailers had fallen disproportionately in recent years, and attributed this to their low volume of sales, higher cost of delivery, and probably, less well diversified outlets. However, they argued that this was not a cause for serious concern since the independents do not appear to be ‘pivotal in setting retail prices’ nor the ‘prime drivers of petrol retail competition generally’. Nevertheless, they agreed that concerns might be raised when the loss of rural independent retailers led to some areas of the UK being underserved by a few retail outlets leading to customers having to drive unreasonably long distances to obtain fuels. Although they recognised these concerns, they argued that other government actions rather than competition legislation would be capable of addressing such issues. The DG (OFT) was quoted in 2006 as saying, ‘it would be wrong to take action under the competition legislation to prevent price competition now in order to avoid some risk that in future competition might be a little less, provided that current competition is based on efficiency or scale advantages rather than predatory pricing and that the market is adequately monitored’.

36 See *id.*., p. xv.
The Parliamentary Trade and Industry Committee (Sixth Report, 1995-6) also maintained that concerns may arise if a significant closure of a large number of fuel outlets in rural areas led to the creation of local monopolies or oligopolies, in which case a certain retailer or group of retailers having a large share of the local market could abuse their position. The OFT’s study of fuel prices in different regions of the UK, and the specific market conditions identified in the Highlands & Islands by Halcrow Fox (transport consultants) have provided clear evidence of the existence of local markets in rural fuel retailing.37

Fuel retail sites are also governed by environmental and safety regulations and the costs of compliance are hardest for those retailers with low-volume throughput and low margins (basically the case with independent retailers in rural areas).38 The Rural Development Commission had expressed concerns in recent years about the cost of complying with regulatory standards in rural areas. Although exemptions and derogations had reduced this burden on some fuel retailers, however the discretion available to the enforcing agencies is limited and their approach varies from area to area.39 Stage I of the EU Petrol Recovery Directive has already taken its toll on rural fuel sites, owing to the extra cost of equipment replacement. It is feared that the number of rural sites that would be forced to close if stage II of the EU Petrol Recovery Directive is implemented could be higher, because the cost of equipment replacement might range from £20,000 to £60,000 per rural outlet.40 All EU member

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37 See Parliamentary Trade & Industry Committee Report; supra note 29, at xix.
38 House of Commons (Trade and Industry Committee Sixth Report), Petrol Retailing xix (Session 1995-1996).
39 See TIC Report; supra note 29, at xx.
states are required to comply with this directive (EU Directive 96/63/EC)\textsuperscript{41} not later than 1 January 2012. However, under UK legislation, sites with fuel sales above 3.5 million litres per annum are expected to install petrol vapour recovery equipment (Stage II) before the 1 January 2010 deadline (2012 for Scotland).\textsuperscript{42} The implication is that smaller outlets retailing less than 3.5 million litres will not be affected by the directive.

In the case of Australia, supermarkets’ entry into fuel retailing is now well established and independent fuel retailers are beginning to lose significant market share. Tables 1.2 and 1.4 show market share by sales volume by brand in 2001 and 2006-7 respectively. The supermarkets normally buy products from independent importers or oil majors or both. They retail fuel at their own outlets and are usually managed by agents on a commission basis.\textsuperscript{43} The major players are Woolworths, Safeways and 7-Eleven, a wholly owned subsidiary. Woolworths expanded its network from 85 outlets to about 200 by the end of 2000.\textsuperscript{44} They have been offering their customers competitively priced fuel and a further discount per litre with minimum purchase

\textsuperscript{43} ACCC, Report from Frontier Economics on Economic Implications of Terminal Gate Pricing p. 6 (2001).
vouchers obtained from their grocery stores. Similar to the independent retailers, supermarkets are not affected by the Franchise and Sites Acts.\textsuperscript{45}

Table 1.2 Market shares of petrol retailer groups in Australia, 2001

<table>
<thead>
<tr>
<th>Company/Group</th>
<th>% Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP</td>
<td>17</td>
</tr>
<tr>
<td>Mobil</td>
<td>16</td>
</tr>
<tr>
<td>Shell</td>
<td>17</td>
</tr>
<tr>
<td>Caltex</td>
<td>19</td>
</tr>
<tr>
<td>Independents</td>
<td>20</td>
</tr>
<tr>
<td>Woolworths (Supermarket)</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: IBIS World Australia; Automotive Fuel Retailing in Australia (2001).

The entry of supermarkets into fuel retailing in Australia represents a ‘rapid and massive change’\textsuperscript{46} to fuel retailing and represents the greatest threat to rural independent fuel retailers. Recent significant changes in the supermarket segment include a co-branding arrangement between Woolworths networks and Caltex in November 2003, and also an alliance between Coles Myer Ltd (CML) and Shell in May 2003. Woolworths/Caltex joint-venture offers their customers a fuel discount of 4 cpl which it intends to extend to their 450 retail stations nation wide.\textsuperscript{47} Based on the terms of the joint venture (JV), a subsidiary of CML will operator Shell’s core retail


\textsuperscript{47} See \textit{id.}, p. 17.
network of 584 service outlets. Also in September 2003, Independent Grocers of Australia (IGA) launched a fuel offer which tied the purchase of $30 worth of groceries bought from an IGA store to a 4 cpl refund on fuel purchased from any supplier. These alliances offer fuel discounts to grocery customers (shopper docket schemes). With these discounts, the supermarkets’ share of the fuels retail market is set to grow rapidly within the next decade (see Table 1.3).

Table 1.3 Projected future outlook of supermarket market share in Australia (estimates as at 2004)

<table>
<thead>
<tr>
<th>Sources of market share</th>
<th>% Market share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Woolworths/Caltex JV</td>
<td>11 (Actual)</td>
</tr>
<tr>
<td>Coles Myer/Shell JV</td>
<td>22 (Actual)</td>
</tr>
<tr>
<td>Coles Myer discount offers + Woolworths</td>
<td>17 (Estimates)</td>
</tr>
<tr>
<td>Planned Increase in Sites from 285 to 400</td>
<td></td>
</tr>
<tr>
<td>Estimated market share by 2010</td>
<td>50</td>
</tr>
</tbody>
</table>

Source: This research.

In February 2004, the Australian Competition and Consumer Commission (ACCC) investigated the impact of these shopper docket schemes and released its report into discount offers as they affect competition in the fuel retail market. The report concluded that it has encouraged competition and lower fuel prices. It also argued that supermarkets have been an integral part of the French and UK fuel markets for over 10 years and have captured substantial market share while delivering competitively priced fuels. The ACCC contended that these countries have remained competitive in

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48 See id., p. 17.
delivering fuel to consumers in spite of the advent of supermarkets into fuel retailing arrangements.\textsuperscript{50}

The Service Station Association (SSA) are of the view that shopper docket offers an indirect means by which supermarkets subsidise below-cost selling of fuels from the proceeds of grocery sales and considers it as unfair trading practice against other competitors in the fuel retailing business.\textsuperscript{51} They also consider ‘below-cost selling’ as unsustainable on its own unless cross-subsidised by a different commercial activity.

The SSA observed that the two joint ventures between Woolworths/Caltex and Coles Myer/Shell have resulted in about 40% of fuels in Australia being sold through a supermarket outlet.\textsuperscript{52} With the exception of BP and Mobil (the remaining non-aligned majors), there are no other players in the fuel retail industry that have the financial capacity to sell fuels below cost on a sustained basis. They observed that the Coles/Shell experience in Melbourne produced an average of 60% increase in fuel sales across the entire Victorian network in the three weeks of the rollout.\textsuperscript{53} These higher volumes are being maintained. The Caltex/Woolworths JV is expected to result in JV sites making sales at the rate of between 800,000-1,000,000 litres per month. The total fuel retail market is estimated at about 1,900 million litres (ML) per month. The SSA estimates that 580 Coles/Shell sites should sell about 650,000 litres per month while the 450 Caltex/Woolworths outlets should each sell about 900,000 litres per month. Therefore, the two major supermarkets were estimated to sell about 790

\textsuperscript{52} See \textit{id.}, p. 1.
\textsuperscript{53} See \textit{id.}, p. 2.
ML per month, leaving about 1,110 ML per month for the remaining sites in the country. Considering a minimum viability of 400,000 litres per month and the total number of fuel retail sites of 8,000, the remaining 1,110 ML per month will only allow about 3,000 sites to operate out of the total non-supermarket outlets of about 7,000.\textsuperscript{54} Therefore, some 4,000 outlets are expected to close.

The SSA calculated that Shell’s market share of 22% (which now comes under Coles’s control) plus Woolworths’ share of 11% yields a total share of 33% to the two major supermarkets. With an estimated further increase in market share of about 17% coming from Coles discount offers and the Woolworths planned increase in sites from 285 to 400, the supermarkets are poised to capture about 50% of the fuel retail market in Australia in two to three years. Table 1.4 shows the relative market share by sales volume by brand in 2006-07, and confirms these projections of the market share of the supermarkets.

<table>
<thead>
<tr>
<th>BRAND</th>
<th>MARKET SHARE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Woolworths/Caltex</td>
<td>22</td>
</tr>
<tr>
<td>Coles Express</td>
<td>22</td>
</tr>
<tr>
<td>BP</td>
<td>19</td>
</tr>
<tr>
<td>Caltex</td>
<td>16</td>
</tr>
<tr>
<td>Mobil</td>
<td>11</td>
</tr>
<tr>
<td>Shell</td>
<td>3</td>
</tr>
<tr>
<td>Independents</td>
<td>7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 1.4 Market share by sales volume, Australia: 2006-7


\textsuperscript{54} See \textit{id.}, p. 2.
The SSA contends that the real impact of such concentration of market power will be to put immense pressure on independent service stations, particularly those in rural and regional Australia and will inevitably lead to the closure of many of these, thereby depriving regional communities of necessary fuel supply services. Moreover, the mechanical repair business associated with most of the rural and regional sites will also disappear. The SSA contends that since the independents have little access to substantial financial support, they will be decimated within a few years under such a market environment, unless the government places restrictions on the activities of supermarkets. Future rises in fuel prices are anticipated, should the projected large number of retail outlets be allowed to close.

The SSA concluded that the supermarket offerings will result in a massive realignment of the supply–demand balance in the fuel retail industry, such that between 40% and 50% of currently existing fuel sites will not be viable and will have to close. Most of the independent outlets are expected to disappear and with them the only real capacity for increasing the scope of competition. They argued that as a minimum the government should outlaw ‘loss leading’ in the fuel retail trade as represented by the shopper docket offers or offer comfort to such rural and regional areas as might be affected by the widespread closure of rural fuel outlets.

\[55\text{ See } id., \text{ p. 1.}\]
1.5 Analytical framework

1.5.1 Research problems
The presence of few fuel outlets in rural and remote locations results in pricing problems, such as high rural fuel prices and rural–urban pump price differentials. A resolution of these problems is expected to boost rural development activities. Fuel retailing in such locations is an endogenous economic activity. However, these problems pose concerns not only to rural communities but also to governments, because high fuel prices generate significant multiplier effects on the cost of transportation, and by extension the prices of all consumer goods/services, and rural business activities. This situation suggests that some regulation of fuel retail activities (as an exogenous input) in such locations might be necessary. However, the question arises as to whether the regulation of fuel retailing activities in rural areas would contribute to a rural development policy.

Preliminary research outcome indicates that government responses are generally in the form of regulatory support mechanisms and fuel subsidy schemes. The former encourages and promotes the activities of independent rural fuel retailers whereas the latter sustains those activities. Another question arises as to whether state aid is necessary in order to promote effective fuel retailing activities in rural areas.

1.5.2 Research questions
The two main research questions are:

(a) ‘How can the regulation of fuel retailing activities contribute to a rural development policy’?

(b) ‘Is state aid essential in promoting fuel retailing activities in rural areas’?
1.5.3 Hypotheses
This study hypothesises that:

(a) The regulation of fuel retailing activities, as an exogenous factor, could contribute to a rural development policy if regulatory support mechanisms and fuel subsidy schemes are targeted at rural transport, and energy infrastructure reforms.

(b) State aid is necessary in promoting fuel retailing activities in rural areas, particularly where market failures have been identified, because economically viable rural areas are necessary conditions for balanced national development.

1.5.4 Research objectives
The objectives of the study are to:

(a) review the literature on regional development theories and approaches to rural development policy in order to identify appropriate theories or approaches that could be applied to the research project;

(b) identify the variety of regulatory support mechanisms and fuel subsidy schemes used to promote fuel retailing activities in rural areas in both jurisdictions;

(c) determine the current relevance and applicability of identified regulatory support mechanisms and fuel subsidy schemes in the regulation of fuel retailing in rural areas;

(d) examine state aid instruments in both jurisdictions in order to determine whether, and if so, how state aid could assist fuel retailing activities in rural areas and/or how state aid instruments could be used to facilitate a rural development policy;

(e) investigate trends in rural development policies in both jurisdictions in order to explain possible differences in approaches to rural development (if any), and to determine the role of fuel retailing activities in an overall rural development strategy;

(f) propose how the regulation of fuel retailing activities could contribute to a rural development policy;
(g) propose or recommend additional regulatory measures that could enhance the regulation of fuel retailing activities such as could boost rural development.

1.5.5 Research purpose
The outcome of the author’s extensive review of the literature on research methods and methodology indicates that research scholars have identified four main purposes for research activities: explanatory, descriptive, exploratory, and prescriptive purposes.\(^5^6\) Patton contends that clarity about purpose is the controlling force in research because decisions about design, measurement, and analysis all flow from it.\(^5^7\) Therefore, he suggests, the researcher should identify the purpose/s for his/her research project (as different from research objectives) by correlating the research questions to the research objectives.

1.5.5.1 Explanatory
Wisker explains that “explanatory research serves to clarify the relationship between variables and the components of the research problem/s. It highlights the complex inter-relationships existing within a particular phenomenon and contained within the research problem/s”.\(^5^8\) Punch reinforces this idea by stating that explanatory (causal) research clarifies the nature of the problem under investigation and explains the basis for any proposed solution. Therefore, this kind of research helps “to explain the

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\(^{56}\) Wisker, G., The Postgraduate Research Handbook pp. 119-122 (2001). Also see Hart, C., Doing a Literature Review: Releasing the Social Science Research Imagination p. 47 (1998). The author’s chosen reporting style for this section and the methodology section is to clarify what the literature on research methods and research methodology says about these sections, and then to relate these to the author’s chosen research purpose and methodology. The aim of this reporting style is to make the choices of purpose and methodology more explicit and clearer.

\(^{57}\) Patton, M. Q., Qualitative Research & Evaluation Methods p. 213 (3\(^{rd}\) ed., 2002).

\(^{58}\) See Wisker; supra note 56, at p. 120. Also see Miles, M. B. & Huberman, A. M., Qualitative Data Analysis pp. 90-91 (2\(^{nd}\) ed., 1994).
complex web of interrelated variables identified and follows from a clearly stated central research question/s and hypothesis/es”.

Both research questions in this thesis possess a fundamentally explanatory intent. Responding to these questions requires the clarification of the research variables such as regulation of fuel retailing activities, state aid as a regulatory tool, and a rural development policy. The research questions can only be answered satisfactorily, and the requirements of research objectives (b), (d), and (f) properly addressed, if the relationship between these three variables is explained. To this extent, this research adopts an explanatory purpose.

1.5.5.2 Descriptive

Miles and Huberman explain that “descriptive research serves the purpose of collection, organisation and summarisation of information and data about the research problem and issues identified therein. This entails an adequate examination of the research problem for the specific purpose of describing the phenomenon by defining, measuring and clarifying it”.

All research is partly descriptive in nature, especially with regard to the ‘who’, ‘what’, ‘when’, ‘where’, ‘why’, and ‘how’ of the study. Therefore, this research adopts a descriptive purpose in parts. To answer the research question and test the proposed hypotheses, it is necessary to address the following research sub-questions:

(a) What are the essential components of a rural development policy?

(b) What are the existing theories on rural development? And if none, what approaches could be deduced from existing theories on regional development?

(c) If so, what are the likely approaches to rural development?

(d) How does the concept of regulation relate to rural development, universal service obligations, and the principle of universality?

(e) How can the concepts of subsidies and state aid be defined and differentiated in relation to the research questions?

These research sub-questions correlate with the research objectives (a)–(f), are integral to the testing of the hypotheses, and are necessary for answering the research questions. However, these questions can only be answered implicitly through the literature review (Chapter 2) and accordingly impose a partly descriptive purpose to this research.

1.5.5.3 Exploratory

Wisker suggests that the primary purpose of exploratory research “is to explore a complex phenomenon, with the objective of clarifying the identified complexities and the revelation of the underlying nature of the phenomenon”. ⁶¹ As Sekaran further clarifies, “exploratory research investigates a specified phenomenon/problems for the purpose of shedding new light upon it and, consequently, uncovering new knowledge”. ⁶² Wisker explains that exploratory research can be carried out through case studies, focus group interviews, structured or semi-structured interviews with experts, and a search of the relevant literature.

⁶¹ See Wisker; supra note 56, at pp. 119-120. For more details, see Miles & Huberman; supra note 60, at pp. 172-174.
This research adopts the case study approach in investigating the research questions, and in testing the hypotheses. The first research question is essentially exploratory in nature and correlates with research objectives (b), (d), and (e).

1.5.5.4 Prescriptive

Wisker contends that a prescriptive research study is a one that aims to propose well defined solutions to the investigated research problem. Prescriptive research prescribes a set of solutions or recommendations, but also presents a well defined, comprehensively explained, and feasible solution. Patton further clarifies that descriptive, explanatory, and exploratory purposes tend to focus upon facts on the ground, but the prescriptive purpose focuses on what should be and what should not be done. Other research scholars agree that research that embraces the prescriptive purpose tends to be more valuable than that which eschews it, since it adds to and expands the parameters of the field.

The first research question, the research hypotheses, and research objectives (f) and (g) impose a prescriptive purpose upon the study. Simply, one of the main objectives of this study is to generate a set of solutions and recommendations (based on research findings) on how the regulation of fuel retailing activities in rural areas can potentially contribute to a rural development strategy. Accordingly, the ultimate purpose of the research is prescriptive in nature.

63 See details of the case study design in the methodology section of this thesis.
64 See Wisker; supra note 56, at pp. 121-122.
65 For clarifications of the difference between basic research and applied research, see Patton; supra note 57, at p. 217.
66 These include Sekaran 2003, Punch 2000, etc.
1.5.6 Methodology
Hart defines research methodology as “a system of methods and rules to facilitate the collection and analysis of data. It provides the starting point for choosing an approach made up of theories, ideas, concepts and definitions of the topic; therefore the basis of a critical activity consisting of making choices about the nature and character of the social world (assumptions). This should not be confused with techniques of research, the application of methodology”. Thus, research methodology is slightly different from research design.

Research design refers to the research blueprint by which it is possible for other researchers’ to replicate the process, whereas research methodology refers to the procedural rules for the evaluation of research claims and the validation of the knowledge gathered. Therefore, research design is an integral aspect of research methodology.

Hart clarifies that research methodology is of critical importance because it identifies the research tools and strategies that will be employed in a research project, and relates their use to specified research aims. This is consistent with Sekaran’s suggestion that “the relevance of a research methodology stems from the fact that it defines the activity of a specified research, its procedural methods, the strategies for progress measurement, and the criteria for research success.

67 See Hart; supra note 56, at p. 28.
On the other hand, the function of the research design is to articulate the strategies and tools by which data and information will be collected and analysed. The research design also connects the research questions to the data/information and articulates the tools by which research hypotheses could be tested and research objectives achieved. In order to exercise these functions, a research design proceeds in four steps. The first step involves the articulation and selection of the research questions. The second step requires identification of the relevant data/information. The third step involves a determination of the data/information collection focus. The fourth step deals with the selection of the method by which data will be analysed and verified.

1.5.6.1 Research approaches

According to Sekaran, the selection of research approach or approaches is a critically important decision, because it gives the researcher the opportunity to consider how each of the various approaches may contribute to, or limit, his/her study. This allows the researcher to satisfy the articulated objectives and research questions and to design the research to satisfy its requirements.

Hart explains that the research approach embraces the quantitative versus the qualitative, and the deductive versus the inductive. Each set of approaches is perceived as referring to polar opposites. However, a researcher should not limit him/herself to any particular approach, but could use a variety of approaches as required by the study.

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68 See Sekaran; supra note 62, at pp. 117-119. For details on issues and options in research design, see Hart; supra note 56, at p. 49.
69 Creswell, J. W., Research Design: Qualitative, Quantitative, and Mixed Methods Approaches pp. 73-86 (2nd ed., 2003). Also see Punch; supra note 59, at pp. 62-68.
70 See Sekaran; supra note 62, at pp. 117-119.
71 See Punch; supra note 59, at pp. 19-27.
1.5.6.1(a) Deductive versus inductive approaches

The deductive approach may be referred to as a testing of theories.\textsuperscript{72} Sometimes, theories are not available for use for particular research projects, in which case the researcher may opt for testing derived or explicit approaches, or conceptual precepts to the subject area. Hart explains that in the case of the deductive approach, the researcher proceeds with a set of theories and conceptual precepts in mind and formulates the study’s hypotheses on their basis. The researcher then proceeds to test the proposed hypotheses. Conversely, the inductive approach commences with a set of observations from collected empirical data and proceeds to formulate concepts and theories in accordance with the observations.\textsuperscript{73} The choice of which method to adopt would largely depend on the research questions, the proposed hypotheses, and the research objectives.

This research opted for the deductive approach, in line with the proposed hypotheses and research objectives. This research adopts the territorial concept of rurality and a mix of endogenous and exogenous approaches to rural development as the basis for argument.\textsuperscript{74}

1.5.6.1(b) Justification for the choice of territorial approach

There are two main approaches to the concept of rurality: rural as a distinct locality, and rural area as a social representation (i.e. territorial approach). The concept of rurality chosen depends largely on the problem to be solved and the case studies


\textsuperscript{73} For more details, see Hart (1998); \textit{supra} note 56, at pp. 81-83

\textsuperscript{74} The territorial concept of rurality and the mix of endogenous and exogenous approaches are explained in more details in Chapter 2.
involved. In the context of this thesis, the territorial approach is the relevant one because it enables the author to regard rural space as a territorial entity, which embraces a regional economy with agricultural, industrial, and service activities. This choice enables the author to take into account other economic activities and relationships within a rural space, instead of conceiving the rural space as one meant for agricultural activities primarily, and every other activity as ancillary.

1.5.6.1(c) Justification for the adoption of the mix of endogenous and exogenous approaches

This approach emphasises the need to forge a link between local actors (entrepreneurs, local and municipal governments, local investors, local associations, etc.) and external institutions (regional and national governments, external private investors, etc.).

According to this approach, rural development can be seen as a complex interplay of networks involving these local actors and external factors whereby resources are jointly mobilised and deployed, and control of the rural development process becomes the responsibility of local and external forces.

The nature of fuel retailing in rural areas, the associated rural problems, and by extension rural development would suggest the need for such interplay of local actors (fuel retailers, local governments, local associations, etc.), and external institutions (regulatory ministries, regional administrations, national governments, etc.).

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75 For details on this mixed approach, see Chapter 2 (Literature Review) pp 24-26.
1.5.6.1(d) Quantitative versus qualitative approach

Punch clarifies that qualitative analysis usually follows from qualitative research techniques, using for instance interviews, case studies, etc. Conversely, Creswell contends that quantitative tools are commonly used for the production of statistical data and data analysis. The tools are structured in such a way as to guarantee objectivity, generalisability and reliability. In this case, the results that are generated through the application of the tools are expected to be constant if the study is replicated, regardless of the identity of the researcher. This also involves the inclusion of a random and unbiased selection of respondents.

The first of these tools (means, standard deviations and frequency distribution) is a cost-efficient method of reducing close-ended questionnaire data into straightforward statistics. These statistics would represent the average and variability of responses, with frequency distribution acting as the graphical representation of the numbers of times particular responses were given. The second tool (scattergram and regression analysis – correlation coefficients) goes a step further in that it helps the researcher to draw conclusions on the relationship between the variables. The third tool (difference or variance tests) measures one sample against a control group or baseline for the purpose of examining the differences between specific variables over a timeframe.

76 For details on designing a qualitative research, see Punch; supra note 59, at pp. 133-148. See Miles and Huberman, Framework for Qualitative Data Analysis; supra note 60, at pp. 5-11. See Patton; supra note 57, at pp. 209-222. For details on hypothesis testing with qualitative research, see Sekaran; supra note 62, at pp. 109-112. For details on qualitative research procedures, see Creswell; supra note 69, at pp. 179-197.

77 See Creswell; supra note 69, at pp. 153-166. For details on quantitative research design and collecting quantitative data, see Punch; supra note 59, at pp. 62-103. For details on experimental designs, see Sekaran; supra note 62, at pp. 144-163.

78 See Punch; supra note 59, at pp. 109-111. See Creswell; supra note 69, at pp. 172-173. Also see Sekaran; supra note 62, at pp. 311-314.

79 See Punch; supra note 59, at pp. 118-124. Also see Sekaran; supra note 62, at pp. 397-405.

80 See Punch; supra note 59, at pp. 113-117.
From the foregoing, it could be deduced that the conditions necessary for the use of quantitative tools are based primarily on the presence of quantifiable research data and the goal of reducing that data into statistical representations that generate observations and patterns. This study does not lend itself to the quantitative approach, but historical data are used where necessary to buttress an argument. This research confines itself to a variant form of the qualitative approach – the comparative contextual analysis.\(^8^1\) Banaker and Travers explain that in socio-legal studies, methods can only be better understood by looking at the different theoretical traditions that underpin the research project. Therefore, methods in socio-legal studies are not just techniques that can be employed to obtain facts about the social world, but can be used as part of a commitment to a theoretical perspective or approach.\(^8^2\)

The selection of research questions and the proposed hypotheses lend themselves to this approach. Therefore, this thesis employs the comparative contextual analysis (or what Gerring refers to as qualitative comparative analysis\(^8^3\)) as the methodology for contrasting the regulation of fuel retailing activities in the UK and Australia; the application of state aid in rural fuel retailing or for boosting rural development in the two jurisdictions; and rural development objectives in both jurisdictions. This choice is informed by the fact that this methodology takes into account the reality of social, economic, political, and historical variables impacting on fuel retailing activities in different jurisdictions.

Testing of the hypotheses of this study involves choosing common comparators for investigating and analysing fuel retail regulation in the two jurisdictions, and likewise state aid provisions for facilitating rural fuel retailing or rural development, and rural development objectives.

The first action involves choosing common comparators for fuel retail regulations which are: fuel retail site regulation; licence/franchise regulation; retail/wholesale price regulation, fuel tax regulation; and environmental regulation. Sites and licence/franchise regulations are relevant comparators in the context of this study because the number of sites belonging to the different categories of fuel retail operators and the licence/franchise agreements between the oil majors and their dealers affects the concentration levels of the fuel retail sector and by implication the barriers to entry. Price and fuel tax regulations are useful comparators because these are directly related to the research problems, i.e. the problems of high rural fuel prices and the rural-urban fuel price differentials.

Environmental regulation has been included as one of the comparators (under fuel tax regulation) because of the current emphasis on combating climate change and protecting the rural environment. Moreover, there is a relationship between modern fuel tax objectives, fuel subsidy schemes and environmental objectives. Contemporary fuel tax objectives include: improvement in air quality and reduction of greenhouse gas emissions; supporting rural and regional development through promoting the production of petroleum product substitutes using agricultural products; and supporting industries that manufacture equipment required to use

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84 These comparators are based on the identified regulatory support mechanisms and fuel subsidy schemes used by both governments in dealing with the research problems. These mechanisms and schemes are summarised in tables 3.1-3.4 (Chapter 3).
petroleum product substitutes (e.g. LPG conversion kits). However, competition regulation is not included in the set of comparators because of the absence of effective competition in most rural/remote areas as a result of the presence of relatively fewer outlets. Moreover, the solution to the research problems does not lie in competition legislation and the two jurisdictions did not provide for such solutions under their respective competition legislations.

The second action involves a comparison of the UK/EU approaches to state aid with the Australian perspective. This includes an identification of the fuel subsidies that are applied in both jurisdictions to promote fuel retailing in rural areas, and their implications for modern fuel tax objectives. The third action involves a comparison of the rural development models in both jurisdictions and a determination of whether these objectives align with an endogenous, or exogenous, or a mix of endogenous and exogenous approaches to rural development.

1.5.6.2 Research Strategy

This study identifies three basic research strategies, or plans for addressing research question/s. These are the survey, the experimental, and the case study strategies. Others might include histories, and economic and epidemiologic research. A researcher may select one, a combination of several, or all of these strategies depending on the nature of the study and the research objectives. Scientific researches tend to use experimental strategy, while the social sciences tend towards survey and case study strategies.

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However, this study adopts the case study strategy based on the conceptual model approach. The conceptual model that is adopted for the purpose of this study is the mix of endogenous and exogenous approaches to rural development. “Case studies are the preferred method when (a) ‘how’ and ‘why’ questions are being posed, (b) the researcher has little control over events, and (c) the focus is on a contemporary phenomenon within a real-life context”. This situation distinguishes case-study research from other types of social science research. Fundamentally, the two research questions which this study aims to answer are ‘how’ and ‘why’ questions, and the issue of fuel retail regulation as it relates to rural development policy is not an abstract but a contemporary issue within a real-life context. Contemporary issues are not within the control of the author of this research, as should be expected in non-experimental research. **Table 1.5** shows the relevant situations for different research methods.

Yin argues that conceptual models are useful for the collection of well defined information and its later analysis and discussion. He explains that this approach is more often used when an issue or issues are being compared and contrasted, and enables the mapping of the issues and for their analyses. Yin further explains that this method enables the explanation of facts through theories or conceptual approaches; the expansion of knowledge through the classification of the relationship between reality and theory or conceptual approach; and most importantly, is best suited for the comparison of two entities.

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86 See *id.*, p. 2.
87 Answers to these questions should ultimately yield a set of recommendations on the best way forward in resolving the research problems.
88 See *id.*, pp. 130-132.
89 See Miles & Huberman; *supra* note 60, at pp. 172-177.
Table 1.5 Relevant situations for different research methods

<table>
<thead>
<tr>
<th>METHOD</th>
<th>Form of research question</th>
<th>Requires control of behavioural events?</th>
<th>Focuses on contemporary events</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experiment</td>
<td>How, why?</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey</td>
<td>Who, what, where, how many, how much?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Archival analysis</td>
<td>Who, what, where, how many, how much?</td>
<td>No</td>
<td>Yes/No</td>
</tr>
<tr>
<td>History</td>
<td>How, why?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Case Study</td>
<td>How, why?</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>


The nature of the research questions, research objectives, and proposed hypotheses would suggest the adoption of this research strategy.

1.5.6.2(a) Case study strategy: Justification for the choice of countries
The study compares the UK and Australian jurisdictions on three issues which are interrelated: the regulation of fuel retailing activities in rural areas; the state aid instruments adopted for regulation of fuel retailing sector and/or for facilitating rural development; and the rural development objectives. The primary reason for choosing these countries is because of the seeming contrast between the positions of rural independents in both jurisdictions. Concerns have been raised by regulatory institutions in the UK and Australia about the possible implications of a high rate of retail site closures in rural areas, which includes high pump prices; effects of higher cost of living in rural areas; and the impact of high fuel prices on rural businesses.

90 This refers to the relative position of independent operators in both jurisdictions as at the time of commencing this research in 2004.
However, the measures put in place for dealing with this situation vary between the two countries.

The choice of countries was based on other interesting similarities and differences. For instance current reports confirm that fuel retail sectors in both countries are operating competitively. Both countries have a well developed independent fuels retailing sub-sector, serving both urban and rural areas. Their fuel retail market structures are also similar comprising oil majors, dealers or franchisees, unbranded independents, independent chains, supermarkets. Rural fuel prices in the two jurisdictions are significantly higher than urban or metropolitan prices.

Tables 1.6 and 1.7 show comparison of both jurisdictions, using five basic criteria: economic, legal, political, social systems and historical backgrounds (with respect to fuels retailing). The results also indicate that the two countries share almost the same characteristics on all five dimensions. However, they differ in their legal and political set-up. The UK operates a unitary parliamentary democracy, whereas Australia operates a federal parliamentary democracy. Both have devolved administrations (component states or regions) for the purpose of dealing with localised issues.

They both have sophisticated legislative and institutional frameworks. Moreover, the Australian system is essentially patterned after the UK, due to historical affiliations. However, there is a major difference in their legal systems, which might affect the issues of regulatory reforms and granting of certain forms of subsidies or state aid. Both countries operate the English common-law traditions. However, as a member of the EU, the UK is bound to apply and to abide by EU rules and regulations, while Australia, as a non-EU country, is not bound by any regional laws and/or regulations.
Moreover, the research identified that they operate at different stages in the
development of their respective fuel retail sectors. For instance, Australia developed a
sector-specific fuel retail legislation which existed between 1980 and 2007. These
differences could reflect the differential treatment that both countries may have
adopted in dealing with the problem of high pump prices in rural and remote
locations, and those related to the high rural-urban fuel price differentials.

Canada and the US also share the same historical affiliations with the UK and could
have been possible comparators in the context of the study. However, the structure of
the fuel retail trade in Canada differs from that of the UK. The supermarkets are yet to
be involved in fuels retailing in Canada. Similarly, in the US the component states
have different regulatory instruments guiding their fuel retail sector. France and
Germany are also some of the EU countries that have fuel retail structures similar to
those of the UK. However, due to language difficulties and the impact of the civil law
tradition on their administrative processes, the author decided not to choose these as
possible comparators.

Table 1.6 Choice of countries (similarity mapping)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Economic</th>
<th>Legal</th>
<th>Political</th>
<th>Social</th>
<th>Historical (petrol trade)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completely similar</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Similar</td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rather similar</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dissimilar</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: This research.
Table 1.7 Justification for choice of countries (UK and Australia)

<table>
<thead>
<tr>
<th>Country/criteria</th>
<th>Economic system</th>
<th>Legal system</th>
<th>Political system</th>
<th>Social system</th>
<th>Historical background</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>Operates a free and competitive market economy. UK is a member of the OECD.</td>
<td>Common law tradition; accepts ICJ jurisdiction; bound by EU rules and regulations.</td>
<td>Head of State: Queen Elizabeth II. Operates a unitary parliamentary democracy, made up of the Houses of Commons &amp; Lords.</td>
<td>Welfarist and egalitarian society.</td>
<td>Initial entrants into the petrol retail trade were the oil majors and also a few independents who were quickly absorbed. To consolidate their influence, the majors introduced the solus trading scheme in the 1930s as a basis for commercial relationships with dealers and independents. The supermarkets emerged from 1965-75 and are currently threatening to control 50% of the trade.</td>
</tr>
<tr>
<td>Australia</td>
<td>Operates a western-style capitalist economy (patterned after the UK system, based on historical affiliations). Australia is also an OECD member state.</td>
<td>Based on English common law; accepts ICJ jurisdiction; but not bound by any regional rules and regulations.</td>
<td>Chief of State: Queen Elizabeth II. Operates a federal parliamentary democracy, made up of the Senate and the House of Representatives (patterned after the UK political setting).</td>
<td>In line with the UK value system.</td>
<td>Initial entrants were also the oil majors, followed by a few independents that were subsequently acquired by the majors. To consolidate their control on the trade, the majors introduced the solo marketing scheme in the 1960s aimed at establishing contractual business relationships with dealers and independents. Supermarkets entered the trade in the mid-1990s, and based on future outlook they could control about 50% of the trade.</td>
</tr>
</tbody>
</table>

Source: This research.
1.5.7 Sources of evidence
The research coverage includes primary and secondary sources as forms of evidence.
The primary materials would include legal documents (including statutes and cases).
The secondary materials include reports from regulatory authorities in both jurisdictions; publications by industry and trade associations; books; journal articles, monographs, conference papers, institutional research projects, speeches, and other internet sources. It was relatively easier to collect relevant data, reports, and publications on the two jurisdictions, because both governments have enacted a Freedom of Information Act,91 and have similar institutions/agencies and regulatory instruments. Some examples are: the OFT (ACCC), Institute of Petroleum (Australian Institute of Petroleum), Petroleum Retailers Association (Service Station Association), etc.92

1.5.8 Structure of the thesis
This thesis is structured in three parts.

Part 1 (Setting the Scene) consists of three chapters: introduction; literature review; and an overview of rural fuel supply (with emphasis on rural fuel pricing) in the UK and Australia.

Part 2 (Investigation Phase) documents the outcomes of the comparative study and analysis and consists of four chapters: comparative analysis of sites and licence/franchise regulation in both countries; state aid instruments for rural

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92 The words in brackets refer to the Australian equivalents of UK institutions/agencies, and regulatory instruments.
development in both jurisdictions; fuel price and tax regulations; and a comparative analysis of the rural development trends and objectives in both countries.

**Part 3 (Conclusions and Recommendations)** is a chapter that discusses and assesses the research outcomes, validates the hypotheses, answers the research questions, reaches conclusions and makes recommendations based on research findings.
Chapter 2
LITERATURE REVIEW

2.1 Introduction
Hart defines Literature Review as “the selection of available documents (both published and unpublished) on the topic, which contains information, ideas, data, and evidence written from a particular standpoint to fulfil certain aims or express certain views on the nature of the topic and how it is to be investigated, and the effective investigation of these documents in relation to the research being proposed”.¹

The objectives of this literature review are firstly, to develop a conceptual linkage within and across key theories, concepts, and ideas relating to the subject area; secondly, to review and discuss the major issues and debates about the research topic; and thirdly, to use the output of this review to justify the choice of research topic, approaches and case studies.

Chapter 1 identifies broad categories of rural areas. The implication is that rural areas are not uniform in their degree of rurality, and therefore rural development policies will have to consider the peculiar needs of each of these categories. However, this chapter clarifies the meaning of rurality, and reviews regional development theories as well as approaches to rural development. The contribution of this exercise is to assist the author in identifying a rural development approach/s for the formulation of hypotheses for this study.

¹ Hart, C., *Doing a Literature Review: Releasing the Social Science Research Imagination* p. 13 (1998). This definition integrates all aspects of the purposes of a literature review.
This chapter also reviews the related concepts of regulation, public service obligation and universality, and state aid/subsidies. The contribution of this objective is to furnish some insight into, and to develop rationale that explains, why governments intervene in the workings of markets, and to determine whether regulatory measures (including public subsidies) are applicable to the fuel retail sector. This chapter equally contributes to an understanding of the factors to be considered when analysing the applicability of different categories of public subsidies to a given situation.

2.2 Review of the theories of rural economic development
This aspect of the literature review will commence with a definition of the concept of rurality, followed by a review of rural development theories and approaches. The review is aimed at providing a source of factors that affect economic development in rural and remote locations, and provides useful insights into the means by which economic growth in industries and services can be encouraged.

There are two parts to the review of rural development theories. The first part deals more specifically with the debate on economic development in rural regions, which involves three approaches: the exogenous, endogenous and the mixed exogenous/endogenous approaches. The mixed approach conceives rural development as interplay of networks comprising local and external actors, in which case resources are mobilised and the control of the development process rests with both local and external factors.

The second part deals with a general review of regional economic growth theories, and how these theories relate to the three approaches to rural development. This part
will review the following models: traditional, pure agglomeration, local milieu, and territorial innovation models.

2.2.1 The concept of rurality
The debate on approaches to rurality is at the heart of rural studies. Two main approaches can be distilled out of the numerous meanings attributed to rurality. The first approach deals with concepts that describe a rural area as a distinct type of locality and the other deals with concepts that perceive a rural area as a social representation. In other words, the approaches can be seen as ‘the rural as space, and the rural as representing space’. These approaches to the definition of rurality are in turn briefly discussed below.

2.2.1.1 The rural as space
A variety of land-use variables or socio-economic variables create the basis for spatial classifications of rural areas. This approach can be sub-divided into two categories (spatial and territorial) in order to refine the meaning of ‘rural’.

The spatial approach is based on the notion that rural space has some characteristics that are different from urban spaces, and is also rooted in models of spatial economics whereby space is seen as a set of points in which economic agents (i.e. producers,
labourers, and consumers) have to find out their optimal location. Spatial models are mostly linked to a hierarchical vision of space, a ranking of goods and services, and the presence of agglomeration and dispersion forces. With such models, structuring of space commences with a concentration of economic activities at the centre (referred to as urban areas) on the basis of transport costs and economies of scale. The concentration of firms and labour forces at the centre then attracts retail businesses and services, which in turn deliver a diverse range of products, skills, and information. This diversification acts as a further incentive for another round of settlements of firms and labour forces in the centre. This agglomeration becomes a cumulative process that continues until the forces of dispersion are triggered. As competition for land use and negative externalities (e.g. pollution and congestion) becomes manifest, activities and agents are pushed out of the centre. Therefore, activities that are less land-intensive and people who enjoy fewer of the benefits that accrue to the centre tend to move away.

Owing to this complex interplay of agglomeration and dispersion forces, a functional specialisation of spaces emerges. The space thus becomes structured such that the centres and peripheries differ in terms of the density of jobs and people, and also in the structure of economic activities and the characteristics of households. Therefore, the further away a rural location is from the centre, the more likely it is to find fewer basic services, less intensive land-use activities, and a relatively higher proportion of unemployed people. The periphery is often regarded as having traditional economic

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6 See id., pp. 1-3.
and social structures, and likely to have a dependent relationship with the urban
centre. On the basis of the spatial models, ‘rural’ means the ‘periphery’. Therefore,
indices of rurality within the spatial approach would include population density, built-
up areas, land use, share of agriculture in employment, density of societies, and crime
rates.

In contrast with the spatial approach, which emphasises a strong connection between
rural and agriculture and the urban–rural dichotomy, the territorial approach focuses
on the economic diversification of rural areas. In this case, space is divided into
territorial entities that embrace a local or regional economy. Therefore, each territorial
entity consists of one or more centres and ‘open space’ and includes industrial,
 service, and agricultural activities. Some of the territorial entities are referred to as
urban territories because they are densely populated, have a metropolitan centre, and a
small area of open space. The other territorial entities are referred to as rural
territories because they have low population density, one or more small- to medium-
sized towns, and a relatively large area of open space. A wide range of different
settings exists in between the two extremes. However, the interrelationship between
the different territories is not conceived as based on dependence, but rather is
perceived in terms of a set of non-hierarchical competing local economies.⁹

The down side to this approach is that the concepts of territory, local, and regional
economy used are vague. These concepts refer to spatial entities in which political,
economic, and socio-cultural life is structured and whose size may be different from

⁹ Saraceno, E., Alternative Readings of Spatial Differentiation: The Rural Versus the Local Economy in
each other. Another down side is that although rural relates to low population density, this approach did not set a strict criterion for defining what ‘rural’ means. The implication is that the territorial approach provides for the co-existence of different rural territories, depending on the definition of the user for this approach.

2.2.1.2 The rural as a social representation

This constructivist approach views rural space as a mental construct that guides us in dealing with the complexity of the social world. In other words, ‘rural’ is a mental image which enables us to organise our behaviour and responses. Therefore, the mental constructs of rural will vary among actors, depending on place, time, and social groups. Some will refer to the rural scenic nature, open space, recreation, backwardness, etc. Some of these social representations of rural locations conceive of them as productive assets and others as consumption assets. The various social representations reflect the conflicts and controversies about alternative uses of rural space and are also related to the issue of power. Such conflicts might involve farmers’ interest groups, who prefer to exploit rural space and adapt some landscape elements; and tourists or nature conservation interest groups who prefer to retain the natural and cultural values of rural space.

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11 See Halfacree; supra note 3, at p. 29
13 See Pratt; supra note 2, at p. 70.
2.2.2 Review of theories on broader regional economic development and approaches to rural development

It might be useful to discuss the broader regional economic development theories, before going into the narrower development approaches for rural regions. The different theories have ramifications for the choice of rural development options in different jurisdictions.

Three approaches can be sifted from the debate on approaches to rural development: the exogenous, the endogenous, and the mixture of the exogenous and endogenous development approaches. These approaches are useful in the conceptualisation of rural development, and have varying implications for the strategies employed by local actors and for rural development policies. These approaches also correspond closely and respectively with the broader theories on regional economic development, namely agglomeration models, the local milieu models and the territorial innovation models.

2.2.2.1 Regional economic development theories

Rural and regional development has a body of theory, which is made up of various informal models. However, “there is no single, broadly accepted and formally defined model that is codified in economics journals”.14 Camagni defines regional development as “the ability of each region to produce (with a comparative advantage) the goods and services that are demanded by the national and international system of

which they form a part”. This definition implies that the process of regional economic change is part of interregional interdependencies, whereby some regions experience more development relative to others, albeit the overall level of regional development may increase in the long run.

Regional firms and production circumstances tend to determine the economic development process considering that firms’ ability to adapt to changes is at the core of realising economic growth. Theories of regional economic growth can be subdivided into four groups depending on the factors in the production function: traditional growth theories, pure agglomeration models, local milieu models, and territorial innovation models. These are discussed below.

2.2.2.1(a) Traditional growth theories

These theories emphasise that output is measured as a function of the input of capital and labour. The neoclassical growth theory and the Keynesian export base theory are the main exponents of traditional growth theories.

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18 Discussion is based on the following contributors: Camagni (supra note 13); Lamboooy (supra note 15); Healy & Ilbery (supra note 16); Malecki, E. J., Technology & Economic Development: the Dynamics of Local, Regional, and National Change (1991); Rijswick, C. W. J., Regional Economic Theory: Its Usefulness for Explaining Economic Development in Rural EU Regions (1997); Molle, W. & Cappellin, R., Regional Impact of Community Policies in Europe (1988).
According to the **neoclassical growth theory**, the evolution of regional growth differences depends on interregional mobility of the factors of production.\(^{19}\) Therefore, given identical production functions, it is expected that capital will ‘migrate’ to regions or localities where labour is abundant and cheap. Likewise, labour is expected to move in the opposite direction. These flows are likely to continue until return on capital and labour are equal in each region. Ultimately, per capita incomes are expected to converge.

Based on the neoclassical theory, the best policy to counter unequal development of regions is non-intervention in terms of built and cultural assets. The aim of public policies in this regard would be to create dynamic rural economies that help bridge the gaps between standards of living with urban areas. Firstly, according to this theory devolution of local responsibilities to local governments is advisable, because devolution has the potential benefit of increasing local ownership and responsibility for rural development policy. This process is followed by active government support that is coordinated with local initiatives. Secondly, active labour market policies that incorporate sufficient flexibility to deal with rural conditions are necessary for enhancing rural employment opportunities. Thirdly, the education and training needs of rural and regional inhabitants\(^{20}\) is designed to be closely linked to business creation and expansion policies in order to achieve the desired efficiency purpose.

However, the future of rural areas is likely to be influenced or transformed by the availability of new information technology and the emergence of information


highways. These technologies will tend to mitigate the disadvantages of distance and low density. It appears unlikely that adequate investment in information technology will take place in rural areas without public support. Therefore, public policies will still play a crucial role in facilitating the transition of rural areas, but these must be tailored to the specific features of particular areas and should be flexible enough to deal with the diversity of rural places.\textsuperscript{21}

In the case of the \textbf{Keynesian (export-based) theory}, economic activities are divided into basic activities for export and non-basic activities for domestic consumption. Based on this theory, regional economic changes would depend on the relative proportion of economic activities in a region that produces goods and services for export from the region. A decent growth of the basic export activities are expected to increase the flow of money into the region, increase the demand for goods and services within it, and thereby caused a corresponding increase in the volume of non-basic activities.\textsuperscript{22} The size of this multiplier effect would depend on the amount of money that is spent in the region. In the neoclassical model, government is expected to pursue active labour market stimulation, whereas in the Keynesian model, the production of goods and services is naturally expected to boost employment.


2.2.2.1(b) Agglomeration models

Agglomeration models pursue the idea that a concentration of the factors of production in a specific location can create external effects or scale economies. Cumulative causation theories and growth pole theories are the main exponents of these models.

The **cumulative causation theory** posits that in the presence of regional growth disparities, a self-reinforcing process starts that tends to maintain the status of growing areas. The outcome is divergence among regions, contrary to the neoclassical theory where convergence is the expected trend. This theory assumes that firms in wealthy regions have distinct advantages relative to firms in lagging regions. For instance the size of the market is larger, enabling scale economies; the possibilities for innovation are greater; and the quality of the labour force is better. Therefore, an expansion in the wealthy region leads to a migration of human resources from lagging regions. In addition, new firms could be attracted to the wealthy regions due to the already existing concentration of economic activity. This possibility could in turn induce another wave of expansion and migration of labour. Moreover, the production of consumer services will also expand to accommodate the increasing population in the wealthy regions. The increase in tax revenues enables the local/regional government to provide more and better infrastructure in the leading regions. This cumulative process of expansion and concentration of economic activities in the wealthy region implies that lagging regions would be deprived of capital and labour. As a result, the lagging regions would sustain cumulative disadvantages and may not afford good infrastructure, school systems, and other public utilities. This will in turn increase their disadvantages and backwardness. In the long run, a de-concentration of
economic activities from the wealthy region commences due to high land prices, shortages in the labour market, traffic congestion, etc. According to his theory, these ‘spread effects’ are not strong enough to rectify the divergence in economic growth between wealthy and lagging regions.

Based on this theory, the public policy responses should be in the form of active implementation of rural development and rural adjustment programmes and schemes because the theory assumes that inequalities among regions are an inherent outcome of the interplay of market forces.\textsuperscript{23}

The growth pole theories are based on the existence of a large and leading firm which propels and stimulates other industries and businesses through multiplier effects.\textsuperscript{24} This firm also acts as a growth pole, because it is relatively large, belongs to a growth sector, and has a high ability to innovate and to create growth. Such a firm can generate three forms of multiplier or polarisation effects. The first pertains to technical multipliers which are achieved through linkages with upstream and downstream industries. The second concerns income multipliers as a result of increased employment which increases the demand for consumer services. The third relates to psychological effects which accrue from the optimism that the presence of a


large firm can generate. Based on these multipliers, the leading or propelling firm can become a ‘growth pool’ by enhancing a positive regional economic environment.

2.2.2.1(c) Local milieu models

According to this group of theories a number of factors within the local milieu (including skill base of the local labour force, technical and organisational know-how, and local social and institutional structures) affect the revenues from labour and capital inputs. Among these theories, there are two major categories: endogenous growth models and theories based on changes in labour organisation.

The endogenous growth theories pertain to non-metropolitan but agglomerated areas with small- or medium-sized firms. These rural economies are usually characterised by production flexibilities, entrepreneurship, district economies, etc.

Theories that emphasise the changes in labour organisation relate to variations in the composition of the labour force among regions in terms of number, costs, skills, and mobility. These differences affect firms’ location decisions. These theories connect with two other theories: spatial division of labour and the regulationist theory. The theory on spatial division of labour posits that spatial inequality is both produced and taken advantage of by firms in their bid for favourable conditions for gainful production. Therefore, investment is attracted to areas with profitable

opportunities, and disinvestment occurs in areas with exhausted opportunities. Consequently, a pattern of geographical differentiation appears and is constantly transformed by further rounds of investment and disinvestment. The regulationist theories advance the notion that capitalist economies develop and evolve through a series of regimes of accumulation, especially in the way labour is organised and controlled in the production process. In this case, the transition period from one regime (e.g. Fordism) to another (e.g. post-Fordism) can be of critical relevance because these are usually followed by a decline of the industrialised regions under the succeeding regime.

2.2.2.1(d) Territorial innovation theories

These theories extend from the local milieu models and emphasise the diffusion of innovations, which is critical to growth. These theories stress that technological ability to adapt to innovations is crucial for entry into new types of production and markets. Various theories come under this group, namely incubation theories, product life cycle theory, the theory of innovative milieu, Porter’s theory, and Storper’s theory.

Incubation theories emphasise the natural tendency of research and development (R&D) and innovative activities to flow towards areas where there is a concentration of people and activities. These areas then benefit from external economies, organisational and technological know-how, and the spin-off effects of a skilled labour force. They create a fertile environment for further innovations. This implies that on the basis of incubation theories, current core economic areas are likely to be the future core areas because they are sustained by continuous innovations.
Product life cycle theory builds on the incubation theories, and can be sub-divided into three phases: innovation, growth, and maturity. According to this theory, locational shifts occur in various phases of the product life cycle. The innovation phase occurs in areas with a high concentration of technical and scientific labour. At the other extreme (maturity stage), the product requires areas with a high amount of low-cost labour (e.g. peripheral regions).

The theory of innovative milieu conceptualises the innovation-driven industrial behaviour within a geographical area and connects the local milieu with innovative processes. Such processes generate dynamic efficiencies to the local milieu. These efficiencies are reflected in the capacities for reshuffling resources from declining production sectors to new ones while using the same technology; the capacity to imitate and create technology; the ability to regenerate a local economy hit by natural causes; and fast reaction capabilities.

Porter’s theory distinguishes two types of competitive advantages for firms: lower costs and product differentiation. This theory asserts that firms can gain and sustain competitive advantage through improvement, innovation, and upgrading. Although the analysis was based on the competitive advantage of nations, it can also be applied to geographic units smaller than a nation.26

Porter identified four main variables (factor conditions; demand conditions; related and supporting industries; firms’ strategy, structure, and rivalry); and two ancillary variables (government and chance) that create a regional context in which competitive

actions of firms could be analysed. These six variables together constitute a dynamic mutually reinforcing system of determinants of competitive advantage for nations or regions (i.e. the so-called diamond). These variables are also influenced by political and socio-cultural factors and are transformed into a dynamic system by domestic rivalry and geographic concentration. Porter found that successful firms are frequently concentrated in particular regions within a country.  

**Storper’s theory** conceives of regions as nexus of untraded interdependencies, which accounts for why specific regions keep emerging as centres for new rounds of economic activities at a time of increasing ease in communication and transportation.  

The theory explains that firms are linked to other firms through formal exchanges (e.g. input–output linkages) and through informal exchanges (i.e. untraded interdependencies). The latter would include labour markets, public institutions, and conventions (e.g. customs, values, etc.). According to this theory, untraded interdependencies are crucial in the capitalist system because all production systems are subject to uncertainty and these are largely resolved through conventions.

There are different combinations of uncertainty and different conventions among regions, leading to different frameworks of productive activities. Therefore, the evolution of the productive or economic system is path-dependent as it involves interdependencies that were considered in making choices over a period of time which

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are irreversible. These interdependencies and the underlying conventions that drive them tend to affect the input–output system, labour market, and knowledge system. The combined effect is the tendency for the production system to move from generality to specificity (e.g. Silicon Valley).

Regional growth theories inform the growing debate on economic development in rural regions. As earlier mentioned, there are three approaches to a rural development policy, and these are discussed below.

### 2.2.2.2 Review of approaches to rural development

#### 2.2.2.2(a) The exogenous development approach

The exogenous models emphasise that rural development is externally determined and the benefits of development are exported from the region, while local values tend to be disregarded by the exogenous actors.²⁹

The model suggests that modern developments lead to a division of economic activities between urban and rural areas, such that urban areas become the repository of major industries and services and rural areas that of agricultural activities. The agricultural sector is seen as dependent on the urban sector because demand for agricultural products mostly comes from the urban sector; is a source of patronage for commodities used in the urban industrial sector; is a source of labour and capital for the industrial sector; and a source of foreign exchange to support the development process of urban areas. Conversely, it might rather be argued that the urban sector is dependent on the agricultural sector for these factors of production and consumption.

Therefore, the process of agricultural development and by extension rural development is perceived as externally determined by the urban sector, in the sense that the products cannot be entirely consumed in the locations where they are produced.

Research shows that the dominant model for explaining rural development until the 1970s was the exogenous development approach. For instance, the EU reflected this model in a rural development policy targeted at modernising the agricultural sector in order to stabilise the rural economy (i.e. the Common Agricultural Policy). This measure proved to be insufficient and subsequently the growth pole theory was additionally adopted, whereby manufacturing companies domiciled in urban areas were encouraged to relocate to rural areas in order to create employment opportunities for the rural population. By the late 1970s, these policies were found to have fallen short of the goal of sustainable economic development of rural regions.  

2.2.2.2(b) The endogenous development approach

This approach is regarded as local development engendered by local action funded by local resources. The benefits of development are retained in the local areas and local values are respected. The emphasis of rural policies has shifted towards a bottom-up

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approach, rural diversification, encouragement of local initiatives and enterprises, support for local businesses, and provision of suitable training.\textsuperscript{32}

This approach is related to the local milieu models, whereby the institutional context of economic activities matter. Therefore, relations between firms and individuals in the local system are established by national and local regulations, local rules and customs that are rooted in the local historical culture.\textsuperscript{33}

This approach embodies two specific rural theories: Bryden’s theory (on the potentials of immobile resources for creating competitive advantages in rural areas), and the community-led rural development theory.

\textbf{2.2.2.2(b)(i) Bryden’s theory}

This theory argues that given the increased mobility of financial and capital flows, skilled labour, information, and other goods and services in an era of globalisation, these resources constitute an unstable basis for rural development. Moreover, these mobile resources are scarce, which implies that rural areas have to compete fiercely for them with each other and with urban areas. The theory thus argues that the development strategy for rural areas should be based on immobile resources that are not subject to competition.\textsuperscript{34}

\textsuperscript{32} See Lowe et al. \textit{supra} note 30, at p. 91.
Immobile resources here are defined as resources that are specific to the locality and cannot be moved to another location. Some are tangible (e.g. property, physical infrastructure, and natural resources), and others are intangible (e.g. knowledge, values, and culture).

These immobile resources reveal the constraints and opportunities for rural development and reflect the effectiveness of local and regional institutions in handling these opportunities and constraints. Based on this theory, economic development of rural areas can be achieved through a combination of tangible and intangible local resources. Therefore, rural development can be explained by how these resources interact with each other in the local context.

Bryden groups these immobile resources under four categories:

a. **Local knowledge capital**: this reflects the capacity of the area to generate, sustain, and build on formal and informal stocks of knowledge and information.

b. **Social capital**: this includes social features, e.g. trust, norms, and networks which facilitate coordination and improve the efficiency of society.

c. **Environmental capital**: this reflects the actual physical features and conditions of the space of an area. It includes natural environmental heritage.


(landscape, climate, etc.), and built environmental capital (structures of historical importance, physical and tourist infrastructure).

d. Cultural capital: this includes customs, language, history, music, art, literature, etc., which define a particular society.

Considering these four types of immobile resources, an endogenous development approach suggests the existence of a local growth potential in each region that is awaiting development. Based on this model, the emphasis in rural development policies has shifted towards support for local entrepreneurship; and from a single agency activity towards an integrated and interdisciplinary approach; and from a traditional support structure towards the creation of a network structure.

On the contrary, Slee argues that an endogenous development approach is a concept without clearly defined theoretical roots, but is a perspective on rural development strongly argued on the basis of value judgements about desirable forms of development. Slee considers only the existence of an exogenous model in which external forces are the principal determinants of rural development, with endogenous factors playing a role in nurturing the process.

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37 See Slee; *supra* note 29, at p. 191.

38 See *id*, pp. 193-194.
2.2.2.2(b)(ii) Community-led rural development theory

This theory stresses encouragement of the self-help capacity of local actors, which is considered as a pre-condition for establishing and sustaining rural economic development. Different authorities have used different phrases to capture the essence of this theory, e.g. ‘community development’ (Keane and O Cinneide)\(^{39}\), ‘community-led rural development’ (Murray and Dunn),\(^{40}\) and ‘bottom-up partnership approach’ (Mannion).\(^{41}\)

This theory is based on the observation that many rural regions and communities encounter genuine difficulties in creating economic development, due to inadequate institutional milieu, insufficient capacity to resolve economic problems, etc. The theory suggests that the key to resolving these issues lies in the building of a self-help capacity within rural communities. The objective is to transform an attitude of apathy and dependency into one of self-reliance. Reid argues that a local self-development project must include the three characteristics, such as local ownership and control of the enterprise or activity; investment of local resources; and the involvement of a local community organisation, e.g. the local authorities or local associations.\(^{42}\)

Some of the proponents of this view on rural and regional development include recent researchers who are dedicated to the development of theories about a new paradigm


for regional development that departs from the classic theories. One of these researchers views regional development as a combination of local characteristics and vertically determined flows, or as a global system consisting of local sub-systems. This view focuses on the relevance of local comparative advantages, especially those associated with qualifications, resource competence, and actual ability to operate at the local level. Based on this view, the researcher developed a model of analysis of rural areas that consists of three elements: the physical element (areas, buildings, roads, flow of goods and services, etc.), the economic element (i.e. business activities), and the social/cultural elements.

Therefore, this model emphasises local society as a crucial element in the make up of a rural area, and views these areas in terms of dynamic units and not passive areas. The model argues that a rural area needs to have a mixture of a physical, economic, and social/cultural elements to be considered as a ‘whole area’; thereby having a separate identity and hence the possibility of developing and using comparative advantages. Based on this concept, it is feasible to see rural locations as possible dynamic units that are not defined by or destined for economic utilisation of physical areas (i.e. classic farming).

However, capacity building is a slow process and consists of two elements: the development of cooperative partnerships among actors, and the adjustment of

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44 See Tangiv; *supra* note 43, pp. 8-9.
institutional structure. According to Mannion, effective partnerships are those which represent and bring together all stakeholders and enable them to identify and bring forward development possibilities; link individual and community development proposals with sources of support and funding; consist of private sector representatives who are prepared to cooperate with community representatives by sharing power, experience, and responsibility; take into cognisance regional or local initiatives and needs.\textsuperscript{45}

The initiative for community-led rural development can rest with community leaders, but with assistance from and partnerships with regional/national authorities, universities, and development agencies. This approach should thrive under an institutional structure that encourages and responds to bottom-up initiatives. Therefore, an adjustment of the institutional structure is necessary due to the linkages between the local, regional, and national authorities.

2.2.2.2(c) Mix of the exogenous and endogenous rural development approaches
The mixed approach to the analysis of rural development stresses the interplay between local and external forces in the control of development processes and rejects the polarisation of exogenous and endogenous development models.\textsuperscript{46}

This approach relates rural development to the process of increasing globalisation, whereby actors in rural regions are involved in both local and external networks.\textsuperscript{47}

\textsuperscript{45} See \textit{id.}, 5.
However, the size and intensity of networks would vary among regions. These networks cover links among institutions, and links between firms and local or non-local institutions.

According to this approach, rural development is viewed as a complex mesh of networks in which resources are mobilised and whereby the control of the development process is the result of interplay between local and external forces. Lowe et al. endorse this approach to rural development and hence propose to transform the analysis of economic development of rural regions into an analysis of networks.48 According to Lowe et al., the focus on networks as sets of power relations could serve an important purpose in integrating economic forms with social processes. Network analysis could generate useful insights into how particular networks produce positive outcomes for rural regions. Conversely, network analysis may also provide insights into possible inequalities and asymmetries within the networks which could be further strengthened.

Based on network analysis, Lowe et al. recommended two important rural development strategies. Firstly, the creation of linkages between internal networks and institutions in a mutually re-enforcing manner as would put rural regions on viable growth trajectories. Secondly, the altering of the balance of power within the local/external networks such that would enable local actors to exert control and to retain a significant proportion of added value. Rural regions trapped in a situation of inequalities and asymmetries within the networks may not generate development. In

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48 See *id*, pp. 100-103.
such cases, the policy objective should be to recast the networks by seeking equity or equality of participation. This approach aligns with the territorial innovation models.

Based on this model, local actors are required to play an active role in internal and external networks; they are expected to have the capacity (i.e. knowledge, skills, and attitude) to identify strengths, weaknesses, opportunities, and threats, and to galvanise themselves in order to address these issues. To complement these efforts, policymakers are expected to act effectively in formulating and delivering facilitative policies; in assisting in promoting local initiatives and projects; and in attracting investments and public funds. Entrepreneurs, operating in tandem, are expected to detect, perceive, and respond to changes in market conditions.

2.3 The concept of regulation
The regulatory debate in most developed countries and particularly in the UK (1980s) came into the open as a result of the transition from public institutions to private enterprises. The debate called for better consideration of accountability and a clearer justification for adopting particular regulatory approaches to different industry sectors.49

There is no fixed definition or meaning of the term ‘regulation’. However, generally speaking, regulation could be defined as ‘the act of controlling, directing, or governing according to a rule, principle, or system’.50 The central meaning of regulation suggests that it could also be defined as ‘a sustained and focused control

50 See id., p. 5.
exercised by a public agency over activities that are valued by a community’. More specifically, regulation refers to ‘the legal rules and other policy measures which express such command and control arrangements, as different from other forms of law such as contract and criminal law’.

Therefore, regulation could be seen as legislative or statutory intervention by a government organisation or agency.

Regulation may impose requirements such as prescriptive and performance standards. Prescriptive standards may involve licensing and registration, information disclosure, dispute resolution, etc. Regardless of which method is used to pursue regulatory objectives, the fundamental purposes for direct government intervention in commercial activities are to promote efficient markets and to protect the public interest. It is generally thought that market mechanisms ensure the most efficient allocation of society’s resources. However, when hindered by externalities, imperfect market structures (e.g. monopolies and oligopolies, etc), information asymmetry, and high transaction costs, market operations tend to be distorted and may not lead to efficient and ‘equitable’ outcomes. This can ultimately result in market failures.

Government intervention is often justified on this basis, and the objective is to enhance competitive conditions and correcting market imperfections in the interest of economic efficiency and social values. These remedial objectives can be achieved by balancing unequal bargaining power and information asymmetry in an industry sector, and reducing the impacts of externalities and moral hazard.

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52 See Prosser; *supra* note 49, at p. 5.
Conversely, Collins argues that this narrow definition of regulation is not completely objective, “because the market system depends for its success on the preservation of the value of inequalities in bargaining position”. He contends that for the market system to provide a superior mechanism for the supply of goods and services, it must also provide incentives for the participants to acquire information and expertise. These incentives could lead to asymmetries of information and expertise which inevitably must be protected to secure the market system. Therefore, in regulating market practices, a distinction has to be drawn between asymmetries of information and expertise that must be protected and those which create an undesirable market failure. Collins suggests that to draw this distinction would require a careful analysis of whether these asymmetries of information, expertise, and other forms of bargaining disadvantage would benefit the weaker party in the long run by sustaining the market for that valued product or service. This general principle would ensure that those participants who obtain their superior bargaining power through diligent research and study do reap the benefit of advantageous transactions as a just reward. Conversely, where the superior bargaining position was obtained by taking advantage of the weaker participants, the general principle would suggest that the weaker parties were unlikely to benefit in the long run if such transactions were allowed, and so the contracts should be unenforceable.

Collins further argues that the application of this general principle requires an investigation of the consequences of regulation, which cannot be determined with any degree of precision in advance. Nevertheless, he maintains that regardless of the fact that it is difficult to determine when market failures are sufficiently serious to justify

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regulation, yet such regulation can help to reduce imperfections in markets that provoke unfair contracts. However, he posits that regulation of substantive unfairness in contracts should be left to the legal system because the regulation of market failures through deterring practices that subvert the market system can only make an insignificant contribution to the reduction of substantive unfairness in contracts. The preference for rules devised by private law as the best approach to handling the complex issues raised by unfairness in contracts does not preclude the importance of specific public regulation in particular market sectors designed to fit the precise purpose.

Sunstein argues that legislative (paternalistic) intervention is often more harmful to the groups it was designed to protect, particularly when this interferes with the pricing mechanism of the market. In other words, he contends that the harm outweighs the benefits of the regulation (regulatory backfiring). This throws up the debate about whether the protected group should be making the choice between harms; or the State (through the legislator) should determine the best interests of its citizens. The objection to paternalism is usually based on the argument that the law should not restrain the discretion of individuals to use the power of self-regulation through the auspices of freedom of contract to forge transactions and relationships of their free choice (i.e. the sanctity of contracts). However, Collins argues that this objection applies only to regulation designed to alter market prices, but does not apply to most regulations of substantive unfairness, because in the latter case the terms of the contract are brought in line with the presumed market price under competitive conditions (i.e. a mimicking of normal market conditions).

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55 Sunstein, C., Paradoxes of the Regulatory State pp. 407-23, University of Chicago Law Review 57 (1990). However, he also contends that issues of social justice in the public interest rank higher than the protection of markets for their own sake.
However, in a broad sense legislative intervention could be used to address a variety of forms of market failures, both in the construction of markets and in the distribution of market outcomes. For instance, regulation could be used to ensure the provision of socially desirable products and services where free markets fail to provide availability or continuity of these. Regulation could also be used to allocate scarce goods in the public interest; to ensure the availability of a public good; or to promote efficient market operations by preventing anti-competitive practices, e.g. predatory pricing.\textsuperscript{56} However, legislative intervention is not limited to correcting market failure, but can also assist in providing access to social justice.\textsuperscript{57} These might include advancing public welfare interests, consumer protection, assurances of the provision of public goods\textsuperscript{58} and other welfare goals, and restrictions on the exercise of private power.\textsuperscript{59}

The core conception which could be derived from the various usages of the term ‘regulation’ in current debates is one of public intervention which affects the operation of markets through command and control. This core conception relates also to the definitions of the term in standard economics texts, e.g. ‘In its widest conception, regulation is State intervention in the economic decisions of companies’.\textsuperscript{60} Generally, regulation is seen as one of the State’s functions that makes evident its constitutional dimensions. Decentralisation of power provides a credible

\textsuperscript{56} See Baldwin; \textit{supra} note 53, at p. 17.
\textsuperscript{58} Ogus, A., \textit{Regulation: Legal Form & Economic Theory} p. 33 (1994). A ‘public good’ is defined as ‘a commodity or service whose benefit is shared as a whole by the public’. Public goods combine two basic characteristics: consumption by one individual does not leave less for others and secondly, society cannot exclude anyone from such benefit whether they pay for them or not. Typical examples are roads and national defence. In this case, the market mechanism of resource allocation cannot be relied upon to determine the supply of a public good because of the free-rider problem.
\textsuperscript{59} See Collins; \textit{supra} note 54, at p. 8.
\textsuperscript{60} Foster, C. D., \textit{Privatization, Public Ownership and the Regulation of Natural Monopoly} p. 186 (1992).
rationale for it. The difficulty that accompanies this core conception manifests in the misleading notion that regulation is basically an external political constraint on markets. Therefore, industry sees statutory intervention as ‘social engineering’ based on non-economic goals and so subject to arbitrariness. Consequently, regulation is often resisted by corporations and this can create problems for effective implementation and control of statutes. However, there are possible demerits to statutory intervention because they can be inappropriately designed, bureaucratic, and rigidly enforced. Yet, regulation has been found to be useful for efficiency maximisation by providing surrogates for market forces, particularly where natural monopoly elements exist in an industry.

Prosser considered three different types of regulation: firstly, regulating a monopoly which involves attempts to mimic market forces through exercises of control on prices and quality of service; secondly, regulation for competition which entails creating conditions for competition to flourish and subsequent policing to ensure continuity, e.g. stipulating and maintaining standard trade practices; thirdly, regulating for social welfare whereby the rationale is not primarily economic but related to notions of public service and the principle of universality, e.g. ensuring the provision of universal service and achieving environmental objectives. However, some of the categories of support schemes for the rural fuel retail market focus on the second type, e.g. regulatory remedies, whereas the other categories deal with social regulation through subsidies and state aids. The failure to separate these three types of regulation has often led to confusion in current regulatory debates. This confusion has

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61 Barton et al. (eds.), Regulating Energy and Natural Resources p. 16 (IBA, 2006).
62 Black, J; Rules and Regulators p. 79 (1997).
63 See Prosser; supra note 49, at p. 5.
64 See Tables 3.1-3.4 in Chapter 3.
resulted in assertions that some types of regulation, particularly social regulation, are illegitimate.\textsuperscript{65}

Ogus argues that there is a need to recognise that regulation is a political/economic concept and therefore can best be understood by some reference to different systems of economic organisation and the legal forms that institutionalise them. He posits that in industrialised societies or communities, there exists some friction between the market and the collectivist systems of economic organisation.\textsuperscript{66} The market system encourages individuals and groups to freely pursue their own welfare goals, subject only to certain basic restraints for orderliness of society. Regulation has little role to play here, rather the legal form that maintains this system is an instrument of private law. Private law instruments tend to be facilitative, private, and decentralised. Private law merely offers a set of formal arrangements within which individuals and groups can pursue their welfare – seeking activities and relationships. Such arrangements involve mutual rights and obligations which are enforceable in courts where necessary. However, in practice it would seem too simplistic to identify the market system exclusively with private, facilitative, and decentralised law, since no society can exist without periodic government intervention. Such impositions and enforcement can affect some private obligations and override private agreements.

Conversely, the collectivist system aims to correct perceived deficiencies in the market system in an attempt to satisfy collective or public interest goals. In this case, the state directs and encourages alternative behaviour (often through its agents) which it believes would not occur without such intervention. Regulation is therefore the

\textsuperscript{65} See Ogus; \textit{supra} note 58, at p. 6.
\textsuperscript{66} See \textit{id.}, p. 1.
legal means for achieving and implementing collective goals.\textsuperscript{67} Regulatory laws tend to be more directive, public and centralised in nature. These laws are directed by the State or its agents and compel individuals and organisations to behave in certain ways with the objective of realising public interest goals and with threat of sanctions for non-compliers. The obligations which are enforced by the state or its agents cannot be met by private agreements between the parties concerned. Regulation is therefore centralised because the state or its agents play a vital role both in its formulation and enforcement. In the same vein, it could be argued that regulation is not always directive, public, and centralised because regulatory laws are formulated and enforced by self-regulatory agencies that are not public institutions. Also, collective goals are occasionally pursued through instruments such as franchise contracts, which behave like private legal obligations in practice.

\textbf{2.3.1 The regulatory spectrum: merits and demerits}

The foregoing establishes the fact that wider conceptions of regulation do reflect more diverse actors in the regulatory process beyond direct government intervention (see Table 2.1). The other actors are markets, contracts, and court interpretation.

Regulation by the markets usually occurs through market competition for terms.\textsuperscript{68} Both domestic and international markets can be more potent instruments of control than government intervention. This is a form of self-regulation that has numerous practical advantages. Firstly, it reduces the need for direct government intervention. Secondly, the market mechanism for regulating contracts, in theory, is the best in terms of ensuring participation of all stakeholders. As a result, market regulation is

\textsuperscript{67} See \textit{id.}, 2.

\textsuperscript{68} Gunningham, N et al.; \textit{Smart Regulation: Designing Environmental Policy} p. 22 (1998).
regarded as the starting point in the selection process for appropriate regulatory mechanisms.

Table 2.1 Components of regulatory intervention

<table>
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<tr>
<th>Steps in the regulatory process</th>
<th>Participants in the regulatory process</th>
<th>Layers of governance</th>
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<td>Third Parties</td>
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<td>Design &amp; Drafting</td>
<td>Banks &amp; Investors</td>
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<td>Insurers</td>
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<td>-Performance</td>
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<td>Interpretation &amp; Enforcement</td>
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<td></td>
<td>Franchisee</td>
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Source: The regulation of franchise relationships (Spencer, 2009) p. 61.

Conversely, Baldwin argues that self-regulation in the absence of control and accountability may be perceived as extending too much autonomy. However, market inefficiencies may lead to the application of other regulatory mechanisms.

Regulation by contracts, like market regulation, is a self-regulatory mechanism because it establishes binding standards for future conduct of contracting parties. Once the contract is signed by the parties, the standards set constitute a form of self-

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69 See Baldwin; supra note 53, at p. 126.
The private law of contract delegates substantial powers to the parties to fix their own binding rules. The self-regulation is effected through the contract attributes, i.e. the standard form and its relational attributes. Contracts are also regulated by the parties through negotiations of contract terms, implied terms, and terms that include dispute resolution procedures. The effectiveness of contracts as a regulatory tool would largely depend on the relative bargaining powers of the parties. However, contracts as a self-regulatory tool differs from the market means of self-regulation, in that the contract form may not represent the views of all stakeholders. For example in licence or franchise contracts, the contract is usually drafted and controlled by the licensor or the franchisor. Therefore, such contracts may serve the interests of the licensor/franchisor more than the interests of the licensee/franchisee. Therefore, licence/franchise contracts may not capture the interests and views of all stakeholders. As a result, public regulation may become necessary, to fill the regulatory gap, where the private mechanisms fail. The two public regulatory mechanisms are in the form of legislative intervention and court interpretations (the former has been discussed earlier and so we now discuss the latter).

The judiciary as a public regulatory tool has the primary role of interpretation and enforcement of the private self-regulation of contracts and the public statutes, and so occupies a special place in the regulatory spectrum. The judiciary can also enforce laws that compel self-regulated market activities. The courts have powers to interpret both express and implied terms. Implied terms would include fiduciary duties, good faith, duty of care, unconscionable conduct. However, court interpretations of vague

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70 See Collins; supra note 54, at p. 63.
71 See id., p. 67.
72 These interpretations also include evaluations of ‘reasonableness’, or ‘fairness’ (by defining suitable criteria for validity) or substantively by analysing the intentions of the parties (using criteria such as the context of the case, explicit terms, and implicit understandings).
principles such as ‘fairness’, ‘good faith’, ‘reasonableness’, etc., can result in uncertainty in judicial outcomes for the contracting parties. The subjectivity imposed by these principles reflects in courts’ unpredictable and sometimes inconsistent interpretations. As a result, courts require access to reliable information and data to guide their interpretations. Therefore, it might be argued that the courts have a special role to play in the regulatory process, but must be guided by the other tools in the regulatory spectrum.

2.3.2 Basis for social regulation
Cream skimming along with other factors such as the concepts of public goods/impure public goods, exceptional market conditions and the notion of distributional justice has compelled many commentators to advocate for regulation of certain industrial sectors. These are explained briefly below.

Market failure can arise in relation to public goods and ‘impure public goods’ and has led to calls for regulation of sectors that produce and supply such goods. Impure public goods are other goods and services which are not pure ‘public goods’ because they do not have the two basic properties of a ‘public good’, but which do contain ‘public good’ dimensions. These are sometimes referred to as ‘impure public goods’ or ‘special products’, and include petroleum products, and education and training as typical examples. Such goods may be supplied and bought in the market but unless corrected by regulatory interventions, they may be subject to some degree of market failure. In the case of petroleum products, their supply has multiplier effects on the

73 See Collin; supra note 54, at p. 232.
75 See Ogus; supra note 58, at p. 33. Ogus clearly established the grounds for social regulation and this section draws primarily from his arguments for this form of regulation.
economy which is driven primarily through the transport sector and industries that make use of these products. Regarding education and training, society derives benefits over and above that acquired by the immediate recipient. For example, it is assumed that education represents a material gain to present and future generations which accrues from a better trained and skilled work force. It is also thought that education may encourage socially responsible behaviour and thereby enhance cultural heritage. In both cases, a misallocation of resources may result from the unfettered operation of markets because the price which suppliers are able to obtain may not reflect the true social value of the product or service. The simplest regulatory intervention in such cases is for the payment of a public subsidy which will reflect the divergence between the private value of the product or service and its social value.\textsuperscript{76}

Exceptional market conditions such as acute and sudden shortages in the supply of goods whose demand is price inelastic or sudden hikes in prices of such goods have often led to calls for regulation. Goods which fall into this category include petroleum products, because individuals have no access to satisfactory alternatives. Rationing as a means of wartime distribution and control of the sales of petroleum products, food, and clothing is a common example. In this case, the social consequences of allowing the market principle to prevail would be unacceptable in distributional terms and with even more dangerous social consequences.\textsuperscript{77}

Regulation may be inspired by a need to achieve a ‘fair’ or ‘just’ distribution of resources, which is unrelated to efficiency objectives. Although the economic goal of allocative efficiency is directed at the maximisation of social welfare, it does not

\textsuperscript{76} See \textit{id.}, p. 35. \textsuperscript{77} See \textit{id.}, p. 35.
specify how this welfare is distributed between individuals or groups within society. However, different views are held on what should be considered as ‘fair’ and ‘just’, hence the concept of distributional justice is subject to value judgement. The liberal theories and socialist ideas on the conception of distributional justice vary. Exponents of liberal theories tend to maintain a balance between a respect for individual liberty and the acceptance of distributions resulting from market processes but with concerns for ‘unjust’ outcomes. They posit that social arrangements within a society should enable all to have access to a minimum level of resources. Therefore, individuals and businesses with higher income must be taxed accordingly to provide this minimum level of resources. Conversely, the common theme for the socialist thinkers is pursuit of equality. This implies the abolition of advantages conferred by power, privileges, and wealth, and the entitlement of individuals to resources that will enable them to participate equitably in society. Based on this school of thought, private property and market processes are incompatible with socialism, rather absolute state control of the means of production and distribution seems the only solution.

