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Shell's submission to the Impact of Petrol Pricing Select Committee in Queensland

Dear Mr Hansen,

Shell Australia is happy to assist in the inquiry into the impact of petrol pricing in Queensland (QLD) and would like to thank the Select Committee for the opportunity to participate and make a submission to the inquiry. We acknowledge and agree that this is an issue of considerable community interest.

Shell believes that the Australian petrol market (including Queensland) is highly competitive as evidenced by the fact that before tax, Australian petrol is amongst the cheapest in the OECD. Australian petrol prices closely track international petrol prices as Australian refineries compete with international refineries and as Australia is a net importer of petroleum products.

Shell believes that there is a place for alternative fuels, such as ethanol blended petrol in the Australian fuel mix and has recently launched Australia's first "super-premium" fuel Shell Optimax Extreme, which is formulated with 5% ethanol. However, the development and sustainability of these blends is dependent on a restoration of consumer confidence and a reliable supply of quality biocomponent (ethanol) at a competitive price.

This submission seeks to supplement the submission from the Australian Institute of Petroleum (AIP) by reiterating some key points in that submission and by providing a few pieces of additional, Shell specific, information.

I understand that you are already in contact with our General Manager, External Affairs, Downstream, Peter Scott, and trust that you will continue to liaise with Peter if you have further questions or comments.

Yours sincerely

SHELL AUSTRALIA SUBMISSION TO THE IMPACT OF PETROL PRICING SELECT COMMITTEE INQUIRY (QUEENSLAND PARLIAMENT)

INTRODUCTION

Shell Australia is happy to assist in the inquiry into the impact of petrol pricing in Queensland (QLD) and would like to express its appreciation to the Select Committee for the opportunity to participate in the inquiry and to make a submission. We acknowledge and agree that this is an issue of considerable community interest.

Shell believes that the Australian petrol market (including Queensland) is highly competitive as evidenced by the fact that before tax, Australian petrol is amongst the cheapest in the OECD. Australian petrol prices closely track international petrol prices as Australian refineries compete with international refineries and as Australia is a net importer of petroleum products.

Shell believes that there is a place for alternative fuels, such as ethanol blended petrol in the Australian fuel mix, but that the development and sustainability of these blends is dependant on a restoration of consumer confidence and a reliable supply of quality biocomponent (ethanol) at a competitive price.

This submission to the Select Committee seeks to supplement the submission from the Australian Institute of Petroleum (AIP) by reiterating some key points in that submission and by providing a few pieces of additional, Shell specific, information. Clearly, there are areas of the Inquiry Terms of Reference that are not appropriate for Shell to comment on. The items in the Terms of Reference highlighted below are the areas Shell addresses in this submission.

- the extent to which current petrol prices increase the competitiveness of alternative fuels such as E-10;
- the economic and financial consequences of current fuel prices, with a particular emphasis on regional Queensland and outer metropolitan areas;
- practical ways that consumers can reduce their petrol bills;
- whether existing information on the fuel efficiency of different makes of motor vehicles is sufficient;
- the extent to which recent fuel increases could be moderated through enhanced domestic competition;
- how the Australian Competition and Consumer Commission's powers could be strengthened to deliver enhanced competition;
- whether Queensland receives its fair share of road funding;
- the capacity and benefits of the Federal Government reducing fuel excise to ameliorate the impact of high fuel prices on families and business;
- whether Queensland motorists are receiving the full benefit of the 8.354 cents per litre subsidy; and
- the efficiency of administration for the bulk end users scheme.

AUSTRALIAN PRICES IN CONTEXT

Australian consumers benefit from having amongst the cheapest petrol prices in the world both before and after tax. Before tax prices are low because margins are small and because of the efficiency of Australian petroleum distribution and marketing operations. The table below gives a comparison between Australian and other country's pre and post tax petrol prices.



Source: AIP website – June Quarter 2005.

Petrol prices are made up of three components:

- Product cost (including ocean freight and wharfage);
- Tax (excise & GST); and
- Gross Shell & retailer share (includes all costs/overheads including freight and small amount of profit)

As the graph below shows, together, government taxes and the import parity cost of petrol make up around 90% of pump prices.



