2 March 2009

The Hon Tony Kelly MLC
Minister for Lands
Minister for Regional Development
Level 34, Governor Macquarie Tower
1 Farrer Place
Sydney NSW 2000

Dear Minister

Caltex welcomes the opportunity to provide comment on the NSW draft Biofuel (Ethanol Content) Amendment Bill 2009. Caltex has been actively engaged in the development of biofuels policy and provided commentary to the Biofuel (Ethanol Content) Act and Regulations 2007.

Biofuels, including ethanol and biodiesel, can play an important part in reducing Australia’s greenhouse gas emissions and reliance on fossil fuels in the longer term once sustainable second generation biofuels are economically viable. Caltex has been supplying ethanol blend petrol to customers in NSW since the mid 1990s, initially through a distributor (Bogas) and in recent years directly under the Caltex brand.

Caltex has been taking all reasonable steps to achieve the current mandated 2% ethanol volumes and reports progress to the Department of Lands on a regular basis. However, achievement of this target has been impeded by lack of operational control over most sites (including Woolworths), limited consumer acceptance of ethanol blends, limited supply of ethanol and the need for new infrastructure or conversions at terminals and retail sites.

In pursuing the reduction of greenhouse gas emissions and the development of biofuel blends, consideration must be given to increasing research and development on second generation biofuel supply chains. However, in moving towards this longer term objective of sustainable second generation biofuels, transitional financial support for production, infrastructure and marketing of current generation biofuels is required.

Stakeholders need to work together to overcome existing concerns about the suitability of ethanol for use in vehicles and any limitations that still exist. Manufacturers and importers of vehicles should ensure that all new vehicles sold in Australia are warranted to use 10% ethanol blended with the relevant grade of petrol. In addition we believe the NSW Government should promote E10 through a range of initiatives, as consumer confidence is fundamental to the achievement of reaching the proposed targets.

Caltex supports the development of biofuels, including ethanol, but is opposed to mandates to achieve volume targets. However, given the government’s intention to mandate increased supply of biofuel blends, Caltex is keen to provide advice on practical issues related to policy implementation. Caltex believes the interim targets in 2010 and 2011 are not achievable and the E10 target is not achievable by 2011. The NSW Government’s policy for expansion of biofuel blends as embodied in the draft legislation faces a number of practical difficulties in implementation.

The issues discussed in the following sections will have a serious impact on the ability of the petroleum market to achieve the objectives of government and industry in their endeavours to reduce greenhouse gas emissions.
greenhouse gas emissions and support the growth of biofuels. These issues relate to impediments created by the operational structure of Caltex's supply chain, the need for increased biofuels supply with greater reliability, the need for greater consumer acceptance of ethanol and the need for infrastructure upgrades across the supply chain.

**Implications of Caltex operational structure for achievement of ethanol and biodiesel volume mandates**

The draft Amendment Bill proposes a phased increase in ethanol content from the current 2% to 4% from 1 January 2010 and 6% from 1 January 2011 to 30 June 2011. From 1 July 2011, primary wholesalers must not sell regular unleaded petrol unless the petrol is E10. For biodiesel the Amendment Bill now incorporates a 2% minimum biodiesel requirement, increasing to 5% from 1 January 2012.

The interim mandate steps for ethanol are not feasible for Caltex, which means Caltex will need to seek partial exemptions for E10 every quarter through to July 2011. Apart from industry-wide issues relating to supply availability and consumer acceptance, Caltex faces much greater impediments to conversion of its service stations than its competitors because of its operational structure.

The Caltex business model differs from competitors: all Caltex Woolworths co-branded sites are operated by Woolworths; a large percentage of the Caltex branded network is made up of individual franchisees and independent retailers who operate service station sites and are solely responsible for determining what product is sold and at what price; additionally Caltex has a significant number of independently owned resellers (distributors) who also determine what product is sold at the wholesale level and at what price. Caltex only controls 44 of the 537 Caltex branded service stations in our network in NSW.

To comply with the 6% ethanol mandate Caltex would need to convert over 90% of its ULP sales to E10. Based on current evidence when there is a range of products for consumers to choose from the target is not achievable. Average market penetration at E10 sites in NSW where we offer a choice between regular ULP and E10 is currently below 20%. Banning ULP and moving from the current 2% mandate to E10 only in July 2011 is preferable to the phased in mandate. Even then, full compliance from the date of the change is probably not possible even with adequate supply because of the need for service station tank replacement.

**Certainty of ethanol supply**

Existing ethanol supply reliability is inadequate. Disruptive ethanol shortages were experienced on multiple occasions in 2008. In each case this was due to problems at the Manildra plant, our sole NSW supplier in 2008. The commencement of the Dalby supply contract, whilst delayed, was a positive step, however startup issues are being experienced to the detriment of Caltex continuity of supply. Unreliable supply damages consumer perception of E10 and significantly reduces Caltex’s wholesale customers' confidence to displace ULP with E10.

Supply failure forces Caltex to supplement the E10 shortages at sites with regular ULP at a cost to Caltex in an attempt to minimise damage to the market.

For the NSW Government to legislate with respect to the required ethanol content in petrol sold in NSW and to make provision with respect to the required biodiesel content in diesel fuel, the supply and quality of product must be guaranteed. Supply must be sustainable in the long term. To achieve this, excess capacity is required so the planned or unplanned shutdown of a biofuels facility will not normally affect supply to end users. Currently this is not the case.