Nevertheless, each of these theories indicates that distributions arising from market processes are not necessarily ‘fair’ or ‘just’. Consequently, these theories influence regulatory policy both directly and indirectly. Indirect influence occurs when government intervention is justified on grounds of market failure. In this case, the distributional theories would suggest that the policymaker should try to predict the distributional consequences of proposed measures and design a form of regulation

78 See id., p. 46.
that would lead to outcomes consistent with what may qualify as ‘fair’ or ‘just’.\textsuperscript{79} The direct influence of the theories could be realised through regulatory instruments specifically designed to pursue redistribution goals, importantly reduction of inequality of income and wealth, but with an emphasis on mitigating handicaps that affect people’s ability to enter and participate in market processes. Thus social regulation can be justified and explained outside of economic analysis, since market failure is not the only reason for regulation, as many regulatory statutes have other goals besides economic efficiency. Feintuck argues that the concept of regulation in the public interest should be built around ideas of equality of citizenship for the protection of democratic values.\textsuperscript{80} Likewise, Sunstein contends that the achievement of social justice represents a higher value than the protection of free markets, since markets are basically instruments that have to be assessed by their effects on society.\textsuperscript{81} He concluded that government action is usually the best way to resolve the twin difficulties of coordination of the private actions of large numbers of individuals, and collective action.

Redistribution policies may also operate within a geographical dimension. The notion of ‘territorial justice’ does suggest some equalisation or redistribution of resources between regions, which can be achieved typically by financing or subsidising services from central funds.\textsuperscript{82}

\textsuperscript{79}For an explanation of the meaning of “fairness”, see Jenkins, O. B., \textit{The Meaning of “Fairness”}. Available online at http://ojtr.org/faithlife/fairnessfl.html, last visited on 23 April 2009. Dr Jenkins explains fairness as a concept related to the concept of justice and difficult to interpret because of the “limitations of human experience and the balance of all desired good”. The Oxford (Advanced Learner’s) Dictionary defines “fair” as “treating each person, side, etc. equally and according to the rules or law”.

\textsuperscript{80}Feintuck, M., ‘The Public Interest’ in Regulation (2004).

\textsuperscript{81}Sunstein, C., \textit{After the Rights Revolution: Reconceiving the Regulatory State} (1990).

\textsuperscript{82}See Ogus; \textit{supra} note 58, at p. 49.
The foregoing underscores the need for periodic government regulatory interventions in market processes when necessary to ensure that the larger public interests are satisfied.

2.4 The notion of public service obligations and the principle of universality

Public service obligation is a term closely associated with public utilities. The core obligation of public service is based on the principle of universality. This principle encompasses ‘a set of obligations which includes non-discrimination, access ‘by all’ to essential utilities at reasonable prices, quality, reliability and adaptation’. There is a close connection between the notion of public service obligations and the concept of regulation.

Public utility reforms have taken place in a number of countries, notably in Europe and the US. These reforms are driven by two factors namely: private ownership which is adjudged to be superior to public ownership; and the introduction and promotion of competitive forces which are expected to increase efficiency and offer better protection of consumers’ interests. The most advanced regulatory reforms in Europe have taken place in the UK, where these two drivers have been put in practice on a larger scale. However, the observation has been that privatisation and competition have not always led to the expected results. Clearly, shortfalls have been observed regarding the treatment of public service obligations within the new regulatory framework. In order to deliver the desired results, it has been suggested that regulatory laws be put in place that allow the implementation of market structures.

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which follow a public service orientation rather than a purely market-based approach.\textsuperscript{85}

Obviously, competition could have positive effects upon the provision of collective goods and services, which includes the reduction of rent-seeking behaviours and information asymmetries; a boost in productivity levels and improvement in organisational schemes; and creation of contestability and transparency which facilitate the pursuit of general interest objectives. However, competition does not always ensure adequate provision of collective goods and services. Although the privatisation process embraces the basic principle of public service (universalism), it also leaves the industries considerable scope for discretion on how to interpret and implement that basic commitment.\textsuperscript{86} The danger in leaving such magnitude of scope for discretion lies in the fact that market forces could elicit a differentiation of products and prices leading to a negative discrimination between consumers and hence a market duplication. Profit seeking motives would naturally cause firms to capture the more profitable categories of customers, the fastest growing markets and lucrative geographic locations. In effect, firms would direct commercial efforts and industrial improvements towards the most lucrative parts of their operation to the neglect of others. Firms may also seek to exclude low income customers from the market through indirect means such as requesting high deposits, prepayment systems etc.

The UK regulatory experience indicates that market forces tend to encourage firms to by-pass or neglect issues such as reliability and adaptation. They mostly interpret their obligations as precise commitments such as performance standards, quality, access to

\textsuperscript{86} See *id.*, p. 182.
information, complaint procedures, etc. There is little incentive to embrace the broader agenda of public service and in effect reduce the scope of the universality principle to narrow sectoral specifications.\textsuperscript{87}

There are economic grounds in support of such behaviours by firms. In certain industries where entry is free, a competitive firm has an incentive to concentrate on those areas of the market that for both geographical and economic reasons attract the lowest costs of supply. In this instance, the effect of competition would be to make it increasingly less profitable for firms to supply the ‘poorer and thinner parts’ of the market (‘cream-skimming’ or ‘cheery-picking’).\textsuperscript{88} Consequently, services in such areas suffer. In an economic sense, this consequence is desirable if it reduces the amount of cross-subsidisation because the twin problems of transport and the need for scale economies makes it costlier for a firm to deliver products of the same description and quality to a remote area of lower demand than to a neighbouring area of higher demand.

Economically, it is expected that prices charged in both urban and rural areas should reflect the costs of supply. Where uniformity of prices is imposed, it does imply the existence of cross-subsidisation which in economic terms is regarded to be allocatively inefficient. This will force demand and supply in the remote areas to be higher than is economically justified.


\textsuperscript{88}See Ogus; \textit{supra} note 58, at p. 32.
There are, however, products and services which society assumes should be available to all at certain minimum standards of quality, quantity, and frequency. Such products and services, e.g. petroleum products, utilities, education, certain modes of transport (ambulance), etc. will not be available universally without regulation because cream-skimming will deprive certain localities of such services.⁸⁹

Some countries (US, Chile, Peru etc.) have created a government-managed universal service fund which is meant to be applied in ways that best advance universal service obligations. The funds could come from annual taxes on the particular sector in question or from general tax funds. These funds could then be used to subsidise a commercial entity that provides the service in question into ill served or underserved areas. Regulators then prioritise the areas or regions as having high, intermediate, or low market potential according to where the ratio of estimated social value to estimated cost is greater.⁹⁰ This approach effectively encourages the private sector to expand the distribution of goods or services into unattractive locations by targeting subsidies to high-value regions, which subsequently spreads to the low-value regions as the need to achieve economies of scale on the basis of geographic proximity increases.

2.5 The concept of public subsidies/state aid
Subsidies are regarded as an important policy tool for promoting business development and for addressing social problems and market failures. Economic theory provides five main justifications for subsidies: growth promotion, income re-

⁸⁹ See id., p. 32.
Available online at http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6VCC-3X059N0-2&_user=1669875&_rdoc=1&_fmt=&_orig=search&_sort=d&view=c&acct=C000054131&_version =1&_urlVersion=0&userid=1669875&md5=d1d37cac7b4c63b908e1811c2086c95c, last visited on 12 April 2009.
distribution, externality correction, provision of special goods, and for increasing returns.  

2.5.1 Definition of subsidy

There are several conventional definitions of subsidy, ranging from the narrow to the very broad. 

For the purpose of this thesis, the author has chosen the contemporary definition of subsidy from the Office of Fair Trading (OFT) literature on ‘public subsidies’ because this definition is broad-based relative to the others. The OFT defines subsidy as ‘any intervention by the State that provides assistance to a firm or groups of firms or individuals’. This broad definition would also include government actions that are not expected to affect competition e.g. provision of general education and general infrastructure.

Forms of subsidy range from direct cash grants, tax credits, loan guarantees, public sector equity participation, cross subsidy, in-kind subsidies such as government provision of goods and services at below market prices, and procurement which involves government purchases of goods and services at above market prices. Subsidies can also be classified in other ways, for instance by purpose of the subsidy or by the instrument used for effecting the subsidy. There could be two categories of subsidies on the basis of purpose, such as resource allocation (e.g. for externality correction, decreasing costs, etc.); and distributional purpose (e.g. addressing regional inequalities, income size-redistribution, etc.). Conversely, there are six identified instruments for effecting subsidies, such as direct cash transfers; tax concessions; provision of cheap credit; regulatory subsidies (where government uses regulatory

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92 For more of these definitions, see id., pp. 12-17.
powers to subsidise particular groups); ‘benefit in kind (where sales by State-owned enterprises are at lower-than-market prices); and purchase subsidies (where a government makes purchases at higher-than-market prices).\textsuperscript{94} There is also a distinction between a subsidy scheme and a subsidy payment. The former is disbursed in a number of payments to different firms or individuals according to set criteria whereas the latter is an individual payment to a firm.

Regardless of how subsidies might be classified, the key rationale for these includes its use to address market failures,\textsuperscript{95} promote economic growth and employment, and as a means of redistributing resources from a stronger sector of the economy to a weaker one. Regardless of what the objective is, the provision of subsidies to firms is a policy decision for government.\textsuperscript{96} However, public subsidies also have its demerits.

In principle, subsidies can distort competition by changing the behaviour of the firm receiving the subsidy and the behaviour of its competitors. Competition distortion arises when the process of rivalry between firms is disturbed and firms no longer receive accurate messages from the market.\textsuperscript{97} Subsidies can reduce firms’ costs or increase its revenue. If these effects occur, the affected firms have little incentive to keep costs low and to compete effectively to stay profitable. Worse still, where subsidies are available only to some firms, or enhance some firms more than others, the overall effect could be that inefficient firms prosper and efficient firms may suffer. Both undesirable effects would make consumers, the market, and society worse off.

Apart from allocative inefficiencies, competition distortion could also lead to

\textsuperscript{94} See Prest; \textit{supra} note 91, at pp. 25-26.
\textsuperscript{96} See OFT on Public Subsidies; \textit{supra} note 93, at p. 6.
\textsuperscript{97} See \textit{id.}, p. 14.
productive inefficiencies (through a reduction on downward pressure on costs) as well as dynamic inefficiencies caused by an alteration in the type and size of investment and innovation. Conversely, a quantitative research carried out by Andreoni and Bergstrom reveals that tax-financed government subsidies to private firms can increase the total supply of ‘public goods’. However, this is beyond the scope of this thesis.

Even in international trade, subsidies are recognised as having effects on private-enterprise producers, notably “those that increase import competition in their domestic market where foreign suppliers of competing products are benefitting from export and/or production subsidies; those that distort conditions of competition in foreign third-country markets where suppliers of competing products from other countries are benefitting from export and/or production subsidies; those that deter entry to foreign markets where import-substitution production subsidies are available to domestic suppliers in those markets; and those that create abnormal competition in their domestic market as a result of trade – diversion effects of distortions of competition in foreign markets”.

It may be argued that consumers benefit from subsidies in the short run through reduced prices. However, if the subsidy is such as to distort competition significantly, the lower prices may not be sustainable in the long run. As the subsidy erodes the efficiency of the market, prices could slowly begin to rise again unless the subsidy continues and increases. This is because production with the subsidy has become less

98 See id., p. 16. Also see Denton et al., Trade Effects of Public Subsidies to Private Enterprises pp. 64-73 (1975).
efficient and so more resources will be required to produce the product or service. The full cost of this extra resource employed will have to be borne by consumers.

Conversely, taxpayers meet the cost of paying for subsidies. It is pertinent to also mention that the process of taxation distorts markets, for instance the incentive for individuals to work may be affected by income tax.

In November 2004, the OFT published a report based on the Frontier Economics research into situations whereby subsidies are most likely to cause competition distortions. The report concluded that public subsidies have the potential to distort competition but there is still some scope for implementing less distorting subsidies. The central objective of the research was to shed some light on appropriate design of subsidies to ensure limited effect on competition. However, their research assumed that if a subsidy is available to all firms and affects them all equally it should not be expected that the subsidy would have a significant impact on competition.

The research also emphasises that the extent to which subsidies can distort competition can vary depending on the characteristics of the subsidy and of the market (see Table 2.2).

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102 See OFT on Public Subsidies; *supra* note 93, at p. 17.
Table 2.2 Subsidy and market characteristics

<table>
<thead>
<tr>
<th>Subsidy characteristics</th>
<th>Market characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>The absolute size of the subsidy as well as its size relative to the costs of the activity being subsidised.</td>
<td>Market concentration.</td>
</tr>
<tr>
<td>The level of selectivity of the subsidy (i.e. whether it is provided to one, some, or all firms in a market).</td>
<td>A high level of product differentiation.</td>
</tr>
<tr>
<td>The direct effects of subsidy on the recipient’s costs.</td>
<td>Whether the firms in the market are of markedly different sizes.</td>
</tr>
<tr>
<td>Whether the subsidy is provided once or on a recurring basis.</td>
<td>Barriers to entry.</td>
</tr>
<tr>
<td>Whether the subsidy is provided directly or indirectly to firms.</td>
<td>Whether firms in the market compete on research and development.</td>
</tr>
</tbody>
</table>

Source: Case studies of public subsidies (OFT, 2006, p4).103

Subsidies and state aid can distort competition in much the same way. However, the concept of state aid as defined by the EU is much wider than that of a subsidy.

2.5.2 Definition of state aid (EU)
Based on Article 87(1) EC, state aid which is deemed to be incompatible with the common market would apply to “any aid granted by a member state or through state resources (in any form whatsoever) which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods in so far as it affects trade between member states”.104

The concept of state aid includes the positive benefits to undertakings (such as subsidies themselves), but also various forms of intervention which tend to mitigate

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the charges or costs which are usually included in the budget of an undertaking and which are similar in character and have the same effects as subsidies.

Most state aid is awarded through financial grants. However, about 25% of all aid is in the form of tax exemptions or social security. Other state aid measures are not easily identifiable as aid but have the same effects. Alternative examples are:
(a) aid granted by the state by selling goods to an undertaking at a reduced price;
(b) through reimbursement of part of the cost of goods and services;
(c) through the acquisition of a holding in the share capital of an undertaking;
(d) by granting a loan to an undertaking/s at a rate of interest below normal commercial rates;
(e) by measures that protect certain industries from the effect of currency fluctuations;
(f) by payment satisfying legal and commercial obligations on behalf of an undertaking such as redundancy costs or outstanding wages;
(g) by provision of market research and logistical or commercial assistance at a reduced rate;
(h) by exemption from the normal application of insolvency rules thereby allowing undertakings owing debts to public bodies to continue trading.\textsuperscript{105}

However, the European Court of Justice (ECJ) continues to emphasise that Article 87(1) EC distinguishes between measures of state intervention in relation to their effects and not by reference to their causes, aims, or method of application. Therefore, the fact that the objective of a measure is to achieve a specific economic or social aim is not sufficient to put the measure beyond the scope of Article 87 (1) EC.

\textsuperscript{105} See \textit{id.}, pp. 5-6.
2.6 Conclusion
This chapter achieved its purpose by clarifying the concepts of rurality, regulation, public service obligation and public subsidies/state aid. This chapter also reviewed the theories of regional development and approaches to rural development. These have assisted the author in generating the hypotheses for the research project.

Before the 1970s, most theories and policies on rural development were based on two points of view: rural areas as residual to the towns and cities; and rural areas as regions with basic characteristics that can only form the basis for exogenous approach to development. In terms of statistics, the definition of rural areas is a question of population density and/or residual areas or a residual to the town. This definition is linked to the traditional view that rural areas are determined from the perspective of agricultural presence and dominance. In many countries, it is the large distances of separation that determine regional differences between rural and urban areas.

In terms of physical planning, rural areas are those left after an identification of the towns/cities according to a hierarchical order and size. The ‘open land’ or ‘open space’, usually referred to as rural districts, is largely marked for agricultural purposes. The reason is possibly because of the opinion or notion that the ‘open land’ falls within the scope of farmers. In terms of politics, rural areas are positively correlated to agricultural activities, and so politicians tend to adopt the sector policy approach to these areas as opposed to a territorial or regional policy approach. This trend is now changing. For instance, with the introduction of the Common Agricultural Policy (CAP) and the Leader Programme in EU legislation, a lot of support measures (that transcend agricultural activities) now target local enterprises and activities.
Traditionally, it could be argued that rural areas are defined by low population density, by an area outside towns and cities, and primarily intended for agricultural purposes. However, this definition is in contrast to the current reality whereby many people live and work in rural areas without necessarily engaging in agricultural activities. Moreover, activities such as mineral extraction, fishing, and manufacturing also take place in some rural locations. Therefore, it is a significant task in itself for municipalities and counties to determine the object field and its numerous players when preparing a policy document for the development of rural areas.

The gradual shift away from the traditional conception of rural areas was recently ushered in since the 1990s by numerous researchers with interest in regional development, but having an economic background. These researchers have been preoccupied with the development of theories about a new paradigm for regional development, considering the pace of globalisation and its impact on rural and regional areas. The point of departure from the classic theories is the notion that regional development takes place as horizontal interactions and responses. Most of the previous theories were of the view that rural development was determined and conditioned by or from the towns or centres (whether they served as recreational arrangements for township residents or as suppliers of food to the towns or as a sort of reserve capital). However, the actual development of rural areas in recent years has in some parts led to the general blurring of the difference between rural and urban, and the appearance of new types of rural areas that need to be examined. These have led to the need for new theories on regional development, new approaches to rural development, and the redefinition of the term ‘rural areas’. These new developments also justify the adoption of the territorial approach to rural development in this thesis.
The new paradigm shift in the approach to rural and regional development facilitates an understanding of rural areas as not being necessarily subject to or derived from area types. This has been the case in recent times, considering that technological advancement and global economic development has brought about new patterns of localisation. These developments have also resulted in new ways of organising business and work which comprise both vertical and horizontal flows. The new paradigm projects that in the future all economic activity may likely be specialised and localised where the comparative advantages for that particular activity is the highest, whereas the markets and business cooperation partners may be somewhere possibly distant from the location of the activity. Under such circumstances, more activities will be possible in rural areas, and an activity in a particular rural area may not necessarily be influenced by a neighbouring locality or the closest city. The comparative advantages can manifest through specific business activity (e.g. mining, petroleum extraction, fishing, manufacturing, etc.), or specific human capital that is specific to a locality (e.g. classic factors of production), or a specific enterprising workforce (e.g. entrepreneurs), or specific recreational value that attracts a certain type of labour force.

The new paradigm is likely to emerge faster among the OECD member states because most rural areas in these states are not relatively underdeveloped in terms of population, level of education, and level of labour market activity. The technical, social, and administrative infrastructures are also fairly well established on the local level. Moreover, as a result of migration from urban areas (particularly those who commute to neighbouring towns), there is an increase in population base, qualifications, and resources. The majority of these rural areas also have enormous
social capital, forged through a strong sense of community drawn from cultural traditions from agricultural society. A significant level of social capital has been noted by some commentators as the most important factor for positive rural development.

Based on the foregoing, the recent increased focus on rural development can be seen in the context of a democratic wish for a more decentralised development. Therefore, the author argues that policies for rural development should not focus only on support for agricultural activities or a kind of preservation policy, but should incorporate a policy for regional innovation with the involvement of both local and non-local actors and new actions. This justifies the adoption of the mix of endogenous and exogenous approaches to rural development in this thesis. The non-local actors’ category would include government intervention, which is usually regulatory in nature.

This chapter reveals that wider conceptions of regulation would include four categories: legislative or statutory intervention; regulation by markets; regulation by contracts; and court interpretations. These multiple layers of regulatory governance all serve useful purposes, and statutory intervention is warranted where the other three layers fail. The research identified three different forms of regulation: regulating for a monopoly; regulating for competition (i.e. creating conditions for competition to blossom); and social regulation (i.e. regulating for market failures through the provision of subsidies). The third form was identified as being more relevant to the research topic.

Public service obligation which is based on the principle of universality drives social regulation. The principles comprise a set of obligations which includes non-
discrimination and access ‘by all’ to essential utilities at reasonable prices, quality, quantity, and reliability. Petroleum products are special goods and their supply and distribution accord with the principle of universality. This makes a case for state intervention, where necessary, in regard to the supply and distribution of these goods.

Subsidies as a means of state intervention would also include government actions that are not expected to affect competition, such as provisions of general education and public infrastructure. The rationale for subsidies was identified as the means to address market failures, and to promote economic growth and employment in order to redistribute resources from a stronger sector to a weaker one. In principle, subsidies can have distortion effects on competition by affecting the behaviour of the receiving firms and their competitors. State aids (including subsidies) can distort competition in a number of ways. Firstly, they could lead firms to set output and price levels inefficiently. Secondly, they could keep inefficient firms in business, encourage entry by inefficient firms, or discourage entry by efficient firms. Thirdly, they could distort investment and R&D decisions. Therefore, care must be taken to design subsidies such that their adverse effects are minimised. In this regard, issues such as the value of the subsidy, the frequency of the grant, selectivity, activity-specific targets, market concentration, etc. have to be considered.

Subsidies and state aids are similar in character and have the same effects, but the concept of state aid is much more than the notion of a subsidy. Subsidy is usually a payment in cash or kind made in support of an undertaking, but the notion of state aid places emphasis on its purpose and is particularly designed for a specific objective/s which cannot be normally met without exogenous assistance. Therefore, the concept
of state aid is much wider than that of a subsidy in that it covers both positive benefits (such as subsidies themselves), as well as interventions of different forms which mitigate part of the charges under the budget of an undertaking/s.

Having reviewed the key concepts and principles pertaining to the research topic, let us examine the supply and pricing of fuel products in rural and remote areas of the UK and Australia and identify the forms of government support for fuel retailing in these locations.
Chapter 3  
OVERVIEW OF RURAL FUEL SUPPLY AND PRICING IN THE UK AND AUSTRALIA

3.1 Introduction  
This chapter aims to unravel the sources of the problems of high fuel prices in rural/remote locations and rural–urban price differentials in the chosen jurisdictions and the impact of these pricing problems on rural and remote locations. This chapter also looks at what governments’ responses to the problems are; and what industry players and analysts think about these problems.

To achieve these objectives, this chapter examines the competitive dynamics of the fuel retail trade, the nature of fuel pricing in rural and remote areas, the range of measures employed by the UK and Australian Governments in dealing with these problems, and a review of the opinions of industry participants and analysts regarding the future prospects of independent fuel retailers and supermarkets in the two jurisdictions.

This chapter identified some specific regulatory support mechanisms and fuel subsidy schemes used by these governments to resolve these fuel pricing problems, which constitute a major part of the analytical framework for this thesis and assisted in defining the common comparators for fuel retail regulations in both jurisdictions.

3.2 The fuel retail market  
The characteristics of the market (demand and supply) largely determine the nature of competition in the fuel retail market. The competitive dynamics in turn determines the nature of fuel pricing. On the supply side, there are three characteristics that drive the
competitive dynamics among fuel retailers and so affect the pricing outcomes. Firstly, there are interdependencies between fuel sales and the sales of other convenience products (non-fuel sales) e.g. confectionary, cigarettes, milk, newspapers, etc. The higher the volume of products sold the greater the customer throughput and therefore the higher the sale of convenience products and profitability.

Secondly, fuel retailers incur two kinds of costs. The fixed costs are those incurred regardless of the volume of fuels sold and include the costs of the site and labour. The variable costs are those that vary with the volume of fuels and quantity of convenience products sold. The main variable cost is the wholesale cost of petroleum products obtained from suppliers. Thus, the aim of every fuel retailer is to cover the variable costs and also make some contribution towards the fixed costs. Inability to achieve this objective could lead to closure. Consequently, fuel retailers must maintain or increase sales through price competition. This competition continues to a point where there is almost no margin above their variable cost, which becomes unprofitable for all retailers. Afterwards, prices begin to rapidly adjust upwards, at which point fuel retailers begin to achieve a margin above their variable costs of supply in order to recover their fixed costs.¹

Thirdly, sales volumes are a major determinant of the profitability of individual fuel retail outlets. Therefore, a fuel retailer wishing to recover the fixed costs of its

operation must achieve a margin on some or all of their sales of fuels and convenience products.\(^2\)

On the demand side there are five major factors that determine the competitive dynamics and the pricing outcomes. Firstly, petroleum products are purchased regularly by consumers. Each purchase entails a consumer deciding on where to buy the products and affords an opportunity for a fuel retailer to increase or lose sales. This emphasises the importance of volume of sales, which is linked with the pricing of products.

Secondly, the market demand for fuels is not sensitive to price, at least in the short run. The market-wide demand for petroleum products is mainly derived from automotive use. Commercial transporters and private car owners have no commercially viable alternative fuel sources to choose from and so have to purchase petrol, diesel or LPG. Therefore, in the short term the demand response to a non-transitory increase in the price of these fuels is negligible. However, in the longer term, consumers may be able to switch to more fuel-efficient cars.

Thirdly, the retail prices of fuels are easily compared since most retailers post prices at the entrance of their outlet. Considering that most fuel retailers locate their sites visibly and conveniently, the cost of price comparisons is relatively small. By implication, fuel retailers will have to monitor each others’ prices and adjust accordingly.

\(^2\) ACCC, Report from *Frontier Economics on Economic Implications of Terminal Gate Pricing* pp. 9-10 (2001).
Fourthly, petroleum products are largely generic products. Therefore, a significant percentage of consumers have little or no brand loyalty. Retailers attempt to differentiate their products using the octane grade, however most consumers buy unleaded petrol, whose quality is similar across retailers. Some consumers patronise the agency cards and so have ties with particular fuel retailers, but their relative proportion is insignificant. The presence of little or no brand loyalty coupled with the ease of price comparison makes price an important determinant of a consumer’s choice of fuel retailer.

Finally, the demand for fuels is localised, as there are costs incurred for searching for fuels outside the location where a consumer lives and works. The implication is that there are price differentials across localities. Price differences have also been observed to persist within a locality over a long period.³

3.3 The nature of petrol pricing
The foregoing indicates that pricing of petroleum products is of critical importance because it determines the volume of sales from a given outlet and by implication the survival rate of outlets.

From the UK perspective, because there are such a high number of fuel wholesalers, this would likely make it difficult for them either to collude in setting prices or to secure unjustified margins. Nevertheless, wholesalers set retail prices for all outlets under their supply agreements (whether company-owned or dealers). They also exert indirect influence on retail prices through the auspices of the selective price support (SPS), which could be classified as a conditional rebate. This could be regarded as a

³ See id., pp. 8-9.
form of price discrimination. However, due to significant competition among wholesalers, the operation of SPS tends to increase price competition among fuel retailers. The evidence shows that its operation has not resulted in consumer harm or worked against the larger public interest. Conversely, SPS is inapplicable to most rural outlets because of the lesser competition they experience. This could be one of the justifications for the support schemes for rural locations.

Under section 45A of the Australian Trade Practices Act (TPA), price discrimination refers to the practice of the sale of the same goods by the same supplier to different customers at different prices. Under the TPA, a supplier should not practise price discrimination between purchasers of products of similar grade, volume and quality, particularly when the magnitude or repetition of the practice results in a significant lessening of competition. However, the TPA also acknowledges that discrimination can occur in good faith to meet a price or benefit offered by a competitor and these are prevalent in the fuel retail trade. Different customers may be charged different prices based on differences in the cost of supply, conditions of payment, and risk allowances. These would not be considered as anti-competitive price discrimination and so not illegal under the TPA.

Differentials in wholesale fuel prices can occur based on differences in bargaining and buying power. For instance, independent distributors having large throughput and

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7 See id., p. 73.
thereby high negotiating power can get the best deals from oil majors who are interested in maintaining their market share. However, this system of pricing places the single site, low-volume operators (small independents) at a severe disadvantage. The independent chains have substantial buying power and are not likely to be affected by price discrimination.\textsuperscript{8} Nevertheless, the evidence shows that price discrimination could be considered as pro-competitive since it is associated with efficiency gains and ultimately of benefit to consumers. The evidence has shown that eliminating price discounting by wholesalers could rather result in price increases which are detrimental to consumers.\textsuperscript{9}

The UK experience shows that pricing abuses are always alleged by a number of independent fuel retailers, e.g. predatory pricing. Theoretically, predatory pricing may be difficult to ascertain in retailing because the producers often give differential discounts to retailers. The implication is that the price–cost test may not be useful here in detecting predatory pricing, because on the basis of differential discounts larger retailers may be able to cut prices and drive away smaller retailers without incurring losses.\textsuperscript{10}

Particularly, there were widespread allegations of predatory pricing by the oil majors in the UK in the wake of the Esso Pricewatch campaign that triggered intense price wars between oil majors and supermarket fuel retailers.\textsuperscript{11} Consequently, the


competitive shake-out precipitated the exit of a large number of independent fuel retailers. However, the Esso Pricewatch could be seen as an attempt by the oil majors to meet the competition posed by the supermarkets. The motive behind this conduct qualifies as an objective justification. Moreover, the conduct resulted in lower fuel prices, which benefited consumers. Likewise, the supermarkets’ loss leading pricing strategy was alleged by the independent fuel retailer group as predatory pricing. However, the supermarkets’ lower fuel prices or loss leading did not result in consumer harm. On the contrary, it could be argued that supermarkets’ pricing strategy promoted price competition among retailers – the object of competition itself. Nevertheless, for a case of predatory pricing to be established in both allegations, it had to be demonstrated that the losses incurred through these pricing strategies could be recouped in the future through the charging of higher fuel prices. Also, it must be shown that entry barriers in the sector are high enough to prevent potential entrants from competing away the alleged predators’ potential future profits. However, the nature of competition between the oil majors and the supermarkets, and among the supermarkets themselves, would suggest little possibility for such recoupment to occur. Moreover, the supermarkets have continued to expand their outlets.

It was recognised in the Competition Commission’s report (2000) that supermarkets do engage in below-cost selling and price flexing – practices which are deemed to operate against the public interest. However, for reasons of practicality and the benefit that accrues to consumers in terms of lower prices, the report made no

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recommendation for remedies. It was considered that the benefits of imposing remedies would be less than the adverse effects on competition.\textsuperscript{13}

In the case of Australia, parallel pricing/price leadership, and predatory pricing have also been alleged. Parallel pricing/price leadership are regular features of the fuel retail trade. Theoretically, they are characteristic of markets where goods and services produced or sold by each firm are close substitutes (i.e. little product differentiation) and where firms are subject to the same demand and supply conditions.\textsuperscript{14} As a result, no competitor can afford to lose market share by refusing to match price reductions by the others. This is also a feature of oligopolistic market structures which occurs at the refining and wholesaling levels of the downstream petroleum industry.\textsuperscript{15} Subsequently, the effects of price discounting at these levels trickle down to the retail level. However, it is difficult to assess whether parallel pricing and price leadership occur because of fierce competition or due to collusive behaviour. It is only the courts that can draw inferences based on the motives behind the conduct. The worst form of collusive abuse would be those attributed to abuse of collective dominance.\textsuperscript{16}

Five conditions exist under which collusion is more likely to occur, as follows:\textsuperscript{17}
presence of a small number of suppliers; firms in the market having similar costs and


\textsuperscript{17} See OFT Report (229); \textit{supra} note 11, at pp. 100-101.
driven by same economic incentives; transparency in pricing; difficult entry; and stable market conditions. Generally, collusion is likely to occur where import competition is low; barriers to entry high; and little product differentiation. In the Australian as well as the UK fuel retail markets, entry barriers are medium; actual import competition is low, although the potentials are high; and products are largely homogeneous, although the grades and brands may vary slightly. Therefore, collusion among the oil majors can occur. However, these may not be sustainable in metropolitan cities because of the large numbers of fuel retailers, threat of imports from independent chains, and the periodic bursts of price discounting. Moreover, current profits from fuel outlets are attributed more to non-fuel goods than to fuels themselves.

Conversely, the evidence of collusion in some rural or country areas is unclear but likely because there are few suppliers and relatively fewer fuel retailers. Nevertheless, the higher margins observed in some rural locations may be a reflection of weaker competitive conditions, collusion, or inertia/conscious parallelism. In Australia, the latter is not considered a breach of the TPA, even though its effects are similar to overt collusion, because it is difficult to prove that the parallel prices were agreed by the parties involved. Similarly, there is a thin line separating the effects of vigorous competition from those of predatory pricing. It may be possible for the courts and regulatory authorities to detect the conduct of predation by investigating the purpose behind the conduct. The starting point in such investigations would be in circumstances where the alleged predator has a market share of more than 25%. However, the conditions necessary to prove a case of predation has to be met, and this is hard to prove.
Also, price wars are a feature of the fuel retail trade and result from rounds of protracted price discounting, which then spill over to adjacent locations.\textsuperscript{18} Generally, price discounting in the fuel retail trade is inevitable considering the high capital costs of refining, product storage, distribution terminals and retail networks. The continuous nature of refinery operations and the need for cost savings create incentives for refiners to operate at full capacity. Consequently, stock build-up could occur during periods of low demand and refiners usually discount prices to clear the excess stock. This could lead to rounds of discounting at the wholesale level until demand rises to meet the installed capacity. Discounting at the wholesale level gradually trickles down to the retail level. Alternative options to clearing stock that has built up are either shutting down the refinery or providing additional storage for products. These options are considered uneconomic unless demand is projected to be high for a sustained period of time.\textsuperscript{19} The defence mechanism open to the oil majors in order to meet vigorous price competition at the retail level is by using SPS. This tends to aggravate the intensity of the price discounting. Unfortunately, independents fuel retailers (branded or unbranded) that are not in receipt of the SPS become exposed to price pressures and inevitably some of them are forced out of the market.

In the case of Australia, the government has been protective of independent fuel retailers and thus argues that the use of SPS could become anti-competitive in the long run if it facilitates the elimination of independents or limits their ability to compete. Furthermore, the Australian Government argues that the anti-competitive impact of SPS may become lethal if it facilitates the exit of, or a reduction in the number of independent fuel outlets in country areas. However, considering the wider

\textsuperscript{18} See \textit{id.}, pp. 48-49.
\textsuperscript{19} See IC Report; \textit{supra} note 6, at p. 68.
geographic spread of country outlets, and the near absence of price discounting, it is unlikely that SPS will find applicability there. Nevertheless, the state of fuel retail competition in rural or country areas is peculiar. The motorists in these locations are supplied by independent fuel retailers with little incentive to compete on price. High gross retail margins have been observed in some of these areas as a result. Inevitably, high retail margins tend to affect the prices of other consumer goods and thus increase the cost of living for rural dwellers. Moreover, they tend to increase the operating cost of local businesses (farming, fishing, manufacturing, services, etc.). Therefore, it might be argued that to achieve effective competition in such locations would require a countervailing power, e.g. the presence of independent chains operating with some scale economies, formation of co-operatives or buying groups among rural residents, or government intervention.

Independent chains with scale operations will likely operate only in areas that are economically viable. Thus, this group are not expected to operate in rural and particularly remote areas. Rural co-operatives are likely to be effective if they have a large buying power. Considering the relatively lower population densities in these locations and the relatively lower per capita income of rural inhabitants, it is unlikely that they will provide adequate countervailing power. More often, the government is needed to provide this power. Tables 3.1-3.4 summarises some of the identified regulatory support mechanisms and fuel subsidy schemes that had been applied in the two jurisdictions. The analytical framework for this study is based on these mechanisms and schemes. Next, let us look at the specific rural fuel supply and pricing situation in each jurisdiction.

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20 See Chapter 1 (Introduction), at pp 37-38.
| Table 3.1-3.4 Classifications of Regulatory Support Mechanisms & Fuel Subsidy Schemes |
|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| Classifications (a) | Regulatory Objectives | Target |
| 1. REGULATORY ACTS & REMEDIES | | |
| State Grants Petroleum Products Act (Australia) | To support communities where the prices of petroleum products are considered to be high. | Country and regional areas. |
| Undertakings (UK and Australia) | To minimise, ameliorate or eliminate anti-competitive aspects of the oil majors’ activities, e.g. the single branding obligation, mergers and acquisitions, etc. | The major wholesalers (refining and non-refining). |
| Petroleum Retail Marketing Sites Act (Australia) | To curtail extensive vertical integration of the oil majors, and create room for entry of independent retailers. | Promotion of independent fuel retailers. |
| Petroleum Retail Marketing Franchise Act (Australia) | To minimise the imbalance in contractual powers by setting minimum terms and conditions for contracting between the oil majors and their franchisees (dealers). | Protection of independent fuel retailers (franchisees). |
| Petroleum Products Price Surveillance Act | To carry out surveillance of petroleum products prices and to regulate wholesale prices. | Rural and regional areas. |
| Trade Practices (Oilcode) Regulation | To institute a comprehensive downstream petroleum retail framework to guide its operations. This would include, terminal gate pricing, dispute resolution mechanisms, prior disclosure by the oil majors, and expiry/voluntary surrender of agreements by retailers and distributors. | The fuel retail sector. |

**Source:** This Research
<table>
<thead>
<tr>
<th>Classifications (b)</th>
<th>Public Policy Objectives</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. FUEL REBATE &amp; GRANT SCHEMES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel Sales Grants Scheme (Australia)</td>
<td>To reduce the differential between rural and urban fuel prices;</td>
<td>All fuel retailers in remote and rural areas.</td>
</tr>
<tr>
<td>Petroleum Product Freight Subsidy Scheme (Australia)</td>
<td>To subsidize remote fuel transporters, in order to reduce the cost of fuel in rural and remote communities.</td>
<td>Fuel distributors in remote areas.</td>
</tr>
<tr>
<td>Diesel Fuel Rebate Scheme (Australia)</td>
<td>To provide a rebate on fuel excise for some business sectors, particularly those involved in primary production and mining.</td>
<td>Primary producers and other businesses.</td>
</tr>
<tr>
<td>Diesel &amp; Alternative Fuel Grants Scheme (Australia)</td>
<td>To provide fuel grants for certain heavy vehicles, especially those used for agricultural production; and to subsidize the use of alternative fuels in road transport, e.g. ethanol, LNG, CNG, etc.</td>
<td>Primary industry and consumers wishing to switch from conventional fuels (petrol &amp; diesel) to alternative fuels.</td>
</tr>
<tr>
<td>Business Fuel Credit Scheme (Australia)</td>
<td>To lower the effective level of fuel taxes for businesses.</td>
<td>All businesses for fuel used off-road &amp; for vehicles above 4.5 tonnes for fuels used on-road.</td>
</tr>
<tr>
<td>Ultra Low Sulphur Diesel (ULSD) Subsidy (UK &amp; Australia)</td>
<td>To encourage its use and thereby improve air quality and promote a better environment.</td>
<td>ULSD producers, importers, and users.</td>
</tr>
<tr>
<td>Residential Fuel Credit Scheme (Proposed in Australia)</td>
<td>To offset the excise component of diesel, heating oil and LPG used for domestic heating, cooking and electricity generation.</td>
<td>Residents of rural communities who have no access to reticulated gas or mains electricity and must rely on other sources of fuel.</td>
</tr>
<tr>
<td>Agricultural Subsidies (UK &amp; Australia)</td>
<td>To reduce the cost of agricultural inputs and the price of agricultural products.</td>
<td>Farmers (usually in rural areas).</td>
</tr>
<tr>
<td>Energy Grants Credit Scheme (Australia)</td>
<td>To encourage local businesses, particularly those involved in primary production that consume diesel.</td>
<td>Primary industry</td>
</tr>
</tbody>
</table>

**Source:** This Research
<table>
<thead>
<tr>
<th>Classifications (c)</th>
<th>Public Policy Objectives</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. EXCISE CONCESSIONS AND REMISSIONS</td>
<td>To support development in rural and remote areas through the production of petroleum substitutes using agricultural products (e.g. ethanol made from wheat or sugar); and to achieve the environmental objectives of reducing greenhouse gas emissions (GHG) and improving air quality.</td>
<td>Primary producers and consumers of petroleum product substitutes.</td>
</tr>
<tr>
<td><strong>Fuel Tax Exemption on Petroleum Product Substitutes</strong> (ethanol, other bio-fuels, LPG, CNG) (UK &amp; Australia)</td>
<td>To enable consumers to switch to cheaper and environmentally friendly petroleum product substitutes.</td>
<td>Equipment manufacturers (e.g. LPG and CNG kits) that aid a switch to petroleum product substitutes.</td>
</tr>
<tr>
<td><strong>Duty Exemption or Remission for Inputs Required to Manufacture Equipment Needed to Facilitate a Switch to Petroleum Products Substitutes</strong> (UK &amp; Australia)</td>
<td>To reduce the cost of vehicles for rural residents due to the near absence of public transportation in such locations; and to cushion the effects of high fuel prices in such locations.</td>
<td>Residents in rural and remote communities.</td>
</tr>
<tr>
<td><strong>Duty Concession or Remission on Vehicles Imported into Rural Communities</strong> (Proposed in the UK)</td>
<td>To encourage the rapid development of renewable forms of energy; reduce the high cost of living in rural areas; and to achieve the objectives of sustainability in energy use.</td>
<td>Primary producers of renewable forms of energy.</td>
</tr>
<tr>
<td><strong>Excise Concessions on the Use of Renewable Forms of Energy</strong> (UK &amp; Australia)</td>
<td>Same as above.</td>
<td>Same as above.</td>
</tr>
<tr>
<td><strong>Excise Exemption on Inputs for Development of Renewable Forms of Energy</strong> (UK &amp; Australia)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** This Research
<table>
<thead>
<tr>
<th>Classifications (d)</th>
<th>Public Policy Objectives</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. OTHER RURAL GRANTS &amp; REBATE SCHEMES</td>
<td>To provide grants for conversion of cars and lorries to LPG and CNG (greener fuels).</td>
<td>Public motorists.</td>
</tr>
<tr>
<td>Energy Savings Trust Scheme (UK)</td>
<td>To encourage the use of Ultra Low Sulphur Diesel in buses for environmental reasons.</td>
<td>Public transportation.</td>
</tr>
<tr>
<td>Fuel Duty Rebate for Buses (UK)</td>
<td>To maintain a vibrant and competitive fishing industry and workforce.</td>
<td>Fishing industry, and local fishermen.</td>
</tr>
<tr>
<td>Fishing Fleet Diesel Fuel Subsidy (UK)</td>
<td>To provide funding for rural bus transportation.</td>
<td>Rural inhabitants.</td>
</tr>
<tr>
<td>Rural Bus Subsidy Grant (UK)</td>
<td>To expand the scope of transport support to include improved bus and rail services; and innovative rural transport schemes, such as rural car clubs and boat clubs.</td>
<td>Rural inhabitants.</td>
</tr>
<tr>
<td>Rural Transport Grant (UK)</td>
<td>To support rural bus transportation, local shops, post offices, petrol stations, and other rural services.</td>
<td>Rural inhabitants.</td>
</tr>
<tr>
<td>Rural Services Fund (Scotland, UK)</td>
<td>To reduce the cost of transportation for rural communities.</td>
<td>Claimants with rural postcodes.</td>
</tr>
<tr>
<td>Rural Travel Bonus (Proposed in the UK)</td>
<td>To reduce council tax payable by rural residents.</td>
<td>Rural inhabitants in remote rural areas.</td>
</tr>
<tr>
<td>Rural Council Tax Rebate (Proposed in the UK)</td>
<td>To encourage green commuting</td>
<td>Rural inhabitants</td>
</tr>
<tr>
<td>Tax-Free Travel Vouchers (Proposed in the UK)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** This Research
3.4 UNITED KINGDOM: Rural fuel supply and pricing situation
Much of the UK fuel retail market exists as a series of local markets which overlap to form a chain of substitution and thus almost constitute a single market. If prices rose abnormally in a certain locality, the situation could spark up competition from an adjacent area, since consumers will not have to drive a long distance to buy fuels at the lower price. However, this argument does not hold for remoter areas, especially north-west Scotland, Orkney, Shetland, the Inner and Outer Hebrides (Highlands and Islands), and the Western Isles.21 The consumers in these areas are considered to be in a captive market because the cost and inconvenience of buying fuels on the mainland in order to avoid higher prices are high.

The main areas of concern identified by consumer representatives in these areas are: the higher prices of fuels at the pump relative to the UK average and the falling number of fuels retail outlets. The price differentials between the UK average and these areas are greater in north-west Scotland, Inner and Outer Hebrides, Orkney and Shetland. The OFT’s 1998 report concluded that the Highlands and Islands (H & I) should be treated as separate from the wider UK market for fuel wholesaling and retailing because the chain of substitution does not extend to these areas, owing to a sparse population (with fewer sites spread across a large area) and poor road infrastructure.

The price differentials even within the H & I area do suggest that it does not operate as a single homogenous market. Additionally, the review conducted by the OFT

21 See OFT Report (1998); supra note 11, at p. 69. Also see annexed map of the UK.
(2000) in these areas found a price differential as high as 5.5 pence per litre (ppl) between the Western Isles and the H & I as a whole.²²

Significant barriers to entry into fuel wholesaling in the H & I were identified in the OFT, 2000, review. Wholesale supplies of fuel can be obtained from BP’s Grangemouth refinery, but may not be bought at terms that are comparable to existing swap arrangements between Shell, Esso and BP, and the supermarkets unless the potential entrant has refining capacity elsewhere in the UK or beyond.²³ This automatically places a new entrant at a price disadvantage. The exception has been Gleener Oils, an independent fuel retailer which established as a fuel wholesaler in this region in 1997.²⁴ Moreover, entry as a non-refining wholesaler requires access to fuel stations. Ordinarily, this access should not be difficult, considering that there are minimal vertical restraints at the retail level in this area. The problem, however, is that almost all outlets in the area have five-year solus ties with existing wholesalers; although a proportion of these contracts come up for renewal each year, the number of outlets are small.²⁵ Therefore, it is unlikely for a new entrant to access a sufficient number of retail stations to operate profitably. Entry at the retail level has not been attractive and the cost of complying with environmental regulations has been high. To earn enough returns, entry has to be on a fairly high scale. The sustained closures of sites in this region are an indication that except for higher volume locations, entry opportunity is unattractive (see table 3.5).

²³ See id., p. 5.
²⁴ See id., p. 5.
²⁵ See id., p. 5.
Table 3.5  Numbers of petrol retailers in the H& I and Western Isles in 1992 as compared with 1998-9

<table>
<thead>
<tr>
<th>Area</th>
<th>1992</th>
<th>1998-9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highlands</td>
<td>177</td>
<td>139</td>
</tr>
<tr>
<td>Western Isles</td>
<td>30</td>
<td>19</td>
</tr>
<tr>
<td>Orkney</td>
<td>43</td>
<td>26</td>
</tr>
<tr>
<td>Shetland</td>
<td>34</td>
<td>21</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>284</strong></td>
<td><strong>205</strong></td>
</tr>
</tbody>
</table>


Table 3.6 shows that the major oil companies, particularly Shell, Esso, and BP, and to a lesser degree Gleener Oils, account for most of the wholesale supply of fuels in the H & I. This table also indicates the approximate market shares for each of the four wholesalers both in terms of the number of sites owned and the volume of fuels supplied. This broad picture shows that together BP, Shell, and Esso account for between 65% and 90% of wholesale supply, although there appear to be differences in market shares within regions of the H & I.

Most fuel retailers in the region are solus-tie independents, having between them an estimated average volume throughput of 980,000 litres for both petrol and diesel (see Table 3.7). Although BP has the highest number of solus-tie outlets (62%), however, they supply lower volumes compared to Esso and Shell. The number of outlets operated by Shell and Esso has fallen in recent years but the remainder generally supply higher volumes.
Table 3.6 Estimated market shares in the supply of petrol in the H & I (1998-9)

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Number of sites</th>
<th>Site %</th>
<th>Average annual petrol volume (litres)</th>
<th>Volume %</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP</td>
<td>122</td>
<td>62</td>
<td>53,500,000</td>
<td>43</td>
</tr>
<tr>
<td>Esso</td>
<td>21</td>
<td>11</td>
<td>40,500,000</td>
<td>32</td>
</tr>
<tr>
<td>Shell</td>
<td>17</td>
<td>9</td>
<td>14,400,000</td>
<td>12</td>
</tr>
<tr>
<td>Gleaner</td>
<td>13</td>
<td>7</td>
<td>2,000,000</td>
<td>2</td>
</tr>
<tr>
<td>Others</td>
<td>23</td>
<td>12</td>
<td>15,000,000</td>
<td>12</td>
</tr>
<tr>
<td>TOTAL</td>
<td>196</td>
<td>100</td>
<td>125,400,000</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 3.7 Average annual throughput (petrol & diesel) in litres (1998 & 1999)

<table>
<thead>
<tr>
<th>Supplier</th>
<th>H &amp; I</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP</td>
<td>690,000</td>
<td>4,140,000</td>
</tr>
<tr>
<td>Esso</td>
<td>2,730,000</td>
<td>N/A</td>
</tr>
<tr>
<td>Shell</td>
<td>1,460,000</td>
<td>3,200,000</td>
</tr>
<tr>
<td>Gleaner</td>
<td>260,000</td>
<td>N/A</td>
</tr>
<tr>
<td>AVERAGE</td>
<td>980,000</td>
<td>2,800,000</td>
</tr>
</tbody>
</table>

Note: Weighted by number of sites for H & I average.

The foregoing partly accounts for a significant differential in the prices of fuels in rural and urban locations in the UK. A number of other reasons have been adduced for this differential including smaller number, sizes and turnover of retail outlets in rural/remote areas; higher cost of delivery to such areas, and ever-increasing costs of pump and tank replacements due to increased environmental regulatory requirements, etc. Additionally, the price of fuels exclusive of VAT is higher in rural areas. Consequently, the interaction of this price with VAT at the standard rate of 17.5%

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26 UK Retail Marketing Survey, Petroleum Review, Independents: Rising to the Rural Challenges 27 (March 2003, Ed.).
increases the price differential (see Table 3.8). Halcrow Fox suggested that
government should introduce a system whereby the VAT on motor fuel varied from
region to region, in order to mitigate the inherently higher costs in rural areas.

Table 3.8 Regional comparison of prices, margins and volumes (1999-2000)

<table>
<thead>
<tr>
<th>Area</th>
<th>Average pump price for unleaded petrol (ppl)</th>
<th>Average combined gross retail / wholesale margin (ppl)</th>
<th>Average annual site volume (petrol &amp; diesel) (litres)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>62.9</td>
<td>5.3</td>
<td>2,800,000</td>
</tr>
<tr>
<td>H &amp; I</td>
<td>66.2</td>
<td>8.7</td>
<td>950,000</td>
</tr>
<tr>
<td>Inner Moray firth</td>
<td>64.2</td>
<td>&lt;8.7</td>
<td>2,170,000</td>
</tr>
<tr>
<td>Remote Highlands</td>
<td>67.0</td>
<td>&gt;8.7</td>
<td>710,000</td>
</tr>
<tr>
<td>Western Isles(Uist)</td>
<td>71.7</td>
<td>14.1</td>
<td>760,000</td>
</tr>
<tr>
<td>Isles of Lewis / Harris</td>
<td>71.5</td>
<td>14.1</td>
<td>1,250,000</td>
</tr>
<tr>
<td>(Western Isles)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: OFT Survey (2000), petrol & diesel pricing in the Highlands & Islands, p. 16.

The Parliamentary Trade and Industry Committee UK (6th Report) considered the
suggestion as impractical, but recommended that government could consider ways in
which the taxation levied on fuels could be adjusted to ensure that fuel retailers in
rural areas as well as rural dwellers are not disadvantaged.27

In summary, the implications of price differentials are: (a) a possible cross-subsidy
from rural consumers to urban consumers; (b) the prices of many goods and services
are likely to be higher in rural areas than urban areas, thereby creating rural poverty;

(c) rural dwellers who rely heavily on motor vehicular transport in the absence of alternative public transport will now have to pay more for fuel than urban dwellers who have other alternative transport options; (d) large price differentials between rural areas and nearby country towns can result in rural motorists having to travel unreasonably long distances to obtain fuel, along with its environmental consequences and road congestion.

The OFT also investigated the way fuel and agency cards operate to see if it contributed in some ways to the high fuel prices in rural communities, particularly in the Western Isles. Cards issued by different wholesalers operate differently, but basically they are meant to permit the purchaser to obtain fuel at a national average price. In the case of Esso’s card, the retailer is refunded the difference between the national average price and the displayed pump price.\(^{28}\) BP is by far the major supplier of fuel through branded sites in the Western Isles, and supplied 60% of total fuels in 1998. In their case, BP pays a handling charge to the retailers which they claim is sufficient to cover the marginal cost of supplying fuel and to bring in customers (who would otherwise be lost to a competitor) to the outlet.\(^{29}\)

The estimates of the possible impact of an agency fuel card on retail income and pump prices are laid out in Table 3.9. The assumptions here are that volume, pump price, and retailers’ income are constant. The OFT observed that while the loss of fuel card facility by a retailer is hurtful to its business, however it does not necessarily translate to a growth in retail volume for those retailers who have the card facility.

\(^{28}\) See id., p. 18.  
\(^{29}\) See OFT Report; supra note 33, at p. 18.
Table 3.9 Possible Impact of National Average Price Agency Card Sales

<table>
<thead>
<tr>
<th>Agency business as a % of total business</th>
<th>With agency card</th>
<th>without agency card</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% drop in retail income</td>
<td>Decrease in pump price (ppl)</td>
</tr>
<tr>
<td>10</td>
<td>8.5</td>
<td>-0.8</td>
</tr>
<tr>
<td>15</td>
<td>13.0</td>
<td>-1.2</td>
</tr>
<tr>
<td>20</td>
<td>17.5</td>
<td>-1.6</td>
</tr>
<tr>
<td>25</td>
<td>22.0</td>
<td>-2.0</td>
</tr>
<tr>
<td>30</td>
<td>26.5</td>
<td>-2.4</td>
</tr>
</tbody>
</table>


Since the local market in the Western Isles is said to be operating competitively, retailers may not be able to raise their prices to counteract the lower margins from agency sales; in the absence of an increase in volume, the expected outcome would be a closure of smaller outlets. This is because the smaller sites would be unable to match the lower unit costs of large volume retailers, and consequently the minimum efficient scale of operation will increase. The resultant effect of market exits of this type should be a reduction in outlets, increased volume at the remaining sites, and a reduction in their unit costs. It is clear that this reduced cost has not been passed on to consumers in lower pump prices and amounts to a significant consumer welfare loss and would indicate the characteristics of oligopoly.

However, the OFT observed that prices and pricing patterns in the Western Isles do not suggest that they have a highly competitive market. The implication is that the impact of agency cards may not lead to market exits but possibly to higher pump prices, since the small retailers will seek to recover the retail margins lost on the agency cards. BP confirmed that additional price support is rarely given to retailers in Western Isles.

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30 See id., p. 19.
this area, except those with an unusually high level of agency business, which compensates them for lost retail income.\textsuperscript{31}

3.4.1 Views across the industry

3.4.1.1 Future role of independent fuel retailers

The following is a summary of the views of industry participants based on the OFT survey of the fuel retail trade published in 1998.\textsuperscript{32} All industry participants agreed that the independent fuel retail sector in general has lost significant market share due to supermarket expansion and with devastating consequences for some rural remote areas that are currently underserved by fuel retail sites. Little future was forecast for poorly located, low-volume sites regardless of whether company owned or dealer owned. Further closures of independent sites were anticipated, particularly those in urban areas where competition between supermarkets and the oil majors, as well as between supermarkets, is vigorous at the retail level.

The refining majors opined that independents who could survive were those that reduced their costs in addition to providing added value services. They all predicted that the rate of closures for independents would continue to be high unless a factor was introduced to alter the current industry structure.\textsuperscript{33} The main reasons adduced for this prediction were that independent outlets were usually poorly located and inferior to their competitors’ sites; and the necessary level of investment required to upgrade the outlets may not be justified by the additional sales. They concluded that rural outlets and independents located in better sites (modern operators) stand a chance of

\textsuperscript{31} See \textit{id.}, p. 20.
\textsuperscript{32} For the OFT Survey, detailed questionnaires were sent to the majority of petrol refiners, wholesalers, and supermarket petrol retailers. Majority of the companies responded including all the major refiners and supermarkets. However, of 970 questionnaires sent to a random selection of Independent retailers, 370 responded and this was considered enough to reach valid conclusions.
\textsuperscript{33} See OFT Report (1998); \textit{supra} note 11, at p. 81.
survival. It is more questionable whether independents located in cities will similarly survive.\footnote{See \textit{id.}, p. 82.}

Some mini-majors, e.g. Murco were of the opinion that independents could only survive in the current climate if they became as efficient as the larger company-owned sites. The main problems of the independent sector which they identified were lower volumes; higher unit costs; insufficient funds for expansion and re-development; and cost of compliance with environmental, and health and safety legislation. The latter would include a number of factors. First, the high cost of testing storage tanks;\footnote{See TIC\textit{ on Petrol Retailing}; \textit{supra} note 25 at p. xix. Also see, H. Fox; \textit{Social \\& Economic Impact: Petroleum Prices \\& Distribution in the Highlands and Islands} para. 1.2.11 (1996). See OFT Report (1998); \textit{supra} note 11, at p. 22.} second, the impact of Stages I \\& II EU Petrol Vapour Recovery Directives on rural fuel retailers and the associated wetstock losses;\footnote{House of Commons, Environment Committee 1\textsuperscript{st} Report; \textit{Volatile Organic Compounds HC 39 paras 135-143} (Session 1994-95). Info on wetstock losses, available online at \url{http://www.forecourttrader.co.uk/news/fullstory.php/aid/907/Taking_control.html}, last visited on 26 March 2009. Also see OFT Report (1990); \textit{supra} note 5, at p. 231.} third, inaccuracies in fuel measurement and the attendant environmental impact and effect on retailers’ profits.\footnote{Moorhouse D., \textit{The Accuracy of Fuel Metering} (A Report by National Weights \\& Measures Laboratory) 4 (Project No; 2.3.6, 2005). Available online at \url{http://www.google.com/search?hl=en&q=The+Accuracy+of+Fuel+Metering}, last visited on 12 March 2009 Australian Institute of Petroleum (AIP), \textit{Temperature Correction of Petrol} 1 (1996). Available online at \url{http://www.aip.com.au/pdf/tempcorrect.pdf}, last visited on 26 March 2009.} They projected that the high rate of closures of independents would lead to a more concentrated market and might result in collusion and abuse of market power, and subsequently an even higher closure rate.\footnote{See OFT Report (1998); \textit{supra} note 11, at p. 82}

Other mini-majors were divided in their views. Most thought that better and higher volume independent sites could survive, and that even lower volume outlets with a diversified product portfolio might also survive. However, they were all in agreement
that the numbers would continue to fall as the market continued to rationalise; and that urban independents were more at risk than the rural outlets, owing to the lower incentive for oil companies and supermarkets to invest in rural areas.\textsuperscript{39}

The supermarkets were of the view that lower-volume independent sites would continue to find it difficult to generate sufficient income. Some observed that environmental legislation was as threatening to the independent sector as price competition. The majority of them identified three factors as key to the future survival of independents: servicing of local community needs; product diversification/product innovation; and government intervention (where and when necessary). They agreed unanimously that the number of independents particularly in urban areas would continue to fall as long as the supermarkets and company-owned outlets of major wholesalers engaged in a battle for market share.

The Petrol Retailers Association (PRA) contends that there is a continued need for independent solus-tie retailers, because the rural and remote areas depend on this group for their fuel supplies. Another reason is that suppliers who require additional market share above the capacity of their own network will need to secure this extra volume through the independent sector.\textsuperscript{40}

A similar body, the Federation of Small Businesses (FSB) contends that fierce competition between the supermarkets and the oil companies has led to a widespread closure of independent retailers as well as licensed and agency operated sites. Businesses agree that prices have fallen as a result which, although currently

\textsuperscript{39} See \textit{id.}, p. 82.
\textsuperscript{40} See \textit{id.}, p. 85.
beneficial to consumers, could serve only in the short term. They argue that once the
exit of independents was fully achieved, the supermarkets and oil companies might be
able to raise prices and consumers may have to travel unreasonable distances to obtain
fuel supplies.\textsuperscript{41} They believe that there could be additional damage to the local
business community. In their arguments in favour of protection for the independents
and other smaller businesses, the FSB made a number of recommendations including,
(a) fuel retailers setting their own pump prices; (b) taking steps to avoid ‘price wars’;
(c) local authorities taking account of the local business lobby when granting planning
permission for new supermarkets/hypermarkets;\textsuperscript{42} (d) amendments to the uniform
business rate to reflect the volume of sales at different sized outlets;\textsuperscript{43} (e) ensuring
security of tenure for licensees and agents under the Landlord and Tenant Act.\textsuperscript{44}

As regards the root cause of the decline in the independents’ sector, opinion was
divided across the industry. Some opined that it was a natural process brought about
by unfettered market forces; some thought that Esso’s aggressive response to the
supermarkets’ competitive threat (Esso Pricewatch) forced the independents to
operate on unsustainably low margins also designed to force further rationalisation of
the supply chain; others blame the supermarkets’ expansion as damaging to the fuel
supply chain.

\textbf{3.4.1.2 Future role of supermarkets}
There was consensus that supermarkets have transformed the fuels retail market in the
UK, and that they achieved this by offering fuels at lower prices and convenient
locations. It was also recognised that they are able to charge lower prices because of

\textsuperscript{41} See \textit{id.}, p. 86.
\textsuperscript{42} See id., 79. Also, see OFT Report (1990); \textit{supra} note 5, at p. 52.
\textsuperscript{43} For details on business rates, see \textit{id.}, pp. 77-79.
\textsuperscript{44} See \textit{id.}, p. 86.
their far higher throughput compared to roadside outlets. Supermarkets are able to derive significant benefits from fuel, being a known value item for consumers, by being seen to be competitive with their supermarket rivals. For instance, Murco commented that a competitive fuel price could boost grocery sales by as much as 20%.46

However, it is the view of the supermarkets and those of other players that the main driver of their pricing competition was with other supermarkets and not with traditional roadside outlets. Other players observed that planning, duty, and storage arrangements in the UK gave the supermarkets unfair competitive advantage. Oil majors, however, perceive supermarkets as their chief competitors and they all expect supermarkets’ growth to continue, albeit at a slower rate than in previous years.48 They propounded a number of reasons for this assertion, as follows: current levels of price competition from other participants; market saturation; and planning restrictions on out-of-town developments.

Some of the mini-majors opined that supermarkets’ growth will continue until they achieve a market share of 30%. Some were of the view that their growth could continue unchecked until they become virtual monopolists, but for planning permission restrictions on out-of-town sites.49 Murco was of the opinion that supermarkets have grown to a point where they could take full control of the supply chain by buying fuels at ex-refinery prices and if convenient import fuels directly from abroad.

45 See id., p. 83.
46 See id., p. 83.
47 For details on planning, duty and storage, see id., pp. 75-79.
48 See id., p. 84.
49 See id., p. 84.
Table 3.10  Impact of the supermarkets in UK petrol retailing, 1998-2005

<table>
<thead>
<tr>
<th>Year</th>
<th>Forecourt shops</th>
<th>% share of forecourt sales</th>
<th>Supermarket forecourt shops</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1,548</td>
<td>25.5</td>
<td>Asda; Co-op; Sainsbury; Somerfield; Tesco; Safeway; Morrisons; Waitrose</td>
</tr>
<tr>
<td>2004</td>
<td>1,428</td>
<td>24.4</td>
<td>&quot;</td>
</tr>
<tr>
<td>2003</td>
<td>1,360</td>
<td>23.2</td>
<td>&quot;</td>
</tr>
<tr>
<td>2002</td>
<td>1,193</td>
<td>16.6</td>
<td>&quot;</td>
</tr>
<tr>
<td>2001</td>
<td>1,144</td>
<td>14.3</td>
<td>&quot;</td>
</tr>
<tr>
<td>2000</td>
<td>1,069</td>
<td>12.1</td>
<td>&quot;</td>
</tr>
<tr>
<td>1999</td>
<td>949</td>
<td>9.8</td>
<td>&quot;</td>
</tr>
<tr>
<td>1998</td>
<td>872</td>
<td>8.1</td>
<td>&quot;</td>
</tr>
</tbody>
</table>


They observed that the supermarkets could import and store fuels under bond at many different locations across the UK, which refiners could not do since they would have to incur duty on transit losses. However, there were mixed views on whether they would consider future joint ventures with the oil majors. Recent alliances between Esso and Tesco regarding joint development of forecourt shops would suggest such a future development, but more currently, virtually all the major supermarkets have similar alliances with oil majors. The supermarkets have strategically used these forecourt shops to drive their fuel retail market shares up since the middle 1990s (see Tables 3.10 and 3.11).

Most supermarkets predicted that they would continue to increase their market share by expanding their networks, until the restrictive planning regime suggests no further expansion. As such, the effects on the independent sector would continue to be fatal.

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50 See id., p. 85.
Table 3.11 Developments of joint venture (JV) shops between the supermarkets & the oil majors, 1998-2005

<table>
<thead>
<tr>
<th>Year</th>
<th>Sites</th>
<th>JV forecourt shops</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>484</td>
<td>Esso / Tesco Express; BP / Safeway; Total / Somerfield; BP Connect; Shell / Sainsbury; Texaco / Somerfield.</td>
</tr>
<tr>
<td>2004</td>
<td>395</td>
<td>Esso / Tesco Express; BP / Safeway; Total / Somerfield; BP Connect; Shell / Sainsbury.</td>
</tr>
<tr>
<td>2003</td>
<td>339</td>
<td>Esso / Tesco Express; BP / Safeway; Total / Somerfield; BP Connect; Shell / Sainsbury.</td>
</tr>
<tr>
<td>2002</td>
<td>243</td>
<td>Esso / Tesco Express; BP / Safeway; Total / Somerfield; BP Connect; Shell / Sainsbury.</td>
</tr>
<tr>
<td>2001</td>
<td>209</td>
<td>Esso / Tesco Express; BP / Safeway; Total / Somerfield; BP Connect.</td>
</tr>
<tr>
<td>2000</td>
<td>94</td>
<td>Esso / Tesco Express; BP / Safeway; Elf / Somerfield.</td>
</tr>
<tr>
<td>1999</td>
<td>54</td>
<td>Esso / Tesco Express; BP / Safeway; Elf / Somerfield.</td>
</tr>
<tr>
<td>1998</td>
<td>6</td>
<td>A few BP / SAFeway shops.</td>
</tr>
</tbody>
</table>


3.4.1.3 Projected future fuel supplies in rural areas

The Highlands and Islands Action Group on Hydrocarbon Fuel Prices (HIAG) represents the interests of fuel consumers in the H & I, and is particularly interested in the higher price of fuels in rural/remote areas compared with other parts of the UK, and the high attrition rate of fuel outlets within the region. In a survey conducted by the HIAG in 1997, concern was expressed over the failure of oil companies to vary their SPS policy to take account of urban–rural cost differentials which consequently discriminate against low volume remote outlets leading to tighter margins, operating losses, and ultimate closures. They argue that the lack of competition between oil companies and their distributors kept wholesale prices high and encouraged retailers to charge higher pump prices to cover their costs. The HIAG insist that there is evidence of parallel pricing in the area, which distorted competition and kept pump prices high. They claim that in areas where there was only one fuel wholesale supplier, there were higher wholesale prices, which could be attributed to abuse of a

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51 See id., p. 89.
dominant position. Moreover, they were concerned about the impact that the closure of independent outlets would have on small communities. They considered that existing safety and environmental legislation rendered unmanned or above-ground storage an impractical option, particularly in areas that are underserved with fuel supplies.

The Western Isles Council (WIC) is essentially concerned with fuel supplies in Western Isles (Isles of Lewis, North & South Uist, and Barra), although it liaises with the HIAG. The population of the WI is about 300,000 but served by roughly 23 petrol stations.\textsuperscript{52} Owing to the absence of a public transport system, the WIC considers fuels as an essential commodity in the area and worries that the products are significantly costlier than in other areas. The WIC observed that rural retailers were struggling for survival due to the abuse of a dominant position by the oil companies and also expressed concern about the operation of agency cards.\textsuperscript{53}

Bruce Peter, Director of the PRA (1986-97), considered that the impact of the 1996 fuel price war in the UK on smaller independent retailers had been severe and also recognised the problems associated with supplies to rural/remote areas, involving social, transport, and competition matters. He concluded that the UK fuels market was undergoing rapid change which could precipitate a less competitive market with further rationalisation. Additionally, he argued that many country areas might eventually be underserved, which might have implications for rural living and development.

\textsuperscript{52} See \textit{id.}, p. 90.  
\textsuperscript{53} See \textit{id.}, p. 90.
He made some recommendations, including: (a) a review of the fuels market by the OFT on an annual basis; (b) categorisation of retail outlets as sensitive and non-sensitive, to be based on a maximum driving distance to obtain fuel of 30km; (c) equalisation of the business rating advantages derived by the supermarkets over oil wholesalers; (d) supply undertakings to be extracted from suppliers operating in areas with inadequate security of supplies; (e) review of the burdens imposed by environmental, health and safety legislation; (f) introduction of a new competition legislation in the fuel retail sector.\textsuperscript{54}

The current PRA spokesperson, Ray Holloway, projected that Britain will be down to between 7,000 and 8,000 fuel stations by 2010, with very few in rural areas. He observed that Leicestershire and the West Country are already ‘threadbare and motorists in Norfolk could be caught out by a complete lack of fuel stations across large areas of the countryside’.

Louden, (at Inverness College) observes that the Highlands & Islands fuels market was marked by local monopoly and collusive behaviour, as the local market was served by few retailers. He argued that there were significant barriers to entry at the supply level which prevented new entrants from participation, coupled with the threat of environmental legislation on lower volume sites operating in the region.\textsuperscript{55} He opined that the current competition legislation has offered little protection to rural consumers, and predicted that the ‘predatory pricing’ which led to the massive closure of independent rural fuel stations would enable the supermarkets and oil company-

\textsuperscript{54} See \textit{id.}, p. 87.
\textsuperscript{55} See \textit{id.}, p. 90.
owned sites to earn supernormal profits in the future. He concluded that regulation could stop this eventuality.56

To militate against the factors that affect the rural independent fuel retailers, managers of retail sites in rural areas have been advised to improve their food, grocery, and convenience goods sales primarily to maintain profitability, and to treat fuel sales, albeit important, as secondary. Secondly, there are indications that improvement in overall retail performance will hinge on cost reductions. Considering the sizes and locations of independent fuel retailers in remote areas, these remedies may not be sufficient.

3.5 AUSTRALIA: Rural fuel supply and pricing situation

Similarly to the UK situation, a series of local fuel markets in the metropolitan areas overlap in such a way as to create competition for adjacent locations, thereby leading to effective price competition. Intense price competition usually produces price variability within cities, which has been of concerns to motorists and the regulatory authorities (ACCC). Conversely, the intense price competition also results in lower pump prices.

This overlap of local markets breaks down when it comes to rural country areas, because of the large distances that exist between these areas and the metropolitan cities. This breakdown in the chain of substitution results in substantial price differentials, which are of serious concern to consumers and local governments in country areas and provincial regions. However, of particular concern are observed

56 See id., p. 90.
price differentials within the country areas themselves, which suggest that there could be several markets within these areas or merely an absence of competition. The presence of significant fuel subsidies for rural dwellers and businesses is a major indicator of an absence of a national geographic market in Australia.

The volume of fuels sold at a retail outlet and freight costs (to a lesser degree) are the main determinants of price differentials observed between regions.\textsuperscript{57} Retail outlets in metropolitan areas with a high volume of sales are able to spread their costs over a larger throughput and so reduce operating margins on each litre of fuel sold, unlike sites with a lower volume of sales. Conversely, outlets in country areas sell less than half the fuel sold by metropolitan service stations. Other determinants of price differentials are volume of sales of non-fuel items, intensity of competition, volatility in fuel prices, and geographic spread of retail sites.

Similarly to the UK experience, profitability in fuel retailing in Australia is derived more from increased sales of non-fuel convenience goods. However, there are lower sales of these higher profit margin non-fuel items in country areas.\textsuperscript{58} It was estimated that average non-fuel revenue per litre in country retail outlets was less than two-thirds of that in metropolitan sites, while profits from non-fuel items was just one-quarter. This lower level of non-fuel sales tends to push up country prices for all types of fuel.

\textsuperscript{58} See \textit{id.}, p. 8.
Competition is generally more intense in metropolitan areas with attendant significant discounting and price cycles, whereas competition is less vigorous and discounting less common in country areas. Owing to the heavy concentration of retail sites in metropolitan areas, price discounting which commences in one location quickly spreads to other locations throughout the area. Conversely, the potential to increase sales through discounting is limited in country areas, particularly in towns with little traffic passing through.

It is practically difficult to supply most country retail outlets directly from the terminals due to their wide geographic spread and the relatively smaller quantities they sell. As a result, most of them are supplied by distributors rather than direct supplies from the oil majors. The higher operational costs incurred by these distributors are passed on to the fuel retailers, leading to higher pump prices (see Table 3.12).

Table 3.12 Examples of retail volumes & unit costs

<table>
<thead>
<tr>
<th>Sites</th>
<th>Location</th>
<th>Monthly volume (litres)</th>
<th>Unit costs (cpl)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Site A</td>
<td>SALE (Remoter Country)</td>
<td>165,000</td>
<td>10</td>
</tr>
<tr>
<td>Site B</td>
<td>TRARALGON (Country)</td>
<td>208,000</td>
<td>6</td>
</tr>
<tr>
<td>Site C</td>
<td>MELBOURNE (City)</td>
<td>480,000</td>
<td>1.8</td>
</tr>
</tbody>
</table>


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59 See id., p. 8.
60 See annexed map of Australia.
3.5.1 Industry views about price differentials

The Victorian Government acknowledged the fact that the costs of distributing and retailing fuels in country areas are inevitably higher when compared with city locations. The Australian Petroleum Agents & Distributors Association (APADA) estimates the average cost of providing distributor services in the country at 5 cents per litre (cpl). Consequently, this is reflected in higher wholesale prices to retailers and higher retail margins. The government expected country consumers to pay more than their metropolitan counterparts to ensure continued access to supplies. Nevertheless, the Victorian Government has urged the Industry Commission (IC) to initiate steps to reduce price differentials. This is based on their view that efficient operation of provincial and rural industries could be affected in a climate of wholesale price discrimination, absence of fair competition, and a flow of cross-subsidies from country to city consumers.

The South Australian Government is also concerned at the level of prices paid by country consumers for petroleum products, and is keen to support any policy aimed at minimising the city–country differentials. Several observers see the price differential as a clear case of cross-subsidisation. The real issue here is not the size of differences between retail prices in metropolitan and country outlets, but differences in retail margins. Many local government authorities, the National Farmers’ Federation, the Victorian Government, etc., all support this view.

Of greater concern were the recorded large differences in prices between nearby country areas. In some of these country centres and smaller country towns, the extra

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62 See id., pp. 81-82.
63 See id., p. 82.
cost of supplying the markets does not justify the higher retail margins. In such cases, local factors were seen as largely responsible.

Most participants also noted that the prices for many other goods and services were higher in the country than in large coastal cities, owing to transport costs and market sizes. They contend that the fuel price differential between the city and rural areas partly accounts for these higher prices of other goods and services in country areas. For instance, many country observers compared the retail prices at the depth of a price war and noted that large differentials of up to 20 cpl occurred from time to time.

1992-3 aggregated wholesale price data illustrates the above views. Table 3.13 shows that the average wholesale price paid by the retailers in Melbourne and Geelong (urban cities) was on average about 2.3 cpl lower than that paid by retailers in other country areas. Also, the table illustrates a wide gap in the retail price and the maximum wholesale price between country areas and metropolitan cities. In some cases, the difference between the average retail price and the average Petroleum Surveillance Authority (PSA) maximum wholesale price exceeded 6 cpl.64

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64 See Industry Commission Report No 40, Petroleum Products; supra note 6, at p. 83.
Table 3.13  Average Melbourne & Victorian country petrol prices for 12 months (ending June, 1993)

<table>
<thead>
<tr>
<th>City / Town</th>
<th>Average actual retail price (cpl)</th>
<th>Average PSA price (cpl)</th>
<th>Retail price minus PSA price gap (cpl)</th>
<th>Derived retail price (cpl)</th>
<th>Volatility (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Melbourne</td>
<td>67.7</td>
<td>66.2</td>
<td>1.5</td>
<td>70.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Geelong</td>
<td>67.5</td>
<td>66.2</td>
<td>1.3</td>
<td>70.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Ballarat</td>
<td>70.8</td>
<td>67.0</td>
<td>3.8</td>
<td>70.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Wodonga</td>
<td>74.2</td>
<td>67.8</td>
<td>6.4</td>
<td>71.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Bendigo</td>
<td>70.9</td>
<td>67.3</td>
<td>3.6</td>
<td>71.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Warrnambool</td>
<td>70.6</td>
<td>67.5</td>
<td>3.1</td>
<td>71.3</td>
<td>4.7</td>
</tr>
<tr>
<td>Mildura</td>
<td>72.8</td>
<td>68.7</td>
<td>4.1</td>
<td>72.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Morwell</td>
<td>73.0</td>
<td>67.3</td>
<td>5.7</td>
<td>71.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Sale</td>
<td>74.1</td>
<td>67.8</td>
<td>6.3</td>
<td>71.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Horsham</td>
<td>73.5</td>
<td>67.9</td>
<td>5.6</td>
<td>71.7</td>
<td>2.1</td>
</tr>
</tbody>
</table>


It follows that if country areas pay wholesale prices that exceed the PSA maximum wholesale price, then retailers could be extracting higher retail margins. It was also observed that cities with the highest gap experienced the lowest volatility. It could be argued that prices in such locations were high and subject to little or no periods of discounting. It could be inferred that weak competition contributed to the large city–country price differentials observed in some areas and could equally explain why retail prices in most country areas were slow to respond to falls in wholesale prices, thereby resulting in rare price variations.

The Parry Committee opined that city retail sites may sell fuels at a reduced margin to induce customers to patronise the site and buy other items or services, thereby using fuels as a ‘loss leader’. However, sales of high margin ancillary non-fuel items are low in country locations mainly because of fewer customers; also it may not be viable

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65 See Inquiry into the Petroleum Products Declaration; supra note 59, at p. 87.
for an operator to provide a large inventory of non-fuel items. On the contrary, the oil majors argue that market forces, especially local factors at the retail level, were responsible for differences between prices in city and country locations. For instance, Mobil insists that the dominant factors accounting for the differential are: differences in relative competitive forces, and volume throughput between the metropolitan areas and country locations.66

The Australian Automobile Association (AAA) acknowledged that variations in price signify the existence of competition and identified four factors that were responsible for the differentials: the differences in volume of sales between sites; freight costs; differences in the operating costs of retail outlets in different regions; and discounting in urban areas in order to increase or maintain market share.67 However, the AAA believes that these factors do not always account for the enormous differences in retail prices that often obtain within regions in country areas.

