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4 December 2008

Senator Mathias Cormann
Chair
Senate Select Committee on Fuel and Energy
PO Box 6100
Parliament House
Canberra ACT 6100

Dear Senator Cormann

Re: Submission to Senate Select Committee on Fuel and Energy

BP Australia Pty Ltd (BP) welcomes the opportunity to assist the Senate Select Committee with their Inquiry into Fuel and Energy. Please accept this letter and accompanying attachments as an initial submission to the Inquiry.

As the Committee is considering a range of issues significant to fuel and energy in Australia, BP understands that the terms of reference for this Inquiry are necessarily quite broad. In this submission BP provides the Committee with our view on fuel and energy policy principles in general, and attaches several submissions that BP has made to recent inquiries on fuel and energy related issues.

In Australia, BP is a major contributor to some of the country's largest resource developments. For example, BP is a 1/6th participant in the North West Shelf Venture which produces oil, condensate, LPG and gas both for use in Western Australia (via pipeline) and for export (as LNG). BP is also a participant in both the Browse LNG project and in gas fields in the Greater Gorgon, both of which are currently being progressed towards development.

BP is a fully integrated refiner-marketer of petroleum products. BP imports both crude oil and refined products, operates two key refining facilities, stores product in terminals, sells products at the wholesale and retail levels and manages a distribution network. BP's operations cover the full range of products, including bitumen for our roads, jet fuel to supply the military and civil aviation industry, and diesel, which is used primarily in the resource sector, as well as the full range of fuels for road use by motorists.

BP is also one of Australia's leading suppliers and servicers of photovoltaic (PV) panels and has been actively evaluating options for the deployment of low carbon power technologies.

Fuel and Energy Policy Principles

BP believes the ongoing supply of secure, reliable and affordable fuel and energy products will rely on competitive international and domestic fuel markets operating within a stable government policy framework.

The volatility in world energy prices in recent times has primarily been determined by supply and demand factors - specifically strong demand and tight supply and, recently, the impact of the global financial crisis. Higher prices indicate that more investment into fuel and energy infrastructure is needed to increase supply to be able to meet demand levels. The movement in prices over recent weeks also illustrates the impact of international and local market forces and exchange rate movements on local petrol prices.

Government policy that provides stable regulation, removes barriers to investment, improves access to resources and modernises tax structures will encourage this necessary investment in energy security. New policy development should be fair and equitable, and not materially upset the basis on which previous investment decisions were made. Incentives offered by the government should be carefully targeted to align with government priorities such as encouraging the investment in cleaner fuels.

The past decade has seen the emergence of climate change as a major environmental, economic and social issue and the need for policy certainty to allow business to manage the associated risks affecting their operations and to allow future investment in Australia's energy infrastructure to be secured. The Government's Carbon Pollution Reduction Scheme, with some modifications, has the potential to become an effective policy tool to guide Australia's transition to a competitive, low emissions economy.

Australia's energy future will be a product of four key drivers of change in energy: growth in the demand of primary energy, the operational challenge to provide energy supplies to fulfil that demand efficiently and competitively, the need for secure energy sources and concerns for the environment.

The solution to these challenges will lie within the efficient and timely development of energy resources, efficient functioning of the energy market, driving and harnessing the continuous improvements and efficiencies provided by technology and the application of a balanced energy policy to shape the regulatory framework within which everything operates.

Submissions to Recent Fuel and Energy Related Inquiries

BP has made submissions to government inquiries on numerous fuel and energy related issues, and we attach the following submissions to this letter to assist the Committee with their inquiry.

- Submission to *Henry Tax Review* (October 2008)
- Submission to *Carbon Pollution Reduction Scheme Green Paper* (September 2008)
- Submission to *Senate Inquiry into National Fuelwatch (Empowering Consumers) Bill 2008 and National Fuelwatch (Empowering Consumers Consequential Amendments) Bill 2008* (August 2008) and *Supplementary Submission* (September 2008)
- Submission to *Inquiry into the Price of Petrol in Australia* (August 2006) and *Supplementary Submission* (September 2006)
- Submission to the *Inquiry into Australia's Future Oil Supply* (May 2006)

- Submission to the *Inquiry into the Provisions of the Petroleum Retail Legislation Repeal Bill 2006* (April 2006)

These submissions detail BP's operations in the energy market, as well as fuel product pricing, emissions trading and future fuel supply in particular. Also attached is a speech delivered by Iain Conn, Chief Executive – BP Refining and Marketing on 23 September on '*The Changing face of energy and role of the International Oil Company*'.

Should you wish to discuss any of the matters raised in this submission, please contact me on (03) 9268 3854 or gavin.jackman@bp.com.

Yours sincerely

Gavin Jackman

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John Condon
Regional Tax Manager, Australasia

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5th November 2008

Dr Ken Henry
Chair
The Australia Future Tax System Review
Panel
Australian Government
Treasury
CANBERRA, ACT

Via email:aftsubmissions@treasury.gov.au

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Dear Dr Henry

Australia's Future Tax System Review

Please find enclosed our submission to this review. BP very much welcomes the opportunity to comment and to making a contribution to this important initiative. If you or any of the review panel would like to discuss the contents of our submission, please do not hesitate to contact me. My direct telephone number is 03 9268 3219 and email john.condon@bp.com.

We also enclose, for information, two other recent BP submissions on the Carbon Pollution Reduction Scheme Green Paper and the Wilkins Review.

We look forward to discussions with you and or your panel members as this review progresses.

Yours faithfully

John Condon

Cc. Gerry Hueston, Associate President, BP Australasia.
Phil Home, Managing Director, BP Australia Exploration & Production.

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SUBMISSION TO AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

BP AUSTRALIA PTY LTD

5 November 2008

EXECUTIVE SUMMARY

BP Australia welcomes the opportunity to participate in this initial consultative phase of the Review of *Australia's Future Tax System.* Our submission focuses on establishing the strategic priority of stimulating infrastructure investment in Australia to meet demand from Asia. We look forward to working collaboratively with the review team, and the Australian Government, to contribute to the development of policy as the Review progresses.

Key messages:-

1. The review of the existing Federal and State systems for taxing resources in Australia should be done in a collaborative and open way engaging with stakeholders to ensure policy development is fair and equitable (level playing field) across both the minerals and petroleum sectors. Reform proposals should be consistent for onshore and offshore investments and any incentives offered carefully targeted, aligning to the Government's priorities for delivering energy security to Australia. BP recommends introducing accelerated depreciation for infrastructure to remove the current disincentive to invest in long life gas to liquids projects. It is important to narrow the gap between pre tax and post tax returns and ensure that projects that are economic pre tax are not discouraged due to an inappropriate tax burden. Existing tax depreciation rates for upstream investment serve to lengthen payback periods and are uncompetitive with depreciation regimes in the rest of the world. Unless remedied this will put major Australian resource projects at risk.
2. Tax reform that materially upsets the basis upon which previous investment decisions have been made, or creates significant transitional uncertainty, should be avoided to protect Australia's reputation as a stable country to invest in. We believe the tax treatment of existing investments should largely remain unchanged.
3. There are a number of major upstream projects in Western and Eastern Australia that are currently being evaluated. Consultation with the industry is critical to ensure tax does not stop otherwise viable projects, that there are no surprises and that there is robust sanctioning of as many projects as possible.
4. The review should also consider tomorrow's energy security. Tax reform proposals should not ignore the interrelationship between environmental taxation and energy security. For example, incentives are required, outside of the proposed emissions trading scheme, to remedy market failures and encourage investment in "green" technologies like solar photovoltaic panels. BP believes Tax reform should compliment the Government's Carbon Pollution Reduction Scheme ("CPRS") and include consideration of accelerated depreciation to stimulate "green" investment across all of its business segments.

BP's Vision for Australia

Our strategy to continue to invest in Australia recognises, despite cyclical downturns from time to time including the current global financial crisis, that structurally Australia is positioned very well to supply the resource needs of Asia. By that we mean there will continue to be, over an extended period of time, a significant demand pull from Asia for

Australia's natural resources resulting in potential for significant investment in local infrastructure. We also expect capital and skills to flow into Australia from Asia. This demand for infrastructure investment will be focussed primarily in the West and in Queensland whereas most of the country's population is in the South East. The scale and pace of the demand from Asia will be significant. Whilst infrastructure investment in resources extraction will be more focussed in the West and in Queensland, wealth created will also flow to the population in the South East. All of Australia will benefit. The Government has an opportunity to create the necessary policy framework to encourage faster investment in infrastructure to enable the resources extraction opportunity presented to the country to be captured early.

Summary of key taxation recommendations for the Review Team

Business	Base	Growth	Low Carbon*
Exploration & Production	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for development expenditure	Carbon Pollution Reduction Scheme ("CPRS") transitional support for Energy Intensive Trade Exposed LNG*
Refining & Marketing	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for investment in clean fuels capability; introduce 40% R&D credit for eligible expenditure and keep current definition of R&D	CPRS transitional support for Energy Intensive Trade Exposed Refining*
Alternative Energy	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for CCS and Solar photovoltaic (PV) development expenditure	CPRS credit for carbon stored; National Gross FIT to replace State Net FIT systems

* Refer to BP Australia's submission on the CPRS Green Paper for additional information

Resources Taxation for Australia

The review of Australia's tax system is an opportunity for the Government to position Australia as being internationally competitive on taxation across the range of Energy businesses, a position it cannot claim today. Moreover the review is an opportunity for the Government to take action to not put at grave risk the opportunity fate has delivered to Australia – to realise the potential from Asian demand for our resources.

Specifically BP believes the Government should act expeditiously to modernise the tax depreciation schedules for infrastructure spending by providing accelerated depreciation to stimulate investment. Presently, the current long life (15 – 20 year write off allowances in the resources sector) are impeding viable pre tax resources projects and are completely uncompetitive with other countries competing for BP's capital. In our Exploration & Production business moving towards cash flow taxation for development expenditure would be entirely consistent with the policy behind the introduction of Petroleum Resource Rent Tax in Australia whereby immediate deductibility of all costs is allowed and no tax is payable until all costs have been recovered.

It is insightful that the North West Shelf project, itself recognised as a marvellous success, only reached its return of capital in 2000 - some 15 years after first production. The current economics of the Browse project, a priority but threatened project for BP in this region, show a total joint venture capital commitment of between A$37B and A$45B, but with a minimum 20 year payback discounted from 2008. The change to a 3 year depreciation schedule proposed by BP would reduce the payback period on Browse by 3 years. BP believes the current risks faced in Australia by investors with such a long pay back period are too high. The pay back period is driven by the anonymously slow tax depreciation entitlements which are among the slowest for upstream capital expenditure anywhere in the world.

By introducing accelerated depreciation for development expenditures the amount of tax the Government will receive over the life of projects will not change. It is purely a change in the timing of the receipt so that less tax is paid in the very early years and more in the later years. We believe these changes are essential to restore competitiveness to the upstream sector and ensure investment is not discouraged. It is clear that the swift development of large scale gas to liquids and other projects will shape much of the wealth and prosperity of Australia for decades to come.

Other countries have recognised the importance of sustainable competitive fiscal regimes and have introduced reforms to allow oil companies to achieve a faster pay back on upstream investment. We summarise recent reforms to resource tax depreciation schedules in other countries that we believe should guide the Government.

Country	Year of change	Capital allowances	Other
UK	2002	100% immediate deduction for development expenditure (previously slow train 25% pa WDA); immediate 100% exploration deduction unaffected.	Royalty abolished. CT rate for resources sector increased from 30% to 40% (current 28% CT rate does not apply to resources sector)
Norway	2005	Depreciation for offshore plant is straight line over 6 years; all LNG developments is straight line over 3 years; immediate 100% deduction for exploration	State tax CT 28% + Special tax CT 50% effectively a 78% CT rate; same tax base for both; interest expense allowed against both; 30% uplift permitted on development capex taken straight line over 4 years for Special tax
Angola		Depreciation 4 years straight line; + uplift of 40% over four years straight line.	
Indonesia	1989	Depreciation at 25% but balance allowed in full in year 5;	Investment credit of 110% for deepwater (increased to 125% for very deepwater in 1992) and 55% for gas fields
Azerbaijan		Depreciation 5 years straight line	

We believe the UK model has proven to be an inspired reform because no UK resources project pays any tax unless payback has been reached – a unique feature. The Norway model also provides incentives for investment, in a more complex fashion but means for every $100 of development capex, a company will secure an undiscounted cash tax reduction of $93.

For resources taxation in Australia BP recommends at a minimum:-

- Introducing accelerated depreciation (3 year write off) for development expenditure for corporate income tax, as has been argued for by APPEA
- Retaining 100% immediate deduction for exploration expenditure including the acquisition of post 1 July 2001 mining rights
- Retaining PRRT for Offshore Projects other than the North West Shelf Project but to work with industry to ensure a level playing field when comparing onshore and offshore gas to liquids projects (including coal methane gas projects).
- Retaining Crude Oil Excise (but no further reform of rates) and Royalty for North West Shelf Project, as has been argued for by Woodside

Our recommendation to retain Crude oil excise and Royalty for the North West Shelf project is driven by the complexity in trying to introduce reform part way through the project's life. If PRRT had applied to the project from commencement it would never pay PRRT because of the generous compounding rates for expenditure that would have applied. Determining the level of carry forward deductions today utilising current compounding rates, and taking into account excise and royalty already paid, would pose significant risks to revenue that are predictable under the current crude oil excise and royalty regime.

We encourage the Review Team and the Government to collaborate with the upstream resources sector and explore options for inspired reform including consideration of scraping corporate income tax altogether for new upstream projects (onshore and offshore) and replacing it with a modified Petroleum Resource Rent Tax – a pure cash flow tax regime that would align pre tax and post tax project economics.