SHELL IS A FUEL WHOLESALER

Shell supplies a wide range of commercial customers, including large commercial end users, owner dealers and independent retailers. Shell supplied service stations, include independently owned Shell branded locations, Coles Express sites and independently owned, non-Shell branded locations. A small number of motorists in remote locations may also buy fuel from Shell operated commercial refueling outlets.

SETTING WHOLESALE PRICES

Shell's wholesale pricing model is based on a Terminal Gate Price (TGP). This model is presently legislated in Victoria and Western Australia. As explained in the AIP submission, Australian refineries compete with international refineries to sell product, particularly as Australia is a net importer of around 20% of its petroleum products. Thus TGP is based on the international product price for the fuel (ex Singapore) and includes a quality premium for Australian grade fuel, ocean freight, landing costs, terminal and overhead costs, excise tax (38.14 cpl) and GST (10%).

The graph below compares Shell's Brisbane TGP to the international product price (IPP) for unleaded petrol during 2005.



Shell uses TGP based pricing around Australia. The TGP is influenced most significantly, of course, by the IPP and tax but is also affected by ocean freight and wharfage charges, the costs of terminal operation and overheads.

BIG DISTANCES, LOW VOLUMES AND LOCAL COMPETITIVE FORCES DRIVE REGIONAL COSTS

Shell customers have the option of purchasing their fuel direct from any Shell terminal, providing the load is purchased in an accredited fuel tanker (to meet industry safety regulations). Shell terminals in Queensland are in Brisbane (Pinkenba), Cairns, Townsville and Mackay. As a result, Shell's delivery system must be very competitive.

Where customers prefer to have their fuel delivered, Shell offers this service and will negotiate a price dependant on volume delivered and location. Depending on where a customer is located, the supply chain, ex terminal gate, may incorporate a combination of hired carrier, fuel depot and Sungold tanker. Sungold is Shell's distributor in Queensland and is a wholly owned subsidiary of The Shell Company of Australia Limited. Delivery in the more remote parts of Queensland is expensive due to the big distances and relatively low volumes of fuel. For example, depots which are used as interim points for storing and then redistributing fuel to customers in the immediate vicinity of the depot have certain fixed costs associated with site rent and operation. As an indication of the costs of a depot, in 1994, an Industry Commission conducted a detailed inquiry into the petroleum industry and estimated that the cost of depots, including delivery in the depot area (within 10 kilometers), could range between 3.0 and 5.5 cpl. Clearly in parts of Queensland, the distances between terminals and depots and the final delivery can be large and they will thus add a further significant amount to the delivered cost.

THE RETAILER SETS PUMP PRICES AT SERVICE STATIONS

The retailer or service station owner sets the pump prices that are seen by motorists. Retail prices in metropolitan and regional areas depend on local competition and local market factors.

Service stations in regional areas will often sell lower volumes of petrol/fuel per site than metropolitan service stations. When this occurs, a higher margin is required on each litre of fuel sold to cover the overhead costs of the service station, often contributing to the higher prices in regional areas. Overheads can include for instance, site rent/cost, wages, electricity and branding.

Virtually all Shell branded petrol stations are operated by either Coles Express, our alliance partner in over 600 sites across the country (and around 113 in Queensland) or by independent operators, who pay a fee for use of the Shell brand.

WEEKLY PRICE CYCLES

In Australian capital cities, petrol prices tend to move up and down regularly. This is due to intense competition. Service station operators set their own prices and discount prices to attract more customers.

Historically, the price cycle has worked like this: One service station reduced its price, lowering its profits but hoping to increase sales not only of petrol but other retail goods. The service station's competitors closely monitored each others prices and usually responded by also reducing their prices or discounting even further to attract more customers.

The downward price spiral continued until the prices reached an unsustainably low level where margins were squeezed to unprofitable levels. Once these low levels were reached, one or more service station operators put up their prices again, returning to earlier levels and the pricing cycle began again.

