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**SUBMISSION BY
BP AUSTRALIA PTY LTD**

ON

**THE PETROLEUM RETAIL LEGISLATION
REPEAL BILL 2006**

TO

**SENATE ECONOMICS LEGISLATION
COMMITTEE**

APRIL 2006



SUMMARY

BP fully supports the repeal of the federal Sites and Franchise Acts and the introduction of an Oilcode (to provide the protection for those not currently covered by the existing legislation).

The Acts only cover the four refiner marketers and, perversely, do not apply to the operations of the dominant players in the retail market ie. the supermarkets.

Market reform will:

- Be good for the long term competitiveness of the market
- Be good for the consumer
- Be good for small business
- Improve security of supply
- Encourage investment, including in biofuels
- Reduce complexity and red tape

Market reform is well overdue as the industry has changed substantially since the Acts were introduced in 1980. They are no longer relevant and promote inefficiencies and inequities.

There are major downsides for the industry if reform does not take place.

Both sides of Parliament have acknowledged the need for reform for over a decade. Major independent studies by organisations such as the Productivity Commission and the ACCC have advocated reform.

It is time for reform of this key sector of the economy.



1. THE RETAIL PETROLEUM INDUSTRY HAS CHANGED DRAMATICALLY SINCE THE SITES ACT AND FRANCHISE ACT WERE INTRODUCED IN 1980.

1.1 The Rationale for the Acts has disappeared or become irrelevant

Both Acts were designed to stop price discrimination, limit the (then) perceived impacts of vertical integration, and provide tenure. These issues have been resolved or, in the case of vertical integration, become a furphy.

1.1.1 A more transparent and fairer pricing system; Vertical Integration now irrelevant

In the 1980s and early 1990s, Federal Government regulation was ubiquitous at all stages of the oil industry eg. crude oil absorption and allocation, crude oil pricing, refinery product exchange arrangements, maximum wholesale price setting, distribution networks and freight rates. From 1988 the Government started to unwind this complex web of regulation and market intervention as it acknowledged that the (then) policy settings were ineffectual and often counter-productive to broader national energy and competition policy objectives. The winding back of government intervention has seen the increase in transparency in pricing which has been industry driven. BP has played an important role in these changes.

There is now much clearer, transparent market information for all participants at each stage of the oil industry ie. from international crude oil prices through to retail pricing.

- At the refinery level, BP led the break up of the volume based product exchange arrangements between domestic refineries with its unilateral action on commercial buy/sell arrangements in 2002.
- At the wholesale level, BP was first to introduce a terminal gate price (TGP) by fuel grade and by terminal, making this available to all parties that met minimum safety requirements. BP currently sells approximately 4 billion litres of fuel per annum at TGP (70% of its volume). BP posts TGP prices on the internet and this transparency is accessed by many in the industry and assists customers making informed choices. Furthermore, given the majority of sites are independently owned, there is strong competition for these customers in the wholesale market. Oil companies not only compete with each other but with product importers for this significant section of the market.
- At the retail level, Australia is recognised in independent surveys as one of the most competitively priced fuel markets in the developed world.

It does not make economic sense that the oil companies would want to drive out the independent sector who are their biggest and best customers. To our knowledge, claims of predatory pricing against the oil companies have never been proven, despite numerous ill-informed allegations. The ACCC and TPA are the appropriate body/Act to deal with such behavior if it were to occur, as it is for every other firm or industry in Australia. Adding to all of this, Oilcode will require wholesalers to:

- (a) push a TGP; and
- (b) to offer the TGP (or lower) to all potential buyers.

With all of this, backed by a stronger Trade Practices Act, there is now a very fair basis of pricing for all competitors.

There is now very real price competition at each stage of the product supply chain which is based on greater transparency in price information and/or the option of accessing imported product. The latter option, of product imports or 'market contestability' by independents, should not be underestimated. This factor, and the break down in the old government mandated volume based refinery exchange arrangements, effectively means Australia enjoys a fully de-integrated product market - from refinery gate to retail pump. Consequently concerns about vertical integration are anachronistic and now rendered irrelevant. It is even less relevant for BP in most states in Australia as we have to purchase product from third parties – be they imports or domestic refineries - like anyone else.

1.1.2 Stronger tenure provisions for all

There is now a stronger legislative framework compared to when the Acts were introduced. More specifically, a stronger Trade Practices Act and further amendments are under consideration - which will affect all industries, not just the retail fuel industry.

To provide additional protection for small business, the oil industry has been trying for many years to agree and introduce an effective Oilcode – one that applies across the industry and applies some protections to independents. The Minister for Industry, Tourism and Resources has achieved this and, in doing so, has agreed to numerous concessions.