Developing new energy supplies for the future.

The discovery of new energy supplies is a critical issue for the future. Australia became a net importer of oil and gas in 2003-04 and has seen an increasing trade deficit in them ever since[1]. Globally, access to new energy resources is also becoming an increasing concern not because the world is running out of resources "below the ground", but because commercial (capability gaps) and political factors "above the ground" are constraining access and development ability. Australia therefore needs a clear focus on increasing the discovery of both conventional and unconventional resources for the future.

Conventional resources include the exploration for more traditional hydrocarbons, often in frontier areas. "At present, only 17 per cent of Australia's offshore sedimentary basins and 26 per cent of potentially prospective onshore basins are covered by petroleum

[1] "Key Statistics 2008" Australian Petroleum Production and Exploration Association.

permits, so we simply do not know what resources remain to be discovered"[2]. However rising supply costs have increased the commercial risk being undertaken in an exploration campaign because seismic and drilling activities have increased dramatically in cost. Incentives to encourage exploration should also be considered as part of the review. For example, the introduction of an investment allowance for exploration in frontier areas at a rate of 175% of eligible exploration expenditures would be one such mechanism that could well stimulate further activity as has been argued for by APPEA.

Challenges for our downstream businesses in meeting higher community and regulatory expectations

Refining and Marketing

In our downstream business we have recently invested in excess of $300m in our two Australian refineries in order to complete major maintenance overhauls and unit upgrades. Both of our refineries are now producing diesel at one of the highest environmental standards in the world, having invested to reduce the levels of sulphur content by 98% to less than 10 parts per million (ppm) since 2003. Lower amounts of sulphur in diesel can deliver lower emissions of pollutants from engines including carbon monoxide, carbon dioxide and sooty exhaust fumes.

BP's refineries have consistently led the Australian oil refining industry in reducing the sulphur content in diesel. The BP Kwinana Refinery in Perth and BP Bulwer Refinery in Brisbane together invested in modifications to their refineries that reduced dramatically the sulphur content in diesel from 500ppm to 50ppm in 2003, two years ahead of government requirements. Once again both refineries have been able to meet the Federal Government's new fuel standards ahead of the 2009 deadline.

BP is now in the process of ensuring all of its import terminals are capable of handling imported diesel that meets the new specifications.

BP has actively supported the development of progressively tighter mandatory fuel quality standards, and our commitment to low sulphur diesel is a demonstration of our commitment to invest in our refinery assets and supply infrastructure in Australia. The R&D tax concession has supported our efforts at both refineries.

BP supports the Federal Governments review of the National Innovation System and the recommendations of the report entitled *Venturous Australia*. BP is comfortable with replacing the Research and Development (R&D) tax concession with a simpler 40% tax credit system for large businesses. In particular the move to a credit system separates the level of R&D support from the prevailing corporate tax rate, i.e. the value of the R&D Tax Concession is not diluted should the corporate tax rate reduce. BP recommends the retention of the current definition of R&D to avoid complexity and uncertainty that would arise with any change.

On Downstream fuels tax BP is broadly comfortable with the overall fuels taxes framework in Australia. It is robust and does not require substantial change. This is particularly so after the major reform that the previous government introduced from 1 July

[2] "Strategic Leaders Report" Australian Petroleum Production and Exploration Association.

2006 following consultation with BP and the industry. The position we have today is a step forward from where we were previously.

The Government can further support by encouraging industry to invest in cleaner fuels capability by offering incentives through the income tax system. Offering accelerated depreciation for investment in clean fuels capability may stimulate further industry investment comparable to BP's.

Alternative Energy

BP has contributed to the Wilkins review and has made a principled case for transitional incentives that could potentially be delivered through the tax system as well as through direct expenditure to stimulate investment in alternative energy sources e.g. solar photovoltaic panels. We note in that submission market failures today that are preventing robust investment that will not be addressed by the CPRS. We would be happy to discuss our submission to the Wilkins review with the Henry Review team at any time.

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9 September 2008

Department of Climate Change
Carbon Pollution Reduction Scheme Green Paper
Submission
GPO Box 854
Canberra ACT 2601
Australia

Dear Department of Climate Change:

BP has spent the better part of a decade supporting the case for policy action and certainty around climate change to allow business to manage the associated risks affecting their operations and to allow future investment in our energy infrastructure to be secured.

With the release of the Carbon Pollution Reduction Scheme (CPRS) Green Paper, it is now clear that Australia's response to climate change has evolved, and in the direction and manner that business requires. We support the commitment to early action; the focus on emissions trading as the key policy instrument, supplemented by complementary measures to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies; and the proposal to deal directly with economic risks rather than allowing them to thwart the whole.

We are therefore pleased for the opportunity to comment on your Green Paper. The impact of the CPRS cannot be understated: it will lead to a structural adjustment of the Australian economy and will be precedent-setting for subsequent national emissions trading systems around the world. Accordingly, the imperative to "get it right" could not be greater.

Yours faithfully,
BP Australia Pty Ltd

Mark A. Proegler

Attachment

BP Australia Submission to the Carbon Pollution Reduction Scheme Green Paper

Overview of BP's Position

BP has spent the better part of a decade supporting the case for policy action and certainty around climate change to allow business to manage the associated risks affecting their operations and to allow future investment in our energy infrastructure to be secured. With the release of the Carbon Pollution Reduction Scheme (CPRS) Green Paper, it is now clear that Australia's response to climate change has evolved, and in the direction and manner that business requires. We support the commitment to early action; the focus on emissions trading as the key policy instrument, supplemented by complementary measures to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies; and the proposal to deal directly with economic risks rather than allowing them to thwart the whole.

Australia's climate change policy goals—to begin greenhouse gas (GHG) emissions-reducing actions now---ahead of more global agreements to bind others, creates key challenges: to achieve meaningful emissions reductions while sustaining economic growth; and to not disadvantage Australia businesses who compete with others (either as imports or exports) who face no such carbon constraint. Solving this issue is fundamental to the scheme's success. It will also allow Australia to influence the design of emissions trading schemes in other energy intensive economies, such as the US, and enhance the nation's ability to effectively engage and lead global dialogue on post-2012 emissions reduction commitments.

The economic risks, in particular to our energy intensive and trade exposed industries (EITEs), need to be addressed directly, rather than being allowed to hold up progress. These risks are real: without proper mitigation, there will be trade distortions due to early action, and it will disadvantage Australian businesses which compete internationally. Policies to support EITEs are not an opt-out from meaningful climate change action; they are an enabling pre-requisite.

For their part, EITEs have an associated responsibility to apply enterprise in reducing their emissions as fast as possible to support the nation's climate change direction. BP accepts this responsibility.

Given the paramount significance of this EITE issue, it is critical that the Government gets it right—which means engaging with business in a transparent way to build a mutual understanding of adjustment costs, trade exposure, and policy goals. Only through focused collaboration will Australia develop an emissions trading system that is effective and an example for the rest of the world.

Summary Points of BP's Green Paper Submission

The Carbon Pollution Reduction Scheme Green Paper provides a comprehensive description of the Government's proposed design elements for emissions trading and supporting policies, and we congratulate the Department of Climate Change for this achievement. There are many design elements proposed by the Government that we

support. With limited modifications, we believe the proposed scheme will become an effective policy tool to guide Australia's transition to a competitive low emissions economy, and BP wants to play a constructive role in this transition.

We have organized our detailed responses by Green Paper chapter. Our main areas of concern are as follows:

- The key policy focus of achieving meaningful GHG emissions reductions needs to be achieved while maintaining economic growth and not disadvantaging Australian businesses—especially in the interim period ahead of global carbon regimes. This will impact the selection of the scheme cap, its trajectory, and the required level of transitional support for business and families, which should be based on economic impacts rather than being constrained by scheme revenue, as proposed. Given the significance of the structural adjustment required across the economy, BP is of the strong view that Government should provide the necessary transitional support from general revenue.
- Australia's "early actions" on climate change, while warranted and supported, require effective transitional support for trade-exposed industries. Without such an enabler, the scheme risks sacrificing economic growth for GHG reductions: Australia needs both.
- Contrary to the designation in the Green Paper, BP believes that the petroleum refining and LNG businesses are emissions-intensive and trade-exposed (EITE). In both cases there is the risk of Carbon leakage and for LNG there is the potential to limit the growth of a commodity that is recognised as an important lever in reducing global emissions by reducing the use of coal fired power.
- We do not support the use of the proposed EITE metric.
- There are a number of alternative ways to designate and provide temporary assistance to EITE industries that should be considered, including a metric based on value added, as well as a recent proposal by the Business Council of Australia (BCA). BP will continue to work with the Government and industry associations in a transparent way to ascertain the required level of transitional support.
- BP offers a number of specific recommendations on CPRS design and implementation issues based in our business views and experience with other trading systems and markets in Australia, Europe, and the United States.

BP endorses the use of a well-designed emissions trading scheme as the centrepiece of climate policy. However given the scale and urgency of required emissions reductions, BP also supports the use of transitional, complementary measures to accelerate the development and deployment of low-carbon technologies, to drive mitigation in sectors not covered by the scheme, and to address other market failures.

DETAILED COMMENTS (by Green Paper chapter)

CHAPTER 1 (Framework)

BP supports Australia's move to begin GHG emissions-reducing actions now: to initiate this structural adjustment of the Australian economy to put it on trajectory to lower emissions. We also fully endorse the use of a well-designed emissions trading scheme as the centrepiece of this policy—to provide for market-based, least-cost solutions to GHG emissions reduction. Given the scale and sense of urgency to reduce emissions, we also support the use of transitional, complementary measures to accelerate the development and deployment of low-carbon technologies, to drive mitigation in sectors not covered by the scheme, and to address other market failures.

By taking climate change action now—ahead of global binding agreements to reduce GHG emissions—Australia faces an additional challenge to achieve meaningful emissions reductions while sustaining economic growth. A key to achieving this will be to not disadvantage Australian businesses that compete with others (either as imports or exports) facing no such carbon constraint. Solving this issue is fundamental to the scheme's success and to Australia's ability to achieve one of its policy goals to help shape a global solution to climate change policy.

CHAPTER 2 (Coverage)

BP fully supports the objective for full scheme coverage—to provide for the widest possible carbon price signal into the economy to encourage behaviour changes. We are also supportive of the detailed Chapter 2 proposals, with the following clarifications.

Gases

The appropriateness of applying emissions trading to each of the Kyoto greenhouse gases needs to be evaluated separately for each gas. For more "specialised" gases it is likely that the transaction costs and complexity associated with their inclusion may outweigh the benefits. Alternative policy measures should be considered in this case.

Transport

BP supports the Green Paper's inclusion of liquid (transport) fuel emissions in the scheme. A primary rationale for this is the resulting, increased reach of the carbon price signal—and thus long-term behaviour changes—to all parts of the economy. As the Green Paper points out, transport emissions, comprising 14% of Australia's total emissions (and 20% of the covered sectors), are a significant emissions contributor. Since the beginning of the year, BP has been working with the Government and the Australian Institute of Petroleum (AIP) to consider the most effective and cost-efficient ways to implement this liquid fuels inclusion in the trading scheme.

Excise Tax Offset BP does not support the Green Paper's proposal to offset carbon price increases on liquid fuels with a matching reduction (offset) to the excise tax for the first three years of the scheme for motorists and for the first year for the road transport sector. From a policy perspective, it contravenes the goals of including

transport fuels in the first place, and delays the onset of needed behaviour changes in that sector. Given that significant transport emissions reductions will only be achieved via an integrated policy approach that addresses vehicle efficiency, fuel carbon content, and consumer behaviour (including urban design), this increases the importance of the first two policy measures. The use of this offset is also inconsistent with the policy of using income transfers to provide consumer assistance, and will introduce price distortions in the carbon market.

From a practical perspective, it will be difficult and costly to implement an excise offset—with a key challenge being managing the trade-off between achieving an absolute "cent for cent" match between the excise tax offset and the product carbon price and maintaining market integrity. To achieve an absolute match will negatively impact carbon market integrity, liquidity, and the necessary development of the secondary market by possibly limiting permit availability or by fixing the carbon (permit) price for a significant part of the market. There will also be transitional issues to consider when this temporary offset is removed after three years.

The offset proposal also fails to cover those liquid fuels that are not subject to excise (such as LPG).

Noting the concerns above, if the Government nonetheless decides to proceed with the carbon excise tax offset, BP recommends that its implementation should:

- Maintain carbon market integrity and liquidity by continued inclusion of freely traded permits associated with transport emissions, which comprise 20% of CPRS permits.
- Provide for a transparent carbon price to the consumer.
- Recognise that an absolute "cent for cent" match of excise tax offset to product carbon price will be difficult to achieve if market integrity and liquidity is to be maintained and if implementation costs and government administrative burdens are to be minimised.

Carbon Price Basis for Products The Green Paper places the obligation for transport emissions on the upstream fuel supplier. As a point of clarification, our customers will continue to have the fundamental liability for the emissions resulting from the use of our products. BP's upstream obligation means that we will be acting as their agent in submitting allowances – essentially on their behalf. BP's upstream obligation for its liquid fuels will require the annual purchase of approximately $0.7 billion[1] of permits as well as the creation of pricing mechanisms to place the appropriate carbon costs on our products. While we are confident of our ability to manage the associated commercial risks inherent in this process, the Government can play a key role in facilitating market functioning and transparency on behalf of consumers. In particular, the Government should stipulate the basis (not the absolute price) for the carbon price component of liquid fuels for retail consumers. This may be in the form of an 'advisory' price published in conjunction with monthly/quarterly auctions, such that the auction clearing price is converted to a cents/litre index for each fuel type expected to apply to fuel sales for the coming period. This will allow retail consumers to understand what component of their pump price represents the carbon value. While BP would support the publication of an advisory price, we would not expect any enforcement powers to attach to this "advisory" price.

