Caltex submission to the Review of the New South Wales *Biofuels Act 2007*

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Caltex welcomes the opportunity to provide comment on the NSW Biofuel Act 2007 legislative review.

Caltex would support the following actions:

- establish an industry advisory committee to provide practical advice to government on developing the industry
- NSW government take a policy leadership role with federal government
- extend accountability of the Act to include producers and end sellers to ensure the entire biofuel supply chain has responsibility for supply, distribution and marketing of product
- government should conduct, and report on behalf of industry, lifecycle emission outcomes
- government should do more to educate consumers about biofuels.

**Caltex and the Australian petroleum industry**

Caltex is a refiner and marketer of petroleum products in Australia, with operations in all states and territories, with about 3,900 employees. It supplies over one third of wholesale transport fuels (petrol, diesel and jet fuel) nationally. It has a branded retail petrol market share of about 16 percent nationally (excluding Woolworths co-branded sites).

Caltex accounts for almost a third of Australia's oil refining capacity. It owns and operates two of Australia's seven operating oil refineries – at Kurnell in Sydney and Lytton in Brisbane. Between them, the Caltex refineries have the capacity to process 244,000 barrels (about 39 million litres) of crude oil per day.

While conventional fossil fuels including refined products will remain dominant over the next few decades, Caltex believes alternatives to conventional refined petroleum products will become increasingly important and is investing in the development of biofuels blend markets and distribution infrastructure.

Caltex produces a range of biofuels blends, including both ethanol and biodiesel blended products. Caltex's ethanol blends consist of a blend of petrol and ethanol at varying percentages. These products include Bio E10 Unleaded, a 10 percent ethanol blend, and the recently announced Bio E-Flex fuel, which contains up to 85 percent ethanol.

Caltex's Bio E10 Unleaded is available at more than 400 Caltex service stations across NSW, ACT and Queensland. The product is also available at some Caltex sites in Victoria. Caltex's Bio E-Flex will be available at over 50 sites in Melbourne, Sydney, Brisbane, Adelaide and Canberra by the end of 2011.

Caltex's biodiesel blends consist of a blend of diesel and biodiesel at varying percentages. These products include New Generation Diesel, a two percent biodiesel blend; Caltex Bio B5, a five percent biodiesel blend; and Caltex Bio B20, a blend with 20 percent biodiesel.

Caltex's New Generation Diesel can be used in all diesel vehicles and equipment and is available in the Newcastle and Hunter regions in NSW. Caltex sells its Bio B5 and B20 to mining companies, and commercial truck and bus fleet customers in South Australia, Queensland and NSW.

Caltex has invested over $20 million in terminals, service stations and blending facilities to support projected future growth in demand.

**Review questions**

1. **Is the objective of the Act still valid?**

   For long term energy security, Australia needs greater diversity in its transport fuel supply to provide options to adjust when liquid fuel demand outstrips supply from conventional crude oil reserves and there is greater reliance on non-conventional sources of liquid fuels (the "peak oil" scenario).

   Caltex supports the establishment of a sustainable Australian biofuels industry, which is still a small but developing industry. Caltex believes that biofuels can play an important role in reducing greenhouse gas emissions from transport and increase Australia's energy security, particularly once economically viable second generation biofuels become available.
Caltex supports the development of biofuels but is opposed to mandates to achieve volume targets. However, given the government’s intention to continue to mandate increased supply of biofuel blends Caltex is keen to provide advice on practical issues related to NSW biofuels policy.

There are a range of factors that influence the establishment of a viable biofuels industry, including non-feedstock inputs, feedstocks, processes, products and markets. Caltex believes there are ten essential steps required for a viable biofuels industry to exist in Australia, outlined in Attachment A. These initiatives would support the development of the industry in NSW.

2. Are the terms of the Act still appropriate to secure the objective?

A primary objective identified by government was to encourage investment in biofuels production facilities to support regional development. Whilst the volume of biofuels sold has increased since the commencement of the Act, there have been no new ethanol facilities built in NSW. Caltex currently sources biofuels from seven suppliers; only two of these are located in NSW. The terms of the Act place obligations on wholesalers and retailers but has not encouraged new investment in biofuel production facilities. Whilst this may have been hampered by excise issues and uncertainty at the federal level and a lack of customer demand, the current framework for development of the industry has not yet delivered the desired investment.

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 production and storage capacity is required so production disruptions and the planned or unplanned shutdown of a biofuels facility will not normally affect supply to end users. Currently this is not the case.

The required ethanol content in fuel has not been achieved. Existing ethanol supply reliability is inadequate. Disruptive ethanol shortages have been experienced on many occasions. In many cases this was due to problems at the Manildra plant, our sole ethanol NSW supplier. Caltex supplements ethanol supply from Queensland. Unreliable supply damages consumer perceptions 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.