Price fluctuation provides motorists an opportunity to save. Companies selling fuel at a very low margin are the reason Australia has among the cheapest petrol in the world, both before and after tax. Most metropolitan markets have a weekly price cycle. To assist motorists in working out the best days to buy petrol in their capital city, Shell has a graph on its website (example shown below) of the average daily price of unleaded petrol in the last two months, at Shell supplied service stations.

Shell suggests people take advantage of when prices are low and buy petrol at those times during the week when price discounting is taking place. Shell suggests that when people see a low price they should fill up, regardless of whether or not they have a near empty tank.

Average Unleaded Fuel Price in Brisbane to Nov 27 2005



COMPETITION

As outlined above, Australia is a highly competitive market for petrol. Evidence to support this includes:

- Australians enjoying among the cheapest pre tax petrol in the OECD (as above);
- Petrol (excluding tax) has reduced in price in real terms over the last twenty five years;
- Returns to Australian refiner-marketers have largely been below the long term bond rate for the last twenty years and well below international benchmarks for the industry Shell made a profit of \$4 million in 2004 in its Downstream business in Australia!; and
- The explosion of retail discount schemes since Shell and Coles Express introduced the 4cpl discount scheme in 2003.
- The ACCC has examined the shopper docket arrangements (2003) and concluded that: 'shopper docket petrol discount arrangements were likely to result in lower petrol prices for consumers, generation of a culture of discounting, and increased non-price competition. In August 2005, in their brochure "Understanding petrol pricing in Australia", the ACCC concluded that 'developments in the petrol retailing market over the last two years indicate that these results have in fact occurred'.

ALTERNATIVE FUELS

Internationally, Shell is recognised as one of the largest blenders of transport biofuels and is or aims to be the market leader in several markets (e.g. in the US, Europe and Brazil). Shell is conducting research into technologies that convert agricultural waste to fuel, with its Canadian partner, Iogen. Shell is also engaged in research and development to develop Biomass-to-Liquid processes, in which a woody feedstock is converted into high-quality diesel fuel components. In this respect Shell has recently announced a partnership with CHOREN Industries. In Australia, Shell is drawing on this international experience to address some of the challenges that exist in the Australian market.

Shell supports the Australian Government's 350 ML target and has recently launched its first biofuels product in this market – Shell Optimax Extreme. The launch of the product in Melbourne, Sydney, Brisbane and Canberra has been highly successful, with ringing endorsements from the Acting Prime Minister the Hon. Mark Vaile, the Federal Minister for

Industry Tourism and Resources the Hon. Ian Macfarlane, Racing legend Dick Johnson and many others from ethanol producers to renewable fuels advocates. The fuel has also been publicly announced as the fuel for the AVESCO V8 Supercar series in 2006 - a major step forward for consumer confidence in ethanol blended fuels.

The fuel is a clear demonstration that Shell continues to lead the way in fuels in Australia (Shell Optimax Extreme is Australia's first and only "super-premium" fuel), but also a significant step forward for alternative fuels as Shell puts its brand quality guarantee behind ethanol as a reputable component in fuels.

Looking ahead, Shell believes the key elements in considering biofuels in Australia are listed below.

The market as the driver of which fuels to produce: Consumer demand for product is the best avenue to a sustainable market for any fuel. Consequently, consumer confidence in biofuels is a critical issue for development of the biofuels industry in Australia. Shell Optimax Extreme is a significant attempt by Shell to demonstrate to consumers that their confidence is warranted.

However it should be noted that ethanol is not the only alternative fuel option. Shell is actively involved in a number of alternative motor transport fuels including petrol, diesel, LPG, biofuels and, internationally, hydrogen. Shell believes customers should be able to choose the fuel which best suits their needs.

Biocomponent cost/price: Fundamental to the uptake of biofuels is the relative cost of biocomponent to fossil oil based petroleum fuel. Tax legislation and the competitiveness of imports will also play a significant role in this equation over the coming ten years. This issue was clearly identified in the Prime Minister's Biofuels taskforce report, which states that "...barring unexpected scenarios such as ongoing oil prices over US\$47 a barrel at a 65c exchange rate, ABARE analysis suggests that Australian biofuels will generally remain uncompetitive with conventional fuels without continuing assistance in the longer term".