[1] Valued at $25/tonne CO2e

Point of Acquittal We support the Green Paper position that the point of acquittal for all liquid fuels should be at the point at which fuel excise is liable to be remitted on all liquid fuels entering the Australian fuels market. As acknowledged in the Green Paper, the fuel excise arrangements are very well defined in legislation, and have accurate and well established measurement, reporting, acquittal and assurance arrangements. The fuel excise arrangements also include detailed mechanisms for the exclusion of fuel that is exported, used for international transport, sequestered in plastics, and supplied to visiting defence forces and consular vehicles – activities which are proposed to sit outside the CPRS or be subject to other specific arrangements under the CPRS, either now or in the future.

Large Users BP supports the principle that large emitters should be responsible for acquitting permits for their direct emissions, including those from liquid fuels. However, given that the primary emissions obligation is on the fuel supplier (which makes use of existing excise tax systems), this will require another mechanism to document this transfer of obligation to the user. We support the creation of such a process, provided:

- The fuel user is registered under the CPRS as being a 'liable entity'
- The upstream entity and the fuel user are in agreement on the specific volumes of fuel for which emissions obligations will be transferred
- The CPRS Regulator has established a system for recording such liability transfers and for incorporating such information as is appropriate in public reporting about emissions obligations (either general or entity specific)

In the interest of simplicity for the start-up of trading, we support the Green Paper proposal to delay opt-in of large users for at least the first twelve months of the scheme. In the interim, we will seek commercial solutions for our large customers who are interested in taking on this obligation. We will also continue our work with the Government and our industry association, the AIP, to develop feasible "netting out" arrangements.

Shipping

BP recognises the fact that the Kyoto Protocol specifically excludes emissions from ships, and that the International Maritime Organisation (IMO) was mandated by the UNFCCC to develop a GHG reduction proposal for the shipping sector. BP believes that the IMO (of which Australia is a member) is the entity best suited to formulate and regulate a global shipping emissions solution. We do not support individual countries establishing their own ship emission trading schemes due to the complexity of administrating schemes as vessels pass through each countries territorial waters, along with the fact that such schemes will do little to reduce overall shipping emissions.

Waste

BP recommends that liable reporting entities should be required to report waste emissions only if they are material; for instance, if they represent more than 5% of the reporting entity's total emissions. This will contribute to the cost effectiveness of the scheme by avoiding costly measurement and tracking of emissions that have minimal impact.

Carbon Capture and Storage

Decreasing carbon dioxide emissions from stationary sources is a key priority for Australia, and carbon capture and storage (CCS) technology is seen as a vital part of the national mitigation portfolio. Accordingly, its effective treatment within a trading scheme is important—to provide for market incentives and commercial flexibility. BP's recommended position is Green Paper Option 1, which provides the opportunity for CCS operators to earn permits for sequestered carbon, which they could then sell or surrender to cover any emissions. This is preferred to Option 2 (where CCS emissions are netted from the originating entity's gross emissions) since it: 1) provides the required commercial flexibility for cases where the CCS facility operator and the "originating entity" are separate commercial entities; and 2) it is more consistent with the provisions in the recent Draft Offshore Petroleum Amendment (Greenhouse Gas Storage) Bill that provides for separate storage rights for a CCS operator. While we recognise that this adds additional regulatory complexity, this primarily comprises the issuing of permits for these "credits"—which will be the same process used to recognise emissions reduction from forestry projects, which are likely opt-ins to the scheme.

LPG

LPG is used in stationary energy and in transport (as autogas). BP believes that LPG for both applications should be included in the CPRS. We support the recommendations of the Australian LPG Association (ALPGA), as documented in their Green Paper submission.

Biofuels

BP supports the preferred position that scheme obligations would not apply to emissions from biofuels or energy from biomass, which would continue to receive a "zero" rating. The biofuels provisions should allow for non-conventional (bio-fuels other than ethanol and bio-diesel) renewable fuels such as renewable diesel and renewable LPG.

Forestry

BP supports the potential opt-in of reforestation activities, provided that suitable long-term liability structures are in place to support trading activity.

CHAPTER 3 (Carbon Market)

BP believes that one of the primary objectives of the CPRS should be to create a robust, liquid carbon market, including the facilitation of an active secondary market, to facilitate least-cost emissions reduction. A well-functioning market and its resulting forward carbon price expectations is a particular need in the oil & gas sector, with its long development timelines and requirements of significant upfront capital investment. It will also facilitate more effective carbon pricing for liquid fuel (transport) products. We support many of the preferred positions stated in the Green Paper, although we have clarifying points and recommendations on a number of issues.

Permit Information Availability

In response to the Green Paper's solicitation for views (Box 3.2) on what permit information should be publicly available, BP's recommendations are:

- Information associated with quantities and prices of permits auctioned should be available to all market participants. However, this information should not include any specific bidding quantities and prices associated at a company level.
- Historical auction results should be available at all times.

Permit Definition and Access

BP fully supports the preferred positions listed in boxes 3.1 and 3.2. We agree that permits should be treated as financial products, and therefore regulated under the existing Financial Services/ASIC regime. We also strongly agree with the preferred position that permits can be traded by any legal or natural person and that there would be no restriction on foreign ownership of permits.

Intertemporal Flexibility

Banking and Borrowing We support the recommendation of unlimited banking, with a preference for Option 1--allowing a certain percentage of a party's obligation to be met using the following year's vintage (not a subset of a year's vintage). We also support the limit on borrowing, with the provision that increased borrowing be allowed in the first year.

Cost Containment and Price Caps The need for explicit cost containment measures may be especially important during the initial years of the cap-and-trade program since emissions abatement activities will take time to initiate and commercially available financial tools and strategies for managing volatility and risk will not be fully developed. Cost containment measures should be designed to address a variety of reasonable concerns about the price and cost impacts of a cap-and-trade system. The primary concerns are twofold: a) short term extreme price volatility; and b) sustained high permit prices, or an allowance price trajectory that discourages important investments in emissions-reducing technologies. While a price cap is one form of cost containment, BP recommends the following package of tools which could be used in various combinations to deal with the key concerns:

- Acceptance of project based domestic and international Kyoto-eligible offsets for part of compliance;
- Acceptance of international allowances for compliance from countries with capped emissions;
- Unlimited banking of offsets and allowances;
- Limited borrowing from the following compliance year.

BP does not support the use of a price cap. Its use as a cost containment mechanism, as proposed in the Green Paper, potentially sacrifices environmental certainty for price certainty, thereby negating a primary benefit of emissions trading. Once the price cap is hit, the Government is obligated to issue permits, the volume of which has no limit, leading to a breach of the scheme emissions cap.

A compliance penalty, which BP recommends, can also effectively serve as a price cap, as it does in the EU ETS (European Union Emissions Trading Scheme). Our view

is that this penalty should be high (e.g. in the EU ETS, it is €100/tonne), and should employ a "make-good" provision requiring the emitter to purchase the proper amount of permits, thereby avoiding the need for the Government to issue additional permits above the cap.

The governance process for the scheme should include a process to deal with the case that allowance prices have reached very high levels. The EU ETS provides a potential example of this.

CHAPTER 4 (Targets and caps)

BP recognises the Government's challenge in providing explicit carbon caps ahead of the completion of Treasury modelling. However, we encourage the Government to confirm, as soon as possible, the near-term CPRS targets (2010-2012), which we understand are consistent with the existing Kyoto commitment that ends in 2012. This is important to provide near-term certainty and established caps before a future international agreement influences the shape of the forward emissions trajectory. BP also recommends the release of information on medium term caps and trajectories as soon as possible—and preferably ahead of the White Paper—to permit assessment of industry impacts prior to its publication. We also encourage the release of the Treasury modelling assumptions as soon as possible—to ensure that industry specific (e.g. LNG) growth estimates are consistent with our projections, and therefore adequately accounted for.

BP supports the announcement of 5-year (minimum) rolling caps, with extension to an international commitment period (once negotiated). However, this should be a mandatory, not an optional, extension, as suggested in the Green Paper. We also support the provision of 5-year minimum information on indicative trajectories, as well as the existence of continuous gateways running 10 years beyond the minimum 5 years of scheme caps.

CHAPTER 5 (Reporting and Compliance)

Effective and robust reporting and compliance systems are a critical foundation to an emissions trading scheme to guarantee system integrity and to provide maximum compatibility with international regimes. BP supports many of the Green Paper proposals in this area, with the following clarifications and recommendations.

Alignment of CPRS (and EEO) with NGER One reporting requirement, based on the NGER model, should form the data set that can be used for all GHG reporting requirements, including CPRS. In addition to what is described in the Green Paper, this should also align with the Energy Efficiency Opportunities (EEO) requirements.

Liquid Fuel (transport) Emissions There is no current requirement in the NGER model to report emissions from the liquid (transport) fuels. This needs to be rectified as soon as possible, preferably linking with existing excise arrangements to avoid duplication of effort. The calculation process for transport emissions should be clarified and integrated as much as possible with the OSCAR system.

Reporting Detail There is a need to further clarify the detailed reporting requirements of the CPRS to permit updates in BP's own reporting systems. These should be released as soon as possible to ensure our ability to meet compliance requirements in an appropriate timeframe.

Assurance BP supports initial mandatory third party assurance for large users. Once a robust system has been established, there should be the provision for self-assessment with periodic audits. This would align with the tax system practices and reduce the cost burden of this assurance process.

Operational Control Given the many and varied contractual arrangements that exist within business and joint ventures in the oil and gas sector, it is essential that the definition of operational control be established and tested as soon as possible. This will permit the identification for businesses that are in scope, and those that are out of scope. Some flexibility in establishing the party that has operational control at facilities where several parties have an interest is important in the initial years of the scheme.

Accuracy BP supports the Green Paper proposal to increase levels of data accuracy over time. However, it needs to be acknowledged that flexibility may be required in the early years of the scheme to accommodate system upgrades to deliver these new levels of accuracy. For complex industrial processes such as refining, the costs associated with improved accuracy could be substantial. Accordingly, requirements for increased accuracy need to be balanced with their cost effectiveness.

Methodologies Calculation methodologies should be aligned between NGER and CPRS. BP supports the approach that the intent to change methodologies will be signalled well in advance (5 years) to allow system upgrades etc.

CHAPTER 6 (Linking)

BP supports the goal to link Australia's trading scheme with other international schemes. This linking expands the potential for economic gains from trade and associated cost savings—whether this comes from direct linking (allowances) or indirect linking (linking via the inclusion of international offsets that are accepted in multiple trading systems, e.g. CDM, JI). Larger and more liquid markets are inherently more efficient, reducing transactions costs and providing capital for a larger pool of opportunities for low cost abatement.

BP also supports most of the Green Paper's preferred positions on linking, with the following clarifications and recommendations:

Permit Units

Australia Units BP agrees that the scheme's carbon pollution permit should be distinct from Australia's international (Kyoto Protocol) units. We suggest that the unit should be called an EMU (Emissions Mitigation Unit).

Kyoto Units The inclusion of Kyoto units (CERs, ERUs, RMUs) in the scheme provides a needed degree of market flexibility and indirect linkage with global regimes. BP believes that the lowest-cost outcome would be achieved by placing no limitations on

the use of these units (as opposed to the limits proposed in the Green Paper) leaving this to the market instead.

Forestry Credits BP supports the use of forestry credits with the caveat that suitable long-term liability structures need to be in place to support trading activity.

Linking Rules

In response to the Green Paper's solicitation for views (Section 6.8) regarding notice before qualitative restrictions on linking rules are changes, BP's recommendations are:

- Linking Rules - notice given before qualitative restrictions are changed
- Qualitative restrictions should follow the preferred position used for quantitative limits, types of Kyoto units and restrictions on conversions of Australia's carbon pollution permits to Assigned Amount Units (AAUs) - that is: provide the maximum feasible level of certainty about future linking arrangements. Notice of a change in the qualitative restrictions should follow the rolling 5 year certainty period with any new change to be recognised in the 5th year when the rolling 5 year period is extended each year.

CHAPTER 7 (Auctioning)

BP supports most of the Green Paper's preferred positions on auctioning, with the following clarifications and recommendations:

- We support the recommendation that the relevant minister will direct the early phase of the scheme - with an independent regulator appointed to manage the auction process at a later date.
- BP advocates the use of monthly or quarterly auctions, which should mitigate working capital requirements without severely affecting the development of needed secondary markets.
- We support the Green Paper's preferred position to auction four vintage years (current + three year future). However, our preference would be to extend this out to five vintage years (current + four year future), in line with emission cap timing.
- BP advocates that at least 50% of a compliance year auctions should be undertaken during the actual compliance year. This should contribute to a high level of (price) transparency and trading volume during the compliance year. This is a particularly relevant issue for BP, given the significant emissions obligation for our liquid fuels (transport) products, and need for effectively adding the carbon price to these products.
- Presuming adequate volumes of permits, BP recommends that auctions for future permit vintages be held twice a year instead of once per year, as indicated in the Green Paper. This should enhance the ability to manage longer term carbon risk.
- BP recommends the use of a sealed bid auction, enabling companies to enter schedules of different volumes and prices in advance. This style of auction would follow a similar format to that of the Settlement Residue Auctions currently undertaken by NEMMCO within the National Electricity Market
- We recommend simultaneous auctions (for current and future vintages) as this would provide better price management.