The existence of large differentials between adjacent country areas has led many observers to believe that there might be collusion in country fuel retailing. The Municipal Association of Victoria (MAV) held the view that there seems to be little or no competition between retail outlets in provincial and rural areas, and that browser prices display little evidence of competitive or customer-friendly practices. The MAV is not convinced that the difference in retail fuel prices between metropolitan Melbourne and rural Victoria can be totally explained by distribution costs, distance, and retail trade characteristics.68

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66 See IC Report No. 40; supra note 6, at p. 82.
67 See id., p. 83.
68 See id., p. 82.
The City of Colac opined that a lack of competition evidenced by little or no variation in prices at outlets in the same rural areas has led to concerns about the question of collusion between retailers in provincial and rural Victoria. The Orange City Council has urged the IC to dispel any community perceptions of collusion, whether or not collusion actually exists.

3.5.2 Participants views on Sites Act

The Australian Government enacted the Sites Act in order to limit the number of retail outlets operated by the oil majors. Similar limitations were not imposed on the independent and supermarket fuel retailers. Clearly, the aim was to alter the fuel retail market structure in such a way as to increase the participation of independents and supermarkets, and reduce the dominance of the oil majors. The government thought that this was one of the strategies for increasing competition and reducing fuel retail pump prices, particularly in country areas.

There are divergent views among industry players regarding this Act. The oil majors were of the view that the Act should be repealed because it limits their operational flexibility thereby placing them at a disadvantage. Caltex noted that the majority of their sites were operated under franchise agreements, being the only alternative mode of operation available to them in the face of relatively small site quotas.

The Trade Practices Commission (TPC) also insisted that the Act be repealed on the grounds that the restriction it imposed on oil companies was unparalleled in the history of the private sector in Australia. They questioned the effectiveness of this legislation in reducing vertical integration by the oil majors, given that the franchisees
were totally dependent on their landlords (the oil majors) for fuels.\(^6^9\) They contended that a better response to vertical integration could be either to reduce or to remove the tie between the franchisees and their landlords, which was a problematic proposition.

The PSA was of the view that the Act may not achieve its purpose. They observed that although the Sites Act may limit the exercise of the market power of oil companies at the retail level, there exist other avenues for the majors to exercise market power, e.g. through franchise agreements, wholesale pricing, and other supply arrangements.\(^7^0\)

The Department of Industry, Science and Technology (DIST) noted that there are strong arguments both for a more deregulated regime and for increased regulation. However, they contended that the status quo should be maintained until the impact of a deregulated regime is clearly assessed.

The MTAA (Motor Trades Association of Australia) recommended that the Act be amended such that sites that sell only diesel should be subject to quotas. They argued that it was necessary to keep the oil companies from gaining total control of the fuel retail market and of retail pricing. They further advocated that possible loopholes in the Act should be identified and tightened in order to strengthen it.

APADA held an extreme view, recommending total divestment and exclusion of oil companies from ownership of facilities beyond the refineries and terminals. However, APADA was not alone in this view, because the Victorian Government investigated a

\(^6^9\) See IC Report No.40; \textit{supra} note 6, at p. 154.
\(^7^0\) See \textit{id.}, p. 155.
proposal by the Victorian Automobile Chamber of Commerce (VACC) that the government should divorce oil majors from operating retail sites in Victoria. However, the government rejected the proposal on the grounds that it was unsure that the presence of company-operated sites reduced competition in Melbourne, and moreover it was not certain that full divorcement of the oil majors from fuel retailing would increase competition.

3.5.3 Industry views on Franchise Act
The Australian Government also put in place a Franchise Act, which was meant to regulate the contractual relationship between the oil majors (franchisors) and the fuel retailers they supply (franchisees). The main objective of this Act was to provide security of tenure for the franchisees. Again, the views of the franchisors and franchisees vary on this Act.

The oil majors argued that the Act restrained their rationalisation efforts. They contended that rationalisation is a regular occurrence in most industries, being a response to commercial realities that ensure that adequate profit generation occurs to meet the required rate of return on a given asset. They argued that the Franchise Act prevented them from disposing of sites that have become uneconomic.71 In such situations, the franchisor may either decide to wait for the full nine years of tenure to elapse, or seek non-renewal of the franchise at the times provided for in the franchise agreement. Based on the latter, the franchisee has to be given the ‘first option to purchase’ the site on terms that are similar to those made to another buyer. Should the franchisee go ahead to purchase the site, the inefficiencies associated with that site

71 See id., p. 160.
might remain within the industry. However, BP recognised the shortfalls of the Act, but advocated for its retention with possible amendments that could support rationalisation while allowing closer scrutiny of assignees and a relaxed termination of contract conditions in favour of franchisors.

The MTAA argued in favour of retention of the Act on the basis that it provided the necessary protection for certain dealers during the pre-franchise period and in the course of a franchise relationship. They observed that since the passing of the Franchise Act, the individual dealers operating oil company-owned outlets have gained security of tenure and have brought to an end numerous cases of short-term eviction of franchisees that used to occur regularly throughout Australia.\(^72\)

The DIST argued that the legislation achieved its aim with regard to dealer protection, and that franchisees regard the requirements for prior disclosure, assured tenure, rights of assignment, and specific grounds for termination as major benefits. They equally argued that the Act had provided the impetus for the development of a self-regulatory downstream Oilcode, and so had laid the foundational rules for the franchisor–franchisee relationship.

The TPC contended that experience in the courts regarding cases related to the Franchise Act has shown that the legislation route was expensive, lengthy, and uncertain.\(^73\) They hailed the efforts of the government in formulating the Oilcode which includes many aspects of the Franchise Act, thereby rendering the latter almost redundant.

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\(^{72}\) See *id.*, p. 159.

\(^{73}\) See *id.*, p. 160.
The Petroleum Retailers Association of Western Australia noted the considerable changes that the fuel retail market has undergone since the enactment of the Sites and Franchise Acts, and supports a strengthened Oilcode (in scope and structure) as a remedy to the situations that the Franchise Act was meant to address.74

### 3.6 Conclusion

The objectives of this chapter were realised by identifying the concerns regarding the high fuel prices in rural/country locations; the urban–rural fuel price differentials, and their impact on rural inhabitants and businesses. This chapter isolated the causes of the problems and also identified the regulatory support mechanisms and fuel subsidy schemes that governments in both countries have applied to the research problems. These mechanisms and schemes have been useful in designing the analytical framework for this study.

The research identified a number of features relating to petroleum products, which should be taken into account when assessing the necessity of support for locations (e.g. rural or remote) where market failures can occur (i.e. where competition is not effective). These would include the following. Firstly, petroleum products currently account for a significant proportion of all fuels used in transportation. Secondly, the products are homogeneous and competition is often based on price and volume. These are also positively correlated. Therefore, price volatility becomes a regular feature of the fuel retail trade and often leads to price wars. In the process, smaller efficient or inefficient competitors are forced out of the trade. Refiners have some cushion for coping with the price wars, for example they could resort to price discrimination, use of SPS to enable its outlets to cope with competition from adjacent fuel stations, or by

74 See id., p. 159.
varying the percentage yield of products from crude oil refining, depending on demand conditions. Thirdly, the demand for petroleum products is price inelastic, and in the absence of effective competition could lead to pricing abuses. The absence of effective substitutes deepens this concern.

At the refining level, the industry operates as an oligopoly as this is dominated by the oil majors. Refining is characterised by high fixed costs relative to variable costs. The implication is that plant and equipment have to be operated at full capacity in order to lower the average costs and make profits. The inevitability of the continuous process of production has further implications for control over the fuel retail trade and price discounting/volatility. This situation compels refiners to control the storage and transportation machinery involved in the wholesaling and retailing functions.

An examination of the dynamics of the fuel retail market revealed that the following characteristics drive the supply side competition: correlation between fuel sales and non-fuel sales; the need to achieve enough margins to offset fixed costs; and the need to achieve substantial sales volumes. On the demand side, the following factors were identified as determinants of the nature of competition among fuel retailers: consumers purchase the products regularly; market demand is not responsive to price rises; cost of comparing fuel prices across outlets is negligible; significant numbers of fuel consumers have little brand loyalty due to limited product differentiation; the demand for fuels tend to be localised. The combined implications of these factors are that price and volume competition is essential in fuel retailing, and price differentials are likely to occur across localities, even within metropolitan cities. However, price differentials within metropolitan areas is not a cause for considerable concern as
motorist can purchase fuels from nearby cheaper sources without having to drive unreasonable distances for such purchases.

An assessment of the fuel supply scene in rural and remote areas in both jurisdictions revealed more similarities than differences. Firstly, the constituent fuel markets in rural/remote locations have characteristics that differ from the wider jurisdictional markets. In some cases, there are different local markets within some of the remote areas with significant price differentials between them.

Secondly, fuel prices tend to be higher in the rural areas compared to the urban cities due to (a) lower volume throughput; (b) higher freight costs; (c) less sales of non-fuel goods; (d) high cost of meeting environment, health and safety regulations; (e) lower intensity of competition arising from a near absence of wholesale and retail price discounting; (f) wider geographical spread of retail sites; (g) absence of independent fuel retailing chains; (h) greater possibilities of conscious price parallelism and possible collusion among country distributors; (i) availability of under-the-canopy discounts; (j) the effect of oil-company agency card sales which results in retailers charging higher pump prices to offset such effects; (k) the greater potential for the oil majors to ‘claw back’ retailers’ margins which could result in retailers charging higher pump prices to offset the ‘clawed-back margins’; (l) supermarket involvement in fuel retailing, etc.

Regional local governments in the UK and Australia are concerned at the significantly higher fuel prices that rural consumers pay and the resultant higher cost of living, and are of the view that these could also damage the efficient operation of provincial and
rural industries. These governments and other national associations, e.g. National Farmers’ Federation, believe that there might be a case of cross-subsidy involved as a result of the city–country differentials. They are of the view that the oil majors could be funding their competition for market shares in the major cities with the profits they derive from the higher wholesale prices from regional centres and rural areas.

The consequences of the high fuel prices in rural areas were identified as: firstly, higher cost of rural living and rural businesses leading to rural poverty and outmigration; and secondly, the environmental impact and problem of road congestion caused by rural motorists having to drive unreasonable distances to obtain fuels. The latter usually occurs where the rural motorists have an incentive to drive to the nearest supermarket to obtain their fuel, groceries, do car wash and pump tyres (i.e. one-stop shopping).

The foregoing would suggest that the problems of high pump prices in rural and remote locations, and rural–urban price differentials require close cooperation from all the internal parties involved in the fuel supply chain, and also the involvement of external actors, mainly government support. Consequently, governments in both jurisdictions have rendered support in the form of direct/indirect subsidies, and regulatory support mechanisms aimed at enabling rural/remote communities and businesses to cope with the higher fuel pump prices. The support measures could be categorised into four major groupings: regulatory support mechanisms (as represented by sites and licence/franchise regulations); fuel grants and rebate schemes; tax/duty concessions; and other rural grants and rebate schemes.
Chapter 4
COMPARATIVE ANALYSIS OF FUEL RETAIL SITES AND LICENCE / FRANCHISE REGULATIONS

4.1 Introduction
The previous chapter defined the nature and extent of the twin-problems of high fuel prices in rural/remote areas and the rural-urban fuel price differentials. The aim of this chapter is to compare the sites and licence / franchise regulatory frameworks for fuels retailing in both jurisdictions in order to determine whether the frameworks assists in solving the research problems, and by extension how these could contribute to rural development.

This chapter examines the regulatory support mechanisms in the two jurisdictions, as well as the legal cases arising from the licence / franchise agreements. Legal cases related to licence agreements used in fuel retailing are decided in the UK based on the general principles of law whereas the enactment of a Franchise Act in Australia meant that franchise cases have to be decided based on the true spirit and dictates of the statute. The objectives of the comparative analysis of cases related to licence / franchise agreements is partly to discern whether the legal judgements reinforce the fuel retail licence / franchise regulations in the two jurisdictions, and partly to examine whether the objectives of the regulations were being met.

The comparative assessment of these regulatory mechanisms is essential because the number of sites belonging to the different categories of retail operators and the licence / franchise agreements between the major operators and their retailers determines the concentration levels of the fuel retail sector and by implication the level of barriers to
entry. Site regulation could also impact on the overall structure of the fuel retail industry, whereas licence / franchise regulations could affect the stability and regularity of fuel supplies to both urban and rural locations.

This chapter contributes to an understanding of the effectiveness (or not) of regulatory support mechanisms as a means of achieving relatively lower pump prices in rural / remote locations, as well as bridging the rural-urban price differentials.

4.2 Fuel Retail Site Regulation in the UK
The major incidence of site regulation in the UK occurred in 1965, as reported by the Monopolies Commission (now Competition Commission).1 The solus fuel marketing system has been identified as the tool which enables the principal fuel wholesalers to exert full control over fuel retail activities. The resolve of the regulatory authorities to modify the solus fuel retail trading system in such a way as to serve the public interest led to the regulatory Undertakings (1966) from the major oil companies.

The report established the argument that the solus arrangements for fuels has led to improvements in fuel stations; caused some reduction in suppliers’ costs which had exerted a downward pressure on prices; has not led to over- proliferation of fuel outlets; and does not restrict the consumers’ choice of fuels. However, the power and resources of the major fuel suppliers are so enormous that if left entirely to pursue their own chosen interests and the policies that promote these they are likely to gain a disproportionate degree of control over the fuel retail trade as may endanger the

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public interest. This becomes more obvious considering that these suppliers operate in a market where their customers’ freedom of choice is restricted by the special problems involved in storing and dispensing fuels in addition to constraints arising from planning legislation and general traffic conditions.²

Moreover, the history of fuel supply in the UK indicates that the major suppliers tend to avoid price competition as much as possible. However, it would be against the public interest if new suppliers were impeded from entering the fuel retail market particularly those that are prepared to sell at lower prices than the established suppliers. Equally, it was considered as against the public interest if the competitive incentive to save costs and deliver lower prices should be weakened by fuel suppliers jostling to secure most of the retail outlets and for long terms.

In order to safeguard the concerns raised by the disproportionate ownership of retail outlets by the oil majors, the government decided to regulate the ownership of sites:³ On this basis, the regulatory authorities argued that it is possible to have a system of solus trading in fuels which would not operate against the public interest. To ensure this, there were features of the system as operated at inception which may be altered or eliminated without necessarily destroying the positive basis of solus trading. Some of the identified features that may have some effects upon the public interest include the acquisition and ownership of retail premises by major fuel suppliers and the terms upon which these premises are let to tenants.⁴

² See id., 157.
³ See id., 159-161.
⁴ See id., 142.
The major oil companies justify their practice of acquiring stations on the basis that it affords them a higher degree of security than a fixed term agreement; greater opportunities to ensure savings in cost; opportunities for improvements in station layout and standards of service at those premises; and ability to set examples which the independent solus retailers can copy. It is clear that company ownership of fuel stations has served a useful purpose by pioneering improvements in facilities and setting better standards of service for the fuel retail trade, although it enables them to exercise considerable control over the trade.\(^5\)

However, serious concerns were thought to arise if that control should be extended since ownership of the station gives the supplier permanent security and with it the problem of barriers to new entry. Moreover, it has been argued that a very large market share of vertically integrated stations is likely to lessen fuel retail competition because refiners directly set the retail prices.\(^6\) It would also appear that the objections stated regarding longer-term solus ties should apply more to permanent ties, principally where such permanent ties exist within a high proportion of retail stations. This was thought as capable of resulting in an undesirable degree of rigidity and concentration in the fuel retail trade and possibly between the fuels suppliers who would not only control effectively the retailing of fuels but would also control other goods which are normally sold in fuel retail outlets.\(^7\)

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\(^7\) See MMC Report (1965) on Petrol; *supra* note 1, at 153.
The recommended safeguards for the trade in lubricants and other petroleum goods were thought to be applicable to the case of company-owned stations. However, where a large proportion of all stations were company-owned it may be difficult to enforce such safeguards. It was thought that unless some limit was imposed, the practice of fuel suppliers acquiring retail premises may be expected to operate against the public interest. However, it was considered that “the form of limitation must be practicable; must have the effect of restricting not the number of stations owned by petrol companies but the percentage of companies’ total sales that pass through them; must not be such as would restrict newcomers and small suppliers from acquiring stations as a means of obtaining access to and extending their market shares; and that such limitations should apply to any stations where the major supplier have both leasehold and freehold interests”.

It was then legislated that major fuel suppliers whose deliveries of fuels in any year to the stations owned by them (directly or in directly, be they stations where they have freehold or leasehold interests) exceed 15% of their total deliveries to fuel stations in that year should not build or acquire any further stations or acquire any such interest while such excess continues. The proviso is that this restriction should not apply in any year in which the total deliveries by the supplier or supplier group to fuel stations are less than 10 million gallons.

The outcome of the 1966 undertakings was to remove the anti-competitive aspects of the solus trade and to encourage the entry of new fuel wholesalers and retailers,

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8 See id., 154.
9 See id., 154.
particularly independent wholesalers and retailers. However, the restriction on the major fuel suppliers regarding company-owned stations was lifted in 1968 in a major policy change aimed at liberalizing the fuel retail sector and has remained so till date because this restriction was subsequently considered as restrictive.

4.3 Fuel Retail Site Regulation in Australia

In the case of Australia, the government decided to regulate the number of sites that could be owned and operated by the oil majors in 1975. The objectives of this regulation were to limit the ability of ‘vertically integrated’ majors to set retail prices and to encourage participation of independent operators in the industry. This included a provision for 50% ties to be placed on oil major-owned sites. However, the Australian Government thought that this might not be enough to limit the effects of the vertical integration in the fuel trade as practiced by the oil majors. Hence, the 1975 ‘undertakings’ were followed by the enactment of the Sites Act in 1980.
The criterion for quota allocation among the oil majors in Australia since 1984 has been the average wholesale market share over the preceding three years.\textsuperscript{13} However, it would seem that the ability of the Sites Act to limit the oil majors’ control of the fuel retail sector did not yield the desired results because the oil majors circumvented the provisions of the Act through other vertical arrangements such as 100% ties, multi-franchising, and equity participation in distributorships.\textsuperscript{14}

It could be argued that the Sites Act rather created some distortions and inefficiencies in the fuel retail sector. For example, the evidence shows that although the number of distributorships has fallen, yet the proportion of these with oil major equity has increased. Therefore, it could be inferred that the majors sought equity in distributorships in order to influence the retail sites associated with them.\textsuperscript{15} It could also be argued that the Sites Act may have reduced the flexibility of the oil majors to respond to changing market conditions, while not affecting the non-refining wholesalers and importers, independents and supermarkets.

The Hyde Consultancy Report pointed out that there could be certain adverse effects associated with eliminating all vertical restraints, for instance restrictions on the ability of oil majors to control downstream assets could result in their withdrawal of capital from their downstream operations.\textsuperscript{16} The report argued that as a result of such restrictions, there could be lesser investment in new infrastructure which will tend to generally drive downstream costs up. The ACCC noted the potentials of vertical


\textsuperscript{16} See ACCC Report on Petroleum Products Declaration; supra note 14, at 34-35.
arrangements to enhance efficiencies and reduce cost, and rather argued that evidence of lack of competition between vertically integrated firms (i.e. price fixing, resale price maintenance, market sharing and abuse of market power) is more detrimental to the public interest than vertical integration per se.\textsuperscript{17}

However, new entrants, changing cost structures and the circumvention of the Act by oil majors through multi-site franchising has meant that the Act failed to meet its regulatory objectives. The government believes that these Acts have not halted the rationalization of fuel sites in the past twenty years. It is now clear that the structure of the downstream petroleum market has changed enough that discriminatory legislation like the Sites Act has been rendered ineffective.\textsuperscript{18} These views were taken into consideration by the Australian Government when it repealed the Sites Act, and based on an industry-wide consensus a new downstream Oilcode was enacted with effect from March, 2007.\textsuperscript{19}

\textbf{4.4 Findings on sites regulation}

The sites regulation in both jurisdictions share some similarities and differences. The similarities are: firstly, the oil majors in the UK established the solus marketing system in 1950 and the oil majors’ operations in Australia adopted the system (under another title, the solo marketing system) in 1951. The common objective for this system is based on the need to institute a proper basis for the control of the dealers (franchisees) and the independent fuel retailers and by extension having full control

\textsuperscript{17} See \textit{id.}, 35.
\textsuperscript{19} The Oilcode and its provisions will be discussed later on in this chapter.
over the fuel retail trade. This control is achieved by determining the wholesale and retail prices and margins for dealers and independent retailers either through the rebate system or through the use of selective price support (SPS) system. The SPS forms part of the exclusive supply agreements and contractual arrangements that the oil majors have with dealers and independent retailers.

Secondly, the governments of both jurisdictions carried out a quasi-regulation of sites. The UK Government carried out this exercise in 1966, whereas the Australian Government did the same in 1975 (nine years later). However, the reasons for the sites regulation are the same and based on the impact of vertical integration of the oil majors’ operations and the concerns that their large-scale ownership of retail outlets might have negative implications for new entry into, and exit from, the fuel retail business. The rise in the number of oil company-managed (i.e. majors) outlets in the UK fuel retail market in the early 1960s set the scene for a massive reduction in the number of independently-owned sites. Currently, the convergence of fuel discounts by supermarkets to drive their market shares in the grocery sector has produced a similar effect on independent operators. Similarly, the very high market share of the oil companies in the Australian fuel retail trade in the early 1960s-70s had implications for independent fuel retailing and particularly with adverse consequences for rural areas. A similar effect is presently being felt by the independent fuel retailers in Australia, as the supermarkets use shopper dockets (fuel discounts) to boost their grocery business.

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The major difference is that the sites regulation in the UK was revised two years later and a full liberalisation ushered in. The government maintained that the two years was sufficient for a number of independent fuel retailers to take advantage of the sites regulation, including the supermarkets. The regulation was regarded as restrictive and might discourage oil company investments in the downstream petroleum sector, and so had to be discontinued. The evidence shows that the site regulation in the UK did not bolster the market share of the independent operators; rather the supermarkets were able to capitalize on the regulation to grow their market share (see tables 4.1 and 4.2).

Table 4.1 Declining Market Share of UK Independents by Retail Volume, 1964 – 2006

<table>
<thead>
<tr>
<th>Year</th>
<th>% Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964</td>
<td>74.8</td>
</tr>
<tr>
<td>1970</td>
<td>54.8</td>
</tr>
<tr>
<td>1974</td>
<td>49.8</td>
</tr>
<tr>
<td>1975</td>
<td>50.1</td>
</tr>
<tr>
<td>1976</td>
<td>51.0</td>
</tr>
<tr>
<td>1977</td>
<td>48.8</td>
</tr>
<tr>
<td>1998</td>
<td>7.4</td>
</tr>
<tr>
<td>2006</td>
<td>3+</td>
</tr>
</tbody>
</table>

Source: This Research (OFT Reports)

On the other hand, the Australian Government decided that the quasi-regulation of sites in 1975 was not enough to cushion the negative effects of the practice of vertical integration by the oil majors in the downstream sector. Consequently, the government enacted full-blown sector-specific sites legislation in 1980. The Act placed stricter limits on the number of sites that could be owned and operated by the oil majors. The Act paved the way for the blossoming of independent fuel retailers, particularly in the rural (country) areas, and also led to the emergence of supermarket fuel retailers.

It could be argued that the Act achieved the major purpose of altering the market structure in terms of market shares of the various categories of fuel retailers, at least in the short term. It also caused an increase in the number of independent retailers in rural areas (in the short term) and, may have lowered prices for fuels in some rural locations (in the short term) than otherwise could have been. Similar to the UK situation, the evidence shows that supermarkets became the long term beneficiaries of the sites regulation because of the convergence of fuels and grocery sales. However, the supermarkets do not operate in rural areas; rather these areas are serviced by the independent fuel retailers. Conversely, the market share of the independent operators has steadily declined over the years since the enactment of the Act (see tables 4.3 and 4.4).
Table 4.3 Retail Outlet Ownership in Australia, 2001

<table>
<thead>
<tr>
<th>Groups</th>
<th>No. of Sites</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil Company / Agents Operated Sites</td>
<td>373</td>
<td>5</td>
</tr>
<tr>
<td>Franchised Sites</td>
<td>2,497</td>
<td>30</td>
</tr>
<tr>
<td>Branded (Owner) Dealer Sites</td>
<td>936</td>
<td>11</td>
</tr>
<tr>
<td>Distributor Supplied Sites</td>
<td>3,920</td>
<td>47</td>
</tr>
<tr>
<td>Independent Chains</td>
<td>479</td>
<td>6</td>
</tr>
<tr>
<td>Supermarkets (Woolworths)</td>
<td>85</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,290</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

**Source:** Parliament of Australia (Parliamentary Library), Current Issues Brief 11 (1999-2000): Petroleum Refining & Marketing in Australia – Changes Ahead (Table 2).

Table 4.4 Market Shares of Retail Sales by Volume by Brand in Australia: 2002-03 to 2006-07

<table>
<thead>
<tr>
<th>BRAND</th>
<th>2002-03 %</th>
<th>2003-04 %</th>
<th>2004-05 %</th>
<th>2005-06 %</th>
<th>2006-07 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP</td>
<td>20</td>
<td>20</td>
<td>18</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>CALTEX</td>
<td>24</td>
<td>22</td>
<td>18</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>COLES EXPRESS</td>
<td>0</td>
<td>16</td>
<td>25</td>
<td>25</td>
<td>22</td>
</tr>
<tr>
<td>MOBIL</td>
<td>19</td>
<td>17</td>
<td>12</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>SHELL</td>
<td>20</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>WOOLWORTHS/CALTEX</td>
<td>10</td>
<td>14</td>
<td>18</td>
<td>20</td>
<td>22</td>
</tr>
<tr>
<td>INDEPENDENTS</td>
<td>6</td>
<td>7</td>
<td>6</td>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

**Source:** Report of the ACCC Inquiry into the Price of Unleaded Petrol: Petrol Prices & Australian Consumers, p76 (2007).

However, the Sites Act had to be repealed in 2007 because of changing cost structures in the sector and the need to encourage new investments by the oil majors. Also, the majors rendered the Act ineffective through multi-franchising and equity participation in distributorships whose objective was to reduce cost and indirectly increase the number of sites under their control. Consequently, the government repealed the Sites Act to create a level playing field for all downstream retail operators.
4.5 Fuel Retail Licence / Franchise Regulations
The oil majors in the UK make use of licence agreements in their contractual relationships with dealers and independent retailers, whereas the oil majors in Australia use franchise agreements for the same purpose. The regulatory framework for these agreements and the court interpretations of cases relating to these, in both jurisdictions, are set out in details in this section of this chapter.

4.5.1 UK Fuel Retail Licence Regulations
The regulatory framework for the fuel retail sector put in place in 1965 by the UK Government covers all licence agreements between the oil majors and their dealers, and between oil majors and independent retail operators. Generally, these agreements are considered to be useful to both the licensors and the licensees. Firstly, these agreements improve the distribution of products by enabling the licensor to establish a uniform network with limited investment. Secondly, they may facilitate the entry of new competitors in the sector, thereby increasing inter-brand competition. Thirdly, these arrangements may permit independent retailers to set up outlets more rapidly and with better chances of success than if they had to set up without the licensor's assistance and experience. Thus, the independent fuel retailers could possibly compete more favourably with large distribution undertakings. Fourthly, the combination of a uniform network and constant cooperation between the licensor and the licensees ensures a constant quality of the products and services, which is beneficial to the consumers and other end users.22

However, there were features of the licence agreements that were thought to be detrimental to the public interest such as: length of the term of franchise agreements; provisions of the agreements regarding the supply of fuel equipment by major fuel suppliers; provisions which restrict the retailer in relation to the sale of his premises, including option clauses and undertakings to obtain the purchaser’s acceptance of the exclusive obligations; and the degree of control which is, or may be, exercised by the major fuel suppliers over the general conduct of their exclusive retailers’ businesses, including trade in lubricants, tyres, batteries and accessories. These are briefly summarised in the following paragraphs.

Firstly, the duration of term of solus agreements varied from one year to twenty or more years during the early stages. Most of the major oil companies were not rigid about the length of the term which they regarded as a matter for negotiation. However, except where they owned the station, they preferred to obtain as long a commitment as possible. The reason is because longer-term agreements provided more security and by extension more opportunity for cost savings. Nevertheless, there was a contrary argument which viewed the longer term of solus tie as being disadvantageous to the fuel retail sector in general. Although the long-term commitments provided for the suppliers a greater measure of security, but this additional security does not appear to be in the public interest because it could become increasingly difficult for new suppliers to enter the market except by building new stations. Given this extra security, the established suppliers would likely be freer to pursue their own interests more rigidly and to control the trade of the retailers more strictly. As the suppliers were already exercising too much control over the retailers’

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23 For more details on the earlier terms of solus arrangements and obligations, see MMC Report on Petrol (1965); supra note 1, at 50-53.
business in lubricants at the time, it was thought that there may be a danger that they could also interfere with their trade in other areas. On this basis, the regulatory authorities recommended and the government adopted a term not exceeding five years, but which provides a clause for its possible continuation thereafter on an annual basis if neither party wishes to terminate the contract. The exceptional cases would be where the retailer has a loan arrangement with a major fuel supplier for a term longer than five years or is the tenant of his fuel supplier.

Secondly, although the suppliers provide fuel storage tanks to some retailers on loan terms, but in effect the tank is like a ‘gift’ to the retailer provided he carries out his ‘undertaking’ to use it solely to sell the supplier’s brand of fuels throughout the contractual period (which was usually twenty years). These loan arrangements involved a significant capital outlay on the part of the supplier, but in monetary terms there does not seem to be an additional cost which the motorist has to bear on account of the arrangements concerning fuel equipment. However, it was of concern that such loan arrangements should be a means of extending the retailer’s exclusive obligations under the solus contract as this will clearly operate against the public interest. Therefore, the regulation stipulated that all such hire purchase agreements regarding fuel equipment that contain provisions restricting the retailer’s alternative use of it should also provide an unambiguous clause stipulating that “the property in the equipment covered in the agreement should pass unrestricted to the retailer at any time on full payment of the balance of the purchase price. Equally, agreements for the loan of petrol equipment which contains such restrictive provisions should provide for the property in the tank to pass to the retailer unrestricted on full payment of that part

24 See id., 143.
25 For more details on the earlier terms of equipment supplies to retailers, see id., 54-55.
of the original price which is equivalent to the unexpired proportion of the original contractual term.\textsuperscript{26}

Thirdly, most solus agreements had provisions that indicated (in effect) that retailers should not dispose of their premises during the term of the contract without transferring the solus obligation to the new owners and also without giving the fuel supplier the ‘first option to buy’.\textsuperscript{27} These provisions were mandatory where there was a loan arrangement between the supplier and the retailer. The major oil companies justified these provisions on the grounds that a solus agreement should provide mutual benefits for themselves and the retailers; i.e. benefits to the retailers through rebates and other financial assistances and benefits to themselves by way of security and the ability to plan deliveries (which become impaired if the exclusive tie is not maintained for the full term). The suppliers argue that clauses requiring the transfer of solus obligations on sale of the property would also act as a safeguard, in case the retailer reneged on or evaded his obligations by transferring the ownership of the premises while indirectly retaining control of it. Nevertheless, these arguments appeared invalid in situations whereby the retailer was compelled by circumstances (e.g. ill-health or death of the proprietor) to dispose of his station during the term of the contract but encounters difficulties with prospective buyers who object to the terms of the tie and subsequently under-price it. However, this counter-argument relates to isolated cases since the retail trade on the whole does not show hostility towards the solus system.

\textsuperscript{26} See \textit{id.}, 145.
\textsuperscript{27} See \textit{id.}, 152.
Moreover, it would be unreasonable to expect that the existence of an exclusive tie would deter serious prospective buyers or materially diminish the realisable price. Additionally, since the major oil companies acquire and build their own fuel stations it seemed unlikely that unfair prices would be obtained for stations under sale, although the retailer could get a better price if he waited till the expiry of the agreement. It may be reasonable to infer that there could be no objections to the insertion of clauses requiring the transfer of solus obligations on sale of a fuel station. Furthermore, the suppliers seemed justified to insert the option clauses in cases relating to loan agreements on the grounds that they have the right to retain future benefits of the development to which the loan has been applied should the retailer wish to sell the station. However, this argument would seem reasonable in cases where the supplier made substantial investments in the premises but not for trivial loans.\textsuperscript{28} For the latter cases, such clauses could be considered as repressive and to operate against the public interest.

Fourthly, it became necessary to assess whether the solus arrangements has led, or might lead to an undesirable degree of influence by the fuel supplier over the entire business of the retailer. There was no evidence to show that any major oil company had made restrictive covenants with retailers concerning their trade in other goods but there was a threat that some might do so in the future.\textsuperscript{29} It was considered that fuel suppliers should not accept from any retailer, with whom he has an exclusive agreement, any commission or other forms of benefits regarding the sales or purchases of lubricants, batteries, tyres, accessories or other goods that are not petroleum products, and that any existing agreement which had such an effect should

\textsuperscript{28} See \textit{id.}, 152.
\textsuperscript{29} See \textit{id.}, 149.
be terminated. It was recommended that fuel suppliers should be prevented from making any arrangements with their solus retailers that involved any restrictive obligations in regard to the purchase, stocking, sale, display and advertising of such goods.\(^{30}\)

The Undertakings was further amended in 1976 which is currently in operation, and considered the extended use of licences, introduced provisions for the settling of certain disputes by reference to arbitration\(^ {31}\), and a requirement to the effect that where a major oil company makes proposals to a licensee for the renewal of a licence it has to be on terms that are ‘fair’ and ‘reasonable’.\(^ {32}\) The ‘fairness’ and ‘reasonableness’ if in dispute is to be judged by an arbitral panel. These Undertakings were further reinforced by Article 85 of the Treaty of Rome and European Commission (EC) Regulation 1984/83 (articles 10-13).\(^ {33}\) However, the EC regulation exempted from the provisions of Article 85 certain categories of long-term exclusive purchasing agreements which include fuel station agreements. Such an agreement with an independent dealer should not exceed ten years.\(^ {34}\) Let us examine the court interpretations of issues relating to some of these provisions in solus (licence) agreements.

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\(^{30}\) See *id.*, 151.

\(^{31}\) See MMC Report (1979); *supra* note 5, at 228. The conciliation system comprised of three schemes: the arbitration scheme (for disputes concerning termination of licences; a compensation scheme; and the obligation for fair and reasonable renewal terms. The requirement for fair and reasonable renewal terms is enforceable because a breach of this constituted a breach of the Undertakings themselves. However, the right to litigation was available as a last resort. Therefore, legal cases that emerged after the 1976 amendments to the Undertakings of 1966 were cases that the conciliation system was unable to deal with. However, the oil majors, especially Esso, Shell, and BP contend that licensee’s have made little use of the conciliation system and tend to prefer the litigation route.

\(^{32}\) See CC Report on Petrol (1990); *supra* note 10, at 325 (appendix 2.2)


\(^{34}\) See *id.*, 291.
4.5.2 Case Law on Licence Agreements in the UK
The number of cases between the major oil suppliers and their licensees underscore
the complexity of solus agreements. These agreements are considered by most judges
as falling into a special category of contracts referred to as ‘contracts in restraint of
trade’.\[^{35}\] The EC Treaty refers to these agreements as those that are likely to make
“the conclusion of contracts subject to acceptance by the other parties of
supplementary obligations which, by their nature or according to commercial usage,
have no connection with the subject of such contracts.”\[^{36}\] In most cases, the tests of
reasonableness and necessity were employed in order to determine the claims from
either party, or amongst parties.

Table 4.5 summarises the chosen cases based on specific issues dealt with in the
litigation arising from the solus agreements. The cases that the author chose to report
in this thesis are those that cover more than one issue; those that are frequently
referred to in other cases, and also those that applied relevant principles or doctrines
of law in such a way as to guide future treatment of related cases. Cases that represent
court decisions at the highest levels have been reported in more details.\[^{37}\]

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\[^{35}\] See Lord Reid’s definition of such contracts in the case of Esso Petroleum Co Ltd v Harper’s
Garage (Stourport) Ltd, House of Lords, (1967) 1 All ER 699.

September 2009.

\[^{37}\] Such cases have continued to shine light on future interpretation of the law of contracts as it relates
to contracts in restraint of trade. The most important one is Esso Petroleum Co Ltd v Harper’s Garage
(Stourport) Ltd, (1965) 2 All ER 933, (1966) 1 All ER 725 ( Court of Appeal), and (1967) 1 All ER
699(House of Lords). The summary of current legal principles in play in this area of law is presented
after the report on the chosen cases.
Table 4.5 Cases on Licence Agreements

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**Source:** This Research

### 4.5.2.1 PETROFINA (GT BRITAIN) v MARTIN and Another

This case deals with the duration of a solus agreement and assignment of rights, interests, and obligations under the agreement. The plaintiffs (Petrofina) imported and distributed motor fuels, greases, lubricating oils and other petroleum products. They supplied these to fuel stations and public garages on the basis of solus

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38 See Petrofina (Gt Britain) v Martin and another, (1965) 2 All ER 176.
agreements. Petrofina’s solus agreements, in line with the practice by other wholesalers, contained a continuity clause whereby the owner of the garage or fuel station is obliged to transfer the solus agreement to a new buyer of the station should they decide to sell it. The practice of tying fuel retailers was prevalent at the time as it is today, albeit to a lesser degree because of the high number of company-owned and operated fuel stations in recent times. However, the exclusive sale of products excluded lubricating oils and greases but the use of lubricants in the lube bay within the licensee’s fuel station was exclusive to Petrofina’s brands.

Mr Martin (the first defendant) negotiated the purchase of a garage that was tied through a solus agreement to Petrofina. On 1 April 1963, Mr Martin entered into a solus agreement with Petrofina based on the above stipulated conditions. In addition, he was to sell products at retail prices fixed by Petrofina; use only lubricants sold by Petrofina in his lube bay; and exhibit only advertisement materials belonging to Petrofina in regard to Petrofina’s petroleum products. The duration of the agreement was for a period of twelve years, with effect from 6 April 1963. Thereafter, the agreement might continue until determined by either party giving three months’ termination notice. However, there was a provision that Mr Martin was not entitled to give such a notice until he had taken delivery of and paid for 600,000 gallons of motor fuels from Petrofina. This quantity of motor fuels was calculated on the basis that the break-even point for fuel sales at the fuel station was about 50,000 gallons per year. In previous years preceding this agreement, smaller quantities than the stipulated 50,000 gallons had been sold on a yearly basis. The implication was that the solus-tie was likely to last for more than twelve years.
After a few weeks of commencing business, Mr Martin realised that his sale of Petrofina fuels were unlikely to generate profits. On 30 May 1963, he started to sell another brand of petrol (just a day after the site was conveyed to him as free from legal charge). On 11 June 1963, Martin sold the garage to another company (the second defendant) which was incorporated on 10 June 1963, of which he was a director. Petrofina, on discovering about the assignment of Martin’s interests to another company brought an action to enforce the solus agreement by injunction.

Looking at the facts of the case, the trial judge (Buckley J) decided as follows: The restriction in the solus agreement whereby Martin was to sell only Petrofina’s fuels...
and to some extent greases and lubricants was in restraint of trade. He considered the restriction as an ‘unreasonable restraint of trade’, even though it was expressed as an exclusive obligation to buy Petrofina’s fuel products. Consequently, the solus agreement was deemed unenforceable.

The reasons specified by the judge for the decision were: Firstly, that a determination of the validity of a restriction in restraint of trade requires an understanding of what the restricting party is entitled for its protection. In this case, the judge reasoned that Petrofina’s restriction was solely designed to protect its competitive position. He considered that Petrofina was not entitled to protect such a position through an agreement with Martin, when it was in breach of the latter’s right to trade in the most advantageous way. Secondly, that Petrofina had not shown that it had any proprietary interest in the fuel station whose value needed to be protected by the restriction since the legal charge had been repaid. Thirdly, that if Petrofina were entitled to protect their competitive position by way of an agreement that imposes such a restriction, the particular restriction in this case was more than was necessary. The reason was that in requiring Martin or his successors in title to carry on with the terms of this agreement and until 600,000 gallons of Petrofina’s fuels were sold,

April 1963, and thereafter until determined by either party giving three months' previous notice in writing to the other provided that the buyer shall not be entitled to terminate this agreement unless and until he shall have taken and paid for a total of six hundred thousand gallons of the seller’s motor fuel. As from the date this agreement comes into effect as a whole any existing agreement of a similar nature between the parties relating to the said premises is cancelled without prejudice to any sums due thereunder.”

40 Buckley J was guided by Lord Atkinson’s elaboration on this issue (see [1919] AC at p 574) as follows: “The public is interested in every one of its members having freedom of action to carry on his trade or business, and deal with the property invested in that trade, within the law, as it seems good to him. The deprivation of the subject of that liberty of action in any given instance is, prima facie, an injury to the public interest, and, if it is to be excused or justified, must be excused or justified on the ground that it affords no more than adequate protection to those interests of the private parties concerned which they have a right to have protected. Competition per se is not one of the things which, however lucrative, a trader is entitled to be protected against.”
Petrofina impeded Martin’s freedom of choice on whether and for how long he could continue to operate the filling station on the site.

It was a common ground that the break-even point for fuel sales at this station was around 50,000 gallons per year, but the effect of clause 10 of the agreement was that the agreement would remain binding on Martin for more than twelve years, unless his average annual sales remained at that level. Consequently, if Martin were to fail to achieve this volume of sales the agreement would remain binding on him, no matter how great were his losses. The previous operators of the station were operating at a loss, having sold 34,000 gallons in 1961, 31,000 gallons in 1962, and 29,500 gallons as at 31 March 1963. Martin’s experience in the first few weeks of operations were not encouraging for him to suppose that he could achieve the expected volume of sales without selling cheaper fuels from other sources, despite keeping the station open for 13 hours a day. Petrofina disagreed with this judgement and appealed the case.

The Court of Appeal argued that a solus agreement in totality was an agreement in restraint of trade, unless the agreement relates to a lease or mortgage. Therefore, although a solus agreement in gross is not generally bad, it would be considered as invalid unless the restraint was reasonable as between the parties to the agreement and also not against the public interest.\(^\text{41}\) The Court of Appeal held that the circumstances in the case were quite different from the case of *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*\(^\text{42}\) to which the appellant’s counsel referred. The appeal court judges held that Petrofina failed to demonstrate to the court that the solus agreement

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\(^\text{41}\) See *Petrofina (Gt Britain) v Martin and Another* (1966) 1All ER 126.  
\(^\text{42}\) See *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*, (1965) 2 All ER 933.
imposed a restraint that was reasonable under the circumstances for the following reasons: firstly, the agreement provided for Martins to transfer the obligations of the agreement to the next purchaser of the fuel station, should a sale of the station occur. The judges thought that this might render the fuel station unsaleable. Secondly, the duration of solus-tie of twelve years or more was considered to be too long. Thirdly, the restrictions on lubricants were considered to be enormous.

The Court of Appeal judges, Lord Denning MR and Diplock LJ relied on these three reasons, whereas Harman LJ relied mainly on the first reason. However, they all adjudged that the solus agreement in this case was in unreasonable restraint of trade and should not be enforced. They were all in agreement that the doctrine of restraint of trade applies to contracts restricting the way in which a trader operates his trade. Lord Denning MR argued that some kind of ties may be enforceable in law depending on the nature of the agreements. Some examples are cases where a public house is ‘tied’, as between lessor and lessee, or mortgagor and mortgagee.\textsuperscript{43}

\textbf{4.5.2.2 ESSO PETROLEUM CO LTD v HARPER’S GARAGE (STOURPORT) LTD [1965] 2 All ER 933}

The issues raised by this case concern the validity of clauses that purport to tie two fuel stations belonging to the defendants (Harper’s Garage Ltd) to the exclusive supply of fuels from the plaintiffs (Esso Petroleum Co. Ltd). This case proved to have far-reaching practical relevance to the legal treatment of solus-tie agreements used in the fuel retail business in the UK.\textsuperscript{44}

\textsuperscript{43} See Petrofina (Get Britain) v Martin and Another (1966) 1All ER 126 at 127
\textsuperscript{44} See Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd, (1965) 2 All ER 933, (1966) 1 All ER 725, and (1967) 1 All ER 699.
Esso entered into an agreement with the defendants on 27 June 1963 for the supply of motor fuels to one of the defendant’s fuel station at Mustow Green, Worcestershire. The solus agreement relating to the Mustow Green garage was for a term of four years and five months because this was the unexpired period of a previous ten year solus agreement on the garage prior to its acquisition by Harpers Ltd. Basically, the solus agreement contained a ‘tying covenant’ (a provision for exclusive purchase of Esso motor fuels for all requirements of the garage at the wholesale schedule prices); ‘a price maintenance clause’ (which provided that Harpers would retail fuels at Esso’s recommended retail prices, which clause had since become unenforceable due to the Resale Prices Act 1964 whose provisions were later consolidated in the Resale Prices Act 1976); ‘the continuity covenant’ (which was an obligation that Harpers Ltd would transfer the terms of the solus agreement to a new buyer of the fuel station should he decide to sell it); ‘the compulsory trading covenant’ (which is an obligation to keep the garage open at all reasonable hours); and an obligation to give preference to the sale of Esso motor fuels.

A separate agreement had earlier been made on 5 July 1962 for the supply of Esso motor fuels to the defendant’s second fuel station named the Corner Garage at Stourport. In the case of the Corner Garage, Esso provided a loan of £7,000 to the defendant, which was secured by a mortgage on the fuel station dated 6 October 1962. The mortgage was to be repaid by instalments over a period of twenty-one years, including the interest on the principle sum. The mortgage was not to be redeemed before the expiration of the twenty-one year term. Both agreements contained provisions to the effect that Esso would be the exclusive supplier of motor fuels, and

that all purchases would be made at Esso’s wholesale schedule price on the date of delivery. Both agreements also stipulated that Harpers Ltd should only resell fuels to vehicles according to Esso’s stipulated retail schedule prices, and the terms and conditions for resale on the day of resale.\textsuperscript{46} The critical provisions of the agreements were contained in clauses 2, 3, and 4.\textsuperscript{47}

It is pertinent to note that Esso introduced solus agreements into the UK fuel retail market in 1950. Initially, the solus-ties were for five years only, but progressively Esso began to negotiate ties for longer periods (up to twenty-one years). This initiative was soon followed by other major oil companies. At the outset, Esso’s solus agreements with fuel retailers did not contain a resale price maintenance (RPM) clause. However, Esso was forced to abandon the RPM clause when lower price fuels began to find its way to the UK fuels market from 1961 onwards. This event was the result of new oil discoveries and the availability of more supplies of fuels than was anticipated. Subsequently, RPM began to affect Esso dealers who in some areas could

\textsuperscript{46} However, this resale price maintenance clause was not enforced in practice by Esso. Esso introduced the resale price maintenance (RPM) clause in 1958 in order to ensure stability of retail prices, and based on the strong pressure from the Motor Agents Association on behalf of the dealers generally.

\textsuperscript{47} See Esso Petroleum Co Ltd v Harpers Garage (Stourport) Ltd (1965) 2 All ER 933 at 937. “2. Esso agrees to sell to the dealer and the dealer agrees to buy from Esso at Esso's wholesale schedule price to dealers ruling on the date of delivery the dealer's total requirements of motor fuels for resale at the above service station.” 3. Esso agrees: (i) To allow the dealer on all motor fuels purchased by the dealer under this agreement a rebate of one penny and one farthing per gallon calculated quarterly in arrear up to February 28, May 31, August 31 and November 30 in each year, and paid as soon as possible, thereafter. (ii) To extend to the dealer the advantages of the Esso Dealer Co-operation Plan. “4. The dealer agrees: (i) To give Esso at least two clear working days' notice of the dealer's requirements of motor fuels and to take delivery in the largest possible loads to be agreed with Esso. (ii) To permit Esso to lock and seal the tanks into which deliveries of the motor fuels are made. (iii) To make payment to Esso for the motor fuels in accordance with Esso's terms of settlement. (iv) Not to resell motor fuels for use in vehicles holding private licences under the Road Traffic Acts except in accordance with Esso's retail schedule prices and terms and conditions for resale ruling on the day of such resales. The dealer shall not operate any discount, dividend or gift scheme (whether in the form of cash or otherwise) in connection with such resales. (v) To operate the service station in accordance with the Esso Dealer Co-operation Plan set out overleaf. (vi) Before completing any sale or transfer of the service station premises or business or making any other arrangement under which any person commences to carry on business there in succession to the dealer to notify Esso in writing and procure such person to enter into an agreement with Esso and the dealer whereby such person is substituted for the dealer for all future purposes of this agreement including this sub-clause.”
not maintain their volume of sales without a price reduction. Accordingly, in a letter dated 3 December 1963 Esso informed the dealers about the decision to abandon the RPM clause.\textsuperscript{48}

On 4 December 1963 Mr Harper wrote to Esso expressing displeasure at the removal of the RPM clause.\textsuperscript{49} Subsequently, Harpers Ltd began to sell another brand of petrol (VIP petrol) at the Mustow Green garage with effect from 12 December 1963. On 18 February 1964, Esso issued a writ in the first action claiming an injunction restraining the defendants from purchasing fuels from other suppliers for resale at the filling station until the expiry of the supply agreement. Harpers Ltd continued to sell Esso’s motor fuels at the Corner garage until August 1964 when they changed over to VIP motor fuels. Harpers Ltd also gave a formal notice to Esso to redeem the mortgage on the Corner Garage, which Esso refused to accept. Consequently, Esso issued the writ in the second action on 28 August 1964 based on the covenant in clause 5 of the Second Schedule of the mortgage as well as the solus agreement.\textsuperscript{50}

\textsuperscript{48}See id., 941. “Dear Sirs, In the belief that it was to the general benefit of the retail petroleum trade of this country, we adopted a policy of retail price maintenance of motor fuels and recent sales agreements signed by dealers have included a price maintenance clause. “Such a policy, however, has not been generally accepted by the trade, and as it appears to be inequitable for us to insist on it being implemented we have now informed the Motor Agents Association that we are deleting such clause from our future sales agreements and advising all our stockists that, where this clause appears in existing agreements, we shall not insist on its implementation.”

\textsuperscript{49}Excerpts of the letter read as follows: “…… resulting from your company’s notice of removal of the price maintenance clause from dealer contracts, we now deem those contracts null and void. It is clearly implied in the contracts that they apply to the marketing of a price protected product and would not have been entered into if that had not been the case. If Esso cannot then provide us with petrol at a price consistent with the maintenance of, or an increase on our present inadequate profit margin, we must look for alternative suppliers. The practice of selling surplus petrol at much cheaper rates into direct competition with your contracted dealers, has largely contributed to the present threat of chaos. It is regrettable that official prices were not adjusted from time to time, or alternatively a cheaper brand introduced for sale at existing Esso stations to absorb this surplus”.

\textsuperscript{50}Clause 5 of the Second Schedule provides that: “during the continuance of this mortgage the purchase exclusively from the lenders all motor fuels which the company may require for consumption or sale on the premises hereby mortgaged (and on any premises owned, occupied or controlled by the company which may be adjoining or otherwise physically connected with the premises hereby mortgaged) as long as the lenders shall be ready to supply the same at their usual list price and not to buy, receive, or sell or knowingly permit to be bought, received or sold on such premises or any of them any motor fuels other than such as shall be purchased from the lenders”. 
The trial judge (Mocatta J) held that the obligations imposed by the solus agreements and mortgage on Harpers Ltd to purchase only motor fuels from Esso was binding and would be enforced by injunction. The judge reasoned that the solus agreements and the mortgage did not contain an obligation on Esso to publish their current retail schedule prices, or their dealers to observe those prices. Therefore, by writing the letter of 3 December 1963 to their dealers, Esso was deemed not to have committed a breach of the solus agreements or mortgage with Harpers Ltd, and so the defendants were not entitled to regard the solus agreements as repudiated.

Secondly, the judge applied a doctrine of the common law to this case whereby a covenant in unreasonable restraint of trade was deemed to be against the public interest or public policy and therefore void. However, his interpretation was that the doctrine applies to the trading use that could be made on a particular plot of land and that it is inapplicable to a covenant that imposes a trading restraint on an individual or a company. Therefore, according to this interpretation the doctrine did not void the obligations imposed by the solus agreements and the mortgage. Thirdly, the judge thought that the injunctions claimed by the plaintiff are ‘truly negative in character’, because in effect they were aimed at restraining the defendants from purchasing fuels from other sources even when those sources sold cheaper fuels. However, he thought that the injunctions should not be refused on account of its negative character.

Harpers Ltd appealed the decision where the matter was judged by Lord Denning MR, Harman and Diplock LJJ.51 Collectively, they over-ruled the previous judgement of the case for the following reasons: firstly, they argued that the solus agreement in

51 See Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd, Court of Appeal (1966) 1 All ER 725.
regard to the Mustow Green garage imposed a significant restraint on trade that was more than necessary for the protection of Esso’s trading interests. Having regard to Esso’s power to fix both the wholesale and retail prices, it was considered that the period of four years and five months was too long. The duration of the contract combined with the continuity covenants might result in a squeeze on the dealers’ margins. Lord Denning considered a three year term for the Mustow Green garage as reasonable. Therefore, the solus-tie was considered to be unenforceable.

Secondly, the doctrine of restraint of trade also applied to covenants in a mortgage (per Diplock LJ). Hamman and Diplock LJJ considered that the terms of the mortgage were oppressive and in excess of what was reasonably necessary to protect Esso’s interest in the land as security for his loan. The solus provisions, in conjunction with the provision for a penal rate of interest in certain events and a provision for the extension of the security if Harpers incurred further debt meant that the mortgage terms were onerous. Moreover, the mortgage could not be redeemed in less than twenty-one years. Diplock opined that a tying covenant for a fixed period of two years or so or for an indefinite period terminable on two years notice may be adequate for the protection of a fuel suppliers’ interest in ensuring continuity of outlet for fuel supplies. This tie was also considered unenforceable.

Thirdly, the judges reasoned that the price maintenance clause in the solus agreement for the Mustow Green garage was severable, but the other covenants (the tying, continuity, and compulsory trading covenants) were not severable. Therefore, the appeal court set aside the injunction granted by the trial judge on the ground that the ties in the agreements were in restraint of trade and so unenforceable.
Esso appealed to the House of Lords. The case was heard by a full House of Lords comprising of Lord Reid, Lord Morris of Borth-Y-Gest, Lord Hodson, Lord Pearce and Lord Wilberforce. Although the individual Lords were generally in agreement regarding the issues to be determined in this case, they arrived at their respective judgements by different reasoning. Thus, the judgement of the case by the Lords are summarised below.52

The first issue in the appeal was a determination of whether these agreements could be regarded in law as agreements in restraint of trade. Lord Reid noted that the law relating to restraint of trade had an ancient origin, and lay within a narrow margin. He noted two original categories of activities that were regarded as being in restraint of trade. Firstly, where an apprentice or a craftsman agrees not to compete with his master after leaving his service, and secondly, where a trader who sold his business agrees not to compete thereafter with the purchaser of his business. However, it is not an easy task to determine to what extent the principles developed from these original categories have been or should be extended to similar cases.

In seeking clarification on the issue, he referred to the most general statement made by Lord Parker of Waddington53, as follows: “Monopolies and contracts in restraint of trade have this in common – that they both, if enforced, involve a derogation from the common law right in virtue of which any member of the community may exercise any trade or business he pleases, and in such manner as he thinks best in his own interest ……. Contracts in restraint of trade were subject to somewhat different considerations. There is little doubt

52 See Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd, House of Lords (1967) 1 All ER 699.
53 See A-G of Commonwealth of Australia v Adelaide Steamship Co Ltd, (1911-13) All ER Rep 1120 at 1123
that the common law in the earlier stages of its growth treated all such contracts as contracts of imperfect obligation, if not void for all purposes; they were said to be against public policy in the sense that it was deemed impolitic to enforce them .....”

Lord Reid also drew from Lord Macnaughton’s statement in the Nordenfelt case as follows, “the public has an interest in every person carrying on his trade freely; so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void”. However, Lord Reid noted that Lord Parker and Lord Macnaughten at that point in time were only familiar with the two original categories of cases, since solus agreements and mortgages within the solus scheme had not developed in those years. He opined that restraint of trade should imply a contract whereby a man gives up some freedom of action which otherwise he would have had. For example, a man buying or leasing a piece of land had no previous right to be there, or trade there, and if he takes up the land subject to a negative restraining covenant, he has not given up a right or freedom that he previously had. He reasoned that ‘tied house’ cases should be explained based on this logic.

Applying this logic to this case, Lord Reid argued that the Mustow Green supply agreement fell within the scope of the doctrine of restraint of trade as developed in the English law. The reason is that Harpers Ltd was entitled to use this land in any lawful way as they chose before they made this agreement, and by making this agreement they agreed to restrict their right to sell fuels supplied by others, except Esso. Therefore, by engaging in this agreement, they gave up a right or freedom which they enjoyed prior to this agreement. Therefore, Harpers had agreed negatively not to sell

54 See Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd, (1891-94) All ER Rep at 18.
fuels supplied by others except Esso, and have also agreed positively to keep the garage open at all reasonable hours during the period of the tie. The appellant’s counsel had argued that these terms were merely aimed at regulating the respondents trading (i.e. promoting) than restricting his trade. However, Lord Reid thought that regulating a company’s existing trade may be an even greater restraint than prohibiting then from engaging in a new trade. Moreover, a contract which obliges a company to take one’s whole supply from one source may be more restraining than a contract where a company sells its entire output to one buyer. He concluded that in his view this agreement or similar agreements were bound to be in restraint of trade. However, since there may be positive benefits to both parties in engaging in such agreements, then the provisions of the agreement in each case has to be examined by judges to ensure that they are reasonable and justifiable.

Lord Reid emphasised that it is now a generally accepted fact in law that a provision in a contract considered to be in restraint of trade must be judged to be reasonable to become enforceable, as stated by Lord Macnaughten in the Nordenfelt case. He thus argued that, “restraints of trade and interference with individual liberty of action, may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed, it is the only justification, if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public”.  

55 See id., p. 18.
On this basis, there are three issues to be resolved in every case. Firstly, a determination as to whether the restraint is more than what is necessary to afford protection to the party in whose favour it was granted. Secondly, a determination as to whether it could be justified as being in the interests of the party that was restrained. Thirdly, a determination as to whether it is contrary to the public interest.

In considering what was in the restraining party’s interest, Lord Reid reasoned that what was against such interests may be against the public interest as well. However, in determining whether the terms of the contract superseded what was necessary for the protection of Esso’s interests would depend largely on the state of the fuels retail business at the time. For this purpose, there was a need to rely on evidence or common knowledge on the subject area. Therefore, he decided to supplement the reported cases on solus agreements with the Report of the Monopolies Commission of July 1965 (Report on the Supply of Petrol to Retailers in the United Kingdom, HC 264).56 This information was relevant in discerning the benefits of the solus agreements to the garage owners and the fuel suppliers. The garage owner’s benefit is that he obtains a rebate on the wholesale price of the fuels he buys and receives other benefits, especially financial assistance. Conversely, the fuel supplier is assured a steady outlet for his refined or imported fuels over a period, and fuel distribution is made easier and economical. Esso argued that they could not have made an investment of about £200 million in refineries and other plants at the time, if they could not foresee steady and assured outlets for their products. This justifies their use of solus-ties to achieve this objective. However, there was no evidence as to the

56 See MMC Report; supra note 1.
additional benefit derivable from a five year term as opposed to a two year tie or even a twenty year tie.

The Court of Appeal held that the ties involved with the agreement with Harpers Ltd were for unreasonably long periods. Lord Reid thought that considering that over 90% of existing filling stations were tied at the time, and that there may be some difficulty and time lag in opening a new filling station, it might well take a longer time to access alternative outlets. Therefore, the argument by the judges at the appeal court to the effect that the appellants could have found other suitable outlets in the area within two to three years may not have been borne out of hard evidence. He observed that Esso is not particular about any one outlet, but rather more concerned with maintaining a stable system of fuel distribution that is efficient and economical. He reasoned that, based on the facts before him, ties of less than five years are likely to be insufficient at the point in time. Therefore, the duration of the Mustow Green agreement does not seem to be unreasonable. Considering the circumstances, he reasoned that the appellants were compelled by circumstances to act in such a manner as to obtain renewals of the majority of their numerous ties, some of which will terminate almost every week. This is based on the fact that Esso, at the time, supplied about seven thousand (about one-fifth) of the thirty-five thousand fuel stations in the UK based on solus-ties. Therefore, Lord Reid allowed the appeal regarding the Mustow Green agreement to stand.

Lord Morris arrived at the same conclusion regarding the Mustow Green agreement, albeit through a slightly different reasoning. In arriving at this conclusion, he clarified the position of the law in regard to the conflict between freedom of trade and freedom
of contract by drawing from Sir George Jessell MR\textsuperscript{57}, Scrutton LJ\textsuperscript{58}, Lord Shaw of Dunfermline\textsuperscript{59}, Lord Denning MR\textsuperscript{60}, and Diplock LJ\textsuperscript{61}. Lord Morris reasoned that the very basis of the Mustow Green contract was restrictive because it was designed to ensure that Harpers Ltd would not sell any other motor fuels from other suppliers, except those belonging to Esso. Therefore, the agreement restricted the manner in which Harpers Ltd would operate their business. However, in a case where a person voluntarily takes up a lease of land with a restrictive covenant attached, it would not seem reasonable to apply the doctrine of restraint of trade. This draws the distinction between a case where a person seeks to claim a greater freedom than that which he currently possesses or has arranged to acquire, and a case where a person fetters his future by sacrificing with a freedom which he possesses.

\textsuperscript{57} See the case of \textit{Printing and Numerical Registering Co v Sampson}, (1875) LR 19 Eq 462 at 465. Sir George Jessell MR stated as follows: “it must not be forgotten that you are not to extend arbitrarily those rules, which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice. Therefore, you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract”.

\textsuperscript{58} See the case of \textit{English Hop Growers Ltd v Dering}, (1928) All ER Rep at 400. Scrutton made a similar statement, to the one above, as follows: “I myself have always regarded it as in the public interest that parties who, being in an equal position of bargaining to make contracts should be compelled to perform them, and not to escape from their liabilities by saying that they had agreed to something which was unreasonable”.

\textsuperscript{59} See the case of \textit{Herbert Morris Ltd v Saxelby}, (1916-17) All ER Rep at 314. In regard to these competing principles of law (i.e. freedom of contract and freedom of trade), Lord Shaw stated as follows: “the delicacy of the operation of law in setting the bounds of either freedom has been long familiar. In these cases, as I have pointed out, there are two freedoms to be considered, one the freedom of trade and the other the freedom of contract: and to that I will now again venture to add that it is a mistake to think that public interest is only concerned with one. It is considered with both”.

\textsuperscript{60} See Petrofina (Gt. Britain) Ltd v Martin, (1966) 1 All ER at 131. In trying to define what is meant by a contract in restraint of trade, Lord Denning MR stated that, “….. every member of the community is entitled to carry on any trade or business he chooses and in such manner as he thinks most desirable in his own interests, so long as he does nothing unlawful; with the consequences that any contract which interferes with the free exercise of his trade or business by restricting him in the work he may do for others, or the arrangements which he may make with others, is a contract in restraint of trade. It is invalid unless it is reasonable as between the parties and not injurious to the public interest”.

\textsuperscript{61} See id., 138. Diplock in the above case also confirmed this point of view by stating that, “a contract in restraint of trade is one in which a party (the covenanter) agrees with another party (the covenantee) to restrict his liberty in the future to carry on trade with other persons not parties to the contract in such manner as he chooses…….”
However, the agreements made by Harpers Ltd were of a different kind, because they owned their garages and Esso had no interest in them or in the land where they were situated. Clearly, the agreements made in reference to the two garages were agreements in restraint of trade and will have to pass the test of reasonableness to be enforceable. Esso alleged that the agreements were reasonable, and so they had to demonstrate to the House of Lords that the restraints contained in those agreements afforded them just the adequate protection of their rights to outlets for their products, effective and economical distribution of their products, and a return on the huge investments in refineries and plants. At the time, solus agreements which lasted relatively fewer years could be regarded as reasonable. In the case of the Mustow Green garage, the duration was for four years and five months, which represented the unexpired period under a previous agreement with another company. Lord Morris concluded that the Mustow Green agreement was reasonable as between the parties.

Regarding the Mustow Green garage, Lord Hodson concurred with the judgement given by the other Lords. He argued that the oil companies were entitled to the protection of continuity of outlets, which is the objective justification for the tying covenant and complemented by the compulsory trading and continuity covenants. However, in reaching a conclusion he relied on a number of reported cases of like nature, particularly from Commonwealth Courts like Canada and South Africa (as Lord Pearce did), where five years had been considered as the ideal term for solus agreements. He also relied on the recommendations of the Monopolies Commission 1965 (as Lord Reid and Lord Pearce did), which stipulated that solus agreements should not usually exceed five years. Therefore, since the duration of the Mustow Green agreement was less than five years, he considered it to be reasonable.
Lord Wilberforce argued that, on balance, the agreements in this case fell within the category of agreements in restraint of trade which requires reasonable justification. The reason was that the agreements directly restrain the exercise of Harper’s trade. The next question was whether these agreements fell within some category that could be excluded from the doctrine of restraint of trade. However, in character, this was essentially a trade agreement between traders, and not a mere transaction in property or between owners of property. If it were the latter, it could be judged as a normal commercial transaction of an acceptable kind. Moreover, the agreements involved other restrictive components: there was a tie for a fixed period with no provision for earlier determination by notice, and there was a fetter on the terms on which the garage could be sold. In the case of the Corner garage, there was an extra fetter on the terms for the mortgage redemption. These restrictions taken together, takes these agreements into the category of those that would require reasonable and objective justification, and thus would have to be subjected to the test of reasonableness. Therefore, Lord Wilberforce agreed with the other Lords that the Mustow Green agreement does pass the test of reasonableness considering the interests of the parties.

The Corner garage agreement at Stourport, presented more difficulties because it involved in addition to the standard solus agreement a mortgage of the garage for a loan which is irredeemable before twenty-one years. All the Lords agreed that the Corner garage agreement failed the test of reasonableness, but they applied slightly different arguments in arriving at their judgements. Lord Reid thought that a tie for twenty-one years “stretches far beyond any period for which developments are reasonably foreseeable”. Conversely, he also opined that it would be unfair to Esso if Harpers Ltd, having used Esso’s financial assistance to build up their business,
became entitled to be free in a relatively short time to seek better terms from a competing supplier. However, in this case, there could not be discerned a greater advantage to the garage owner from a twenty-one year tie than he obtains from a five year tie. Moreover, there was no evidence to show that a shorter duration of tie would be inadequate for Esso. Therefore, Lord Reid dismissed the appeal as regards the Corner garage agreement. In making his judgement, he stated that his opinion regarding the length of solus ties permissible in a solus agreement should not be regarded as a general rule. He also referred to the case of Petrofina (Gt Britain) Ltd v Martin, which in his opinion should also not be regarded as laying down a general rule.

The case of the Corner garage involved a solus agreement, a loan agreement and a mortgage, and Lord Morris thought that all could be linked together as incidents of one transaction. He contended that the intention of Esso was likely to be that in providing for redemption of the mortgage for the same period of time as the solus-tie (i.e. twenty-one years), it should act to support or reinforce the solus agreement. The appellants argued that the doctrine of restraint of trade did not apply to covenants contained in land mortgages. However, Lord Morris took the contrary view. He argued that in relation to the duration of twenty-one years, Esso failed to demonstrate that that period of time was reasonable in the interest of the parties. Consequently, he concurred with the decision of the Court of Appeal that in the circumstances Harpers should be allowed to redeem the balance of the loan.

62 See Lord Denning MR & Diplock LJ in the case of Petrofina (Gt Britain) Ltd v Martin, Court of Appeal (1966) 1 All ER 126.
In the case of the Corner garage, Lord Hodson considered that the duration of twenty-one years was so long that it must be justified positively, or be regarded as unreasonable. He opined that covenants in restraint of trade must be tested with the same criterion of reasonableness, whether they are contained in mortgages or not. Therefore, he saw no reason why the doctrine of restraint of trade should not be applicable to mortgages. He agreed with the decision of the Court of Appeal that the tying covenant and the compulsory trading covenant are closely linked with the provision that the mortgage will be irredeemable for twenty-one years.

In judging the issue of the mortgage contract in the Corner garage agreement, Lord Pearce thought that the prolonged fetter on the right to redeem seemed to have been inserted for the purpose of prolonging the solus tie and is connected. The implication was that the existence of the mortgage did not help the appellant’s argument regarding the issue of reasonableness of the tie. Consequently, he dismissed the appeal in respect of the Corner garage on the basis that the tie (made more onerous by the terms of the mortgage for the same number of years) for a duration of twenty-one years was not reasonable in the circumstances.

Lord Wilberforce agreed with the other Lords that the Corner garage did not pass the test of reasonableness because of its unduly long duration. He also noted that the fact that a transaction is a mortgage does not protect the contents of the arrangements from examination. He reasoned that if the purpose and nature of the lending goes beyond its security value, and extends to other independent purposes, then the terms of the mortgage may and should be independently scrutinized.63 In this case, he opined that

the mortgage in conjunction with the solus agreement was designed by Esso to tie the Corner garage to its fuel products for as long as possible, if not indefinitely. Since the mortgage and solus agreements tie in together by virtue of same duration of term, and so were designed to work together, therefore an adverse conclusion to the restriction imposed by the solus agreement must equally apply to the mortgage. Consequently, Lord Wilberforce dismissed the appeal relating to the Corner garage.

4.5.2.3 SHELL UK LTD V LOSTOCK GARAGE LTD

This case deals with a determination of what constitutes an implied condition of a solus agreement and the effects of price discrimination on a licensee.\textsuperscript{64} Lostock (a small garage) was tied to Shell by a solus agreement. The terms were similar to most solus agreements whereby the garage was required to sell only fuels supplied by Shell, and to keep the garage open at all reasonable times. Originally, the agreement was for a period of twenty years, commencing from April 1955 to March 1975. However, owing to the regulation of fuel retail activities by the Monopolies and Mergers Commission UK in 1966, the agreement was altered with effect from 1966 to allow Lostock the entitlement to terminate the agreement by giving twelve months’ notice at any time after 1971.

During the fuel price war of 1975, Lostock was unable to reduce its retail prices as Shell continued to charge at the old price. Shell introduced a price support scheme (as did other oil majors) to enable its filling stations meet the competitive pressures brought about by intense price competition. However, two neighbouring but larger garages benefited from this price support, and owing to its small size Lostock was not

\textsuperscript{64} See Shell UK Ltd v Lostock Garage Ltd, Court of Appeal, (1997) 1 All ER 481.
in receipt of price support. Consequently, the two neighbouring garages were able to undercut Lostock, and the latter began to operate at a loss.

In 1975, Lostock erroneously believed that the tie with Shell had ended in 1971 and failed to serve a twelve months’ termination notice to Shell before obtaining fuel supplies from another supplier. Shell threatened the supplier with proceedings for inducing Lostock to breach its solus agreement, and the supplier stopped supplying Lostock. In response, Lostock resumed taking supplies from Shell and subsequently served a twelve months’ notice of termination to determine the agreement in March 1977. Shell brought an action against Lostock, claiming damages for a breach of the solus agreement by taking supplies from another supplier. Shell also claimed an injunction restraining Lostock from obtaining future supplies from other suppliers while the solus agreement was still in force.

Lostock claimed a declaration that the agreement was void and unenforceable, and as being in unreasonable restraint of trade. Lostock also contended that the agreement was subject to an implied condition that Shell would not discriminate against their garage in favour of neighbouring and competing garages in such a way as to render their fuel sales uneconomic. Therefore, Lostock insisted that Shell was in breach of that implied term by rendering price support to neighbouring garages and excluding them. Consequently, Lostock sought an injunction restraining Shell from enforcing the agreement.

The trial judge (Kerr J) held that Shell could not enforce the tie so long as its price support policy had caused hardship for Lostock. However, the judge refused to grant
the declaration and injunction sought by Lostock, but awarded damages for their actual loss. Lostock, being dissatisfied with the judgement, appealed the case and Shell counter-appealed for the injunction sought.

The Court of Appeal (comprising of Lord Denning MR, Ormrod LJ, and Bridge LJ) held as follows:

(a) There should not be implied to the agreement a provision that Shell should not abnormally discriminate against Lostock, because such an implication is not necessary to validate the agreement. Moreover, such a provision could not be formulated with any degree of precision (Bridge LJ dissenting). Therefore, it followed that Shell was not in breach of the agreement by operating the price support policy, and Lostock’s appeal on the basis that the agreement was void because Shell discriminated against the garage was dismissed. Lord Denning noted that in *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*, Mocatta J also refused to make such an implication and there was no appeal from his decision.

However, in making his decision, Bridge LJ referred to Judge Kerr J’s findings on the effect of the discrimination on Lostock. Bridge contended that under those circumstances, it would be an absurdity for Lostock to be bound by the agreement. He posited that the necessary foundation for the application of the classic doctrine on

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65 See *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*, (1965) 2 All ER 933, at 941-945.
66 See *Shell UK Ltd v Lostock Garage Ltd*, (1997) 1 All ER 481, at 495. Kerr J was quoted as follows: “I am satisfied on the evidence that, so long as the scheme lasts, [Shell] would be compelling [Lostock] to trade at a loss so far as their sales of petrol are concerned if the covenants in the agreement are enforceable against them. [Lostock] must continue to keep their premises open for the sale of petrol at all reasonable times. But so long as Barber's and the Plumley garage are supported and [Lostock] are not, as is the present position, I am satisfied that [Lostock] must operate at a loss if the agreement is enforced. The advent of the VIP garage, together with the operations of the ICI and Esso garages, would probably in any event have put [Lostock] under great pressure and perhaps have forced them into a loss-making situation. This would be a situation which they would have had to accept. But the grant of the [Shell's] price support scheme to Barber's and Plumley's undoubtedly made their position much worse, and for the time being economically untenable so far as their sales of petrol are concerned.”
which terms are implied in contracts was present in this case. Accordingly, that doctrine requires that terms or provisions should be implied in contracts to remove contractual absurdities which reasonable parties to it could not have intended. However, Bridge LJ agreed with Lord Denning MR that this case presents an extreme difficulty in defining the appropriate degree of discrimination which any implied term should preclude. Therefore, the criteria that Shell must not discriminate unfairly, abnormally, or unreasonably in respect of its price support policy does not indicate where the line should be drawn with any precision. It was for this reason that Lord Denning, and Ormrod LJ decided to dismiss the appeal brought by Lostock relating to price discrimination. Bridge LJ, however, reasoned that in spite of the lack of precision in the criterion that should be embodied in the implied term, the court should not shrink from the task of deciding which side of the line the case falls. He refused to accept that the difficulty in defining with precision what provision is to be implied is an insurmountable barrier to the implication of any term limiting Shell’s freedom to discriminate. He further argued that his test of the degree of discrimination prohibited by any implied term was whether such was enough to render Lostock’s fuel sales business impracticable or uneconomic. Therefore, he thought that Lostock’s appeal should be allowed, although his was a minority judgement.

(b) Shell’s cross-appeal against the dismissal of their claim for an injunction restraining Lostock from breaking the solus-tie provision was dismissed on the following grounds:

(i) Lord Denning argued that it is now a settled matter that a solus agreement is a contract in restraint of trade, and referred to *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*. Therefore, this case falls within a special class of cases
whereby the courts have to investigate the terms of the contract to determine whether or not they are fair and reasonable. If they are judged to be unfair or unreasonable, the court is entitled to refuse to enforce them. In most cases, the courts tend to consider the reasonableness of the terms at the time the contract was made. However, in this case Lord Denning ruled (the other appeal judges consenting) that the court should not enforce a contract in restraint of trade where after the contract had been entered into it was found to be operating unfairly and unreasonably, in circumstances that could not have been previously anticipated. Therefore, the court should dismiss Shell’s counter appeal, and decline to enforce the solus-tie provisions, as long as Shell was operating their price support scheme to the detriment of Lockstock. When the agreement was altered in 1966, it had seemed reasonable and fair to retain the solus-tie provision. However, when Shell introduced their price support scheme, which excluded Lostock, it had become unfair and unreasonable to insist on the enforcement of the tie.

(ii) Lord Denning MR and Ormrod LJ ruled (and Bridge LJ consenting) that it would be unjust and inequitable to grant Shell an injunction restraining Lostock from breaking the solus-tie provision whilst Shell were operating the price support policy and excluding Lostock from it. This scheme inflicted financial hardship on Lostock during the time it was in operation, and so Shell were not entitled to enforce the tie provision.

(iii) Bridge LJ decided (and the majority of the judges dissented) that Shell were in breach of an implied contractual provision not to discriminate against Lostock in a manner as to render it commercially unprofitable for them to continue to trade on the
express contractual terms. He argued that the breach should result to a repudiation of the agreement by Shell.

(iv) Lord Denning MR and Ormrod LJ (Bridge LJ dissenting) ruled that since the price support scheme had been terminated, the tie remained enforceable until the solus agreement terminated after Lostock’s twelve months notice to Shell (i.e. in March 1977). They argued that in the circumstances, Lostock was not entitled to claim an injunction against Shell until the expiry of the notice.

4.5.2.4 ESSO PETROLEUM CO LTD V ADDISON and OTHERS

This case involved Esso (the plaintiffs) and 120 Esso licensees (defendants), comprising of companies and individuals who retailed motor fuels at fuel stations which operated under licences from Esso.\(^67\) The legal proceedings arose between Esso and the licensees over the construction of Esso’s standard form of license agreement and some aspects of the operation of their fuel stations. There were three categories of these disputes: those arising out of the operation of a national sales promotion called Esso Collection; those arising from certain changes to the financial provisions of the licences introduced by Esso between 1 January 1966 and 1 April 1998; and those regarding the supply of motor fuel at higher than ambient temperatures (i.e. hot fuel). The facts of the case, provisions of the licence agreements, and the basis for court rulings are summarised as follows.

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67 See Esso Petroleum Co Ltd v Addison and others, (2003) EWHC 1730 (Comm). Similar charges were brought against Esso Petroleum Co Ltd in the following cases: Esso Petroleum Co Ltd v David and others, (2003) EWHC 1730 (Comm); Esso Petroleum Co Ltd v Milton, (1997) 2 All ER 593; and Esso Petroleum Co Ltd v Mahoney, (2000) All ER (D) 993.
The first issue required a determination as to whether Esso licensees were obliged to participate in and to bear the total cost of Esso promotional schemes. The Esso ‘Tiger Token’ promotional scheme operated nationally in the UK from 1986 to February 1996. The scheme involved issuing tokens to motorists which they could redeem for gifts. Esso expected the individual filling stations to bear the total cost of administering the scheme, as part of their trading expenses. The licensees were also expected to bear part of the cost of providing the promotional gifts. To offset part of the cost of providing the gifts, individual retailers were credited each month with an allowance determined by the volume of fuels ordered the previous month. Based on the nature of the scheme, it was inevitable that the cost of providing the gifts would be deferred somewhat, because of the time lag between when motorists collect tokens and the actual time that they redeem these tokens for gifts.

Consequently, at the end of the promotional scheme many licensees had owed substantial amounts to Esso which the latter sought to recover. This resulted in group litigation by Esso licensees to the effect that Esso was supposed to bear the cost of administering the scheme. Therefore, it was left to the courts to determine whether on the true construction of the relevant license agreements and the way the scheme operated, the claimant (Esso) was entitled to recover from the fuel retailers the cost of the promotional gifts supplied to them for the purpose of the scheme.

