ECONOMIC DEVELOPMENT AND INFRASTRUCTURE COMMITTEE

Inquiry into Mandatory Ethanol and Biofuels Targets

Melbourne—6 August 2007

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Mr R.G. Bowden, Chief Executive Officer, Service Station Association of Australia.

The CHAIR—Welcome to the public hearings of the Economic Development and Infrastructure Committee's Inquiry into Mandatory Ethanol and Biofuels Targets in Victoria. All evidence taken at this hearing is protected by parliamentary privilege. Comments you make outside the hearing are not afforded such privilege. Mr Bowden, could you state your name and your business and position within that business for the transcript.

Mr BOWDEN—Sure. Ronald George Bowden. I am the Chief Executive Officer of the Service Station Association.

The CHAIR—That is in Melbourne?

Mr BOWDEN—No, that is based in Sydney. We are incorporated and based in Sydney.

The CHAIR—Thank you very much. Over to you, Mr Bowden. You have the opportunity to speak and then we will ask questions, or if you wish we can ask questions based upon information we have had provided.

Mr BOWDEN—I might make a fairly brief introductory statement because often I find in these sessions it is the questions and the issues that are on people's minds that are more important. We certainly are sympathetic with any organisation that seeks to further use biofuels and we certainly have been an advocate of such for many years. We have cooperated with the New South Wales Government and also with the Federal Government on these issues and we are delighted to see that there is an increasing amount of interest shown in all sectors in this side of fuel. From our perspective we look more at the long-term situation, rather than the short-term situation. The short-term situation, of course, is dominated in the public's mind by petrol prices. We have never come across an issue that is so emotive as petrol prices, with the possible exception of interest rates, and we are certainly not in a position to comment on those. Certainly the public interest, and therefore the media interest, which then translates through to a political interest in petrol prices, is unprecedented. It is unfortunate, therefore, that quite often when there are inquiries into—if I call it liquid fuels, transport fuels—that may have perhaps a longer-term benefit rather than a shorter-term benefit, a lot of the attention seems to be based on, 'What's that going to do to petrol prices next week?' The difficulty there, of course, is trying to set long-term policies that are good for the nation, good for society, but do not necessarily fix next week's household budget problem.

Having said that, these are things that you need to deal with and move on in developing good policy. From our perspective, good policy means an increasing amount, an increasing use of biofuels or renewable energy. Your brief is specifically biofuels and that is appropriate, but they are part of the renewable energy scene that in the longer term picture are really important. In fact I was reading in the *Financial Review* this morning that the US House of Representatives has passed a contentious bill to further increase and further support increased use of biofuels and renewable energy sources and that is a very desirable thing. When it comes to the business of how do you go about taking a policy and putting it into practice, that is where it gets hard. That is probably a lot of your brief and I must admit it is not an easy one. I do not think there is any magic bullet or clever solution that I could certainly put to you that is going to say, 'Look, here's the way'. Certainly one of the important things in trying to set a plan or a program to implement a greater use of biofuels is to try to do it in such a way as to minimise any adverse impacts on the market and that those adverse impacts do not lead to artificially or otherwise higher prices for consumers.

The reason we have to guard for that is because if biofuels by themselves were a cheaper or cheap or viable alternative to fossil fuels, to oil based fuels, then it would happen anyway. To get good outcomes for consumers, market-driven schemes, market-driven initiatives, are often the best. The fact that we do not have a market-drive implementation of biofuels means that

there is some barrier, and quite simply it is cost. The reason that we can do it now is that crude oil is at $70 a barrel plus and it is probably likely to continue to go higher. Ten years ago when crude oil was at $40 a barrel, no. You could not even have this debate because the economics were not there. The economics are there at the moment largely because of the Federal Government excise holiday, which under current policy is not evergreen – it starts to roll back in a few years time and you know all about that.