- BP's preference is for auctions to begin as early as possible; fourth quarter, 2009, would be preferable.
- We support the Green Paper proposal to hold one auction for the relevant year's vintage at the end of the financial year - before the surrender date. This should provide the market with the access to true-up positions and without being affected by any liquidity issues that may be evident in the secondary market.
- BP believes that only the Government should release permits under the auction process. Those entities that receive free permits should look to the secondary market to monetise any residual permit length. This will help develop the secondary market and provide less complexity to the auction process
- BP would support any assistance from the DCC to mitigate working capital issues associated with purchasing future vintage permits, subject to that assistance not requiring onerous or restrictive prudential requirements.

CHAPTER 9 (EITE)

Achieving a successful solution for providing transitional assistance to Emissions Intensive Trade Exposed (EITE) industries--realising emissions reduction while maintaining economic growth--will be the key determinant of ETS success. Policies to support EITEs are not an opt-out from meaningful climate change action; they are an enabling pre-requisite.

Australia's climate change policy goals—which BP supports—to begin GHG emissions-reducing actions now, ahead of more global agreements to bind others, creates key challenges: to achieve meaningful emissions reductions while sustaining economic growth; and to not disadvantage Australian businesses who compete with others (either as imports or exports) who face no such carbon constraint. Solving this issue is fundamental to the scheme's success-- and to Australia's ability to use this achievement to enhance its ability to effectively engage and lead global dialogue on post-2012 emissions reduction commitments. Accordingly, the treatment of EITE industries is an enabler to climate change policy success in Australia and beyond. In particular, a well functioning Australia emissions trading system could be precedent setting for similar policy developments in the United States, which is also an energy and resource intensive economy.

In large measure, BP supports the stated key rationales for providing assistance to EITE industries, with the following clarifications:

- address the major (*not "some of the")* competitiveness impacts of the scheme on EITE industries in order to reduce carbon leakage
- provide transitional support to EITE industries that will be most severely affected by the introduction of a carbon constraint
- support production and investment decisions that would be consistent with a global carbon constraint

BP endorses some of the key Green Paper concepts for EITE support, e.g. that this assistance, in the form of permits, is transitional, will decrease with time, and will be reviewed five years after the scheme start. However, we do not support the cap on total assistance, nor do we agree with the proposed metric to determine EITE status. In addition, as currently envisaged, BP is very concerned that the Green Paper

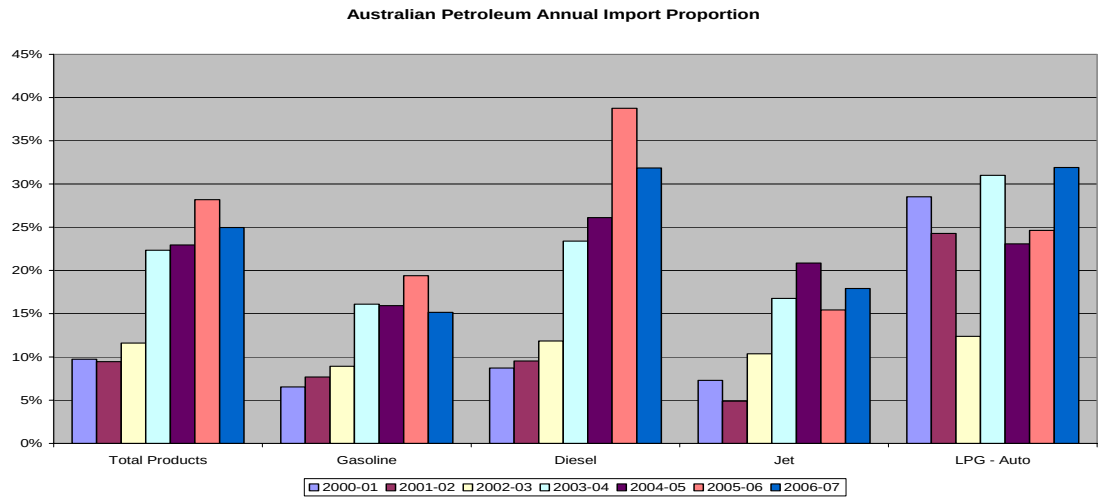
proposal would provide no temporary assistance to two industries that are trade exposed and emissions intensive: petroleum refining and LNG.

Cap on EITE Assistance The Government acknowledges that the CPRS represents a fundamental economic restructuring of the economy. It also recognises the resulting competitive impacts on Australian industry that are magnified by the (current) lack of carbon constraints on most of Australia's competitors. Accordingly, the level of total transitional EITE assistance should be the amount required to maintain industry competitiveness and economic growth. It should not be capped by CPRS permit auction revenue, or an arbitrary percentage of it. The Government should be prepared to fund transitional assistance to industry and consumers from the general revenue (if required), which would represent Australia's investment and contribution to a successful scheme. It also needs to acknowledge that its selected emissions cap and trajectory will have a direct bearing on business impacts and on the total amount of required assistance.

Petroleum Refining Industry

The continued viability of petroleum refining during the transition to a low-carbon economy in Australia is an important contributor to Australia's energy security. BP operates two refineries in Australia. Our Bulwer Island refinery outside of Brisbane processes 88,000 barrels of crude oil per day, and produces a range of products including LPG, petrol, kerosene, jet fuel, heating oil, diesel, bitumen and sulphur. BP's Kwinana Refinery, located in Western Australia outside of Perth, is Western Australia's only refinery. With a capacity of 138,000 barrels of crude oil per day, it is also Australia's largest refinery.

Trade Exposure We believe that the Australia refining industry is trade-exposed. Petroleum products are sold in Australia at import parity prices, as documented in a recent report by the ACCC.[2] Accordingly, carbon costs cannot be passed on to the market. Imports represent 25% of liquid fuels demand in Australia, and come from Singapore, South Korea, Taiwan, and India—none of whom have any carbon constraints. The following figure[3] depicts Australian imports by product.



[2] "Petrol Prices and Australian Consumers: Report of the ACCC Inquiry Into the Price of Unleaded Petrol", Chapter 7, December 2007.
[3] AIP

Emissions Intensity The Australian refining industry is emissions-intensive. In addition, recent investments to meet Australian clean fuel standards have increased asset emissions intensity.

Based on the Green Paper proposals, the petroleum refining industry would not qualify for EITE designation and temporary assistance (Box 9.5). Given the inability of the refining sector to pass on carbon costs, this will erode margins and investment, leading to loss of Australia refining capacity as facilities shut down, increasing imports and carbon leakage—which is in direct conflict with Australia policy goals. Reduction of domestic refining capacity will also reduce Australia's supply security. This refining sector issue highlights the interaction of Australia's policies for climate change and energy security, and the need for clarity on this issue to drive the preferred outcome.

In terms of numbers[4]:

- Investment in Australia refining has averaged $1 billion per year for the last 5 years; this will diminish without EITE support.
- Over the last 15 years, a carbon price of $50/tonne would have accounted for 40% of total Earnings Before Interest, Tax and Depreciation (EBITDA). At $20/tonne it would have been 16% of EBITDA.
- From 1999-2001, the costs of a carbon price of $40 per tonne would have exceeded industry profits.

To remain viable, the refining industry will require transitional support in the form of EITE assistance. Given that finding a solution to this EITE issue is an ongoing one, BP will continue to consult with the Government, undertake our own analysis, and work with the AIP to ascertain what this level of support should be. Note: please see the AIP Submission to the Green Paper for additional details on the industry and discussion of this EITE issue.

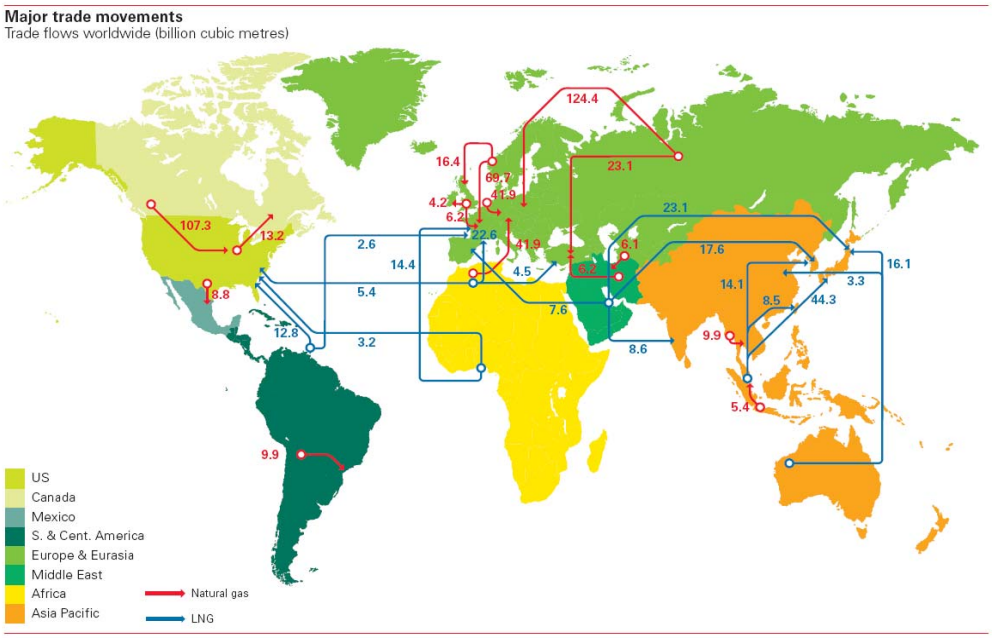
LNG

BP is a 1/6th owner of the North West Shelf (NWS) LNG project, Australia's single largest resources project. The venture has been operating since 1989 and will produce 16.3 million tonnes per annum of LNG with the recent addition of a 5th LNG train, for export markets in Asia. BP is also actively evaluating the development of future LNG projects with our Joint Venture partners in the Browse and Carnarvon basins off the northern coast of Western Australia.

Trade Exposure The Australian upstream oil and gas industry—particularly the LNG industry—operates within a globally competitive environment. The demand for natural gas has grown steadily over the last twenty years, especially in the Asia Pacific region, where gas consumption has more than quadrupled since 1980. Australia currently exports around 15½ million tonnes of LNG per year, to customers in Japan, China, South Korea and Taiwan. Japan remains Australia's major customer, with around 80 per cent of Australia's LNG exports in 2006-07. Australia currently accounts for approximately 9 per cent of global LNG exports.[5]

[4] Source: AIP
[5] *BP Statistical Review of World Energy*, June 2008

The following figure shows major global liquefied natural gas trade movements in 2007, highlighting Australia's major markets and major competitors in the Asia-Pacific region.



The development of oil and gas resources is also characterised by significant up front capital investments and long development lead times. For this reason new LNG investments are typically underpinned by long term (15+ years) sales contracts. In Asia, LNG pricing terms are usually indexed to global oil prices with the consequent commodity price exposure borne by the supplier.

The majority of the existing NWS LNG sales contracts were originally executed prior to the introduction of the CPRS, and while a number of these have recently been extended, the Commercial terms generally do not allow us to pass on any new carbon costs to our customers, as these were simply not anticipated at the time. In addition, the terms of any new LNG sales from existing or future LNG projects has to be put in the context of the competitive supply environment. With major competition likely to come from countries such as Indonesia, PNG and Qatar it is highly unlikely that Australian producers will be able to directly pass on these costs.

Emissions Intensity The LNG production process is emissions-intensive, and comprises two major sources: naturally occurring CO2 in the gas reservoir and those arising from combustion during the liquefaction process. Notwithstanding the debate around the specific Emissions Intensity measure, the fact remains that LNG is and will be a significant contributor to growth in emissions.

It is important to note the impact that several years of severe capital cost inflation has had in the industry. Unit capital costs per installed tonne of LNG capacity has increased circa fivefold in the last 10 years, drawing a significant distinction in the economics between existing and new LNG projects. The former will benefit from relatively lower unit development costs and written down values whereas new projects do not. The incremental impact of the introduction of the CPRS will be more significant on new LNG projects.

Based on the Green Paper proposals, the LNG industry would not qualify for EITE designation and temporary assistance (Box 9.5). This will lead to significant additional costs for this sector. BP strongly believes, however, that the role of gas in a carbon constrained world will become increasingly significant in tackling climate change, and while LNG exports are a major source of current and future revenue for Australia, it is also uniquely positioned to contribute to global emissions reductions. Accordingly, it is important that the introduction of the CPRS does not disadvantage LNG relative to our international competitors and to coal.

Given that finding a solution to this EITE issue is an ongoing one, BP will continue to consult with the Government, undertake our own analysis, and work with the Australian Petroleum Production and Exploration Association (APPEA) to ascertain what this level of support should be. Note: please see the APPEA Submission to the Green Paper for additional details on the industry and discussion of this EITE issue.

EITE Approaches & Permit Allocation

EITE Metric The use of the proposed emissions intensity metric (total emissions per unit revenue) to determine EITE status does not sufficiently reflect the materiality of carbon cost impacts across the disparate sectors. Its revenue component is distorted by the structure of the industry, e.g. those with high input costs, and it disadvantages businesses further down the production chain of a given product. While the use of a single metric is desirable from an implementation perspective, it must not lead to improper classification and potential unintended consequences.

Alternative EITE Metrics & Approaches BP supports the use of an alternative intensity metric that relates to the "materiality of financial impact", which is a Green Paper criterion. Examples of "value added" metrics include emissions/ (EBITDA + labour), emissions/(EBIT + labour) or emissions/operating costs. When considering the need for support to EITE industries, it is important to review the impact on both existing infrastructure and major new investments. In addition, these values should be based on long-run averages to recognise the cyclical nature of many industries.