Three forms of licence agreement were current during the period of the promotional scheme. These forms of agreement were broadly similar in form and in substance, but were different in some respects. Premier A licence agreement was the form of agreement in 1986. This was replaced by the Partnership Licence Agreement (PLA)
in 1989. The PLA was later modified in 1992. Both forms of the PLA were expressed
to run for a fixed duration of three years, whereas the Premier A licence agreement
was expressed to run as agreed on an individual basis with the licensees. Part II,
clause 12 of the Premier A form of licence covers incentive schemes and stipulated
that, “the licensee should join in promotion and sales incentive schemes for Esso
products as Esso may reasonably request from time to time.”\(^{68}\) The Seventh Schedule,
clause 8 of the PLA (1989) also stipulated that, “the licensee will at the licensee’s
own expenses (unless otherwise provided for) comply with the conditions set out in
the Seventh Schedule hereto.”\(^{69}\) Clause 24 under the Seventh Schedule covers
promotional activities and incentive schemes, and states that, “the licensee will join in
all sales, promotional and incentive activities and schemes as Esso may from time to
time require.”\(^{70}\) The PLA (1992) followed closely the same pattern as the 1989 PLA.

On the basis of the true construction of the licence agreements, the court ruled that the
licensees were obliged to join in the promotion at their own expense based on clause 8
of the 1989 PLA. Therefore, any licensee that joined in the promotional scheme and
operated it with full knowledge of its terms had inevitably entered into a scheme
contract with Esso whereby he became liable for the cost of gifts supplied to his outlet
for that purpose. For those licensees who claim that they were given an assurance that
they would not incur any costs in the course of operating the promotional scheme, the
court ruled that its precise terms and effects would have to be determined in separate
proceedings.

\(^{68}\) See \textit{id.}, point 17
\(^{69}\) See \textit{id.}, point 18.
\(^{70}\) See \textit{id.}, point 18.
The second issue dealt with whether Esso was entitled to make adjustments to retailers’ margins, fees, and allowances; and whether such adjustments were reasonable or arbitrary. During the latter part of 1994 and early 1995, Esso reviewed its fuel retail operations in order to detect the cause of its declining market share. The review exercise revealed that supermarkets were driving down prices at the pumps which resulted in Esso’s outlets being uncompetitive. Consequently, Esso embarked on a Business Process Redesign (BPR). Following the review of marketing operations of the fuel stations, Esso decided to adjust margins, fees and allowances. These adjustments gave rise to the dispute with the licensees whom complained that Esso reduced licensees’ margins and allowances, and increased fees to an extent where it was commercially unfeasible for them to operate their businesses. They contended that in adjusting these, Esso had exceeded its entitlements under the licence agreements.

However, clause 6 of the Fifth Schedule to the PLA provided for margin/allowance review. Having determined that Esso was entitled to make adjustments in margins, fees and allowances, the court also needed to determine whether these adjustments were made arbitrarily or whether there was a reasonable driving force behind it. Following the outcome of Esso’s review of their fuel retail operations in 1994/1995, Esso decided in 1996 to jettison the Esso Collection Promotion Scheme because the company thought that it was better to compete directly on price, as a way of attracting and retaining customers, than through gift promotions. Consequently, Esso introduced

71 Clause 6 provided as follows: “prior to the 1st of November in every year, Esso will review the Licence Margin and the sum payable in respect of the Monthly Operating Cost Allowance. Following such review, Esso will notify the licensee of the result of its review and if in Esso’s opinion changes are required to the licence margin or cost allowance such changes will take effect on the 1st of December following the review. Esso reserves the right, if necessary, to make adjustments to the licence margin and/or the cost allowance at any other time upon notification to the licensee.”
a new strategy (the Pricewatch Scheme) whereby Esso ensured that it matched the retail prices set by competing fuel stations in a given area. The retailers were meant to bear part of the burden of operating this new scheme themselves because they were expected to frequently monitor the prices being charged by competing sites in their areas and report back to Esso. This monitoring activity added to the retailers’ costs, but overall Esso bore the major part of the costs of the scheme. Esso regarded the operation of this scheme as necessary to retain its presence as a major player in the motor fuel retail market. The introduction of this scheme, based on the BPR, may have necessitated the frequent adjustments in margins, shop fees, and operating cost allowance (three times in 1996, and subsequently in 1997 and 1998).

On the basis of the above facts, the trial judge ruled that clause 6 of the fifth schedule of the PLA entitled Esso to adjust the margin, shop and marketing fees and operating cost allowance at its discretion, although it was not entitled to make such adjustments “arbitrarily, capriciously or irrationally.” Esso was not also entitled to make such adjustments as would render the businesses of the defendants uneconomic. Considering the need for Esso to make necessary adjustments to its operations in order to meet the supermarket competition in fuel retailing, the trial court was satisfied that all the adjustments before it were not made arbitrarily, dishonestly or irrationally. In the same judgement, the trial judge (Moore-Bick J) ruled that if those necessary adjustments which Esso was compelled to make had affected adversely the business of any of the licensees’, the matter would have to be determined in separate proceedings.

72 See id., point 149.
The third aspect of the dispute relates to what is known as ‘hot fuel’ or ‘wet stock losses’. Petrol (and to a lesser extent diesel) has a high co-efficient of expansion and as a result the observed volume of any given delivery is significantly affected by its temperature. The observed volume of these fuels at the time of loading tends to be more than the recorded volume after cooling has taken place in the storage tanks. The difference in volume is regarded as wet stock losses to the retailers. Similarly, motorists who obtain fuels shortly after a given delivery in a filling station would have received a relatively hotter fuel, and are also likely to incur wet stock losses after the fuel has cooled in the fuel tanks.

Licensees were obliged to obtain all their requirements of motor fuels from Esso as stated in the solus agreements. All fuel station operators were also required to keep records of the quantity of fuels on their premises (known as ‘wet stock’). Many licensees began to notice that they were incurring wet stock losses which they could not account for. Subsequently, they observed that these losses must have been caused by the contraction of fuel after cooling in the storage tanks. Consequently, they complained to Esso that they have received less fuel than they ordered and paid for because the fuel delivered to them was ‘hot’ when loaded into the tanker.

The petroleum industry had recognised the need for a standard temperature accounting for products passing through the refining and distribution system. The licensees who claim to have received deliveries of hot fuel contented that Esso was under an obligation to adopt the standard temperature accounting and was in breach of contract for not doing so. The court recognised the fact that petrol (and to a lesser degree diesel) are highly volatile substances. In the case of petrol, a change in
temperature of 4 degrees centigrade produces a change in volume of about 0.5%, and 0.3% with diesel. Therefore, if the temperature is significantly higher than ambient temperature at the time of loading into the road tanker, there can be a significant reduction in volume at the time of cooling. Expert evidence before the court, revealed that although the standard temperature accounting has been used in the oil industry for over fifty years (as at the time of the case), it was not generally applied within the UK for the sale of petrol or diesel, either by fuel suppliers to retailers or retailers to motorists. However, the court was more directly concerned with identifying the terms on which Esso sold motor fuels to the licensees and to determine whether or not it failed to comply with its obligations.

Based on the facts, the court ruled that the agreements for the supply of fuel by Esso to its licensees provided for the sale and delivery of a stated volume measured at the temperature at the distribution terminal at the time of loading into the delivery vehicle. Therefore, Esso was not in breach of contract for delivering fuel at temperatures higher than ambient temperature at the time of loading into road tankers. Clause 6 of the licence agreement and clause 1 of the Fifth Schedule provided that the licensee was bound to buy all fuel requirements from Esso on Esso’s current terms and conditions. Clause 5 stipulated that, “the seller’s measurements of quantity will be accepted by the buyer”.\(^73\) Clause 8 provided that “all packages contain full measures when delivered by the seller but owing to the volatile nature of petroleum the seller cannot be held responsible for any shortages after the packages have left the seller’s premises.”\(^74\)

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73 See id., point 154.
74 See id., point 154.
The judge also noted the opinion of experts that it would be technically possible in the future to introduce equipment required to enable standard temperature accounting to be carried through the entire distribution chain (i.e. from the refinery to the pump). However, this will require the co-operation of the entire industry to implement and would take some time to actualise. However, standard temperature measurement at the pump was yet to be introduced at the time of the case, and has not yet been introduced in the UK. The judge argued that until this technology is introduced, there must be a point in the distribution chain where the transition from standard temperature accounting to accounting in observed volumes occurs. The current practice provides for that transition to occur at the loading gantry on the sale of fuels by the supplier to the retailer. Moreover, the judge reasoned that petrol pumps in the UK dispense fuels based on observed litres and not standard litres. For this reason, it is not feasible to account for motor fuels on a standard-litre basis throughout the fuel retail distribution system. The experts agreed that considering the circumstances, the adoption of standard temperature accounting for the sale of fuel to retailers would operate to the advantage of some and to the disadvantage of many. Even if Esso were to supply its licensees in standard volumes measured at the loading gantry, there would still be a differential between the standard volume supplied and the observed volume received into the retailer’s tank due to evaporation.

Esso’s licensees appealed against the decisions of the trial judge. Firstly, they challenged the judge’s construction of the standard forms of the contract and argued that the judge should have adopted a more restrictive interpretation of Esso’s rights to adjust margins, fees and allowances. Secondly, they contended that the judge should
have found that Esso acted “arbitrarily, capriciously, dishonestly or irrationally.” Thirdly, they challenged the judge’s ruling on the issue of wet stock losses.

The appeal judges (Ward, Tuckey, and Neuberger LJJ) affirmed the decisions of the trial judge on the issues raised by the appeal as follows.\(^\text{75}\) Firstly, based on the facts of the case, the trial judge was entitled to construe Esso’s standard form of agreement in the way he did. They held that the judge made a clear finding of fact that Esso had not made the adjustments in margins, fees, and allowances based on improper motives. Rather, these were based on rational responses to commercial situations.

Secondly, regarding the issue of hot fuel, the appeal judges held that if a contract for the sale of goods by volume did not provide expressly a measurement system for those goods, the natural implication would be to adopt a measurement system that accords with established good practice in the trade or industry concerned. In this case, the trial judge found that each contract with the licensee was for the purchase and sale of a volume of fuel measured in accordance with the prevailing and established industry practice. This measurement was carried out at the point of delivery into road tankers at the temperature at which fuels reached the loading gantry in the normal course of operations. They concluded that the trial judge made the right decision on the issue.

\(^{75}\) See *Esso Petroleum Co Ltd v Addison and others*, (2004) EWCA Civ 1470.
4.5.3 Summary of Current Legal Principles in Play in this Area of Law

The cases of *Petrofina (Gt Britain) v Martin and Another* and *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd* defined the nature of solus agreements and how these special class of cases should be treated by the courts. On one hand, solus agreements were generally considered to be in the interest of the licensors, the licensees, and the general public. Solus agreements afford the licensor adequate protection to outlets for their fuels and ensure a return on their substantial investments in refineries and plants. These agreements ensure a steady supply of fuels and other supplementary support measures (i.e. loans for refurbishing retail sites, loans for fuel equipment, etc) to the licensees, while also facilitating economical distribution of fuels in the public interest. On the other hand, these agreements were basically regarded as falling within the doctrine of restraint of trade. However, based on the usefulness of solus agreements they are enforceable by the courts provided that they pass the test of reasonableness.

An important legal principle that emerged in the case of *Petrofina (Gt Britain) v Martin and Another* is that solus agreements could not be used by a licensor to protect its competitive position, particularly when such restrictions on a licensee is more than what is necessary for such protection. This is important considering the vigorous nature of competition in fuels wholesaling and retailing.

Price discrimination is also a regular feature of the fuels retail trade, and also a contentious one among the licensees because price competition is vital in the trade and determines to a large extent the volume of fuels sold by retailers. The case of *Shell UK v Lostock garage* indicates that the issue of price discrimination as an
implied term in a solus agreement presents significant difficulties in defining the appropriate degree of discrimination which an implied term should embody or preclude. The lack of precision in the criterion that should be embodied or precluded from an implied term makes it difficult for the courts to allow any case or appeal that falls under price discrimination.

Retailers’ margins, fees and allowances are crucial determinants of the profitability of fuel outlets. The judgement of the case of *Esso Petroleum Co Ltd v Addison and Others* in the Court of Appeal reveals that reasonable commercial decisions by licensors such as promotional schemes and adjustments in retailers’ margins, fees, and allowances are allowable in courts provided that the contracts contains relevant provisions relating to these decisions.

The issue of wetstock losses also has implications for retailers’ profitability. However, the appeal court judgement in the case of *Esso Petroleum Co Ltd v Addison and Others* indicate that for similar cases the current industry temperature accounting standards for fuel retail operations should remain in force until standard temperature measurement at the pumps is introduced in the UK.

### 4.5.4 Australian Fuel Retail Franchise Regulations

The Australian solo marketing scheme is the equivalent of the UK solus trading scheme, and so shares similar issues and difficulties in the contractual relationship between the oil majors and the retailers (franchisees and independent retail operators). The refining wholesalers in both jurisdictions faces two major risks which they must cushion: the potential volatility of demand which arises from the tendency of
consumers to change brands in response to price differences; and the high capacity utilization needed to make refining economic. Inevitably, they are forced to respond to these risks (through vertical agreements) by tying retail outlets to contractual arrangements for exclusive supply/ resale of their refined products.\footnote{See IC report; \textit{supra} note 15, at 32.}

Oil majors in Australia only need to own one of the capital assets needed to operate a fuel retail site (the outlet, pumps or storage facility) to insist on exclusive supply ties. The only exception occurs where a retailer provides his own capital, pumps and storage (as in the case of independent retailers) in which case he can sell unbranded products and choose between suppliers. These categories of retailers are few in the major capital cities as shown in table 4.6.\footnote{See \textit{id.}, 33.}

<table>
<thead>
<tr>
<th></th>
<th>Sydney</th>
<th>Melbourne</th>
<th>Brisbane</th>
<th>Adelaide</th>
<th>Perth</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of non-oil major sites</td>
<td>233</td>
<td>305</td>
<td>197</td>
<td>56</td>
<td>80</td>
<td>871</td>
</tr>
<tr>
<td>Total no. of all sites</td>
<td>1,011</td>
<td>1,036</td>
<td>657</td>
<td>310</td>
<td>413</td>
<td>3,427</td>
</tr>
<tr>
<td>% of non-oil major sites of total sites</td>
<td>23.0</td>
<td>29.4</td>
<td>30.0</td>
<td>18.1</td>
<td>19.4</td>
<td>25.4</td>
</tr>
</tbody>
</table>

\textbf{Source:} ACCC, Inquiry into Petroleum Products Declaration P33.

Table 4.6 also reveals that the oil majors utilize franchise agreements extensively. The majority of non-oil major sites are usually single businesses without the economies of scale derived from chain linkages, and are mainly located in rural areas. In cases where retailers have franchise agreements with the oil majors, the product ties are further consolidated through guarantees on borrowing, tied lease of land,
buildings and equipment and these are included in such arrangements or documented through separate agreements.

### 4.5.5 Quasi-Fuel Franchise Regulation of 1975

Considering the inevitability of vertical arrangements in the petroleum industry and some of the detrimental effects it could have on competition, the Trade Practices Commission (TPC) decided in 1975 to stipulate a number of conditions for exclusive dealings which the oil majors were mandated to reflect in all agreements with its franchisees and independents. These conditions were similar to the Undertakings signed by the oil majors in the UK in 1966 and are as follows.

1. No ties should be placed on dealer-owned sites for fuels, lubricants and other products.
2. No ties should be placed on lubricants under any circumstance.
3. Resellers were required to hold sufficient stocks to meet demand for branded fuels.
4. Resellers were expected to have reasonable access to equipment in order to sell another supplier’s fuels.

However, the evidence shows that no retailer was able to secure the last condition for the following reasons: franchisees’/lessees’ fear of retaliation from the supplying oil major; costs of separating brands; the ownership of storage tanks and pumps by the oil majors; and the Laidely agreement which prevented cross fuelling between brands. Indeed, the oil majors mounted a successful common law prosecution for ‘passing off’ (i.e. a retailer selling from a pump a brand other than that advertised on the

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78 See *id.*, 42-43.
79 For details, see *id.*, 119.
pump) which effectively prohibited such actions by retailers. On this basis, all oil majors reintroduced full ties into their franchise agreements in 1988.\textsuperscript{80}

It has been observed in Australia that small businesses prefer franchise agreements because it reduces the capital investment required to establish goodwill which in turn minimizes the risk of business failure. Such agreements usually include an exclusive territory, effective IT-driven management systems, and the supply of an established brand belonging to the oil major or their distributors.\textsuperscript{81} However, in practice the ability of a franchisee to take advantage of an exclusive territory and goodwill is limited by the relative undifferentiated nature of petroleum products. Equally, the conditions that restrict supply to one brand would mean that franchisees have little control over supply. The indications are that franchisees also have no control over prices.

The evidence shows that the franchisee under the conditions of lack of independence does not always achieve the objective of reducing the risk of business failure. These risks would include the level of price volatility; the amount of SPS provided by the supplier; and any sudden increases in rents, leases or other marketing fees. The nature of franchise agreements (like any other exclusive supply arrangements in the industry) permits the transfer of countervailing power from the fuel retailer to the supplying oil majors, which allows the latter to achieve more predictable demand for their product through indirect vertical integration. In other words, the franchisees have the appearance of a ‘glorified employee’ of the oil majors.

\textsuperscript{80} See \textit{id.}, 43.
\textsuperscript{81} See \textit{id.}, 35.
4.5.6 The Petroleum Retail Marketing Franchise Act 1980

The foregoing situation probably led to the enactment of the Franchise Act which set out in details the preferred relationship which the oil majors should have with their franchisees’ with some semblance of relative equity in the contractual relationships. However, prior to the enactment of the Franchise Act a number of government enquiries were set up because of the perceived imbalances in negotiating power between the franchisor and the franchisees. Hence, the Act was meant to redress such imbalances by setting minimum terms and conditions for all franchise agreements and delivering greater security of tenure to the franchisees’ and the ability to accrue goodwill.

The Act covers all agreements on outlets retailing over 360,000 litres of fuels per annum and applies also to multi-site franchisees but not restricted to oil majors’ franchisees. The following are the minimum conditions imposed by the legislation:

- “the right to assign and appropriate goodwill; tenure of three years with two further three-year terms at the option of the franchisee (i.e. in effect a 9-year term);
- franchisors should not impose unreasonable terms on the franchisees, including increasing rents or withdrawing rebates arbitrarily; prohibition of price discrimination between like-branded franchisees, except where the price discrimination can be justified by differences in the costs of supply or the need to meet competition;
- disclosure of all relevant information by the franchisor to the franchisee at least three days prior to the latter entering into an agreement with the former (to enable the franchisee make an informed decision)”.

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4.5.7 Case Law on the Petroleum Retail Franchise Act 1980

Some identified cases arising from the Franchise Act are set out below to give a perspective on how the courts interpreted crucial provisions of the Act. The cases also tested whether the court interpretations facilitated the objectives of the Franchise Act or not.

<table>
<thead>
<tr>
<th>Provisions of the Act</th>
<th>Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assignment of Rights and Interests (s11)</td>
<td>Bayata Pty Ltd and Another v Ampol Petroleum Ltd, (1982) 45 ALR 349; Chenoa Pty Ltd v Shell Co of Australia, (1988) 81 ALR 1; Ampol Petroleum Ltd v Calaby Pty Ltd; Esso Australia Ltd v RT &amp; MI Abela Pty Ltd.</td>
</tr>
<tr>
<td>Protection against Price Discrimination (s20)</td>
<td>BP v Trade Practices Commission, (1986) 66 ALR 148; Mobil Oil Australia Ltd v Brain Brindle; Chronopoulos v Caltex Oil (Australia) Pty Ltd.</td>
</tr>
<tr>
<td>Contracting out of the Statute</td>
<td>Caltex Oil (Australia) Pty Ltd v Best; Richards v Golden Fleece Petroleum Pty Ltd; Beckford Nominees Pty Ltd v Shell Co of Australia; Ampol Petroleum Ltd v Calaby Pty Ltd; Esso v RI &amp; MI Abela Pty Ltd.</td>
</tr>
<tr>
<td>Rental Increases (s13)</td>
<td>Chronopoulos v Caltex Oil (Australia) Pty Ltd.</td>
</tr>
<tr>
<td>Interim Franchise Agreements (s3 &amp; s14)</td>
<td>Dinyarrak Investments Pty Ltd v Amoco (Australia) Ltd.</td>
</tr>
</tbody>
</table>

**Source:** This Research
The key provisions of the Franchise Act dealt with termination of agreements, renewal of agreements, assignment of rights and interests in a retail site, application of the Act to agreements prior to the commencement of the Act, protection against price discrimination, protection against imposition of impossible or unreasonable obligations, contracting out of the statute, and interim agreements. The identified cases are listed under these various categories as shown in table 4.7. The cases chosen for reporting in this thesis are those that collectively best represent the court interpretations and rulings regarding the cases brought under the Act, and also those that cover more than one provision of the Act.

4.5.7.1 MOBIL OIL AUSTRALIA LTD V BRIAN BRINDLE
This case dealt with termination of agreements and what the correct basis should be under the Franchise Act 1980, as well as issues arising from wholesale price discrimination. The original case was brought before the Federal Court of Australia, and was decided by the trial judge (Wilcox J).84

Mr Brian Brindle (the respondent) operated a Mobil (the applicant) fuel station within the country district of Wollongong for more than 21 years. At the time of the case, he occupied two sites (one for about eight years and the other for about six years). The parties executed four agreements to govern their relationship. Firstly, there was a lease of a fuel station at Towradgi for a term of three years. Secondly, there was a Reseller Contract between the parties (meant to operate in conjunction with the lease). The terms of the contract obliged Mr Brindle to sell no less than two million litres of refined fuels per annum at the Towradgi fuel station. However, Brindle was not required to purchase, in any particular year, a quantity exceeding 50% of the fuel sold

84 See Mobil Oil Australia v Brian Brindle, (1984) 56 ALR 541.
Thirdly, there was a Meter Wholesale Contract, which was interdependent with the Reseller Contract, which consisted of a system of supply whereby Mobil provided fuel to a filling station on a consignment basis. Under the system, fuel was delivered to the storage tanks of the fuel station at such times, and in such quantities as Mobil wished. The fuel remained the property of Mobil until it was sold at the pump to a customer through a bowser. The dealer was liable to pay to Mobil the wholesale list price for what had been sold. The contract provided for Mobil to enter the premises at any time to carry out an audit of sales. Either party was free to suspend this contract, upon breach of the contract by the other party. Fourthly, there was an Equipment Loan Contract (which ran concurrently with the lease agreement) that provided for the lessee to use items of plant owned by Mobil at the fuel station.

The nature of competition within the Wollongong district (a rural location), and the price discrimination as practised by Mobil (but not peculiar to Mobil alone) began to have a negative impact on Brindle’s business. The evidence of the respondent and three experienced fuel station operators within the district revealed that price was the major factor influencing sales of retail motor fuel in the district. Within the district, there were other categories of competitors. There were sites known as freeholders (i.e. fuel stations operated on land owned by the proprietors of the station), and commission agency sites. Fuel supply arrangements between the oil majors and these categories of retailers differ from that of their dealers or franchisees (who operate on the basis of a lease agreement). The freeholders are supplied fuel at a substantially

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85 The implication of the Meter Wholesale Contract was that, regardless of the 50% proviso in the Reseller Contract, a dealer operating under this contract has to take 100% of his fuel supplies from Mobil. The reason is that the contract prohibits the storage of fuel purchased in the open market (i.e. foreign or secondary fuel) in the storage tanks containing Mobil’s fuel held on consignment basis.
lower price than the lessee dealers. There were two of such sites near Mr Brindle’s
fuel station. The commission agency sites were owned and operated by the oil majors
and managed by commission agents. The fuel supply arrangement in this case was
that the oil majors owned the fuel stored at the site and retailed it to customers
through the commission agents, who were remunerated through sales commission.
Therefore, the oil majors were able to adjust the retail prices at such sites to meet
competition. There were also two such commission agency sites near Mr Brindle’s
fuel station.

Under the Reseller Contract, Mobil had the sole right to determine the wholesale price
of the fuels supplied, which was usually adjusted to return a retail margin of 3.0-3.5
cents per litre to the dealer. Brindle complained (which was supported by other
dealers) that this margin was inadequate even in normal times to meet retail costs and
to provide a decent return on investment. The situation tends to be aggravated during
times of strong price competition, when the dealers could consider shaving off some
of their margins in order to match competitors’ prices. However, Mobil (like the other
oil majors) had a policy of Selective Price Support (SPS) for such periods of strong
competition. Brindle complained that there was often a delay in the application of
SPS. During the intervening period, the dealer had to reduce or eliminate retail
margins to retain customers. In trying to find a lasting solution to problems arising
from price competition, Brindle decided to purchase an oil tanker to achieve cheaper
supplies.

The lease on the fuel station located in Towradgi was due to terminate in March 1984,
and the respondent failed to renegotiate favourable terms, as well as the price which it
paid to the applicant for fuel supplies. Subsequently, the respondent defaulted on the payment for a delivery of fuel made on 29 November 1983. On 23 December 1983, Mobil served upon the respondent a notice of termination based on the Franchise Act 1980. The notice of termination covered all four agreements between the parties, followed by an application and an order on 29 December 1983 requesting the respondent to surrender the fuel station to Mobil.\(^{86}\) The respondent sought to renegotiate the agreement in the interim, and following unsuccessful attempts he filed a cross-claim on 4 June 1984, seeking a declaration to nullify the notice of termination.

The Federal Court of Australia held that it was not just and equitable for Mobil to refuse to renew the franchise agreements for the following reasons. Firstly, the non-renewal would lead to disastrous consequences for the respondent. Secondly, the circumstances surrounding the default in payment were understandable, considering the effects of wholesale price discrimination among the various categories of sites supplied by Mobil within the district where the respondent operated.\(^{87}\) Therefore, the court ordered that the lease should be renewed at a true rental value provided that, (a) the respondent repaid his debts, and (b) that the respondent was not obliged to purchase fuels at a wholesale price higher than his competitors within the district.

In delivering the judgement, the court considered that the lease between Mobil and Mr Brindle falls within the definition of the term “franchise agreement” as stated in the Franchise Act 1980.\(^{88}\) The Franchise Act defines it to include, (a) “an agreement

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\(^{86}\) For details of the action against Mr Brindle, see *id.*, 550.

\(^{87}\) The Judge referred to similar cases as follows: *Richards v Golden Fleece Petroleum Pty Ltd*, (1983) 49 ALR 337; and *J & M O’Brien Enterprises Pty Ltd v Shell Co of Australia*, (1982) 45 ALR 81.

\(^{88}\) See *The Petroleum Retail Marketing Franchise Act 1980*, supra note 82.
containing provisions by virtue of which a corporation (the franchisor) grants to another party to the agreement (the franchisee) the right to occupy or use premises in connection with the retail sale of motor fuel by that person at those premises, (b) “an agreement under which a franchisor is entitled or required to supply motor fuel to a franchisee for retail sale by that person at particular premises or under which a franchisee agrees to acquire motor fuel from a franchisor for retail sale by the franchisee at particular premises”.

The court reasoned that the Reseller Contract between Mobil and Mr Brindle fell within this definition.

Moreover, the court also took into consideration the true spirit of the Act. The main policy behind the legislation was to give greater security of tenure to franchisees than they would have under their contractual arrangements with the oil majors without the Act. This underlying policy was referred to by Fox, J in Chronopoulos v Caltex Oil (Australia) Pty Ltd, Mason CJ, Dawson, Toohey, Gaudron and McHugh JJ, in Caltex Oil (Australia) Pty Ltd v Best; Toohey, J in Richards v Golden Fleece Petroleum Pty Ltd and by Fox, J in J & M O’ Brien Enterprises Pty td v Shell Co of

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89 See Section 3 of the Franchise Act.
90 See Chronopoulos v Caltex Oil (Australia) Pty Ltd, (1982) 45 ALR 481 at 484. Fox, J emphasizes that, “the principal purposes of the Franchise Act are to give security of tenure to retail operators of service stations, and a protection against price discrimination by corporations supplying motor fuel to them”.
91 See Caltex Oil (Australia) Pty Ltd v Best, (1990) 97 ALR 217 at 224. “The statutory purpose of giving greater security to franchisees marketing motor fuel by retail would be frustrated and the scheme of regulation would be undone if the Act were to be read as permitting a provision such as cl 17.4 to be included in a franchise agreement. In the case of a statute, the object of which is to protect the interests of a class of persons who are at a disadvantage in negotiating a contract on fair terms with a class of corporations having superior bargaining power, the courts must reject an interpretation which would allow the statutory purpose to be circumvented. This is particularly so when the attempted circumvention takes the form of the adoption of a provision in the contract which would enable the party possessing superior bargaining power, by its unilateral action, to alter the parties’ rights and obligations under the contract in such a way as to deprive the contract of the statutory protection.”
92 See Richards v Golden Fleece Petroleum Pty Ltd, (1983) 49 ALR 337 at 347-348. “The legislation seeks to put franchisees in the position of independent operators, protecting them against termination of their agreements and giving them rights of renewal of those agreements. Franchisors and franchisees do not stand in the relationship of master and servant, principle and agent, or in any fiduciary capacity that imposes rights and obligations apart from those which the parties have contracted, controlled as they are by the legislation”.
Section 10 of the Act dealt specifically with the supply of motor fuel. The franchisor was under obligation, pursuant to this Act, to supply fuel to the franchisees during the term of their agreement in reasonable quantity as may be required at the premises. However, special provisions were made in the Act for cases where supply was not possible due to shortages of supplies, industrial dispute, or other circumstances beyond the franchisor’s control, i.e. s10 (4) (b).

Under the circumstances, the critical issue that arose under s17 (1) (c) was whether the court was satisfied that the non-renewal of the agreements was ‘just and equitable’. Section 17 (12) entitles the court to order a re-determination of the provisions of the agreement to be renewed, if it was not satisfied that the non-renewal of the agreements was ‘just and equitable’. The court ruled that in this case the decision by Mobil not to renew the agreement was not ‘just and equitable’.

In the case between *Mobil Oil Australia Ltd v Brian Brindle*, Mobil appealed the decision of the court forcing the corporation to renew the agreement with Mr Brindle. However, the appeal court upheld the decision of the Federal Court on the basis that the Franchise Act was meant to “give greater security of tenure to retail

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93 See *J & M O’Brian Enterprises Pty Ltd v Shell Co of Australia*, (1982) 45 ALR 81 at 82. “The broad intention of the principal provisions of the Act is to give greater security of tenure to companies and individuals marketing motor fuels by retail.” Those provisions are the duration of agreements (Section 13), their renewal and termination (Sections 16 & 17), and the assignment of rights and interests (Section 11). These provisions were cemented by Section 7 (1) of the Act, which stipulates that “a provision in any agreement is void to the extent that it purports to exclude, limit or modify, or is otherwise inconsistent with, the operation of a provision of this Act or any right or remedy based on or arising out of a provision of this Act”.

94 In such circumstances, the franchisor is bound to use its best judgement and discretion – “to supply motor fuels to its franchisees in such manner as is fair and equitable as between each of its franchisees and as between its franchisees and any other persons to whom it supplies motor fuels, having regard to the respective needs of its franchisees, of those other persons and of the public”, i.e. s10 (5).


96 See *Mobil Oil Australia Ltd v Brian Brindle*, (1985) 62 ALR 89.
operators of service stations and protect them from price discrimination from suppliers”. 97 Secondly, the power of the court in determining the amount payable by the franchisee under an agreement to be renewed is not restricted only to the payment of rentals. Section 17 (12) of the Act provides that the court may determine “any other provisions of the agreement as to be renewed”. This provision includes price discrimination (s20), and entitlements by the court to determine a term relevant to the price of motor fuel within such an agreement.

4.5.7.2 RICHARDS V GOLDEN FLEECE PETROLEUM PTY LTD

This case relates to termination of agreement on the basis of an allegation of ‘wilful adulteration’ of products supplied to a franchisee. The applicants (Mr and Mrs Richards) secured a lease from the respondents (Golden Fleece) of a fuel station in Dianella. The lease and a reseller supply agreements were for a term of three years. 98 Golden Fleece claimed that the Richards obtained fuel from another supplier, stored the ‘foreign’ product into storage facilities provided by Golden Fleece which already contained the company’s products, and then proceeded to sell the mixture of the fuel from both sources. Golden Fleece accused the Richards of ‘wilful’ adulteration of motor fuel supplied to them under the franchise agreement. Secondly, Golden Fleece contended that the Richards wilfully ‘passed off’ the fuel from another supplier as fuel supplied to them by Golden Fleece, and that this action was carried out without their consent.

97 See the judgement of the appeal court judges (Fox, Pincus, and Burchett JJ), at 90. Also see BP Australia Ltd v Trade Practices Commission, (1986) 66 ALR 148. Section 20 of the Franchise Act permits a franchisor to engage in price discrimination in order to meet or match a price or benefit offered by a competitor.
Each of these allegations (if proved beyond reasonable doubt), is a valid ground for termination of a franchise agreement under s 16 (2) of the Franchise Act. Similarly, each allegation constituted a breach of the lease and reseller supply agreement, albeit the relevant covenants were not in identical terms to the Act. The Richards denied the allegations and insisted that they did not breach the provisions of s16 (2). They relied upon s16 (6) whereby “in any proceedings under s16 (4), the court shall not declare a notice to have been terminated, or to terminate a franchise agreement unless – (a) a ground specified in the notice is established by the franchisor to the satisfaction of the court; and (b) the court is satisfied that the termination of the agreement and any related agreement or agreements is just and equitable, having regard to all the circumstances”.

However, following an order for the recovery of specific documents from the Richards, Mr Richard deposed that they had ordered fuel from North Suburban on three occasions, identified as 03 August, 21 October 1982 and 04 February 1983. A representative of North Suburban who was subpoenaed by the respondent to provide evidence, however, revealed that the Richards had ordered and received fuel on seven occasions. The Richards acknowledged ordering and receiving fuel on the extra days when faced with this revelation, but denied having placed order for fuels on 02 March 1983 as alleged by the respondents. A representative of North Suburban produced evidence from his records that on 28 Feb 1983, they received an order from the applicants for super petrol. However, the representative of North Suburban could not show evidence regarding who placed the order or how it was placed. The suspicion was that it could have been done by telephone. Moreover, no employee under the

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Richards had the authority to order fuel. Nevertheless, the court was not satisfied with Mr Richards’ account of his activities on 02 March 1983. If the onus lay on the Richards to prove that they did not place the order, the court could have inferred that they may have failed to discharge that onus. However, in this case the onus lay on Golden Fleece to prove that the Richards placed the order.

The notices of termination for the lease and reseller supply contract were not based on the fact of delivery, but on allegations of adulteration and ‘wilful passing off’. The respondents failed to establish a proof that the applicants ordered the fuel or that fuel was delivered with their consent, or that the applicants wilfully adulterated fuel supplied to them by the respondents on the basis of paragraph (e) of s16 (2). But the failure of the respondents to prove these did not dispose of the ground for termination based upon paragraph (f) of s16 (2).

Section 16 (2) (e), stipulated that a franchisor can terminate a franchise agreement with a franchisee if “the franchisee misrepresents the octane rating of, or wilfully adulterates, motor fuel supplied to him under the franchise agreement”. S16 (2) (f), stated that a franchise agreement could be terminated by a franchisor if “without the consent of the franchisor, the franchisee wilfully passes off motor fuel supplied to him by a person other than the franchisor or a related corporation as being motor fuel supplied to him by the franchisor or a related corporation”.

As far as s16 (2) (f) is concerned, the real issue facing the court was to determine whether the Richards ‘wilfully’ passed off the fuel supplied by North Suburban, on the morning of 02 March 1983, as fuel supplied by Golden Fleece. In the
circumstances of this case, it was clear that the Richards knew about the fuel delivery to their petrol station on 02 March and that the fuel was not supplied by Golden Fleece. But, the fact that they went ahead to sell the fuel under the logo of Golden Fleece would mean that they intentionally, deliberately, and with full knowledge of what they were doing, ‘passed off’ Shell’s petrol as that of Golden Fleece. Therefore, the court was satisfied that the applicants’ conduct fell within paragraph (f) of s16 (2), and that the notices given on this basis were proper.

However, the applicant invoked s16 (4), which stated that, “where a franchisor serves notice on the franchisee under sub-section (3) terminating the agreement, the franchisee may apply to a court for an order declaring the notice to have had, or to have, no effect”. Section 16 (4) had implications for s16 (6). S16 (6) operated as a positive prohibition against the court declaring a notice to have terminated, or to terminate, a franchise agreement unless the court was satisfied that there was a reasonable ground for the notice of termination and that the termination was “just and equitable”, having considered all the circumstances and effect on the franchisees.

In making a decision, the judge had to consider two matters that were relevant to what could be regarded as “just” and “equitable” in the context of the Franchise Act. Firstly, the legislation was meant to put the franchisees in the position of independent operators by protecting them against undue termination of their agreements with franchisors and providing them with rights of renewal of those agreements. On the basis of the legislation, the relationship between the franchisors and the franchisees was not a master and servant, or principle and agent type that imposes rights and

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100 See Richards v Golden Fleece Petroleum Pty Ltd, (1983) 49 ALR 337 at 346. Toohey, J contended that, “it is apparent that Section 16 of the Franchise Act is designed to protect a franchisee against termination of the franchise agreement”. 
obligations, apart from those which the parties have contracted themselves.\textsuperscript{101} Those rights and obligations that were mutually contracted must also be in line with the Franchise Act, and controlled by it.\textsuperscript{102} Secondly, the only loss that Golden Fleece had suffered in this event was the loss of potential revenue that would have accrued to it had they (and not North Suburban) supplied the fuel. Thirdly, there was no evidence that consumers had suffered any detriment as a result of the applicant’s conduct, albeit some consumers had been misled. Fourthly, the foremost consideration of the judge in terms of what was ‘just and equitable’ was the implications of the termination of the contracts for the applicants. The termination would mean that they would lose the entire benefit of the business they built up. Moreover, the Richards secured loans in order to purchase plant and equipment by mortgaging their own house. If they no longer operated the fuel station, it was unlikely that they would be able to meet those obligations.

The judge considered that Golden Fleece failed to satisfy him that the termination of the contracts would be ‘just and equitable’. He held that the consequences of the termination on the applicants would be too grave as to outweigh all other considerations, and was satisfied that the termination would not be ‘just and equitable’. Therefore, he declared the notices of 15 March 1983 given by Golden to the Richards to have had no effect. However, the judge ruled that the Richards should repay to Golden Fleece the costs of the application and cross-claim because Mr

\textsuperscript{101} See id., 348.
\textsuperscript{102} See id., 349. Toohey maintained that Section 16 should not be construed in such a manner as to restrict its remedial operation or purpose. In this case, Toohey states, that, …..I agree with counsel for the respondent that s16 of the Commonwealth Act deals with the termination of a franchise agreement so exhaustively as to leave no room for the operation of s81 of the Property Law Act” The latter is an Act of the State of Western Australia which imposes a pre-condition to be satisfied before forfeiture or re-entry under a lease. In order words, Toohey’s interpretation of s16 and Fox’s interpretation of s7 (1) would mean that a contracting out of the franchise Act was disallowed.
Richards’ conduct of 02 March 1983, coupled with previous deliveries from North Suburban without the consent of Golden Fleece meant that the Richards brought upon themselves the giving of the notices and should bear the costs of the court hearing.

4.5.7.3 CHRONOPOULOS V CALTEX OIL

This case deals with the right of a franchisor to increase rental charges unilaterally and the application of the Franchise Act retrospectively. Caltex Oil (the respondent) leased out a fuel station to the McDonalds on 2 May 1980 for a three year term. The fuel station was registered under the Real Property Act 1900 (New South Wales), at a time when the Franchise Act 1980 was not in existence.

The lease included a lease agreement and a reseller supply contract. Clause 10 of the reseller supply contract stipulated that, “the buyer shall not assign this agreement or any of its rights or obligations hereunder or attempt or purport so to do without the prior written consent of Caltex”.

However, on 17 November 1980, the McDonalds (proprietors of Chronopoulos) sent a letter to Caltex notifying them of plans to re-assign its interest in the fuel station. Caltex replied on 28 November 1980, and in the letter gave conditions under which Chronopoulos should proceed with the reassignment plans. The implication of section (c) in Caltex letter is that this clause would negate the use of lube bays for minor service work being currently permitted under the existing fuel station permit. Having met these conditions, on 28 December

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103 See Chronopoulos v Caltex Oil (Australia) Pty Ltd, (1982) 45 ALR 481 at 484.
104 See id., at 484. The letter reads as follows: “I have been offered $35,000 plus (1) take over all stock, plant and equipment; and (2) take over leases on cash register and water pressure machine, to assign my lease to Messrs George & Danny Chronopoulos. Your approval is requested as soon as possible”.
105 See id., at 484. Caltex letter reads as follows: (a) not to match the offer made by Messrs Chronopoulos, (b) to process the request from the McDonalds on the condition that Chronopoulos fulfils Caltex requirements on their financial capacity to operate the service station, (c) to request the McDonalds to inform Chronopoulos of Caltex plans to convert the service station into a convenience (“C”) store”. ‘C’ means convenience store.
Caltex reassigned the Deed of Lease it had with the McDonalds to Chronopoulous. On 02 September 1981, Caltex informed the applicants (Chronopoulous) by “notice of rent review”,\textsuperscript{106} that they are required to pay rental for the premises in the sum of $21,999 per annum from 01 October 1981, as different from the previous rental of $13,428 as contained in Clause 1 of the original agreement.

The original lease to the McDonalds was entered into before the Franchise Act 1980 came into force on 19 September. Section 6 (2), and s6 (6) of the Act regulated the extent to which the Act could be applied retrospectively.\textsuperscript{107} The claim for increased rent gave rise to this case, and the court had to determine the validity or otherwise of an increase in rent by Caltex. Clause 1 of the lease agreement conferred on the lessor (Caltex) the discretion to raise or lower the rent. The lessee (Chronopoulous) argued that part of clause 1 under which the discretion to alter rent was given was void in common law, or alternatively is an ineffective part of the covenant. The judge

\textsuperscript{106}See id., 483-484. Clause 1 of the lease agreement also contains the provision for rent review, as follows: The Lessee shall pay to the Lessor rental of Thirteen Thousand Four Hundred & Twenty-Eight Dollars ($13,428.00) per annum payable by equal monthly instalments in advance on the first day of each month during the term, the first such payment (or, the apportioned part thereof) to be made on the First Day of May 1980 \textit{PROVIDED HOWEVER} that the Lessor shall have the right to review upon or after each anniversary of the commencement date the amount of the annual rental payable hereunder and shall be entitled to increase or decrease the annual rental to such amount as the Lessor shall, in its discretion, think fit and, subject to the following further proviso, commencing on the first day of the month after notification of the new rental is served on the Lessee, the Lessee shall pay to the Lessor, by equal monthly instalments thereof as aforesaid, the annual rental notified by the Lessor which shall be the rental reserved hereunder until further reviewed as provided in this clause \textit{PROVIDED THAT} such notification shall be served on the Lessee at least twenty-one (21) days prior to the said first day of the month on which the new rental commences and the Lessee shall have the right to give to the Lessor at any time, prior to such commencement three (3) months’ written notice of termination of this Lease and in the event of the Lessee giving such notice to the Lessor, the rental payable by the Lessee hereunder until the termination of this Lease at the expiration of the said three (3) months’ notice shall be the rental payable immediately prior to the review.

\textsuperscript{107}See Section 6 of the Franchise Act. Available online at http://www.austlii.edu.au/au/legis/cth/num_act/prmfa1980359/s6.html, last visited on 20 July 2009. Section 6 (2) states that, “subject to section 1, the provisions of sections 10, 17 and 20, sub-section 22 (1), (2) and (5), sections 23, 24, 25, 26, and 27 and, to the extent necessary for the application of those provisions by virtue of this sub-section, this Part, extend to a franchise agreement in effect immediately before the commencement of this Act”. Section 6 (6) stipulates that, “subject to sub-section (2), (3) and (4), this Act does not apply in relation to a franchise agreement that was entered into before the commencement of this Act”.
reasoned that the fact of discretion to alter rent does not mean that the clause is void, or unenforceable as argued by the lessee.

The rest of the submissions relied on the application of the Franchise Act. The respondent submitted that only certain sections of the Act were applicable (i.e. section 6 (6)), because the lease agreement was entered into before the commencement of the Act. Conversely, the applicants relied on the general policy of the Act, which is based on securing tenure for the franchisees. Thus, they argued that a situation where the lessor is allowed to raise the rent as it wished, thereby leaving the lessees only the option to terminate the lease by giving three months notice is not consistent with the policy guiding the Franchise Act. However, the judge reasoned that the Act provided for termination of agreements in certain situations s16 (2) (a-k), and therefore security of tenure was not absolute. Rather, the crux of the matter in relation to the policy of the Act was to determine whether the Act was clearly opposed to rental increases not agreed by the lessees. However, the Act did not proscribe changes in rental charges as clarified in Section 7. Thus, the relevant part of clause 1 in the lease agreement did not offend against s7.

The applicants also referred to s13 (8), which prescribes the terms of leases granted after the commencement of the Act, and also of renewal of leases (including those in effect immediately before that date). They argued that the power to increase rent can

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109 See Section 7 of the Franchise Act. Available online at http://www.austlii.edu.au/au/legis/cth/num_act/prmfa1980359/s7.html, last visited on 20 July 2009. S 7 (1) provides that, “this Act applies, notwithstanding any agreement to the contrary and, in particular, but without limiting the generality of the foregoing, a provision in any agreement is void to the extent that it purports to exclude, limit or modify, or is otherwise inconsistent with, the operation of a provision of this Act or any right or remedy based on or arising out of a provision of this Act”.

be used, indirectly, to force lessees out of business. However, the court held that this case is based on the right and power of a franchisor to review rental charges unilaterally.

Section 17 does not have a direct bearing on the case, as it deals with lengthening of the tenure of franchisee, by requiring renewal, unless a notice of non-renewal is given by the franchisor and grounds are stated in line with those set out in s16. However, when and if the question of renewal did come about, the court (if appealed to) might exercise the power to review the rental situation in accordance with s17 (1) (6) and s17 (12).\footnote{See Section 17 of the Franchise Act. Available online at http://www.austlii.edu.au/au/legis/cth/num_act/prmfa1980359/s17.html, last visited on 20 July 2009.} However, the judge dismissed the application based on the entitlement to periodic review of rental charges conferred on the franchisor by the Franchise Act.

\textbf{4.5.7.4 ANJAC PTY LTD V CALTEX OIL}

This case relates to the conditions under which a refusal to renew franchise agreements were acceptable under the Franchise Act.\footnote{See Anjac Pty Ltd v Caltex Oil (Australia) Pty Ltd, (1985) 69 ALR 733.} The respondent and franchisor (Caltex Oil) gave notice of termination of a franchise agreement it made with the applicant and franchisee (Anjac Ltd), pursuant to Section 17 of the Franchise Act. The applicant contested the validity of the notice on the ground that Caltex did not provide details of its basis for refusal to renew the agreement.

The applicant and the respondent entered into a deed of lease and a supply agreement for petroleum products on 10 September 1982. The terms of the contract were to expire on 31 July 1985 (i.e. duration of three years). However, s17 (5) of the Act stipulated that Caltex was not entitled to refuse or fail to renew the franchise
agreement, unless it had served Anjac Ltd a notice in writing of its decision to refuse to renew the agreement, and that the basis for non-renewal complied with the requirements of s17 (5).

The bases for non-renewal or refusal to renew a franchise agreement are specified in s17 (1) of the Act. However, s17 (2) (a) and (b) stated the conditions under which a franchisor was entitled to sell its interest in the marketing premises other than to the franchisee. Section 17 (2) (a) stipulated that one of those conditions was that, “before entering into the agreement, the franchisor has offered the interest for sale to the franchisee on terms that were no less favourable to the franchisee than the terms of the agreement with that person”. The core message of this sub-section is that the franchisee should be given the first option to buy, if the franchisor chooses to sell its interest in the marketing premises. In this case, Caltex stated that its grounds for refusal to renew the franchise agreement were based on s17 (1) (c) (i). Subsequently, Caltex instructed its agents (L J Hooker Ltd) to sell the premises either to Indopal Pty Ltd for $1.4 million or if this failed to carry out a public auction of the premises.

The crux of the case was for the court to determine whether Caltex’s notice of 31 May 1985 adhered with the terms of s17 (5). However, the meaning of s17 (5) was likely to vary from case to case depending on the grounds of s17 (1) that the notice relied on. In the notice served on Anjac, the ground for Caltex’s decision was identifiable and related to s17 (1) (c) (i). The point of argument in relation to the notice was that

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113 See Section 17 of the Act. One of such grounds is contained in s17 (1) (c) (ii) as follows: “a franchisor shall not fail or refuse to renew the franchise agreement except on one or more of the following grounds:...... the franchisor has, in good faith and in the normal course of business entered into an agreement, or negotiations for an agreement, (other than an agreement containing a provision having the effect of prohibiting the use of the marketing premises for the retail sale of motor fuel) to sell its interest in the marketing premises to a person other than an associate of the franchisor”.
Caltex did not prove beyond reasonable doubt that the proposal to dispose of the interest in the marketing premises was “in good faith and in the normal course of business”.

In court, Caltex lawyers tried to demonstrate that Caltex was acting in good faith and in the normal course of business by showing that the returns from the sale of petroleum products were uneconomic and that the land value had become so high that it was more profitable for Caltex to dispose of the fuel station. Unfortunately, these reasons were not stated in the notice given to Anjac Ltd under s17 (5) in the form that would satisfy the requirements of that provision.

Another reason why Caltex lost the case related to the explicit documentation of the full particulars of the proposal to dispose of the premises. Caltex stated in the notice that the agreement for sale of the premises would be in the standard form of the contract for sale, but the terms of the “standard contract for sale” were not fully disclosed in the notice as well as the summary of the effect of the contract. The exclusion of the full particulars of the contract for sale had meant that Caltex was not sufficiently compliant with s17 (5). The judge concluded that in terms of s17 (7) (a) he was not satisfied that Caltex had served Anjac a notice in accordance with s17 (5). Consequently, Caltex was ordered to renew the franchise agreement and to pay the applicants costs for the legal action.

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114 See Anjac Ltd v Caltex Oil, (1985) 69 ALR 733 at 735.
4.5.8 Summary of Current Legal Principles Based on Court Interpretations of the Franchise Act in Australia

The special nature of solo agreements based on the restraints they impose on the franchisees necessitated the enactment of the Franchise Act in the first place. There are legal principles that emerge from the court treatment of cases relating to franchising arrangements in the fuel retail sector in Australia. Firstly, s16 (2) (a-k) of the Franchise Act prescribed the grounds under which a franchise agreement may be terminated by a franchisor. These grounds imply that security of tenure is not absolute. Section 17 (1) also specified the bases for non-renewal of a franchise agreement.

However, the judgement of the cases of Mobil Oil Australia Ltd v Brian Brindle, Richards v Golden Fleece Petroleum Pty Ltd, and Anjac Pty Ltd v Caltex Oil Australia reveals that the courts held the statutory purpose of the Franchise Act as sacred. This purpose was to confer security of tenure to franchisees and to protect them against price discrimination from their franchisors. Thus, the statute recognised the imbalance in bargaining power between the franchisors and the franchisees. Therefore, most cases brought to the court under the Franchise Act that dealt with termination or non-renewal of agreements was judged on the basis of this true spirit of the Franchise Act. The grounds on which the franchise agreements were terminated were made to pass the ‘just and equitable test’, which included a consideration of all the circumstances and the effect of the termination or non-renewal on the franchisees. This test is not fundamentally different from the ‘test of reasonableness’ which solus agreements must pass through, in the case of licence agreements in the UK.
Secondly, the case of *Chronopoulos v Caltex Oil Australia* shows that the franchisor is entitled to periodic adjustment in rental charges to their franchisees as warranted by commercial conditions. This is consistent with the provisions of s7 of the Franchise Act. However, s17 (1) (6) and (12) empowered the court (if appealed to) to review the rental situation if the increase in rental charges appeared to be unreasonable. This legal principle also emerged from the case of *Esso Petroleum Co Ltd v Addison and Others*, in the UK.

**4.5.9 Assessment of the Effectiveness of the Franchise Act**

Based on the cases detailed so far, it is clear that the judges adhered to the purpose and true spirit of the Franchise Act, which was to ensure greater security of tenure for the franchisees by regulating the duration, renewal and termination of such agreements and assignment of rights and interests under these agreements. To a large extent, the Act was also meant to protect the franchisees from price discrimination from their suppliers.

The major oil suppliers felt disadvantaged by the operations of the Franchise Act and court rulings based on the provisions of the Act. Consequently, they devised means of circumventing what they regard as an unnecessary intervention by the government in the fuel retail market. This was achieved by exploiting the loopholes in the Franchise Act such as, (a) lack of a specific section dealing with whether franchising arrangements should be based on a single-site or multi-site model. (b) The Franchise Act did not limit the oil majors’ ability to increase the number of commission agent sites. (c) The Act did not forbid the oil majors from becoming shareholders with their distributors. (d) The Act entitled them to make reasonable adjustments in rents, leases
and marketing fees as the market situation demanded. This entitlement to adjustments could be open to abuses as some of the oil majors probably used this opportunity to indirectly set retail margins for the franchisees or ‘clawback’ any margin benefit when fuel prices increase.

As a result, there was a marked shift in the nature of the franchising arrangements. Initially, franchise arrangements were negotiated with an individual retailer on a single site basis, but during the 1990s the oil majors started to negotiate franchise agreements covering a number of sites (multi-site franchises) ranging from five to over 30 sites. According to Shell (which had 14 multiple franchise systems operating in Australia), the eventual number of multiple site systems would depend on market conditions and site availability. Shell’s sites participating in these systems were drawn from its primary network of 630 sites and the firm expected to have over 300 sites operating within this format by the end of 1996. Mobil’s intention was not to use multi-site franchise systems to the extent that Shell had. BP in consultation with its dealers launched initially a trial small-scale, multi-site franchise operations in 1994 which it expanded afterwards. Conversely, Ampol /Caltex were precluded from multi-site franchising because of the ‘undertakings’ they signed with the government during the merger process.

The adoption of multi-franchising systems has caused serious concerns amongst existing franchisees as they see it as a ploy by the oil majors to extend their control over margins and threaten their existence. It could be argued that the capital requirements needed to enter into such agreements were much higher than for a single

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117 See id., 38.
118 For more details on the Undertakings, see id., 26-27.
site franchise thereby raising the barriers to entry and making transfer from one supplier to another unlikely for most small-scale operators unless capital assistance is available from the franchisor. Owing to the fact that participants in the multi-site franchise arrangements were chosen on the basis of application, unsuccessful applicants claimed that the system undermined their long-term viability. Although price effects were not been observed from the presence of multi-site franchises, most franchisees feared that this arrangement may in the future enhance the oil majors’ total control over retail prices and allow more location-specific retail price discounting, particularly targeting independent operators.\footnote{See id., 39.} Based on the foregoing, one might argue that the objectives of the Franchise Act were circumvented by the major oil suppliers over a period of time by reclaiming their control over the fuel retail trade through means that could not reasonably be covered by the Act.

However, the ACCC acknowledged that such arrangements represented a means for reducing costs by spreading overheads. The Commission contended that any firm risking its capital had a legitimate right to determine how and with whom it wished to share the risks and therefore could judge the relative merits of franchise applications. It also noted that franchise agreements may not be renewed in some cases and that a franchisee exiting in such a declining market (and with its supplier as its only likely buyer) would likely have little bargaining power. While acknowledging the inevitability of structural adjustments and novel approaches (e.g., multi-franchising) that tend to minimise costs within the fuel retail sector, the ACCC was not in favour
of regulatory rigidities that discouraged the oil majors from making necessary new investments in the sector.\textsuperscript{120}

The evidence regarding the effectiveness of the Act pointed to the speedy pace of rationalisation\textsuperscript{121} and the attendant high rate of exit of franchisees usually before the completion of the guaranteed nine-year term. Such franchisees were paid off for the remainder of the term and most of the franchisees raised issues regarding the adequacy of this payment.\textsuperscript{122} Moreover, the inherent tendency of the industry to seek increased efficiency through improvements in economies of scale and scope has often hampered the viability of franchisees that are unable to restructure or improve their sites. Conversely, it might be argued that given the frequent innovations that occur in the industry, a shorter tenure could have increased the associated risks for franchisees and perhaps reduced whatever pay-off they received from their franchisors.

Some franchisees pointed to unexpected variability in fuel pricing; and rents on site and capital equipment as factors that have reduced margins below expected levels.\textsuperscript{123} The rents and marketing fees charged by the franchisors often included a risk premium based on the added value derived by the franchisees from the greater security of tenure. The reason is that the Franchise Act increases the franchisor’s cost since a longer tenure for the franchisees increased their investment risk.\textsuperscript{124} Regarding the issue of variable rents, it could be argued that rents should reflect the opportunity

\begin{itemize}
\item \textsuperscript{120} See id., 39.
\item \textsuperscript{121} See id., 16. There were about 20,000 fuel retail sites in Australia in 1970. Subsequent rationalisation has reduced the number of retail sites to 9,000 as at 1995. The ACCC has projected that this number is likely to reduce to around 5,000 – 6,000 by 2010.
\item \textsuperscript{122} See id., 40.
\item \textsuperscript{123} See id., 40.
\item \textsuperscript{124} See IC Report on Petroleum Products; supra note 15, at 162.
\end{itemize}
cost of a site, but in the fuel retail business the conversion of sites to other uses could be quite costly thereby reducing its value for alternative uses.

The IC pointed out that the Franchise Act had undermined economic efficiency and the pace of restructuring in the fuel retail sector, by allowing some unviable sites to remain in business longer than necessary. The Commission posited that a more flexible term (between 3-5 years) which was normal in other industries could have facilitated efficient industry restructuring. The IC also noted that although both the Trade Practices Act (TPA) and the Franchise Act prohibited price discrimination, but they differ in interpretation. Price discrimination is a breach of the TPA if only it leads to a substantial lessening of competition. However, based on the Franchise Act a franchisor was not allowed to charge different prices to their franchisees regardless of whether it had significant effect on competition or not. It could be argued that price discrimination in this strict sense may be unfair to a fuel wholesaler considering the peculiarities of the trade. The exclusivity of the franchise supply arrangements and differentials in buying power creates an opportunity for a franchisor to charge different prices to different franchisees.

The Hilmer report indicated the benefits of generic legislation as opposed to the costs of industry-specific legislation such as the Franchise Act. The report argued that industry-specific regulatory efforts tend to result in a unique business environment that could be protected from full competitive forces to the detriment of consumers and the general public. Consequently, the report argued in favour of national policies that progressed reforms on a broader front and that led to the reduction in the costs of

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126 See id., 164.
developing and implementing a number of industry-specific regulatory arrangements.\textsuperscript{127}

\textbf{4.5.10 Emergence of the Oilcode and the Repeal of the Sites & Franchise Acts}

The Australian Government’s review of the industry in 1994, 1996, and 2001 revealed that the cost structures were changing and that the Sites and Franchise Acts were no longer working as designed, and decided to repeal the 1980 Acts and replacing them with a mandatory Oilcode\textsuperscript{128}, under s. 51AD of the Trade Practices Act 1974.\textsuperscript{129} However, the Franchise Act was hailed as a reasonable piece of legislation and the government also decided that a modified form of the Act will constitute the foundation of the Oilcode. The government thought that the Sites and Franchise Acts had not halted the rationalisation of fuel sites from 1980 to 2006. It became clear that the structure of the downstream petroleum market had changed so much that discriminatory legislation like the Franchise Act should undergo reforms.\textsuperscript{130} The Oilcode is intended to revise tenure provisions and applies to a range of agreements, including commission agencies which were not covered by the Franchise Act.\textsuperscript{131}

\textsuperscript{127} Hilmer, F. G., \textit{National Competition Policy} (Report by the Independent Committee of Inquiry into National Competition Policy) 13-14, (1993).
\textsuperscript{131} The prescribed mandatory industry code of conduct (the Oilcode) came into effect on 1 March 2007. Available online at http://www.accc.gov.au/content/index.phtml?itemId/783104, last visited on 29 September 2009.
The Oilcode utilizes the provisions taken from the Franchise Act as its building blocks and aims to provide a fair and reasonable conduct between oil majors, distributors and retailers; a national approach to terminal gate pricing; and the resolution of disputes between the parties.\textsuperscript{132}

The objectives of the Oilcode are threefold: to assist industry participants to make informed decisions when entering, renewing or transferring a fuel reselling agreement through the disclosure of specific information; to improve transparency in wholesale fuel pricing and provide better access to declared petroleum products at a terminal gate price (TGP); and to improve the operating environment for all industry participants by providing access to a cost-effective and timely dispute resolution scheme as an alternative to litigation. The provisions under these objectives are briefly outlined below.

Under the Oilcode, a fuel reselling agreement between suppliers and retailers contains the following provisions: (a) the supplier grants the retailer the right to conduct a fuel reselling business and is able to exert substantial control over the business.

(b) The retailer is required to pay, or agree to pay, a fee before commencing business.

(c) The reselling business will be associated with a trademark, commercial symbol or advertising that is owned, used, licensed or specified by the supplier.

(d) The amount of fuel that will be sold under the agreement is expected to be at least 30,000 litres per month.

\textsuperscript{132} ACCC Report (2006), Submission to the \textit{Senate Economics Legislative Inquiry into the Price of Petrol in Australia}. Available online at http://www.accc.gov.au/content/index.phtml/itemId/764980/fromItemId/653960, last visited on 25 September 2009.
(e) The agreement will have a minimum duration of five years except in certain cases, for example where the upfront initial investment is less than $20,000.

(f) The supplier will provide a disclosure document to a prospective retailer at least 14 days before the agreement is entered into. This will include the provision of leasing documentation to the retailer, and the disclosure of materially relevant facts such as the finalisation of certain court proceedings and bankruptcy matters as the supplier becomes aware of them.

(g) A supplier will not prevent a retailer from associating with other retailers for lawful purposes.

(h) The supplier will make allowances for a cooling-off period of at least seven days after entering into the agreement before the retailers could pay any money under the agreement.

(i) The supplier will follow certain procedures before the expiry of the agreement or if the parties agree to terminate the agreement early; or where a variation, renegotiation or transfer of the fuel reselling agreement is sought; or in situations where it becomes necessary to terminate the agreement because of a breach by the retailer.

The Oilcode also provides for a nationally consistent approach to terminal gate pricing arrangements between wholesale fuel suppliers and their retailers. The definition of TGP as used in both Western Australia and Victoria (where the practice was introduced in 2001) is a fuel price based on import parity, plus cost to terminal gantry, plus excise and the Goods & Services Tax (GST).

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\text{TGP} = \text{Import parity-based price} + \text{Cost to terminal} + \text{Excise duty} + \text{GST}.
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133 For clarification purposes, a wholesale supplier under the Oilcode is somebody who sells declared petroleum products such as petrol and diesel from a wholesale facility such as an oil refinery, a shipping facility, or a facility connected by a pipeline to a shipping facility. A customer is somebody engaged in the business of buying declared petroleum products from a wholesale supplier.

134 See id., 6. GST is the equivalent of VAT in the UK.
Another issue addressed by the Oilcode regards a more preventive approach to dispute resolution. The dispute resolution scheme includes the appointment of a Dispute Resolution Adviser (DRA), and covers disputes arising where a wholesale supplier fails to supply a declared petroleum product to a customer; or disputes arising between parties to a fuel reselling agreement; or from any provision of the Oilcode regarding TGP or fuel reselling agreements. However, the Oilcode provides separate procedures for dealing with special cases, such as disputes arising from supply of products at a TGP and those connected with failure to supply. The reason is that the Oilcode takes into consideration the potential for commercial damage that may result as a consequence of failure to supply declared petroleum products. Such disputes are addressed directly by the DRA. The discussions on further development of the Oilcode is on-going and the parties have worked on the development of four new supplementary Codes covering prior disclosure and the expiry/voluntary surrender of agreements for retailers and distributors.

4.6 Findings on licence/franchise regulations
Firstly, there is a common ground in both jurisdictions that solus agreements (UK) or solo agreements (Australia) are classified as contracts in restraint of trade. The common difficulties arising from agreements between the major oil suppliers and their licensees or franchisees are the issues of exclusive selling and price discrimination. All the legal cases covered in this chapter relate to one or the other.

In its simplest form, an agreement between a fuel wholesaler and a retailer cover issues relating to the solus tie, the term, the purchase price, payment arrangements, the minimum notice required to deliver products, transfer of ownership, failure to
supply (including force majeure), and termination. Some of the agreements provide for the offer of sale of the wholesaler’s lubricants, product advertisements, and the use of wholesaler’s brand name. The agreement may also include arrangements for some forms of financial support, e.g. loans granted to the dealer for site development, etc. In some cases, the contractual arrangements are separated into two or more: the solus agreement, fuel supply agreement, loan or mortgage agreement, shop agreement, etc.

Considering a wide range of consumer goods, it could be said that the principle of setting up retail distribution outlets each dedicated wholly or mainly to selling one brand of a commodity is not only wasteful but operates against the public interest. The general expectation in a market system is that the motorist should have a wide range of brands and grades to choose from in any particular fuel station. However, the retailing of fuels presents special challenges and problems because each grade of each brand must be stored in a separate tank and dispensed through its own separate pump on a forecourt that gives access to vehicles. Therefore, it is unusual for any given fuel retail site to stock all brands and grades belonging to all suppliers as it would probably require as many as 28 pumps and tanks for adequate coverage of brands. It could be argued that if the oil suppliers had chosen a mixed site system as opposed to the exclusive system, the outlets offering a wide range of choice would be too few.\textsuperscript{135}

The counter-argument that flows from this is that the exclusive system could lead to over-proliferation of fuel retail outlets on the theoretical basis that the supplying companies would tend to follow one another in creating exclusive stations on specific roads or within small districts where demand was only sufficient for fewer outlets.

\textsuperscript{135} See MMC Report (1965); \textit{supra} note 1 at 137.
However, it is unlikely that fuel suppliers would willingly create conditions whereby the equipment, personnel and the premises they have invested in would be under-utilised. This has not been the case because of the high rate of site rationalisation in the two jurisdictions.

Discriminatory discounts usually have the effect of excluding from the trade those dealers who are not in receipt of them, thereby making it impossible for the excluded dealers to secure products at competitive prices. Suppliers contend that excellent distributors or bulk buyers would likely not be able to maintain certain standards of service if they were not offered incentives. Thus, such distributors or buyers may be forced under the pressures of unrestricted competition to reduce standards of service and performance which would not serve the public interest. Where this protection takes the nature of an agreed discount or margin, the suppliers regard such preferential treatment as a just reward for the services rendered by the dealer or large volume buyer.  

Theoretically, the most crucial requirement for effective price discrimination to occur is that resale between consumers would be minimal. As this is the case with retailing in general, price discrimination is always likely to occur. The most significant negative effect of price discrimination is that it may be used to stifle or even foreclose weaker market segments. Many independent fuel retailers complain that price discrimination, either in the form of preferential discounting or differential rebates put

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136 See id., 140-141.  
138 See id., 27.
them at a disadvantage relative to supermarkets and other larger retailers. Moreover, they argue that to ensure fairness, differences in prices should reflect differences in cost. However, by receiving extra discounts and other benefits from its suppliers a large retailer could offset the resource cost of his inefficiencies and still survive the competition for market shares. Such large retailers may be considered to have extracted a hidden subsidy for his inefficient operations and depending on the size of this subsidy may drive away from the market more efficient operators who probably were not large buyers.\footnote{Competition Commission Report, \textit{Discount to Retailers} 66-67 (1981). Available online at \url{http://www.competition-commission.org.uk/rep_pub/reports/1981/135discountsRetailers.htm}, last visited on 16 August 2009.} However, the evidence shows that the strong competition between retailers ensures that the benefits of such preferential discounts (as reflected in lower buying prices) are being significantly passed on to the consumers. Thus, retail prices tend to be lower through the buying power of the large retailers and supermarkets than in the absence of price discrimination.\footnote{See \textit{id.}, 68.} Conversely, price discrimination could lead to higher total sales as a result of more customers being served than would be likely under uniform pricing.\footnote{Office of Fair Trading (OFT), Research Paper 13: \textit{Competition in Retailing} 96-99 (1997). Available online at \url{http://www.oft.gov.uk/shared_oft/reports/comp_policy/of195.pdf}, last visited on 29 August 2009.}

However, the use of Selective Price Support (SPS) in the fuel retail trade presents peculiar difficulties. The varying level of wholesale price support applied by the oil majors to selected fuel resellers could affect the retail pricing regime. In both jurisdictions, the oil majors provide SPS to their licensees/franchisees to help them maintain their market share in response to price discounting by other retailers in certain localities. By providing SPS, franchisees are guaranteed a margin on fuel sold. However, it also enables the oil majors to exercise control over which retail sites
would meet lower prices offered by its competitors. Other retail players (independents, branded or unbranded) who are not in receipt of this support or who obtain their supplies from non-refiner sources become exposed to extreme pressures at such times. It could be argued that through SPS mechanisms and the use of commission agents, the oil majors are able to lead price cycles which benefit the motorists by way of lower prices. The SPS policy could have a significant impact on city-country (or urban-rural) price variations. SPS has limited application in rural areas because of the presence of low volume sites, higher cost of supply, and lesser competition relative to urban locations. Wholesale price support is only considered in cases where the country or rural dealers are either willing or forced to lower retail margins. Therefore, sustained use of SPS could lead to high fuel price differentials between rural and urban locations.

Secondly, the regulations of the licence/franchise arrangements in both jurisdictions (UK in 1966, and Australia in 1975) are similar on the basis of the objectives for the regulation. The objectives for the regulations were to redress the imbalance of power in contractual relationships between the franchisor (usually the oil majors) and the franchisees (the dealers and independent retailers); and to increase the security of tenure for the licensees / franchisees. The governance of the regulations in this case involved two levels: the markets and contracts. However, the market and contract levels of governance are characterised by imbalance of power and uncertainty for the licensees / franchisee, particularly in the fuel retail sector. Evidence from this investigation suggests that private, self-regulation through the workings of markets and contracts results in a relationship whereby there is an imbalance of power in favour of the licensor / franchisor and uncertainty for the licensee / franchisee. The
reason is that the market interaction between the licensor / franchisor and the licensee / franchisee establishes these conditions, which are reinforced by the contract through the interaction of the standard format of the agreements (generated by the licensor / franchisor) and the weaker bargaining power of the licensees / franchisees. This situation has been responsible for the numerous litigation cases associated with the fuel retail trade. This condition establishes a case for legislative intervention when necessary. However, the Australian experience with the Franchise Act exposes the difficulties involved in regulating a trade where the producer of the goods is also the wholesaler, and participates in the retail business as well.

There are differences in the regulation of agreements between the oil majors and the resellers in the two jurisdictions. Firstly, the UK regulatory approach tends to be more holistic when compared to the Australian initial approach in 1975. The UK licence regulation covered provisions such as the length of the term of agreements, supply of fuel equipment to retailers by the oil majors, restrictions in relation to the retailers’ sale of his premises, and the degree of control exercised by the fuel suppliers over the retailers non-core businesses, e.g. lubricants, tyres, batteries, etc. On the other hand, the Australian franchise regulation in 1975 provided for the removal of ties placed on dealer-owned sites for fuels, lubricants and other non-petroleum goods. It also contained other provisions regarding adequacy of supply of products to retailers, and reasonable access to fuel equipment from their suppliers.

However, the major differences between the regulations in both jurisdictions relates to the legislative enactment of the Franchise Act by the Australian Government in 1980, and how that affected the treatment of related court cases. The result was that the
Franchise Act introduced a third level of governance, i.e. markets, contracts, and statute. The latter brought about rigidities both in the workings of the markets and the contracts. For instance, prior to the 1966 regulation of solus agreements in the UK and the enactment of the Franchise Act 1980 in Australia the courts relied primarily on general principles and doctrines of law, i.e. law of contracts, property law, etc. Afterwards, the courts in the UK continued to rely on these general principles of law, but guided by the provisions of the 1966 fuel retail regulatory framework. In the case of Australia, most of the trial judges maintained that the Franchise Act disallows attempts at contracting out of the statute. In making their decisions, the judges relied mainly on the true spirit and purpose of the Act, which was to protect franchisees from price discrimination and to provide security of tenure. Therefore, doctrines flowing from the law of contract and property law were not to be readily carried over into a consideration of the operation of the franchise statute.

However, direct government intervention through the auspices of the Oilcode (which replaced the Franchise Act) depends primarily on self-regulatory tools, such as prior disclosure which tend to be ineffective in addressing the objectives of a franchise regulation. For instance, the use of disclosure as a regulatory tool is inadequate because it is self-regulatory in nature.\textsuperscript{142} The use of self-regulatory measures assumes that the contracting parties could willingly support each others role in the regulatory process. However, a franchisee is not a full participant at any stage in the governance of the franchise relationship and therefore not suitably equipped to perform its role in the regulation of the contractual relationship.

\textsuperscript{142} Spencer, E. C; Balance of Power, Certainty and Discretion in the Franchise Relationship: An Analysis of Contractual Terms, a Paper Presented at the 22\textsuperscript{nd} Annual International Society of Franchising Conference (ISoF), Saint-Malo, Brittany, France, 2008.
Regarding the Australian fuel franchise regulations, neither self-regulatory mechanisms nor legislative intervention are able to achieve the stated goals of redressing the imbalance of power in the contractual relationship between the franchisor and the franchisee or reducing uncertainty in franchise relationships. This analysis lends credence to the argument that the fuel retail sector should be free from legislative intervention (i.e. deregulated), except in cases where markets are failing as might be expected in some rural and remote areas. In the latter case, government intervention could be in the form of fuel price reduction for rural motorists or cost-cutting measures for rural fuel retailers. Alternatively, the regulation of franchise agreements is more likely to be effective if all contracting parties are equipped to fulfil their roles at all stages of the governance of the relationship. The above arguments probably necessitated the move by the Australian Government to repeal the Franchise Act and to deregulate the fuel retail sector under the guidance of the mandatory Oilcode.

4.7 Conclusion
The investigation about how the sites and licence / franchise regulations could resolve the fuel pricing problems in rural / remote locations, and thus contribute to rural development by encouraging the growth of rural independent fuel retailers revealed that these regulatory support mechanisms have limited effectiveness.

The ‘undertakings’ obtained from the oil majors in 1966 (and subsequent amendments in 1968 & 1976) reflects a genuine effort by the UK Government and regulatory authorities to correct some aspects of the contractual imbalances (between the oil suppliers and their retailers) and some aspects of the solus trading system that could
operate against the public interest. Although, the ‘undertakings’ were meant to strengthen the solus system, but the 1976 (amended) version which has remained in force (till date) is yet to undergo further amendments to reflect the changing fuel retail market structure. The sites regulation was in place for two years and encouraged new entrants. However, it did not stem the decline in the number of independent fuel retailers, but rather encouraged the expansion of supermarket fuel retail outlets. Supermarkets, like the oil majors thrive on economies of scale and consider most rural locations as uneconomic places to invest. Consequently, the expansion of supermarkets outlets led to lower pump prices in urban locations. Motorists in rural areas closest to the cities have been known to travel long distances to patronise the supermarket fuel outlets, with consequences for the few retail outlets in their local areas.

The UK fuel retail licence regulations are useful in terms of ensuring a smoother fuel supply and distribution system, by improving the contractual relationship between the fuel suppliers and the retailers across the entire sector. The legal cases examined also reinforced the provisions of the licence regulations, by making sure that all solus agreements met the test of reasonableness as should be required for contracts that are deemed to be in restraint of trade.

Conversely, the Australian Government considered the ‘undertakings’ from the oil majors in 1975 to be inadequate to check the industry concentration arising from vertical integration of the major oil companies’ operations. Consequently, the Sites & Franchise Acts were enacted to restrict the ability of the oil majors to own and operate a high number of outlets, to determine franchise terms and fuel prices unilaterally, as
well as facilitate the development and entrenchment of the independent fuel retail sector. In the short term, these Acts encouraged new entrants, particularly the independent retailers and supermarkets who were not affected by the Sites Act. However, in the long run these Acts were unable to prevent further decline of the smaller independent retailers who usually operate in the rural/remote locations. On the other hand, the supermarkets have grown their market share significantly by discounting fuels to promote their grocery business as is the case in the two jurisdictions. Therefore, the Australian experience of fuel retail site regulation indicates that it is ineffective in the long run to impose site restrictions on the major fuel suppliers. However, for specific purposes such impositions may occur for a short period of time. In this case, the purpose was to give independent wholesalers and retailers an opportunity to develop with a view to lessening the market concentration and reducing the market power of the oil majors.

Similarly, attempts at correcting contractual imbalances through legislation are usually fraught with difficulties. On a positive note, some aspects of the Franchise Act were useful in terms of regulating the duration, assignment of rights and interests, and termination of solo agreements. The regulation thus ensured more efficient and smoother fuel supplies to both urban and rural locations. However, licence/franchise regulations do not directly translate to lesser fuel prices for rural areas or a reduced rural-urban fuel price differentials. Nevertheless, it might be argued that these pricing problems could be exacerbated in the absence of more economically efficient and smoother fuel supplies.
The court cases examined revealed that the judges made their judgements strictly on the basis of the contents and the purpose of the Franchise Act. However, historical antecedents of the fuel retail sector show that the oil majors developed this sector and have been in the ascendancy from the outset. Therefore, it is difficult to whittle down their bargaining powers significantly through restrictive legislation, such as the Franchise Act. The experience of Australia in this context reveals that the oil majors find ways to circumvent such legislation. For instance, in Australia the majors thwarted such attempts by using vertical arrangements such as multi-site franchising, insistence on 100% ties with their retailers or franchisees, and equity participation in distributorships. Multi-site franchising schemes enabled them to exert considerable control over retail prices, particularly when the need for price discounting arises. Their control over prices plus multi-franchising could mean that they are able to carry out location-specific price discounting when necessary.

The introduction of the Oilcode served some useful purposes, particularly the terminal gate pricing which has furnished more transparency on fuel pricing and the provision of a dispute resolution mechanism. However, the Oilcode relies in some respects on prior disclosure which assumes that all industry operators are likely to work together for the common good. This is often not the case. More worrisome is the fact that the Oilcode does not address the increasing dominance of the supermarket / oil major alliances. This alliance currently accounts for over 50% of the market, and their ability to use their grocery business to cross-subsidize their fuel retail operations is capable of driving many large and small competitors in several locations from the fuel retail sector. Based on the current situation and future forecasts, there is a significant possibility that the structure of the fuel retail sector will mimic that of the retail
grocery market (i.e. a duopoly). Duopoly, in the absence of any countervailing forces, may likely translate to lesser price competition and ultimately higher retail prices for fuels for urban locations, and even higher prices for rural areas.
Chapter 5
FUEL PRICE AND TAX REGULATIONS

5.1 Introduction
This chapter investigates how fuel wholesale and retail price regulations could resolve the research problems and thus contribute to a rural development policy. However, preliminary investigation reveals that fuel tax and VAT (or Goods and Services Tax, GST, in the case of Australia) constitute together more than 50% of fuel retail prices, and so are important components of pump prices that could be regulated in the two jurisdictions. This chapter also examines in detail the interface between fuel price regulations and fuel tax objectives, including environmental considerations. Holistically, this chapter looks at the intersection between fuel price regulation, fuel tax policy, transport policy and environmental policy, in the context of a rural development policy.