You then have a situation of what is the market, what is the marketability of biofuels going to be if that policy is enacted and it has to stand on its own two feet. I do not have an answer to that because, amongst other reasons, I have no idea what the price of crude oil is going to be in five years time, and I do not think too many people do. It is not going to be cheaper, although some people say it is going to be cheaper. For example, most of the major oil producers would say that their target barrel price for crude oil for future developments is $40 a barrel; in other words, a project has to stack up at $40 a barrel. You might say, 'At $70 a barrel that's easy.' But when you are doing long-term capital investments of many billions of dollars you have to allow for all sorts of eventualities. If the industry is saying that $40 a barrel is a realistic hurdle then there is a chance that at some stage it might be $40 a barrel and in that scenario the cost of producing biofuels would make them prohibitive. You then start to come up with these dilemmas about, 'This is what's good for the country, this is what's good for our economy, renewable, it backs out imports', it has so many good things, biofuels, but there is the potential for there to be a cost disadvantage to consumers that we all want to avoid. When it comes to setting policy these are the imponderables that you have to consider. Perhaps I might leave it at that and maybe we can go through some question and answer sessions based on some of the thoughts that you have already developed.

The CHAIR—Thank you, Mr Bowden. My first question goes to what you have outlined in your submission as two key items. The first you are talking about is the unjustifiably high retail prices that might emerge, and you have outlined that in your verbal submission. You also outlined in your written submission the importance of competitive supply and product accessibility. In your verbal evidence you have spoken quite a bit about imports. The other day we had evidence in relation to CNG and the lack of service stations that provide CNG for those vehicles that might be converted to use it. Have you any comment either on CNG in relation to its ready availability here in Australia and, secondly its distribution potential within your organisation's members?

Mr BOWDEN—Yes. Even though I have not prepared for that in terms of today's hearing—

The CHAIR—No, that is fine. If you want to take things on notice you are welcome to do that.

Mr BOWDEN—No, I am quite happy to respond to that. Natural gas, methane, is a very light gas as opposed to LPG, which is a C3 or a C4 hydrocarbon, therefore is a little more dense. The problem with the gas is, to make it a reasonable transportation fuel you need to turn it into a liquid. To turn it into a liquid you either need a very low temperature or high pressure or in the case of CNG, both. Now, LPG, because it is denser can be handled through established technologies. You have seen the LPG bullets at service stations, in backs of taxis and things like that, and that is a viable fuel in terms of handling. Methane, which is a lot lighter, requires much higher pressures and lower temperatures to convert it into a liquid. That means the tank thickness, for example, has to be a lot higher. You may have seen photographs of CNG liquid carriers, seagoing ships that take the stuff overseas. An LPG unit tends to be a bullet that is long and round. That design of cylinder is not strong enough for the very high pressures required for CNG. CNG tends to be in spheres because that is the greatest mechanical shape you can get out of shape. That is what you would have to think about in terms of the motor car.

The technology is nowhere near refined enough for it to become widespread as a car fuel. It is possible you could do it for large units—I think large transport, trucks, buses—where you have the size and the space and the powerful engine to be able to carry these very heavy fuel tanks, but in automobiles I cannot see CNG really matching it. Even now with LPG, the smaller four-cylinder cars, which are increasingly a higher part of the nation's fleet, are not really suitable for LPG because of the size and the weight of the tank. CNG is going to exacerbate that even more.

The CHAIR—Have you any comments in terms of distribution because evidence we received earlier in this inquiry related to the fact that not enough service stations had distribution points to enable more of the fleet to be using CNG.

Mr BOWDEN—Yes. This is a chicken and egg thing. A service station is a business and it is a supply and demand business and it has to make a profit. If nobody is going to invest in the capital—and for CNG it would be substantial, unless there is going to be a substantial market for it and it is not on the drawing board.

The CHAIR—Thank you.

Mr THORNLEY—I had a related question about a mandated ethanol blend and what the capital investment implications of that might be for service stations in terms of their in-ground infrastructure and so on and whether that was a concern to station owners.