A recently released BCA report[6] also offers a potential alternative to the Green Paper approach that should be considered. This method calculates carbon costs relative to industry/activity value added (described as EBITDA+labour), and recommends these costs be borne by the company up to a 3% to 5% threshold, above which the trade-exposed business would receive free permits for a transitional period. This is an idea that bears further study and analysis as the Government reconsiders other approaches to this EITE issue.

BP recommends that the Government review the AIP submittal to the Green Paper, which provides thorough industry analysis of alternative emissions intensity metrics.

Permit Allocation The basis for permit allocation to EITE industries should be via an industry benchmark that represents emissions per unit input (or output), which should be allocated on a facility basis.

[6] *How Emissions Trading Can Work for the Environment and the Economy*, August 2008

Other Recommendations

Refining

- State and Local Government based caps (Queensland) on CO2 emissions should be removed since this interferes with the CPRS, which will set the Australia national cap. State emissions reductions should be a market-based outcome resulting from emissions trading.

LNG

- Harmonisation with existing regulations: Existing regulations must be modified to take account of the fact that CO2 abatement opportunities will now be driven by an economic justification to do so i.e. new LNG projects should not be mandated to sequester CO2 on purely environmental grounds.

CHAPTER 11 (Tax and Accounting Issues)

Tax Issues

BP is in general agreement with the Government's proposals in regard to tax, and particularly the specific tax regime proposed to deal with the income tax consequences of permit transactions. However we believe that further consideration and clarification should be given to the following areas:

- Free Permits There will be tax timing issues for entities that receive free permits that are not used until subsequent income years. This could be addressed by recognising the income in the year the free permit is used, or exempting free permits from the tax system. It will also be necessary to address the issue of ensuring there is no double taxation of unused free permits under the 'rolling balance' closing stock method.
- Timing of Surrender There need to be clear rules to recognise the point when a permit is surrendered and deductions are available, particularly for companies that may operate under substituted accounting periods.
- Market Value of Closing Stock BP seeks clarification on how the market value for the closing stock of permits is to be determined for the 'rolling balance' calculation.
- GST Clarification The Green Paper contains sound proposals regarding GST treatment, but this section is particularly brief and raises concerns that conflicting technical interpretations could be adopted - either by taxpayers or the ATO - which may be contrary to the Government's intended position. For this reason clarification which is binding on the ATO would be highly desirable to avoid any potential uncertainty. In particular, it would be good to ensure that it is clear that permit instruments are not interpreted as representing "financial supplies" and thereby give rise to the inability to claim input tax credits in taxable businesses.
- Associated Transactions The tax rules need to be clear and able to deal effectively with any associated transactions that arise under the scheme, including hedging and derivative type transactions.
- International Taxation The tax treatment of cross-border transactions and international participants to the system has not been addressed and needs to be clarified.

- Stamp Duty While this is a State tax rather than a Federal matter, it would be desirable to understand whether and how stamp duty is likely to apply to permit related and associated transactions under the scheme.

Accounting Issues

BP is familiar with the accounting challenges of an emissions trading system given our involvement in the EU ETS. Accordingly, we are aware of the current challenges arising from the lack of explicit accounting requirements for emissions-related assets and liabilities under International Financial Reporting Standards (IFRS). We support the Government's actions to encourage the International Accounting Standards Board (IASB) to amend IFRS to facilitate emissions-related reporting rules ahead of the scheme start to provide certainty. The implications of an inconsistent approach and hence inconsistent reporting between companies include:

- risks to shareholder value and effective decision making
- potentially increased volatility in market prices in early stages
- impacts reflected in income statements and on balance sheets
- difficulty in making competitor comparisons/benchmarking for both BP and regulators
- difficulties in company/business transactions and valuation
- the use of more than one reporting methodology, particularly for tax purposes. This will lead to increased complexity and potentially risky manual interfaces to adjust one process to the other.

CHAPTER 12 (Transitional Issues)

Given the significance of economic reform under the Carbon Pollution Reduction Scheme as well the imperative to reduce emissions soon, and at scale, parallel policies and actions will be required to effectively meet climate change policy objectives and provide the needed transition to a lower-carbon economy. BP supports many of the Green Paper comments, with the following clarifications and recommendations.

Guidelines

Need for Streamlining Transitional or complementary measure should only be introduced or maintained where the CPRS cannot deliver the proposed policy objective.

Support for Existing Processes BP fully supports both the Commonwealth and the States through COAG in their efforts to review existing measures and remove those that duplicate the intent of the CPRS. This is an essential step to reduce the compliance burden for industry and ensure that legislation is fit-for-purpose.

Climate Change Action Fund

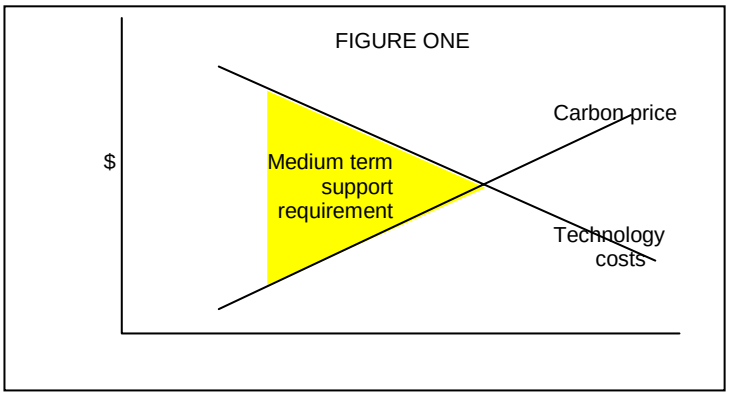
As detailed in the CPRS, the CCAF is designed to provide funding to those industries that do not receive free permit allocation. In order to bring about the deployment of low emissions technologies at the scale and speed that is required to mitigate climate change, this fund should be broadened to support LETs (Low Emissions Technologies)

from any industrial sector that can deliver significant abatement, regardless of support under an EITE or ESAF designation.

Complementary Measures

Carbon Price BP believes that a carbon price introduced under the CPRS will be the primary long term policy mechanism that drives the use of low carbon technologies. We also recognise that in the medium term, complementary measures will be required. In summary, this is because (i) the costs of new technologies will initially be high; (ii) the carbon price is initially likely to be low; and (iii) the urgency with which science indicates that the world must reduce its carbon emissions.

These transitional, complementary policies will help drive the development and deployment of low carbon technologies, whose initial carbon costs are high. This is shown in Figure 1.



This illustrates two key points:

- The carbon price is generally expected to be introduced at a modest level and then rise as the cap in the trading scheme is tightened;
- The cost of new technologies will start high and then reduce as they are deployed with increasing knowledge and scale, with first movers quickly disadvantaged against later entrants who are able to access their learnings and drive down costs.

Combinations of transitional, market-based measures (such as NRET) and direct project support (along the lines of the former Low Emission Technology Development Fund, or perhaps the Climate Change Action Fund) are likely to be the most efficient medium term basis for the accelerated deployment of new technologies. Their continued utilisation will be a key policy response to protect against both (a) locking in a higher future mitigation burden by tolerating too slow a start in technology deployment, and (b) the risk of short term carbon price shocks if the need for accelerated carbon reduction forces the economy to deploy new technologies at the top of their price curve without any other protection.

An important benefit of this approach is that the use of direct policy support will both accelerate the deployment of technologies *and also* accelerate their path down the cost curve. The sooner the technologies move down the cost curve, the sooner they can be supported by a carbon price alone, and these complementary measures can be removed.

The Appendix includes BP's May 2008 Submission to the Wilkins Review, and includes more detail on complementary policies and providing solutions to market failures, as exhibited in the solar photovoltaic (PV) industry.

Chapter 13 (Governance)

BP supports the Government's recommendations for the proposed governance structure. In particular, we agree that:

- Governance arrangements should provide as much certainty and predictability for regulated entities and the market as is practicable.
- Elected representatives (the Parliament and the Government, acting through the responsible minister) would be given responsibility for policy decisions with significant and far-reaching implications, and an independent regulator would be responsible for decisions that are essentially administrative in nature or that involve individual cases.
- Indicators of scheme caps and gateways should be included in the establishing Act and that actual scheme caps and gateways would be set out in delegated legislation.
- Industry assistance criteria and levels of assistance would be determined by Parliament, not the Regulator.
- A special-purpose regulator to administer the scheme should be established, accountable to the responsible minister.
- The consolidation of the proposed scheme regulator, the Greenhouse and Energy Data Officer, and the Renewable Energy Regulator should be considered. In addition, an independent expert committee should conduct a public strategic review of the independent regulator every 5 years.

APPENDIX

1. "Op-ed" Gerry Hueston, "Carbon reduction: Getting closer to getting it right"
2. BP submittal, Wilkins Strategic Review of Climate Change Programs, 20 May 2008
3. BP in Australia *at a glance* webpage

Carbon reduction: Getting closer to getting it right

Australia's approach to climate change has evolved. Now, BP's Gerry Hueston argues that the country must evolve with it, by coming together to translate the new policy consensus into practical action and results.

BP has spent the best part of a decade repeatedly arguing the case for policy certainty around climate change to allow business to manage the associated risks affecting their operations and to allow future investment in our energy infrastructure to be secured. With the release of the Government's Carbon Pollution Reduction Scheme Green Paper, it is now clear that Australia's response to climate change has evolved, and in the direction and manner that business requires.

This is an evolution of certainty, as the Green Paper provides a clear signal to business that there is a policy commitment to early action, based on market mechanisms, and with economic risks dealt with directly rather than thwarting the whole.

This is an evolution of leadership, because in some countries there is no consensus for early action at all, despite clear evidence that the costs of delay outweigh the costs of action.

This is an evolution of strategy, because it has the potential to deliver a competitive advantage to Australia through the adoption of market mechanisms, such as emissions trading, in comparison to the use of inefficient taxes and regulations.

And this is an evolution in progress, because despite Australia having a lot at stake as an energy exporter and an economy dependent on energy intensive industries it has chosen to address the risks directly and not opt out of addressing its challenges.

Now, the challenge is to translate our evolution in principles into practical actions, as the Green Paper becomes a White Paper.

Now is certainly not the time to be mired down in unproductive arguments, and yet it is evident that Business and NGOs have got off to a bad start. Many have quickly settled into the old terms of debate: presenting an adversarial paradigm of business wanting opt-outs from meaningful action.

This paradigm is flawed. I support early action on climate change and I support emissions trading because it provides a broad based response to reducing our emissions, and in a way that can allow the impact on the

Australian economy to be carefully managed. But for a decade now, progress has been thwarted by an obsession with the risks to the short term economy. Unfortunately this progress is still at threat unless all parties become involved in a policy debate that includes getting the balance right both now and in the future.

There is no doubt that risks to our economy are real: without proper mitigations, *there will* be a trade distortion due to early action, *it will* disadvantage Australian businesses which compete internationally, and *it will* put at risk thousands of jobs across the economy. Critically, *there will also be* a social impact as families on low incomes face a disproportionate burden from higher fuel and energy costs.

These risks are unintended, unproductive, and unnecessary: and unless we tackle them they will continue to be able to thwart meaningful progress and put at risk Australia's energy security. Even the sickest of patients cannot take his medicine unless the side-effects are treated. The less mitigation there is for the risks, the less meaningful the carbon price can be.

It is clear then that we must get the *right* mitigation policies in place if we are to avoid excessive trade distortion, enable Australian businesses to compete both at home and abroad, secure present and future employment and cushion the impact on those in our community who are disadvantaged.

Mitigation is not opting out, and it in no way undermines the effectiveness of a Carbon Pollution Reduction Scheme. It is in fact the confidence that Australia can get these mitigation policies right that encouraged the business community to abandon their reticence on climate change, and to become involved in preparing for action. *Getting it right* is ultimately what has enabled Australia's approach to climate change to evolve.

Business, Government and NGOs must stop debating whether to support these policies – and start focussing on the practical details of how to make them work.

After all there is plenty at stake. Across the world we're at an inflection point as far as the future energy mix is concerned. Demand for energy is increasing at a rapid rate, and with that comes increased greenhouse gas emissions. If we can get our policy structures right, we will be able to smooth the transition to a lower carbon economy while providing for a stable and secure energy future. If we don't, then that transition could be very difficult and very costly indeed.

A global trading system should of course be Australia's ultimate objective; otherwise some high-emitting nations will enjoy a "free-ride" on the reductions of others. But just because that is not achievable immediately, should not deter Australia from starting now. There is no doubt that the only

way to effect any change is to set an example, and find ways that will allow for cooperation.

But we won't be able to move on to a focussed and fruitful discussion of the policy details that can lead to effective change both at home and abroad until we acknowledge that the broad principles in the Green Paper are sound.

Gerry Hueston is President of BP Australasia and a member of the Business Council of Australia's *Sustainable Growth Taskforce.*

bp

20th May 2008

Mr Roger Wilkins AO
Strategic Review of Climate Change Programs
Department of Finance and Deregulation
John Gorton Building
King Edward Terrace
PARKES ACT 2600

Dear Sir,

Strategic Review of Climate Change Programs

BP Australia welcomes the opportunity to contribute to the Strategic Review of Climate Change Programs commissioned by the Minister for Finance and Deregulation Hon. Lindsay Tanner MP and the Minister for Climate Change and Water, Senator the Hon. Penny Wong. We trust that the comments within this letter will be received as a useful contribution to your Review and we would be happy to discuss them with you at your convenience.