1.2 The structure of the industry has changed

Both Acts were designed implicitly, if not explicitly, to impede structural adjustment in the industry. For this purpose they have failed. Since 1980, the shape of the industry has changed dramatically despite the Acts. The number of integrated refiner marketers has reduced from nine to four. The number of retail sites has declined from around 20,000 in 1980 to about 6,500, and may continue to decline as a result of the continuing forces of structural adjustment in the industry, not as a result of market reform.



The 1980s and 1990s saw more independents enter the market; the 1990s saw the introduction of multi site franchising (MSF) arrangements by most of the players. Following on from a poor profit result in late 1990s, BP had little choice but to seek efficiencies such as multi site franchising, or leave the market. Single site franchising was no longer sustainable for either BP or its single site franchisees.

As part of the move to MSF, BP also accelerated the downsizing of its company owned network and started to foster its dealer owned network. Most BP sites were sold as going concerns to independent operators, quite a few of whom were the incumbent single site franchisee.

The 1990s also saw the rise of convenience store concept in the sector. The industry is now reliant on non-fuel sales for a significant portion of revenue – a significant change in the business model which is often not appreciated by those outside the industry.

However, since 2000 the pace of change has accelerated with the entry of the two major food supermarketers who are now the dominant players in the retail market. They have captured about a 50 per cent market share and operate between them about 1100 sites. The basis, and the sustainability of their success is debatable. However, what is beyond question is that the two new dominant players in this sector have been totally unencumbered by the Sites or the Franchise Acts when they came to pursue their particular business models.

This is a freedom and flexibility not available to all refiner marketers. Market reform will merely allow BP to compete on the same basis as the supermarkets and all other competitors who are completely outside the scope of the current discriminatory legislation. Competition from the supermarkets is not only on the fuel side of the business, but also in convenience store sales - the only growth area in the industry. The supermarkets already have a significant competitive advantage with their marketing and logistics position and scale in the procurement and upstream food and grocery operations.

The real irony is that two companies can operate an unlimited number of convenience stores while BP can only operate only 87. If the industry were to be regulated today, starting from scratch, it would be seen as absurd and discriminatory to impose regulation only on some players.

2. THE OUTCOME OF ALL OF THIS IS THAT WE HAVE A REGULATORY FRAMEWORK TODAY THAT IS:

2.1 Inequitable

Structural changes in the industry mean the Acts are no longer effective or relevant. The effect of these regulations leads to discriminatory impacts where it covers some players (refiner marketers) but not others. The two dominant supermarkets can freely operate between them about 1100 sites. BP can only operate 87.

The supermarkets have every right to compete in this industry and have added a new competitive dimension through their capacity to cross subsidise from other parts of their business. This of course makes competition even tougher and all the more reason for refiner marketers to be able to compete on the same terms.

2.2 Inefficient

The current Acts lead to undue complexity and do not allow BP to choose the optimum business models to compete most efficiently in the market place in today's environment. Inefficiencies and the resultant imposition of additional costs and bureaucratic red tape – an issue currently before government – ultimately have to be passed on to the consumer. Removal of these inefficiencies can only improve the cost base, promote innovation and more competition, provide more flexibility (eg. with biofuels) and have a positive outcome for the consumer.

2.3 Discouraging investment

The Acts add to sovereign risk by discouraging investment in all stages of this critical energy infrastructure in Australia. Globally, BP sees value in operating an integrated supply chain, ie. a refinery servicing its retail and commercial markets. The Sites Act discriminates against refiners which is to the disadvantage of Australia in terms of investment in refining, industry policy and energy security. In industry policy terms it amounts to reverse protectionism by hindering domestic investment.

2.4 Failing to protect many players

For BP, the current Acts only protect the few franchisees that are left in the market. Under Oilcode their rights and protection remain. The Sites and Franchise Acts do nothing for the many independents, who operate the bulk of the industry's sites at present. Oilcode provides protections for these sites that experience little protection now. This can only be good for competition and the small business sector of the industry.

2.5 Failing to produce the best competitive outcome for the consumer

The only way that markets will be fully competitive is if BP and the other oil companies are allowed to compete on the same regulatory basis as other players. All of these inequities and inefficiencies mentioned above mean that the consumer is denied the best offer, price and choice.



3. THE REFORM AGENDA HAS BEEN THOROUGHLY DISCUSSED

There is a broad consensus amongst parties on the need to progress the reform agenda. While some individuals are not completely satisfied with Oilcode, all agree it is a significant improvement on the current regime. Oilcode is a significant concession to the proposal that the industry should be completely deregulated and rely on generic regulation. Hence the Government's proposal is a balance of interests and very much in the vein of regulatory reform - and not deregulation. All parties have agreed to a 12 month review of Oilcode operation.