More specifically, this chapter investigates the purpose of fuel tax and how it drives transport policies in both jurisdictions, as well as the distributional effects of relatively higher fuel taxes (or higher pump prices) on sub-groups of the population. Public transport has been regarded as the alternative to private transport for rural and remote areas. Hence, this chapter also examines the potential for developing effective public transport solutions and infrastructure in these areas. The role of central government, local councils, parishes, and local investors in developing rural transport solutions are also explored. The role of central governments in developing rural transport solutions, in the two jurisdictions, are discussed in the light of a deregulated transport sector. Other rural transport policy options are discussed, including the potential for fuel duty concessions and remissions.
5.2 United Kingdom

5.2.1 Components of fuel retail price
The components of fuel prices consist of costs of crude oil and its transportation to the refinery, refinery costs, fuel duty plus VAT, and wholesale/retail margins (see Table 5.1).

Table 5.1 UK unleaded petrol pump price composition - January average 2007 (Average major brand price)

<table>
<thead>
<tr>
<th>Component</th>
<th>Price per litre</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pump Price</td>
<td>87.80</td>
<td>100</td>
</tr>
<tr>
<td>Duty &amp; VAT</td>
<td>61.40</td>
<td>70</td>
</tr>
<tr>
<td>Petrol Cost (costs of crude oil, refining costs, and wholesale margin)</td>
<td>18.85</td>
<td>22</td>
</tr>
<tr>
<td>Gross Retail Margin</td>
<td>7.50</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: UK Petrol Industry Association Ltd (UKPia)

5.2.2 Wholesale price regulation
Wholesale petroleum prices in the UK are based on the prevailing international price of the particular fuel and adjusted to account for transport costs. The Rotterdam market represents the bulk trade in petroleum products in North West Europe (UK inclusive), and consequently petroleum product prices are tied to this market. Therefore, movements in the prices of products in Rotterdam influence the wholesale
pricing arrangement in the industry, and the wholesale price is also linked to the retail price of fuels.¹

Crude oil accounts for a small proportion (about 12%) of the pump price of petrol in the UK, although it represents a significant proportion of a refinery’s costs. The fact that crude oil and refined products are internationally traded goods means that it is not feasible to regulate the wholesale price of fuels. However, it is possible to regulate wholesale margins, which are determined by the major oil suppliers (usually the oil majors).² The evidence reveals that the UK has no experience yet of wholesale price regulation because the fuel retail market is deregulated in this respect. The Office of Fair Trading (OFT) maintains that the market is operating competitively and so direct government intervention in fuel pricing is unwarranted.³ However, the OFT continues to monitor and supervise the fuel retail trade and fuel prices to detect early warning signs of anti-competitive pricing, if any.

5.2.3 Retail price regulation
Fuel duty and VAT account for a significant proportion of the retail price of fuels (see Table 5.2). The level of fuel taxes has obvious implications for the cost of living both for fuel consumers and non-fuel consumers, and more so in rural and remote locations. Thus, we should examine the UK Government’s policy with regard to the regulation of fuel taxes.

² The Australian experience shows that it is problematic to regulate wholesale prices, wholesale and retail margins. For more details, see pp. 50-3 of this chapter.
³ See OFT 230; supra note 1, at pp. 3-4.
Table 5.2 Average UK fuel prices and taxes for unleaded petrol, diesel, and LPG, 2000-08

<table>
<thead>
<tr>
<th>Year</th>
<th>Petrol (Average)</th>
<th>Petrol (pence)</th>
<th>Petrol (duty)</th>
<th>Petrol (tax as % of price)</th>
<th>Diesel (Average)</th>
<th>Diesel (pence)</th>
<th>Diesel (duty)</th>
<th>Diesel (tax as % of price)</th>
<th>LPG (Average)</th>
<th>LPG (pence)</th>
<th>LPG (duty)</th>
<th>LPG (tax as % of price)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>80.72</td>
<td>48.55</td>
<td>75.09</td>
<td>82.24</td>
<td>51.55</td>
<td>77.61</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>40.93</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>75.12</td>
<td>47.15</td>
<td>77.77</td>
<td>77.74</td>
<td>54.20</td>
<td>84.08</td>
<td>38.18</td>
<td>10.00</td>
<td>40.93</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>73.68</td>
<td>46.07</td>
<td>77.47</td>
<td>75.57</td>
<td>48.04</td>
<td>79.44</td>
<td>37.47</td>
<td>4.50</td>
<td>40.93</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>76.28</td>
<td>46.14</td>
<td>75.40</td>
<td>78.04</td>
<td>46.14</td>
<td>74.04</td>
<td>38.76</td>
<td>4.50</td>
<td>40.93</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>80.81</td>
<td>50.19</td>
<td>77.07</td>
<td>82.51</td>
<td>47.10</td>
<td>72.07</td>
<td>38.53</td>
<td>4.50</td>
<td>40.93</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>87.55</td>
<td>47.10</td>
<td>68.82</td>
<td>91.39</td>
<td>47.10</td>
<td>66.53</td>
<td>40.05</td>
<td>4.50</td>
<td>26.14</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>91.64</td>
<td>47.10</td>
<td>66.39</td>
<td>95.35</td>
<td>47.10</td>
<td>64.33</td>
<td>45.03</td>
<td>4.50</td>
<td>24.85</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>95.40</td>
<td>48.85</td>
<td>66.21</td>
<td>97.88</td>
<td>48.85</td>
<td>64.90</td>
<td>47.23</td>
<td>6.47</td>
<td>28.89</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>107.46</td>
<td>50.52</td>
<td>62.08</td>
<td>118.22</td>
<td>50.52</td>
<td>57.74</td>
<td>56.17</td>
<td>8.43</td>
<td>29.81</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Duty and VAT (17.5%) included in the price.

5.2.4 The purpose of fuel tax in the UK

There are two reasons for fuel tax in the UK: to generate revenue and to reduce the rate of car usage for environmental reasons. Fuel taxation is an important part of the UK Government’s revenue. The estimate of the contribution of fuel duties to total revenue for 2004-05 was £23.5 billion, or 5.2% of the total revenue. The bigger contributors relative to fuel duties are income tax, national insurance, VAT and corporation tax. According to the Treasury Department estimates, an increase in duty on petrol and diesel by around 7.3 pence per litre will generate about the same revenue (i.e. £3 billion) as a one penny increase in the basic rate of income tax.

6 See Leicester; supra note 4, at pp. 8-9.
estimate underlines the huge potential of fuel duties as a source of government revenue.

The second reason for fuel taxation relates to the effects of road transport on the environment. Individual decisions about car ownership and usage involve private and social costs. Some of the private costs include the vehicle purchase price, road tax, vehicle maintenance (MOT), insurance and fuel expenses. The use of road transport by each individual also imposes social costs (externalities) such as noise and air pollution, congestion, road infrastructure damage, accident risk imposed on other road users. Road fuel combustion leads to the emission of a variety of air pollutants. Some of these gases contribute to global environmental problems. For example carbon dioxide and other gases contribute to global warming, and sulphur dioxide and nitrogen oxides can cause acid rain. Generally, these emissions can create localised poor air quality. For example, emissions of black smoke and particulates can contribute significantly to respiratory disorders. Nitrogen oxides and volatile organic compounds can react to create photochemical smog. The social costs of many pollutants depend on when and where they are emitted, because their effects can be influenced by the population density of an area and traffic levels.

These social costs are often not accounted for in the pricing of fuels. The role of government policy in this regard is to ensure that these negative externalities are internalised in the price of fuels. Fitting vehicles with ‘clean’ technology can help to

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reduce these emissions. Different types of fuels emit different levels and kinds of emissions (see Table 5.3). For example, diesel is associated with higher emissions of nitrogen oxides and particulates than petrol. The emissions of carbon dioxide, nitrogen oxides, and volatile organic substances can be reduced by fitting a three-way catalytic converter.\(^9\)

**Table 5.3 Environmental Performance Comparison of LPG Relative to Petrol and Diesel**

<table>
<thead>
<tr>
<th>Pollutant/Emission Type</th>
<th>Harmful Effects</th>
<th>Environmental Effects</th>
<th>Emissions from LPG compared to petrol engines</th>
<th>Emissions from LPG compared to diesel engines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nitrogen Oxides</td>
<td>Irritation of the respiratory organs (poisonous)</td>
<td>Acid rain</td>
<td>30% less</td>
<td>60-90% less</td>
</tr>
<tr>
<td>Hydrocarbons</td>
<td>Some of these are carcinogenic</td>
<td>Greenhouse effect/summer smog</td>
<td>30% less</td>
<td>95% less</td>
</tr>
<tr>
<td>Carbon Monoxide</td>
<td>Extremely poisonous</td>
<td>Some greenhouse effect</td>
<td>30% less</td>
<td>95% less</td>
</tr>
<tr>
<td>Carbon dioxide</td>
<td>Non-toxic</td>
<td>Significant greenhouse effect</td>
<td>12% less</td>
<td>n/a</td>
</tr>
<tr>
<td>Particulates</td>
<td>Potentially carcinogenic</td>
<td>Winter smog</td>
<td>n/a</td>
<td>100% less</td>
</tr>
</tbody>
</table>

**Source:** Combined Gas Systems (UK)

However, the assessment and measurement of the total external costs associated with road transport can be problematic because this involves difficult estimates of the potential effects of greenhouse gases, the annoyance cost of noise, the value of life saved, etc. Nevertheless, it can also be a useful exercise to attempt to quantify these social costs, no matter how difficult.\textsuperscript{10} For instance, in 1993 Pearce et al. estimated that the annual aggregate external costs of road transport in 1991 was between £22.9 billion and £25.7 billion, depending on the valuation of a saved life. They broke the numbers down as follows: £13.5 billion (congestion costs), £1.3 billion (road damage), £2.8 billion (pollution costs, excluding noise pollution), £0.6 billion (noise pollution), and between £4.7 billion and £7.5 billion (accident costs).\textsuperscript{11} Newbery carried out a similar empirical evaluation by drawing in part from Pearce et al., and employing the techniques suggested by the Royal Commission on Environmental Pollution (18\textsuperscript{th} report). He estimates external costs of road transport for 1993 to be between £29.3 billion and £36.9 billion per annum, depending on the valuation of a life and the assumed effects of particulates on mortality and morbidity.\textsuperscript{12}

Theoretically, there are a number of methods for dealing with socially detrimental activities. This can be achieved through a regulatory framework (i.e. by setting allowable traffic volumes or emission levels); or through market mechanisms such as taxes and charges; or by specifying fuels production technology (e.g. pollution abatement equipment, etc).\textsuperscript{13} However, economists prefer the market mechanism (i.e. use of price instruments) as the ideal policy tool for addressing externalities. The

\textsuperscript{10} For details on techniques for putting money value on environmental damage, see the Royal Commission on Environmental Pollution (18\textsuperscript{th} Report); supra note 8, at APPENDIX C (Box C).
\textsuperscript{11} Pearce et al., Blueprint 3: Measuring Sustainable Development (1993)
\textsuperscript{13} See Blow & Crawford; supra note 9, at p. 17.
desirable methods are usually those that aim to correct the externalities as directly as possible because such methods produce faster results. Thus, a tax or a quantity control on emissions is likely to be superior to alternatives such as limiting traffic levels or specifying technology. The reason is that limiting traffic does not encourage the use of less polluting technology, and it is unlikely to achieve a significant reduction in pollution. Similarly, specifying the use of certain equipment has the same abatement effect, and the same equipment cost will apply to all motorists regardless of the mileage they cover. For motorists who do relatively smaller mileage, the reduction in pollution may not be significant enough to justify the cost of fitting the equipment.

Although tax is ideally the best policy choice for regulating externalities, there is a pitfall to its usage. To charge taxes and enforce quantity controls requires the measurement of the emission levels of each motorist, which is problematic. Thus, the downside to the imposition of environmental taxes is that the level of pollution reduction is difficult to measure. The extent of this pitfall will depend on the costs of mistakes made in setting the level of pollution abatement. In certain situations, quantity controls (i.e. setting an emission level) may be preferable to charging a tax. For example, if the costs of pollution are very high it may be necessary to reduce emission levels below a certain fatal threshold.

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However, taxes can have superior benefits over regulation because each unit of pollution is charged for. This can result in a sustained incentive for motorists to reduce levels rather than simply complying with the minimum standard set by regulation. With the latter, there is no incentive to exceed the minimum standard but taxes provide the motorist with additional incentive because each unit reduction in pollution produces a tax saving. Determining the appropriate tax levels is also difficult, because the optimal level of pollution reduction depends on costs and benefits which are uncertain themselves.

Determining appropriate tax levels is made more complex by the existence of other externalities and other pre-existing taxes used by government to generate revenues. Taxes directed at one externality may interact with other tax provisions.\textsuperscript{16} For example, fuel tax could be used to reduce fuel consumption. This could lead to the production of more fuel-efficient cars, which will produce a different effect on mileage, and encourage more road usage as a consequence. This could in turn lead to more road congestion than otherwise would have been. Environmental taxes can also interact with taxes aimed at raising revenues. This interaction can erode the tax base of such revenue-raising taxes by causing a reduction in the consumption of the good or the level of activity on which they are set. Nevertheless, these same considerations equally apply to alternative policies such as quantity controls. Consequently, it has been argued that for environmental taxes to achieve their objectives, the environmental benefits and the revenues generated as a result of a fuel duty increase must outweigh the costs to consumers or producers of the fuels.

\textsuperscript{16} See id., pp. 18-20.
Direct measurement of emissions may not be possible in practice. Where this is possible, it would require substantial administrative costs or expensive metering technology.\textsuperscript{17} Therefore, theoretical analysis of different policy options to abate pollution tend to ignore administrative and measurement costs which are relevant in practice. For example, it is not feasible to measure each motorist’s car exhaust emissions by time and place, but it is possible to tax fuels because they are related to the externality. This rule is applicable to carbon dioxide emissions from vehicles, because there is a linear relationship between this emission and fuel consumption. There is also a positive correlation between the global warming effects of carbon dioxide emissions. Therefore, a fuel tax would approximate a direct charge on this externality.

However, it is not always possible to find a practical tax base that is generally applicable to all emissions because the cost of other exhausts emissions (e.g. black smoke, particulates, etc) can vary by location and weather conditions.\textsuperscript{18} Consequently, fuel taxes are not a particularly accurate way to charge for these environmental costs. Thus, it may be useful to apply a range of taxes and subsidies to approximate the direct charge on the externality, but the correct combination is also not always obvious.\textsuperscript{19}

In some cases, taxes may be effective in achieving emissions reduction. For example, the introduction of a tax differential in favour of unleaded over leaded petrol resulted in a substantial increase in the share of unleaded petrol in total petrol sales. Other

\textsuperscript{17} See Smith; \textit{supra} note 7, at p. 4.
\textsuperscript{18} See Blow & Crawford; \textit{supra} note 9, at pp. 20-22.
factors, such as the introduction of catalytic converters, which can only work with unleaded petrol and the fact that both types of fuel are close substitutes may have contributed to its increased share. In other cases, regulation may be necessary where it is difficult to find a tax base that is well linked to the externality. For example, in regulating emission standards, new cars can be fitted with catalytic converters, which may result in the decline of emissions of nitrogen oxides, carbon monoxide and volatile organic substances.

Nevertheless, the UK Government believes that one way of reducing the amount of damage caused by road transport is to discourage excessive car usage. The government achieves this by levying tax, in excess of VAT, on road fuels, to ensure that the price that consumers pay reflects these social costs. However, the evidence reveals that the purpose of fuel tax as an instrument for altering consumer behaviour is not always successful because the demand for fuels is price-inelastic (at least in the short term).

Empirical evidence suggests that a 1% increase in the real cost per mile of driving will reduce miles travelled by less than 0.5% (in the short term).\(^{20}\) This suggests that the consumers’ response to an increase in fuel cost per mile is not proportionate. It is this lack of a proportionate response by motorists to fuel price increases that makes a fuel tax an attractive source of government revenue. The Institute for Fiscal Studies argued in their analysis of the 1999 ‘green’ budget that there seems to be a contradiction in government policy on fuel duties. They contended that, in the long run, this policy cannot be a good source of revenue and at the same time act as a

\(^{20}\) See Smith; supra note 7, at p. 4.
measure for curtailing car usage. Nevertheless, sustained high duty rate does affect the behaviour of motorists in the long run because some have switched to using LPG or buying more fuel efficient cars, which tend to reduce the harmful effects of fuel consumption on the environment.

5.2.5 Excise duty and UK transport policy
The government in its 1998 budget speech laid down the future transport policy for the UK. Until 1993, the use of road fuel taxes as fiscal instruments for dealing with the social costs of road transport have been primarily for revenue generation purposes, and secondarily to address external costs associated with road transport. However, since 1993, road fuel duties have been partly designed to correct environmental problems associated with road transport. In recognition of the need to correct these externalities, the then Chancellor (Norman Lamont) announced in the March 1993 budget a 10% increase in road fuel duties (partly to compensate for the revenue loss from the abolition of car tax in November 1992). He further announced an annual real increase in fuel duties of at least 3% to be applied in subsequent budgets (the fuel duty escalator). Additionally, VAT was imposed on domestic supplies of fuel and power in order to return greenhouse gas emissions in the UK to 1990 levels by the year 2000, in line with the agreement at the UN Convention on Climate Change at Rio.

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23 See Blow & Crawford; supra note 9, at p. 22.
24 For details on the introduction of the road fuel tax escalator, see Bolton et al.; supra note 22, at pp. 19-22.
In the 1994 budget, the duty level on road fuel gas (LPG) was frozen to make it a viable alternative to petrol and diesel. In 1995, the duty on LPG was reduced by 15% to bring the price in line with those of petrol and diesel. In the 1996 budget, the level of duty on LPG was further reduced by 25% to encourage faster switching to the alternative fuel. Moreover, in the 2004 budget, the Chancellor gave a three-year certainty for the duty treatment of alternative fuels. Firstly, the budget provided 20p per litre duty differential in favour of bioethanol and biodiesel. This was guaranteed until at least 2007. Secondly, the budget reduced the duty differential in favour of LPG by the equivalent of 1p per litre for each of the next three years to 2007. Thirdly, the budget froze the duty differential in favour of natural gas at its current level (equivalent to 41p per litre) to 2007.

In the 1994 budget, the then Chancellor (Kenneth Clarke) announced that all fuel duties would be increased by at least 5% in real terms in future budgets. In the 1995 budget, the government increased the relative duty on super-unleaded petrol, due to concerns over the high level of carcinogenic aromatic hydrocarbons in this fuel. The 5% fuel duty target was re-affirmed by the Chancellor in the 1996 budget.

The Chancellor of the in-coming Labour Government (Gordon Brown) announced in his 1997 budget an increase in annual fuel duties of at least 6%. The government stated in its budget that “environmental taxation must meet the general tests of good taxation. It must be well designed to meet objectives without undesirable side-effects;

\[25\] See Blow & Crawford; supra note 9, at p. 23.
it must keep deadweight compliance costs to a minimum; distributional impact must be acceptable; and care must be had to implications for international competitiveness. Where environmental taxes meet these tests, the government will use them”. To this end, the government stated that fuel duties have enabled the UK to meet its Kyoto target on greenhouse gas emissions reduction. The government estimated that increased fuel duties between 1996 and 1999 may result in carbon savings of between 1.0 and 2.5 million tonnes by 2010.

What was not clear was whether the government’s claims were based on valid means of measuring success at meeting these objectives. For instance, it was unclear whether the government had or intended to measure the impact or effectiveness of the ‘fuel duty escalator’ with such criteria as a reduction in the volume of fuel consumed, or the mileage travelled for a constant volume. The evidence from the Financial Secretary’s statement shows that government assumed that the amount of fuel consumed was less than it would have been but for the higher duty levels. The lack of a measuring device makes it easier for the general public to infer that the important element in fuel taxation is more in terms of revenue generation than environmental concerns. Nevertheless, the common opinion among the five major oil companies is that the demand for motor fuel is relatively price-inelastic. Shell went on to comment that although the tax applied to pump prices has risen significantly over the years, they were yet to experience a corresponding change in fuel demand in the UK.

These observations help to reinforce public opinion.

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29 House of Commons, Trade and Industry Committee (5th Report); Impact on Trade and Industry of Motor Fuel Taxation xiv (Session 2001-02).
30 See id., xxvii.
In addition to the ‘fuel duty escalator’, the UK Government introduced differential road fuel duties to encourage the use of fuels that were considered to be environmentally friendly. For instance, the government introduced a duty differential in 1997 in favour of unleaded over leaded petrol. This differential widened in subsequent years until the use of leaded petrol was officially abolished in 2000. There was also a duty differential in favour of diesel over petrol, because standard diesel engines produce significantly lower emissions of certain pollutants, e.g. carbon monoxide, nitrogen oxides and hydrocarbons, than petrol engines. The invention of catalytic converters has removed this advantage, because fitting a three-way converter to a petrol engine can reduce nitrogen oxide and hydrocarbon emissions below that of diesel engines.

The 6% fuel duty escalator has ceased to apply to future budgets from 1999, but the government maintained that decisions about road fuel duties would be taken on a budget-by-budget basis. The Chancellor announced in the 2000 budget that duty rates would from then on increase in line with inflation. The government further stated that any real increases in road fuel duties in the future would be lower, and that the revenues would be ring-fenced and used for the modernisation of roads and public transport (hypothecation). According to the Chancellor, appropriate levels of fuel duties in the future are expected to take into account the government’s economic and social objectives and UK’s environmental commitments.

32 See Bolton et al.; supra note 22, at 23.
33 Institute for Fiscal Studies, *The IFS Green Budget Analysis* pp. 109-10, Commentary No. 80 (2000). Hypothecation means the allocation of resources from future duty increases to specific ends. Under genuine hypothecation, any reduction in consumption would lead to lower spending on transport in the long run. The IFS has argued that the link between taxation of road fuel to spending on transport is tenuous. Similarly, they argue that there is a contradiction in this policy because in the long run it cannot be a good source of revenue and at the same time act as a measure for curtailing car usage.
However, compared to most European countries, the UK has one of the highest post-tax fuel prices. This is because the fuel duty and the VAT interact to raise the overall tax component of fuel prices (see Table 5.4).

Table 5.4 EU Price Comparisons (2007)

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>25.73</td>
<td>28.88</td>
<td>61.33</td>
<td>61.86</td>
<td>87.04</td>
<td>90.74</td>
</tr>
<tr>
<td>Netherlands</td>
<td>29.44</td>
<td>31.47</td>
<td>60.42</td>
<td>36.11</td>
<td>89.86</td>
<td>67.58</td>
</tr>
<tr>
<td>Denmark</td>
<td>28.17</td>
<td>30.25</td>
<td>52.53</td>
<td>38.34</td>
<td>80.70</td>
<td>68.59</td>
</tr>
<tr>
<td>Italy</td>
<td>29.57</td>
<td>33.12</td>
<td>51.47</td>
<td>39.98</td>
<td>81.04</td>
<td>73.10</td>
</tr>
<tr>
<td>France</td>
<td>27.68</td>
<td>31.17</td>
<td>53.90</td>
<td>40.38</td>
<td>81.58</td>
<td>71.55</td>
</tr>
<tr>
<td>Germany</td>
<td>25.46</td>
<td>28.92</td>
<td>57.26</td>
<td>43.17</td>
<td>82.72</td>
<td>72.09</td>
</tr>
<tr>
<td>Belgium</td>
<td>29.84</td>
<td>33.54</td>
<td>54.50</td>
<td>33.77</td>
<td>84.34</td>
<td>67.31</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>29.13</td>
<td>31.33</td>
<td>40.13</td>
<td>27.16</td>
<td>69.26</td>
<td>58.49</td>
</tr>
<tr>
<td>Spain</td>
<td>28.25</td>
<td>30.94</td>
<td>36.30</td>
<td>29.24</td>
<td>64.55</td>
<td>60.18</td>
</tr>
<tr>
<td>Ireland</td>
<td>26.61</td>
<td>30.85</td>
<td>41.64</td>
<td>36.46</td>
<td>68.25</td>
<td>67.31</td>
</tr>
<tr>
<td>Sweden</td>
<td>24.83</td>
<td>29.19</td>
<td>52.11</td>
<td>41.08</td>
<td>76.94</td>
<td>70.27</td>
</tr>
</tbody>
</table>

Source: UK Petrol Industry Association Ltd (UKPia)

In 1998, the EU concluded an agreement with the European car manufacturing group to reduce the average carbon dioxide emissions from the new car fleet. To support this agreement, the UK Government created incentives for individual motorists to demand more fuel-efficient vehicles.

The Royal Commission on Environmental Pollution, in its 1994 report on transport and the environment, recommended that “fuel duty be increased year by year so as to double the price of fuels, relative to the prices of other goods, by 2005”. The report also recommended that the government should press for the revision of the EC Directive on fuel prices so as to ensure a sustained year-by-year increase in fuel prices.

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34See the Royal Commission on Environmental Pollution; supra note 8, at p. 240. Recommendation 28, however, is a product of a strict environmental research and did not take into account the economic multiplier effects of a doubling of fuel prices on the prices of other transported goods.
In responding to this report, Newbery estimated that the total external costs of road transport far outweighed the revenue raised from fuel and road taxes. He concluded that a large increase in fuel duties could be justified. However, he posited that fuel taxes were a blunt instrument for dealing with many of these social costs. It has been argued previously that the main social cost that fuel taxes can effectively address is the global warming effect of carbon dioxide emissions. Thus, the Royal Commission aimed its proposals at addressing this.

Realistically, the effects of global warming are difficult to estimate, the revenue from fuel taxes are far in excess of Newbery's estimates, and the implied carbon tax from the Royal Commission’s proposal are far greater than the EU’s suggested rate for a carbon tax. When a product is taxed for both revenue generation and environmental purposes, it implies that theoretically the tax could be broken down into the revenue-raising component and its externality-correcting component. Thus, it may be erroneous to compare total revenue generated from fuel taxes and the global warming costs, because road fuels are also taxed partly for revenue generation purposes.

### 5.2.6 International comparisons

In comparison to other EU countries, current UK levels of fuel taxation are the highest (see Table 5.4). The Road Hauliers Association (RHA) estimated that the European average price for a thousand litres of diesel is £540, as against £810 in the

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36 See Blow & Crawford; supra note 9, at p. 26.

37 See Trade and Industry Committee (5th Report); supra note 29, at p. 38. Memorandum submitted by the Road Haulage Association (RHA) to the Trade and Industry Committee.
UK. Conversely, the Institute for European Environmental Policy (IEEP) stated that although UK fuel duties were the highest in Europe, the differential in prices was much less when compared to levels of national GDP (see table 5.5). On this basis, they quantified that UK taxation levels as a percentage of GDP (40%) compares favourably with most EU countries. For instance, Sweden has 58%, France 50%, and Germany 44%.

<table>
<thead>
<tr>
<th>Petrol</th>
<th>GDP per capita (divided by 100)</th>
<th>Diesel</th>
<th>GDP per Capita (divided by 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>5.4</td>
<td>Luxembourg</td>
<td>6.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>3.1</td>
<td>Denmark</td>
<td>4.1</td>
</tr>
<tr>
<td>Austria</td>
<td>2.9</td>
<td>Austria</td>
<td>3.8</td>
</tr>
<tr>
<td>Ireland</td>
<td>2.9</td>
<td>Belgium</td>
<td>3.8</td>
</tr>
<tr>
<td>Germany</td>
<td>2.7</td>
<td>Germany</td>
<td>3.7</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.6</td>
<td>Netherlands</td>
<td>3.3</td>
</tr>
<tr>
<td>Spain</td>
<td>2.4</td>
<td>France</td>
<td>3.3</td>
</tr>
<tr>
<td>France</td>
<td>2.3</td>
<td>Ireland</td>
<td>3.0</td>
</tr>
<tr>
<td>Italy</td>
<td>2.3</td>
<td>Italy</td>
<td>3.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.3</td>
<td>Finland</td>
<td>3.2</td>
</tr>
<tr>
<td>Finland</td>
<td>2.2</td>
<td>Spain</td>
<td>2.9</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.2</td>
<td>Sweden</td>
<td>2.8</td>
</tr>
<tr>
<td>Greece</td>
<td>2.1</td>
<td>Greece</td>
<td>2.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.9</td>
<td>Portugal</td>
<td>2.7</td>
</tr>
<tr>
<td>UK</td>
<td>2.0</td>
<td>UK</td>
<td>2.0</td>
</tr>
</tbody>
</table>


The IEEP also stated that the UK has relatively lower employment and lower corporation taxes; administrative costs were relatively lower; and have comparatively fewer tunnels and toll bridges. However, the Federation of Small Businesses (FSB)

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38 See id., xiii.
39 See id., p. 138. Memorandum submitted by the Institute for European Environmental Policy (IEEP) to the Trade and Industry Committee.
40 See id., p. xiv.
opined that small businesses were usually unincorporated and therefore did not benefit from low rates of corporation tax.\textsuperscript{41}

From the foregoing, it could be argued that UK levels of fuel taxation are the highest in the EU, regardless of whether these are balanced by lower corporation tax, motoring infrastructure costs, or social welfare benefit costs. It could also be inferred that small companies that are heavily reliant on road transport will be hit the hardest by high fuel taxation levels. In rural areas, rises in fuel taxation could have a devastating impact. Rural motorists have had to pay the same high taxes despite being responsible for little of the current levels of air pollution. Small fuel retailers in rural areas obtain supplies at wholesale prices which are sometimes more than the price at which major supermarkets retail fuel to consumers.\textsuperscript{42}

As a result, associations like the Petroleum Retailers Association (PRA) and the FSB have proposed that fuel wholesalers should be made to sign an agreement never to exceed a maximum wholesale price for fuel sales in order to protect local independent fuel retailers and rural motorists.\textsuperscript{43} From the Australian experience of wholesale price regulation, this is not a credible long-term option. However, so long as the demand for fuel remains relatively inelastic, the government may not consider fuel taxation as the real problem that rural fuel retailers are facing in terms of attracting custom and increasing volume throughput.

\textsuperscript{41} See \textit{id.}, p. 153. Memorandum submitted by the Federation of Small Businesses (FSB) to the Trade and Industry Committee.  
\textsuperscript{42} See \textit{id.}, p. 154. Memo submitted by the FSB to the Trade and Industry Committee.  
\textsuperscript{43} See \textit{id.}, p. 154.
More rural fuel outlets have closed mainly because of the economic effects of a highly competitive industry, but also because of the high cost of capital needed to finance the purchase of fuel with 70-80% of fuel tax contained within the price. Low margins, small volume throughput, competition from supermarkets, etc. are the main challenges faced by the independent fuel retailers, especially those in rural areas. For the rural motorist, it would seem that the government is yet to address fully the absence of an alternative form of transport to the car.

Nevertheless, compared to other OECD countries, the UK also has among the highest petrol taxes and the highest diesel taxes, whereas Australia has one of the lowest petrol and diesel prices – on both a pre-tax and post-tax basis (see Figure 5.a).\footnote{International petrol and diesel price comparisons. Available online at http://www.aip.com.au/pricing/internationalprices.htm, last visited on 15 October 2009.}
Figure 5.a  International fuel price and tax comparisons in OECD Countries, 2009

Petrol prices and taxes in OECD countries March quarter 2009

Diesel prices and taxes in OECD countries March quarter 2009

Source: Australian Petroleum Statistics, Department of Resources, Energy & Tourism.
5.2.7 Distributional effects of increase in fuel duty on sub-groups of the population

Periodic objections to high fuel taxes are usually based on the effect that the tax will likely have on certain groups of the population, particularly those within the low income band and those living in rural areas. A number of empirical studies have been conducted to determine the distributional effects of fuel tax increases on different sub-groups within the population.

Smith examines these effects based on income and population densities. The study analyses the effect of a 6% real increase in fuel tax by comparing the cost of achieving a given level of economic welfare before the tax increase, with the cost of achieving the same level of economic welfare after the tax increase.\(^45\) The study used the cost-of-living index to measure how much extra income was needed to return to the original welfare level.

The analysis reveals that the effect of fuel duty rises on the cost of living for households across different income groups and population densities in the UK is felt most by households in the middle-income bracket, followed by poor car-owning households and rural dwellers.\(^46\) This finding does not imply that a fuel tax policy used to protect the environment is inappropriate. Overall, the UK tax and benefit system is progressive, and creates an argument for compensation for sub-groupings of the population that bear the higher burden. For example, the adverse effect of fuel tax increase on the cost of living for rural inhabitants could be compensated by improving rural public transport.


\(^{46}\) See Smith; *supra* note 7, at pp. 5 and 8.
Leicester’s study assesses the extent to which recent price increases can be attributed to government policy; whether there is a case for fuel duties to be altered based on pump price changes; and the effects of fuel duty changes on different sub-groups of the population.\textsuperscript{47} He finds that the poorest household are not disproportionately affected by high fuel prices; instead those households in the upper half of the income bracket face the largest increase in their cost of living. That is not to say that the impact on the poorest households is not substantial, but this category consume very little fuel. Nevertheless, he finds that among the households that own cars, the poorer households are worse hit.\textsuperscript{48} This category would include some rural inhabitants who are heavily reliant on private transport.

Blow and Crawford’s study reveals that an increase in fuel taxes has a direct effect on the cost per mile of travel, and may also have an indirect effect by inducing changes in fuel efficiency.\textsuperscript{49} Thus, the direct effect is to increase the cost of vehicle usage and consequently cause a reduction in individuals’ mileage. The indirect effect tends to work in the opposite direction by increasing fuel efficiency through the manufacture and purchase of more fuel-efficient vehicles and the scrapping of older, less-fuel efficient vehicles. Thus, the effect of fuel taxes on mileage may be different from their effect on fuel consumption.

The longer-term effects of an increase in fuel taxes may also be to reduce the level of vehicle ownership. The level of this response would depend on the availability of other modes of travel such as public transport. Therefore, responses are likely to vary

\textsuperscript{47} See Leicester; \textit{supra} note 4, at p. 1. This briefing note updates and revises Smith’s study titled, “The Petrol Tax Debate”.

\textsuperscript{48} See \textit{id.}, p. 14.

\textsuperscript{49} See Blow & Crawford; \textit{supra} note 9, at p. 24.
according to individual circumstances. For example, rural inhabitants may have minimal or no access to reliable public transport. In the short term, there is little alternative to the use of private cars for travel purposes. However, in the longer term people can alter their circumstances by migrating away from rural areas in order to reduce the distance between home/workplace and amenities. Conversely, government can alter the circumstances of rural inhabitants by increasing access to public transport.

Their study also shows that the welfare effects of taxes on road fuels and car usage do alter the set of relative prices faced by consumers and will differ across types of households and across the income distribution. The evidence also suggests that a 30% increase in fuel prices will reduce mileages by about 12%. The overall distribution of welfare effects of such a reform based on the empirical evidence is that poorer households are relatively less affected since most of them don’t own cars. Amongst households that own cars, the welfare effects are greatest for poorer households, particularly in rural areas.

Research by the Automobile Association (AA) indicates that the effects of the cost of fuel was felt most by people who live in rural areas, those on lower income, and younger people. A similar study commissioned by the AA and the UK Petroleum Industry Association (UKPia) also found that households in medium- and low-density areas account for about 31% of all households that own cars, and these groups are more severely affected by fuel price increases than households in high density

50 See Blow & Crawford; supra note 9, at 51.
51 For more details, see The Great British Motorist (AA) 2000.
This finding is consistent with similar conclusions reached by Blow and Crawford, Skinner and Fergusson. These other studies find that rural households are disproportionately affected by fuel price increases.

**Table 5.6** Indicators on car ownership and usage, by area type (1995/97)

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Rural</th>
<th>London</th>
<th>Metropolitan</th>
<th>Large Urban</th>
<th>Great Britain (Average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of Households with a Car</td>
<td>83</td>
<td>61</td>
<td>59</td>
<td>69</td>
<td>69</td>
</tr>
<tr>
<td>Annual Car Mileage</td>
<td>10,200</td>
<td>7,800</td>
<td>9,000</td>
<td>9,200</td>
<td>9,600</td>
</tr>
<tr>
<td>Public transport as a Percentage of all Journeys</td>
<td>4</td>
<td>20</td>
<td>14</td>
<td>9</td>
<td>9</td>
</tr>
</tbody>
</table>

**Source:** Road Fuel Prices and Taxation, House of Commons Library, Research Paper 00/69 (2000) p. 31.

Table 5.6 represents information from the National Travel Survey and reflects a significant level of rural dependence on car transport. This issue has been of concern to rural communities and the Scottish Government. According to the Rural Scotland Price Survey conducted by Mackay Consultants for Highlands & Islands Enterprise in 1999/2000, the price of unleaded petrol in the Highlands and Islands was 9.5% higher than in Aberdeen, and diesel was 11.3% higher. However, these differences reflect factors other than fuel duty, such as the cost of delivering fuel to those locations, local monopolies or oligopolies, etc.

One of the principles behind levying excise duties is that they can be charged across the board by all who purchase the good or service. However, with fuel duties it is

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53 See Bolton et al.; *supra* note 22, at p. 43.
likely that this principle will produce distributional effects, considering the greater reliance by rural dwellers on private transportation. The application of fuel tax exemptions or relief’s tailored to specific locations might subsidise an individual’s decision to live in a given place, possibly without regard to the circumstances in which they make the choice to live there. It has to be argued that compensation for living in these areas, as well as support for businesses located there, could better be addressed through the benefit system, or by the provision of regional aid.

5.2.8 Transport in rural areas in the UK
Rural transport provision depends on the ability to overcome accessibility issues. In this context, accessibility means the ease with which people can obtain the services and facilities that they desire. Thus, accessibility is seen as the instrument for achieving social justice, greater social inclusion, and sustainability of rural communities. Figure 5.b shows the vicious cycles of public transport demand in rural areas, particularly those adjacent to urban areas. In one of such cycles, increased car ownership enables rural inhabitants to access urban facilities where goods and services are relatively cheaper. There is also more choice in urban locations and some rural dwellers who work in urban cities can do their shopping close to their place of work.

55 See Bolton et al.; supranote 22, at p. 45.
Consequently, this can reduce significantly the demand for goods and services in rural locations and force a decline in rural facilities. This can in turn increase the benefits of owning a car and create a further increase in car ownership. In another vicious cycle, this triggers a reduced demand for public transport. Consequently, bus operators suffer reduced revenues or incur losses and may respond by increasing fares or reducing the frequency of service. These responses are seen by potential public transport users as inadequate and poor quality public transport service. As a result, there is an increase in the benefit of car ownership which gives rise to greater car ownership. The problem can be compounded by the recent demographic changes whereby there has been an increasing influx of high income earners from urban areas and wealthy retirees into rural areas.

One way of counteracting the vicious cycle is for the local authority to subsidise bus companies operating in rural areas.\textsuperscript{57} However, if subsidy funds dry up, the bus operators are likely to respond by reducing service frequency and/or increasing fares, or withdrawing services altogether. Each time a cycle of decline is completed, the most vulnerable members of the communities (low income earners, elderly, disabled, young persons) bear the greater brunt of less access to employment, goods, and services.

The Transport Act of 1978\textsuperscript{58} placed the burden of provision of socially desirable transport services onto local authorities. As a result, few policies have been specifically directed by the government towards rural transport issues. However,

\textsuperscript{57} See Brake & Nelson; supra note 56, at p. 264.

under the 1985 Transport Act, registered public transport services in the UK were deregulated and this event marked a new era for transport provision in rural areas. However, prior to the enactment of this Act the UK Government reasoned that local councils together with the operations of a free market system could ensure adequate provision of rural transport needs. Subsequently, the former network of public transport services in rural areas were replaced by skeletal commercial services and local authority supported services.

**Figure 5.b** Vicious cycle of demand for public transport in rural areas

To facilitate the provision of these services, the government proposed to increase funding to the Rural Development Council for: community transport schemes; provision of four years of transitional funding when changes to licensing regulations

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meant that local councils could not specify which services the bus operators would offer; and removal of cross-subsidy of less profitable routes by profitable routes.\(^{60}\) However, statistics from the Department of Transport (DoT) in 1996 (i.e. about twelve years later) indicated that rural areas lack bus services (see Table 5.7).

**Table 5.7** Frequency of bus services by population density in Great Britain (percentages of households), 1996

<table>
<thead>
<tr>
<th>Frequency of Service</th>
<th>Built-Up Areas</th>
<th>Towns over 25k</th>
<th>Towns over 25k</th>
<th>Rural Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 mins or less</td>
<td>53</td>
<td>38</td>
<td>12</td>
<td>7</td>
</tr>
<tr>
<td>About every 30 mins</td>
<td>31</td>
<td>35</td>
<td>32</td>
<td>18</td>
</tr>
<tr>
<td>About every 60 mins</td>
<td>5</td>
<td>10</td>
<td>25</td>
<td>21</td>
</tr>
<tr>
<td>Less frequent daily service</td>
<td>-</td>
<td>2</td>
<td>10</td>
<td>29</td>
</tr>
<tr>
<td>No daily service</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>8</td>
</tr>
</tbody>
</table>

**Source:** Root et al., The Costs of Rural Travel (1996) p. 26.

The UK Government’s view is that this could be improved or alternative modes of transport have to be considered. This situation accounts for why rural dwellers are heavily reliant on private vehicles. The study conducted by Root et al demonstrates that a higher percentage of rural households use cars than urban households (81% compared to 65%). Similarly, a higher percentage of rural households (37%) have two or more cars than urban households (21%).\(^{61}\) Gray, in his estimation of rural reliance on car journeys, found that around 24% of rural car journeys are completely dependent on the car, and 35% of rural car journeys are heavily reliant on the car. However, he contends that there may be a significant potential for a modal shift, with

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20% of the journeys being either reliant/discretionary or discretionary usage of the car.\textsuperscript{62}

Table 5.8 indicates that rural households spend 18% more on energy (i.e. fuels and power) and less on environmentally friendlier forms of transport (i.e. buses and trains). Consequently, rural households are expected to contribute more per household to carbon emissions than non-rural households. These costs when considered together with other higher costs of living place an additional constraint on rural inhabitants’ budget. The adverse effects of transport are generally felt more acutely in remote rural areas than in towns or the neighbouring countryside. Also, total motor costs are higher in rural than in urban areas. This finding is in line with Gray’s findings on the cost of rural motoring.\textsuperscript{63} However, low population densities make it difficult to provide adequate substitutes, such as conventional public transport services.

Nevertheless, many schemes have been devised to improve access to essential public transport services in rural areas. Some are based on government initiatives and some based on endogenous self-help efforts with the cooperation of local councils. The latter include community buses, taxi buses, post buses, social car schemes, and in less remote locations, dial-a-ride services. Some of the social car schemes would include education (school buses), social and other care service transport, and non-emergency patient transport services. Such innovative transport schemes are mostly dependent on

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{62} Gray, D., Rural Transport: An Overview of Key Issues p. 25, prepared for the Commission for Integrated Transport (2001). Available online at http://cfit.independent.gov.uk/pubs/2001/rural/rural/key/pdf/rural.pdf, last visited on 20 September 2009. Car dependent are journeys which could not be made without a car. Journeys that rely heavily on access to a car; i.e. trips which would be extremely inconvenient to make by another mode. Car reliant journeys for which less convenient, rapid or flexible alternatives to the car do exist. Car reliant/discretionary journeys which are usually made by car but which could be made by another mode without too much inconvenience. Discretionary journeys which could quite easily be undertaken by a mode other than the car
\item \textsuperscript{63} See id., pp. 29-30.
\end{itemize}
\end{footnotesize}
voluntary help, and on financial assistance from the Rural Development Commission, local authorities, etc.\textsuperscript{64}

**Table 5.8** Household expenditure on transport (£/week) by population density in the UK, 1995

<table>
<thead>
<tr>
<th>Item</th>
<th>Greater London</th>
<th>Other Metropolitan Areas</th>
<th>High Population Density</th>
<th>Medium Population Density</th>
<th>Low Population Density</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Expenditure</td>
<td>316.25</td>
<td>255.27</td>
<td>282.32</td>
<td>293.61</td>
<td>289.19</td>
</tr>
<tr>
<td>Fuel/Power</td>
<td>12.05</td>
<td>12.90</td>
<td>12.22</td>
<td>13.17</td>
<td>13.85</td>
</tr>
<tr>
<td>Total Motor Costs</td>
<td>30.94</td>
<td>31.60</td>
<td>36.45</td>
<td>38.05</td>
<td>40.6</td>
</tr>
<tr>
<td>New Car/Van Purchase</td>
<td>2.43</td>
<td>2.93</td>
<td>6.22</td>
<td>3.61</td>
<td>5.67</td>
</tr>
<tr>
<td>Petrol</td>
<td>7.74</td>
<td>8.05</td>
<td>9.78</td>
<td>10.61</td>
<td>11.44</td>
</tr>
<tr>
<td>Diesel</td>
<td>0.38</td>
<td>0.41</td>
<td>0.53</td>
<td>0.61</td>
<td>1.13</td>
</tr>
<tr>
<td>Insurance &amp; Tax</td>
<td>5.87</td>
<td>5.45</td>
<td>6.16</td>
<td>6.42</td>
<td>6.62</td>
</tr>
<tr>
<td>Repairs, etc</td>
<td>3.88</td>
<td>2.78</td>
<td>3.10</td>
<td>3.27</td>
<td>4.10</td>
</tr>
<tr>
<td>Second-hand Car/Van Purchase</td>
<td>7.91</td>
<td>9.22</td>
<td>7.24</td>
<td>10.27</td>
<td>8.74</td>
</tr>
<tr>
<td>Rail &amp; Tube Fares (excl. season tickets)</td>
<td>2.31</td>
<td>0.49</td>
<td>1.17</td>
<td>1.38</td>
<td>0.76</td>
</tr>
<tr>
<td>Bus &amp; Coach Fares (excl. season tickets)</td>
<td>1.53</td>
<td>1.95</td>
<td>1.30</td>
<td>1.20</td>
<td>0.82</td>
</tr>
<tr>
<td>Motor Costs as a % of Total Expenditure</td>
<td>9.8</td>
<td>12.4</td>
<td>12.90</td>
<td>13.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Rail &amp; Bus Fares as a % of Motor Expenditure</td>
<td>12</td>
<td>8</td>
<td>7</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>

Notes: Population density (persons per household), High: > 7-9; Medium: 2.2-7.9; and Low: < 2.2. Table only lists selected aspects of motor costs.

**Source:** Source: Root et al., The Costs of Rural Travel (1996) p. 28.

Government policies towards rural public transport have been scanty, primarily because of the deregulation of transport services. However, there are a few

\textsuperscript{64} Nutley, S. D., *Unconventional Modes of Transport in Rural Britain: Progress to 1985* pp. 73-86, Journal of Rural Studies, Vol. 4 (1), 1988. Also, see the Royal Commission on Environmental Pollution; \textit{supra} note 8, at p. 181.
examples. Under the Bus Service Operators Grant (BSOG), the registration of a bus service entitles the operator to a fuel duty rebate from central government. The government set up a Rural Transport Partnership Fund in its 1998 White Paper on Integrated Transport. The partnership comprises local authorities, private sector, community, and voluntary transport sectors. The pool of funds is allocated to projects that generate long-term improvements to public transport services, and those that help reduce social exclusion of rural people.

**Table 5.9** Projected rural transport funding, UK

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(£)</td>
<td>(£)</td>
<td>(£)</td>
<td>(£)</td>
</tr>
<tr>
<td>Rural Bus Subsidy Grant</td>
<td>-</td>
<td>90</td>
<td>132</td>
</tr>
<tr>
<td>Rural Bus Challenge</td>
<td>-</td>
<td>48</td>
<td>60</td>
</tr>
<tr>
<td>Countryside Agency</td>
<td>4.8</td>
<td>17</td>
<td>47</td>
</tr>
<tr>
<td>Total</td>
<td>4.8</td>
<td>155</td>
<td>239</td>
</tr>
</tbody>
</table>

**Source:** Gray, D., Rural Transport, p. 34.

In 1998, the Rural Bus Subsidy Grant was introduced in order to improve rural bus services, including their administration and marketing. The interaction of this grant with free bus travel for elderly people (over 60s) throughout Scotland caused an increase in bus usage generally. The Rural Bus Subsidy Grant funds rural transportation with an annual budget of around £32.5 million and is administered by county councils and unitary authorities. In England and Wales, the Rural Bus Challenge (RBC) Fund was introduced in 1998 with the objective of creating cost-effective innovative rural public transport and was administered by the Department

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65 See Brake & Nelson; supra note 56, at p. 263.
for Transport. This fund was phased out in 2004. There is also the Parish Transport Fund administered by the Countryside Agency. The Scottish Government also set up the Scottish Rural Community Transport Initiative.

Table 5.9 shows the projected rural transport funding under these schemes from 1995 to 2004. There are also a few other fuel subsidy schemes in the UK. Agriculture is subsidised. However, the subsidy applies to tractors, generators, combines, and grain dryers, but not to vehicles used for transportation of produce and livestock to market. The Fishing Fleet Diesel Fuel Subsidy applies to marine diesel used by fishermen, and attracts zero tax and duty. There is also a 75% Fuel Duty Rebate for buses that use Ultra Low Sulphur Diesel (ULSD). The Energy Saving Trust Scheme provides grant for conversion of cars and vans to liquefied petroleum gas (LPG) and compressed natural gas (CNG) (i.e. cleaner fuels).

However, a number of schemes have been proposed or recommended by some associations and interest groups. These include: The Essential User Rebate Scheme (EUR) for hauliers; a reduction in VAT levels for motorists and/or businesses located in rural areas; excise duty rebate for all classes of transport in rural areas; Vehicle Excise Duty reduction on a graduated scale based on carbon dioxide emissions; Rural Services Fund; Rural Transport Grant; Rural Travel Bonus; Tax-Free Travel Vouchers; and Rural Council Tax Rebate. Most of these proposals have not been granted, because of the technical difficulties involved with their design, implementation and monitoring.

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66 See Trade and Industry Committee Report (5th); supra note 29, at pp. xxiv, 93, 151, and 152.
67 See id, pp. 40-41, 58, 70, 150-2, and 156.
Non-transport solutions have also been sought. Firstly, some town planners have thought about concentrating rural populations into larger settlements or key villages that might support the provision of essential services. Secondly, the development of telecommunications may enable the provision of some services remotely, thereby reducing the need to travel. This may also create additional rural employment (e.g. telecottages). These measures might somewhat reduce the extent of car travel in rural areas. In suitable rural locations, these measures could be combined with other environmentally friendly transport modes (e.g. cycling and walking) by creating better conditions for these. However, the most difficult problem arises in the less isolated rural areas, especially those closest to large conurbations (i.e. suburban locations). In this case, road improvements, population dispersal and changes in land use combine to generate large flows of traffic with attendant high levels of pollution. There are also pressures for the construction of new infrastructure.

The 18\textsuperscript{th} report on Transport and the Environment (The Royal Commission on Environmental Pollution) noted that increases in fuel prices will not in themselves bring about a switch to public transport on the scale that would be desirable on environmental grounds. It also noted that public contributions, by way of subsidies, to the cost of providing public transport can be justified on both social and environmental grounds. The report also identified that trains, buses, and trams are significantly more energy efficient on average compared to cars and lorries, and that

\footnotesize
\begin{itemize}
  \item \textsuperscript{69} See \textit{id.}, p. 246.
\end{itemize}
buses and coaches make more efficient use of existing road facilities. The report concluded that a sustainable transport policy for the future must have the objective of increasing the proportion of personal travel and freight transport by using environmentally less damaging transport modes.  

There are suggestions that public transport should be subsidised on a consistent basis or that subsidies where present should be increased to discourage people from using their cars or acquiring one and instead use buses and trains. The argument behind these suggestions is that if public transport is closely linked to lower social costs than private transport, then lowering the costs of public transport is an alternative to raising the costs of private car usage. However, the social cost of transport varies with location, time, and traffic conditions, and so it could be expected that the differential costs between public and private transport would similarly vary.

Thus, designing ideal subsidies for rural locations is a complicated exercise. This is more so, if subsidies translate to an under-reflection of the social costs of road transport. In this case, subsidising public transport could attract new users, including people who have moved away from other forms of transport. Consequently, such a policy will produce an undesirable side-effect to a policy aimed initially at reducing the impact of transport decisions on society. Rail and most bus services in the UK are now privatised and government may be reluctant to subsidise directly many fares under a free market system. Government subsidies would largely depend on how prices are regulated and also on the public’s acceptance of large subsidies to privatised industries.

70 See id., p. 245.
71 See Blow & Crawford; supra note 9, at p. 29.
Empirical evidence suggests that cross-price elasticity of demand between transport modes is low, thus subsidies to public transport may not be too effective in discouraging people from car ownership and usage. Some commentators (e.g. Newbery) suggest that quality improvements in public transportation may be a better way of encouraging a switch from private to public transport. An example is providing more road space to buses and less to private cars. Another argument that affects the policy of subsidising public transport is that the application of subsidies requires public funds. These are generated through taxes, and so such a policy may result in distortions to other sectors of the economy.

5.2.9 Other policy options

Of all the components of fuel price, the wholesalers’ and retailers’ margins have the greatest influence on the differential between rural and urban fuel prices. VAT tends to magnify this differential because it is charged on the full selling price (excise duty included). For instance, a differential of 7.2 ppl between the Highlands and Islands and urban Scotland would be 6.1 ppl without VAT.

The wholesale and retail gross margins are much higher in rural areas due to three factors. The first relates to transport costs. Fuel suppliers have to deliver fuels over long distances (on poor road networks) to a sparse network of fuel stations. Evidence from the OFT report (1998) shows that the extra cost of delivery to North West Scotland is 2p per litre more than elsewhere. The second pertains to retailers’ overheads, which tend to be higher because of the smaller turnover than that of other

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72 See id., p. 29.
74 See OFT Report 230; supra note 1, at p. 71.
fuel stations in urban locations. The third factor is accounted for by the impact of competition and supermarket fuel discounting. Fuel discounting in urban areas implies that margins tend to be lower relative to rural areas. Some rural areas adjacent to urban locations are affected by this competition and attract lower margins compared to some other rural locations. For example, the fuel market in North West Scotland is regarded as separate from the rest of the UK and insulated from the strong competition that ensued with the introduction of Esso’s Pricewatch and supermarkets’ entry and expansion into fuel retailing.75

The current focus is on pursuing policies that enable fuel stations to remain open by reducing their operating costs. This, rather than reducing the prices they charge, could enable them to survive. For example, the UK Government secured derogation from the EU Petrol Vapour Recovery Directive for small stations in rural areas (north of the central belt). Implementation of the directive in the affected rural areas would have entailed a capital cost of around £3,000 per station.

A current Health and Safety Executive directive requires fuel retailers to carry out more regular testing of storage tanks, particularly when the tanks are 20-, 25-, and 30-years old, with twice a year tests afterwards.76 The estimated cost for each test was put at around £500 per tank.77 Meeting the cost of compliance with this regulation is hardest for those retailers with low margins and low-volume throughput, and these are usually independent fuel retailers in rural areas. Most retailers in these local communities have cited environmental pressures as one of the major causes of their

75 See id., p. 69.
77 H. Fox; Social & Economic Impact: Petroleum Prices & Distribution in the Highlands and Islands para. 1.2.11 (1996).
closure. The Rural Development Commission has expressed concerns in recent years regarding the cost of meeting regulatory standards in rural areas. Although exemptions and derogations have reduced the environmental burden on some qualified fuel retailers, however the discretion available to the enforcing authorities is limited and their approach differs from locality to locality.

It might also be argued that the requirement for full closure of sites with tanks filled with concrete could deter entry or exit by imposing huge costs on a company that must exit the market. Conversely, new entry might occur with the re-opening of such closed sites. However, due to this requirement, re-opening of these sites may be as difficult as constructing new ones.\(^7^8\) The Scottish Government operates the rural transport fund, and a percentage of this fund is used to help rural fuel stations with tank replacement and groundwater issues. Local authorities have discretionary powers to provide rate relief of up to 100% to fuel stations under the wider rate relief for village shops and post offices scheme.\(^7^9\)

Other possibilities have been suggested. The first one is duty derogation. This involves applying lower rates of duty to rural areas. The UK Government could apply for a similar derogation for specific policy considerations which would require unanimous EC Council agreement (article 8.4 of EC Council Directive 92/81).\(^8^0\) This has been permitted in the Azores and on certain Greek Islands (article 9 of EC

\(^7^8\) OFT Report 230; supra note 1, at p. 22.
Council Directive 92/82). However, there would be technical difficulties in delineating the boundaries of the areas that could benefit from such derogation. This might arise because it is difficult to monitor the influx of motorists from adjacent areas to those that benefit from derogation.

The second is essential user rebates. To counteract the technical difficulties involved with duty derogation or reduction the suggestion is that a more effective way might be to target essential users in particular areas as eligible for discounted fuels at rural fuel stations. A number of issues would have to be considered in this case, such as definitions of how peripheral a location need be to qualify for the rebates, of the income band that qualifies for essential user rebate, and what constitutes an essential user.

The third possibility is reducing dependence on the car. Motorists in rural locations face the same fuel price or duty increases as those in urban areas, but the realities of rural life and the lack of public transport alternatives constrain their ability to reduce car usage in response to price increases. Nevertheless, government can reduce the need to travel among rural communities by supporting rural shops and services, and innovative modes of transport through the Rural Transport Fund. For example, the Scottish Rural Transport Fund managed by the Scottish Government supports the

82 See Scottish Parliament Research Note 99-52; supra note 73, at 7-8. The UK Road Haulage Association, in a memorandum submitted to the Trade and Industry Committee, also made a case for the application of Essential User Rebate Scheme to domestic hauliers. For more details, see Trade and Industry (5th report); supra note 29, at 40-41.
Rural Public Passenger Transport Grant, the Rural Community Transport Initiative, and the Rural Petrol Stations Grants. The downside to this policy is that it is likely to take a long time to implement measures that reduce car dependency, due to the lack of viable interim alternatives.

5.2.10 EU taxation of energy products and environmental policy
Some environmental regulatory measures in regard to road transport are in force in the UK, mainly through the adoption of EC directives on emission standards for vehicles which were introduced in 1989 and 1991. The directives set the emission standards for vehicles and based on these, all new cars from January 1993 must meet the emission standards through the fitting of a catalytic converter.

To promote EU environmental objectives and in keeping with the Kyoto protocol, the EU devised a community system of minimum rates for the taxation of energy products and electricity. This is aimed at encouraging more efficient use of energy, mainly to reduce greenhouse gas (GHG) emissions in order to protect the environment. A second objective is to improve the internal market mechanisms and thereby reduce competition distortions between mineral oils and other energy products. However, this taxation system is applicable only to products used as motor or heating fuels and to electricity. To facilitate environmental protection, the EU authorises member states to grant tax advantages to businesses that take specific measures to reduce their GHG emissions.

The Council Directive 2003/96/EC of 27 October 2003 restructured the taxation rates for various energy products. Table 5.10 shows the minimum levels of taxation

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84 See Blow & Crawford; supra note 9, at p. 26.
applicable to motor fuels. The Directive allows member states to differentiate between
energy products used for transportation and those used for industrial or commercial
purposes.

Table 5.10 EU minimum levels of taxation applicable to motor fuel

<table>
<thead>
<tr>
<th>Products (Euro)</th>
<th>Current Minimum Excise Rates</th>
<th>Minimum Excise Rates From 01.01.2004</th>
<th>Minimum Excise Rates From 01.01.2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petrol (/1000 l.)</td>
<td>337</td>
<td>421</td>
<td>421</td>
</tr>
<tr>
<td>Unleaded petrol (/1000 l.)</td>
<td>287</td>
<td>359</td>
<td>359</td>
</tr>
<tr>
<td>Diesel (/1000 l.)</td>
<td>245</td>
<td>302</td>
<td>330</td>
</tr>
<tr>
<td>Kerosene (/1000 l.)</td>
<td>245</td>
<td>302</td>
<td>330</td>
</tr>
<tr>
<td>LPG (/1000 l.)</td>
<td>100</td>
<td>125</td>
<td>125</td>
</tr>
<tr>
<td>Natural gas</td>
<td>100 (/1 000 kg)</td>
<td>2.6 (/gigajoule)</td>
<td>2.6 (/gigajoule)</td>
</tr>
</tbody>
</table>

(The volumes are measured at a temperature of 15°C).

Source: EU Community Framework for the Taxation of Energy Products and Electricity

Table 5.11 shows the minimum levels of taxation applicable to fuels for industrial
and commercial uses. The minimum levels of taxation are lower than those used for
transport purpose. Fuels are considered as raw materials for industrial and commercial
purposes, and these include agriculture; horticulture; forestry; stationary motors;
vehicles intended for use off the public roadway; civil engineering and public works;
plants and machinery used in construction. Table 5.12 also shows the minimum levels
of taxation applicable to heating fuels and electricity, which are even lower when
compared to those applied to industrial and commercial use.
Table 5.11 EU minimum levels of taxation applicable to fuels for industrial or commercial use

<table>
<thead>
<tr>
<th>Products</th>
<th>Current Minimum Excise Rates</th>
<th>Minimum Excise Rates From 1.1.2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diesel (/1000 l.)</td>
<td>18</td>
<td>21</td>
</tr>
<tr>
<td>Kerosene (/1000 l.)</td>
<td>18</td>
<td>21</td>
</tr>
<tr>
<td>LPG (/1000 kg.)</td>
<td>36</td>
<td>41</td>
</tr>
<tr>
<td>Natural gas</td>
<td>36 (/1 000 kg)</td>
<td>0.3 (/gigajoule)</td>
</tr>
</tbody>
</table>

(The volumes are measured at a temperature of 15°C).

**Source:** EU Community Framework for the Taxation of Energy Products and Electricity.

However, the Directive provided for differentiated rates of taxation based on a number of conditions: “when the differentiated rates are directly linked to product quality; when the differentiated rates depend on quantitative consumption levels for electricity and energy products used for heating purposes; or the following uses: local public passenger transport (including taxis), waste collection, armed forces and public administration, disabled people, ambulances; between business and non-business use, for the energy products and electricity”.

Moreover, the Directive in certain cases provided for exemptions; total or partial exemptions; or reduction in the level of taxation depending on the local circumstances in a member state. The following activities are completely exempt from taxation: “energy products and electricity used to produce electricity and electricity used to maintain the ability to produce electricity. However, member states may, for reasons

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86 See Article 5 of the EC Directive 2003/96/EC.
of environmental policy, subject these products to taxation, i.e. energy products supplied for use as fuel for the purpose of air navigation other than in private pleasure flying; energy products supplied for use as fuel for the purposes of navigation within Community waters, including fishing, other than private pleasure craft, and electricity produced on board a craft”.

### Table 5.12 EU minimum levels of taxation applicable to heating fuels and electricity

<table>
<thead>
<tr>
<th>Products</th>
<th>Current Minimum Excise Rates</th>
<th>Minimum Excise Rates From 1.1.2004 (Business Use)</th>
<th>Minimum Excise Rates From 1.1.2004 (Non-business Use)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diesel (/1000 l.)</td>
<td>18</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Heavy fuel oil (/1000 kg.)</td>
<td>13</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Kerosene (/1000 l.)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>LPG (/1000 kg.)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Natural gas (/gigajoule)</td>
<td>-</td>
<td>0.15</td>
<td>0.3</td>
</tr>
<tr>
<td>Coal and coke (/gigajoule)</td>
<td>-</td>
<td>0.15</td>
<td>0.3</td>
</tr>
<tr>
<td>Electricity (/MWh)</td>
<td>-</td>
<td>0.5</td>
<td>1.0</td>
</tr>
</tbody>
</table>

(The volumes are measured at a temperature of 15°C).

**Source:** EU Community Framework for the Taxation of Energy Products and Electricity

The following activities qualify for either total/partial exemption or a reduction in their taxation levels: “energy products used under fiscal control in the field of pilot...

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87 See Article 11 of the EC Directive 2003/96/EC.
projects for the technological development of more environmentally-friendly products or in relation to fuels from renewable sources; biofuels; forms of energy which are of solar, wind, tidal or geothermal origin, or from biomass or waste; energy products and electricity used for the carriage of goods and passengers by rail, metro, tram and trolley bus; energy products supplied for use as fuel for navigation on inland waterways (including fishing) other than in private pleasure craft, and electricity produced on board a craft; natural gas and LPG used as propellants”.

The differentiated rates of taxation, total or partial exemptions, and reductions in taxation also align with the EU consumer policy strategy. This strategy is expected to shift the focus of regulation in favour of citizen-focused outcomes, which could be achieved by addressing market failures that harm consumer welfare and enhancing socio-economic inclusion and cohesion through guaranteeing access to essential services and products at affordable prices. In this way, the EU consumer policy coupled with these exemptions could be instrumental in guaranteeing core European values of fairness, openness, solidarity, sustainability, and transparency.

In addition to these differentiated rates of taxation, derogations, and reductions in taxation, there are available grants from the Cohesion Fund for the establishment and development of trans-European networks for transport, telecommunications and energy. The objective of the fund is to promote the harmonious development of the Community and the internal market. The report recommended that the European

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88 See Article 14 of the EC Directive 2003/96/EC.
90 See EU Consumer Policy Strategy; supra note 89, at p. 3.
Commission should give support only to those developments which are consistent with sustainable development and respect for the environment. The report advocated the pursuit of measures that increase the cost of transport to reflect the environmental and social costs at the Community level, in order to protect the competitive position of member states.
5.3 Australia

5.3.1 Components of fuel retail prices
The components of fuel pump prices consist of crude oil costs (including transportation to the refinery); refinery costs (including distribution costs and wholesale margin); fuel duty plus VAT (including State franchise fee); and the retail margin. Table 5.13 shows the breakdown of retail petrol price in Australia as at 1999. Similar to the UK, crude oil accounts for about 26% of the pump price whereas the total duty (including GST and State fee) accounts for about 60%. Table 5.14 represents a five-city annual average of the components of Australian retail petrol price from 2003-07, and indicates that the average fuel tax has declined from 51.4% in 2003-04 to 40.5% in 2006-07.

Table 5.13 Australian retail petrol price components, 1999

<table>
<thead>
<tr>
<th>Components of Petrol</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Price</td>
<td>100</td>
</tr>
<tr>
<td>Refinery Feedstock</td>
<td>26</td>
</tr>
<tr>
<td>Refinery Charges</td>
<td>1</td>
</tr>
<tr>
<td>Distribution</td>
<td>9</td>
</tr>
<tr>
<td>Fuel Excise plus GST</td>
<td>47</td>
</tr>
<tr>
<td>State Franchise Fee</td>
<td>12</td>
</tr>
<tr>
<td>Gross Retail Margin</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Petroleum refining and marketing in Australia – Changes Ahead, Australian Parliamentary Library (1999).

5.3.2 Wholesale and retail price regulation
The wholesale and retail pricing of fuels in Australia is dictated by international factors: the price of crude oil, the international market for refined fuels, and the US/
AUS exchange rate. The dynamics for fuel pricing is much the same as in other OECD countries. The difference between the pump price of fuels in one jurisdiction and another lies in the level of taxes and excise duties. About 70% of oil consumed by Australian refineries is imported. Australian crude producers are free to export crude oil and petroleum products into international markets as well as sell these within Australia, depending on where they get better prices.

Table 5.14 Components of Australian retail petrol prices (five-city annual average), 2003-04 to 2006-07

<table>
<thead>
<tr>
<th>Components of Retail Price</th>
<th>2003-04 Average Price 90.30 cpl</th>
<th>2004-05 Average Price 100.6 cpl</th>
<th>2005-06 Average Price 121.1 cpl</th>
<th>2006-07 Average Price 121.6 cpl</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude Oil</td>
<td>29.6</td>
<td>41.6</td>
<td>56.6</td>
<td>56.1</td>
</tr>
<tr>
<td>Gasoline Crack (Refining Costs)</td>
<td>6.1</td>
<td>3.0</td>
<td>4.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Wholesale Margin (excl. GST)</td>
<td>4.3</td>
<td>5.3</td>
<td>7.4</td>
<td>8.1</td>
</tr>
<tr>
<td>Excise + Wholesale and Retail GST (TAXES) (51.4%)</td>
<td>46.4</td>
<td>47.3</td>
<td>49.2</td>
<td>49.2 (40.5%)</td>
</tr>
<tr>
<td>Retail Margin (excl. GST)</td>
<td>3.9</td>
<td>3.4</td>
<td>3.8</td>
<td>4.4</td>
</tr>
</tbody>
</table>


92 Excise is a flat value levied by the government on petrol leaving a refinery. The GST, which is the UK equivalent of VAT, is levied on the final price of petrol at a flat rate of 10%. The margins represent the additional price added by both the wholesaler/distributor and the retailers to cover the costs of distribution and retailing and provision for profits.

Singapore refinery price (Singapore Mogas 95 Unleaded) is the international refined petrol benchmark for the Asia–Pacific region.\textsuperscript{94}

Although crude oil accounts for a small percentage of the pump price, it can affect the prices of fuels quite significantly. Since the years 2003-08, the prices of fuels have increased markedly because of the increase in world crude oil prices arising from increased demand from China, political uncertainty in the Middle East, high gasoline demand from North America, thirty year low of oil stocks in the OECD countries, and supply uncertainty in Iraq, Nigeria, Russia, and Venezuela.\textsuperscript{95} Most recently, pump prices have risen following supply concerns in Russia, Iraq, and Nigeria, and increased levels of the US and UK terror alert. Consequently, retail fuel prices do reflect these factors in addition to wholesale and retail margins, transportation and storage costs within Australia, franchise fees and bulk breaking costs. Fuel prices are also affected by intense competition for market share, especially in metropolitan cities, which often leads to discount cycles.

The price of fuels paid by consumers therefore reflects market forces. Prices are set by fuel retailers in accordance with their estimation of the demand and competition in their localities. Price differentials exist because fuel prices in regional centres and country areas reflect the size of, and competition within, the local fuel market.

Based on the foregoing, it is not feasible to regulate the price of crude oil or refinery and distribution costs. However, it might be possible to regulate wholesale and retail margins, and fuel duty. The latter constitutes more than half of the pump price of fuels and so is the most important component of fuel prices in Australia.

The Australian Competition and Consumer Commission (ACCC) investigated the possibilities of regulating both wholesale and retail prices in their search for ways to reduce fuel price variability and rural-urban price differentials. The Australian Government has indirect powers to regulate prices at the wholesale, retail and terminal levels. Although at the Commonwealth level the Australian Government has no specific powers to control prices, under s.51 of the constitution it has power to ‘regulate prices charged by trading, financial, or foreign corporations’. Some of the States have legislation to regulate fuel prices while some have regulated retail prices in the past. Some are planning to introduce retail price caps in certain regional areas, e.g. Western Australia. Government price regulation could take the form of setting price caps (maximum prices chargeable), minimum prices and specific daily prices, thereby controlling price movements.

Through price regulation, price cycles could be limited (where minimum or maximum prices are set) or eliminated where specific prices are set. The Australian Price Surveillance Act (PSA) 1983 provided for the surveillance of the prices of certain goods or services, including petroleum products. However, the ACCC could not set prices under the PSA. Therefore, national price regulation can only take place if the

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96 ACCC Report on *Reducing Fuel Price Variability* 76 (2001). Available online at http://www.accc.gov.au/content/index.phtml/itemId/321896, last visited on 5 August 2009. The ACCC regulated the wholesale prices of oil refiners up to 1 August 1998, after which wholesale prices were deregulated, although they could be re-regulated in the future.
Commonwealth Government, States and Territories resolve and liaise closely on its implementation.

Apart from the arguments that regulation of pump prices would eliminate or limit price cycles, the ACCC observed that retailers also favour this option because it could give them more certainty to prices and would receive fewer criticisms from their customers.

Nevertheless, there are arguments against retail price regulation. Firstly, it could lead to higher average prices, if firms have market power and the regulators provide for retail margins that may be higher than could be determined in a competitive setting. Secondly, it would be difficult for regulators to determine retail margins considering the different cost structures across the retail sector, the range and nature of services provided, and the relative turnover from fuel and non-fuel items. Therefore, if the price cap is set too high, discounting with attendant price cycles can still occur. It may also permit inefficient operators to remain in business. If it is set too low, it may result in operators being driven out of business, thereby reducing the degree of competition in the industry with possible supply implications. Thirdly, this option may also limit or eliminate the ability of retailers to compete on price to attract customers, but rather on factors such as quality of service. Fourthly, regulating fuel retail prices would run contrary to the global trend towards deregulation and globalisation.97

The PSA price places a cap on wholesale prices to prevent oil majors from charging higher prices, particularly in country areas. Ministerial Directions were also put in

97 See id., p. 77.
place to ensure that some of the costs of supplying country consumers were not reflected in the maximum wholesale price applicable to some districts.\textsuperscript{98} One major limitation to imposing an effective wholesale price regulation is the possibility that the oil majors may circumvent it by selling fuels through distributors, particularly in country areas. Despite this possibility, the Industry Commission (IC) argues that there could be some merit in wholesale price regulation, particularly in some country areas where little competition takes place.\textsuperscript{99} Wholesale price regulation tends to be less restrictive than pump price regulation, and placing a cap on wholesale prices could act as a ceiling on retail prices, thereby leading to lesser price cycles. This form of regulation is usually justified where competition is less intense and wholesale prices too high.

On the down side, almost all the arguments against retail price regulation would apply to wholesale price regulation. In addition, past experiences in Australia show that retail price cycles existed despite wholesale price regulation, and restrictions on wholesale prices may not translate into lower retail prices, depending on which party appropriates the gains.

Based on the arguments for and against both retail and wholesale price regulation, the ACCC concluded in 2001 that these may also lead to results that are inconsistent with the public interest. There are practical difficulties involved in determining an


\textsuperscript{99} See \textit{id.}, p. 78.
appropriate price cap or level, as substantiated by the experience of the Western Australian Government regarding their operation of a maximum wholesale price.\textsuperscript{100} Therefore, the ACCC opined that price regulation should be considered as anti-competitive and should only be considered where there is a proof of market failure. Industry analysts argue that intervention in this case (if the aim is to generate long-term positive effects) could take the form of an integrated industry development approach involving creation of change in the local markets or the encouragement of new entry. The Commission also recommended the continued close monitoring of fuel pricing arrangements in Western Australia.\textsuperscript{101} This view is supported by some commentators (Cousins and Fels), who argue that where industries are highly concentrated and barriers to entry high there may be a significant role for ongoing price surveillance as this exercise will help boost consumer information and confidence.

5.3.3 Fuel tax regulation
Government taxes represent almost 60\% of the pump price,\textsuperscript{102} whereas Australia’s tax revenues from crude oil and LPG have reduced significantly. Thus, petroleum taxes have switched from the wellheads in the oilfields (i.e. government tax take from crude oil) to the petrol pump or point of sale (i.e. government tax take from refined products). The basis for this switch revolves around successive governments’ resolve to encourage exploration and development of Australia’s petroleum resources.

\textsuperscript{100} See IC report No 40; \textit{supra} note 98, at p. 81.
\textsuperscript{101} See \textit{id.}, p. 81. Also see Cousins, D & Fels, A., \textit{The Re-Emergence of Price Surveillance} 308, UNSW Law Journal 32-1 (2009).
Likewise successive governments have continued to raise taxes at the pump by relying heavily on the relative unresponsiveness of fuel demand to changes in prices.

5.3.3(a) The objectives of fuel tax in Australia

Petroleum products excise has increasingly become an important source of revenue for the Australian Government. In 2001-02, this revenue was estimated to be $12.2 billion and accounted for 7.5% of total government revenue.\(^{103}\) Thus, fuel excise is Australia’s largest source of government indirect tax revenue and the third largest source of tax revenue after income and company taxes.

Table 5.15  Global policy developments in fuel taxation

<table>
<thead>
<tr>
<th>Time</th>
<th>Policy Development</th>
<th>Fuel Tax Objective</th>
<th>Fuel Tax Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Since</td>
<td>Cost imposed on road infrastructure from</td>
<td>Funding road infrastructure costs</td>
<td>Taxation of petroleum products used in transport</td>
</tr>
<tr>
<td>Early 1900s</td>
<td>transport fuel users</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1900s</td>
<td>Economic Development</td>
<td>General revenue raising</td>
<td>Taxation of petroleum products used in transport</td>
</tr>
<tr>
<td>1970s</td>
<td>Response to crude oil price shocks of mid- to</td>
<td>Energy security or fuel diversity,</td>
<td>Low or zero fuel tax rates on petroleum substitute products</td>
</tr>
<tr>
<td></td>
<td>late-1970s</td>
<td>via encouragement of substitute</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>products</td>
<td></td>
</tr>
<tr>
<td>1980s</td>
<td>Increased awareness of the effects of fuel</td>
<td>Reducing the costs of some fuel</td>
<td>Low or zero fuel tax rates on petroleum substitute products</td>
</tr>
<tr>
<td></td>
<td>use on the environment and human health</td>
<td>use</td>
<td></td>
</tr>
<tr>
<td>Early 2000s</td>
<td>Effects of change on regional and rural</td>
<td>Regional development and industry</td>
<td>Low or zero fuel tax rates on petroleum substitute</td>
</tr>
<tr>
<td></td>
<td>communities, especially primary production</td>
<td>assistance</td>
<td>products produced from agricultural products</td>
</tr>
</tbody>
</table>

**Source:** Report of the Inquiry into Fuel Taxation (Commonwealth of Australia, 2002) p. 9

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\(^{103}\) Commonwealth of Australia; Report on Fuel Tax Inquiry 85 (2002). Available online at [http://fueltaxinquiry.treasury.gov.au/content/report/default.asp](http://fueltaxinquiry.treasury.gov.au/content/report/default.asp), last visited on 5 October 2009. Rebates, subsidies and grants for fuels were around $2.9 billion. Therefore, the net revenue to the government was $9.3 billion.
Australia, like most other OECD countries, responds to global policy developments in fuel taxation. Table 5.15 indicates the global policy developments in fuel taxation. Similar to the case of the UK, the primary focus of fuel taxation in Australia since the early to middle part of the twentieth century is for revenue generation. However, since the second half of the twentieth century, new objectives have been introduced.

However, three groups of objectives have been attributed to contemporary fuel taxation arrangements in Australia: raising revenue to fund government expenditure; addressing the social costs related to fuel use, such as costs related to damage to the road infrastructure by road users and environmental costs (effects of air pollution, road congestion, noise effects from vehicle use, costs of road accidents, effects of global warming from emission of greenhouse gases); and broader industry and social objectives.  

The nature of environmental costs and their relationship to fuel use can vary significantly. Some examples are that the cost of pollutants affecting air quality would vary with the location of the fuel and the type of vehicle used; traffic congestion would depend on location, time, and weather conditions; the costs of road damage would depend on the type of road, the type of vehicle, and the amount of fuel used; motor vehicle accidents is not directly related to the consumption of fuel, but would depend on vehicle maintenance, driver competence, and general road and weather conditions; and noise effects are indirectly related to fuel use and would vary depending on location and type of vehicle. The externality that is directly related to fuel consumption is carbon emissions, and this could be tied to the effects of global

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warming. The foregoing would suggest that it is problematic to determine accurately the cost of the externality, and internalising it by imposing a fuel tax on all users often results in public suspicion as to the real objectives of fuel tax. Nevertheless, if these external costs to road transport are not addressed there could be a mis-allocation of resources within the economy. For instance, there may be an imbalance between private and public transport, rail or road transport, or distortions may arise due to lack of commitment to restrict carbon emissions.

External costs, as noted in the case of the UK, can be internalised by using economic instruments, such as taxes (excise duty), subsidies and grants, user-charges, remediation levies, tradeable permits, and performance bonds. This can also be achieved through regulatory instruments such as equipment specifications and mandatory standards. In some cases, moral suasive measures can also be applied, such as public enlightenment campaigns aimed at changing behaviour and attitudes. The UK uses a combination of pricing and regulatory instruments to internalise the external costs of road transport. On the other hand, Australia has relied predominantly on regulatory instruments for internalising externalities, but increasing consideration is being given to pricing mechanisms. Some examples are grants for conversion of motor vehicles to LPG in Western Australia, and stamp duty concessions for ‘cleaner’ vehicles in New South Wales.