Long run primacy of carbon price signal

BP strongly supports the use of market based mechanisms as the most efficient means of allocating resources to the reduction of carbon emissions. We should therefore aim for the most transparent and least distorted market possible, as we would with any other sector of the economy. The logic of this position suggests that the "destination" for climate change policies is a sole reliance on a carbon-price which is applied as broadly as possible across the economy and across all the greenhouse gases. With this is mind, your Strategic Review of Climate Change Programs is of paramount importance. Over the past decade, a plethora of policies have been introduced at both State and Commonwealth level to address the challenge of climate change, increasing the compliance burden for business. For example, in the absence of mandatory national greenhouse gas reporting, many schemes have been introduced to capture greenhouse and energy data, including the Greenhouse Challenge Plus program, Energy Efficiency Opportunities legislation and a host of State schemes. We strongly support the rationalisation of these policies and replacement with a single reporting framework through the National Greenhouse and Energy reporting legislation that will support the introduction of the Australian Emissions Trading System (ETS).

However, the simplicity of this position underestimates the complexity of the challenge. In fact, as a dictum, the same piece of rationalist logic could be applied across a broad spectrum of Government policies such as taxation, service provision or trade policy. In actual fact, however, much of Government business and policy debate is devoted to the exceptions to the rules of economic rationalism rather than their application, because the complexity of society demands that these exceptions are provided.

Thus whilst we acknowledge and support the view that the destination for climate change policies should be a pure and unencumbered reliance on an ETS, we equally acknowledge that the reality is more complex. There will be legitimate reasons for exceptions, and therefore we recommend that Government acknowledges and makes transparent the case for them.

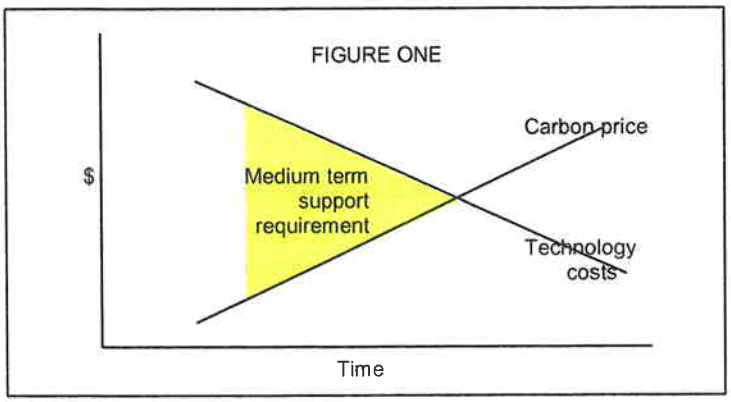
We see broadly that these areas will require additional policy focus, alongside the ETS:

- In the medium term, direct support to accelerate the development and deployment of new low carbon technology options;
- An enduring focus on policy to address market failures that are separate to climate change and therefore are not addressed by a carbon price;
- An enduring focus on other aspects of environmental policy to ensure they do not undermine or exacerbate the challenge for carbon pricing.

We explore these areas in more detail below.

Medium term requirement for complementary measures

The speed with which we need to address the emissions reduction task must not be underestimated if we are to reduce our total carbon emissions to 60% below 1990 levels by 2050 whilst at the same time growing our economy. The power stations that will be operating in 2050 and beyond are being designed today, and the technology choices that Australia makes in the next decade will reposition its ability to reduce carbon emissions for a generation.



It is therefore of strategic importance to the climate change challenge that the appropriate policy signals are taking effect in the market straight away in order to accelerate the deployment of new technology. However, as Figure One demonstrates, new low carbon technologies are caught in a paradox:

- The carbon price is generally expected to be introduced at a modest level and then rise as the "cap" in the ETS is tightened;
- The cost of new technologies will start high and then reduce as they are deployed with increasing knowledge and scale, with first movers quickly disadvantaged against later entrants who are able to access their learnings and drive down costs.

Unfortunately, because of the implacability of the science-driven requirement to reduce our carbon emissions in a short timescale, we need to drag forwards the deployment of new low carbon technologies before the point at which these trajectories would otherwise intersect.

Policymakers effectively have two options at their disposal. On the one hand, they could drive up the carbon price faster and sooner by setting tough and non-negotiable targets in the ETS, so that the economy has no choice but to deploy low carbon technologies quickly and the carbon price floats freely at whatever level is required. The problem with this approach is that to begin start deploying the technologies on an industrial scale, such that the first projects bear fruition in a medium term (2020) time horizon, an initial carbon price of some hundreds of dollars per tonne would likely be required in our estimation. With these costs borne across the economy in the form of higher fuel and utility bills for working families and industry, such a policy response does not appear tenable.

On the other hand, the second policy response is to seek to reduce the effective technology cost by maintaining and strengthening transitional measures. Combinations of market based measures (such as MRET) and direct project support (along the lines of the former Low Emission Technology Development Fund) are likely to be the most efficient medium term basis for the accelerated deployment of new technologies. Their continued utilisation will be a key policy response to protect against both (a) locking in a higher future mitigation burden

by tolerating too slow a start in technology deployment, and (b) the risk of short term carbon price shocks if the implacability of the carbon reduction imperative forces the economy to deploy new technologies at the top of their price curve without any other protection.

An important second benefit of this approach is that the use of direct policy support will both accelerate the deployment of technologies *and also* accelerate their path down the cost curve. The sooner the technologies move down the cost curve, the sooner they can be supported by a carbon price alone, and these complementary measures can be dispensed with.

Economic rationalists could perhaps counter that history typically demonstrates that markets have worked best when fettered with the fewest constraints and interventions. Indeed, if we had an indefinite period of time to meet the challenge of climate change, we would agree with them that an unfettered carbon market would be the most efficient means of resource allocation. But we do not have an indefinite period of time: we must halve our carbon emissions quickly, during a period when we expect to double our energy consumption. It would be pressing the purity of economic rationalism into the realms of negligent complacency, were we to argue that a single policy instrument, the carbon price, could bear this whole burden.

The scale of the challenge will be reflected in the scale of the medium term policy commitment required. Policymakers have become used to supporting renewable energy through relatively generous mechanisms but on only a very small aggregate scale. For example, the entire current installed wind capacity in Australia creates on average some 2,500GWh of power per year[1]. A single 500MW clean coal power station with 80% availability would provide that amount plus a further 1,000GWh of additional power as well – 3,500GWh in total, from just one project. Even a modest 5cpl per kWh subsidy such as has effectively been provided to renewable energies such as wind and hydro through the MRET scheme would sum up to the equivalent of $175 million of subsidy *every single year* to a single project of this scale, if the same support mechanisms were applied – or billions of dollars over the life of the project.

We make this point not to argue that this should be the basis for policy setting, but rather as a means of seeking to adjust the mindset of the community when it considers the scale of policy support required. The deployment of low carbon power on a scale never before achieved will need support on a scale never before applied: the challenge is not to support small projects with ten or fifty million dollars at a time, but rather to convert the capital stock of the economy as a whole. Writing bluntly, the requirement will run to billions of dollars from both the private and public sectors.

The deployment of low carbon power on a scale never before achieved will need support on a scale never before applied.

It would be folly to transfer the burden of this task onto a single policy instrument, and we argue strongly that an ETS must be supported by additional medium term measures at scale. In 2007, BP was one of a group of companies who called for a National Low Emission Technology Strategy[2] to oversee these policy measures, and we recommend that the Wilkins Review adopts such a recommendation as its own.

For the last two years, BP and Rio Tinto, through their joint venture company, Hydrogen Energy, have been studying the feasibility of building a 500MW Integrated Gasification and Combined Cycle (IGCC) power plant with Carbon Capture and Storage (CCS) near Perth. Although we have recently concluded that the geological formations that we have studied do not provide the level of certainty we require for an early project, we have nevertheless acquired valuable perspectives on the challenges of deploying this technology at scale. We have attached therefore Hydrogen Energy's submission to the Garnaut Review, "Australian Climate Change Mitigation – a project developer's perspective on the challenges for CCS"

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[1] http://www.auswind.org/downloads/factsheets/WindEnergyInAustralia.pdf
[2] http://www.businessandclimate.com/

with this letter and would be happy to facilitate a meeting with the Project Director at your convenience.

Not all market failures relate to carbon

It would be a mistake to survey the entire landscape of policies relating to energy technologies that happen to have a low carbon footprint, and to assume that carbon is the only motivation for putting policies in place to support them.

For the solar photovoltaic (PV) industry, for example, a carbon price will provide marginal assistance but it does not overcome the fundamental market failure that it faces, which is the systematic locking out of its power from a proper place in the value chain. Indeed, our belief is that Solar PV would be economic today, even without a carbon price, were it able to claim its proper place in the value chain.

Solar PV is a distributed peak-load generation source that is currently being denied the opportunity to contest the competitive generation markets available to other generation sources. The power generation (wholesale) market is fundamentally different to the retail market, in that the wholesale market operates on a half-hourly basis and prices within it reflect the real time value of power in the given half hour. Retail prices however are based on a 365 day, 24 hour average of the value of power in order to simplify tariffs for the consumer. In real time therefore, average retail prices are below true value during peak periods, but in compensation of this are above true value in off peak periods.

Solar PV is a peak power generation source. It ought to be paid the wholesale value of the power that it generates, but instead it is paid the retail value which significantly undervalues its contribution. For example, the standard retail tariff in Sydney is 12c/kWh, whilst the wholesale value of electricity during summertime peak period can reach as much as 25c/kWh[3]. When a consumer installs a solar PV system, they are absolving their electricity retailer of the need to purchase power at such levels – but in return they are compensated at 12c/kWh. The retailer pockets the difference between the two, which is the true value that the solar PV system has created, and thus the individual that has actually made the investment in a solar system is denied the rewards of that investment.

Our belief is that Solar PV would be economic today, even without a carbon price, were it able to claim its proper place in the value chain

The best response to this market failure would be to address it directly. Modern and inexpensive metering systems enable the power that is generated by solar PV systems to be measured in half hour increments. In the long run, regulators should ensure that retailers are obliged to reimburse the owners of such systems for the true value of the power they generate, which is of course the real time avoided cost of the generation that the retailer would otherwise have been obliged to purchase, plus the avoided costs of transmission and distribution. With access to fair, real-time market pricing for their product, solar PV systems should not need additional policy support.

However, this is not current policy and there are no current plans to remove the structural market failure imposed upon the owners of solar PV systems by the way that the market has been set up by the electricity regulators. Policy support is therefore needed to address this market failure, and care must be taken not to sweep away such support on the misunderstanding that the support was aimed at a carbon objective.

In recent history, this market failure has been partially addressed by the Photovoltaic Rebate Programme (PVRP), a direct subsidy. The level of direct subsidy that this programme has provided has been the subject of many changes and thus the ability of the industry to

[3] "The value of PV in summer peaks" Dr Muriel Watt, University of NSW, 2004

develop efficiently in response to it has been significantly curtailed. Similarly the support has been focused at domestic investors, and thus prevented access to commercial investors and rooftops that will enable the industry to develop the commercial scale needed to move down the cost curve. Moreover the decision in the 2008 Federal Budget to means-test the PVRP and restrict it to households with less than $100,000 annual taxable income has dealt a severe blow and effectively caused the industry to "down tools" on important programmes such as "Solar Cities". Industries which rely on direct subsidies are of course inherently vulnerable to such Budget decisions, which partly explains why support has been growing to replace the subsidy with a Feed In Tariff (FIT) which more directly addresses the market failure in question.

A FIT operates in lieu of real time market pricing, by "deeming" what the proper value of PV generation is and then paying it through a fund raised from a network levy. It is a poor substitute for removing the market failure, but in the interim it is an appropriate transitional measure. Some States and Territories have announced small FITs, and the COAG process is co-ordinating a national FIT model.

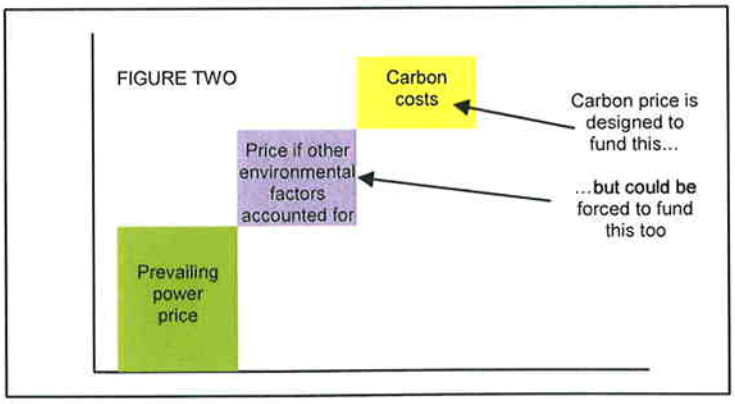
It is important that the Wilkins Review acknowledges that some of the policy measures which support new energy technologies are aimed at addressing market failures other than climate change, and thus should not be assumed to be replaced by a carbon price.

Interaction with other environmental policies

Although the Wilkins Review is primarily focussed on those programs that are explicitly designated as Climate Change policies, it is important to note that other policies could have a profound effect on the efficacy of the ETS. For example, continued approval of power stations under the various Environmental Protection Acts around the nation at below-world-standard levels is placing an undue burden on the carbon price.

Post-combustion capture of CO2 from a coal fired power station depends as a pre-requisite upon the installation of Flue Gas Desulphurisation for example, whilst pre-combustion capture in an Integrated Gasification Combined Cycle achieves best in class performance across a range of pollutants not related to climate change, such as emissions of Mercury, oxides of Nitrogen and Sulphur, and Particulates.

The approval of power stations in Australia that do not meet these world-best-practice-standards means that the Carbon Price has to cover not just the cost of acquitting carbon itself, but also playing catch up on the other (necessary pre-requisite) environmental factors. A post-combustion capture power station, for example, would have to fund Flue Gas Desulphurisation as well as carbon acquittal, placing an unnecessary burden on the carbon price by allowing the conventional power price to remain at levels lower than would otherwise prevail. Figure Two highlights this burden in indicative form.