Pricing of ethanol blended fuels must take account of the additional costs to be borne by fuel suppliers, distributors and retailers. These additional costs will depend on the overall strategy of blending and distribution, but will include distribution and storage costs, blending facilities, biotreaters (water separation from hygroscopic ethanol blended fuels and wastes), retail site upgrades (additional channels and improved storage) and marketing.

In light of this, the Federal Government's present tax strategy (production subsidy for ethanol) is a positive vehicle for promoting market entry. Shell believes that initiatives like that in Queensland, providing grants for supply infrastructure are also an important part of establishing the biofuels industry, providing some incentive for potential biofuels sellers to enter the biofuels market.

However, it is important to emphasise that whilst these initiatives can help promote market entry, they should not necessarily be used to promote an expectation of price discounting with ethanol blends.

Pricing of blends depends on:

- The relative price of ethanol and fossil oil fuel;
- The additional costs of supply infrastructure;
- The percentage of ethanol in the blend (ie at 10% ethanol, any cost saving on ethanol component has to be divided by 10 before arriving at a maximum possible saving across the price of the whole litre of fuel);
- RVP (Reid Vapour Pressure) penalties (ie the cost of adjusting base fuel) if there is no appropriate variation or waiver; and
- The tax regime (imports receive same treatment as domestic production and tax increases from 2011 through to 2015).

Of these, the price fluctuations of the commodities ethanol and petrol are the most difficult to manage. Future scenarios where companies are committed to ethanol blends and the ethanol price becomes more expensive than petrol represent a significant risk.

Infrastructure costs: There are significant costs associated with the blending, distribution and sale of biofuels – particularly ethanol.

Biocomponent quality: Shell has a world wide reputation built on quality fuels and will not compromise its fuels to its customers. Any biofuel components must be of suitable quality and the development and maintenance of appropriate Australian quality standards is vital for development of the industry.

Supply outlook: Australia is a net sugar and grain exporter, but a net transport fuel importer. Shell appreciates that these facts do lend themselves to some sentiment around supply security. However, Shell supports the view put forward in the Government's Energy White Paper, which found that there was no case for intervening in energy markets to address any perceived energy security problem.

In terms of volumes of biocomponent available, at least in the short to medium term, there will be challenges in securing volumes of supply as the balance between demand and construction of appropriate biocomponent producing plants is struck.

Other factors: The environmental benefits of biofuels are well covered in the Biofuels Taskforce report. The report clearly states that there are benefits and dis-benefits of using biofuels. E.g "Emissions of CO are reduced under E10 compared with neat petrol; there is little change in VOC emissions, and NO_x emissions are increased".

Also of importance and relevance is comparison to the effect of the Government's clean fuels programme. The continued tightening of Australian fuel standards has made a significant contribution to vehicle emission reduction and will continue to do so through to the last round of the present programme in 2008/9 (see Fig 5, page 101 of the task force report).

The Biofuels task force report has examined these matters extensively, and thus it is not intended to go into these issues here, suffice it to comment that the environmental benefits of biofuels are mixed and that the existing clean fuels programme is already making a significant contribution to reduced vehicle emissions.

Conclusion: Shell in Australia has consistently stated that for biofuels to become a sustainable and significant part of the Australian fuel mix, there must be consumer confidence in biofuels and a reliable supply of suitable quality biofuels at a competitive price.

CONCLUSION

Shell believes that the Australian petrol market is highly competitive as evidenced by the fact that before tax, Australian petrol is amongst the cheapest in the OECD. Australian petrol prices closely track international petrol prices as Australian refineries compete with international refineries and as Australia is a net importer of petroleum products.

Shell believes that there is a place for alternative fuels, such as ethanol blended petrol in the Australian fuel mix, but that the development and sustainability of these blends is dependant on a restoration of consumer confidence and a reliable supply of quality biocomponent (ethanol) at a competitive price.

Shell would be happy to provide any further information that will assist with this inquiry.

Shell has a comprehensive website at <u>www.shell.com.au/petrolpricing/</u> that covers a wide range of topics and clearly explains pricing including, for instance, differences between city/metropolitan and country/regional prices.