Mr BOWDEN—It is not a concern in the current environment because of the grants that are available from the Federal Government, and they have recently been extended to allow more and more sites to come on board. That is an initiative we welcome as part of the Federal Government's commitment to biofuels targets, but we would not be comfortable with, say, a mandated approach across all service stations because there would be some cases where that service station really is not appropriate and yet that service station operator would be faced with a substantial capital cost burden with little chance of being able to recover that from the market. It is not surprising therefore, as in the case of the Federal Government, there is seen to be a desire for a bit of a policy shift within the industry that some financial incentive be provided to kick-start the conversion or the availability of those measures.

Mr DAVIS—I want to pick up the second-last point in your letter:

> Finally, as the oil supply and retail industry in Australia is truly national and state based conditions and product specifications that are inconsistent with other states place burdens on the industry, create extra layers of expense which invariably lead to higher prices.

How much in terms of higher prices? How much is it—

Mr BOWDEN—That's a very difficult one for me to say—

Mr DAVIS—10, 20, 30 per cent.

Mr BOWDEN—You will probably be taking submissions from the oil industry and they are in a better position to give answers to those layer-type questions. We are talking about a few cents a litre. We are not talking about 20c or 30c a litre. The more universal the quality issues are, the specifications issues are, the more the industry is free then to divert supplies in an optimal sense, both in terms of cost and in terms of availability. Adelaide is a case in point because it is totally reliant upon shipping and there can be delays in shipping, there are times when the market goes a bit haywire. That will not happen here in Victoria or in New South Wales where there is strong refinery supply.

Mr DAVIS—You also say:

> However, the issues of competitive supply and product accessibility would remain and would need to be satisfactorily dealt with if excessive price rises are to be avoided.

What do you mean by 'excessive'?

Mr BOWDEN—One way to guarantee that prices go up is to mandate that a certain thing must be provided because then an oil company or oil companies will then say, 'For us to continue business here in, say, Victoria, we need to go and buy some ethanol'. You go around to the ethanol suppliers and they know very well that the oil companies have no choice so they can write their own ticket.

Mr DAVIS—Then it might be 10 or 20 per cent or something.

Mr BOWDEN—There is a chicken and egg here. Eventually if the market is strong enough, then enough players in the ethanol side or the biodiesel side will come into the market because it is a good market. In that transition period you run the risk of there being a distort on that supply-demand balance. You get good outcomes when you get a good balance, being supply and demand, both at the wholesale and the retail side. The partners are lining up fairly well between the oil companies and the consortia that are producing ethanol and biodiesel. The more players you have then the better shape you are in to introduce a mandated arrangement because then you have proper competition at that wholesale level. Other people would say that the good thing about mandating is it provides a market environment for people to invest in, and the more biofuel suppliers, but then that takes maybe two or three years to get off the ground and the market can be distorted over that period of time. Nobody is going to say, 'Thanks very much for putting my petrol prices up because of some benefit we're going to have in three or four years time'.

Mr DAVIS—To complete this little run of things, and picking up on something you said a little bit earlier, you talked about mandating and what it would mean if every station were mandated, or if stations were required to supply in some way. You thought that would have an adverse effect on some stations. Do you want to detail what that would mean for those individual service stations?

Mr BOWDEN—Depending upon the circumstances of individual service stations, the cost of converting one tank to be able to handle ethanol fuels, depending on the concentration et cetera it could be as high as $20,000. If a new tank had to be put in because it was an additional grade, you could be talking about $70,000, $80,000, $90,000. It varies from situation to situation about what that service station would have to do to be able to take another grade of fuel, if it were another grade of fuel. On the other hand, if all fuel was to be, say, two per cent ethanol—all unleaded petrol was to be two per cent ethanol—then it is arguable there that you may not have to have expenditure based on required clean-up tanks to get the stuff ready for ethanol blends. We tend to work on the 10 per cent ethanol blend because the industry so far Australia-wide has gone down that path of introducing a separate grade of biofuel that is called E10 rather than a lower amount. If the industry itself would prefer that if a target of, say, two per cent for a region or a state were to be met, they would rather meet it by selling the appropriate amount of E10 as a separate product rather than having two per cent rigidly in every drop of ethanol.