The use of regulatory measures and economic instruments has its advantages. Regulating emission standards has the advantages of certainty and ease of

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106 See Report on Fuel Tax Inquiry; supra note 103, at pp. 63-64.
administration in achieving the desired emission standards. On the down side, it is often difficult to target precisely the regulated standards. For example, if the target is urban air pollution, imposing emission standards would also result in significant costs for motorists in regional and rural areas where the pollution problem is relatively much less. However, the relevant policymakers in Australia recognise that market-based measures are preferable to regulatory instruments, all things being equal. The advantages of economic instruments in this regard are: firstly, these can be applied to all fuel consumers in direct proportion to their external costs; secondly, economic instruments enable fuel consumers to respond in a variety of ways to reduce their external costs; and thirdly, these instruments provide an incentive for sustained changes in behaviour.

Johansson, in comparing the effectiveness of regulation versus economic instruments in addressing externalities arising from road transport argues that different externalities could be dealt with using different instruments. Examples are: congestion and greenhouse gas emissions could be dealt with by employing economic instruments; air pollution could be addressed with a combination of regulation and economic instruments; and external costs of vehicle accidents and noise pollution could be effectively addressed through the regulatory route.

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Non-fuel economic instruments could also be used to address the external costs of road transport, e.g. fixed charges. The presence of a fixed charge can influence the decision to consume fuel. However, their application is limited because they do not capture the variable nature of some of these costs. For example, once paid, a fixed charge will not reduce the mileage of the motorist or the load he carries, or the type of vehicle he uses.

5.3.3(b) Modern fuel tax objectives

The modern fuel tax objectives actively encourage the production and use of petroleum product substitutes by levying low or zero tax rates on these substitutes. A number of rationale for this have been suggested such as, improving air quality; reducing greenhouse gas emissions; reducing the reliance on imported petroleum products; supporting development in regional and rural areas through the production of these substitutes using agricultural products e.g. ethanol produced from sugar or wheat; and supporting industries e.g. manufacturers of equipment needed to facilitate the use of the substitutes (for instance, LPG conversion kits).

The implication of these new objectives is that it might be difficult to justify further tax concessions on petroleum products in most market economies. However, the evidence shows that despite the tax concessions on these substitutes since the middle of 1970s, petroleum products have remained the major source of energy for transport purposes and may remain so for the next couple of decades. The convenience, efficiency and accessibility of petroleum products for transportation purposes have encouraged governments to rely heavily on taxing them for revenue generation.

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110 See Fuel Tax Inquiry; supra note 103, at pp. 10-11.
purposes. Fuel tax then interacts with the broad-based consumption taxes such as GST to substantially increase the tax component of fuel prices.

It is also universally agreed that the performance of a tax system in meeting the primary objective of revenue generation for government expenditure should be assessed based on efficiency and equity criteria. Similar to the case of the UK, the Australian Government contends that a framework for assessing petroleum product taxes should have regard to the generally accepted objectives and the set of desirable characteristics of an efficient tax system.

The difference in energy use determines the tax treatment that different types of energy sources receive. For instance, previously coal, wood, and oil were major sources of energy for heating but have now been replaced by gas and electricity. The latter energy sources are generally subjected to very low or zero fuel taxes in most OECD countries. Similarly, petroleum product substitutes (e.g. ethanol, LPG, CNG) attract little or no tax because these sources of energy are less energy efficient and less convenient in terms of availability and storage. However, these sources of energy are also environmentally friendly. For example, in Australia ethanol is not taxed and both natural gas and other biofuels are not within the excise regime.

Some of the recommendations by the Australian Fuel Taxation Inquiry Committee relates to the Australian inconsistent application of fuel taxation among fuels. The Committee believes that fuel taxation should not be discriminatory between fuels, but rather government should aim to minimise the application of fuel taxation to

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112 See Fuel Tax Inquiry; supra note 103, at p. 10.
intermediate inputs into production (i.e. business inputs). The Committee thus recommended that fuels should be taxed according to their energy content, such that all fuels will have the same tax burden, i.e. fuels with higher energy content will attract a higher tax rate and vice versa. This approach should help to reduce distortions in resource allocation arising from differential fuel taxation, and provide a clearer framework for both current and future fuels. This is in line with the concept of neutrality with regard to closely related economic decisions as referred to in many debates on tax policy. Nevertheless, deviations from neutrality (in the form of higher or lower rates of tax) may be explicitly justified when considering economic activities, where the responses of producers and consumers to the signals provided by the market result in outcomes that are against the best interests of the entire community.

However, the principle of equity emphasises the notion of fairness among tax payers. The official opinion in Australia is that the burden of tax should be borne according to the ‘ability-to-pay’ principle. The application of the ‘ability-to-pay’ principle raises two concepts of equity: “horizontal equity, which means that people in similar economic circumstances should be treated similarly; and vertical equity, which means that people in different situations should be treated differently, with those who are better off bearing a greater share of the tax burden”.

\[113\] See IAC Report No. 397; supra note 111, at p. 18.
\[114\] See id., p. 79.
5.3.4 Excise duty and Australian transport policy
The institutional framework for transport policy and administration is well developed in Australia. However, we are concerned in this chapter with issues relating to how road fuel taxes drive the Australian transport policy.

Fuel duty was initially introduced in 1929 when domestic refineries were constructed and locally produced refined products entered the market. Then the government introduced an excise on petrol at the rate of 0.18 cents per litre (cpl) which was hypothecated to road funding. The most significant expansions of fuel excise occurred in 1957 when excise duty on diesel and aviation turbine kerosene was introduced, to ensure that the operators of diesel vehicles contributed to the maintenance of roads and that the operators of commercial airline fleets contributed to the heavy costs of providing airport and air-route facilities.

In 1959 the legislators passed the *Commonwealth Aid Roads Bill* which formally terminated the hypothecation arrangements for road funding. The government proffered the following reasons for bringing to an end the formal hypothecation arrangements. Firstly, the tax burden was not only borne by the motorists because a significant amount of the fuel tax was paid by commercial transport operators who subsequently passed on the cost to consumers of their goods and services. Secondly, the government believed that it was not a proper practice to allocate the proceeds of

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any one tax to a particular expenditure. Instead, government thought that taxes should contribute to an overall pool to be used for any desirable expenditure purpose. Thirdly, the significant annual fluctuations in fuel tax receipts lead to irregular funding for roads, thus making forward planning difficult for road authorities.

The enactment of the Aid Roads Bill effectively severed the formal link between fuel taxes and road funding until in 1982 when the government enacted the *Australian Bicentennial Road Development Trust Fund Act 1982* (ABRD Act), which established a roads programme to be funded by a surcharge of 1 cpl on fuel tax levied on petrol and diesel.\(^{120}\) This surcharge was subsequently increased to 2 cpl a year later. The ABRD surcharge was replaced by the *Australian Land Transport Development Act 1988*, which is still in force and provides for a variable percentage of tax on petrol and diesel to be paid into a trust fund for expenditure on road funding.

Until the 1980s, the main rationale for fuel taxes has been to provide a general source of government revenue. However, tax concessions have been a part of the fuel taxation structure for fuel used other than as a transport fuel or for uses of petroleum products other than as fuel. These concessions are usually in the form of remissions, refunds of excise duty, or lower excise rates.\(^{121}\) The Australian Government perceived these concessions as mechanisms for providing tax relief to legitimate users of fuels for uses other than as a transport fuel.

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\(^{121}\) Excise remission refers to a situation where payable excise duty is either forgone or waived. A refund and rebate are similar mechanisms whereby duty that has been paid is returned to the payer under peculiar circumstances. However, a rebate within the excise system is normally paid to a different party whereas a refund is usually paid to the entity that has the legal obligation to remit the excise.
The provision of these concessions commenced in 1957, with the provision of an exemption certificate scheme aimed at exempting all off-road users of diesel fuel from payment of diesel tax.122 This scheme remained in operation after the formal discontinuation of hypothecation of petrol and diesel tax to road funding. However, this scheme was discontinued in 1982 due to alleged abuse of the scheme whereby on-road users were obtaining diesel that had been purchased duty free through the scheme. This scheme was replaced by the more transparent Diesel Fuel Rebate Scheme (DFRS). The scheme provided tax rebate on diesel fuel for certain activities, mainly in the agricultural and mining industries in order to maintain Australian competitiveness in these key export industries.123 The scheme also contained a limited number of community and social welfare objectives. Based on this new scheme, all users of diesel fuel were required to purchase duty paid fuel. Eligible users were allowed to claim a rebate equivalent to the diesel tax for specific off-road usage.124

Government levied excise on LPG for vehicular movements between 1974 and 1979 through the *Liquefied Gas (Road Vehicle Use) Tax Collection Act 1974*.125 This was done to ensure that LPG users contributed to road maintenance, and the rates varied between 2 cpl in 1974 to 2.125 cpl in 1979. However, this tax was abolished in 1979.

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122 See History of Fuel Taxation in Australia; *supra* note 117, at p. 9. Subsequently, the Petroleum Products Freight Subsidy Scheme was introduced in 1965 to reduce the price of petroleum products in remote areas of Australia via a reduction of the freight component of the purchase price of fuels.


when the government made a commitment to a five-year guarantee on excise-free status for alternative fuels (LPG and CNG). Government also announced that any changes to this status would be notified to the users at least one year in advance. Ethanol was added to the list of alternative fuels in 1980 and so attracted a duty-free status. These new measures were meant to encourage the diversification of Australia’s domestic fuel supply, following the second world oil price shock of 1979.

The 1983 budget introduced two major changes to the fuel excise system: the introduction of an excise duty on kerosene, fuel oil, and heating oil; and the introduction of a six-monthly indexation of fuel tax rates. The tax rates applied for these products (i.e. 1.872 cpl) were significantly lower than the rates for petrol and diesel (9.027 cpl), which effectively created a parallel system to the DFRS for the provision of excise relief for certain users of fuel. However, the condition for this concessional rate of duty on kerosene, fuel oil, and heating oils is that they should not be used in an internal combustion engine. The indexation arrangements introduced by the government were meant to remove problems associated with past discretionary increases in fuel tax, by maintaining the real value of tax collections, thereby providing a higher degree of stability for industry and consumers. Indexation arrangements remained until 2001, when the government discontinued the policy as part of a decision to review fuel taxation.

The 1990s witnessed a flurry of discretionary and sometimes arbitrary increases in fuel duty for revenue generation purposes. For example, in the 1993 budget, the government announced a 5 cpl increase in diesel fuel excise and a 3 cpl increase in

126 See History of Fuel Taxation in Australia; supra note 117, at p. 11.
fuel duty on heating oil, kerosene, and fuel oil. The government also levied taxes on fuels used as intermediate inputs in production. In its recommendation to the government, the IC in 1994 urged that the diesel fuel rebate for domestic users should be scrapped, and that the wider issue of fuel duty charged on intermediate inputs should be addressed. However, the government went on to abolish the diesel fuel rebate for domestic users, and stayed action on the issue of excise on intermediate inputs. In the 1995 budget, the government increased the duty on light fuel oil to the same level as that of diesel based on the rationale that some users (e.g. railways) were substituting the lower fuel oil for diesel.

The fuel taxation policy of the 1990s was criticised as not having met the test of equity and neutrality in tax design. For example, primary production and some mining operations were taxed lightly on their consumption of diesel fuel, whereas such concessions were denied most railways, most coastal shipping, road transport users, quarrying, tourist resorts, etc. James argued that the abolition of the excise on petrol, diesel, and fuel oils used as intermediate inputs could have cost the government at least $4.8 billion in forgone revenue. However, he contended that this forgone revenue could have been recouped through taxes on externalities or road user charges. More revenue could also be generated by increasing taxes on fuel used in final consumption and/or through an expansion of existing tax bases (e.g. extension of sales tax to services). He further argued that the impact of such consumption taxes on the


128 See History of Fuel Taxation in Australia; supra note 117, at p. 113.
consumer could be offset by the lower cost of consumer goods brought about by the lower cost of fuel inputs to producers.

These arguments are backed by economic theory, which indicates that the imposition of any tax on intermediate inputs (such as fuel) to the production process will raise the price of the final goods. This will amount to a misallocation of resources because such a tax will tend to divert resources away from those industries that intensively use fuels for production, and into other industries. Consequently, such a policy will unduly reduce the production and supply of goods by the manufacturing sector and set up a negative multiplier effect. The restricted supply of goods will in turn affect the prices of goods relative to other goods and services, thereby distorting both consumption and production decisions. These distortions are not in line with the principle of tax neutrality, which requires a well designed tax system to have at least a positive impact on production and consumption decisions, as well as on efficiency in resource allocation. Ultimately, such a taxation policy is likely to yield a sub-optimal level of social welfare.

However, it was not until the 1990s that the Australian Government introduced environmental measures as one of the objectives that a fuel tax system should pursue. Consequently, in 1994 a fuel tax differential was introduced on leaded petrol, coal tar and coke oven distillates as a first measure. This was followed in 1999 with government’s announcement of the Measures for a Better Environment package. These measures included an early introduction of ULSD, the Greenhouse Gas

\[129\] See IAC Report No. 397; \textit{supra} note 111, at Appendix K (The Inefficiencies of Intermediate Input Taxation).

Abatement Programme, Alternative Fuels Conversion Programme, Renewable Remote Power Generation Programme, and Service Station Remediation. The Fuel Tax Inquiry report provides details on these measures, which are summarised below.

The government committed to a further reduction in the sulphur content of diesel, from 500 ppm in 2003 to 50 ppm in 2006, through an early introduction of the ULSD before it became mandatory in 2006. The objectives were to improve air quality and to provide benefits in certain locations, e.g. in underground mining operations, etc.\(^{131}\)

To achieve these objectives, the government provided an excise differential between regular diesel and ULSD to encourage new refinery capital investment over the period from 2000 to 2005, and to provide an incentive for diesel consumers to switch demand to ULSD. The excise differential consisted of an extra 1 cpl on regular diesel from January 2003, and 2 cpl for 2004 and 2005.

The objective of the Greenhouse Gas Abatement Programme (GGAP) is to support projects that will result in net reductions in greenhouse gas emissions, particularly in the period 2008-12. Funding has been provided at $100 million per annum. Two projects have received funding to promote the use of ethanol as a transport fuel. BP received $8.8 million to replace petrol production at its Bulwer Island refinery with a fuel grade petrol/ethanol brand. Also, Mossman Central Mill Company in Queensland received $34 million to produce ethanol fuel. The GGAP is achieving reductions in greenhouse gas emissions at a relatively low cost ($6 per tonne of carbon dioxide

saved per annum) by targeting large-scale projects.\textsuperscript{132} The use of non-taxation measures to address greenhouse gas emissions is increasingly becoming the preferred strategy as opposed to the levy of more fuel taxes.

The objectives of the Alternative Fuels Conversion Programme were to reduce greenhouse gas emissions and to improve air quality by encouraging heavy commercial vehicles and public transport buses to operate on LPG or CNG instead of diesel. The Commonwealth Scientific and Industrial Research Organisation (CSIRO), in the year 2000, carried out a study which compared the air quality performance of these fuels on vehicles.\textsuperscript{133} They found that LPG and CNG had significantly better air quality performance compared to low sulphur diesel fuels. The government allocated funding for this programme to the tune of $75 million from 2000-04. The programme funds up to 50\% of the cost to convert existing heavy vehicles fuelled by diesel to LPG or CNG, and up to 50\% of the extra cost of purchasing a new LPG or CNG bus or other commercial vehicles weighing over 3.5 tonnes. This programme led to a reduction of emissions of particulates by 72–99\%. Reduction in emissions over the life of a converted vehicle was estimated at $70 per tonne, which is significantly higher than the cost of reductions achieved with the GGAP.\textsuperscript{134} However, there are also savings from avoidance of healthcare costs from improved air quality. This is also an example of a targeted environmental improvement measure outside of the fuel tax system.

\textsuperscript{134} See Fuel Tax Inquiry; \textit{supra} note 103, at p. 204.
The Renewable Remote Power Generation Programme (RRPGP) supports an increase in the use of renewable energy generation (i.e. wind turbines, micro-hydro, wave, tidal, etc) in rural and remote parts of Australia that currently rely on diesel for electricity generation. The objectives of the programme included a reduction in greenhouse gas emissions, increased use of renewable energy technologies in remote areas of Australia, improved electricity supply for remote users, improved energy infrastructure for indigenous communities, and to assist the large-scale development of renewable energy technologies, with export possibilities in mind. Government investment in this programme was around $264 and was planned for a period of four years. The Australian Greenhouse Office projects that this programme will reduce diesel consumption for remote electricity generation by more than 50 million litres per annum. This saving in diesel consumption is insignificant considering that the average annual sale of diesel in Australia is roughly 13 billion litres, and around 700 million litres of diesel is used annually for power generation.

Nevertheless, the objective of the programme is not to completely replace diesel but to reduce dependence on it. On the down side, not all remote locations benefited from this programme because some areas are geographically unsuited for wind, water, tidal or solar power generation. This programme also conflicted with the Petroleum Products Freight Subsidy Scheme (PPFSS) which was designed to reduce the cost of fuels in remote areas by covering the cost of freight above a certain limit. $1.2 million dollars subsidy was paid to transport 14 million litres of diesel to remote locations, and some of this diesel has been used for generators. To resolve the conflict, the fuel tax inquiry committee recommended to the government that this programme be

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135 See id., p. 206.
136 See id., p. 208.
replaced with a more transparent provision of fuel credits for excise paid on diesel used for commercial electricity generation. However, this recommendation impacted adversely on this programme by removing the incentive to switch to renewable sources of energy in remote areas.

It has been suggested that a percentage of the revenue collected through fuel taxes should be used for monitoring service station sites and to clean up contaminated sites caused by leaking underground fuel storage tanks. This is in recognition of the fact that the rate of service station rationalisation has been high, and consequently the number of stations has declined from about 20,000 in 1970 to 8,300 in 2000. Thus, some of the closed sites required remediation of soil contaminated by leaking underground fuel tanks. Concerns for remediation liability could also impede the smooth transfer of ownership or the re-use of these sites for valuable ends. The liability issue could be a source of hardship for site owners in rural areas because the value of sale for alternative uses may be lower than the cost of necessary remediation work. Consequently, some owners have abandoned their sites.

Currently, policies on remediation of service stations are undertaken by State, Territory, and local governments. However, the government recognises that the issue of liability in regard to the environmental impact of sites closure is important. However, it does not support the use of fuel taxation revenue for specific environmental or industry restructuring objectives because it is likely to have secondary effects on other sectors of the economy. The government considers that

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137 The Victorian Automobile Chamber of Commerce is one of the organisations that suggested the establishment of a clean-up fund for underground fuel storage tanks, in its submission to the Fuel Tax Inquiry (see p. 4 of the submission). The submission is available online at http://fueltaxinquiry.treasury.gov.au/content/Submissions/Industry/downloads/VACC_239.pdf, last visited on 2 October 2009.
under the terms of the 1997 State Roles and Responsibilities, the Local, State and Territory Governments should continue to deal with the issue of sites remediation.\textsuperscript{138}

Apart from the Measures for a Better Environment, the government also announced further parliamentary amendments to its original tax reform proposal of 1998 (\textit{A New Tax System}\textsuperscript{139} package). The package included the retention of an amended version of the DFRS and the introduction of three new schemes, which are the Diesel and Alternative Fuels Grants Scheme (DAFGS), the Fuel Sales Grants Scheme (FSGS) and the Product Stewardship (Oil) Scheme. Under the New Tax System, the DFRS was extended to rail and marine transport, and was also extended to cover all similar fuels in keeping with the tax neutrality principle. Rebate rates were equalised for all eligible activities in line with the equity concept, and were extended to a full rebate of fuel duty.

The DAFGS replaced the proposed diesel fuel credit for transport operators under the new system. The objective was to reduce transport costs for businesses in regional and rural Australia, and to address the environmental concerns regarding emissions from diesel consumption within urban areas. The FSGS was introduced in order to bridge the rural–urban price differentials that had widened with the introduction of the GST. The objective of the Product Stewardship Scheme was to encourage the reuse of waste oils by taxing lubricants and providing a benefit to oil recyclers for the treatment of waste oil products.

\textsuperscript{138} See Fuel Tax Inquiry; \textit{supra} note 103, at p. 211.
5.3.5 International comparisons

Figure 5.1\textsuperscript{140} is based on official statistics from the Department of Industry, Tourism & Resources (\textit{Australian Petroleum Statistics}) and the International Energy Agency (IEA) for March 2009, and reveals that Australia has among the lowest petrol and diesel prices of all OECD countries.

This indication is consistent with previous data available from the IEA, showing that the retail price of petrol in Australia in the December quarter 2008 was the fourth lowest among OECD countries, at A$1.24 per litre. For the same period, average prices in the UK were A$2.25 per litre, Japan A$2.14, Germany A$2.36, and the United States A$0.95 per litre.\textsuperscript{141}

The figures available from the same source on diesel show that the retail price of diesel for non-commercial use in Australia was the fifth lowest among OECD countries in the March quarter 2005, at A$1.06 per litre. In the UK the price was A$2.06 per litre, Japan A$1.12 per litre and Germany A$1.65 per litre. However, the US, Mexico, Canada, and New Zealand had lower diesel prices than Australia.\textsuperscript{142} Commercial users of diesel in Australia pay significantly less than the retail price because the government provides subsidies for diesel use. Petrol and diesel are also subject to Australian GST.\textsuperscript{143}

\textsuperscript{140} See p21 of this Chapter.
\textsuperscript{141} See Petrol-Frequently asked Questions; \textit{supra} note 95, at p. 5.
\textsuperscript{143} Australian Taxation Office, http:// www.ato.gov.au, last visited on 29/10/2004. However, all the GST revenues collected by the government, including those levied because of increased petrol and diesel prices, are passed to the States and Territories.
5.3.6 Transport in rural areas in Australia
The use of public transport for rural travel in Australia is as problematic as in the UK. Consequently, rural dwellers are heavily dependent on private transportation. However, it has been argued that public transport is more energy efficient than car transport, and so would help reduce dependence on fuels as well as carbon emissions. Public transport could also reduce health costs arising from road accidents as well as transport disadvantage suffered by those without cars.

Concerns have been raised about the poor state of public transport in rural and regional areas. Some of the submissions to the Senate Standing Committee on Rural and Regional Affairs and Transport in 2007 confirm these concerns. Some of the examples are summarised below. The International Association of Public Transport has suggested that schools, shopping and recreation centres be brought closer together to mitigate the need for private transport. The Western Sydney Regional Organisation of Councils has advocated for the development of high-quality integrated services to enhance public transport patronage. The organisation also suggested a substantial increase in public transport funding. The Western Australian Government (WAG) has carried out some public transport measures aimed at improving accessible public transport, integrating transport and land-use planning, and enhancing existing public transport infrastructure. In 2001, the WAG invested $60 million to improve cycling infrastructure in the State.

Evidence reveals that the level of investment in rural and regional public transport services is insignificant compared to that of urban areas.\textsuperscript{145} Most local governments have limited funding capacity to make the necessary investment, and most State Governments have not shown as much commitment to rural areas as they have to urban areas. Local town transport services, where they exist, are as infrequent as the inter-suburban services. Inter-town services connecting smaller towns to regional centres are even more infrequent, thereby discouraging potential and occasional users. In areas where poor basic public transport services exist, their usefulness is often marred by deficiencies in coordination and organisation.

The Senate Committee on Rural and Regional Affairs and Transport stated recently, in its 2009 report that the key challenge for government is to provide more effective public transport services without necessarily incurring a huge cost in public subsidy.\textsuperscript{146} This would also include provisions for centralised information and marketing of these services. The Committee recommended that improvements in access to public transport could be met by improving route bus service levels, increasing and diversifying the use of existing school bus services during non-school hours, and increasing the use of community transport services. The Committee noted that community transport is a growth sector, servicing a large number of community needs. This mode of transport could be better targeted to special needs than is possible with public transport. For example, this mode of transport could service the social needs of people with disabilities. Community transport services could also be based


\textsuperscript{146} See \textit{id.}, pp. 48-9.
on daily, weekly or on door-to-door service, and the services could be provided by National and State Governments, local councils, or charitable groups (e.g. Rotary Clubs). Community transport is currently funded by local councils, or by the Commonwealth/State Home and Community Care Program (HACC), or by States (separate from the HACC). The Australian Government contributes to the HACC program, and the transport component of the HACC contributes to community transport. However, the burden of providing adequate public rural transport, and also transport services for special needs groups, is increasingly borne by local councils. The report suggested that the interface between regular public transport and community transport could be coordinated and organised in a cost-effective way.

The Committee recommended that the Commonwealth Government should take necessary steps to improve the effectiveness of present community transport services; enhance future transport needs of groups targeted by community transport; strike a proper balance between community transport and regular public transport; and encourage the division of responsibilities, actions, and funding to meet these needs. The Committee concluded that there is a need to plan for long-term change that would set the trend towards a reduction in car dependence in rural and regional areas, by creating incentives for change in behaviour and providing the means for that change to occur. It was noted that modes of transport such as walking, cycling, and public transport will continue to be unsuitable for certain travel needs. However, the government needs to create the conditions to enable people to use them where suitable.147 The public transport share of the transport mix is small, and so only a small change in behaviour by motorists may be needed to achieve a significant

147 See id., p. 51.
increase in the use of public transport. The higher the number of people using public transport, the stronger would be the viability of better services. However, Kilkenny argues that new economic geography models show that overall reductions in transport costs may work against the economic development of low density rural locations. Her empirical study infers that rural development would depend on increasing amenities and diversity among rural communities.\textsuperscript{148}

5.3.7 Distributional effects of high fuel prices on communities
Dodson and Sipe examines the impact of high fuel prices on communities, and explain the precarious position of outer suburban communities to future rises in fuel prices.\textsuperscript{149} They find that those Australians most likely to be adversely affected by high fuel prices are those most reliant on car transport and who lack access to suitable alternatives. These are the people who live on the fringes of urban areas, and those in regional and remote communities, and also socio-economically disadvantaged outer suburban areas. They argue that the long-term solution for fuel-vulnerable communities may be to build local and small-scale road infrastructure, and to create high quality public transport services linked to local centres, with good walking and cycling routes.

In a separate research effort, Dodson and Sipe demonstrate the interrelationship between the vulnerability of Australian communities to higher fuel prices, car

transport dependence, and housing debt.¹⁵⁰ Their findings have useful implications for land-use planning with a focus on creating communities that are less dependent on car transport and an increased role for the use of bicycles where possible. Some commentators have suggested tax cuts as a credible measure for easing the impact of fuel prices on suburban households because this measure directly lowers the consumer price of fuels.¹⁵¹ They argue that these could be targeted at households with the highest levels of car dependence. However, the government’s preferred method is to apply cuts to personal income tax rates. The government’s previous experience at targeting a sector or specific communities with reductions in fuel tax resulted in compliance and monitoring problems. Thus, the 2006 budget provided for $36.7 billion in personal tax cuts over four years based on changes to tax rates and thresholds.

The Australian Senate Economic References Committee, in their 2004 report on the distributive effects of the taxation system, expressed concerns that households in rural and remote communities face a unique set of challenges compared to those faced by households in major cities.¹⁵² The report recommended that the tax/welfare system designed to support households must reflect these different challenges

However, the Australian Government had provided schemes in the past to alleviate the cost of rural transport. The schemes were based on reducing the prices of

petroleum products, or curtailing rural–urban price differential, or subsidising the price of diesel for businesses operating in rural areas.

(a) Petroleum products freight subsidy scheme, 1965-2006

This was introduced in 1965 with the aim of reducing the prices of petroleum products in regional and rural areas. The scheme was amended in 1983 to specifically target remote communities. It operated by reimbursing fuel distributors the excess fuel freight cost above a certain threshold (the ‘Customer Pays Margin’). The subsidies were paid to the fuel distributors on the basis that they signed an undertaking to pass on the benefit to their customers. Most of the eligible locations consist of remote indigenous communities in Queensland, Northern Territory, and Western Australia. Others include Lord Howe Island in New South Wales and Amata in South Australia.

The value of subsidy depends on the remoteness of the location. Although the freight subsidy did not offset other costs involved in fuel supply to remote communities (e.g. retail margins), it does ensure that fuel distribution to remote areas is cheaper than it could otherwise have been. On the down side, the scheme was a disincentive for the adoption of less expensive modes of fuel transport for remote communities. The administrative costs were found to be disproportionately higher than the cost of the subsidy. Moreover, rural communities face a range of higher living costs and it may not be justified that one cost out of many should be singled out for a specific subsidy scheme. If the objective was to reduce the general high cost of living, the government

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153 See Fuel Tax Inquiry, supra note 103, at pp. 164-6. The Scheme was temporarily abolished in 1974, because the government thought that the scheme was a disincentive for the adoption of more efficient and less expensive modes of transport to remote communities. The scheme was reintroduced in 1978, shortly before the government removed fuel duty for LPG used for road transport in 1979.

154 See annexed map of Australia.
could use the more transparent benefit or income tax system to achieve the same purpose.

(b) **The diesel fuel rebate scheme (DFRS), 1982-2006**

Some of the economic activities that benefited from the DFRS take place in rural areas, such as mining, agriculture, forestry, and fishing. This scheme subsidised diesel used for business purposes and ensured that the final products from these activities were competitively priced. However, the high compliance costs on the part of the beneficiaries and the high cost of administration by the taxation office represented a significant burden to the government.

(c) **Fuel sales grants scheme, 2000-2006**

This scheme was introduced in July 2000 to reduce the price differential between urban and rural locations and to cushion the impact of the GST on the prices of refined products in rural and remote communities. To that effect, the scheme provided fuel retailers with grants of one cpl in rural zones and two cpl in remote zones. An additional grant of one cpl was provided for locations where the fuel price was consistently over $1.21. The disadvantage of this scheme laid in the difficulty of boundary delineation for the purpose of its administration. There were reported cases where fuel stations on the fringes of metropolitan areas received the grant, and so had a price advantage over competitors in close proximity. Also the bulk end users, like the mining companies located in rural and remote areas, were entitled to the FSGS grant even though they also received GST input tax credit on their fuel purchases.

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5.4 Summary and Discussion of Findings
The components of fuel retail prices are similar in both jurisdictions, but differ in two respects. Firstly, all fuel duties are levied and collected by the UK Government, whereas the Australia Government and individual States and Territories charge fuel taxes. Secondly, the UK Government charge relatively higher fuel duties, which are reflected in the relative pump prices in both jurisdictions.

Wholesale fuel prices in the two jurisdictions are determined by crude oil prices and international fuel prices. Consequently, the only component of the wholesale price that could be regulated is the wholesale margin. There is no evidence that wholesale margins have been regulated in the UK. However, the Australian experience of wholesale price regulation reveals the difficulties associated with setting optimal price caps. If the price cap is set too high, it may trigger a round of price discounting and result in price cycles. If it is set too low, a high number of operators may exit the business, with attendant supply and competition implications.

Fuel retail prices also have not been regulated in the UK. The OFT monitors periodically and reports on the state of the fuel retail sector. However, the Australian experience of fuel retail price regulation shows that price regulation may leave the fuel retail market in a worse state than it could have been under normal competitive conditions. The arguments against fuel wholesale price regulation are equally applicable to fuel retail price regulation.

The component of fuel retail price that accounts for more than 50% of prices, in the two jurisdictions, is the fuel duty plus VAT (UK) or fuel duty plus GST (Australia). Thus, realistically the duty and VAT (or GST) are the two components of the fuel
retail price that could be regulated by the governments. An examination of the purpose of fuel tax, in both jurisdictions, reveals that the primary objective is to generate revenue for the governments. However, since the 1990s these governments have increasingly relied on fuel taxation to achieve environmental objectives by addressing external costs associated with road transport. This secondary objective is aimed at discouraging private car transport. These objectives of a fuel tax create an incentive for governments in the two jurisdictions to increase, rather than reduce, fuel duty.

An investigation of the distributional effects of increases in fuel duty or higher pump prices of fuels on sub-groups of the population indicates that the effects are felt most by middle-income households, poor car-owning households, and rural inhabitants (perhaps with the exclusion of high-income earners, and rich retirees who migrate to rural areas). A similar investigation of the impact of high fuel prices on communities in Australia reveals that the effects are likely to be felt most by households who are most reliant on car transport and who lack access to suitable alternatives. The people that are likely to be affected are those living on the fringes of urban areas and those in regional and remote communities.

To counteract these adverse effects, it has been argued in the two jurisdictions that increasing the use and efficiency of public transport is the intuitive solution. The reasons are that public transport could reduce dependence on private transport, contribute to a reduction in greenhouse gas emissions, reduce health costs associated with pollution and road accidents, and also reduce social isolation amongst those with transport disadvantage. Further investigation into the adequacy of public transport
infrastructure and provision in rural areas indicates that the local councils bear a disproportionate burden of this task. Therefore, more still needs to be done by central governments in both jurisdictions to break the vicious cycle of car dependence in rural areas.

EU environmental objectives and a commitment to the Kyoto protocol combine to make it difficult for the UK Government to grant fuel tax concessions to the disadvantaged sub-population affected by high fuel tax or high fuel pump prices. To achieve these objectives, the EU has devised a system of minimum rates for taxation of energy products (as contained in Council Directive 2003/96/EC of 27 October 2003). However, the Council Directive provided for differentiated rates of taxation, from which local public passenger transport, including taxis could benefit. The directive also created exemptions; total or partial exemptions; or reductions in the level of taxation depending on local situations in each Member state. Fishing could benefit from exemptions. Projects for the technological development of environmentally-friendly products, or in relation to fuels and energy from renewable sources e.g. bio fuels, solar, wind, tidal forms of energy qualify for total or partial exemptions. Products used for carrying goods and passengers by rail, metro, tram, or trolley buses, as well as natural gas and LPG used as propellants, all qualify for a reduction in tax levels.

Nevertheless, there have been a number of government initiatives in the UK aimed at improving public transportation. Examples are the introduction of the Rural Bus Subsidy Grant, Rural Bus Challenge, and Parish Transport Fund. There are also a number of rural transport initiatives introduced by the Scottish Government.
Arguments have been made regarding the need for government to create better conditions for the promotion of other transport modes, such as walking and cycling. Some non-transport solutions have also been suggested, e.g. adequate provision of telecommunications to reduce the need to travel. Other policy measures have been put forward, such as duty derogation for rural areas, essential user rebate, and support for rural shops and services to reduce car use. However, some of these measures are fraught with difficulties in their effective design and targeting. In the case of duty derogation and essential user rebate, there are technical difficulties in defining and monitoring the boundaries of the target areas.

Thus, it is challenging to design appropriate subsidy schemes for some rural locations. Nevertheless, a number of these have been tried in Australia and in some cases the results have been inconsistent with the objectives, e.g. the PPFSS, DFRS, FSGS, etc. Consequently, they had to be amended sometimes to reduce the problem of compliance and to lighten the burden of administration. Most have now been scrapped since 2006, primarily because of the government’s environmental policy and a resolve to deregulate the fuel retail sector.

5.5 Conclusion
This chapter set out to examine the potential contributions of fuel wholesale and retail price regulations to a rural development policy. This involved an investigation of a number of issues such as, (a) the purpose of fuel tax and how it drives a transport policy; (b) the interface between fuel price regulations and fuel tax objectives; (c) the distributional effects of higher fuel taxes or higher pump prices on sub-groups of the population; (d) the potential for developing effective public transport solutions and
infrastructure in rural areas; (e) the role of central government, local councils, and local investors in developing rural transport solutions; and (f) the potential for government subsidies such as fuel duty concessions and remissions. These objectives were met and a discussion of the findings has been presented in the preceding section of this chapter (i.e. section 5.4).

However, based on the findings this thesis argues that the regulation and administration of fuel tax could contribute to rural development, if a certain percentage of the proceeds are dedicated to improving rural public transport, including a number of innovative approaches to rural transport, such as transport for special groups – school buses, ambulances, etc. This remains a difficult proposition in countries where the public transport sector is deregulated, e.g. in the UK. In such cases, private investors and voluntary agencies are usually the key exogenous actors in rural public transport provision.

Nevertheless, the UK Government could increase funding for local governments to ensure that the benefits of public transport are realised on a universal basis. Fuel tax proceeds could also be used to extend business tax credits for those operating in rural and remote locations. This would not only increase their competitiveness, but could help create and retain jobs in these areas. Funds could also be dedicated to rural fuel station remediation, especially those that are closing. This might prevent environmental disasters, and also ensure that the premises could be easily re-opened or used for alternative purposes. For a longer term solution to the problems of high rural fuel prices and rural-urban fuel price differentials, the UK Government could possibly consider the EU provisions for total or partial exemptions from fuel taxes for
projects that develop environmentally friendly fuels or those that produce fuels and energy from renewable sources

In the case of Australia, the government has tried various fuel subsidy schemes with the aim of dealing with the problems of high rural fuel prices and high rural-urban price differentials. However, the results have been inconsistent and the Australian Government have now abandoned most of these fuel concessions and remissions since they conflict with government’s current environmental and fuel retail deregulation policies. However, similar to the EU directive (2003/96/EC) which provided for total or partial or differentiated rates of fuel taxation, the Australian Government could also provide fuel concessions that encourage the production of environmentally friendly fuels and energy sources. These concessions as part of State aid instruments for promoting rural development are examined fully in Chapter 6.
Chapter 6
STATE AID INSTRUMENTS: APPLICABILITY TO RURAL/REMOTE LOCATIONS

6.1 Introduction
The previous chapter investigated the contribution of fuel price and tax regulations to rural development. The chapter found that environmental considerations affect decisions regarding fuel concessions and remissions. However, a percentage of the fuel tax proceeds could be hypothecated to improvements in rural public transport.

This chapter investigates the second hypothesis of this study, by comparing the state aid instruments in the UK and Australia. This comparison is important in the sense that few rural and regional subsidies are introduced in the UK by statutes, whereas most of the Australian state aid instruments for rural and regional development are introduced by statutes. Moreover, most of the subsidies for regional development in the UK are principally based on European state aid rules and guidelines because they have to comply with European law due to the UK accession to the EU.

In carrying out the comparison, this chapter examines the subsidy provisions in the UK and the various provisions of the European state aid policy in order to identify the existence or not of aids that are compatible with rural development objective. Similarly, state aid instruments in Australia designed for the purpose of rural development, particularly fuel concessions, are assessed in terms of their long-term applicability to rural areas. This assessment is based on their compatibility with environmental objectives, and the character of the subsidies and the markets where they are applied.
The findings of this investigation contribute to an understanding of whether rural development policy could be pursued solely through an endogenous approach as different from a mixture of endogenous and exogenous approaches.

6.2 United Kingdom

6.2.1 Structure of subsidy provisions in the UK
Subsidies are granted by a range of central and devolved government departments and agencies in the UK. Regional agencies and local authorities are important providers of subsidy and business support aimed at meeting social, environmental, and other objectives. However, these various arms of government develop their subsidies independently, but using common guidelines for policy appraisal as directed by HM Treasury.

In Scotland, enterprise agencies play a major role in granting subsidies. Invest Northern Ireland acts as the Department of Enterprise, Trade and Investment’s delivery arm for subsidies in that province. In Wales, the Welsh Development Authority handles smaller subsidies, while the Welsh Assembly Government plays a direct role in the administration of larger subsidies. Local authorities in these devolved administrations also have powers to disburse discretionary subsidies to meet social, environmental, and other objectives. These departments and agencies all operate under the EU general guidelines on the granting of subsidies.

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2 See id., pp. 48-9.
6.2.2 UK subsidy design and control
The design and control of subsidies, currently in 2009, pass through five phases as follows:

(a) Guidance on project appraisal for all government departments and executive agencies is contained in the Green Book (which applies to England, Wales, and Northern Ireland) and in the Scottish Public Finance Manual for Scotland (SPFM). According to the Green Book, the basic rationale for government intervention is either to rectify a market failure or to address distributional objectives where necessary. All such policy considerations are expected to conform to the Rationale, Objectives, Appraisal, Monitoring, Evaluation and Feedback (ROAMEF) cycle. The SPFM follows similar procedures as the Green Book.

These best practice guidelines are useful in the assessment of proposed new policies, projects, or programmes, including the provision of subsidies. The guidance compels policymakers to investigate the options that could achieve the same set of objectives, and choose the one that would deliver the highest net benefit. The project appraisal guidelines recommend that policymakers take account of social, financial, and environmental costs in assessing programmes and projects. However, the guidelines do not explicitly include the cost of competition distortions in the market(s) affected by the policy.

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4 See id., p3.
6 See OFT 750; supra note 1, at 47.
The OFT contends that the guidance should have included potential competition distortion effects in the assessment of costs, to prevent the choice of an approach that has significant competition distortions over another with similar costs and benefits but with less significant distortions.

(b) Regional bodies in the UK administer a significant number of subsidy schemes based on Regional Selective Assistance (RSA) and Selective Finance for Investment (SFI) guidelines. These two major subsidy schemes provide grants to firms in Assisted Areas (AAs) or under-performing areas of the UK. These two schemes accounted for about £196.8m of subsidies provided in 2002. However, subsidy provisions under these schemes are subject to the European state aid rules on regional aid. Regional aid is of considerable interest to the European Commission, and so the EU regional aid guidelines confer on member states the greatest level of flexibility in the design and provision of such subsidies.

These schemes are administered at the regional level, but the Department of Trade and Industries (DTI) developed national guidelines for their administration. However, these guidelines focus on ensuring the effectiveness of grants at enhancing

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7 See id., p. 53.
9 Please note that DTI was disbanded on 28 June 2007 and was replaced by the Department for Business, Enterprise and Regulatory Reform (BERR). BERR was disbanded on 6 June 2009 and was replaced by the current Department for Business, Innovation and Skills (BIS).
regional growth and providing sustainable skilled jobs in the AAs. The criteria set out in these guidelines reflect those of the European state aid rules. Some of these are, firstly, that the project’s viability in the AAs is doubtful without the grant. Secondly, the jobs created through the grant must meet a certain minimum quality (applicable only to SFI). Thirdly, the acceptable cost per job created should not be above a certain maximum level. Fourthly, considerations should be given to the extent to which the project displaces jobs in competing firms rather than creating new ones. These criteria limit the magnitude of regional aids and ensure that the benefit derived from the project outweighs the costs. However, similar to the project appraisal guidelines, the OFT contend that these guidelines do not cover other characteristics of the subsidy that may affect competition.

(c) Regulatory Impact Assessment (RIA) is compulsory for all legislative proposals for regulations that affect businesses, voluntary bodies, and charities. Following a UK Government White Paper in 2001, all RIAs must include a competition assessment procedure.\(^\text{10}\) However, this process involves only measures that could be introduced through legislation. Thus, the scope for the RIA process is limited, as only few

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subsidies are introduced through legislation in the UK. The OFT have also published case-studies on how to assess the competition effects of subsidies.\textsuperscript{11}

(d) The Treasury’s Fees and Charges Guide, and the SPFM (Fees and Charges Section) discourages public sector bodies from cross-subsidising their commercial activities with funds they receive for their public sector activities. The aim is to ensure that commercial investments made by public bodies do not distort markets through the allocation of common costs between their commercial and non-commercial services.

(e) The State Aid Policy Unit (SAPU) of the Department for Business, Innovation and Skills (BIS) provides the formal link between the European Commission and UK subsidy providers for all state aids. Therefore, all notifications of state aid are passed through the SAPU, but the unit is not responsible for ensuring adherence to the state aid rules. The SAPU’s role is to monitor the process and to render advice on state aid rules and procedures to all government units that are responsible for providing aid to businesses.\textsuperscript{12} Monitoring could be useful in identifying the competition effects associated with existing subsidies. Thus, information gathered through the monitoring process could be used to improve subsequent design of subsidies. In some cases, monitoring could help identify concerns that have slipped through the project appraisal phase.

However, the European Commission is responsible for monitoring and enforcing the European state aid rules, whereas the responsibility for adherence to the rules remains with the subsidy provider. There are a few cases where the European rules specify


\textsuperscript{12} See OFT 750; \textit{supra} note 1, at p. 59.
that a subsidy proposal goes through a competition assessment by its provider. In such cases, the SAPU can review it before forwarding it to the EU Commission as part of the aid notification process. Therefore, the SAPU only considers the competition effects of these subsidies where the state aid rules specifically require it.

The government recognises that subsidies, when properly designed under certain guidelines, could be a potent tool for addressing market failures and increasing social welfare. However, the OFT contends that such policy appraisal guidelines should incorporate competition distorting effects as one of the factors to be considered when designing a subsidy.

6.2.3 UK expenditure on subsidies

The European rules on state aid stipulate that member states should provide annual state aid notifications, including how much subsidy were disbursed, the objective the aid is pursuing and the instrument for delivering the aid.13

Table 6.1 UK State aid by primary objective

<table>
<thead>
<tr>
<th>Sector</th>
<th>State Aid (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transport</td>
<td>27.2</td>
</tr>
<tr>
<td>Research &amp; Development</td>
<td>25.7</td>
</tr>
<tr>
<td>Regional Aid</td>
<td>21.0</td>
</tr>
<tr>
<td>Small &amp; Medium Scale Enterprises</td>
<td>14.5</td>
</tr>
<tr>
<td>Sectorial</td>
<td>6.7</td>
</tr>
<tr>
<td>Employment</td>
<td>2.1</td>
</tr>
<tr>
<td>Training</td>
<td>1.6</td>
</tr>
<tr>
<td>Environment</td>
<td>1.2</td>
</tr>
<tr>
<td>Rescue &amp; Restructure</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

**Source:** OFT 750, Public Subsidies (2004) p. 10

Tables 6.1 and 6.2 show the distribution of UK state aid by primary objective and by aid instrument. The tables indicate that around 75% of the aid (as at 2004) was disbursed to the transport, research and development, and regional aid sectors, and that this aid was delivered mainly through grants and tax credits.\(^\text{14}\)

**Table 6.2 UK State aid by aid instrument**

<table>
<thead>
<tr>
<th>Aid Instrument</th>
<th>State Aid (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant</td>
<td>70</td>
</tr>
<tr>
<td>Tax Credit</td>
<td>13</td>
</tr>
<tr>
<td>Advice</td>
<td>8</td>
</tr>
<tr>
<td>Reimbursable Grant</td>
<td>6</td>
</tr>
<tr>
<td>Tax Relief/ Rate Reduction</td>
<td>2</td>
</tr>
<tr>
<td>Equity Capital</td>
<td>1</td>
</tr>
<tr>
<td>Government Loan/Guarantee</td>
<td>0</td>
</tr>
<tr>
<td>Soft Loan</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

*Source: OFT 750, Public Subsidies (2004) p. 11*

HM Treasury estimated the value of subsidies in 2003 at £8.2bn. This figure includes transfers through the Common Agricultural Programme (£2.3bn), transfers to public bodies (£2.1bn) and subsidies for public transport infrastructure, revenue support, and the Strategic Rail Authority (£2.5bn). The remainder (£1.3bn) represents grants made to private firms.\(^\text{15}\) This figure does not include some subsidies that are not classified as state aids but as public expenditure, such as tax relief, capital grants, and loan guarantees. It also does not include subsidy payments made by local authorities. However, the amount of subsidy granted in the UK that meets the European state aid criteria in 2002 was £2.8bn, which was far less than the annual figure for subsidies granted.

\(^\text{14}\) See OFT 750; *supra* note 1, at p. 9.

\(^\text{15}\) See *id.*, p. 8.
However, 2008 figures from the EU state aid scoreboard indicate that UK’s aid expenditure has risen sharply because of the impact of the global financial crisis. Total state aid granted by the EU member states in 2008 was approximately 279.6 billion Euros. In absolute terms, the UK had the highest State aid expenditure of all member states (72.5 billion Euros), followed by Germany (66.8 billion Euros), Ireland (37.5 billion Euros) and Belgium (19.4 billion Euros).\textsuperscript{16} Aid to the financial sector for ‘rescue and restructure’ objectives accounted for most of this expenditure.

\textbf{6.2.4 UK membership of the European Union}\textsuperscript{17}

The events of the World War II and Winston Churchill’s suggestion in his speech at Zurich University in 1946 for the formation of a kind of United States of Europe set the scene for the creation of the European Union. Subsequently, in 1949 the governments of the UK, France, and Benelux decided to create a Council of Europe.\textsuperscript{18} Eight years later (1957), the Treaties of Rome established the European Economic Community (EEC) and the European Atomic Energy Community. The following year (1958), the EEC held its first session of the European Parliamentary Assembly in France. The initial emphasis by the parliament was based on trade cooperation among European countries. Thus, in 1959 seven countries (UK, Austria, Denmark, Norway, Sweden, Switzerland, and Portugal, joined together to form the European Free Trade Association (EFTA). In 1961, the UK applied formally to join the European Communities, SEC (2009) 1638; \textit{State Aid Scoreboard (Autumn 2009 Update): Facts and Figures on State Aid in the EU Member States}, pp7-8. Available online at http://ec.europa.eu/competition/state_aid/studies_reports/annex_2009_autumn_en.pdf, last visited on 27 October 2009.


\textsuperscript{17} This section is a brief account included only to establish the position of the UK within the EU.

Community (EC) but it was not until 1973 that the UK, along with Ireland and Denmark, joined the EC officially.

During the latter part of 1974, the EC’s heads of government decided to constitute themselves into the European Council and agreed to hold meetings three times a year. The Council also agreed on the modalities for elections into the European Parliament, and to set up the European Regional Development Fund, and an economic and monetary union.

However, Britain’s membership of the EU was opposed by a cross-section of the populace and political interests (these groups are often referred to as Eurosceptics). Some argued that the relationship between the UK and the EU could be limited to trade only and should not extend to common currency and regional politics. Others feared that the UK/EU relationship could lead to significant changes in British constitutional rules and the framework of the government; distribution of formal authority and resources; regulatory rules, guidelines and codes; business processes; and the cultural aspects of institutions. This led to the call for a referendum on Britain’s involvement with the EC project. The 1975 referendum shows that around 67.2% of the citizens were in support of the UK remaining a member of the Community. The European Council established the European Monetary System and the Exchange Rate Mechanism (ERM) in 1978. In response to growing anxiety about the EC project as regards the monetary and political agenda, the UK, of all the

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19 The Conservative Party houses a considerable number of Eurosceptics.
Community member states, was alone in deciding not to be a part of the ERM. However, the Maastricht Treaty\(^\text{21}\) of 1992 created the Euro and the three-pillar structure of the modern EU.\(^\text{22}\) The signing of the Amsterdam Treaty\(^\text{23}\) in 1997 marked the beginning of the common foreign and security policy, conferred more powers on the European Parliament, and defined the rights of individuals within the Union. The Lisbon Treaty\(^\text{24}\) further confers more powers on the EU’s parliament, and created the positions of a European President, a European Foreign Minister, and a diplomatic service.

The single European market entered into force in 1993 and was acceded by all member states. However, the idea of lifting border control was put forward by the EC (the Schengen Agreement),\(^\text{25}\) and the UK and Ireland dissented due to fears of illegal immigration and terrorism. Subsequently, the Schengen Agreement came into force between Germany, France, Belgium, Spain, the Netherlands, and Luxembourg. In 2001, the Treaty of Nice was signed to reform the institutional structure of the EU to provide for eastward enlargement. The enlargement took place in 2004 as ten new countries joined the EU: Hungary, Poland, Cyprus, Estonia, the Czech Republic, Slovenia, Lithuania, Malta, the Slovak Republic, and Latvia. Prior to the enlargement,


\[^{22}\] The three pillars consist of the European Community, the Justice and Home Affairs, and the Common Foreign and Security Policy.


in 2002 the common European currency (the Euro) entered into circulation in twelve participating member states,\(^{26}\) excluding the UK.

The UK’s membership of the EU has been fraught with resentment by a section of the British people based on accumulation of power at Brussels, of further enlargement, and its implications for immigration. Some Eurosceptics believe that the idea of European integration is largely driven by elites and not by the popular will of the people. However, the current economic recession has seen the powers of the European Council weakened as member state governments took unilateral actions to save their banks, car companies, and to secure jobs as much as possible. This has led to record-level budget deficits in most member countries and has thus weakened the tight budgetary discipline set by the EC. The former EU Internal Market/Competition Commissioner Mario Monti has called for a new deal on how to integrate social policies in the Eurozone without endangering single market rules.\(^{27}\) Therefore, the EC will have to re-assert its right to set competition policy in a new era of significantly enhanced state intervention and ownership.

Based on the foregoing, it could be argued that Britain has not always agreed with all EU policies, particularly on its monetary policies. However, for the purpose of this chapter, it may suffice to say that Britain’s support for a single European market commits it to the EU state aid policies.\(^{28}\)

\(^{26}\) The participating countries are Germany, France, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Finland, Greece, Luxembourg, and Austria.


6.2.5 EU guidelines on state aid or subsidies
The fundamental rationale behind the EU guidelines on state aid is that the provision of state aid can distort competition in three main ways: by causing firms to set output and pricing levels inefficiently; by keeping inefficient firms in the market, discouraging entry by efficient firms or encouraging entry by inefficient firms; and by distorting investment and R&D decisions.²⁹

The EU guidelines require that any rescue aid or subsidy must be warranted on the grounds of serious social difficulties that have no undue spill-over effects on other member states and provided that the subsidy is non-discriminatory. The EC Treaty generally prohibits state aid, but with exemptions for aids that target objectives which are compatible with the common market; for instance aid is allowed to promote cultural conservation, remedy of damages caused by natural disasters, and for horizontal objectives such as training, R&D, and aid to small- and medium-sized enterprises (SMEs).³⁰ These are in keeping with the two broad aims of the EU: maintenance of freedom, security and justice within internal borders; and an internal market where competition is free and undistorted; and sustainable development based on balanced economic growth, price stability, a highly competitive social market economy, social justice and protection. These aids are in line with EU shared values which include human dignity, free markets, respect for human rights, minority rights, equality, freedom, the rule of law, etc. The common principles prevailing in EU member states also stress pluralism, non-discrimination, justice, tolerance, solidarity, etc.

³⁰ See OFT report on Public Subsidies; supra note 1, at p. 32.
Articles 87–9 of the EC Treaty\textsuperscript{31} defined the group of subsidies that are regarded as state aids and subject to a specific set of guidelines and regulations drawn up at European level. The objective of articles 87–9 is to prevent state aids that harm the Common European Market. The EC Treaty defined state aid as any government intervention that fulfils four criteria: it conveys an economic advantage to some firms – i.e. selective; it is a transfer of state resources – either a cost or loss of revenue; it distorts or threatens to distort competition; it affects trade between member states – the product or service is or could be subject to intra-community trade.

Article 87 (1) – ex Article 92 – captures the reluctance of the EU to encourage state aid as follows: “Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market”.

However, Article 87 (2–3) – ex Article 92 – created exemptions as follows:

“The following shall be compatible with the common market: (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division”.

3. “The following may be considered to be compatible with the common market:

(a) Aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

(b) Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) Aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) Aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;

(e) Such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.” 32

From the foregoing, aid may be permitted under Articles 87–89 if it is designed to: 33 facilitate the development of certain activities or economic areas; promote the economic development of underdeveloped areas; promote the execution of an important project of common European interest; or remedy a serious disturbance in the economy of a member state, or; promote culture and heritage conservation.

The guidelines on state aid now places compatible aid into three categories:

(a) Regional aid – for regions suffering low growth or high unemployment.

(b) Sector-specific aid – with specific rules for sensitive sectors, and

(c) Horizontal objectives – e.g. aid for SMEs, R&D, training, or employment.


33 See Public Subsidies; supra note 1, at p. 34.
Based on the four criteria that define state aid, it follows that three types of subsidies are not considered as state aid:  

(a) Subsidies that do not affect intra-community trade;

(b) Subsidies whose value is below a given threshold and so pass through the ‘de minimis’ block exemption. The special rules for small amounts of aid allow government bodies to grant up to €200,000 cumulatively to any individual firm over a rolling three-year period without informing the EC; (c) Subsidies that are provided on a non-selective basis but have different effects on individual recipients.

6.2.5.1 Aid for rural development

The Council Regulation (EC) No. 1257/1999 on support for rural development defines a new policy for it and seeks to establish a coherent and sustainable framework for the long-term future of rural areas in Europe. Article 51 of this regulation declares that Articles 87–8 of the EC Treaty are applicable to aid for rural development. This regulation forms the basis for complementing Agenda 2000 reform

34 See id., pp. 32-3.
36 See Unicredito Italiano SpA v Agenzia and Ufficio, Case C-148/04, ECJ (15 December 2005). Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62004J0148:EN:HTML, last visited on 30 October 2009. Paragraph 1, states that, ‘Article 87(1) EC prohibits aids which ‘favours certain undertakings or the production of certain goods’, that is to say, selective aid. Aid may be selective in the light of that provision even when it concerns a whole economic sector. That is the case with a tax reduction which applies only to the banking sector and, within the banking sector, benefits only undertakings which carry out certain operations. Since it does not apply to all economic operators and is, in reality, a departure from the ordinary tax scheme, it cannot be considered to be a general measure of tax or economic policy. Such a tax reduction must therefore be prohibited under Article 87(1) EC…”
package\textsuperscript{38} on agricultural policy, by promoting a competitive and multifunctional agricultural sector as part of a comprehensive, integrated strategy for rural development in member states.

Article 33 stipulates the aspects of rural development for which support may be granted, as follows:\textsuperscript{39} “support shall be granted for measures, relating to farming activities and their conversion and to rural activities, which do not fall within the scope of any other measure referred to in this Title. Such measures shall concern: land improvement, reparcelling, setting-up of farm relief and farm management services, marketing of quality agricultural products, basic services for the rural economy and population, renovation and development of villages and protection and conservation of the rural heritage, diversification of agricultural activities and activities close to agriculture to provide multiple activities or alternative incomes, agricultural water resources management, development and improvement of infrastructure connected with the development of agriculture, encouragement for tourist and craft activities, protection of the environment in connection with agriculture, forestry and landscape conservation as well as with the improvement of animal welfare, restoring agricultural production potential damaged by natural disasters and introducing appropriate prevention instruments, financial engineering.”

Thus, this policy stresses the development of alternative sources of income as an integral aspect of a rural development policy, while recognising that farming plays a number of important roles, such as the preservation of rural heritage, the environment and traditional landscapes. However, Article 37 of this regulation stipulates that support for rural development may be extended to measures that are compatible with other community policies.


\textsuperscript{39} See \textit{Article 33 of the Council Regulation (EC) No 1257/1999}.
Therefore, the regulation covers both agricultural and non-agricultural activities in its support for rural development. Therefore, let us examine the EC policies on key aspects of rural development issues, such as agriculture, small- and medium-scale enterprises, transport, energy conservation, environmental protection and services of general interest.

6.2.5.2 EC policy on state aid for agriculture

State aid rules in the agricultural sector are based on three objectives: to ensure that these rules are (a) compatible with the general principles of competition policy; (b) consistent with the Community’s common agricultural and rural development policies;\(^\text{40}\) (c) coherent with the EU’s international obligations, and in this context the WTO Agreement on Agriculture.\(^\text{41}\)

\(^\text{40}\) **ARAP v Commission of the European Communities**, Case T-82/96, CFI (17 June 1999) ECR II-1889. Available online at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61996A0082:EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61996A0082:EN:HTML), last visited on 28 October 2009. Paragraph 86 states that, “it must be borne in mind at the outset that a common market organisation pursues a set of distinct aims, reflecting the various objectives of the common agricultural policy, as defined by Article 33(1) EC. It seeks in particular to ensure optimum employment of farmers and ensure a fair standard of living for them, to stabilise markets and to assure the availability of supplies to consumers at reasonable prices. Moreover, Article 33(2) provides that, in working out the common agricultural policy, account is to be taken of the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions, the need to effect the appropriate adjustments by degrees and the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole.” Also see **Walter Rau and Others v Commission of the European Communities**, Joined Cases (C-279/84, C-280/84, C-285/84, C-286/84), ECJ (11 March 1987) ECR I-1069. Available online at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61984J0279:EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61984J0279:EN:HTML), last visited on 28 October 2009. Paragraph 21 elaborates on the set of distinct aims that the common organisation of the agricultural market should pursue as follows. “It must be pointed out that according to the settled case-law of the Court … in pursuing the various aims laid down in Article 39 of the Treaty, the Community institutions have a permanent duty to reconcile the individual aims. Although that duty to reconcile means that no single aim may be pursued in isolation in such a way as to make the achievement of the others impossible, the Community institutions may allow one of them temporary priority in order to satisfy the demands of the economic or other conditions in view of which their decisions are made.”

Guidelines for state aid to agriculture were established with the adoption of Council Regulation (EC) No 1257/1999 on support for rural development. Council Regulation (EC) No 1290/2005 created two funds to finance agricultural expenditure. The European Agricultural Fund for Rural development finances the rural development programmes of the member states, whereas the European Agricultural Guarantee Fund finances direct payments to farmers and measures to regulate agricultural markets (e.g. intervention and export refunds). Article 41 of this regulation specified that the programming period for rural development financed programmes would take effect from 1 January 2007.

Regional aid guidelines are not applicable to investments in the processing and marketing of agricultural products. Similarly, the Commission Regulation (EC) No 69/2001 on De minimis aid is not applicable to agriculture. Similarly, the Commission Regulation (EC) No 70/2001 on aid for small and medium enterprises

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does not apply to agriculture. However, Commission Regulation (EC) No 68/2001\textsuperscript{47} on training aid is applicable to the agricultural sector.

Aid for investment in agricultural holdings may only be considered to fall within the derogation provided for by Article 87(3) (c) EC\textsuperscript{48}, if such investments improve the conditions of agricultural production thereby facilitating the development of the sector. Thus, such investments have to meet certain objectives as specified by the guidelines for state aid in the agriculture sector as follows: reduction of employment costs; increased quality of products; improvement and redeployment of production; preservation and improvement of the natural environment, hygiene conditions and animal welfare standards; and diversification of farm activities.\textsuperscript{49} The guidelines provided for a maximum rate of aid at 40\% gross, and 50\% for less-favoured areas.

Investment aid for the processing and marketing of agricultural products may be granted to firms that are economically viable and which comply with the minimum standards regarding the environment and animal welfare.\textsuperscript{50} Eligible costs for the purpose of grant aid include the acquisition of new machinery and equipment, construction, acquisition or improvement of immovable property, and general costs. The maximum aid rate is set at 50\% for eligible expenses in Objective 1 regions and

\textsuperscript{48} See Article 87 of the EC Treaty (Ex-Article 92). Available online at http://ec.europa.eu/competition/legislation/treaties/ec/art87_en.html, last visited on 20 October 2009. Article 87 (3) (c), stipulates that the following may be considered to be compatible with the common market: “(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest”.  
\textsuperscript{49} See Agriculture and Rural Development; supra note at 41, at p. 1.  
\textsuperscript{50} See Article 7 of the Council Regulation (EC) No 1257/1999.
40% in other regions.\textsuperscript{51} Aid for diversification into other activities related to agricultural production, processing and marketing of products may be treated as investment in agricultural holdings or investment in agricultural products, depending on the size of the investment. Larger scale investments are assessed as aid for processing and marketing activities, whereas small-scale investments are regarded by the Commission as aid for agricultural holdings.

The Commission previously took a positive view on start-up aid for producer groups, with the intention of providing an incentive for bringing farmers together, concentrating their supply, and adapting their production methods to market requirements. Subsequently, this support had been deemed as unnecessary and has been discontinued with effect from the date of this regulation.\textsuperscript{52}

The Commission supports all environmental aid schemes in the agricultural sector provided they are compatible with the general objectives of the Community environmental objectives. Environmental aid that is compatible with the ‘polluter pays’ principle includes those that eliminate pollution at source. The Commission supports production methods that protect the environment and encourages the use of environmental farming.\textsuperscript{53} The Commission previously supported temporary relief to cushion the effects of costs of new mandatory national environmental requirements, and also provided relief from certain new energy taxes or levies on environmentally

\textsuperscript{51} See Article 28 of the Council Regulation (EC) No 1257/1999. Objective 1 regions are those whose development is lagging significantly behind, i.e. whose per capita GDP is less than 75% of the EU average. The regions include Azores, Canary Islands, Madeira, etc. For details on the classification of the regions into three Objectives for the purpose of administering the Structural Funds, see General Provisions on the Structural Funds. Available online at http://europa.eu/legislation_summaries/regional_policy/provisions_and_instruments/l60014_en.htm, last visited on 29 October 2009.

\textsuperscript{52} See Note (44) of the Council Regulation (EC) No 1257/1999.

\textsuperscript{53} See id., Article 22.
sensitive inputs such as pesticides and herbicides. These may be justified where necessary to offset a possible loss of international competitiveness. Regarding clearly justified cases, such as aid for the development of biofuels, the Commission supports the provision of operational aid to the producers to offset additional costs involved in the use of environmentally friendly inputs as compared with conventional production methods.\(^{54}\)

### 6.2.5.3 State aid for transport services

The EC provisions for the Community transport policy apply only to transport by road, rail, and inland waterway, and are established by Article 2 of Council Regulation (EEC) No 1107/70\(^{55}\) and Articles 70–80 EC.\(^{56}\) Article 87 EC also applies to this sector. Article 73 EC\(^{57}\) makes special provisions for state aid that meets the needs of coordination of transport\(^{58}\) or that requires a reimbursement for the discharge of certain obligations related to the concept of public service. Council Regulation

\(^{54}\) See Directive 2003/30/EC of the European Parliament and of the Council of 8 May 2003 on the Promotion of the Use of Biofuels or other Renewable Fuels for Transport, Official Journal of the EU (L123/42). Available online at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:123:0042:0046:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:123:0042:0046:EN:PDF), last visited on 24 October 2009. Note (7) states that, “increased use of biofuels for transport, without ruling out other possible alternative fuels, including automotive LPG and CNG, is one of the tools by which the Community can reduce its dependence on imported energy and influence the fuel market for transport and hence the security of energy supply in the medium and long term. However, this consideration should not detract in any way from the importance of compliance with Community legislation on fuel quality, vehicle emissions and air quality”.


\(^{57}\) See id., Article 73. This Article stipulates that, “aids shall be compatible with this Treaty if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of a public service.”

governed compensation for carrying out obligations inherent in the
concept of public service operated in the road, rail, and waterway sectors. Thus, the
Commission is favourably disposed to public service obligations imposed for urban,
suburban, and regional transport services. Moreover, member states may conclude
public service contracts with transport undertakings to ensure adequate transport
services, which particularly accommodate social and environmental factors, town and
countryside planning, or with a view to extending reduced fares to certain categories
of passengers. Compensation for such public services is calculated based on the cost
of providing them. The Commission may, where applicable, apply Article 86(2) EC,

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60 See Municipality of Amelo and Others v NV Energiebedrijf IJsselmij, Case C-393/92, ECJ (27 April 1994) ECR I- 1477, paras 46–7. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61992J0393:EN:HTML, last visited on 28 October 2009. Paragraph 46 states that, “Article 90 (2) of the Treaty provides that undertakings entrusted with the operation of services of general economic interest may be exempted from the application of the competition rules contained in the Treaty in so far as it is necessary to impose restrictions on competition, or even to exclude all competition, from other economic operators in order to ensure the performance of the particular tasks assigned to them.” Also see Criminal Proceedings against Paul Corbeau, C-320/91, ECJ (19 May 1993) ECR I- 2533, paras 12-14. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61991J0320:EN:HTML, last visited on 28 October 2009. Paragraph 14 states as follows: “that latter provision thus permits the Member States to confer on undertakings to which they entrust the operation of services of general economic interest, exclusive rights which may hinder the application of the rules of the Treaty on competition in so far as restrictions on competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertaking possessed of the exclusive rights.”


62 See EC Treaty; supra note 31, at Article 86(2). Article 86(2) provides that “Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law and in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.”
which precludes services of general economic interest from compliance with the competition rules.

The Commission currently pursues a policy of shifting the balance of transport modes in favour of those with lesser environmental impact so as to achieve a sustainable transport system. Consequently, the Commission takes a favourable view of aid which enhances the development of combined transport; rail services, including investments in rail infrastructure; and inland water transport. Council Regulation (EC) No 718/1999 on Community fleet capacity to promote inland waterway transport encourages member states to promote this mode of transport. Similarly, Council Regulation (EC) No 1192/69\(^{63}\) provides for compensation for railway undertakings based on extra costs they may have to bear compared to other transport undertakings.

Council Regulation (EC) No 543/97\(^{64}\) specifies the other circumstances that may warrant the provision of aid for road, rail, and waterway undertakings. Aid may also be granted for the purpose of developing transport systems and technologies which are economical for the Community, but not extended to commercial exploitation of these systems and technologies. Thus, air and maritime transport modes are not

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\(^{64}\) Council Regulation (EC) No 543/97 of March 1997 Amending Regulation (EC) No 1107/70 on the Granting of Aids for Transport by Rail, Road and Inland Waterway. Available online at http://www.legaltext.ee/text/en/T50570.htm, last visited on 26 October 2009. See Article 3 of Regulation (EC) No 1107/70, which outlines the special circumstances under which Member States are allowed to take co-ordinated transport measures or grant aids in respect of the concept of public service obligations.
priority areas for the Commission; hence they are subject to the EC competition and state aid rules.  

6.2.5.4 State aid for energy supply and conservation

The Commission is actively interested in the security of energy supplies and energy conservation. In its Green Paper on European strategy for security of energy supply, the Commission stated that the diversification of energy sources creates conditions for greater security of supplies. To promote this strategy, the Commission supports the development of indigenous sources of primary energy, particularly renewable sources of energy used in the production of electricity. The Commission allows operating aid for the production of renewable energy. Operating aid covers the difference between the cost of production and the market price of energy from that particular source.  

The Commission’s support for energy conservation is based on its guidelines on state aid for environmental protection. For example, the guidelines encourage the

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67 Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the Internal Electricity Market, Official Journal of the European Communities (L283/33). Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2001:283:0033:0040:EN:PDF, last visited on 30 October 2009. Note (1) stipulates that, “the potential for the exploitation of renewable energy sources as a priority measure given that their exploitation contributes to environmental protection and sustainable development. In addition this can also create local employment, have a positive impact on social cohesion, contribute to security of supply and make it possible to meet Kyoto targets more quickly. It is therefore necessary to ensure that this potential is better exploited within the framework of the internal electricity market.”

development of processes leading to the production of electricity from energy sources such as gas, and authorises such aid systems for a period of 10 years. The Commission supports aid schemes for generating electricity by using renewable sources of energy such as wind, solar, small-scale water stations, and biomass, etc. Note 14 of the Council Directive 2001/77/EC (concerning common rules for the internal market for electricity) stipulates that the directive aims at guaranteeing the proper functioning of support mechanisms for renewable energy sources at the national level, such as investment aid, green certificates, direct price support schemes, tax refunds, and tax exemptions or reductions. The Commission believes that biofuel promotion could enhance both security of supply and climate change policy in a sustainable manner. Consequently, the Commission supports aid for the use of certain biofuels which deliver both environmental benefit and sustainability, e.g. biofuels made from residues, wastes, and cellulose material, etc. Operating aid may also be extended to firms distributing electricity and heating to the public where the cost of producing the electricity or heating exceeds its market price.

The guidelines also cover state aid granted for the remediation of contaminated sites. Article 87(3) (c) of the EC Treaty provides the basis for investment aid to firms repairing environmental damage by remediating contaminated sites. The guidelines provide that such investment aid is compatible with the Community’s environmental objectives only if it results in environmental protection. The environmental damage covered by the guidelines includes damage to quality of soil, surface water, or groundwater. State aid may not be granted where the polluter is easily identifiable. In such cases, the polluter must be made to pay for the remediation work in line with the

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69 See id., p. 32.  
70 See id., p. 14.  
71 See id., p. 33.
‘polluter pays’ principle.\textsuperscript{72} However, where the polluter is not easily identifiable, or based on special circumstances cannot be made to bear the cost, the person directly responsible for the remediation work may be granted aid for that purpose. In such cases, aid may be granted up to 100% of eligible costs.\textsuperscript{73}

\subsection*{6.2.5.5 State aid for small- and medium-sized enterprises}

The Commission Regulation (EC) No 70/2001\textsuperscript{74}, Article 2(b), defines small- and medium-sized enterprises as independent enterprises which have fewer than 250 employees (50 for small enterprises), and have either an annual turnover of €40 million (€7m for small enterprises) or an annual balance sheet total not exceeding €27m (€5m for small enterprises). Eligible enterprises must conform to the criteria of independence for SMEs. They must not be owned by one enterprise or jointly by several enterprises (having more than 25% or more of the capital base or the voting rights) that fall outside of the definition of an SME.

The Commission recognises the beneficial contribution of SMEs to economic development. SMEs are regarded as the major drivers of structural change and regeneration as they facilitate a shift of economic resources from declining sectors to expanding sectors. However, one of the difficulties SMEs face is in obtaining capital and credit, mainly due to the limited guarantees and collateral that they can offer. Thus, their limited capital restricts their access to new technology and potential markets. The introduction of new regulation usually entails higher costs for SMEs.

\textsuperscript{72} Polluter, in this context, refers to the person liable under the applicable law in each member state.

\textsuperscript{73} Eligible costs, in this case, are the costs of the remediation work less the increase in the value of the land. The guideline includes all expenditure incurred by an undertaking in remediating its site as eligible costs.

\textsuperscript{74} See \textit{Commission Regulation (EC) No 70/2001}; \textit{supra} note 46, at Article 2(b). The definition of Small- and Medium-Scale Enterprises is contained in ANNEX 1 of the Regulation.
The European Court of Justice (ECJ) has also recognised the economic potential and the handicaps faced by SMEs and contend that they are entitled to special consideration from the Commission. However, the ECJ opines that this recognition should not translate into indiscriminate approval of all schemes regarding such enterprises.\(^{75}\) The provisions of this regulation, without prejudice to other EC regulations or directives applicable to specific sectors, do not apply to agriculture or to aid for export-related activities.\(^{76}\)

The regulation provides for aid to SMEs for investment in both tangible and intangible assets inside or outside of the European Community. Investment in tangible assets refers to fixed assets, whereas investment in intangible assets means investment in transfer of technology through acquisition of licences, patent rights, and technical knowledge. Eligible costs of tangible investment are costs relating to land, buildings, machinery, and equipment, whereas eligible costs of intangible investment are the costs of the acquisition of the technology. Aid for investment in intangible and tangible assets must be in the nature of an incentive, and must continuously or periodically lead to reduction in costs to the SMEs. The aid must also be necessary to achieve the stated objectives which market forces alone would not secure; must be proportionate to the difficulties which have to be overcome to secure the socio-economic benefits that are desirable in the common interest; and the positive effects on competition and trade must outweigh the negative effects.\(^{77}\)

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\(^{76}\) *Commission Regulation (EC) No 70/2001; supra* note 46, at Article 1(2).

\(^{77}\) See id., Preambles.
The regulation also stipulates the intensity of investment aid for SMEs. The maximum aid intensity for small enterprises is 15%, and 7.5% for medium-sized enterprises. Higher thresholds apply to investments that take place in locations that qualify for regional aid, in which case the maximum threshold is determined by the level of regional investment aid approved by the Commission for each member state.

6.2.6 EU State aid control
The European System for state aid control was introduced in order to reduce the risk of the EU Commission approving subsidies that distort competition and prohibiting those that do not. The state aid control is established by Articles 87–9 EC (ex-Articles 92–4) with the principal objective of promoting the common market through prevention of much aid that could confer an unfair competitive advantage to the recipients relative to their competitors, and hence result in competition and trade distortions. State aid control is implemented through a process of prior notification and approval. The Commission uses a system of controls made up of regulations, guidelines, and procedures in order to assess whether a proposed aid is likely to be compatible with Article 87(3) EC (ex-Article 92 (3). Apart from the formal supervision of state aid by the European Commission, there is also the judicial level of control whereby the ECJ and the Court of First Instance of the European Communities (CFI) enforces the EC state aid law.

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78 See id., Article 4(2).
80 See European Aid Control; supra note 29, at p. 3.
6.2.6.1 State aid supervision by the European Commission

Article 88 (EC)\textsuperscript{81} and Council Regulation (EC) No 659/1999\textsuperscript{82} empower the European Commission to supervise any plans of member states to provide or alter aid and to continuously review all systems of aid existing in those states. The supervisory system under EC Regulation No 659/1999 and Article 88EC prescribes four categories of control of state aid, as follows: new aid, existing aid, unlawful aid, and misuse of aid. However, Regulation (EC) No 659/1999 was adopted pursuant to Article 89 EC\textsuperscript{83} which entitles the EC to make regulations for the application of Articles 87 and 88 EC. Therefore, where the previous case law regarding the application of Article 88 EC conflicts with this regulation, the latter should take precedence.\textsuperscript{84}

Plans to grant new aid\textsuperscript{85} must be notified to the Commission before it is implemented.\textsuperscript{86} The Commission, on receipt of a notification for the grant of aid,  

\textsuperscript{83} See Article 89 EC. Available online at http://ec.europa.eu/competition/legislation/treaties/ec/art89_en.html, last visited on 29 October 2009.
\textsuperscript{85} Council Regulation (EC) No 659/1999, Article 1(c). Article 1(c), defines new aid as follows: “new aid shall mean all aid, that is to say, aid schemes and individual aid, which is not existing aid, including alteration to existing aid.” Article 1(d), defines aid schemes as follows: “aid scheme shall mean any Act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the Act in a general and abstract manner and any Act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and /or for an indefinite amount.” Article 1(e), defined individual aid as follows: “individual aid shall mean aid that is not awarded on the basis of an aid scheme and notifiable awards of aid on the basis of an aid scheme.”
conducts a preliminary examination and decides whether the plan constitutes state aid within the meaning of Article 87 (1) EC\textsuperscript{87} and also whether the aid is compatible with the objectives of the common market.\textsuperscript{88} If the aid meets both criteria, the Commission may instruct the member state to proceed to implement the aid plan. Conversely, state aid plans that fail to meet the objectives of the common market would have to undergo further formal investigation procedure. Therefore, member states are prohibited from putting any notifiable new aid into operation and this prohibition remains effective during the period of preliminary assessment and where applicable the period of formal investigation procedure.\textsuperscript{89}

\textsuperscript{86} See Article 88(3) EC.
\textsuperscript{87} See Article 87 (1) EC. Available online at http://ec.europa.eu/competition/legislation/treaties/ec/art87_en.html, last visited on 29 October 2009. The article stipulates that, “Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.”
\textsuperscript{88} See Italian Republic v Commission of the European Communities, Case C-66/02, ECJ (15 December 2005), para 76-82. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62002J0066:EN:HTML, last visited on 29 October 2009. Paragraph 77 defines State aid according to the meaning of Article 87(1) EC as follows: “according to settled case-law, the definition of aid is more general than that of a subsidy, because it includes not only positive benefits, such as subsidies themselves, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect.” Similar cases are as follows. See UFEX and Others v Commission, Case T-613/97, CFI (7 June 2006), para 158. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61997A0613(01):EN:HTML, last visited on 29 October 2009. See Enirisorse SpA v Sotacarbo SpA, Case C-237/04, ECJ (23 March 2006), paras 3-5. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62004J0237:EN:HTML, last visited on 29 October 2009. Also see Kingdom of Spain v Commission of the European Communities, Case C-501/00, ECJ (15 July 2004), para 90. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62000J0501:EN:HTML, last visited on 29 October 2009.
\textsuperscript{89} See Italian Republic v Commission of the European Communities, Case C-364/90, ECJ (28 April 1993), para 48. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61990J0364:EN:HTML, last visited on 29 October 2009. The ECJ held, in this case, that the process of informing the Commission during the administrative procedure stage that the contested aid measures were yet to be disbursed does not guarantee that the measures would not be applied subsequently (i.e. between the time when the Commission was informed and the time when the contested measures were notified.
In the case of Lorenz GmbH v the Federal Republic of Germany, the court held that:

"in stating that the Commission shall be informed of plans to grant new or alter existing aid in sufficient time to enable it to submit its comments, the draftsmen of the Treaty have sought to provide this institution with sufficient time for consideration and investigation to form a prima facie opinion on the partial or complete conformity with the Treaty of the plans which have been notified to it. It is only after being put in a position to form this opinion that the Commission is bound, if considers the plan incompatible with the common market, to initiate without delay the contentious procedure, provided for in Article 93 (2) by giving notice to the Member State to submit its comment." 90

The Court further held that while it is necessary for the Commission to be allowed sufficient time to form a preliminary view on the plans notified to it, it had to define its position within a reasonable period to prevent unnecessary delays. Guided by Articles 173 and 175 of the Treaty, the court determined that the reasonable period would be fixed for two months. Therefore, on the expiry of two months after notification of an intention to grant an aid the commission should have made a decision, failing which the member state concerned could implement its plan, provided it gave prior notice to the Commission. 91


91 See Lorenz GmbH V Federal Republic of Germany and Land Rheinland/Pfalz, para 4. The Court further held that if at the end of the preliminary examination, the Commission concluded that the aid was compatible with the Treaty, it should inform the Member State concerned. However, the Commission was not entitled at that stage to adopt a decision based on Article 189 of the Treaty. Such a decision was considered to be applicable at the end of the contentious procedure as laid down in Article 93(2).