An ethanol mandate could effectively amount to a mandate on imports from July 2012 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 should be passed onto consumers.

Despite these difficulties, policy certainty is required. To assist investment certainty, implementation of the displacement of all regular unleaded petrol with E10 from 1 July 2012 should not be deferred based on inadequate supply. Instead, the exemption provisions should be utilised to manage supply shortfalls.

3. Should the terms of the Act be amended to enhance the achievement of the objective?

Given that no new plants have been established, and achieving the interim mandate targets prescribed in legislation has not been possible it would suggest that the legislation and policies supporting development of the industry in NSW are inadequate.

The Act applies to volume fuel sellers and they must ensure that mandate targets are achieved. A person who fails to comply with minimum biofuel requirements (in the absence of an exemption) is guilty of an offence. Since the commencement of the Act Caltex has applied and been granted exemptions which in part are based on unreliable and/or insufficient supply. To enhance the achievement of the Act, we recommend that biofuel producers be accountable for their performance and report regularly on their quality, supply reliability, inventory and the sustainability of product. There is no accountability for the producer to maintain product supply under the current regime and there are no consequences for producers when they do not supply product.

Responsibility for compliance should also be passed through to end sellers to the extent practicable. Due to the inability of fuel wholesalers to influence product choice, marketers of the
product who have a much greater influence on customer acceptance of the product need to be accountable under the Act.

A government education campaign to inform consumers about the product and vehicle compatibility would support acceptance of the product. Demand for biofuels remains low mainly due to consumers’ lack of understanding about biofuels and consumer confidence is fundamental for a viable biofuels market. Establishing a well-informed market that understands the product and is confident in its use will continue to help build demand for biofuels.

4. **Should the terms of the Act be amended to enhance air quality outcomes?**
   
The *Protection of the Environment Operations (Clean Air Regulation 2010)* adequately covers air quality provisions. However, maintenance of the Reid vapour pressure (RVP) allowance of at least the 7kpa in fuel containing ethanol is critical to the future viability of ethanol fuels. This suggests the Act could contain a provision to guarantee an ongoing vapour pressure allowance.

5. **Should the terms of the Act be amended to enhance climate change outcomes?**
   
   As stated earlier in the submission Caltex believes that biofuels can reduce greenhouse gas emissions.

   Caltex foresees future growth potential for the Australian biofuels industry. Currently, the mining and commercial sectors are driving demand for biodiesel as businesses become increasingly aware of the need to be more accountable for their greenhouse gas emissions. Fleet owners are also seeking to invest in low carbon emitting vehicles such as hybrids, electric vehicles and flex-fuel vehicles.

   A common concern with biofuels is that they do not reduce greenhouse gas emissions and are not sustainable on a lifecycle basis. To build industry wide consensus on the benefits of biofuels, Government, as an independent expert, needs to analyse and calculate on behalf of industry each production system and report the lifecycle greenhouse outcome. Where ethanol production facilities provide this data, government should audit and verify the results. This would go some way in building consumer and marketers’ confidence that biofuels will reduce greenhouse gas emissions.

   Government has a role to play in the development of sustainable second and third generation production facilities. Further R&D investment is required for the optimisation of crops and conversion processes for biofuels production including the identification and development of second generation feedstocks. The NSW Government can take a lead in this area and provide support for R&D.

6. **Should the terms of the Act be amended to enhance fuel self-sufficiency outcomes?**
   
   No, fuel self-sufficiency is not an appropriate policy objective as it could distort trade and reduce economic efficiency. Caltex supports the enhancement of energy security through greater diversity of fuel supply provided this is achieved without distortion of inter-fuel competition. Currently, we believe there are market failures (including inadequate consumer knowledge and lack of carbon pricing) that may result in a less than optimal market share of some alternative fuels, including biofuels. Our policy proposals, including recommended changes to the Act, are designed to help correct those market failures. Once these market failures are corrected, all conventional and alternative fuels must compete on a level playing field.

7. **Should the terms of the Act be amended to enhance cheaper fuel price outcomes?**
   
   Caltex would not support this as being an objective of the Act nor amendment of the Act to meet the objective. Biofuels are currently not cheaper than petrol and diesel when energy density (energy content per litre) is taken into account.

   The discussion paper makes reference to the federal government’s favourable fuel excise treatment for biofuels and incentives for domestic production of fuel ethanol and concludes that biofuels are therefore generally cheaper than petroleum fuels. The provision in the legislation for exemptions to be granted if the price at which biofuels are available becomes uneconomic is intended to guarantee that biofuels will never be dearer than petroleum fuels as a result of the mandates.
There is no guarantee that biofuels will maintain a discount with the product it seeks to replace. Producers seek to maximise their profit and will increase their price in line with the products with which they compete.