An ethanol mandate could effectively amount to a mandate on imports from July 2011 unless local supply is competitively available. In addition, a mandate without adequate surplus capacity would allow the limited number of suppliers to charge higher prices which would be passed onto consumers.

**Consumer response to ethanol**
Based on existing sales and feedback from consumers, acceptance of E10 remains low. There are few genuine consumer incentives to use ethanol blends. Only half of consumers are willing to consider their use, mainly due to concern over impact on engines. As mentioned above, average market penetration at E10 sites in NSW where we offer a choice between regular ULP and E10 is currently below 20%.

Price is the major driver of E10 sales but only about 60% of motorists buy wholly or partially on price. This suggests an upper limit of about 60% on ethanol market penetration unless non-price factors become significant.

Some grade of unblended fuel must be available to provide consumer choice but choice means fuel retailers can’t force motorists to buy E10 in order to meet suppliers’ mandate targets. This means unleaded petrol must be displaced with E10 to achieve volume targets even at the 2% level, meaning more expensive premium petrol is the alternative unblended grade.

Infrastructure impediments

To comply with the mandates proposed to be in place from July 2011, Caltex would need to increase sales of neat ethanol from 30ML pa to 153ML pa and biodiesel from 11ML pa to 73ML pa. Infrastructure upgrades would need to be undertaken at terminals and service stations across NSW.

There is currently inadequate terminal tankage for any increase in ethanol sales at Newcastle and the Silverwater facility is not estimated to be on stream until 2010. (Mobil is the operator of this facility). The capital expenditure involved with upgrading terminals and service stations, including new tanks where required is between $15 million and $18 million. The upgrade at the Silverwater terminal alone is now estimated to be more than $6.5million.

The introduction of E10 into tanks needs to be closely monitored to ensure that environmental risks are not exacerbated. Consistent with the NSW Government’s Underground Petroleum Storage Systems (UPSS) Regulations 2008, it is illegal to continually allow or ignore contamination resulting from a leaking or faulty UPSS. The requirement to have E10 only may increase the risk of leakage because of the increased number of service stations selling the product and may force the acceleration or reprioritisation of tank upgrades under the current Caltex storage tank upgrade program. More generally, it will be important for the NSW Government to ensure it biofuels mandate timing is not inconsistent with the enhanced government policy on UPSS integrity.

Specific comments on Biofuel (Ethanol Content) Amendment Bill 2009

Definitions

- Schedule 1, Section 4A Major Retailers

The definition should be amended to delete “owns” and substitute an operational control definition.

The person/company who owns the site may not be the person/company responsible for decision making with regard to product supply to customer. For example, it might be a Caltex franchised site or a site owned by a property trust or a superannuation fund. The legislation should target the person/company who controls the decision making processes with regard to what fuel is sold and at what price.

- Change 20 to 10 service stations.

To ensure that the legislation captures franchisees and resellers who are accountable for decision making, it is necessary for liability to extend as far as practical towards individual retailers. Caltex recognises there may be practical difficulties for individual retailers in meeting a mandate liability eg remote from E10 supply or uneconomic tank replacement, but there is a provision for the minister to grant exemptions on such grounds. Caltex believes there is a substantial number of retailers who control 10 or more service stations that would significantly contribute to the volume of biofuels being sold and who should be able to meet the mandate requirements.

Biofuel volume requirements

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Schedule 1, Part 2, Section 6 and 7 - Minimum biofuel requirements

Caltex does not support the staged minimum ethanol percentage being mandated and recommends the draft Amendment Bill delete Part 2, Sections 6 and 7.

However, should the Government wish to pursue this policy, Caltex would support the 1 July 2011 target of displacing unleaded petrol with E10 provided certain criteria are met including surplus supply capacity and recognition of site conversion timeframes.

Part 2, Section 6 From 1 July 2011

When E10 replaces unleaded petrol, the provisions in this part outlining the minimum volume of ethanol to be sold should cease to have effect.

Sections 6(4) and 7(4)

These sections enable the Minister to prescribe an earlier start date. This should be omitted so industry has certainty across the supply chain in putting in place appropriate plans and expenditure to achieve compliance by a firm date. Supply availability should not drive mandate timing and Caltex opposes any notion of the mandate being implicitly linked to specific plant expansions or new plants.

However, should the legislation not omit this reference the advice to the Minister for a regulation to prescribe a start date as an earlier date for the application of the mandate should be expanded to incorporate:

a) excess supply of ethanol and biodiesel being available so as to provide adequate security of supply
b) the availability of ethanol and biodiesel at a quality acceptable to the purchaser.

Compliance

Schedule 1 Part 3, Sections 15, 16 Exemptions

Provision is made for certain volume sellers in remote areas where compliance with the legislation could impose economic hardship to be able to seek exemption.

Caltex would not want to see retailers closing their business and leaving communities with no local supplier. However, exemptions should not result in adverse affects on competition, for example if one service station has a choice of ULP and E10 and another only E10. Competitive impacts should be grounds for exemption for all competitors in such circumstances.

Schedule 1 Part 3 – 17(1) (c) Suspension of minimum biofuel requirements

The Minister may suspend the operation of minimum biofuel requirements if satisfied that compliance with the requirement “may have an adverse effect on the retail price of petrol or diesel fuel for motorists”.

An explicit provision to suspend the operation of minimum biofuel requirements based on price should be removed as it is highly likely that prices will rise from time to time and the switching on and off minimum requirements would create uncertainty for production, distribution and marketing of products and confusion for consumers.

Caltex would welcome the opportunity to discuss any of the matters raised.

Yours sincerely

Frank Topham
Manager Government Affairs & Media