Existing aid is subject to continuous review by the Commission. As part of the review process, the Commission may institute a formal investigation procedure into the operation of aid. If the Commission finds that the aid is operating inconsistently with the common market, it must instruct that the aid be abolished or altered to bring it in line with the objectives of the common market. However, the Commission’s decisions in such matters are not implemented retrospectively. Thus, any existing aid which has been granted prior to the Commission’s decision that it is no longer compatible with the common market would not be subject to a recovery order.
Aid plans and implementation are generally regarded to be unlawful\textsuperscript{94} where the aid is not notified to the Commission or if the aid is notified but implemented prior to a decision being made by the Commission. Such aids may be suspended or recovered.

Article 15 of the Regulation (EC) No 659/1999 provided that the powers of the Commission to recover unlawful aid shall be for a limitation period of ten years, commencing from the day the unlawful aid was awarded to the beneficiary, either as an individual aid or under an aid scheme. Furthermore, Article 15 stipulates that any action taken by the Commission or by the member state, acting at the request of the Commission, with regard to the unlawful aid shall interrupt the limitation period.\textsuperscript{95}

However, the Commission may consider that aid has been misused\textsuperscript{96} and order its recovery where aid has been duly authorised by the Commission, and the recipient or member state used the aid for purposes other than those for which it was approved. In such cases, a formal investigation procedure is followed prior to a decision by the Commission.\textsuperscript{97}

\textsuperscript{94} Council Regulation (EC) No 659/1999, Article 1(f). Article 1(f) defines unlawful aid as follows: “unlawful aid shall mean new aid put into effect in contravention of Article 93 (3) of the EC Treaty.”

\textsuperscript{95} See Scott v Commission of the European Communities, Case C-276/03 P, ECJ (6 October 2005), paras 30-38. Available online at \url{http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003J0276:EN:HTML}, last visited on 29 October 2009. Based on the ECJ interpretations, the procedure for recovery of unlawful aid is essentially between the Commission and the Member State, and not directly with the beneficiary. Therefore, the Commission could interrupt the limitation period by an action which has not been notified to the beneficiary of aid. See similar cases on procedures for notification as follows. P & O European Ferries (Vizcaya) SA and Diputacion Foral de Vizcaya, Joint Cases C-442/03P and C-471/03P, ECJ (01 June 2006), para 103. Available online at \url{http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003J0442:EN:HTML}, last visited on 30 October 2009. Also see Air One v Commission, Case C-395/04, ECJ (10 May 2006), para 36. Available online at \url{http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62004A0395:EN:HTML}, last visited on 30 October 2009.

\textsuperscript{96} Council Regulation (EC) No 659/1999, Article 1(g). Article 1(g) defines misuse of aid as follows: “misuse of aid shall mean aid used by the beneficiary in contravention of a decision taken pursuant to Article 4(3) or Article 7(3) or (4) of this Regulation.”

whole membership of the Commission acting together, rather than the Commissioner for Competition Policy being the sole decision maker.  

6.2.6.2 Reform of state aid systems of control

The OFT carried out a study in 2005 to propose a set of reforms to assist state aid controls by putting forward an effects-based approach for approval of aid. By implication, state aid should be assessed based on economic logic and approved where the level of distortion to competition that results was justified by the benefits of the aid to the common interest. An improvement in this system of controls could reduce the risk of approving aids that distort competition significantly, and those that do not. The OFT also set out the economic framework for examining the impact of subsidies on competition. The framework revealed that the extent of distortion to competition depended on the characteristics of the subsidy (e.g. size and nature/number of recipients) and the market characteristics in which the recipients

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98 See Assocation des Amidonneries de Cereales de la CEE and others v Commission of the European Communities, Case T-442/93, CFI (27 April 1995) ECR II-1329, para 101-103. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61993A0442:EN:HTML, last visited on 30 October 2009. Paragraph 102 reads as follows: “in those judgements, the Court also stated that the principle of collegiality thus established is based on equality as between the members of the Commission in the decision-making process and signifies that decisions must be deliberated on jointly and that all members of the college bear collective responsibility at political level for all decisions adopted.

operate (e.g. level of market concentration, product differentiation and barriers to entry and exit).\textsuperscript{100}

Based on the foregoing, the OFT has rolled out proposals for changes to state aid controls as follows.\textsuperscript{101} Firstly, they recommended that block exemptions should continue to be applied for cases where competition effects are likely to be very small due to the small size and specific targeting of the aid.

Secondly, they adopted a two phase approach for assessing the compatibility of aid under Article 87 (3) EC (see Figures 6.a and 6.b). Phase 1 assessment would determine the likely significance of distortion to competition and should be incorporated into the Commission’s guidelines. Criteria to be used for the assessment should include market failure remedy, eligibility for aid, market share of recipients, overall levels of aid required, etc. Phase 2 assessment would be conducted for proposed aid that does not pass the phase 1 assessment, and should be based on transparent economic logic (cost / benefit analysis), and on case-by-case. Thirdly, the National Competition Authorities (NCAs) could render formal advice regarding the eligibility of proposed aid in line with the economic criteria of the guidelines. The Commission could be guided by this advice, but should not however be committed to it.

To carry out a detailed assessment in line with Phase 2 requirements, a number of steps need to be followed.\textsuperscript{102} Firstly, the product and geographic markets would have to be defined. Secondly, a number of factors that may prevent or restrict the recipient

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\textsuperscript{100} See Public Subsidies; \textit{supra} note 1, at pp. 14-30.
\textsuperscript{101} See European State Aid Control; \textit{supra} note 29, at p. 5.
\textsuperscript{102} See \textit{id.}, pp. 50-8.
from raising prices or compel it to innovate would need to be assessed. Such factors include the number of competitors (including their intentions and incentives) and degree of product differentiation. Thirdly, barriers to entry and exit need to be examined. Finally, the subsidy and market characteristics would need to be assessed. These assessment procedures underline the tight control that the Commission exerts on aid applications and how difficult it could be to get one approved.
Figure 6.a Approval route for state aid under the current system

Member State develops subsidy

If subsidy is less than €100,000 and complies with regulation EC/69/2001, it is de minimis aid and exempt from Article 87(1)

Member state assesses whether subsidy is “State Aid” according to the criteria set out in Article 87(1) EC

If subsidy is not State Aid, Member State can grant without further reference to the commission

If subsidy is State Aid, the Member State must notify it to the commission

The Commission considers whether the State Aid is compatible with the common market, as set out in Article 87(3) EC

The Commission approves the State Aid if the commission thinks that it fits under one of the guidelines on State Aid

The Commission approves State Aid if, following a full analysis, it considers the aid to be compatible

The State Aid is prohibited

Source: OFT 821, European State Aid Control, p. 17
Figure 6.b Questions for phase 1

Does the Aid address the market failure criteria in the guidelines?

- **NO**
  - Apply phase 2 Assessment

- **YES**
  - Are selection criteria acceptable?
    - **NO**
      - F E W
    - **YES**
      - How many firms are eligible? (Or in case of competition, how many participate?)
        - **NO**
          - Is market share of any recipient greater than the prescribed level?
            - **NO**
              - Apply Phase 2 Assessment
            - **YES**
              - Approve subject to medium ceiling e.g. 15% of cost of activity/investment
        - **YES**
          - Approve subject to higher ceiling e.g. 20% of cost of new activity/investment

**Source:** OFT 821, European State Aid Control, p. 6
6.2.7 The EU policy on economic and social cohesion

The objective of economic and social cohesion is to pursue a balanced development throughout the EU, by reducing structural disparities between regions and promoting equal opportunity for all. The idea of ensuring economic and social cohesion in the EU dates back to the Treaty of Rome in 1957, where a remark was made, in the preamble, about reducing regional disparities. This idea stems from the premise that social integration should be pursued as a parallel process to political and economic integration.\textsuperscript{103} However, like most ideals, it is unlikely that in the near future citizens across the EU would experience living in the EU as though it were a single state, or a single social area. Therefore, it is likely that the idea of social cohesion, in this context, is based on social inclusion of all citizens of the EU within and without their own geographical boundaries. Thus, the concept of social and territorial cohesion is bound to be contentious and controversial.\textsuperscript{104}

However, the idea was put to effect in the 1970s when Community action was initiated towards coordinating the national instruments and providing additional financial resources. Initially, it was forecast by the EC that the adoption of a single internal market would contribute to bridging the gap between regions. This gap is often measured in terms of income levels or per capita GDP.\textsuperscript{105} Thus, initial efforts at

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{105}Cuadrado-Roura, J.R., et al., \textit{Economic and Social Cohesion in the EU: a Critical Approach} p. 3, being a Paper Presented at the 44\textsuperscript{th} European Congress of the Regional Science Association, Portugal
\end{itemize}
\end{footnotesize}
mobilising national financial instruments were tentative. As these measures proved inadequate, and with the adoption of the Single European Act in 1986, economic and social cohesion became a major objective as well as completing the single market target.

In 1992, the Maastricht Treaty incorporated the economic and social cohesion policy into the EC Treaty as contained in Article 158 (ex Article 130a) and Article 159 (ex Article 130b).106 Article 158 (ex Article 130a) provides that, “In order to promote its overall harmonious development, the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas.”107 Article 159 (ex Article 130b) stipulates that, “Member States shall conduct their economic policies and shall coordinate them in such a way as, in addition, to attain the objectives set out in Article 158. The formulation and implementation of the Community's policies and actions and the implementation of the internal market shall take into account the objectives set out in Article 158 and shall contribute to their achievement. The Community shall also support the achievement of these objectives by the action it takes through the Structural Funds (European Agricultural Guidance and Guarantee Fund, Guidance Section; European Social Fund; European Regional Development Fund); the European Investment Bank; and the other existing financial instruments. The Commission shall submit a report to the European

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107 See Wolfgang Heiser v Finanzamt Innsbruck, Case C-172/03, ECJ (3 March 2005) ECR I- 1627. Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003J0172:EN:HTML, last visited on 28 October 2009. Paragraph 2 stipulates that the fact that a measure has a social purpose does not mean it should be excluded from classification as aid within the meaning of Article 87 EC. Article 87 (1) does not distinguish between measures of State intervention by reference to their causes or their aims but defines them according to their effects.
Parliament, the Council, the Economic and Social Committee and the Committee of the Regions every three years on the progress made towards achieving economic and social cohesion and on the manner in which the various means provided for in this Article have contributed to it. This report shall, if necessary, be accompanied by appropriate proposals. If specific actions prove necessary outside the Funds and without prejudice to the measures decided upon within the framework of the other Community policies, such actions may be adopted by the Council acting unanimously on a proposal from the Commission and after consulting the European Parliament, the Economic and Social Committee and the Committee of the Regions.”

The economic and social cohesion idea is largely implemented through the regional policy of the EU, because its overriding objective is to bridge regional economic and social divides. Hence, regional policy financial instruments (i.e. Structural Funds and Cohesion Funds) were created to narrow the regional gaps. Thus, regional policy is the EU’s second largest budget item, behind the common agricultural project (CAP). For example, €348b has been allocated to this policy for the period 2007–13. Since the enlargement of the EU to 27 member states in January 2007, the EU population has increased by 20% and its economy by around 5%. Average GDP per capita has decreased by more than 10% and regional disparities have doubled. However, around

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60% of the regions lagging behind (i.e. Objective 1 regions) in terms of development are in the 12 member states that joined the EU in 2004.\textsuperscript{110} This increase in the number of member states sparked a debate for the reform of EU cohesion policy. Subsequently, the EC initiated new proposals in the third cohesion report, meant to change the rationale, focus, and implementation procedures of structural and cohesion funds.\textsuperscript{111} As a result, the direction of regional policy and expenditure is shifting towards the Central and East European countries. Nevertheless, structural assistance remains crucial in geographical areas facing peculiar structural problems. Examples are areas undergoing industrial restructuring, rural areas, areas dependent on fishing, areas facing natural and demographic barriers.

The evidence shows that the UK has participated in the EU social and economic cohesion programme that are funded through the EU structural funds. For example, the UK received a total of 11.3 billion Euros of EU structural funds, plus an additional 15.9 billion in national match funding for the programming period 2000-2006.\textsuperscript{112} However, the structural funds are managed separately by the various devolved administrations. Scotland received £2.3 billion or 3.4 billion Euros (at 2006 prices) of


EU structural funds during the period 1994-2006. These funds were meant to finance mainstream projects such as, development and adjustment of lagging regions; development of rural areas; adjustment of agricultural structures; integration and adaptation of persons excluded from the labour market. Wales received over £1.5 billion of EU structural funds during the period 2000-2006, and together with match funding from other sources amounted to over £3.8 billion of total project investments. For the period 2007-2013, the EU has made a budget of about 308 billion Euros for the structural and cohesion funds. Based on this budget, the UK is expected to receive 9.4 billion Euros.

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6.3 Australia

6.3.1 State aid and subsidies in Australia
Similar to the UK (EU), the Australian Government and individual states provide aid and subsidy grants. The granting of aid to states by the Australian Government commenced after 1927 with the enactment of the States Grants Act 1927 (SGA).

The Act was meant to distribute the surplus revenue accruing to the Consolidated Revenue Fund to all states, based on population numbers of the individual states. This Act was amended in 1973 (States Grants Act 1973) and repealed by Act No. 122 of 1976. Subsequently, the Australian Government decided to deal with states grants on the basis of specific need of industry sectors and states. Some grants were applied mainly to education, road infrastructure development, and energy products (including petroleum products).

However, unlike the UK (EU) the Australian Government enacted an Act in 1965 specifically for the grant of subsidies on petroleum products, i.e. the States Grants (Petroleum Products) Act 1965. The South Australian Government also enacted a separate subsidy Act, i.e. Petroleum Products Subsidy Act 1965. Other similar legislation followed, such as State Grant (Special Assistance to South Australia) Act 1960; State Grants (Rural Reconstruction) Act 1971; States Grants (Rural Adjustment) Act 1976; Fuel Sales Grants Act 2000; Products Grants & Benefits

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Table 6.3  Summary of major subsidy types\(^{120}\) and their characteristics

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Targeting of subsidy</td>
<td>Paid to fuel distributors for supplies to rural and remote retail sites, etc</td>
<td>Mining operations; primary production; electricity generation at specific residential premises; rail and marine transport</td>
<td>Businesses; vehicles with a gross vehicle mass of 4.5 tonnes or more; eligible users of alternative fuels (CNG, LPG, ethanol, biodiesel, etc)</td>
<td>Paid to fuel retailers in rural and remote areas</td>
<td>Mining operations; primary production; agriculture; rail and marine transport; eligible vehicles</td>
</tr>
<tr>
<td>Absolute size of subsidies</td>
<td>Low</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Subsidy size relative to cost of fuels</td>
<td>Low</td>
<td>High</td>
<td>Medium</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Level of selectivity</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Effects of subsidy on recipient’s cost</td>
<td>Low</td>
<td>High</td>
<td>Significant</td>
<td>Low</td>
<td>Significant</td>
</tr>
<tr>
<td>Frequency of subsidy</td>
<td>Continuous until its expiry on 30 June 2006</td>
<td>Continuous until its expiry on 30 June 2006</td>
<td>Continuous until 30 June 2006</td>
<td>Continuous until 30 June 2006</td>
<td>Continuous until 30 June 2012</td>
</tr>
</tbody>
</table>

Source: This research

Table 6.3 summarises the major subsidy types and their characteristics based on the OFT criteria for analysing subsidies.\(^{121}\) In this section, we will examine (for all identified subsidy schemes) the policy objective/s, target, size of the subsidy,

\(^{120}\) These subsidy schemes represent the corresponding Acts as discussed subsequently.

\(^{121}\) Note that the OFT criteria for characterising subsidies was chosen based on the author’s previous choice of the OFT definition of subsidies in Chapter 2.
duration, reason/s for government’s decision to continue or discontinue the scheme as the case may be.

6.3.2 The States Grants (Petroleum Products) Act (SGPP) 1965

(1965-2006)
This Act was meant to grant financial assistance to the States and the Northern Territory in regard to prices of certain petroleum products (petrol, diesel, and aviation gasoline or aviation turbine fuel). The states are reimbursed by the Australian Government for payments made to distributors of eligible products as registered under the scheme in accordance with that put in place by the minister for the purposes of the Act.

The distributors are supposed to pass on the benefits to the retailers in order to reduce pump prices. For this purpose, the distributors were only permitted to be registered if entered into an agreement in writing with the Australian Government and the State, or having given an undertaking in writing to the government to the effect that:

“(a) he or she will sell any eligible petroleum product at a price that gives to the purchaser the benefit of any payment received or to be received by the distributor in respect of the sale; and (b) he or she will not make a claim for a payment from the State in respect of a sale of any eligible petroleum product unless he or she sold the product at a price that gave to the purchaser the benefit of the payment that the distributor claims to receive in respect of the sale”.

Some persons or companies were excluded from registering under the scheme at any time because they were not regarded as distributors. These included “(a) a case where the person is an incorporated company – the person is, or is related to another

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122 See id., p. 3 (S. 4)
company, that is, the owner or operator of a mini-refinery; or (b) in any other case – the person is the owner or operator of a mini-refinery”. False declarations accompanying claims for payment were “punishable on conviction by a fine not exceeding $5,000 or imprisonment for a period not exceeding two years, or both”. This Act was repealed by the Fuel Tax (Consequential and Transitional Provision) Act 2006.

6.3.3 Petroleum products freight subsidy scheme (PPFSS), 1965-2006 Consistent with the objectives of the State Grants (Petroleum Products) Act 1965, the PPFSS was introduced in 1965 in order to reduce the cost of delivering certain fuels to rural and remote places in Australia. This was achieved by subsidising the freight component of the purchase price of the fuels, such as automotive distillate, petrol, aviation gasoline, and aviation turbine fuel.

The subsidy was paid to independent fuel distributors and oil companies, who in turn were required (through signing an undertaking) to pass on the benefit of the subsidy to the fuel consumers. Eligible places under the scheme included rural and remote retail sites, safe anchorages, airports, and large volume users in rural and remote locations, such as mine sites, etc.

Under the scheme, consumers were required to bear part of the freight costs (‘consumer pays margin). In situations where the average freight cost exceeds the consumer pays margin, a subsidy was paid to the fuel distributor that was equal to the

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123 See id., p. 4 (S. 4D)
excess. The Australian Government budgeted $17 million for the scheme from 1999–2004. Of this, $3.5 million was spent in 2000-01.\textsuperscript{126} The scheme was discontinued on the 30 June 2006, because current environmental concerns could not justify the provision of this type of assistance. Secondly, the administrative costs were disproportionately high relative to the smaller total amount of the subsidy distributed.

6.3.4 Petroleum Products Subsidy Act 1965 (South Australia), 1965-2006

This Act was designed to subsidise the distribution of certain petroleum products in certain country areas in South Australia.\textsuperscript{127} Eligible petroleum products were motor spirit (petrol), automotive distillates, and aviation gasoline or aviation turbine fuel. Similar to the States Grants Act, registered distributors of eligible products were expected to pass the benefits of the payments made to them to the purchasers of those products.

For petroleum product customers in those country areas, this Act was supposed to deliver additional lower pump prices over and above the beneficial impact of the States Grants Act. The subsidy was specifically provided by the Australian Government to the State of South Australia for the purpose of this Act, and the fund was warehoused in a trust account at the Treasury and under the authority of the Treasurer. False or misleading declarations in regard to this Act were considered to be an offence punishable on conviction by a fine of $2,000 or imprisonment for 12 months.


6.3.5 State Grant (Special Assistance to South Australia) Act 1960
This refers to a special sum of money (1.27 million pounds) paid to South Australia from the Consolidated Revenue Fund to assist the development of the South Australian State. This was in addition to a similar payment made to the state under the States Grants (Special Assistance) Act 1959. The latter Act was repealed by the Statute Law Revision Act (No. 216, 1973).

6.3.6 State Grants (Rural Reconstruction) Act 1971
The Commonwealth of Australia and a number of States with large expanses of rural areas (New South Wales, Victoria, Queensland, South Australia, Western Australia, and Tasmania) entered an agreement on rural reconstruction based on the need to provide assistance to persons engaged in rural industries throughout Australia. This agreement and the funding that went with it were meant to deliver benefits to those rural industries and inhabitants. The rural reconstruction Act 1971 and its successor, the Rural Adjustment Act 1976 were part of the efforts of the Australian Labor Government to fulfil its electoral promises to rural and remote communities of Australia.

The schedule for rural reconstruction constituted a scheme under which assistance could be provided to those industries, and was financed from the Consolidated Revenue Fund. The schedule covered debt reconstruction, farm build-up, and rehabilitation of viable businesses. A sum of 100 million dollars was budgeted for the scheme during the period 1971 to 1975.\footnote{State Grant (Special Assistance to South Australia) Act 1960 (S. 3). Available online at \url{http://www.austlii.edu.au/au/legis/cth/consol_act/sgatsaa1960498/}, last visited on 15 October 2009. State Grants (Rural Reconstruction) Act 1971, Part III, Clause 11). Available online at \url{http://www.austlii.edu.au/au/legis/cth/consol_act/sgra1971417/s4.html}, last visited on 15 October 2009.}
6.3.7 States Grants (Rural Adjustment) Act 1976
Like the Rural Reconstruction Act, the Rural Adjustment Act was entered into by the same states and the Australian Government. The outline for the scheme for rural adjustment covered all agricultural, horticultural, and pastoral industries. The main objective of the scheme was to restore economic viability to farms and farmers whose activities were threatened. These took the form of debt reconstruction; advances for recurrent expenditure; plant, livestock and property development (see parts 1–7 of the schedule). Some of the objectives of the scheme were also to alleviate hardship for persons that were forced to exit their business by harsh market conditions, and to rehabilitate those considering exiting their business.

6.3.8 Diesel fuel rebate scheme (DFRS), 1982-2006
The DFRS or the off-road subsidy scheme was designed to provide tax or duty rebate paid on diesel and allied fuels for specific off-road uses. The primary objective of the scheme was to maintain Australia’s competitiveness in key export businesses, such as agriculture and mining. The legislative authority for the introduction of the DFRS was based on Section 78 of the Excise Act 1901. Subsequently, the DFRS was amended in 2002, based on the need to balance the requirements of businesses in regional and remote Australia with the provision of incentives for the use of cleaner fuels in these locations. Eligible users included those involved with primary

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production; mining operations; rail transport; marine transport; electricity generation
at specific residential premises, including hospitality businesses, hospitals, nursing
homes, and other medical or nursing care concerns.

In terms of the absolute size of the scheme, it was second to the Energy Grants
(Credits) Scheme Act (EGCS) 2003. Table 6.4 shows the breakdown of the rebates
by industry or operator for the period 2002–03. The mining industry accounted for
nearly 50% in monetary terms, but represented only 4% of claims. Conversely,
agriculture, which received the second largest rebates, had 25% of total rebates in
monetary terms, but represented 86% of all claims. The total number of claimants in
2002–03 was as high as 93,000.

Table 6.4 DFRS rebates paid estimates by industry/operation (2002–03)

<table>
<thead>
<tr>
<th>Industry/ Operation</th>
<th>Number of Claims Paid</th>
<th>Total Amount Paid</th>
<th>Average Amount Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>$'000</td>
</tr>
<tr>
<td>Mining</td>
<td>7,362</td>
<td>3.6</td>
<td>1,113,605</td>
</tr>
<tr>
<td>Agriculture</td>
<td>176,084</td>
<td>85.8</td>
<td>579,570</td>
</tr>
<tr>
<td>Rail</td>
<td>444</td>
<td>0.2</td>
<td>263,686</td>
</tr>
<tr>
<td>Marine</td>
<td>4,793</td>
<td>2.3</td>
<td>123,682</td>
</tr>
<tr>
<td>Fishing</td>
<td>7,613</td>
<td>3.7</td>
<td>97,988</td>
</tr>
<tr>
<td>Forestry</td>
<td>6,071</td>
<td>3.0</td>
<td>46,108</td>
</tr>
<tr>
<td>Electricity generation</td>
<td>2,407</td>
<td>1.2</td>
<td>14,146</td>
</tr>
<tr>
<td>Hospitals</td>
<td>130</td>
<td>0.1</td>
<td>1,466</td>
</tr>
<tr>
<td>Aged homes</td>
<td>91</td>
<td>0.0</td>
<td>296</td>
</tr>
<tr>
<td>Nursing homes</td>
<td>40</td>
<td>0.0</td>
<td>77</td>
</tr>
<tr>
<td>Other medical</td>
<td>29</td>
<td>0.0</td>
<td>38</td>
</tr>
<tr>
<td>Like fuel use – all industries/activities</td>
<td>230</td>
<td>0.1</td>
<td>51,813</td>
</tr>
<tr>
<td>Total</td>
<td>205,294</td>
<td>100.0</td>
<td>2,292,477</td>
</tr>
</tbody>
</table>


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Rebate Scheme (Amendment) Bill 2002. Available online at
134 Australian Taxation Office (ATO), Diesel Fuel Rebate Scheme, p. 286 (2002). Available online at
6.3.9 Diesel and alternative fuels grant scheme (DAFGS), 2000-2006

Similar to the DFRS, the DAFGS was designed for business users and vehicles with a gross vehicle mass of 4.5 tonnes or more. However, it differed from the DFRS because it included eligible users of alternative fuels, such as CNG, LPG, recycled waste oil, and renewable fuels such as ethanol, biodiesel, canola oil, etc.\textsuperscript{135}

The DAFGS was introduced in 2000 as part of the Australian Government’s alternative fuel programmes or measures for a better environment package.\textsuperscript{136} The purpose of the scheme was to provide an opportunity for heavy vehicle users and bus operators to convert to cheaper natural gas and LPG. This would enable the latter to lower the cost of public transport.\textsuperscript{137} Under the scheme, the Australian Government retained the price differential between diesel and alternative fuels to encourage the widespread use of the latter in order to reduce greenhouse gas emissions and to improve air quality. As a result, the size of alternative fuel subsidies relative to the cost of the fuels was low. The grants were as follows: LPG (11.93 cpl); ethanol (20.81 cpl); diesel (18.51 cpl); and CNG (12.62 cents per cubic meter).\textsuperscript{138}

The DAFGS constituted a building block for the more robust Energy Grants (Credits) Scheme 2003 and the Energy Grants (Cleaner Fuels) Scheme 2004. These were to take effect after the expiry of the DAFGS on 01 July 2006.


The purpose of this legislation was to provide fuel tax concessions to fuel retailers for sales of petrol and diesel to users in regional and remote areas in order to cushion the effects of higher fuel prices and to reduce the price differentials between urban and rural areas.139 Fuel retailers were made to register for the scheme under the Product Grants and Benefits Administration Act 2000.140 All fuel retailers were eligible to receive grants under the scheme, provided the sale of fuel was in an eligible location and to the end users of the products.141

The FSGA was one of the major fuel grants schemes, and attracted a government budget of about $270 million per annum (according to 2005–06 figures).142 Under the scheme, fuel consumers in non-metropolitan areas and those in remote locations received a rebate of 1 cpl and 2 cpl respectively. Similar to the PPFSS, retailers were meant to sign an undertaking that required them to pass on the benefit of the subsidy to the purchasers. However, there were concerns about compliance issues arising from eligibility for the lower and higher grant rates based on geographic boundaries. These anomalies were likely to have an adverse impact on resource allocation and competition. The Service Station Association suggested that the government could deal directly with the problem of rural–urban price differential by introducing a

141 See FSG Act 2000; supra note 139, at Section 7.
mandatory Terminal Gate Pricing that would ensure that the ex-refinery price of petroleum products was the same for all fuel stations and bulk users.\textsuperscript{143}

However, the previous Australian Government Acts mentioned in this section were administered by the Secretary of the Department but to underscore its importance to the government at the time, this Act was administered directly by the Commissioner of Taxation.\textsuperscript{144}

6.3.11 Energy Grants (Credits) Scheme Act (EGCS) 2003
This Act replaced the Fuel Sales Grants Act 2000 when it expired on 30 June 2006.\textsuperscript{145} The scheme was designed to replace the DFRS and the DAFGS, but with a continuance of the benefits inherent in both schemes.\textsuperscript{146} The Fuel Tax Inquiry recommended that these schemes should be substituted with a Business Fuel Credit Scheme,\textsuperscript{147} which would lower the effective level of fuel taxes for businesses, and a Residential Fuel Credit Scheme\textsuperscript{148} for diesel, heating oil, or LPG for domestic use in remote communities without access to the electricity grid or natural gas pipelines.

The main purpose of this scheme was to actively encourage the use of cleaner fuels in line with the Environment Protection and Biodiversity Conservation Act 1999.\textsuperscript{149}

\textsuperscript{144} See id., S. 5. This was meant to ensure strict compliance and monitoring of the grant scheme.
\textsuperscript{147} See Fuel Tax Inquiry, supra note 124, at p. 130.
\textsuperscript{148} See id., p. 167.
\textsuperscript{149} Environment Protection and Biodiversity Conservation Act 1999. Available online at
Act relates to diesel and alternative fuels used for on- or off-road purposes and covers various sectors, such as mining operations and activities; primary production; agriculture; livestock; horticulture; fishing; forestry, marine, and rail transport.\(^\text{150}\)

Persons or companies “are entitled to on-road credit if they purchased or imported into Australia, on-road diesel fuel or on-road alternative fuel for (a) use in a registered vehicle that has a gross vehicle mass of 20 tonnes or more; or (b) incidental use in relation to such a vehicle”.\(^\text{151}\) Also, persons or companies are entitled to an off-road credit if they purchased or imported into Australia off-road diesel fuel for use in the activities prescribed above.

The EGCS scheme is Australia’s largest fuels subsidy scheme, followed by the defunct FSGS and the PPFSS schemes. The government budgeted above $3.7b per annum for the scheme, based on 2005–06 figures.\(^\text{152}\) The cost of providing grants for low sulphur fuels during the period 2005–07 was estimated at $42m. The estimated cost of biodiesel grants alone during the period 2003–07 was $234m.\(^\text{153}\)

\(^\text{150}\) See EGCS Act 2003; supra note 145, at Ss. 11-39.
\(^\text{151}\) See id., S. 42.
Table 6.5 Offset rates for certain cleaner fuels under the Energy Grants (Cleaner Fuels) Scheme Act 2004\textsuperscript{154}

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>Duration</th>
<th>Fuel’s Offset Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biodiesel</td>
<td>Biodiesel start day until the end of 30 June 2011.</td>
<td>100% of biodiesel’s excise duty rate.</td>
</tr>
<tr>
<td>Renewable diesel</td>
<td>Renewable diesel’s start day until the end of 30 June 2011.</td>
<td>100% of biodiesel’s excise duty rate.</td>
</tr>
<tr>
<td>Biodiesel, CNG, ethanol, LPG, LNG, methanol or renewable diesel</td>
<td>Lasts from 01 July 2011 to the end of 30 June 2012.</td>
<td>80% of the fuel’s excise duty rate.</td>
</tr>
<tr>
<td>Biodiesel, CNG, CNG, ethanol, LPG, LNG, methanol or renewable diesel</td>
<td>Lasts from 01 July 2012 to the end of 30 June 2013.</td>
<td>60% of the fuel’s duty excise duty rate.</td>
</tr>
<tr>
<td>Biodiesel, CNG, ethanol, LPG, LNG, methanol or renewable diesel</td>
<td>Lasts from 01 July 2013 to the end of 30 June 2014.</td>
<td>40% of the fuel’s excise duty rate.</td>
</tr>
<tr>
<td>Biodiesel, CNG, ethanol, LPG, LNG, methanol or renewable diesel</td>
<td>Lasts from 01 July 2013 to the end of 30 June 2012.</td>
<td>20% of the fuel’s excise duty rate.</td>
</tr>
</tbody>
</table>

Source: Australian Taxation Office; Section 8, Part 2 (2004)

The EGCS is expected to expire by 2012 and will be succeeded by the Energy Grants (Cleaner Fuels) Scheme Act 2004 which is expected to last until 30 June 2015.\textsuperscript{155} Initially, the fuel offset rate for biodiesel will be 100% of the excise duty rate until 30 June 2011. Subsequently, with effect from 01 July 2011 an offset rate of 80% will apply to biodiesel and other alternative fuels, such as CNG, ethanol, LNG, LPG, methanol, or renewable diesel.\textsuperscript{156} The offset rate will be reduced progressively until

\textsuperscript{154} See Energy Grants (Cleaner Fuels) Scheme Bill 2003; supra note 153, at Section 8, Part II.


2015, when the effectiveness of the grants would be reviewed (see Table 6.5). A claim under the Products Grants & Benefits Administration Act 2000 for energy grants both for on-road and off-road diesel fuel was scheduled to be made before July 2007. Otherwise such claims would have to be made under the new Fuel Tax Act 2006 (item 9 of Schedule 3 to the Fuel Tax – Consequential & Transitional Provisions – Act 2006).157

6.3.12 Fuel Tax Act (FTA) 2006
This Act provides a single system of fuel tax credits which was designed to minimise or remove the incidence of several fuel tax schemes applicable to taxable fuels. This is also to ensure that fuel tax is applied only to “(a) fuels used in private vehicles and for certain other private purposes; and (b) fuel used on-road in light vehicles for business purposes”.158 To achieve this objective, fuel tax credit is provided to minimise or remove the incidence of fuel tax applied to “(a) fuel used in carrying on an enterprise (other than fuel used on-road in light vehicles); and (b) fuel used for domestic heating and domestic electricity generation; and (c) fuel packaged for use other than in an internal combustion engine”.159 The Act also applies to certain compressed and liquefied gaseous fuels, unlike the Fuel Sales Grants Act.

Business taxpayers, non-profit bodies, and non-business taxpayers are entitled to fuel tax credits. This is extended to businesses that are registered for Goods and Services (usually methanol) and a catalyst. Renewable diesel fuels are diesel fuel substitutes produced from renewable feedstock like biomass, slaughter house waste, tallow, or recycled vegetable oil. Chemically, petroleum diesel are hydrocarbons, biodiesel are esters, and renewable feedstocks for producing renewable diesel are not neither hydrocarbons nor esters.

157 See Fuel Tax Bill (Consequential & Transitional Provisions); supra note 142, at S. 40.
158 See Fuel Tax Act 2006; supra note 152, at p. 3.
Tax (GST). In this case, fuel tax credits are provided based on two scenarios. Firstly, the credits apply “where the businesses acquire, manufacture or import fuel for use in carrying on the enterprise (whether the fuel is used as fuel or otherwise)”. Secondly, they also apply “where the businesses acquire, manufacture, or import fuel to make a taxable supply to a private user for domestic heating or to package the fuel for the purpose of making a taxable supply of it for use other than in an internal combustion engine.\textsuperscript{160} For non-business taxpayers, credits are provided for fuel if it is to be used in generating electricity for domestic consumption.

Conversely, fuel tax credits are not applicable to fuel used in light vehicles on a public road; motor vehicles that do not meet environmental criteria; or fuel to be used in aircraft.

This Act specified the amendments to and dates for the repeal of previous Acts relating to grants provided for petroleum products. The States Grants (Petroleum Products) Act was repealed on 1 July, 2007; the Fuel Sales Grants Act on 1 January, 2007. The Energy Grants Act will be repealed on 1 July, 2012.\textsuperscript{161} This Act therefore provided for transitional arrangements from the Energy Grants to the new consolidated Fuel Tax Act.

6.4 Comparative Analysis of Findings
Provision of state aid for regional and rural development in the UK and Australia are somewhat similar in terms of their objectives, arms of government units that are allowed to grant aids, targeting of aids, mode of aid delivery, and legislative

\textsuperscript{160} See Fuel Tax Act 2006; \textit{supra} note 152, at p. 9.
\textsuperscript{161} See FTA (Consequential & Transitional Provisions); \textit{supra} note 142, at Schedule 1 (part 3) & Schedule 2 (part 2) & Schedule 3 (part 7).
instruments for promoting rural development. However, they differ significantly in terms of subsidy design, governance systems, and selectivity.

Both governments recognise that subsidies could be useful in addressing market failures, improving social welfare, and promoting development in areas that are lagging behind in terms of economic development. In the UK, subsidies are granted by central government, devolved administrations, government departments, regional agencies, and local authorities. Similarly, subsidies are granted by the central government, states, territories, and local authorities in Australia. The UK Government operates two major subsidy schemes which are targeted at AAs or economically-underperforming areas. Around 21% of state aid is directed at regional development in the UK. Similarly, most of the state aid in Australia was designed for regional and rural development. Around 83% of aid in the UK is delivered through grants and tax credits. Similarly, most state aid in Australia is delivered through grants and tax concessions.

However, government departments and agencies in the UK operate and design subsidy schemes with common guidelines as directed by HM treasury (and the SPFM in the case of Scotland), and the EU general guidelines for the granting of subsidies. Generally, the EC Treaty prohibits state aid because of its distorting effect on competition. However, the EU guidelines on state aid provides that aid may be granted where there are serious economic, social, geological, or environmental problems, provided that the aid does not affect other member states and that it is provided in a non-selective way. Thus, aid may be provided to promote the development of areas where the per capita income level is low, or where there is
serious unemployment. Aid can also be provided to facilitate the development of certain economic activities or of certain economic areas, provided the aid does not affect trading between member states. Member states are also allowed to provide grants of up to €200,000 (i.e. De minimis provision) for these purposes without prior notification to the EC.

The provision of state aid in EU member states is governed at two levels: statutory regulations and the courts (i.e. the CFI and the ECJ). The statutory regulations are implemented through prior notification to and approval by, the EC. The EC uses systems of control involving regulations, guidelines, and procedures to ensure that approved aid complies with Article 87 (3) EC. At the judicial level of governance, the CFI and the ECJ interpret and enforce the EU state aid law, hence the existence of a large body of case-law on EU state aid. Moreover, all subsidy proposals in the UK must undergo a regulatory impact assessment (RIA), and from the year 2001 the UK Government introduced competition impact assessment as one of the criteria for completing the RIAs. There is no evidence of a formal system of RIA for subsidy design and provision in Australia as these are largely introduced through legislation.

Therefore, the provision of subsidies in the UK is strictly controlled through these guidelines. Conversely, provision of subsidies in Australia is governed only by statutory legislations. However, the administration aspects are conducted by the Secretary of the relevant government departments. Regarding tax concessions, the Australian Office of Taxation is directly involved in their administration.
The EU rural development policies (as well as the CAP) are applicable to the UK. Council Regulation (EC) No 1257/1999 and Agenda 2000 reform package for rural areas form the basis for promoting a comprehensive and multifunctional agricultural policy. These measures are further consolidated by the EU policy on economic, social, and territorial cohesion. These support instruments recognise that agriculture alone cannot guarantee the vitality of rural communities, in terms of jobs and economic growth. Thus, both regulatory instruments promote measures that support the broader rural economy, thereby contributing to the regeneration of rural areas and the promotion of diversification of rural economic activities in member states. To promote these diversification objectives, the EC designed sector-specific regulations and guidelines on agriculture, transport, energy conservation, SMEs, and the provision of services of general interest (e.g. telecommunications, electricity, certain forms of transport, like ambulances, school buses, etc.). In respect of guidelines on transport, the EC’s policy is geared towards shifting the balance in favour of those with less adverse impact on the environment.

Similarly, the Australian Government introduced statutes between 1960 and 1976 designed for rural assistance, reconstruction, and adjustment. However, these were discontinued in favour of more sector-specific targeting of aids and most of these were related to petroleum products. Nevertheless, the provision of fuel subsidies in Australia began in 1965 with the enactment of the States Grants (Petroleum Products) Act. Subsequently, a number of fuel subsidy schemes were introduced on an ‘ad-hoc’ basis, but with positive intent. Some of the fuel subsidies were designed to reduce the pump price of petroleum products in rural and remote areas, e.g. PPFSS (which was introduced as part of the legislation aimed at rural assistance and development). The
FSGS was introduced to reduce high rural fuel prices and to mitigate the rural-urban fuel price differentials. Some of the subsidies were designed to reduce the cost of fuels for rural business activities (agriculture, mining, manufacturing, etc.), e.g. the DFRS. Some were introduced to encourage businesses to switch to alternative fuels that comply with government’s environmental objectives, e.g. the DAFGS and the EGCS.

The introduction of these subsidies could be criticised on two grounds: they did not take account of the cost and other possible difficulties in their administration; and there was no assessment of their impact on competition. In the first instance, there were compliance issues with the PPFSS, FSGS, and DFRS. Sometimes, businesses were entitled to two or more of these subsidies. For example there was a period when the FSGS coincided with the EGCS and some businesses were eligible to both. In the second case, it could be argued that fuel subsidies applied to rural and remote locations in a non-selective way might not have a significant impact on competition because these areas consist of several local markets (which are often separated by large distances) with distinct characteristics. Thus, these local markets do not overlap with each other or with urban markets. However, application of fuel subsidies to rural areas closest to urban locations is likely to produce a spill-over effect on competition. It is not clear whether these subsidies may have created disincentives for research and development decisions within the sector. The size of some of these subsidies may not have been enough to discourage innovation within the sector. Moreover, the subsidy schemes with the largest absolute sizes, i.e. DFRS and the ECGS (see table 6.3) were provided as a business input and not for on-road transport.
Nevertheless, since 2006 the government has demonstrated the political will to deregulate the fuel retailing sector. Thus, it may well be that future subsidies will undergo a regulatory impact assessment. Similarly, the Australian Government has demonstrated a strong commitment towards meeting the environmental challenges expressed in the Kyoto protocol by introducing in 1999 the ‘Better Measures for the Environment Package’ and enacting the Environment Protection and Biodiversity Conservation Act 1999. Subsequently, the government provided for a transitional period of six years for the phasing-out of most petroleum product subsidies, and a replacement of these with measures that promote the use of environmentally-friendly fuel products, e.g. LPG, LNG, ULSD, methanol, biofuels, etc. For instance, ULSD subsidy was increased from 1cpl to 2 cpl to encourage the use of cleaner fuels. However, socially important subsidies were provided for regional and rural areas, e.g. a temporary reduction in petrol excise by 4cpl to help reduce transport cost in these locations. The fuel tax inquiry also recommended the provision of a residential fuel credit scheme for remote areas that are neither connected to the electricity grid nor the natural gas system.

Most recently, all fuel grants in Australia have been replaced with a single system of fuel tax credits, and thus led to the enactment of the Fuel Tax Act (FTA) 2006. Consequently, the SGPP and FSG were repealed with effect from 2007. The ECGS will expire by 2012. The Fuel Tax (Consequential & Transitional Provisions) Act 2006 provided the guidelines and transitional caveats for the phasing-out of previous legislation on fuel grants. The FTA took into consideration government’s environmental objectives as well as the need to support businesses, particularly those that operate in rural communities. It also specified conditions under which business
taxpayers, non-business taxpayers, and non-profit bodies would benefit from fuel tax credits. However, credits are not applicable to fuels used in light vehicles on public roads; all vehicles that fail to meet environmental criteria; or fuels used for air transport.

6.5 Conclusion
This chapter set out to examine the relevant state aid provisions in the UK and Australia with the aim of identifying the existence or not of state aid instruments that are compatible with rural development objectives. In the case of Australia, the objective is to assess the long term applicability of fuel concessions to rural areas based on their compatibility with government’s environmental objectives and the characteristics of the subsidy schemes.

In the UK, the national government and devolved administrations (including local authorities) have powers to disburse subsidies to tackle social, economic, environmental, and other objectives. There is no evidence that the UK Government have granted fuel tax concessions to rural motorists, fuel retailers or businesses, except those granted to farmers under the CAP and those granted to the fishing fleet. The reason is that the character of the subsidies are shaped by the application of the common guidelines for policy appraisal as directed by the HM Treasury, and the EU general guidelines on the provision of state aid. Recent guidelines emphasise the need to ensure that all subsidy proposals pass through a competition filter test. The aim is to detect proposals that are likely to create competition distortion effects.
The EU regulations in support of rural development, Council Regulation (EC) No 1257/1999 and Articles 158-162 of the EC Treaty on Economic and Social Cohesion entitle member states to design and fund specific rural projects through the EU structural funds. These projects are expected to be notified to the European Commission. Apart from these regulations, the EC also provided for the De minimis aid which exempts state aids that are below 200,000 Euros from notification. These regulations complement the Agenda 2000 reform package on agricultural policy, and together these are directed at the objective of promoting an integrated strategy for rural development in member states. Council Regulation (EC) No 1290/2005 created the European Agricultural Guarantee Fund for financing agricultural activities. This fund finances direct payments to farmers and also measures that promote the agricultural sector. However, rural development programmes for member states is financed through the European Agricultural Fund for Rural Development. The EC regulations in support of rural development is not restricted to agricultural activities, but extends to other aspects of rural development such as the promotion of rural transport, SME’s, energy conservation, and environmental protection.

In the case of Australia, there is evidence that during the period 1965-2006 the Australian Government subsidised petroleum products for rural motorists and business as a means of reducing the cost of rural living. There is also evidence that the Australian Government pursued a policy of rural reconstruction and adjustment between 1960 and 1976, but discontinued this policy in favour of sector-specific requirements. Table 6.3 indicates that subsidy size relative to cost of fuels was high for the DFRS and EGCS, and the effect of subsidy on recipients cost was significant for the DAFGS and the EGCS. These subsidies could have failed the competition
filter test and would not have been granted in the UK. However, most of the rural fuel subsidy schemes were discontinued since 2006 because of the inherent conflict between the schemes and the government’s environmental objectives. However, the funding for these fuel subsidies has been reallocated to infrastructure development. Nevertheless, the Australian Government retained the EGCS whose objective is to facilitate the use of environmentally friendly fuels by the primary and manufacturing industries. The Energy Grants (Cleaner Fuels) Scheme (EGCFS) was also retained to promote the use of biodiesel, ethanol, methanol, renewable diesel, LPG, and LNG. The EGCS and the EGCFS have been consolidated under the FTA and are due to expire by 2012 and 2015 respectively.

The foregoing would suggest that both the UK and Australian Governments are currently proactive in providing support for rural and regional development. Similarly, both governments currently discourage the use of fuel subsidies as a tool for pursuing rural development objectives. Nevertheless, the future thrust of rural and regional development in both jurisdictions would likely involve a close network of exogenous factors (local businesses, local governments, local associations, etc.) and exogenous factors (i.e. central government, regional government, external investors, etc.). This is likely to materialise faster in the UK (due to its involvement with the EU) than in Australia. This prospect is investigated in more details in the chapter 7.
Chapter 7

TRENDS IN RURAL DEVELOPMENT POLICY IN THE UK AND AUSTRALIA

7.1 Introduction

The research findings from Chapters 4–6 indicate that the regulation of fuel retailing activities on its own makes a limited contribution to rural development policy. Based on current economic and environmental points of view, it is neither justifiable to directly subsidise wholesale prices for fuel retailers in rural areas, nor to provide fuel concession to fuel consumers in those areas. It may be appropriate to reduce the cost of fuel retailing in rural areas, e.g. through business rate reductions, government support for remediation of closed sites, and derogation from environmental costs (testing of storage tanks, vapour recovery equipment, etc). However, it is possible to provide and subsidise public transport in these areas to reduce the need for private transportation. It is also feasible to encourage rural inhabitants to switch to cheaper alternative fuels (i.e. LPG, ULSD, biofuels, etc.) by reducing excise duty levied on these substitutes in the short term.

These measures may or may not contribute to a reduction in fuel prices in rural areas or the rural–urban price differentials, depending on the location and number of fuel retail outlets in a given area. Hence, this thesis argues that fuel retailing activities could contribute to rural development in the wider context of an integrated rural development policy driven by a convergence of endogenous and exogenous inputs. The economic activities generated through an integrated approach to rural development could increase consumer demand for fuels and help reduce rural fuel
prices with the attendant reduction in rural–urban price differentials, and/or enable rural communities to afford the relatively higher prices.

Therefore, the objective of this chapter is to trace the evolution of rural development policy in both jurisdictions to examine what forces are driving those developments, and to determine whether their current rural development models are consistent with an integrated approach, driven by a mixture of endogenous and exogenous factors. Thus, this chapter will contribute to an understanding of the rural development models currently adopted in both jurisdictions and thus unravel the potential and future contributions of fuel retailing activities in rural areas.

7.2 United Kingdom

7.2.1 Pre-CAP rural development perspectives
Rural UK is almost entirely the product of the evolution of agricultural processes since prehistoric times. The historic link between agriculture and the rural environment in the UK could be understood in this historical context. The advent of the industrial revolution transformed the landscape and led to the UK becoming the world’s first urban nation. The construction of railways, new roads, and improved transport infrastructure resulted in the speedy development of towns and eventually a significant level of migration of people from rural to urban areas.¹

The industrial revolution also had an impact on agriculture and altered the state of rural communities. Firstly, urban consumers demanded more and cheaper foodstuffs. Secondly, there was an increasing dependence on imported food supplies. However,

the aftermath of the agricultural depression of the late nineteenth century gave rise to further commercialisation of agriculture and a reduction in agri-employment.\textsuperscript{2} As industrial activities continued to increase and diversify, the importance of agriculture in the rural economy began to decline. Some rural areas became transformed into industrial cities and towns. What remained of the rural settlements became synonymous with agricultural production, which products are mainly sold to urban consumers. Hoggart et al. describes the prevailing understanding of rurality at the time as “essentially defined and maintained by an urban-centred population (and arguably exists for that population as well)”, and the associated rural tradition “derives more overtly from a conception of rural space as an arena for consumption”.\textsuperscript{3}

The end of the Second World War brought about a new agricultural revolution driven by agrichemicals, mechanisation, and government subsidy. Over a period of time, agricultural production became less land and labour intensive and more capital intensive and thus ushered in a period of increasing government support through financial incentives.\textsuperscript{4} Following the food shortages that Europe faced in the aftermath of the Second World War, the EU decided to tackle the problem on a continental basis, under a subsidised common agricultural policy.

7.2.2 The Common Agricultural Policy (CAP)

The CAP was developed in the 1950s with the policy objective of achieving self-sufficiency in basic agricultural products by subsidising their production. The policy


\textsuperscript{3} Hoggart, K. et al., \textit{Rural Europe: Identity and Change} (1995).

later began to place emphasis on direct payments to farmers as the best way of ensuring that they were provided with a reasonable standard of living and that they provided consumers with quality food at reasonable prices while embracing environmentally sustainable production techniques. The CAP then accounted for nearly 70% of the EU budget.\(^5\) Financial assistance was provided for the restructuring of farming so that they were adapted to the social and economic situation at the time. Other measures were introduced such as assistance for farmers wishing to retire early, and for professional training. The role of farmers went beyond ensuring self-sufficiency in basic foodstuffs to include improvements in the quality of rural economies and preserving traditional landscapes and biodiversity.

However, the policy of achieving self-sufficiency in food production and ensuring that the EU had a viable agricultural sector began to result in almost permanent surpluses of major farm produce. Production limits helped to reduce the surpluses; for example milk quotas were introduced in 1983. Consequently, some of the excess production was exported with the help of export subsidies; others were stored or disposed of within the EU.\(^6\) These measures had high budgetary cost implications, and the export subsidies distorted the world markets for agricultural products. These represented half-measures at curtailing the spiralling cost of the CAP and the commodity surpluses.


With the advent of the Rio Earth Summit in 1992, the EU became concerned about the environmental sustainability of agriculture. Thus, changes had to be made to the original policy of CAP to adapt it to current realities. However, the cost of the CAP and environmental concerns were not the only drivers of change. As agricultural processes became modernised with the help of new technology, and as the EU society became more service-driven, the number of people working on the land declined from more than 20% when the CAP was introduced to 7%. This development had implications for the survival of rural economies. The negotiations leading to the WTO Agreements on agriculture which commenced with the Uruguay rounds (1986-94) ensured that definite action was taken by the EU to reform the CAP.

7.2.3 Impact of WTO agreements on agriculture on the CAP

The Uruguay round of world trade negotiations commenced in 1986 and was concluded in 1994. The negotiations led to the creation of the World Trade Organisation, which was empowered to enforce multilateral trade agreements, including an agreement on agriculture. The Uruguay agreement on agriculture established common rules in three areas of agricultural policy for all parties to the agreement. These are export subsidies, market access, and domestic support.

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The agreement provided a clearer definition of what constitutes an export subsidy, and also led to a 36% reduction in the maximum expenditure on export subsidies and a 21% reduction in the maximum quantity of exports that could benefit from such subsidies, relative to the base period. New export subsidies were prohibited. Barriers against agricultural food imports such as quotas, export restraints, and variable levies were substituted with a more transparent tariff-only system. Countries were also bound to the tariffs; hence no country is allowed to increase tariffs unilaterally. Developed countries were required to cut their tariffs by an average of 36% over six years, with a minimum tariff cut in any one line of 15%. However, allowance was made for a minimum 5% of domestic consumption to be open to import competition to minimise trade protectionism.

The agreement also provided a safeguard which allows temporary duty increases above the bound tariff levels during periods of low global prices or a sudden upsurge in imports. Thus, the increase in duty could be triggered based on low prices of commodities or a huge quantity of imports.

Based on the agreement, all domestic support in the form of subsidies to farmers was rated according to their effects on production (i.e. green box, amber box, and blue box). Subsidies with minimal effect on the quantities of commodities produced are not subject to reduction, and so are classified in a ‘green box’. Subsidies such as

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10 See id., p. 1. The WTO clarifies that “trade is distorted if prices are higher or lower than normal, and if quantities produced, bought, and sold are also higher or lower than normal – i.e. than the levels that would usually exist in a competitive market. For example, import barriers and domestic subsidies can make crops more expensive on a country’s internal market. The higher prices can encourage over-production, if the surplus is to be sold on world markets, where prices are lower, then export subsidies are needed. As a result, the subsidising countries can be producing and exporting considerably more than they normally would.”

11 See Articles 9-10 of the Agreement on Agriculture.

12 See Article 4 of the Agreement on Agriculture.

13 See Article 5 of the Agreement on Agriculture.
market price support were classified in an ‘amber box’. Subsidies under this box are subject to a limit (the aggregate measure of support, AMS) which is capped. For developed countries this cap has to undergo further reduction by 20% over six years. The De minimis exemptions permit a country to exclude support for a particular product from its calculation, provided that such support is not greater than 5% of its total value of production. The exemption also includes non-product specific support which is less than 5% of the value of total agricultural production. However, specific quantities produced but subject to output controls were classified in the ‘blue box’. These are not subject to the AMS and were exempted from reduction in subsidies.

These common rules are still central to the ongoing Doha Round of negotiations on further reform of agricultural trade policies. Article 20 of the WTO Agreement on agriculture committed members to continue the reform process designed to reduce domestic support and protection, while the Doha Round trade negotiations progress.

These rules did not have adverse implications for the EU agricultural policy, because most EU direct payments to farmers were classified in the ‘blue box’. Moreover, the new, reduced tariffs did not significantly change the level of protection. However, EU agricultural policy had to be reformulated within the constraints of the commitments it undertook as part of the agreement on agriculture at the end of the Uruguay round. The commitments cover the three areas of export subsidies, market access, and domestic support. The cap placed on expenditure on export subsidies has been the most constraining WTO provision for the CAP. Thus, the EU is bound by a reduction

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14 See Article 6 of the Agreement on Agriculture.
16 See Article 20 of the Agreement on Agriculture.
both in the value and quantities of export subsidies, particularly in the sugar, dairy, and poultry sectors. The Uruguay agreement on agriculture also required the EU to replace previous variable levies used to protect the domestic market from low-priced imports with fixed tariffs that cannot be exceeded. Moreover, for certain categories of commodities, a minimum of 5% of the total consumption must be open to competition from imports. The new tariff levels have had a significant effect on the EU because of the flexibility built into the agreement whereby a country can allocate higher tariff cuts on less sensitive products. With some commodities, e.g. sugar, the EU has used the special agricultural safeguard to provide additional protection.

The Uruguay agreement on agriculture was flexible in regard to the classification of the various forms of farm support and these supports were based on their impact on production. Support mechanisms such as administrative prices, direct payments, and input subsidies were classified accordingly. Support systems such as environmental payments, social payments, or direct payments not linked to production, were considered to have posed less distortion to international trade and were allowed. The trade distorting payments are now subject to a strict ceiling.

The direct consequences of the domestic support ceiling for the EU have been limited. While the EU’s WTO commitments have not prompted a major re-adjustment to EU agricultural policy, they have helped to shape an entire new framework for CAP reform because of the constraints on domestic support that is remotely or directly linked to production. Also, the constraint imposed by the WTO agreement on export subsidies rendered the old system of high intervention prices impracticable because it becomes difficult to offload such quantities on world markets. If additional disciplines
on domestic support arise from the ongoing Doha Round,\textsuperscript{17} such as elimination of export subsidies and further tariff cuts, there could be further reform of the CAP to ensure compliance.

\textbf{7.2.4 CAP reform process}

Events at the continental and global levels, coupled with technological developments, such as the development of biotechnology, brought the CAP to a turning point. Consequently, a year before the commencement of the WTO negotiations on world trade (i.e. in July 1985) the European Commission carried out a comprehensive review on the potential impact of these developments on the agriculture sector and society and made recommendations to the European Council and the European Parliament.\textsuperscript{18}

This document (the Green Paper) reviewed several issues facing the CAP, such as international and budgetary constraints, economic and social objectives of the CAP, the role of the agricultural sector in the economy, the implications of the advent of biotechnology, the need for new uses for agricultural products e.g. the production of bio-ethanol, the need to restore a balance to external trade, regulation and control of practices harmful to the environment and a promotion of practices friendly to the environment, the necessity for income support, etc.

Based on the outcome of the intensive consultations that were carried out by the Commission regarding the Green Paper, the Commission recommended guidelines on


the future for Community agriculture in December 1985. In this document, the EC highlighted the major priorities that should guide the future operations of the CAP, as follows: “(a) to gradually reduce production in the sectors which are in surplus and to alleviate the resulting burden on the tax payer; (b) to increase the diversity and improve the quality of production by reference to the internal and external markets and the desires of consumers; (c) to deal more effectively and systematically with the income problems of small family farms; (d) to support agriculture in areas where it is essential for land use planning, maintenance of the social balance and protection of the environment and the landscape; (e) to make farmers more aware of environmental issues; (f) to contribute to the development in the Community of industries which process agricultural produce, and thus involve agriculture in the profound technological changes which are taking place.” The Commission opined that it was necessary to achieve these objectives to prevent a gradual process of re-nationalisation of agricultural policy. To achieve these objectives, the Commission pointed out that it would require an understanding that the stated priorities were linked to changes in production and in the markets, and so required increased flexibility in the use of available instruments under Community regulations.

The foregoing events led to the publication in 1988 of the EC’s Communication The Future of Rural Society, which pointed towards the need for a formal rural

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20 See *id.*, p. 5.

21 See *id.*, p. 6.

development policy for Europe. In this document, the EC expressed doubts about the impact of the progressive exposure of the erstwhile protected Community agriculture to actual market conditions. Therefore, reform measures were needed to restore order to the markets, to diversify and improve the targeting of support for farmers, and to facilitate structural adaptation. The Commission suggested a review of all present legislation and funding mechanisms that support rural development and the need to create strategies and measures that target rural development.\(^{23}\) The EC recommended that actions and measures that go beyond agriculture would need to be considered in order to stem the problem of rural decline. Thus, a rural development policy would include policy for “creating lasting, economically justified jobs, outside the farming sector (economic diversification). A rural development policy of this kind must reflect very fully local needs and initiatives, particularly in respect of small and medium-sized firms, and lay heaviest emphasis on maximizing indigenous potential.”\(^{24}\)

The Commission’s Green Paper and the subsequent guidelines enshrined in *A Future for Community Agriculture* triggered an increasing level of debate in the UK (in the 1990s) regarding the future of rural areas. The House of Lords Select Committee concluded in 1990 that the EC guidelines formed a proper basis for future rural policy development.\(^{25}\) Based on this conclusion, the Countryside Commission rendered advice on the formulation of rural strategies which placed emphasis on the need for a coordinated local approach as the best way of addressing competing rural demands.\(^{26}\)

\(^{23}\) See *id.*, p. 7. More practical guidelines and suggestions are outlined in Part Three of this Communication.

\(^{24}\) See *id.*, p. 8.


Consequently, the Department of Environment issued a Rural White Paper in 1995 which stressed that the reality of life in the countryside was such that only small-scale changes based on differences in local circumstances were likely to succeed.

The 1995 Rural White Paper (UK) was widely criticised for identifying the components of an integrated rural policy without specifying the means for integrating the sectoral policies and their institutions. Neither did the document specify how a rural development agenda could take account of the social, economic, and environmental pressures for change at the time, but rather focused on self-help as the means for delivering a rural vision. However, the 1995 Rural White Paper marked a paradigm shift from the traditional agricultural fundamentalism to a more balanced view of rural areas.

### 7.2.5 Leader initiative

The EC recommendations in the publication, *Future of Rural Society* resulted in the launch of the Community Leader initiative in 1991, which embodied the endogenous rural development approach. This initiative became the first Europe-wide experience with local development in rural areas. The idea was to enable rural communities to pursue their own development objectives, as each community faces different

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challenges and problems. Thus, from inception the Leader initiative was designed based on the Community-led Rural Development Model, since the initiative was meant to promote economic development in communities through a bottom-up approach.

Leader I was a kind of pilot project and was designed to pursue a novel small-scale approach to rural development in lagging areas (Objective 1), and in areas facing structural problems with relatively smaller financial resources (Objective 5b).[^1] Under the Leader Scheme, 217 areas were identified for revitalisation. The local action plan within the chosen rural areas was designed and implemented by local partnership, with the aid of EU structural funds. The initiative also encouraged communities to form regional, national, and international networks to enable them to benefit from their collective experience.

However, during this period there was a divergence of approach between the UK and European policy programmes. The efforts of the Rural Development Commission (UK) were meagre compared to the scale of EU rural development funding under the Structural Funds and the Leader Scheme. The policy objectives associated with the EU rural development programmes emphasised more integrated operations, the development of rural partnerships, and the development of a wider range of rural interests. As a result, tensions developed between the UK traditional agriculture-based community policy and the emerging paradigm of the territorial and integrated approach to rural development.[^2] The UK Government’s initial reluctance to


incorporate the European rural policy agenda within a national rural policy framework heightened the tension and uncertainties. One commentator opined that it seemed that the institutional framework for agriculture and rural policy had become a captive of old cultural values and was serving as an obstacle to more radical and progressive EU policy reform on rural development.\textsuperscript{33}

Nevertheless, the feedback from the Leader I launch encouraged the Commission to launch Leader II in 1994 to broaden the experience to 1,000 rural areas within the EU. This time, the Commission opted for a decentralised approach in partnership with member states. Innovative measures by public and private actors were also stimulated at the local level. Joint learning and networking were consolidated through the setting up of the Leader II Observatory and the initiative became a part of the programming logic of the EU structural funds.\textsuperscript{34} The Observatory became the anchor point for EU-wide networking and capacity building. Leader II transcended the local communities and was the responsibility of national or regional tiers of government depending on member states’ choice.

Several developments led to the launch of Leader + in 2001,\textsuperscript{35} which extended the coverage of the initiative to all rural areas in the EU. The major one was the launch of, and the provisions contained in, Agenda 2000 and the Rural Development Regulation. The Leader + initiative was designed to promote the implementation of

\textsuperscript{33} See Sue Richards’ comments in Ward, N., \textit{A Department of Rural Affairs: Radical Reform or Red Herring} p. 15, Centre for Rural Economy Working Paper 54, University of Newcastle (2000).

\textsuperscript{34} See id., p. 13.

integrated, territorial, and original strategies for rural sustainable development, with a strong focus on partnerships and networks. About €5b investment was projected for this initiative during the period 2000–06. About €2b of this projected amount was funded by the European Agricultural Guidance and Guarantee Fund (EAGGF) Guidance section, and the remainder was expected to come from public and private contributions.36

Of the €88b budgeted for rural development up to 2013, about 6% will be dedicated to the funding of Leader projects from 2007 to 2013.37 Leader + incorporated further improvements to Leader II, including the following: (a) promotion of more ambitious pilot strategies for integrated rural development; (b) introduction of priority themes around which the local action groups should focus their development strategies; (c) introduction of an eligibility criteria for the partnership structure which limited the participation of public actors to 50% in the decision-making bodies; (d) an increased focus on cooperation between rural areas, including support for joint rural development projects between Leader groups.38

The guidelines emphasise the need for an integrated approach, but the development strategies were designed to focus on one of the following four themes: (a) adding value to local products; (b) improving the quality of life in rural areas; (c) use of new technologies to make rural products and services more competitive; and (d) making the best use of natural and cultural resources.39 The initiative also involved the

37 See Leader Initiative; supra note 30, at p. 1.
38 See Guidelines on Leader+; supra note 35, at point 12.
development of operational programmes with a common evaluation strategy. Evaluation studies were carried out to provide a sound basis for programming and to inform the public and budgetary authorities about the effects and the value of the public intervention.

The evidence shows that the UK participated in the Leader programme and other EU rural development initiatives that are funded through the EU structural funds. For example, the Rural Development Programme for England (RDPE) has allocated more than £21 million during the period 2007-2013 to seven Local Action Groups (LAGs) across the East of England based on the Leader approach. Scotland received £130 million for other specific EU initiatives such as Leader (rural communities), EQUAL (gender equality), etc. The Leader programme accounts for 5% of the total Scottish Rural Development Programme (SRDP) allocation (i.e. about £38 million). An extra $19.2 million Convergence Funding was extended to seven LAGs in the remote Highlands and Islands. The EU has allocated 376.7 million Euros to the Welsh Rural Development Programme for the period 2007-2013. The Leader programme accounts for around 47 million Euros, of that amount.

Similarly, the Leader II programme supported over 2000 projects and developed over 2000 new businesses in Northern Ireland. The Leader+ programme in Northern Ireland accounted for 5% of the total SRDP allocation (

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Ireland was also active, and was jointly supported by the EU (with a contribution of £10 million) and the Department of Agriculture and Rural Development.\textsuperscript{44} Of the 171 million Euros allocated to the Northern Ireland Rural Development Programme for the period 2007-2013, the Leader programme accounts for 100 million Euros.\textsuperscript{45}

Owing to the positive progress of the Leader initiative, the principles behind the initiative have now been integrated (since 2007) into the EU rural development policy. The key principle is the act of promoting a truly local approach as the driver of an integrated rural development using EU structural funds.\textsuperscript{46}

\textbf{7.2.6 Agenda 2000 and rural development regulation}


The MacSharry reforms in 1992 (but implemented in 1994) marked the first major reform of the CAP, based on the EU’s commitments to the WTO agreement on agriculture, and also focused specifically on rural development issues.\textsuperscript{47} The reform introduced a significant reduction in supported prices for beef, grains, and oilseeds to

\textsuperscript{46} See Leader Initiative; supra note 30, at p. 1.
converge EU prices with those of world market prices. To compensate for these price cuts, the reform introduced direct payments to arable and beef farmers. The reform introduced the obligatory set-aside measures to reduce excess production of arable crops.48 The objectives of the structural policy were also modified in 1993 to facilitate the development and structural adjustment of rural areas.

Thus, the MacSharry reform of the CAP was not entirely focused on agriculture but rather as a means of achieving a wider goal of an integrated rural development. This implied a paradigm shift from a total farm economy (specialisation) to a mix of a well developed farm economy as well as a diversified rural economy (diversification).49

The first European Conference on Rural Development served as an opportunity for a variety of stakeholders to discuss and contribute ideas to the future of rural development policy in Europe. The Conference concluded with a ten-point declaration for a rural development programme in the EU, which contributed to the design of Leader+. Emphasis was placed on the need for an integrated approach to a diversified and sustainable rural development policy.

The Conference also urged Europe’s policymakers to “(a) raise public awareness about the importance of making a new start in rural development policy; (b) make rural areas more attractive to people to live and work in, and become centres of a more meaningful life for a growing diversity of people of all ages; (c) support the ten-point programme and cooperate as partners in the fulfilment of each and every one of

49 For more details on the specialisation and diversification rural development paths, see OECD Documents, Better Policies for Rural Development pp. 56-60 (1996).
the goals, which are embodied in this declaration; (d) play an active role in promoting sustainable rural development in an international context.\textsuperscript{50}

The outcome of the Cork declaration resulted in the formulation of an EC regulation on rural development,\textsuperscript{51} whose main objectives were to address rural challenges by including a number of measures which would promote adaptation and development. Such measures include: provision of basic services for the rural economy and population; renovation and development of rural areas; diversification of agricultural activities to non-agricultural activities; encouragement for tourism and craft activities; and financial engineering. The regulation stipulated the approach and principles to be adopted when applying these measures. Note 14 of the regulation states that, “whereas, given the diversity of the Community’s rural areas, rural development policy should follow the principle of subsidiarity; whereas it should therefore, be as decentralised as possible and emphasis must be on participation and a ‘bottom up’ approach; whereas therefore, eligibility criteria for rural development support should not go beyond what is necessary to achieve the objectives of rural development policy.”\textsuperscript{52}

Subsequently, Agenda 2000 reforms were launched to modernise key agricultural and rural development policies and to prepare the EU for further enlargement. The reforms focused on the need to update the European model of agriculture, to narrow

\textsuperscript{52} See id., Note 14.
the gaps in wealth and economic prospects, and for tight budgetary controls until 2006.\textsuperscript{53} Agenda 2000 also introduced the concept of a comprehensive rural development policy, which incorporates the development of a multifunctional agricultural sector and the promotion of diversification measures that support the broader rural economy.\textsuperscript{54} The reform increased the funding for rural development and tied funding for rural development to the EAGGF Guarantee Section, partly for ease of administration and also to indicate that the agri-environmental and rural development schemes are now an integral part of the mainstream CAP.

Agenda 2000 reform also created two pillars for the CAP, consisting of Pillar I (traditional market measures and price support) and Pillar II (rural development and agri-environmental measures).

The Agenda 2000 agreement covered the 2000–06 period, but mandated a mid-term review to be carried out in 2003.\textsuperscript{55} The Luxembourg Council of Agricultural Ministers met in June 2003 for the Mid-term Review (Fischler reforms) and agreed on three issues:\textsuperscript{56} (a) the bundling of all production-linked payments into a single farm payment to be paid to farmers based on their historical entitlements but linked to land rather than production; (b) transfer of money between CAP objectives. For example up to 5% of the value of a single farm payment to larger farmers would be transferred


to rural development measures; and (c) a continuation of the sectoral reform process. In response to this review, the EC established common rules for direct support schemes for farmers under the CAP in Council Regulation (EC) No 1782/2003.57

However, the political relevance of rural issues in the UK was ushered in by New Labour’s electoral victory in 1997,58 the formation of the Countryside Alliance in 1997, the House of Lords 18th report on Agenda 200059, and the increasing pressure from environmental interest groups (e.g. Greenpeace UK). Consequently, the Countryside Agency was created in 1999, followed by a Rural White Paper in 2000.60 The principles embodied in this White Paper aligned more closely with those of the EU commitment to involving local communities in the task of developing rural areas; for example the White paper stated that its goal is one of “helping people in rural areas to manage change, exploit the opportunities it brings and enable them to create a more sustainable future.”61


Its main proposals were: (a) 50% business rate cut for village shops, pubs and petrol stations which offer a benefit to the community; (b) giving local councils discretion to end the 50% council tax discounts for second homes, with the money going to providing cheaper homes; (c) putting £100m towards one-stop health care centres in 100 communities; revitalising rural post offices with £270m of investment; (d) putting £240m into rural transport schemes with a new £15m special transport fund to support car clubs, taxi services, and community transport; (e) giving extra rate relief to farmers who diversify into new businesses; (f) strengthening the role of parish councils to give local people more say in how local services are provided; (f) increasing the number of farmers' markets from 250 to 400; (g) building 9,000 affordable new homes each year across rural districts; (h) giving £37m extra regeneration money to market towns to bring in new business; (i) and using information technology to connect people in rural areas to goods and services.

Subsequently, the UK Government initiated an independent review into the delivery of government rural policies, led by Lord Christopher Haskins. The report was published in November 2003, and one of its main recommendations was that the development of rural policy should be separated from its delivery. It stressed that the Department of Environment, Food and Rural Affairs (Defra) has responsibility for policymaking, and those policies should be carried out through national, regional, and local agencies working individually and in concert. Thus, policy and delivery functions should be managed separately.

Building on the Rural White Paper (2000) and Lord Haskins report (2003), Defra formulated the 1994 Rural Strategy document, with emphasis on three priority areas for rural policy as follows: (a) economic and social regeneration (i.e. supporting rural enterprises but targeting greater resources in areas of greatest need); (b) social justice for all (i.e. addressing rural social exclusion where it exists and providing fair access to services and opportunities); and (c) enhancing the value of the countryside by protecting the natural environment. The government announced the Rural Strategy 2004 on 21 July 2004, followed by the appointment of a sub-committee (Environment, Food and Rural Affairs Committee) to undertake further inquiry into the strategy to ensure its relevance and practicability. The terms of reference included a review of the proposal to establish an integrated agency; the proposal to streamline rural, agricultural and environmental funding schemes; the delivery mechanism for the strategy, including the IT strategy that underpins it; and the extent to which the strategy incorporates the recommendations contained in Lord Haskins’s review of rural policy delivery. On 10 February 2005, the UK Government published the draft Natural Environment and Rural Communities (NERC) Bill. A sub-committee was appointed to undertake a pre-legislative examination of the draft Bill to ensure that it carried forward the main provisions of the Rural Strategy.

The government’s response to the recommendations of this committee was positive and culminated in the Natural Environment and Rural Communities Bill of 12
October 2005, which set the scene for full engagement with rural issues as well as better engagement with EU policies, guidelines, and funding schemes for rural development. While these fast-paced developments on rural policy were taking place in the UK, there were further developments on the EU front.

7.2.7 Salzburg European Conference on Rural Development and the Commission proposal on Rural Development Policy 2007-13

The second European Conference on Rural Development Policy held in Salzburg (November 2003) was a follow-up to the Cork Conference on Rural Development. The Salzburg Conference was held at a time when rural policy needed to evolve to meet the new challenges presented by an enlarged EU. The conference reviewed the EU experience of the Leader+ rural development programmes from 2000–06, to draw conclusions and lessons for the next generation of programmes during the period 2007–13. The conference was represented by major stakeholders in rural development within the EU, including representatives of member states, other European institutions, Leader groups, international organisations, national and regional programme management authorities, sectoral organisations, NGOs, experts, etc.


The conference reached the following conclusions regarding the role of rural development policy in the rural economy and for rural communities.\textsuperscript{68} (a) The growing diversity of rural Europe required a comprehensive policy, flexible instruments and appropriate resources to address rural issues. (b) Rural development could contribute significantly to social and economic development and improve territorial, social, and economic cohesion. (c) A consolidation of public support is essential for an integrated, territorially-oriented rural development. The panellist argued that in this regard, public support for rural development should be treated as an investment and not a subsidy. They recommended the formulation of a single rural policy, funded by a single rural development fund. (d) The shifting emphasis from agricultural policy to rural policy should not diminish the role of agriculture in rural development.

The main recommendations by the conference participants were that EU rural development measures should be brought under a single fund from 2007 onwards; member states were to have greater flexibility and freedom to decide on the allocation of their funds; and that while recognising the importance of agriculture, greater emphasis should be placed on rural development. The conclusion by the Salzburg Conference regarding the continuation of the Leader initiative was positive and stated that rural development should be implemented in partnership between public and private organisations and civil society in line with the principle of subsidiarity.

\textsuperscript{68} See \textit{id.}, pp. 105-25.

7.2.8 Future direction
Agenda 2000 reforms were set for a period expiring at the end of 2006. Thus, the Mid-term Review of the CAP set out the CAP framework from 2007 to 2013. Based on the outcome of this review, the EC came up with rules for voluntary modulation of direct payments to farmers as contained in Council Regulation (EC) No 3781/2007 of 27 March 2007. This was followed with regulations on a comprehensive rural development policy with emphasis on community participation, and the funding arrangements.

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Currently, all UK devolved governments have brought their rural development policies in line with the evolving EU policies, as set out in their respective comprehensive Rural Development Programmes for the period 2007–13.\(^3\) The Commission for Rural Communities has also published its review of the state of rural areas between 1998 and 2008\(^4\) to assess developments within this period and discover what needs to be done going forward from then. However, it is unlikely that the current CAP framework, which expires in 2013, will be the last CAP reform. This review did not alter significantly the level of market price support provided to EU farmers. Agreements reached in the Doha Round negotiations on the extent of tariff reduction and disciplines on export subsidies and trade-distorting domestic support arrangements may influence further reform of the CAP.

7.2.9 Discussion of the EU rural situation and key approaches to the EU’s rural development policy

The EU’s rural development policy evolved, as part of the development of the CAP, from a policy which addresses the structural problems of the agricultural sector to one that deals with the contemporary multifunctional agricultural sector and the challenges faced in its wider rural context. Since the years 2000–06, the UK


government has evolved its rural development policy in such a way as to reflect the EU ideals of rural development. Currently, the two systems have been harmonised and all rural development programmes in the UK now come under EU funding arrangements.

Life in rural locations presents challenges, considering the wide distances from major cities and equally long distances between rural areas and between settlements. Rural development has grown in importance among the EU member states as a result of unfavourable trends affecting a substantial number of the Community’s rural areas. The current underlying trends are agricultural decline, employment losses, migration of women and the most highly trained young people, increasing rural unemployment, closure of business and public services, and environmental damages. Together, these factors tend to reduce the attractiveness and sustainable development of rural locations. Particular structural features of rural areas relative to urban cities are low population density, isolation, higher average age, lack of knowledge transfer, dependence on external sources of supply, and lack of advanced services/utilities.