Influences on the price competitiveness of biofuels include fluctuating exchange rates, international oil prices (which affect the local price of petrol and diesel), excise, production costs and feedstock prices. With the cyclical nature of the price of feedstocks which is not related to petroleum prices it is conceivable that the price of ethanol or biodiesel would not be competitive.

Biofuels will become more price competitive with conventional petroleum products as international oil prices increase. It is generally accepted that oil demand will outstrip conventional oil supply in the foreseeable future (although this may still be some years away or even next decade), leading to higher oil prices or even oil price shocks if supply is very tight.

Australia is a net importer of petroleum products and will increasingly be so in the future. The local biofuels industry needs to be internationally competitive against both imported petroleum products and imported biofuels.

The discussion paper suggests that there is an opportunity once all ULP is replaced by E10 that oil companies could reformulate the blendstock to meet octane requirements which would have the potential of saving several cents per litre. It would not be feasible to go to RBOB when there is an ethanol shortage as there needs to be a certainty of supply, which is not the current situation. Given the marginal viability of refining and competing priorities for capital, if any savings can be achieved these would be reinvested in refining and would not lead to savings for motorists.

8. Are the terms of the Act appropriate to ensure that biofuels delivered under the mandate are sustainable?

This is an important aspect in developing support for the biofuels industry. There should be clear guidelines for producers and purchasers to follow.

In determining the sustainability of alternative fuel products their ‘life cycle’ impacts need to be considered and should be linked to the provision of financial assistance. The most efficient use of resources would be to provide greater support for alternatives that provide a higher reduction in emissions on a ‘life-cycle’ basis. For example, neat ethanol produced from sorghum results in an 18 percent reduction in greenhouse gas emissions compared to petrol as opposed to a 46 percent reduction from neat ethanol produced from molasses.

However, full life-cycle emission reductions are highly dependent on the configuration of particular projects. In general biofuels produced from second generation feedstocks are expected to provide greater emission reductions than first generation plants. The verification process is very important in determining sustainability it must be consistent and not preference any particular technology. We would support the NSW Government undertaking this process to provide independent analysis and report results.

Currently the Act requires volume fuel sellers to sell only ethanol and biodiesel that complies with a biofuel sustainability standard. It is the requirement of the fuel seller to report sustainability compliance. The Act should be amended to place the obligation on the producer to report and demonstrate sustainability. This would provide producers with an opportunity to market product based on life cycle analysis and encourage investment in sustainable technologies.

8.6 Should Australia establish a national biofuels sustainability standard?

Yes, a national sustainability standard for biofuels needs to be established to support the development of the local biofuels industry and to ensure that in the future only sustainable biofuels including imports can benefit from government biofuels policies. This will help develop consumer confidence in the quality of the biofuels they purchase. The standard needs to take practical account of existing Australian regulations and policies, for example environment planning legislation, whilst being in line with accepted international benchmark standards.

9. Are the terms of the Act sufficient to ensure that appropriate fuel is available for older vehicles and non-road uses?

1 Prime Minister’s Task Force 2005
Yes, there is sufficient available in the marketplace for older vehicles and non road users as premium petrol grades generally do not contain ethanol and this will continue for the foreseeable future.

The financial impact for vehicles that need to purchase PULP would be minor in the context of total running costs.

Manufacturers and importers of vehicles should be required to only sell new vehicles in Australia that are warranted to use at least 10 percent ethanol blends. All diesels should be warranted to use five percent biodiesel blends with a higher percentage as a longer term policy objective.

10. Are the terms of the Act relating to flexibility in mandate settings appropriate?

The discussion paper raises the issue of varying the ethanol content of E10 to manage ethanol shortages, by for example reducing the content to E5 or E6. This is not an ideal way of managing poor supply. If greater flexibility was permitted it must be managed in a way that the required published ethanol content is not abused and that the intended ethanol content be enforced when not in a supply crisis.

Currently E10 may be modified to provide E9 to manage short term shortage of supply. The cost is borne by Caltex. To change to E5 or E6 would require a price change and changing product signage, this would likely destabilise consumer confidence in the product.

Deferment of the ULP ban is not recommended due to the risk of further exacerbating the uncertainty in the market for investors and fuel suppliers.

11. Are the terms of the Act appropriate to encourage the development of an advanced biofuels industry in NSW?

No. The biofuels industry is at relatively early stage of development. Current first generation facilities will play a role in long term energy security and climate change mitigation. However, it will be the commercial production of next generation biofuels that will make a more significant contribution.