Opposition to reform has included seeking collective bargaining rights. Legislative changes are now progressing to allow this. Other opposition to reform relates to prohibiting below cost selling and requiring all buyers to purchase at the same terminal gate price. Aside from whether these are anti-competitive, such issues are generic and rightly come under the Trade Practices Act (which we understand is being reviewed in its own right). It is therefore appropriate it is treated separately to the reform debate.

As well as support for reform from the majority of stakeholders, the arguments for reform have been recommended by an array of major independent studies such as those of the Productivity Commission (in 1994) and the ACCC (in 1996) and from those parties again, and several others since then. Both the Coalition parties and the ALP have also publicly called for reform. From a consumer viewpoint, we understand that the peak motoring body, the Australian Automobile Association, supports reform, as it did when last considered in 1998. In fact, most stakeholders have publicly supported reform.

4. HOW MARKET REFORM WILL IMPACT BP

Market reform will:

- Be good for the long term competitiveness of the market
- Be good for the consumer
- Be good for small business
- Improve security of supply
- Encourage investment, including biofuels
- Reduce complexity and red tape



By levelling the playing field BP, and its business partners and customers, will be able to compete more effectively and efficiently with the supermarkets and in their own market segments. This move will benefit the consumer through more competitive pressure on prices, improved service and offers, together with greater choice (eg. a market of supermarkets, oil companies, franchisees and independents).

BP's plans in the event of market reform occurring are in a separate commercial-in-confidence submission.

5. IF REFORM DOES NOT PROCEED THE RAMIFICATIONS ARE SERIOUS

5.1 In the short term BP will have no incentive to invest

BP will have no incentive to invest in facilities, offer enhancement and customer offers adversely affecting our ability to compete in the industry.

5.2 In the longer term BP's viability in Australia would be under threat and we believe this would not help the country's security of supply

If reform does not proceed it is likely to lead to further market share gains for the two supermarkets. This would place further pressure on the long term viability of the other oil competitors (particularly for BP and Mobil who are not aligned with the major supermarkets). If BP exited the domestic retail fuel market it would raise a question mark over our Perth and Brisbane refineries - BP does not operate refineries that are not in service of its retail customers and businesses. This also has implications for energy security and our innovations in biofuels and future clean fuels. For example, it has been oil companies like BP rather than supermarkets that do and drive this investment. The current legislation clearly disadvantages those who operate, maintain and invest in the key national supply infrastructure assets such as refineries, pipelines and major terminals – the critical elements of Australia's energy security now, and in the future.

5.3 The consumer will not benefit

The industry may in time develop to a point where there is no strong retail competition to the two supermarkets - this cannot be in the consumers' or Australia's best interests.

5.4 Small business will be hurt

Small business in the industry will be denied protections which they currently don't have. Oilcode provides much needed protection for small business. From BP's point of view, the ability of our distributors and independents to compete will continue to suffer.

5.5 BP's capacity to develop future biofuels will be constrained

BP has led on commitments to biofuels (see Attachment 1). But the capacity to develop and fund further biofuels investments would be constrained. One of the challenges in biofuels, especially ethanol, is the risk involved in the marketing of the e10 products. These risks can be significantly reduced if BP has a sufficiently large platform of directly operated sites from which to launch the new fuels. This would enable us to take a further step along the biofuels route. It also reduces the risks (and access to funding and markets) for existing and potential biofuels producers. It is of no benefit to them if we commit to long term supply contracts and, because of the absence of market reform, have our viability threatened. The current regime works against all Parties' policies in this regard.

5.6 BP's corporate citizenship efforts may have to be scaled back

In recent years BP has:

- Led the way on the introduction of Clean Fuels in Australia, eg. ultra low sulphur diesel (ULSD), hydrogen bus trial in WA, BP Ultimate and now renewable based fuels.
- Led the way on material commitment to biofuels. On 31st March this year BP announced it had signed 2 contracts and a Memorandum of Understanding to provide the market with over 200 million litres of biofuels per annum by 2008. That announcement signals the early delivery by a single company of over half of the Federal Government's national target of 350 million litres by 2010. Market reform will give BP greater confidence in an even greater biofuels investment.
- Led the design, development and deployment of Opal petrol into indigenous communities to fight petrol sniffing. BP initiated this work based on our Values and our capacity to innovate.
- Led the way in developing Global Choice to offset greenhouse gas emissions, which is a world first program to offset carbon for the transport sector. We have seen this program adopted by others.
- Led the way in developing an indigenous employment program in our retail network.

Ironically, BP has been disadvantaged in our central business of fuel retailing. We have one hand tied behind our back. The only foundation for the above to be sustained is in an environment of mutual benefit. This will not be the case if BP continues to be discriminated against in terms of its ability to compete.



CONCLUSION

The retail fuel industry has changed significantly since the Sites and Franchise Acts that were introduced in 1980. They are now no longer relevant and promote inefficiencies and inequities.