Mr DAVIS—That mandating might add a lot of costs. A lot of service stations are quite marginal businesses, they face enormous cost pressures. Would it impact on those family businesses?

Mr BOWDEN—It would. The rate of service station closures in Australia in the last

three years has doubled, versus the trend prior to that. The last three years coincides with the entry of supermarkets into petrol retailing. The damage—and that is my word—that the supermarkets do is, with their shopper docket they basically are able to set up a net price to the consumer that the independent can never match because the independent can not offer a similar shopper docket discount. As a result, the supermarket share of the retail market overall is somewhere in the order of 50 per cent, and yet they only have about 15 per cent of the number of outlets. What that means is that there is a large number of service stations competing for only half of the market. Their volume throughputs are down; many closures. In many cases those independents can not compete on price. What I am saying is, they have already stripped their expenses as narrow as they can. Any further impost is likely to tip them over. In many cases, service stations are being sold for the land value. As you increase imposts, unless there is going to be a big bust in land prices, as you increase the impost you are going to put more of those people over the edge. There are now many places in most cities that I talk to, certainly in Sydney, where you can drive for half an hour down major roads and not pass a service station, let alone have a choice of brand. You are not going to get new builds in established areas. You are only going to get new builds in developed areas out on the fringes. Oil companies are not doing it any more. Oil companies are not building new service stations. It is only a developer who thinks that there might be money in building a service station there.

The CHAIR—Thank you. Mr Crisp.

Mr CRISP—Ethanol got off to a bad start in the consumer's mind some years ago with a lot of publicity about engine damage and so on. Have we progressed past that or is that still lingering with us?

Mr BOWDEN—That is not an issue any more. That was a furphy. To be brief, ethanol started to be introduced in New South Wales on the south coast, Illawarra, from about 1992 onwards. Up until a couple of years ago there were no regulations that were limiting the amount of ethanol. It was quite legal for ethanol quantities to be as high as 25 per cent, and often they were. The problem with that is because there was no excise on ethanol, those merchants were able to significantly undercut the traditional market. The traditional market responded by giving it a bad name. In fact there was no evidence from any body that showed that there was any damage, but neither the NRMA nor the Motor Traders' Association of New South Wales had had any report of any damage to a vehicle because of high amounts of ethanol. Ethanol is sold at 25 per cent or thereabouts in Brazil for many years in the same cars that are riding around our streets here. That was an exercise in protecting the market. Those same organisations are now fully behind the ethanol product and are heavily engaged in buying the product.

The CHAIR—That is very interesting. Mr Thornley.

Mr THORNLEY—Yes. I am interested in your observations about E85 as well as mandated E10—and there is a further chicken and egg challenge there because you have to get the vehicle manufacturers obviously to be manufacturing E85 optimised engines. But I am interested in how the service station owners would perceive that as a longer-term strategy moving to try and have a line of supply into E85 and E85 compliant engines and a whole set of separate—

Mr BOWDEN—We think there is tremendous potential for that for a number of reasons. If you look at, say, two per cent, if we call it E2, then effectively that means every drop of all the oil company supply has to be mixed with two per cent ethanol and away you go. At 10 per cent, which is the industry standard at the moment, you still require oil company involvement because 10 per cent of it is ethanol and 90 per cent of it is petrol. Where does the petrol come from? It comes from the oil companies. Who controls the distribution? The oil

companies. What is their commercial incentive? None. They do not make ethanol. There is no commercial incentive for them to produce ethanol. But if you have a product availability that was almost non-reliant on the oil companies, which in the case of E85 that is what you are talking about, you are then talking about something that can operate completely independent of and against the oil company. There are challenges, but those challenges technically have been solved because E85 was commonly used in Brazil and there are a lot of cars in the states, in the US, that can run on E85. They are called—I had the name on the tip of my tongue. They are multipurpose vehicles.