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.

An established and efficient supply chain from feedstock production through to retail infrastructure is needed to continue the development of a biofuels industry and allow for expansion of the market as demand increases. It will be equally important to ensure that as the market moves from first generation to second generation that the existing infrastructure and supply chain can support both. The commercialisation of second generation biofuels will be challenging without an established supply chain.

Financial assistance should be considered to help develop the biofuels supply chain, from production and distribution to the wholesale and retail level. Investing in infrastructure to adapt to new markets is expensive so in moving towards the longer term objective of sustainable second generation biofuels, transitional financial support for production, infrastructure and marketing of first generation biofuels may be required.

The infrastructure required to support the continued development of the biofuels industry is still in its initial stages. Biofuels require separate storage tanks from conventional petroleum products and new blending facilities to enable the proper blending of biofuels with petrol and diesel. This infrastructure requires significant investment by industry participants but is necessary for a reliable biofuels supply chain. Service station upgrades to support biofuels cost around $20,000 for tank cleaning and product re-distribution on the forecourt and, if necessary, tank replacements on average cost $500,000.

If bio-based industries establish themselves in regional areas close to their feedstock supply, it is important that established infrastructure exists for end-users and customers to be able to access the product in a timely and efficient manner. It is crucial that bio-based industries do not isolate themselves from their customers and market. Transportation costs to terminals and markets need to be considered in determining whether local products can be competitive particularly against imported product, which will generally enter the country close to major markets.
While biofuels blends are locally available, the policy stance of federal and state governments is not uniform and a strategic policy framework does not exist. Both federal and state governments, in conjunction with industry stakeholders, need to adopt a proactive policy framework that targets both supply and demand issues and encourages continued development of biofuels in Australia. The NSW government is in a position to drive this policy agenda.

Governments need to consider the impacts that changes to a range of policies such as mandates, R&D incentives, excise, industry development grants, carbon prices, fuel standards and sustainability requirements have on a developing biofuels industry.

Government policies can have an impact on investment in developing markets, particularly if one technology receives greater assistance and incentives than another. The level of support provided to various alternative fuels should be consistent to ensure that investment in certain sectors is not discouraged.

Equitable taxation and subsidies are required for the development of the alternative fuels markets as they naturally influence industry investment and consumer behaviour. The Australian biofuels industry must be required to be internationally competitive and therefore a level playing field with imports in terms of excise and subsidies is necessary, although transitional arrangements may be implemented (as is currently the case for ethanol).

Beyond the transitional period, government policies should be neutral between all fossil and non-fossil liquid fuels so there are no distortions of inter-fuel competition.

12. Are there any other issues you feel need to be examined in the review of the Act?

Specific comments on Biofuel Act 2007

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.

The definition should be amended to mean a person who operates or controls the operation of more than 10 (see below) service stations in NSW. This qualification would assist in clarifying the responsibilities of Caltex’s border reseller operators.

- 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

Part 1, Section 5 – Act applies only to sales to person in NSW or for delivery in NSW

Currently the Act makes no distinction between the sales volumes reportable under the mandate’s volumetric requirements and the volume that is captured under the ULP ban. This conflicts with advice received from the Office of Biofuels and should be clarified in the Act.

It is not possible for Caltex to accurately report the wholesale volume brought into NSW by independent resellers from interstate terminals as once the fuel is sold, we have no further ownership of the fuel and hence no record of any consequent sales.
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. Caltex is unable to access exemption provisions as they are targeted to small business only. Caltex recommends that all all volume sellers should be able to apply for exemption.

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

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Biofuels – ten essential steps for a viable industry

Scientists round the world are racing to develop new-generation renewable fuels from algae and other sources but Australia still lacks a policy vision and strategic framework for this fledgling industry.

Caltex proposes 10 key points for a policy framework:

1. Provide more information for consumers.
2. Implement the proposed 50% discount on new excise taxes to be introduced over 5 years starting in July 2011.
3. Avoid effective removal of tax concessions for 20% biodiesel blends as a result of making a biodiesel blend standard.
4. Ensure manufacturers make vehicles so they can run on at least E10 blend and ensure warranties include this fuel.
5. Ensure biofuels meet all fuel quality requirements including national fuel quality standards.
6. Ensure sustainability criteria take into account “life cycle” ecological impacts – and link this to the provision of financial assistance.
7. Optimise crops and conversion processes for biofuels production in Australia.
8. Financial assistance for developing the biofuels supply chain – including distributors, wholesalers and retailers – and for developing technology including vehicles.
9. Targeted financial assistance to new Australian biofuels producers for a limited period.
10. Ensure a level playing field for taxation on domestic and imported biofuels from July 2011.