This burden could be removed if environmental regulators moved progressively towards world best practice. But in the interim, every time a new "dirty" power station is approved, it is enabled to sell low cost power into the grid, reduce the market price of power, and thus increasing the economic hurdle for every form of "clean" power, be it wind, solar, clean coal or other technology and thus adding extra burdens to the task to be completed by the carbon price.

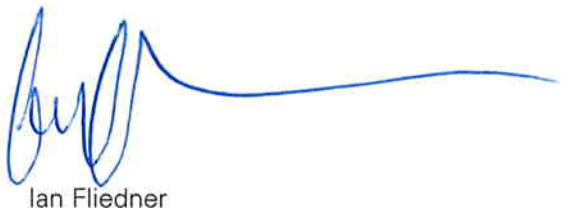
Conclusion

In summary, the tenor of our submission to the Wilkins Review is as follows:

- In the long run and in an ideal world, the burden of reducing carbon emissions would fall solely upon a carbon price transmitted as part of an Emissions Trading System;
- In the medium term and in a complex and less than ideal world, medium term policy measures will be required to directly accelerate the deployment at scale of low emission technologies, and they will be required on a scale beyond that which has been available in the past;
- Not all market failures are carbon market failures, and thus they will not all be addressed by a carbon price. Technologies such as solar PV happen to have carbon benefits, but the main market failures hindering them relate to market structure rather than carbon and measures to overcome those particular failures will continue to be needed;
- The impact of environmental regulation outside the specific climate change area also needs considering. The continued approval of power stations at below world's best practice on other environmental factors simply drives down the cost of power and increases the burden that must be worn by the carbon price.

We trust that this has been a helpful submission.

Yours faithfully



Ian Fliedner

BP Australia

BP in Australia at a glance

BP Australia is driven by the upstream exploration, refining of crude oil and natural gas, the downstream marketing supply of fuel, lubricant and bitumen products

BP has worked in Australia since 1920. Today, we're involved in a range of activities, such as exploring natural gas and crude oil resources. We also refine and market petroleum products, produce lubricants, and help to generate a significant amount of solar power.

Our crude oil refineries at Kwinana in Western Australia and Bulwer Island in Queensland are flourishing, having been upgraded to produce some of the cleanest fuels available in Australia.

We also make and market BP and Castrol lubricants. Castrol is one of Australia's market leaders providing world-class quality lubricants for the local market.

BP Solar has been operating in Australia for over 20 years. We're the only company in Australia producing solar cells on a commercial scale. The BP Solar facility at Sydney Olympic Park is the largest of its kind in the southern hemisphere and recently boosted its capacity by 25 per cent.

We have 2 key petroleum refining facilities and

a network of almost 1,400 service stations in Australia

We also have a network of almost 1,400 service stations throughout Australia, including a number of 24-hour truckstops on the country's major highways. Our focus on superior locations, as well as the fresh food and coffee we provide through our Wild Bean Cafés, have made us a strong competitor in both the fuel retail and convenience sectors.

Our exploration business is focused on the North West Shelf (NWS), where we're one of six participants in Australia's largest resource development. The NWS is rare in that it produces the full range of hydrocarbon products: natural gas, liquefied natural gas, liquefied petroleum gas, crude oil and condensate. To meet the growing demand for energy in China, we've rapidly expanded capacity and output at the NWS project.

See more about BP in Australia at www.bp.com.au.

bp

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18 April 2008

Professor Ross Garnaut
Garnaut Climate Change Review
Level 2, 1 Treasury Place
Melbourne VIC 3002

Dear Professor Garnaut,

We are pleased for the opportunity to comment on the Garnaut Review's "Emissions Trading Scheme Discussion Paper". We view your work is an important supplement to the detailed discussions on the design of the Australia Emissions Trading Scheme, which will have a fundamental impact on the Australian economy and be precedent-setting for subsequent national emissions trading systems.

BP advocates the need for a global carbon price, and we feel that well-designed emissions trading schemes play a key role in facilitating a market response to this price signal, leading to carbon emissions reductions at least cost to the economy. However, it is important to emphasize that, while emissions trading is a necessary precondition, it is not sufficient to drive an appropriate level and rate of technology development; additional incentives will be required to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies.

Yours faithfully,
BP Australia Pty Ltd

Mark A. Proegler

Attachment

BP Submittal to Garnaut Climate Change Review
Emissions Trading Discussion Paper

BP Australia has welcomed Australia's policy approach to GHG and the endorsement of emissions trading as a primary policy tool to reduce GHG emissions in Australia. We are also encouraged to see multiple sources of knowledge and input on this issue, including the National Emissions Trading Taskforce (NETT), the Task Group on Emissions Trading (TGET), the Garnaut Climate Change Review, and the collective learnings from other trading regimes around the world. Accordingly, we are pleased for the opportunity to comment on the Garnaut Review's "Emissions Trading Scheme Discussion Paper". We also wish to be actively engaged in subsequent consultation on this subject.

BP advocates the need for a global carbon price, and we feel that well-designed emissions trading schemes play a key role in facilitating a market response to this price signal, leading to carbon emissions reductions at least cost to the economy.

Moreover, emissions trading can create significant engagement with those regulated by such a scheme because they have to make conscious decisions about their emissions, leading to benefits beyond the specific scope of the trading scheme.

However, it is important to emphasize that, while emissions trading is a necessary precondition, it is not sufficient to drive an appropriate level and rate of technology development; additional incentives will be required to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies.

Summary Comments

The Garnaut Emissions Trading Scheme Discussion Paper offers some new insights into the Australia ETS design—many of which BP supports. Our submittal focuses on some specific topics, noting our areas of agreement and disagreement with the Paper. In summary, this includes:

- Reiteration of key principles governing ETS design elements
- Coverage, including the inclusion of liquid fuels, which we support while noting the limitations of this approach
- Support for both direct and indirect linking with other emissions trading regimes
- Support for permit auctioning as well as administrative allocations, depending on competitive impacts and the ability to pass through costs; the refining and LNG industries are candidates for administrative allocations, at least in the near term
- Key principles for auction design
- Key principals for cost containment mechanisms, as well as examples
- Governance

ETS Principles & Design Features

BP agrees with the key principles outlined in the Discussion Paper, and we would emphasize the importance of a liquid, robust allowance market as a key factor in the emissions trading system (ETS) success and in meeting its primary objective of achieving emissions reductions at least cost. A well-functioning market and its resulting forward carbon price expectations is a particular need in the oil & gas sector, with its long development timelines and requirements of significant upfront capital investment.

A fundamental condition for a liquid market is a large number of buyers and sellers, while market integrity requires a stable and predictable regime that establishes and protects the rights of those buyers and sellers in a fair, commercially reasonable, transparent manner. While such a regime will enhance liquidity and trust in the market, liquidity cannot exist if the market is poorly designed or if the various cost-containment and structural provisions do not work together effectively as a whole. BP recommends the following measures to promote liquidity and integrity:

- Robust systems for measuring, monitoring, and reporting emissions
    - Third-party verification; transparent registries; standardised methodologies are all essential. Underpinning systems should be developed in such a way to give maximum compatibility with existing national and international tools & protocols.
- Long-term investment confidence and appropriate accountability
    - In order to promote significant (permanent) behavioral/operational changes and new technology investment, the market and regulations must provide a clear long-term framework for investment
- Compatibility with existing (and future) policies - any emissions trading program should be developed to work in harmony with existing regulations and be flexible to change as new policies and measures emerge.
- Key design features:
    - Acceptance of project based domestic and international offsets for part of compliance;
    - International linking to accept allowances from other trading regimes
    - Unlimited banking of offsets and allowances;
    - Effective multi-year compliance periods;
    - Point of regulation/obligation provisions that balance the need to match this obligation to the emitter with the costs and procedures for doing so; and
    - A well-designed compliance requirement that will support efficient trading of highly fungible allowances and offsets

ETS Key Design Elements

Coverage BP believes in principal with the Paper's recommendations to cover as many gases and sectors as possible. However, there are other factors to consider:

Gases: the appropriateness of applying emissions trading to each of the Kyoto greenhouse gases needs to be evaluated separately for each gas. For more "specialised" gases it is likely that the transaction costs and complexity associated with their inclusion may outweigh the benefits. Alternative policy measures should be considered in this case.

Sectors: the Paper recommends the inclusion of all industrial sectors, which BP supports since we believe it is important that all sectors of the economy should contribute equitably to national goals to reduce greenhouse gas emissions. While we understand the importance of including the transport (liquid fuel) sector in the cap, this will have limited environmental effectiveness given the relatively small impact that resulting fuel price rises will have on fuel demand and on the choice of new motor vehicles. Significant emissions reductions in this sector will only be achieved via an integrated policy approach that addresses vehicle efficiency, fuel carbon content, and consumer behavior—the latter comprising a range of actions across many time scales, including traffic management, road pricing, city planning, etc.

Linking Connecting the Australia emissions trading system with other existing systems expands the potential for economic gains from trade and associated cost savings—whether this comes from direct linking (allowances) or indirect linking (linking via the inclusion of international offsets that are accepted in multiple trading systems, e.g. CDM, JI). Larger and more liquid markets are inherently more efficient, reducing transactions costs and providing capital for a larger pool of opportunities for low cost abatement.

Direct Linking In general, linking with other systems will be accomplished more easily if the elements in each system are similar, which is an important consideration in the design phase of the ETS. For example, monitoring requirements across systems need not be identical in every way, but they need to be accepted as comparable in rigor by companies and governments; the use of common protocols (e.g. WRI/WBCSD GHG Protocol) will help facilitate this. Transparency and public access to emissions data are also essential design features in building acceptance of the program and associated monitoring requirements. Key criteria in evaluating the direct linking of programs should include the consideration of:

- Environmental integrity, specifically the potential to expand environmental benefits compared with the absence of linking
- Cost effectiveness, including the potential for lower (or higher) costs in linked systems compared to systems that operate independently
- Fairness to all participants

Indirect Linking The linkage of trading systems via offsets such as CDM and JI also offers advantages[1], and is more likely to occur in the near term than direct linking. Accordingly, it is important that the ETS provides for unfettered inclusion of offsets such as CDM and JI. BP does not support the Paper's recommendation that CDM credits accepted by the ETS be limited based on their country of origin.

[1] "Linking Emissions Trading Systems" Policy Brief, IETA, Andrei Marcu, October, 2007

Allowance Allocation BP fully agrees with the Paper's statement that "The most important point is that the impact of an ETS on the price of goods and services is *independent* of the approach adopted by governments for allocating permits". However, because permits have economic value, the chosen allocation method (e.g. administratively allocated or purchased/auctioned) will determine how this economic impact is distributed amongst regulated entities, consumers, and other parties—and this will have significant consequences, especially given the billions of dollars involved in the Australia ETS. The allowance framework will accordingly play a key role in meeting political, economic, and technology objectives.

An emission allowance allocation system should seek to mitigate economic transition costs to entities that will be relatively more adversely affected by GHG emission limits or that have already made investments in higher cost, low-GHG technologies, while simultaneously encouraging the transition from older, higher-emitting technologies to newer, lower-emitting technologies.

The purpose of allocation is to initiate a market for carbon on an efficient and equitable basis, rather than to create an indirect tax and revenue source for government. BP recommends that Australia should distribute allowances in a manner consistent with achieving fundamental objectives of cost-effectiveness, fairness, transparency, and simplicity. Additional guiding principles include:

- Mitigates economic impacts caused by competition from firms operating with no "carbon constraint"
- Reflects the capacity of different sectors to recover costs through the inclusion of carbon in product pricing
- Avoids perverse incentives that discourage or penalise investments in low-GHG technologies and fuels
- Helps to ensure market liquidity
- Minimises administrative complexity and maximises transparency regarding the use of allowance value

For sectors that can fully pass through costs and are not exposed to competition not subject to a carbon price, permits should be distributed via full auctioning.

For sectors that face challenges from competition not exposed to a carbon price and who are unable to pass on increased costs of carbon constraints, some administrative allocation, phased out over time, should be used to help manage the transition to full auctioning.

Examples of BP businesses exposed to an international carbon price with very limited ability to pass through costs-- and therefore candidates for administrative allocation of permits–include our activities in petroleum refining and LNG production and export.

Auction Design Auctioning should be seen as a way to allocate carbon into the market and allow it to operate—not as a tool to manage the market. Key principles for auction design include transparency, simplicity, scale, and timing.

Auctioning Revenue Given that the primary objective of an emissions trading system is to achieve cost-effective emissions reduction, any revenues from auctioning of permits should be used primarily for this purpose, and returned back to the private sector through some form of recycling. This revenue should be used primarily to support the development and deployment of low-GHG technologies,

such as carbon capture and storage (CCS). In addition, the processes for managing these revenues and their distribution should be proscriptive and transparent.

Cost Containment Mechanisms The need for explicit cost containment measures may be especially important during the initial years of a cap-and-trade program while the development and deployment of low-carbon technology may lag behind the level needed to achieve mandated emission reductions targets and commercially available financial tools and strategies for managing volatility and risk are not fully developed.