From an industry point of view market reform will:

- Be good for the long term competitiveness of the market
- Be good for the consumer
- Be good for small business
- Improve security of supply
- Encourage investment
- Reduce complexity and red tape

The impacts for BP if reform does not occur are:

- BP in the short term will have no incentive to invest
- In the long term BP's viability in Australia is under threat
- BP is limited in committing to future biofuels investment
- BP's corporate citizenship efforts may have to be scaled back

And importantly, in the broader marketplace:

- The consumer will not benefit
- Small business will be hurt

Market reform has been pursued by both sides of Parliament for over 10 years. The arguments in support are overwhelming. It is time to proceed with reform.

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ATTACHMENT 1

31ST MARCH 2006

PRESS RELEASE

BP brings biofuels into the mainstream

BP Australia today announced it has signed two contracts and a Memorandum of Understanding to provide to consumers over 200 million litres of biofuels per annum by 2008. The announcement signals the early delivery by a single company of over half of the Federal Government's national target of 350 million litres.

BP President, Mr. Gerry Hueston said "BP will invest in refining and distribution infrastructure and secure product to enable biofuels to play a role in the future of Australia's petroleum supplies. This announcement is the culmination of many years of work by BP and demonstrates our ability to deliver cleaner fuels to Australian motorists."

"In delivering these initiatives we would like to acknowledge the support of the Federal and State Governments," said Mr. Hueston. "This work signals a unique change to the composition of Australia's fuel supply and is evidence that much progress is being made towards the Federal Government's biofuels target."

The initiatives include:-

- Investment to allow production at BP's Bulwer Refinery in Queensland of 110 million litres per annum of biodiesel through a new technology, with the fuel being made available to the market from 2007. The biomass feedstock has been secured through a contract for supply of tallow from Colyer Fehr Tallow Pty Ltd.
- A Memorandum of Understanding with Primary Energy Pty Ltd to purchase the entire output from a new ethanol plant to be constructed by Primary Energy in Kwinana, Western Australia. This would see the production of 80 million litres of ethanol per annum to be sold across Australia as e10 from 2008.
- A contract for purchase of 23 million litres of ethanol from CSR over 2 years. The ethanol will be purchased from CSR's Sarina distillery near Mackay and blended to produce e10 that will be sold into the Queensland market later this year.

"BP believes biofuels have an important role to play in strengthening Australia's security of supply," said Mr. Hueston. "However, the role of sound policy settings cannot be underestimated. The Government's Energy White Paper and introduction of legislation for petroleum market reform are steps that will result in far greater confidence in investing in the future marketing and distribution of these products."

ENDS

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Notes to editors:

Biodiesel derived from hydrogenation of tallow

- At its Bulwer Refinery, BP will produce approximately 2 billion litres of diesel per annum containing a 5% component of biodiesel derived from tallow using new technology.
- BP will use a new, internally-developed technology which allows tallow to be converted to biodiesel using hydrogen.
- The Bulwer Refinery is particularly well suited to this technology.
- The biomass-feed, which will initially be tallow, will be sourced from Colyer Fehr Tallow Pty Ltd and other local sources.
- The fuel from the Bulwer Refinery will be made available to all current suppliers and will meet the relevant Australian specifications for conventional diesel, providing an equivalent level of performance to users.

Ethanol and e10

- The e10 fuel blended in Western Australia will be sold at BP's sites in Perth and to other suppliers in Perth and across Australia from 2008.
- The ethanol produced at the new plant in Kwinana will use approximately 200,000 tonnes of Australian wheat as a feedstock. WA currently exports approximately six million tonnes of wheat.
- The Kwinana plant will also generate renewable electricity from biomass as an integral part of its process. Together, the renewable fuel and renewable electricity will result in a reduction in greenhouse gases to the order of 200,000 tonnes per annum.
- BP e10 delivers a similar engine performance to that of traditional petrol, with the added benefit of lower emissions.
- e10 fuel is not new for BP; in fact, BP commenced marketing e10 in Queensland in 2001. Fuel ethanol blends have been successfully marketed by BP in the United States under the Amoco and ARCO brands since the mid 1980s.
- BP has now sold more than 20 million litres of e10 in Australia without recording a single vehicle complaint.
- An updated list of BP locations at which motorists can purchase e10 is available online at www.bp.com.au.

General

- Biomass typically refers to plant materials and animal waste used as a source of fuel. Examples include tallow, sugarcane, corn, wheat, sorghum, beets, vegetable oils, wood and straw.
- BP Australia is at the forefront of companies working to significantly improve the environment through the introduction of clean fuels.
- BP has a global commitment to deliver cleaner fuels and already offers low sulphur and low benzene products in over 130 cities worldwide.