There are engine management systems that can now automatically adjust to whatever level of ethanol you put in there. There are some running around in Australia now. There is quite a few in the states, even though there is not a lot of E85 available in the states. The benefit in Australia—and I am told that on a large scale basis it costs an owner around about $200 to have those flexi-fuel vehicles equipped. Now, that would have to be on a tooled-up factory basis; I am not saying that that could happen straight away here in Australia. Again you would need to—and you will be talking to FCAI on this issue, but the advantage to Australia is that you can then encourage a local industry. Let us say in some rural part of Victoria you could encourage a producer to produce E85 and market it into a local market distribution with a local distributor. With E85 available for flexi-fuel vehicles, you could then encourage one or two of the car dealers in that town to make E85 vehicles available. There might be a cost surcharge in setting this up, but then to come back to an earlier comment, without some financial assistance it is difficult to see biofuels really locking in by themselves on their own two feet financially. You could have a government department based in a regional area that fitted this bill, having their vehicles as flex-fuel vehicles so you are starting now to create a market. You are starting to create a five year, for argument's sake, starter kit to get an industry started. Then there are various industries, co-ops, local initiatives that could pick up on that and start to grow. You do not have to have a state wide shift. You do not have to have big oil companies on board. You can create a viable alternative.

Mr THORNLEY—Following up on that, from the service stations' point of view—and obviously a huge amount depends on the scale and volume of the station and how many tanks they have, and I suspect on whether they are an oil company owned station or not. But I am interested in your thoughts on, at what percentage volume of the fuel market would we start seeing a decent number of service stations being willing to have an E85 supply in one of their tanks? I am presuming they sell higher volumes out of some tanks than other tanks.

Mr BOWDEN—Yes.

Mr THORNLEY—I do not know how they think about all that.

Mr BOWDEN—Put it this way: you would probably have to have at least 10, 15 per cent of the market before you are going to get that investment; and people prepared to make the investment. To try to run it out over a large area like the state of Victoria of New South Wales would be a very difficult task, but the opportunity—

Mr THORNLEY—(indistinct) atrocious.

Mr BOWDEN—But the idea of setting up little local area markets because there is a natural attraction from there does have some merit.

Mr CRISP—Perhaps as a quick closing comment, we have focused on ethanol; any comments on biodiesel?

Mr BOWDEN—I think biodiesel has even greater potential because there is such a demand for off-road use in farms and mining. Most of the use is in a fairly small area. We

think of a motor car, we think of ethanol. We think of a motor car having the flexibility to drive all over the place, and so it should. But if you are talking about farm machinery, if we are talking about mining, you are talking about areas where—taking place in a small area. There is a huge market for entrepreneurial biodiesel manufacturers to produce modules that go on skids that can be put on the back of a truck and taken from farm to farm to produce from the farmer's own stock enough biodiesel to run that farm's machinery for the whole year and then they go off to another farm. There is tremendous potential for biodiesel. The biggest thing with biodiesel is for the industry—that is the fuel industry—to work with the engine industry to make sure of proper fuel compatibility at various concentrations with the engine technology; in other words, warranty issues et cetera.

The CHAIR—Thank you. I have a final question, from the retailer's perspective is there any profit margin variation between them selling biofuels and conventional petrol?

Mr BOWDEN—Generally speaking, no. The margins on fuels are mostly quite low. Inner cities around about 3c a litre. In the country it can be probably as high as maybe 5c a litre. If they are going to have a fuel it has to provide those returns to them, otherwise it is not worth having it. That can be done by subsidising the raw material coming in or by a higher price at the pump if the market can bear the higher price. We have already seen that the market, while it is very keen to see green fuels, is not prepared to pay a premium for them. In fact the only reason that we have a higher penetration of E10, which we do, is because the excise—a relief that equates to about 3c a litre on E10—is now part of the industry. When it was not, when it was on par, there was very little penetration. All regulators need to be aware that while there is probably sentiment of support for environmental solutions, generally speaking, the consumer is not prepared to pay for them.

The CHAIR—Thank you very much.

Mr BOWDEN—Thank you very much for giving me the opportunity to speak this morning.

Witness withdrew.

Hearing suspended.