Rural areas represent about 80% of the EU territory. The present trend towards concentration of production activities in urban areas is expected to shift towards a more balanced geographical distribution. The EU enlargement has stirred up the debate on the principle of spatial cohesion which lies at the heart of all rural

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77 See id., p. 1.
expectations. Spatial cohesion integrates citizens’ capacity to build their futures, beyond distribution of goods and capital.\textsuperscript{78} It became obvious (from the disciplines laid down in WTO agreements on agriculture) that the CAP could not solely deliver the goal of rural development, but all other rural sectors have to be mobilised towards a sustainable development of a diversified and balanced rural society and environment. It has been advocated that setting up a European Rural Fund is an absolute essential condition for achieving the objectives of the rural development policy, ensuring spatial cohesion in the EU and a key success factor for enlargement.\textsuperscript{79}

The EU Commission provided a number of justifications for designing a rural development policy. Firstly, rural areas play an increasing role in the recreational needs of urban dwellers.\textsuperscript{80} Secondly, ‘green tourism’ offers these areas an alternative economic base. Many rural areas boost landscape amenities whose development could be key to local economic prosperity. Thirdly, there is a need to support the ongoing development of a healthy agricultural sector. Fourthly, rural areas have the potential to improve the quality of life for the whole society by providing a healthy and secure environment. Therefore, rural development policy, as part of EU territorial policies, was introduced with the aim of maintaining and improving the balanced and dynamic economic development necessary to achieve social and economic cohesion within the Union.\textsuperscript{81}

\textsuperscript{79} See \textit{id.}, p. 2.
\textsuperscript{80} See EU Approach to Rural Development; \textit{supra} note 75, at p. 1.
\textsuperscript{81} See \textit{id.}, p. 3.
A number of structural instruments have been proposed by the EU that could support regional and local development.\textsuperscript{82} Firstly, rural infrastructure and other factors could be developed to prevent rural exodus. Secondly, economic diversification could be promoted, especially creating niche products, jobs, and micro-enterprises. Thirdly, relevant investments could be made to protect and conserve rural heritage, including forestry. Fourthly, local development could be hinged on integrated rural settlement development in order to increase the attractiveness and quality of life, and to support rural diversification. Fifthly, green tourism could be promoted in rural areas, as well as preserving the environment and recreational capacity. Sixthly, investments could be directed at the development and use of renewable forms of energy. Other measures that could contribute to the maintenance of rural areas include: development of social, economic, and cultural services; development of socio-economic links between rural and urban locations; maintenance of the young population; and prevention of social exclusion.\textsuperscript{83}

Thus, five key approaches could be distilled from the EU’s design of a rural development policy: flexible, integrated, thematic, bottom up or community-led and strategic approaches. Firstly, the policy offers a flexible approach based on the principles of partnership and subsidiarity. Thus in designing rural development programmes, member states have a reasonable degree of flexibility in striking a balance between the sectoral dimension (i.e. agricultural restructuring) and the territorial dimension (i.e. land management and the socio-economic development of rural areas). Secondly, the policy is based on an integrated approach. This approach is reflected in the objectives of the policy that promote economic, social, and

\textsuperscript{82} See \textit{id.}, pp. 4-5.
\textsuperscript{83} See \textit{id.}, p. 5.
environmental concerns for agriculture and also the wider rural economy (i.e. rural diversification).

Thirdly, the policy takes a thematic approach, in the sense that measures are grouped around the objectives of the policy (known as axes). Rural development programmes revolve around three thematic axes: economic issues (i.e. employment creation and competitiveness); social issues (i.e. quality of life); and the environment and the countryside (i.e. climate change, biodiversity, sustainable use of land, forests and agricultural production systems). Fourthly, the policy adopted the ‘Leader’ principle of a community-led approach to rural development programmes. The policy emphasises participation by the communities through the creation of local action groups who carry out locally generated development proposals with the aid of the European Agricultural Fund for Rural Development. The three thematic axes are cemented by the ‘Leader’ approach, which acts as a horizontal axis for implementing the rural development policy.

Fifthly, the policy also adopts a strategic approach to ensure the targeted use of resources. This approach involves three measures. (a) The relevant Council Regulation and EU strategic guidelines set priorities for rural development, which reflects EU policy priorities, e.g. economic growth, job creation, and sustainable development. (b) Each member state is required to develop a national strategic plan which ensures that the proposals for using the Community fund are in line with EU strategic guidelines. The national plans are notified to the Commission which ensures that Community, national, and regional priorities are consistent. (c) The Commission
and member states closely monitor and assess the results of strategies and programmes.

7.3 Australia

7.3.1 Pre-1970s era
Similar to the UK, rural areas in the nineteenth century were synonymous with agricultural production. Agricultural production was introduced to the Australian landscape by colonial forces. The Europeans came with a system of farming which has developed over time. Following the Second World War, more intensive forms of agricultural production were introduced through massive land clearing and the use of novel agricultural inputs such as irrigation, pesticides, fertilisers, etc. Thus, the end of the Second World War began a series of major changes in agricultural production, the global market situation, and agricultural policy. Since then, global capitalism has had a significant influence on agribusiness. Australia was one of the main suppliers of the post-war European market.

During the 1950s and 1960s, agriculture prospered because it was protected, subsidised, and regulated by the government. Australian rural producers capitalised on the substantial subsidies they received and increased production. Australia became a large overseas exporter of such agricultural products as wool, sugar, beef, and wheat and imported a large volume of processed and manufactured goods. However, as

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agricultural expansion increased in other Western countries, overproduction occurred and consequently the prices of agricultural products crashed globally. Thus, agriculture became vulnerable to market forces and in the late 1960s farmers experienced cost-price squeeze. In reaction to the pressures felt by farmers, the government responded with an assortment of palliatives such as subsidies, concessions, tax relief, cheap credits, loans to marketing authorities, etc.\textsuperscript{87}

Britain’s entry into the EU CAP meant that Australia no longer had access to their traditional colonial trading partner. The few years following this period witnessed the removal of subsidies in Australia. The farmers responded to the crisis by forming the National Farmers’ Federation, which adopted the view that the subsidies created inefficient farmers and wage inflexibility and thus were regarded as major problems afflicting the agricultural sector. Hence, Australian agricultural policy has moved (since the mid-1970s) towards a non-subsidised agricultural sector within a free trade world market, with corresponding implications for rural development policy. As Europe and the US continued to subsidise their agricultural sector, this had a negative impact on Australia’s agricultural sector and by extension the condition of rural areas.\textsuperscript{88}

**7.3.2 Post-1970s era**

The Whitlam Labor Government in the early 1970s introduced a number of statutes based on rural adjustment and reconstruction in order to address these problems. The support for rural development took the shape of assistance to farmers and all other

\textsuperscript{87} Lawrence, G., Capitalism and the Countryside: The Rural Crisis in Australia p. 9 (1987).

\textsuperscript{88} Share, P. H. et al., The Vertical and Horizontal Restructuring of Rural Regions: Australia and New Zealand; in Alston M., Family Farming in Australia and New Zealand. Key Papers No 2, Centre for Rural Social Research, Wagga Wagga, 1991.
forms of rural development were based on the self-help and self-reliance principle.\textsuperscript{89} Some commentators contend that two interrelated processes are necessary to prepare individuals psychologically to reach a level of capability for self-help: the development of the individual and the creation of a community culture.\textsuperscript{90} Thus, these policies were seen by the Federal Government as ‘ad hoc’ initiatives to address the problems of Australia’s rural communities, and were guided by the concept that agricultural activities are tied to rural locations.\textsuperscript{91}

However, following the ousting of that Labor Government, rural and regional policy at the Federal level assumed a low profile.\textsuperscript{92} The incoming administration argued that it is the responsibility of State Governments to develop the regions and also the responsibility of local governments to develop the rural areas. Following the election of the Hawke Labor Government in 1983, there were fresh calls for a Federal role in rural and regional development. However, despite the calls, Government decided in favour of a more neoliberal non-interventionist policy position. The emphasis on


market-led solutions to rural decline and disadvantage resulted in Federal Government and State Governments adopting a minimalist role in promoting rural social and economic development.\textsuperscript{93} It should be noted that part of the government’s minimalist role included efforts at cushioning the impact of high fuel prices for rural inhabitants and the primary industries. Beyond these objectives, rural development tended to be lowly funded and emphasis rather placed on community driven self-help responses to rural economic and social problems.

However, based on this self-help model, government maintained the view that the main issues to address in ensuring rural social and economic well-being are the productivity and profitability of primary industries, particularly agriculture. Thus, government policies in this regard have been targeted at liberalising the economy and promoting economic efficiency and productivity in primary industries. Most of the series of reforms in other policy areas were designed to improve Australian international competitiveness in the global market place. The policy changes included the deregulation of banking and finance, reduction of import restrictions and tariffs, freezing of interest rates, floating of the dollar, and tax cuts with a corresponding reduction in government spending. These reforms were largely based on the idea that Australia’s integration into the global economy would depend on embracing the market system of economic organisation, deregulation, and the removal of government protection.

A number of commentators\textsuperscript{94} have suggested that government’s intention to improve national economic and social well-being may have been counterproductive, because those reforms were thought to have exposed many industries, particularly the agricultural sector, to the vagaries of a volatile global market. Consequently, these policies worsened the existing social and economic problems in rural areas. The symptoms of the exacerbation of rural problems manifested in the forms of a reduction in agricultural employment, falling levels of economic activity, farm amalgamation, outmigration and population decline, service withdrawal, etc. These symptoms have been accompanied by rising levels of economic and social disadvantage.

7.3.3 The emergence of a formal rural and regional development programme

Since the 1990s the role of agriculture as the prime driver of social and economic life in Australian rural areas has somewhat diminished, and with it an increasing recognition that the task of rural development would have to go beyond palliative measures directed at the agricultural sector. Consequently, the Australian Government renewed its interest in rural and regional development in the early 1990s when rural disadvantage became evident. The evidence was the outcome of a series of reports and inquiries on the state of rural and regional Australia. Following the growing evidence of contracting economic and social development in rural and regional areas,

the government included a regional development programme in its White Paper titled the ‘Working Nation’ (1994).  

Following the release of the White Paper, the National Board of Employment, Education and Training published its report, *Making the Future Work*, which set out advice to the government and recommendations on how the task of generating employment could be achieved. This strategy promoted regional leadership, infrastructure improvements, education, and training schemes. It also led to the formation of 66 Regional Development Organisations (RDOs) across Australia, who had the responsibility of designing specific regional strategies based on individual regional priorities. The RDOs’ responsibilities included fostering regional economic development and improving policy coordination between Federal, State and local Governments. Despite the sound framework put in place by the government, about $263 million (i.e. 4.1%) of the $6.4 billion earmarked for the ‘Working Nation’ strategy were budgeted for regional development.

The Australian Government’s philosophy remained that regions should be assisted to help themselves. Hence, the regional development strategies became largely based on the bottom-up community-led model. The bulk of the funding was channelled towards regional infrastructure development, particularly roads and telecommunications. However, most of the projects were concentrated in the growing areas where the long-

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term viability of projects could be assured. Thus, many smaller and declining rural communities were precluded from benefiting from substantial investment in services and infrastructure. The formation of RDOs was not popular with all the states, as some (e.g. Western Australian Government) complained of inadequate funding under the programme. As a result, only a few RDOs were formed.

Rural and Regional development receded further with the incoming administration of the John Howard led Liberal–National Coalition in 1996. One of his first policy decisions was to abolish all Commonwealth regional development programmes, with a return to the argument that states and local governments should take charge of regional and rural economic development. The government policy for regional and rural areas focused more on family benefits and support for small businesses (through the Diesel Rebate Fuel Scheme). In place of regional programmes, the government introduced the Job Network and Dole programmes.

Thus, the Australian Government confirmed through this policy change that they would not engage in proactive regional economic development strategies, but would contribute to regional development indirectly through further economic reform and deregulation. The government’s policy choices were understandable, particularly in the light of global trends towards economic rationalism, globalisation, and liberalisation (deregulation). On the other hand, the forces of global competition

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exerted considerable pressure on communities who would have to adapt to the forces of change.\textsuperscript{100}

Therefore, the challenge for government was to deliver policies that strike a balance between the need for the country to operate in line with these global trends and the conflicting need to help rebalance communities which are jolted by the forces of change. Some of these changes have manifested in the form of population decline, and consequently the rationalisation, privatisation, and centralisation of many public services, e.g. schools, hospitals, police stations, public housing, etc.

Nevertheless, most State Governments have designed various policies and structures aimed at promoting regional development. However, the role of the states has been to encourage, facilitate, and monitor development. For example, the Western Australian Government introduced the Regional Development Commissions Act 1993\textsuperscript{101} to promote economic and social development in regional and rural areas. For the purpose of the implementation of this Act, the State was divided into nine Regional Development Commission areas. The primary focus of these Commissions was on regional economic development comprising the following objectives: diversification of economic base; developing and integrating core infrastructure and related services; developing a favourable business and investment climate; integrating and coordinating land use planning; and maintenance and enhancement of the region’s competitive advantages.

\textsuperscript{100} Australian Productivity Commission, \textit{Meeting the Challenge of Change in Regional Australia}, a speech delivered by the Chairman of Productivity Commission in a symposium organised by the Institute of Public Administration Australia (2000). Available online at \url{http://www.pc.gov.au/speeches/?a=7833}, last visited on 10 November 2009.

While these goals are laudable, there is evidence of poor funding to support them. For example, the Wheatbelt Development Commission which covers 44 local government areas with a combined population of 70,000 had a total operating budget of $1.2 million in the 1997–98 financial year.\textsuperscript{102} These Commissions tend to work better with those communities that utilise a community-driven model of operation. Thus, the Commissions have been more successful in those areas having adequate economic and social capital to initiate and support local development initiatives.\textsuperscript{103} Conversely, the Commissions have been less effective in stimulating economic growth in the smallest and most impoverished communities. The general lack of funding for regional development programmes probably explains why the Commissions tend to adopt the self-help approach among small rural communities, rather than adopt a more proactive approach.

However, there are some discernable benefits in the community-led approach (i.e. bottom-up approach) to regional and rural development. The devolution of responsibility for rural development to sub-regional and local levels of government has helped some entrepreneurial communities to reverse long-term patterns of economic, social, and demographic decline.\textsuperscript{104} On the other hand, many declining rural communities may not have sufficient resources to undertake successful local initiatives. In those communities where successful projects have been initiated, the

benefits are often limited and temporary and sometimes undermined by other
government policies that result in the withdrawal of local services.\textsuperscript{105}

To counteract these problems, a number of commentators have argued for a more
integrated approach to regional and rural development,\textsuperscript{106} particularly the model that
encourages local communities to work together on a collective regional basis with
adequate government funding (i.e. more like the Leader+ model).\textsuperscript{107} Such an approach
could help to pool local people, their resources, and knowledge together for the good
of communities. Since smaller communities are not expected to achieve the goal of
development alone, the higher levels of government may have a role to play. This role
may take the form of creating a regional development framework which facilitates
partnerships towards development objectives, and local capacity building. Regional
development objectives could also be widened by the Federal Government to include
not only the economic aspect of development, but also the social and cultural needs
and goals of the inhabitants.

7.3.4 Dimensions to the changing rural systems and rural policy
Rural and regional policies are influenced by demographic, economic, social,
environmental, and technological changes. One commentator contends that the
Australian rural policy is influenced by agrarian sentiments (which is common to
many Western societies) and could possibly explain the inconsistencies between rural


policy and other adjacent areas of government policies. Nevertheless, government policies and provision of important rural services also have a significant impact on the direction of rural development. There are five major dimensions to be considered in relation to the forces that drive rural policy development in Australia.

The first dimension relates to the pace of demographic transition. The rural society evolved under agrarian ideals that largely differentiated rural from urban in cultural, social, and political terms. However, the speed of rural demographic transition is increasing and marked by several indicators such as an ageing farm population, outward migration of the younger age groups, and significantly lowers population growth rates relative to metropolitan areas. Thus, the traditional community fabric keeps changing as the local population changes in number and makeup. The rural challenge in this regard is to maintain community functions with a smaller, but older, population. The demographic patterns are also becoming more diverse and less distinct from the people of metropolitan areas. Therefore, public policy interventions need to take account of the emerging heterogeneous nature of rural communities and carefully target support schemes at the areas that are most in need.

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The second dimension that affects regional and rural policy is the pattern of government expenditure and support schemes. For example, direct state support for primary industry (agriculture and mining) as well as support for regional and rural development has always been meagre. This is symbolic of the public policy tension between competitive efficiency and equity considerations. The Australian Government, based on its current neoliberal economic philosophy is clearly in favour of the former, which is typified by the withdrawal of government from service provision. This policy has been blamed as being partly responsible for the spiral of decline in rural communities.\(^{112}\) The agricultural financial support programmes are at less than A$1 billion (i.e. about 4.5% of the gross value of production, GVP) compared to the OECD average of 28.9% and the EU’s GVP of 33.7%, based on A$ = $US0.90 as at 2007 data.\(^{113}\) Mining receives little support and is wholly corporatised and run by some of the largest global mining companies. The case of mining is not a matter of concern since it is highly capitalised by global standards. However, the Federal Government and State Government’s annual contribution to rural development programs is estimated at A$260 million. The combined total of primary industry and rural support amounts to A$1.25 billion, which is about 0.4% of the nation’s $310 billion non-metropolitan GDP as at March 2008.\(^{114}\)


\(^{114}\) See *id.*, p. 12.
The third dimension relates to the pace of globalisation. However, the Australian agricultural sector has been one of the beneficiaries of the convergence of market forces and globalisation. Thus, agricultural activities have benefited from new technological developments and have increased in scale. For example, the total productivity growth rate in this sector has averaged 2.3% per annum over the past 20 years which is more than double the rate of overall growth of the economy.\textsuperscript{115} The mining industry, which is also rural, has benefited from a boost in productivity arising from globalisation. Manufacturing has witnessed a decline and employs less than 10% of the workforce, while new rural industries, particularly in the energy sector, are fast emerging (i.e. biofuel; and wind, solar and wave generating firms for electricity purposes).\textsuperscript{116} As a result, the primary industry contributes around 8–9% to the GDP, 60% of exports, 17% of R&D expenditure, but employs only 4% of the labour force.\textsuperscript{117} This negative balance between productivity levels and workforce has contributed to persistent outmigration, especially of youths.

The fourth dimension is the increasing environmental regulation, which in most cases has boosted efficiency and caused a positive adaptation in farming. The measures are designed to control global warming and the attendant climate change, protection of biodiversity, encouragement of afforestation, etc.


\textsuperscript{116} See Renewable Energy Focus; \textit{Australia Funds Utility-Scale Wave Power Stations}. Available online at http://www.renewableenergyfocus.com/view/5148/australia-funds-utilitiscale-wave-power-station/, last visited on 10 November 2009.

\textsuperscript{117} See Sorensen; \textit{supra} note 113, at p. 13.
The fifth dimension relates to the complexity and turbulence of rural systems, which are generated by the technologically driven pace of change. Thus, contemporary rural systems deal with a complex mixture of challenges, such as knowledge expansion, creation of human and social capital, environmental regulation, social service provision, attraction of private venture capital finance, as well as the need for leadership and adaptive capacity.

7.3.5 The regional Australia summit 1999
Following concerns about the sense of alienation felt by rural and regional Australia, the then Deputy Prime Minister/Minister for Transport and Regional Development initiated this summit through an address to the National Press Club in February 1999. The aim was to provide an opportunity for people from rural, regional, and remote areas to contribute their opinions and perspectives on how best to tackle the challenges facing those parts of Australia. The expected outcome was a development framework of partnership between the government, business, and community sectors, to deliver a prosperous and adaptable future for regional, rural, and remote areas.

Following the address by the Minister for Transport and Regional Development, the Australian House of Representatives Standing Committee on Primary Industries and Regional Services commenced an Inquiry into Infrastructure and the Development of Australia’s Regional Areas. However, in its submission to the House of Representatives, the Australian Local Government Association (ALGA) made a case for government investment in regional Australia based on its assessment of the threat from global economic forces, the impact of structural adjustment, and the lack of

investment in rural areas. ALGA was of the view that the development of sustainable regional communities represented a challenge for governments at all levels.\textsuperscript{119}

The association identified two crucial roles that government could play in this regard. Firstly, government could provide and manage infrastructure development. Secondly, government could provide leadership and facilitate behaviour change needed for rural and regional sustainability in a complex domestic and global economy. The final report of this inquiry was published in June 2009, and established a clear framework and guidelines for the funding of regional and local community infrastructure.\textsuperscript{120}

Some of the main themes explored at the Summit include community and industry leadership, finance and facilitating entrepreneurship, communications, infrastructure, the role of the three tiers of government, value adding to regional communities, new industries and new opportunities, etc.\textsuperscript{121} The central message delivered by the participants was that the time was ripe to reshape the future of rural Australia in order to face the challenges brought about by globalisation and the impact of associated government policies, such as deregulation, privatisation, etc.


The summit realised that there were no easy solutions to rural community problems, but emphasised the need to draw on partnerships between communities, businesses, and all levels of government. Other stakeholders were also expected to make their contributions to locally developed plans. The participants recognised that successful communities would be those that were able to reinvent themselves by capitalising on their natural resources, natural strengths, and human assets. However, to achieve success would require significant investment in education, training, skill development, and leadership in order to enhance human capacity of rural Australia. Considerable investment is also needed in the area of telecommunications. This investment cannot be met by rural communities and thus underscores the need for government participation in the process of rural and regional reinvention.

At the conclusion of the summit, a vision for regional Australia was developed\(^\text{122}\) and built on three fundamental principles, as follows: (a) “a ‘bottom-up’ rather than a ‘top-down’ approach should be built into responses aimed at empowering communities at the local level; (b) governments, businesses and communities have a joint responsibility to address the problems facing regional Australia and should work together in a spirit of partnership; (c) responses should be sufficiently flexible to cater for the particular circumstances and needs of regional, rural, and remote communities.”\(^\text{123}\)

To achieve the vision for regional Australia, a number of critical success factors were identified at the summit: (a) improved access to government assistance programmes;

\(^{122}\) See id., p. 43. The Vision statement is for: “A strong and resilient regional Australia which has the resources, recognition and skills to play an equal role in building Australia’s future and is able to turn uncertainty and change into opportunity and prosperity”.

\(^{123}\) See id., p. 43.
(b) closer coordination between the different tiers of government; (c) options to stimulate business investment in regional Australia; (d) improved access to services from government, businesses, and other organisations; (e) new government mechanisms or processes; (f) improved human resource development, including education and training; (g) leadership development and building of community capacity; (h) provision of physical infrastructure critical to community and local industry development.

In the light of the following requirements, the Summit recommended that governments, urban businesses, and industry must become more responsive to these critical success factors when designing and delivering programmes and services. To become responsive to rural and regional needs the Summit recommended the following steps: 124 (a) governments must create a climate (particularly tax incentives) which encourages investment in rural enterprise; (b) the three tiers of government must remove those unnecessary regulatory impediments which increase the cost of doing business and hence stifle innovation in rural and regional Australia.

Key business leaders expressed their support for the idea of partnerships, and expressed the view that tax incentives were a critical factor in attracting investment to areas outside the major metropolitan areas. Consequently, a Steering Committee was formed to review the recommendations of the summit and focus on the engagement of other stakeholders beyond the government, e.g. the corporate and community sectors. Following the success of deliberations at the summit, the Federal Government of Australia established a Regional Australia Summit Taskforce comprising all relevant

124 Regional Australia Summit Communiqué, Regional, Rural and Remote Australians Want to Determine their Own Futures. Presentation of the Summit Recommendations (1999).
Federal Government Departments and Agencies. The objective of the Taskforce was to ensure that response to the summit was coordinated across all relevant government departments and agencies. The Taskforce liaises with the Steering Committee to refine and develop policy ideas and options in line with the recommendations from the summit. One of the fallouts of the regional summit in 1999 was government’s decision to increase funding for the agricultural sector in 2004, in recognition of the role it plays in generating a significant proportion of national GDP.

7.3.6 The implications of the WTO agreement on agriculture for rural development in Australia

Australia is a leading member of the Cairns Group with obligations on the WTO agreement on agriculture. Since 2006, the Australian Government has been pursuing a policy of deregulation. Also, as a nation pursuing neoliberal agricultural policy since the 1980s and with a long history of agricultural export, the Australian Government regards the concept of multifunctionality in the agricultural sector as a protectionist measure that encourages high levels of trade distorting domestic support. This posturing is contrary to the EU agricultural policy which encourages a multifunctional

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127 Multifunctionality, in this sense, means agricultural production that takes into account the need to protect the landscape character, biodiversity and other social and environmental concerns.

agricultural sector and the high levels of state support that is required to pursue such a policy.

Some commentators contend that the Australian Government’s negotiating position in regard to the WTO agreement is based on the its understanding of the relationship between agriculture and the environment, whereby agriculture is linked to production, and biodiversity protection issues are not classified within the farming system.\textsuperscript{129} As a result, successive Australian Governments have intervened in the accumulation process in order to promote the creation of large agricultural productive units.\textsuperscript{130} Environmental problems on the farmland are addressed using a range of market-oriented measures aimed at seeking the cooperation of entrepreneurs through self-help initiatives, e.g. the National Drought Policy\textsuperscript{131} and the Landcare Programme.\textsuperscript{132}

On the basis of this model of agri-environmental governance, it is expected that the Australian Government will insist that agri-environmental support be confined to the Green Box to prevent other governments (particularly EU member states) from seeking to justify income support to farmers based on socio-cultural or environmental grounds. If the Cairns Group position (and Australia is a leading member of this group) is accepted at the Doha Rounds, WTO members will be allowed to provide environmental subsidies to farmers on the grounds that the payments are linked as


directly as possible to the environmental outputs that are required. However, the American Government has joined the Cairns Group in its argument that land should be farmed to protect biodiversity, social mobility, and landscape quality.133

7.3.7 The role of actors on the local development stage & future direction

These various dimensions to the changing rural systems and the outcome of the regional summit have currently combined to stimulate local efforts at rural development, and such efforts are tied to local problems, resources, institutions, and governance. However, evidence from a recent research into the nature of participants at the local development stage reveals that there are various informal and sometimes part-time actors.134 These are complexly networked, often with flexible roles across several dimensions.

The research identified six major groupings:

(a) Business actors, which include major corporations involved in mining, agribusiness, infrastructure, retail, and services; SME sector; industry bodies and associations.

(b) Community groups, which include area-based groups; economic, social, and environmental groups; and national and international groups.

(c) The three tiers of government (i.e. central, states and territories, and local); politicians and bureaucrats.

(d) Government agencies and clients (e.g. Productivity Commission, Bureau of Infrastructure, Transport and Regional Services, etc).

(e) Research organisations, which includes government; private and corporate, Cooperative Research Centres; University-based Research Institutes; Commonwealth Scientific and Industrial Research Organisation; religious organisations.

(f) Energetic individuals, e.g. institutional leaders.

The evidence from that research indicates that the synergistic but uncoordinated interaction between these numerous and diverse regional and rural actors creates pockets of minor development stimuli which, taken together, produces significant benefits and changes to the current rural experience in some locations. It follows that local action evolves to suit local conditions, and might be effective when several local and foreign actors are involved. However, it might be argued that the outcome of such interplay could be maximised in a much more coordinated fashion.

Some might question the usefulness of coordination in regard to the current local development impetus. For instance, within the private sector there exist similar uncoordinated efforts of large corporations, SMEs and Non-Government Organisations (NGOs) who operate competitively to deliver economic growth. However, it may be useful to refer to the importance of teamwork at the local level, the need for cooperation and collaboration between the agencies involved, the need for adaptability in analysis of results and action, and the usefulness of a feedback mechanism for further improvements in development efforts.
Perhaps the most important political development came with the election of the Labor Party in the November 2007 Australian General Elections. One of the political manifestos of the Labor Party relates to the issue of rural and regional development. These developments make a compelling case for a more formal and organised style of engagement among the various actors, particularly as the Australian Government has provided funding for regional and local community infrastructure in June 2009.

7.4 Comparative perspectives on rural development policy in both Jurisdictions

There are interesting similarities and differences between the developments of rural policy in the two jurisdictions. The agricultural sector remains relevant in terms of greater diversity of produce and large-scale production, but its economic importance is steadily declining in both countries. There are similarities in the social and economic challenges faced in rural areas as the agrarian society adjusts to changes in global markets, production methods, and government policy. Consequently, rural areas in both countries have witnessed contraction of local economies, population decline due to outmigration, withdrawal of services, and the collapse of social and cultural ways of life.

The UK and Australia have a history of proactive government involvement in rural development, although the former became involved earlier through the EU CAP.

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135 In the 27 November 2007 general elections, the centre-left Australian Labor Party led by Kevin Rudd defeated the incumbent centre-right coalition Government led by Liberal Party leader and Prime Minister John Howard.
137 See Parliament of the Commonwealth of Australia; *supra* note 120.
However, they have adopted different approaches to addressing rural decline and disadvantage at different times. In the UK, rural development has a high place on the political agenda (and has done since the 1990s) at both national and European levels. The focus in recent times is not merely on increased productivity and competitiveness in agriculture, but rather on the viability of rural life. As in the case of Australia, the UK adopted the EU approach of a locally driven ‘bottom-up’ rural development policy. However, the key difference is that in the UK (EU), this approach has been accompanied by substantial financial and administrative support from higher tiers of government. Moreover, the EU (UK) formal policy on an integrated approach to rural development coupled with the cohesion policy and the CAP ensures that the locally driven model of rural development achieves its objectives.  

Developments in Australian regional policy at the Federal and State levels suggest that the emphasis has been on market-led solutions. This approach has seen both tiers of government adopting minimalist roles in promoting rural economic and social development. The case of the UK was similar, until the 1988 EC publication of the Green Paper titled ‘The Future of Rural Society’ and the subsequent guidelines contained in ‘A Future for Community Agriculture’. These developments at EU level triggered an intense degree of debate in the 1990s regarding the future of Britain’s countryside, which resulted in a more robust engagement with rural development policy by the year 2000.

However, under the market-led model of rural development, the productivity and profitability of primary industries, particularly agriculture and mining, were assumed to be the critical elements in ensuring regional and rural socio-economic well-being. Accordingly, both the UK and Australian Governments have pursued policies aimed at liberalising the economy and promoting economic efficiency and productivity in primary industries. Hence, rural and regional development policies beyond these aims tend to receive little funding and often emphasise community driven self-help responses to economic and social problems. However, since the year 2000, the UK has adopted the EU Leader model of rural development which emphasises the ‘bottom-up’ approach involving a network of partnerships, but backed by substantial government funding. There are indications that similar networks of partnerships towards rural and regional development have emerged in Australia, based on a study conducted in 2009.139 However, the Federal Government of Australia has also established formal funding for rural and regional infrastructure development in 2009, but has no formal engagement with funding rural and regional projects beyond agricultural activities. Nevertheless, the evolution of both formal and informal groups towards rural and regional development in Australia would suggest that the adoption of intra- and inter-regional cooperation and collaboration, such as the Leader Programme, would be easy to administer and coordinate.

The most crucial difference between the UK and Australia lies with the role of the EU’s CAP. Although the CAP is not essentially a regional development policy, subsidies received by UK farmers have a significant impact on the viability of small and large farms and by extension enhance local rural economies. CAP payments to

139 See Sorensen; supra note 113.
farmers have reduced incidents of farmer outmigration and farm amalgamation, thus relatively maintaining economic, social, and cultural activities in rural communities. It was estimated that since the EU accession in 1973, the CAP helped to increase farmer’s real incomes. Until the early 1980s, the price of farmland more than quadrupled, while the price of agricultural produce almost trebled, well ahead of the rise in the cost of living. On the other hand, there are arguments in the UK that the CAP is the biggest subsidy ‘of them all’ and should be scrapped because of its distorting effects on competition.\textsuperscript{140}

In the case of Australia, there is an absence of an equivalent form of price support for farmers. The continuous exposure of agriculture to distorted global markets has contributed to processes of farm amalgamation, dwindling farm incomes, and a decline in agricultural service centres. The ongoing exposure of the agricultural sector to open market forces has encouraged a culture of agricultural exploitation which seeks constantly to increase the productivity of the land. Since the UK is part of the single European market for agricultural as well as for other goods, this has resulted in a reduction rather than an increase in agricultural production. Thus, the CAP reform indirectly removed the pressure for member states to exploit the land to the fullest extent possible, which in turn has triggered the emergence of alternative enterprises within rural areas, such as tourism, and the leisure and recreation enterprises.\textsuperscript{141}


This diversification effort has been supported by the Leader programme, which provides local residents with the necessary skills and resources to pursue such strategies. Diversification strategy has been an important theme in Australian rural development options. However, the lack of financial resources, local skill development, and leadership has been obstacles to the establishment of alternative enterprises. Under the Australian federal system of government, collaborative and integrated attempts to find solutions to rural problems are often hampered by ideological differences; the political parties on one hand, and between the Federal, State and local arms of government on the other hand. For instance, the RDOs under the ‘Working Nation’ strategy represented an attempt to integrate regional policy across the different tiers of government. The RDOs had a slight resemblance to the Leader programme and could have been a credible platform for diversification of rural development activities. However, the RDOs were truncated by ideological differences between the three tiers of government, political tensions and a lack of funding.

Perhaps the Australian Federal and State regional development strategies might benefit rural areas if lessons are learnt from the level of financial and administrative support given to local programmes in EU member states. The formation of the Australian Regional Development Taskforce by the Federal Government in 2000, and the release of funding for rural and regional development in 2009, would suggest future improvements both in government participation in funding local projects and in human-capital development. Thus, the Australian Government would be in a position to take the lead in providing a vision for rural development by committing to the principles of environmental sustainability, social inclusion, and financial support for
local initiatives. To reach these objectives, the social cohesion principles of the EC may provide a model to be considered by the Australian Government.

The development of infrastructure and a strong commitment to education in rural areas could be important contributors to improved social and economic well-being of rural inhabitants. These factors could make it possible for people in rural areas to develop the alternatives to traditional agriculture, and to retain SMEs, which provide both employment and help to sustain the fabric of smaller communities. However, many rural regions in Australia are beginning to diversify into new industries, particularly in the renewable energy sector. The greater challenge relates to the provision of training and education in sparsely populated areas, particularly where the population is too small to support traditional educational institutions. However, investments in communications infrastructure, and the development of flexible delivery of education, offer some prospects of improvement.

7.5 Fuel retailing activities as a component of an integrated rural development policy

As previously argued in the introduction part of this chapter, fuel retailing is more likely to boost rural development activities with the adoption of an integrated approach to rural development policy. Such an approach would involve a coordinated interplay between state actors (i.e. exogenous factors) and non-state actors (which could be endogenous or exogenous). Table 7.1 shows the position of fuel retailing activities as a vital component of an integrated rural policy, as well as other interrelated factors such as public transport and development of renewable sources of energy.
Based on the comparative perspectives of rural development policy in the UK and Australia, the UK currently operates the integrated approach to rural development as a result of the interaction between national policy and European policies on rural development, and social and territorial cohesion. This is reflected in the UK-wide rural development programmes for the period 2007–13. These rural and regional development programmes do not include agriculture, which is separately financed through the EU agricultural fund. In the case of Australia, there is also ample evidence of the interplay of various state and non-state actors in the process of rural and regional development; but the activities of these actors are largely uncoordinated. Moreover, there is an absence of a formal and coherent rural development policy. Government inputs are largely on an incremental basis. Perhaps the provision of funding may encourage impetus for a more organised and integrated form of rural development which would take into account the funding of locally generated projects (much like the Leader programme approach).

In the absence of an integrated rural development policy, the role of fuels retailing as a driving force in rural and regional areas may not produce optimal results. This argument is based on the reasoning that an integrated approach to rural development, as Table 7.1 would suggest, is likely to boost economic activities, increase fuel patronage, and help to drive down fuel prices, as well as the fuel price differentials between rural and urban locations. Even where this approach fails to drive down fuel prices, the economic welfare generated may be sufficient to enable rural inhabitants to afford the relatively higher prices. The other components of an integrated approach, such as public transport provision and the increasing dependence on petroleum
products substitutes would further reduce dependence on petroleum fuels. Information communications and technologies are also likely to minimise transport needs.

**Table 7.1** The components of an integrated rural development policy

<table>
<thead>
<tr>
<th>Components</th>
<th>Rural Policy Objectives</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interagency or Inter-governmental</td>
<td>To ensure that all relevant Government Agencies and Departments produce rural impact statements with a view to achieving concrete objectives; and to reduce wasteful duplication of functions and gaps between the multiple agencies involved in rural development.</td>
<td>Relevant Government Agencies and Departments.</td>
</tr>
<tr>
<td>Secretariat</td>
<td></td>
<td>Rural communities, tourists, visitors, industries, etc.</td>
</tr>
<tr>
<td>Fuel Retailing Activities</td>
<td>To ensure that petroleum product substitutes and environmentally friendly fuels are retailed, with the objective of reducing the cost of fuels and by extension a reduction in the cost of rural living.</td>
<td>Rural communities, tourists, visitors, industries, etc.</td>
</tr>
<tr>
<td>Public Transport Provision</td>
<td>To reduce the need for private transportation, and by extension the consumption of fuels.</td>
<td>Rural inhabitants, tourists, etc.</td>
</tr>
<tr>
<td>Rural Energy</td>
<td>To develop and promote alternative energy sources and technologies.</td>
<td>Rural residents.</td>
</tr>
<tr>
<td>Infrastructure Reform</td>
<td>To reduce the need to travel, and to enhance the attractiveness of rural communities.</td>
<td>Rural residents, tourists, retirees, etc.</td>
</tr>
<tr>
<td>Rural Information and Communications</td>
<td></td>
<td>Rural communities.</td>
</tr>
<tr>
<td>Infrastructure Reform</td>
<td>To stimulate and encourage the growth of SMEs; and to expand the range of financial options available to rural businesses.</td>
<td>Rural communities, particularly youths.</td>
</tr>
<tr>
<td>Rural Entrepreneurship &amp; Venture Capital Development</td>
<td>To ensure that rural communities have a well educated and adaptive workforce.</td>
<td>SMEs in rural communities.</td>
</tr>
<tr>
<td>Human Capital Development</td>
<td>To increase the demand for petroleum products; create employment opportunities; expand the local tax base thereby generating improvements in local services.</td>
<td></td>
</tr>
<tr>
<td>Expansion of Value-added Activities</td>
<td>To ensure that local authorities are well funded to execute useful community development strategies.</td>
<td>Local Governments in rural areas.</td>
</tr>
</tbody>
</table>

**Source:** This Research

Most importantly, continued application of an integrated approach may at some point in the future alter the nature of fuels retailing in rural and regional areas. For instance,
agricultural products may be used to produce biofuels on a small-scale basis for use within rural areas. Ethanol could be made from food feedstock (e.g. sugar cane or corn) or from non-food feedstock (e.g. corn stover, wheat chaff, pine trees). The argument against the large-scale production of certain biofuels is that the practice is likely to drive the prices of foodstuff higher than it would otherwise have been. Ethanol made from these non-food feedstocks could substitute for petrol for use in private cars, but this technology is still in its infancy and not yet commercialised. However, these could be produced as small or medium enterprises and its use confined within rural and regional locations.

Also, biodiesel could be made from vegetable oil or animal fat (i.e. tallow), and vegetable oils could be derived from soy beans, rape seed (canola), palm oil, or sunflower oil. This could substitute for petroleum diesel or be mixed in a certain ratio with ultra-low sulphur diesel. When produced in limited quantities, these significantly cheaper fuels may well serve the needs of rural communities. The crystallisation of these developments in the future may change the mix of fuels sold at rural forecourts as well as increase the social and economic welfare of the inhabitants by substantially reducing the cost of rural living. Likewise, the use of petroleum products for electricity generation, domestic heating, and industrial purposes, etc., could be replaced with renewable sources of energy derived from wind, tidal, solar, geothermal, wave, hydroelectric, etc.

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7.6 Conclusion
Despite resistance by the UK Government in the 1980s and early 1990s to the EU model of rural development policy, the government made quick strides to harmonise its rural strategies with those of the EU during the 2000–07 period. The two UK Government White Papers on rural strategies signalled the need for a rural development policy change from one that emphasises agricultural specialisation to a diversified rural economy that takes into account economic, social, and cultural values. The adoption of the Leader programme initiative and acceptance of EU structural funding by the UK Government ensures that the community-led model of rural development receive considerable funding. A mixture of community participation and government funding of locally generated projects and initiatives have produced an integrated approach to rural development consisting of both state and non-state actors who facilitate the process. Such an integrated approach is conducive to appropriate contributions of fuel retailing to the overall social, economic, and cultural welfare of rural communities.

In response to increasing awareness of problems facing rural Australia, a regional summit was launched in 1999 in order to identify the means for responding to rural decline and disadvantage. The steering committee released an interim report in April 2000. One of the submissions to the summit was the report of an Australian study of the rationale of the EU Leader programme. The study recommended that its achievements be taken into account in generating rural development policy. Moreover, the language of the summit and the recommendations made reflect the ideas associated with the Leader programme. Despite this, there is still a belief within

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government circles that economic priorities should take precedence over social and cultural goals. This is in contrast with the Cork Declaration which recognises that non-economic quality of life issues are crucial to ensuring sustainable social, cultural, and economic development in rural areas.

Nevertheless, the summit provides an opportunity for Australia to learn from the experience of the UK in its European context, to ensure that the rhetoric of improved well-being is translated into reality in Australia’s rural and regional areas. An important development in the aftermath of the summit was the Australian Government’s formation of a Regional Development Taskforce. However, by the year 2009 the Australian Government unveiled its funding plans for rural infrastructure development. These developments have intercepted the myriad of complexly networked groups of informal and part-time actors in the rural development process. Thus, the missing element for an integrated approach to rural development in Australia is for the Australian Government to abandon its rural policy model of community self-help, and rather allocate annual funding to locally generated projects and initiatives besides agricultural projects. This thesis argues that it is under such conditions that rural fuel retailing activities could achieve optimal contributions. The greatest challenges to the achievement of an integrated approach to rural development in Australia would be to come to terms with the difficulties imposed by three tiers of government; the problems of distance between rural locations (i.e. spatial scale and the physical environment); the culture of agricultural productivism; and the neoliberalist economic posturing that is unsympathetic to non-market solutions to problems of rural development.
Chapter 8  
CONCLUSIONS AND RECOMMENDATIONS

8.1 Introduction
This thesis investigated the problems of high rural fuel prices and rural–urban fuel price differentials in the UK and Australia, based on the premise that a resolution of these problems would contribute to rural development. On that basis, the thesis posed two main research questions. The first question deals with how the regulation of fuel retailing activities in the two jurisdictions could contribute to a rural development policy, whereas the second question relates to whether state aid is essential in promoting fuel retailing activities in rural areas in the two countries. To analyse and answer these questions requires the establishment of an analytical framework and a theoretical basis for rural development.

The analytical framework for this study was established based on identified broad categories of regulatory support mechanisms and fuel subsidy schemes applied in both jurisdictions (see Tables 3.1-3.4). The framework consists of a set of common comparators, including sites and licence/franchise regulations, fuel price regulation, fuel tax regulation, state aid instruments, and rural development models adopted in both jurisdictions. Chapter 2 establishes the theoretical basis for rural development policies by clarifying the definition of rurality and the various regional development models and approaches to rural development. In the context of this study, the author adopted the territorial definition of rurality and a mix of endogenous and exogenous approaches to rural development.
Thus, the study hypothesises that the regulation of fuel retailing activities (an exogenous factor) could contribute to a rural development policy if regulatory support mechanisms and fuel subsidy schemes are targeted at rural transport, and energy infrastructure reforms. The hypothesis to the second question is that state aid is necessary in promoting fuel retailing activities in rural areas, particularly where there is evidence of market failure. The second hypothesis is based on the premises that socially and economically viable rural areas are essential for a balanced national development; and that fuel retailing activities could contribute optimally to an integrated rural development policy if state funding is generally applied to all the components of a rural development agenda. Therefore, the economic welfare created through state funding of rural strategies and locally generated projects would boost the fuel retail sector, possibly force pump prices down, and reduce the rural–urban fuel price differentials. Moreover, rural residents may still be able to afford the relatively higher fuel prices as a result of the enhanced economic prosperity, even in the absence of a reduction in pump prices.

This concluding part of the study highlights the research outcomes, and discusses the main research findings in terms of their implications for the relevant theories and concepts, and implications for practice and further research in this area. This chapter also answers the research questions, discusses the hypotheses in the light of research findings, makes a thesis statement, makes recommendations, and highlights the contributions of this study to the literature on regulation and rural development policy.
8.2 Discussion of main research findings

(a) The problems of high fuel prices in rural and remote areas, and the rural–urban price differentials as established in Chapter 3 require concerted efforts and cooperation between internal parties involved in the fuel supply chain and external actors, particularly the Federal (Australia) or National (UK) Governments. The multiplier effects of these problems are a cause for concern for local governments and rural residents as well as tourists. The consequences are clearly manifest in more remote areas than in rural areas closer to urban areas, and include higher cost of living, loss of rural services, outmigration, environmental impact, and road congestion caused by rural motorists having to drive long distances to obtain cheaper fuels and groceries from supermarkets in urban areas.

However, the form of solution to these problems would depend on governments’ expenditure priorities, environmental objectives, and rural development policy. These could take the form of regulatory support mechanisms (e.g. sites and franchise regulations), or government fuel and transport subsidies, or indirect forms of rural support based on a rural development policy (e.g. rural infrastructure development, funding for SMEs, etc).

(b) The UK and Australian experiences of site regulation reveal that it is ineffective in the long run to impose fuel site restrictions on the oil majors.¹ The UK had a two-year period of site restrictions which aimed at encouraging new entrants and to stem the decline in the number of independent fuel retailers. While this policy encouraged the expansion of supermarkets, it did little to mitigate the declining market share of the

¹ ACCC, Inquiry into the Petroleum Products Declaration, pp. 37-39, Volume 1 Main Report (1996). These pages provide details of multi-sites franchise arrangements by the oil majors that undermined the sites and franchise legislation.
independent retailers. The supermarkets operate fuel retailing on the basis of economies of scale and scope, and hence do not operate in rural areas. Thus, the expansion of supermarkets resulted in lower pump prices in urban areas but had mixed results in rural areas in the sense that rural motorists who live closest to urban areas patronise the supermarkets, thereby causing a further reduction in the number of rural fuel outlets, shops, and services.

Australia had a longer period of site regulation, lasting from 1980 to 2006. The objective was to limit the excessive control which the oil majors had on the fuel retail trade, and to facilitate the development of the independent fuel retail sector. The problem with seeking an expansion in the number of independent fuel retailers to introduce competition and drive fuel prices lower may be a good idea in the urban locations. However, the population of a given rural settlement would largely determine the number of fuel stations that could operate profitably. Some rural locations may not accommodate more than three to four outlets on a profitable basis, thus a further increase in the number of retailers would prove to be counterproductive.

In Australia, similarly to the case of the UK, site regulation did not succeed as envisaged in preventing further decline in the number of independent categories of fuel retailers (see Table 4.4). However, it enabled the supermarkets to emerge in the 1990s, and this category of fuel retailers has since substantially grown their market share by discounting the price of fuels to boost their grocery trade (as is the case in the UK).²

The Australian experience also reveals that the oil majors tend to resist legislative efforts at reducing their control over the oil business in general. In this case, the oil majors circumvented site regulation by devising vertical restraints such as multi-franchising, insistence on 100% ties with franchisees, and equity participation in distributorships. On the basis of these vertical restraints, oil majors were able to retain their control over wholesale and retail prices, which becomes critical when they have a need to discount fuel prices or force prices up.

(c) The experience of both jurisdictions regarding licence/franchise regulations, as shown in chapter 4, indicates that it is difficult to correct contractual imbalances through statutory legislation. This is reflected in the large number of legal cases between fuel suppliers and their licensees/franchisees. Additional justification for franchise regulations is also based on the legal interpretations of solus (UK) and solo (Australia) agreements. These contracts, although necessary and useful, are considered to be in restraint of trade and so must pass the test of reasonableness. Overall, this regulation has the positive effect of ensuring fewer interruptions in fuel supply to retail outlets through improvements in contractual relationships between the major suppliers and the retailers. The implication of this for rural and remote areas is that fuel prices may have been higher in the absence of franchise regulations. Licence regulations in the UK have existed since 1966 to date and were in the form of ‘undertakings’ obtained from the oil majors, whereas the Australian franchise regulations were introduced by legislation and have lasted from 1980 to 2006. Nevertheless, the provisions of the Australian Franchise Act form the basis for the newly introduced fuel retail legislation (the mandatory Oilcode).

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Licence/franchise regulations do not have a direct effect on fuel prices nor can they directly reduce the rural–urban fuel price differentials. However, fuel prices and the rural–urban differentials could be greater in the absence of more efficient and smoother fuel supplies to rural and urban locations. Nevertheless, the use of multi-franchising schemes also enabled the oil majors in Australia to counteract the effects of the Franchise Act on their bargaining powers. Thus, the huge challenge in making the sites and franchise legislation work lies in a government’s ability to prevent oil majors’ attempts at circumventing the legislation.

(d) There is no evidence in the history of the fuel retail market that the UK has regulated either retail or wholesale margins, and the following possibly explains why. The Australian experience reveals enormous difficulties associated with this form of government intervention. The arguments against the regulation of retail and wholesale margins far outweigh the arguments in its favour.\(^4\) The arguments in its favour are that regulation of pump prices would eliminate or limit price cycles; and that it would furnish price certainty to the benefit of motorists. Conversely, the arguments against it are numerous and weighty. Firstly, it could be difficult for regulators to determine retail and wholesale margins due to the different cost structures among the various categories of fuel retailers. Secondly, these forms of regulation would likely limit or eliminate price competition among retailers and thus effectively undermine the very basis of competition. Thirdly, it could lead to higher than average prices, if the concentration level in the sector is high and the regulators mistakenly set higher retail margins than could be determined in a competitive situation. Fourthly, globalisation

and deregulation are associated concepts, which are against direct regulation of fuel retail prices.

(e) The study finds in chapter 5 that, of the components of fuel pump price, the fuel duty and VAT levied on fuels are realistically the two that could be regulated by government. However, governments levy fuel tax primarily to generate significant revenue for public expenditure; although since the 1990s the UK and Australian Governments have increasingly relied on fuel taxation as a means for achieving environmental objectives. Thus, the policy direction in regard to fuel tax regulation weighs more towards its increase rather than a reduction. An investigation into the distributional consequences of high fuel duty on sub-groupings of the population in both jurisdictions reveals that rural residents are one of the groups adversely affected.

(f) This study also finds that there are avenues for granting selective fuel tax concessions in both jurisdictions, barring environmental objectives. In the case of the UK, the government could be guided by the EU system of minimum rates for taxation as contained in Council Directive 2003/96/EC. This Directive provides for differentiated rates of taxation for local public passenger transport, including taxis. Projects that qualify for total or partial exemptions include those that are aimed at technological development of environmentally friendly products or those that produce fuels and energy from renewable sources, e.g. biofuels, wind, solar, tidal forms of energy products. Those that qualify for a reduction in tax levels include products used

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for carrying goods and passengers by rail, metro, tram, etc., as well as the use of natural gas and LPG.

The Australian Government has tried a number of ad-hoc fuel subsidy schemes, and the results have been inconsistent. Most of these were discontinued in line with the government’s resolve to pursue its environmental and deregulation policies. However, similarly to the EU Directive on differentiated rates of fuel taxation, the Australian Government retained some socially important subsidy schemes, particularly those that promote the environmental benefits and those that encourage the production of environmentally friendly fuels and energy sources.\(^6\)

Differentiation in rates of fuel taxation, encouragement of the production of petroleum products substitutes and renewable sources of energy, and the retention of socially essential subsidies are part of the solution to the problems. However, these policies do not address who should be the investor in these renewable energy products or who should provide the funding for investment in these products.

The UK Government and the devolved administrations have all taken advantage of funding under the EU rural development policy and EU structural funds for rural and regional development. Subsequently, numerous projects are to be funded as contained in their respective rural development programmes for 2007–13.\(^7\) Thus, it is also expected that increasing use will be made of the EU provision of a De minimis ceiling

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\(^6\) Tax concessions were discussed in details in chapter 6.

\(^7\) For example, the Scottish Rural Development Programme 2007-13 is a £1.6 billion programme designed to develop rural Scotland over the next six (6) years. More details are available online at [http://www.scotland.gov.uk/Topics/farmingrural/SRDP](http://www.scotland.gov.uk/Topics/farmingrural/SRDP), last visited on 6 December 2009.
of €200,000 that need not be notified to the EC.\textsuperscript{8} These could be used to promote the production of biofuels and energy products for rural and regional consumption.

Moreover, the scene is set for massive investment in renewable energy in the UK. Based on national targets set by the EU, the UK is expected to meet its 2020 target of 15\% of electricity derived from renewable sources of energy. The UK Government estimates that at least 32\% of electricity consumed in the UK will have to be generated from renewable sources in order to meet the 15\% target. This would require an extra 30 GW of renewable electricity generating capacity.\textsuperscript{9}

Recently, the EC announced that £270 million has been approved for offshore wind projects and carbon capture and storage (CCS) plants in the UK.\textsuperscript{10} Of this amount, the Hatfield CCS project received £160 million; the Aberdeen offshore wind farm received £36 million; and £66 million was dedicated to the addition of an intermediate offshore platform on the planned link between Shetland and Scottish mainland for connecting offshore wind and marine generation.

The UK Government also set a robust target to reduce carbon dioxide emissions by 80\% by 2050. Meeting this target would depend on progress made towards developing renewable energy sources. The UK Energy Research Centre recently undertook a study on how the UK Government could achieve the 2050 carbon


reduction target. The study identified multiple possible pathways for an affordable transition to sustainable low-carbon energy. However, this could not be achieved without a change in lifestyles and energy generating technologies, as well as international commitments and agreements. The study concludes that investing in low-carbon energy technologies now will save the UK Government billions of pounds in its goal to reach this target. Therefore, the next decade is likely to witness a significant number of renewable projects and investment in renewable energy technologies by the UK Government and private investors. It is highly probable that some of these projects will be located in rural areas and could help reduce the use of diesel fuel for electricity generation.

In the case of Australia, since the year 2000 the Australian Government has allocated significant funding towards its programmes contained in ‘Measures for a Better Environment’. Under the Greenhouse Gas Abatement Programme, the government provided funding to the tune of $100 million per year. Two of the projects receiving funding are engaged in the production of ethanol as an alternative transport fuel. The Douglas Shire Council and Mossman Central Mill Company in Queensland received funding of $7.35 million and $34 million respectively for the production of ethanol fuel. British Petroleum received $8.8 million to replace its petroleum production at the Bulwer Island refinery with a fuel grade petrol/ethanol blend.

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The Alternative Fuels Conversion Programme, which was designed to encourage public transport buses and the heavier commercial vehicles to operate on either LPG or CNG instead of diesel, received a yearly funding of $75 million from 2000–04.\textsuperscript{13}

The Renewable Remote Power Generation Programme, which supports the use of renewable energy in remote parts of Australia that currently rely on diesel for electricity generation, was allocated funding of $264 million from 2000–04.\textsuperscript{14} This fund has been applied across the States and Territories under sub-programmes. Some examples of the sub-programmes are as follows. An allocation of $38.2 was provided to the Renewable Energy Rebate Programme to serve remote areas of the Northern Territory. The Renewable Energy Diesel Replacement Scheme attracted a budget of $22.3 million to serve remote areas of Queensland. The Remote Area Power Supply Programme was allocated funding of $18 million to serve remote areas of Western Australia. The Renewable Remote Power Generation Programme in South Australia attracted funding to the tune of $7.6 million. The Indigenous Community Services Project managed by the Aboriginal and Torres Strait Islander Commission attracted funding of $8 million.

The Australian Parliament passed a law in 2009 which requires that 20\% of the Country’s electricity be derived from renewable sources, thus matching the EU target of 20\%.\textsuperscript{15} As a result, the Australian Government in its May 2009 budget created the Renewable Energy Demonstration Program (REDP) to support the commercialisation

\textsuperscript{13} See \textit{id.}, p. 204

\textsuperscript{14} See \textit{id.}, p. 206.

of renewable energy and help facilitate the deployment of new renewable energy technologies as a replacement of the use of diesel for power generation in Australia. Consequently, in November 2009 the Australian Government approved funding of $235 million for four renewable energy projects under the REDP. Ocean Power technologies received $66.5 million to build a wave power facility which will generate 19 MW of energy that will supply green energy to 10,000 homes. This is the first commercial-scale ocean energy project in Australia. MNGI Pty Ltd received $62.8 million for the 30 MW Paralana geothermal project. Geodynamics was allocated $90 million for the 25 MW Cooper Basin geothermal demonstration project. Interestingly, $15.3 million was allocated to Hydro Tasmania for the King Island renewable energy integration project. This involves the integration of renewable technologies into existing electricity networks and mini-grid systems in remote areas.

(g) In both jurisdictions, there are strong arguments in favour of increased availability and efficiency of rural public transportation as a way of counteracting the adverse effects of high fuel duty and the attendant high fuel prices. This appears a reasonable approach because it will tend to reduce the use of private transport and simultaneously enable society to reduce carbon emissions. In addition, this solution has implications for social isolation amongst those that have transport disadvantage, and will help to reduce health costs associated with pollution and road accidents. The latter will probably apply more to urban areas than rural areas.

However, this solution does not address the impact of the effects of high fuel prices on other consumer goods and services. Neither does it address the main issue of who

\[\text{Renewable Energy Focus, } \textit{Australia Funds Utility-Scale Wave Power Station} \ (2009). \text{ Available online at } \text{http://www.renewableenergyfocus.com/view/5148/australia-funds-utilityscale-wave-power-station/}, \text{ last visited on 26 November 2009.}\]
provides the public transport or who should fund it. Where a government pursues a policy of deregulation in the transport sector, as is the case in the UK, it becomes the responsibility of private investors and local government authorities to provide public transport. Private investors may consider such investment as highly risky. Thus, in the absence of sufficient local government funding towards rural public transport, there could be a vacuum in respect of availability and accessibility of rural bus transport unless the Federal Government provides funding under an integrated rural development strategy.

(h) The UK and Australian Governments recognise the usefulness of subsidies in terms of addressing market failures, and improving social and economic welfare, particularly in areas that are economically and socially backward. As a result, both governments and the devolved administrations grant public subsidies. However, subsidies are granted in the UK in a more structured manner and consist of two levels of control: control within the UK using common guidelines as prescribed by HM Treasury (SPFM, in the case of Scotland) and control under the EU general guidelines. Another distinguishing factor is that state aid proposals in the UK and EU undergo a competition impact assessment,17 whereas state aid in Australia is usually legislated and does not take account of the impact of competition on subsidies. As a result, these legislations are usually short-lived, as the Australian Government realise that they have out-lived their usefulness.18

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18 This is explained in more detail in Chapter 6.
Generally, the EU Treaty prohibits state aid because it can distort competition and affect trading among member states. However, there are certain situations where the EU Treaty permits the application of state aid. Those exemptions that concern rural areas include: 19 aid granted to areas where there are serious economic, social, geological, or environmental problems; aid that promotes the development of areas where the standard of living is low, or where there is serious unemployment; and also aid that facilitates the development of certain economic activities or of certain economic areas, provided the aid does not affect inter-community trading. For the purpose of this kind of state aid, the EC has provided for grants to the tune of €200,000 (De minimis aid) without requiring prior notification. This provision, coupled with the funding provided by the EC under the Community Structural Funds, may provide the much needed opportunity for the UK Government and devolved administrations to capitalise and operate an integrated rural development strategy based on the community participation model.

(i) The pace of globalisation and technological development and their impact on rural areas have led to a gradual shift in paradigm from the classical theories of rural development, which perceive rural areas as residual agricultural areas which are conditioned by the urban areas, to one which facilitates an understanding of rural areas as not necessarily subject to agricultural production or derived from urban area types. Apart from the impact of the pace of globalisation which includes the impact of the WTO agreement on agriculture, contemporary rural societies in both jurisdictions face similar challenges based on the pattern of demographic transition, composition of

the population, pattern of government expenditure, and increasing environmental regulations.

Classical theorists were of the view that rural development takes place as horizontal interactions and responses. However, technological advances and global economic developments have resulted in new patterns of localisation, particularly among OECD countries. These developments have resulted in new ways of organising work and business which combines both vertical and horizontal flows. This situation encourages more economic activities beyond agricultural production in rural areas, particularly the development of small and medium scale enterprises (SMEs). The increasing activities of SMEs would in turn result in increased production of goods and services, and will furthermore alter the patterns of localisation. These developments would also entail increasing levels of infrastructure development, in terms of road, ICT, energy, education and training infrastructures, etc. These projects are beyond what could be funded by local governments alone and thus would involve Federal Governments and private investors playing crucial roles.

These developments have implications for theories on rural and regional development, and implications for practice. Classical theories on rural and regional development will have to be jettisoned in favour of the new paradigm which recognises changes in rural areas in terms of a de-emphasis on agriculture specialisation and the promotion of diversification of rural and regional economic activities.20

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20 This has occurred in the UK and is developing in Australia as indicated in Chapter 7.
There are implications for practice, in the sense that rural development in OECD and EU member states may no longer be driven by endogenous factors alone, but that rural development strategies will increasingly involve cooperation among networks that include government financial support/incentives and other exogenous factors (i.e. a combination of Bryden’s theory\(^{21}\) and the Community-led rural development model\(^{22}\)). For example, the UK Government has jettisoned its rural policy that emphasises support for agricultural activities and has adopted the EU rural and regional development policy which emphasises state funding of a diversified rural economy based on community-generated projects backed by public funds.\(^{23}\) Similarly, the Australian Government has recognised that agricultural activities alone may no longer sustain the rural society and has signalled a change towards a more diversified rural economy. These are represented by the setting up of a Regional Development Taskforce in 2000\(^{24}\) and a funding programme for rural infrastructure in 2009.\(^{25}\)

### 8.3 Answer to research questions

The thesis commenced with the basic premise that the regulation of fuel retailing activities could mitigate the problems of high fuel prices and rural–urban price differentials and thus contribute to rural development. Based on the foregoing

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\(^{21}\) See Chapter 2, pp. 19-21.

\(^{22}\) See id., pp. 21-24.


discussions of the main research findings, it is obvious that sites and licence/franchise regulations have limited effectiveness in terms of mitigating these problems.

Similarly, the Australian experience of wholesale and retail price regulation proves that it is problematic to regulate these. Government emphasis on taxing fuels to achieve environmental objectives discourages fuel tax concessions for now and in the foreseeable future. However, a certain percentage of the proceeds from fuel tax could be targeted at improving rural public transport, including transport for special groups. Where a government policy of deregulation discourages the provision of public transport using public funds, this objective could still be achieved through enhancement of local government funding for this purpose.

Government could also extend business fuel tax credits for rural businesses for use as an input, as this will likely increase their competitiveness as well as create and retain rural employment. A certain percentage of the fuel tax proceeds could be used to reduce the cost of operating rural fuel stations, such as testing of underground storage tanks, sites remediation, and other environmental costs.

However, these direct forms of fuel retail regulation are not effective in resolving the research problems. Thus, some indirect forms of fuel retail regulation that contribute to a rural development policy and at the same time address the research problems may be necessary. Therefore, this thesis argues that fuel retailing activities will achieve optimal contributions within the wider context of an integrated rural development policy, backed by significant government funding. Thus, all the components of a rural
development policy (see Table 7.1) would require government funding, leading to an increase in rural economic welfare.

There are three scenarios of the likely outcomes of pursuing such an integrated approach. The first scenario is that government financial assistance for SMEs might lead to locally generated proposals that enable the production of petroleum product substitutes specifically for rural consumption, such as biofuel plants (e.g. ethanol, methanol, biodiesel, etc.). Ethanol could be blended with petrol in a certain ratio to reduce the consumption of petrol, or it could be used separately as in Brazil. Biodiesel could be used separately or blended with ULSD to reduce the consumption of the latter. SMEs could set up LPG and CNG conversion equipment which would enable rural residents and businesses to switch to LPG or CNG rather than to use diesel. In line with modern fuel objectives, the governments could levy low or zero tax rates on these environmentally friendly petroleum product substitutes to enable their economic production and pricing.\textsuperscript{26} Over a period of time, these developments could help transform the nature of fuels retailing in rural areas. This transformation would entail a change in the fuel mix sold by fuel retailers in these areas. The mix could consist of biodiesel, ethanol, LPG, CNG, ULSD, petrol/ethanol blend, ULSD/ethanol blend, biodiesel/ULSD blend, and methanol/ULSD blend. Since these are cheaper fuels and usually there are excise exemptions for ethanol and biodiesel\textsuperscript{27}, this scenario is likely to resolve the twin problems of high fuel prices and high rural–urban fuel price differentials. The knock-on effect is likely to boost economic production and increase socio-economic welfare.

\textsuperscript{26} See Chapter 5, p. 57.

\textsuperscript{27} See Fuel Tax Inquiry; supra note 14, at pp 156-158.
The second scenario is that in the absence of SMEs producing petroleum products’ substitutes, the increased prosperity that results based on a government funded, integrated rural development strategy would likely generate additional demand for fuels and force a reduction in retailers’ margins and thereby reduce pump prices. The third scenario is that even without a reduction in pump prices, the extra prosperity generated by such an integrated approach may ensure that rural residents and businesses are able to afford the relatively higher fuel prices.

8.4 Validation of research hypotheses
The first hypothesis states that, ‘the regulation of fuel retailing activities, as an exogenous factor, could contribute to a rural development policy if regulatory support mechanisms and fuel subsidy schemes are targeted at rural transport, and energy infrastructure reforms’. Evidence from this study suggests that a boost to rural public transport would reduce the need for private transport and so reduce the consumption of fuels, and a reform of the energy infrastructure would reduce the consumption of petroleum products in the primary industries and in domestic applications.

In the UK, there are a number of government initiatives aimed at subsidising rural transport based on the hypothecation of a certain proportion of the proceeds from fuel tax. Such initiatives include the Rural Bus Subsidy Grant, the Rural Bus Challenge, and the Parish Transport Fund which are applicable in England and Wales. There are also similar rural transport grants introduced in Scotland.

In the case of Australia, government support for rural transport takes the form of fuel tax concessions (e.g. FSGS) and a reduction in the cost of transporting fuels to rural
and regional locations (e.g. PPFSS). These schemes have been discontinued since 2006, based on environmental considerations and the government’s policy of deregulation. However, the government retained a few socially desirable fuel concession schemes. For example, there is a fuel rebate of 4cpl to help reduce transport costs for those residing in rural and remote areas. The rebate on ULSD was increased from 1cpl to 2cpl to encourage rural residents and businesses to switch to more environmentally friendly fuels.28

There is also evidence from this research that a reform of rural energy infrastructure would reduce the consumption of fuels for industrial and residential purposes. In Australia, there are numerous jointly funded renewable energy projects between the Federal Government and the states/territories aimed at replacing the use of diesel fuel for electricity generation. The electricity generated also reduces the need for the use of diesel in operating industrial and domestic generators.

The second hypothesis states that, ‘state aid is necessary in promoting fuel retailing activities in rural areas, particularly where market failures have been identified, because economically viable rural areas are necessary conditions for balanced national development’.

However, evidence from this study indicates that the role of state aid in directly promoting fuel retailing activities is limited. The Australian Government tried a number of fuel subsidy schemes (e.g. PPFSS, FSGS, etc.) aimed at directly reducing the prices that fuel retailers charge in rural and remote areas. However, these were

28 See id., p 33.
heavily criticised because they were applied in a selective way, the administrative and compliance costs also seemed to outweigh the benefits of the schemes.

The UK Government’s regulatory efforts are directed at ensuring the survival of rural fuel stations by reducing their costs rather than at reducing the prices they charge. Examples are: firstly, the UK Government secured derogation from the EU Petrol Vapour Recovery Directive for certain small fuel stations in Scottish rural areas. This directive would have involved a capital cost of around £3,000 per station.\(^29\) Secondly, the Scottish Government operates a rural transport fund, whose budget is partly directed at helping rural fuel stations with tank replacement and groundwater problems. Thirdly, local authorities in the UK have discretionary powers to provide rate relief of around 100% for rural fuel stations.\(^30\) The impact of these policies on rural fuel expenditure is indirect, because if a community’s only fuel station were to close, motorists would have to pay more to travel to the nearest fuel station. However, these policies do not address the research problems, and thus a more holistic approach seems necessary.

8.5 Thesis statement
This thesis thus argues that fuel retailing activities are likely to contribute significantly to an integrated rural development policy where state funding is generally applied to rural development strategies and projects. The economic welfare generated through the interaction of exogenous (state intervention and external


investors) and endogenous (local partnerships, and locally generated projects) factors is likely to boost fuel retailing activities. Thus, this could lead to a reduction in both fuel prices and the rural–urban fuel price differentials.

In the absence of a reduction in fuel prices, rural inhabitants may still be able to afford the relatively higher fuel prices as a result of a boost in economic welfare. An outcome of such an integrated approach could be the emergence of SMEs that specialise in the production of biofuels in limited quantities directed at use within rural locations. This prospect could in turn lead to a paradigm shift in fuel retailing in rural and remote areas whereby there is a significant change in the current fuel product mix.

8.6 Lessons from the UK and Australian experiences of fuel retail regulation
The research revealed a number of lessons to be learned from their experiences. (a) It is difficult to regulate an industry or sector where the fixed costs are high compared to the variable costs. (b) It is challenging to regulate an industry or sector (such as fuel retailing) where the producers of the product are also wholesalers and retailers. (c) The fuel retail market is at a mature stage. Therefore, as consolidation takes place, inefficient sites are rationalised resulting in their closures. These closures can affect rural independent garages leading to socially undesirable consequences. Some areas may experience absence or reduction in competition, which could create a monopoly situation and attendant high pump prices.
(d) The fuel retail trade, like other components of the petroleum value chain, becomes more profitable when operating at a significant scale and scope. The supermarkets’ successful entry into fuels retailing is based on this principle. (e) It is possible to indirectly promote and support the existence of rural fuel retailers, particularly those that are shielded from the influence of supermarkets’ fuel pricing strategy. Those that are located adjacent to urban areas are vulnerable to the effects of vigorous competition arising from price discounting.

(f) It is difficult to legislate against vertical integration as practiced by the oil majors. Their control over the fuel retail trade has historical roots. Therefore, they are capable of circumventing policies such as the sites and licence/franchise regulations that tend to limit or affect their operations. However, it may be necessary to regulate site allocation and the exclusive agreements between the suppliers and the retailers as a short-term measure. Aspects like environment, and health and safety should be regulated (care must be taken to assess the compliance costs on rural fuel retailers with a view to cushioning this).

(g) Retail and wholesale price regulations are ineffective in the medium–long term, mainly because it tends to eliminate price competition, an important element in the development of the competition process. (h) Price discrimination is a regular feature of the fuel retail trade, owing to differences in bargaining power. However, this conduct is regarded as pro-competitive, since it promotes price competition and results in benefits to motorists.

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Government policies to combat greenhouse gas emissions have currently assumed the centre-stage in global politics. Therefore, the use of fuel concessions to address the problems of relatively high fuel pump prices and high rural–urban fuel price differentials is increasingly being discouraged by OECD and EU member states. An increase in the provision of rural public transport is thought to be one of the measures for tackling these problems. However, some of the socially vital subsidies could be used, but targeted at specific rural businesses that use cleaner fuels. The problems of high rural fuel prices, rural–urban price differentials, and the attendant high cost of rural living could be addressed in a more holistic manner by applying a robust rural development policy. Table 8.1 gives a rough indication as to the likely stages of fuel retail sector regulation. The first step is to encourage the entry of rural independents through incentives, e.g. the fuel rebate/grants schemes and the fuels freight subsidy. This stage would likely apply to developing countries that are yet to sign up to the Kyoto protocol.

The second step is aimed at establishing the presence of independent fuel retailers by regulating the contractual relationships between these and their major fuels suppliers. This could be followed by policies aimed at cushioning the impact of high pump prices on rural businesses and the encouragement of the use of petroleum product substitutes. The third step becomes relevant once the independent fuel retail sub-sector has been established. Subsequently, there could be a relaxation of policies that produce market distortions, e.g. the fuel subsidies and restrictive Acts. The latter could be replaced with a sector-specific trade practices framework, such as the Oilcode. Some of the socially vital subsidies such as fuel concessions may or may

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not be retained. Where they are retained, they may be targeted at specific rural businesses that use cleaner fuels.

**Table 8.1 Stages in the regulation of the fuel retail sector: The UK & Australian Experiences**

<table>
<thead>
<tr>
<th>Stages</th>
<th>Government Action</th>
<th>Regulatory Objectives</th>
</tr>
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| Stage 1 | - Fuel rebate/grant schemes and petroleum products freight subsidy.  
- Creating independent access to terminals, storage and distribution infrastructure (facilities). | - To encourage the entry of rural independents and to reduce rural pump prices.  
- To increase the prospects of increased activities by the independent petrol retail sector; and to increase possibilities for product imports.  
- To rectify contractual imbalances between the major suppliers and their independent dealers or other unbranded independent retailers.  
- To promote the growth of the independents as a medium-term measure.  
- To cushion high diesel prices for rural businesses using the product as an input into production.  
- To encourage the use of more environmentally friendly fuels. | |
| Stage 2 | - Establishment of minimum conditions for dealership or franchise agreements or for supplying independent retailers without imposing restrictions on either party.  
- Introduction of Sites & Franchise Acts.  
- Introduction of diesel rebate for rural businesses, particularly USLD.  
- Introduction of fuel concessions on petroleum products substitutes and inputs required for a switch. | - To rectify contractual imbalances between the major suppliers and their independent dealers or other unbranded independent retailers.  
- To promote the growth of the independents as a medium-term measure.  
- To cushion high diesel prices for rural businesses using the product as an input into production.  
- To encourage the use of more environmentally friendly fuels.  
- To remove market distortions; promote the use of environmentally friendly fuels; and to embrace policies that promote rural businesses and enhance the socio-economic welfare of rural inhabitants. | |
| Stage 3 | - Removal of fuel grants and freight subsidy schemes.  
- Removal of restrictive sites and licence/franchise Acts.  
- Retention of fuel and duty concessions for specific rural businesses, using ULSD, LPG, CNG, and biofuels.  
- Introduction of a comprehensive rural development policy. | | |

**Source:** This Research.

[http://www.accc.gov.au/content/item.phtml?itemId=771848&nodeId=fd100c294232594ec7b32c7bbb9ef606&fn=Guide%20to%20the%20Oilcode.pdf](http://www.accc.gov.au/content/item.phtml?itemId=771848&nodeId=fd100c294232594ec7b32c7bbb9ef606&fn=Guide%20to%20the%20Oilcode.pdf), last visited on 27 November 2009.
8.7 Recommendations

8.7.1 United Kingdom

On the basis of this research, I wish to propose a set of eleven recommendations in their relative order of importance.

(a) The UK Government may need to take full advantage of the provisions for EU state aids (particularly the De minimis provision, the funding provisions for SMEs, and funding for rural development programmes), and target the rural communities with such funds. These could be used to boost the rural transport grant schemes and finance other meaningful rural development projects.

(b) Planning Permission authorities could take into account the need for rural fuel retailers to expand their stations in order to increase their offer of non-fuel goods and services when allocating sites.

(c) A discretionary business rate relief of 100% could be granted to rural outlets throughout the UK.\(^{33}\)

(d) Exemptions from compliance with testing of old storage tanks could be made less selective, but extended to all rural fuel retailers. However, the lack of tests for tanks aged 20–30 years still poses environmental, and health and safety concerns. Therefore, the government could ensure that these tests are carried out with taxpayers’ money.

\(^{33}\) See CC Report; supra note 30, at pp. 129-61.
(e) The government may wish to intervene and resolve the problem of who owns the disputed vapour recovered during transfer of fuels from road tankers to storage tanks. Rural fuel retailers cannot afford wetstock losses (fuel losses based on the contraction of fuels from $15^\circ$ C at which they are loaded to the fuel tankers). Likewise, their suppliers cannot afford to forfeit the return on investment made in the vapour recovery equipment.

(f) Rural fuel retailers could be compensated for losses arising from the use of pre-loaded tickets as the current means for liquid fuel measurement. All fuel suppliers could be advised to make an allowance of 0.2–0.3% for such losses. Subsequently, current legislation covering the measurement of liquid fuels may be amended to eliminate distortions caused by the replacement of the dipsticks with pre-loaded tickets. Such distortions are likely to affect the viability of rural sites.

(g) The derogation from the EU stage I vapour recovery directive could be granted to all rural sites in the UK, as opposed to the current selective application to only certain rural areas in Scotland. Similarly, the EU stage II vapour recovery directive should be waived for all rural sites in the UK.

8.7.2 Australia
Similarly, I wish to propose a set of four recommendations based on their relative importance.

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34 Petrol Retailers Association (PRA), *Proposals for Amendments to the Measuring Equipment Regulations 1983 & the Weights and Measures Order 1985*
(a) The Australian Government may consider adopting a more robust approach to rural development policy that goes beyond the development of rural and regional infrastructure.

(b) The Australian Government may wish to adopt the proposed residential fuel credit scheme, to be applied specifically to remoter country areas where a renewable energy project is currently non-existent.\(^{36}\)

(c) The effectiveness of terminal gate pricing may need periodic assessment as this pricing policy has important implications for fuel pump prices in rural areas.

(d) The deregulation process may need to be monitored stringently, to ensure that all industry participants are adhering to the tenets of the Downstream Oilcode. The reason is because the Oilcode relies on cooperation among industry participants and on the prior disclosure of information (regarded by some industry analysts as weak tenets).

\section*{8.8 Research contributions}
This research has in the author’s view made a number of significant contributions to the existing body of knowledge.

The first contribution is the application of the modern conception of rurality to the regulation of fuel retailing in rural areas, in order to facilitate an understanding of a potential paradigm shift in the future role of fuel retailing in these areas within the context of an integrated rural development strategy.

\(^{36}\) See Fuel Tax Inquiry; \textit{ supra} note 12, at p. 167.
A second contribution is the classification of support schemes for rural fuel retailers; rural communities; and rural businesses. These were broken down into two broad categories: the regulatory support mechanisms and the fuel subsidy schemes.

A third contribution relates to a clarification of when and how state aid should be applied in the context of rural fuel retailing activities.

A fourth contribution is in regard to the application of the wider concept of regulation (which includes statutory intervention, markets, contracts, and court interpretations) to an investigation of the potential contributions of the regulation of fuels retailing to a rural development policy and the applicability of state aid.

A fifth contribution is the identification of the core constituents of a comprehensive rural development policy.

A sixth contribution is the identification of the stages towards introducing a sustainable independent fuel retail sector based on UK and Australian experiences of the regulation of fuel retailing activities.

The overall contribution made by these six specific contributions is in the author’s view, a significant one which should assist the design and implementation of further research into these subjects.

8.9 Topics for further research
The research has generated four related research questions. Firstly, the environmental objective of combating or mitigating climate change has become a global
phenomenon. Governments of OECD member states are actively encouraging the rapid development of the production of biofuels and other renewable forms of energy. It might be interesting to research into how government subsidies could help to develop these environmentally friendlier fuel and energy options.

Secondly, the downstream petroleum assets such as terminals, storage tanks, and distribution infrastructure hold the key to successful regulation of the fuel retail sector. Most OECD countries have developed independent downstream assets that could be used by the independent wholesale and retail sectors. In some other cases, provision is made for the oil majors to grant third-party access to the independent sector. The issue of third-party access to these facilities would become an issue for developing countries as they restructure and privatise their National Oil Companies. It might be important to research into how the independent fuel retail sectors in developing countries could secure access to such facilities?

Thirdly, it is well known that the oil majors’ downstream operations are vertically integrated, at least financially. A research question might arise as to how compatible is vertical integration with a deregulated fuel retail market.

Fourthly, this research indicates that the Australian fuel retail sector, which was previously heavily regulated, is now being deregulated. It might be useful for further research to be carried out to assess fully whether the previous regime of fuel subsidies could survive after implementation of a fully deregulated market.
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