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19 June 2017

By E-mail

Ms Shirley Chan
Clerk to Panel on Economic Development
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Ms Chan,

**Panel on Economic Development
Joint Letter from Hon James TO Kun-sun, Hon WU Chi-wai and
Hon Andrew WAN Siu-kin dated 31 May 2017**

**Competition Commission's Report on
Study into Hong Kong's Auto-fuel Market**

We refer to your letter of 1 June 2017, forwarding to us the joint letter from Hon James TO Kun-sun, Hon WU Chi-wai and Hon Andrew WAN Siu-kin to the Chairman of the Panel on Economic Development. Our response is provided below.

On the competition in Hong Kong's auto-fuel market, the Government endeavours to maintain market openness and remove barriers to enter into the market. In a free market economy, similar to other consumer products-related

industries, we do not interfere with the auto-fuel industry or regulate its pricing and operational arrangements as far as possible. Any parties who are interested in operating petrol filling stations (PFSs) and have sufficient funds can bid for PFS sites. There is no other restriction on their qualifications.

The Government has taken a series of measures, including removing the requirement for bidders of PFS sites to hold import licence or supply contract; re-tendering all existing PFS sites upon expiry of their leases, instead of renewing the leases to the existing operators; introducing the “super bid” tendering arrangement in order to facilitate new entrants in acquiring a critical mass of PFS sites to achieve economy of scale. All these measures aim to remove barriers for new entrants to enter into the market.

Since the introduction of the “super bid” tendering arrangement in 2003, two new operators have obtained 35 out of the 61 PFS sites put up for tender and successfully entered the market. The share of the three biggest incumbent operators in terms of the number of PFS has dropped from over 90% to about 70%. This reflects that the “super bid” tendering arrangement has facilitated new entrants in acquiring a critical mass of PFS sites to achieve economy of scale, and has facilitated them to compete effectively in the auto-fuel market.

Currently, six oil companies operate around 180 PFSs in Hong Kong, viz. ExxonMobil, Shell, Chervon (i.e. Caltex), Sinopec, Petrochina and Feoso. The market situation of other neighboring major cities is similar to Hong Kong’s auto-fuel market. For instance, in Singapore and Tokyo there are four and six oil companies respectively operating the majority of the PFSs. Given the size of the Hong Kong market, competition does exist in the auto-fuel market to a certain extent.

On the suggestion of re-introducing 95 Research Octane Number (RON) petrol, the existing legal requirements as well as the lease conditions of PFS sites do not prohibit the supply of 95 RON petrol. We agree with the Competition Commission (the Commission)’s recommendation that more choices should be provided to the consumers. In view of the Commission’s recommendation, we will discuss with the relevant Government departments and the oil companies the feasibility of specifying in the lease conditions the requirement to supply 95 RON petrol in the PFS sites due to be tendered or re-tendered, having regard to the operational arrangements of the oil companies, the environmental conditions at individual PFSs and other relevant factors.

On the suggestion of splitting large PFSs into smaller PFSs, currently Hong Kong has over 180 PFSs and over 60 liquefied petroleum gas filling stations which are sufficient to meet the demand of auto-fuel. Nevertheless, we will examine the feasibility of splitting large PFSs into smaller PFSs in consultation with the relevant Government departments, having regard to the relevant planning criteria and environmental conditions at individual PFSs etc.

On the long term recommendation regarding potential “structural” reform options, as pointed out by the Commission in its report, many of the measures to facilitate new entrants would incur substantial costs. For example, the proposal of introducing a new open access terminal storage facility will involve the supply of new land. Given the scarcity of land in Hong Kong, we need to balance the different needs of the community. As regards the suggestion of constructing a pipeline to import fuel from the Mainland, it will also have substantial implications on land use, environment and safety. We will need to carefully consider the pros and cons as well as the tenability of the suggestions before determining whether we will undertake any detailed study.

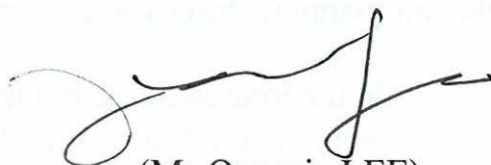
Regarding the issue on price of diesel, retail prices of auto-fuels in Hong Kong are determined by the oil companies having regard to commercial practices and their operating costs (such as tax and other operating costs including land premium, staff costs, transportation costs, advertising expenses, costs of operating oil terminal, etc.). Since the relevant data are commercially sensitive information of the oil companies, in a free market economy, the Government does not have the power to request the oil companies to provide such detailed information. Besides, as the oil companies generally provide various kinds of discounts and other promotions to consumers, the actual prices paid by consumers are effectively lower than the pump prices listed at PFSs.

On the other hand, as indicated in the Commission’s report, the gross margin does not represent the actual net profit margin earned by the oil companies. The oil companies must fund various outlays including discounts, operating costs, land and construction costs, etc. Therefore, the increase in diesel gross margin does not necessarily translate into an increase in the net profit. Since we do not have the power to request the oil companies to provide their commercially sensitive information such as cost data, we are unable to accurately analyse the difference between the gross margin of diesel and petrol.

The first batch of PFS sites are scheduled for retendering in the third quarter of 2018. To tie in with the tendering work, we plan to complete the study on the relevant tendering arrangements by early 2018. We will report the

outcome to the Panel on Economic Development after we have completed the study.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Queenie LEE', with a stylized flourish at the end.

(Ms Queenie LEE)
for Secretary for the Environment

C.C.

Hon Jeffrey LAM Kin-fung, GBS, JP
Chairman, Panel on Economic Development

Hon Anna WU Hung-yuk, GBS, JP
Chairperson, Competition Commission