In addressing this need, BP believes that explicit cost containment measures should be based on the following principles:

- Measures should be clear, effective and easy to administer;
- They should not breach the legislation's overall GHG emission cap and ensure that needed reductions are achieved in a timely manner;
- They should, to the maximum extent possible, provide objective, clear and predictable information about the factors influencing future allowance prices;
- They should not supplant the development of commercially available financial tools and strategies for managing volatility and risk;
- They should minimise the opportunity for intentional manipulation of market prices by market participants;
- The application of many of the measures should diminish over time, so that cost-minimising market forces can properly spur investment in the most cost efficient, long-term solutions for reducing GHG emissions

Cost containment measures should be designed to address a variety of reasonable concerns about the price and cost impacts of a cap-and-trade system. The primary concerns are threefold: a) short term extreme price volatility; b) sustained high allowance prices, an allowance price trajectory that discourages important investments in emissions-reducing technologies; and c) illiquidity. All of these problems can be guarded against, to some degree, by allowing a sufficient amount of qualified project-based offsets to qualify for compliance purposes. In further addressing these concerns, it is important to use well-considered tools that can be relied upon to effectively mitigate these concerns and that will work well together while being consistent with the principles above. BP recommends the following package of tools which could be used in various combinations to deal with the key concerns:

- Acceptance of project based domestic and international offsets for part of compliance;
- Acceptance of international allowances for compliance from countries with capped emissions;
- Unlimited banking of offsets and allowances;
- Effective multi-year compliance periods

Governance

While the foundation of a successful trading program includes a rigorous system for collecting and reporting accurate emissions data, its effective operation is dependent on the market's ability to function with integrity and minimal government interference.

The Paper suggests the creation of an Independent Carbon Bank (ICB) to oversee the operation and administration of the Australia ETS. While BP agrees in concept with an independent regulator (leading to effective hypothecation of (auction) revenue), there are concerns that the ICB possesses the capacity to act as both regulator and market participant, which would undermine confidence in the market. The government's market design elements (cap, banking provisions, offset use, etc.) should be the primary levers to influence market price—not direct intervention by an entity like the ICB.

bp

Ian Fliedner

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Renewables, Offsets and COAG Branch
Department of Climate Change
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30 July 2008

Dear sir / madam

Design Options for the Expanded National Renewable Energy Target Scheme

I am pleased to provide this response to the above consultation process on behalf of BP Australia Pty Ltd ("BP").

BP supported the establishment of the Mandatory Renewable Energy Target (MRET) scheme and now supports its expansion to 45,000GWh in 2020. Whilst we believe that a carbon price, introduced under the Commonwealth Government's Carbon Pollution Trading Scheme ("CPRS") will be the long term policy mechanism that drives the use of low carbon technologies, we also know from our own work that in the medium term complementary measures will be required. In summary, this is because (i) the costs of new technologies will initially be high; (ii) the carbon price is initially likely to be low; and (iii) the urgency with which science tells us the world must reduced its carbon emissions means that we cannot delay whilst this paradox resolves itself. Our submission to the Strategic Review of Climate Change Programs by Roger Wilkins (the "Wilkins Review") contains further details of this position and is attached as an appendix.

The remainder of this response addresses the specific questions raised in the National Renewable Energy Target ("NRET") design options paper.

Stakeholders views are sought on the scope of design issues under consideration, their interactions, and other issues that should be addressed during design of the expanded scheme.

We believe that the issues listed in the NRET design options paper are appropriate.

Stakeholders views are sought on possible approaches to setting annual targets and their implications for investment mix, generation profile and cost of the measure.

In principle, the annual increases in the NRET target should start slowly and then accelerate towards the end of the scheme, when deployment costs can be expected to be lower.

However, part of the energy challenge facing Australia is to deploy renewable energy at a much larger scale than seen to date. The Government will need to be alert to the possibility that the successful early deployment of a few large scale renewable energy power stations (large wind farms in the US can be many hundreds of megawatts) would be a very good thing but could swamp the NRET and create a hiatus in the value of RECs for the rest of the industry. Even unlimited banking capability would not completely address this problem because the income from banked RECs is both in the future, and uncertain in value.

To overcome this problem, should it arise, the Office of the Renewable Energy Regulator ("ORER") should retain the ability to re-profile the annual targets in an upwards direction, if in doing so they accommodate the entry of large early renewable projects. There should be no symmetrical ability to revise the annual targets downwards, because that would introduce too much regulatory risk. This ability to accelerate the rate of increase in annual targets would help ORER to reduce REC price volatility in the face of the entry of large scale projects.

Recommendation 1: ORER should have the power to accelerate, but not decelerate, the rate of increase in annual targets between now and 2020, if in doing so they increase the stability of REC prices in the face of the entry of large scale renewable projects.

Stakeholders views are sought on the treatment of renewable energy sources and technologies, including the treatment of forest biomass and solar water heaters.

Whilst we do not have a firm recommendation on specific individual technologies, we do note that the purpose of NRET is to help accelerate the deployment of renewable technologies whose costs are initially too high to be supported by a carbon price which is initially too low. Over time, technologies should be expected to move down a cost curve so that they can be supported by a carbon price alone. Different technologies are already at different stages of their cost curve. ORER may ultimately have to rule that a given technology is sufficiently economic to be supported by the CPRS alone, and therefore should cease to be eligible for additional support under NRET. To minimise regulatory uncertainty, any such change should only be introduced after considerable consultation and notice, and should never apply retrospectively to projects already committed to.

Apart from this consideration however, the definition of eligible sources should be as broad as possible to encourage innovation and avoid picking winners.

Recommendation 2: Definition of renewable energies should be as broad as possible. However, ultimately ORER may have to rule some renewable energies as ineligible for NRET inclusion on the grounds that they have become commercially viable on the basis of a carbon price.

It is very important that a deeming process continues to be available for small-scale renewables such as Solar PV on residential roof tops. This will continue to be required even if all the States and Territories move to introduce an effective gross Feed In Tarriff. The view, expressed in some quarters, that an NRET and a FIT are alternative policy mechanisms to achieve the same aim is flawed. This is because

a Feed In Tarriff is intended to remunerate Solar PV for its peak power characteristics, which are currently unrewarded, rather than to remunerate its "renewable low-carbon energy" values which would still need to be addressed via an NRET deeming process.

Recommendation 3: A deeming process for small scale renewables should be retained. NRET is not an alternative to a Solar Feed In Tarriff, which seeks to address different policy aims.

Stakeholders views are sought on approaches to banking of RECS and their potential impacts on investment profile, generation level and technology mix and on the cost of the measure.

Banking should be unlimited in order to incentive least cost approaches to early deployment. The danger that a small number of large scale renewable projects can swamp the scheme by banking large numbers of RECs is addressed by our Recommendation 2, above.

The danger that the aggregated early deployment of renewable projects leads to excessive banking and thus risks disincentivising new generation in later years is a real one. However, it is a reflection of success: "more early deployment than expected" will in fact be a good thing. We do not believe that the target of 20% renewables represents a policy cap, and that having achieved it Australia will be satisfied to retain 80% fossil fuel generation thereafter, or indeed that after 2020 it will be satisfactory for renewables to decline again.

Therefore we believe the Government should review the operation of NRET, perhaps in 2015, and if it discovers that there has been "too much early success" in the deployment of renewable technologies it should exercise an option to increase the target or increase the duration of the NRET scheme to ensure that renewable energies continue to be deployed and to build on this early success.

Recommendation 4: Banking should be unlimited. If excessive early banking threatens later deployment of renewables, the Government should consider a further extension of the NRET scheme in a review in 2015.

Stakeholders views are sought on the implications of restricting the eligibility period for projects under the scheme.

Different renewable energy technologies will have different requirements, and a restricted eligibility period will therefore impact some technologies harder than others. For example, large scale projects might have associated capital requirements (eg network connection costs) that are not borne by smaller projects, and thus they would be differently impacted by a restricted eligibility period. In the interests of competitive neutrality, and also of broadening the participating technologies in order to reduce cost, this should be avoided.

However, as we note in Recommendation 3, ORER may ultimately have to judge that some renewable energy technologies have become viable in their own right under the Carbon Pollution Reduction Scheme and therefore no longer eligible for NRET support. This will be a more appropriate way of ensuring that NRET is constantly focussed towards the deployment of new and emerging renewable technologies, rather than the arbitrary application of an eligibility period.

Recommendation 5: There should not be a fixed eligibility period within the duration of the scheme.

Stakeholders views are sought on how projects already in operation should be treated and whether projects predating 1997 should be treated differently from those predating 2007.

Stakeholders views are also sought on the treatment of additional generation created, for example, through capacity additions or refurbishment.

Generally speaking, the rules should not be changed retrospectively to harm or benefit any pre-existing project, and because the intent of the NRET is to encourage the deployment of new renewables it follows that pre-existing renewables generation should not be eligible to create RECs under the extended NRET. We therefore propose that generation installed before 2007 be treated under the extended NRET in the same manner that pre-1997 capacity is treated under MRET: ie only generation in excess of an agreed baseline should be eligible.

However genuine capacity additions at existing projects should be eligible to create RECs under the extended NRET. Refurbishments should also be eligible, subject to an additionality test, ie to the extent that they are genuinely creating additional generation and are not simply the consequence of best practice maintenance that would have been required even in the absence of NRET extension.

Recommendation 6: Pre-2007 generation capacity should be treated under the extended NRET in the same way that pre-1997 capacity was treated under MRET. Subject to an additionality test, generation arising from extensions and refurbishments should be fully eligible.

Stakeholders views are sought on methods and timing for phasing out the RET scheme between 2020 and 2030 and on their implications for investment profile, generation level, technology mix, and the cost of the measure.

The NRET should be phased out to the extent (and at the point in time) that its original objectives are no longer required. That is to say, it is no longer necessary to provide additional support to new renewable technologies because their costs have fallen and the carbon price has risen.

The extent to which the carbon price has risen will be clear and measurable, and by 2020 we expect to have sufficient experience of the CPRS in operation to be able to make prudent forecasts. Therefore the most appropriate way to phase out NRET will be to reduce the shortfall charge each year such that where:

Shortfall Charge + Carbon Price = Y

that Y remains constant. However, the translation of the carbon price into a deemed "dollars per MWh" price will be complex and will vary between different electricity markets depending on the competing fuel source that is being displaced. This will therefore require careful consideration. There is no particular reason why 2030 should be selected as the date by which the Shortfall Charge will have reduced to zero.

The extent to which technology costs will have fallen is harder to discern. Certainly, some technologies may be competitive under the CPRS, as our Recommendation 3 acknowledges. But from the vantage point of 2020, it may well be that the challenge is to deploy a new tranche of renewable energies

(perhaps to reach 30% renewables by 2030, for example) and policy support may be needed for this next wave of technology deployment. Government will need to take a view nearer the time as to whether a further extension of NRET is required in order to deploy the next wave of technology.

Recommendation 7: Government will need to decide nearer the time whether a phase out of NRET is justified from 2020 or whether a further extension is justified. Where a phase out is selected, it should be implemented by a phased reduction of the shortfall charge impact, timed to meet the rising price of carbon permits in a manner that will be revenue neutral for the project.

Stakeholders views are sought on the appropriate level of the shortfall charge, in particular on whether it should be set at a very high level to encourage compliance or at a level only slightly above the maximum expected REC price.

BP believes that the shortfall charge should be set as a level only slightly above the maximum expected REC price, in order to provide an effective cap on the REC price. This is because we believe that adding the potential for a REC price spike to the potential for a carbon price spike would be too much risk for the economy.

The Shortfall Charge should be set to incentivise the deployment of those technologies that are near market, and thus for which there is a reasonable expectation that they will be viable under the CPRS alone within the foreseeable future. More remote technology options, still at the start of their Research and Development phase rather than moving into their Deployment phase, would need to be targeted with other policy instruments.

Recommendation 8: The Shortfall Charge should be set just above the expected maximum REC price such that the REC price is sufficient to bring forwards near-market technologies entering their deployment phase, but not more remote technologies still in their R&D phase.

Conclusion

We make 8 recommendations in response to the NRET Design Options paper. In summary our recommendations are:

1. ORER should have the power to accelerate, but not decelerate, the rate of increase in annual targets between now and 2020, if in doing so they increase the stability of REC prices in the face of the entry of large scale renewable projects.

2. Definition of renewable energies should be as broad as possible. However, ultimately ORER may have to rule some renewable energies as ineligible for NRET inclusion on the grounds that they have become commercially viable on the basis of a carbon price.

3. A deeming process for small scale renewables should be retained. NRET is not an alternative to a Solar Feed In Tarriff, which seeks to address different policy aims.

4. Banking should be unlimited. If excessive early banking threatens later deployment of renewables, the Government should consider a further

extension of the NRET scheme in a review in 2015.

5. There should not be a fixed eligibility period within the duration of the scheme.

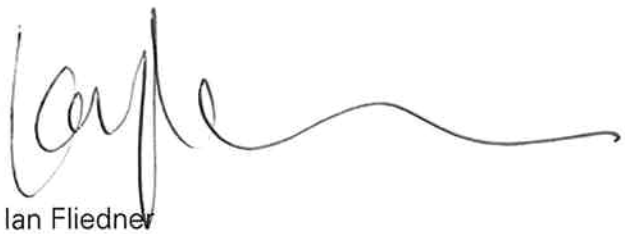
6. Pre-2007 generation capacity should be treated under the extended NRET in the same way that pre-1997 capacity was treated under MRET. Subject to an additionality test, generation arising from extensions and refurbishments should be fully eligible.

7. Government will need to decide nearer the time whether a phase out of NRET is justified from 2020 or whether a further extension is justified. Where a phase out is selected, it should be implemented by a phased reduction of the shortfall charge impact, timed to meet the rising price of carbon permits in a manner that will be revenue neutral for the project.

8. The Shortfall Charge should be set just above the expected maximum REC price such that the REC price is sufficient to bring forwards near-market technologies entering their deployment phase but not more remote technologies still in their R&D phase.

Please do not hesitate to contact me if you would like to discuss this response further, and I hope it has been helpful.

Yours faithfully



Ian Fliedner
Director, External Affairs
BP Australasia

BP AUSTRALIA PTY LTD

SUBMISSION TO

Inquiry into the National Fuelwatch (Empowering Consumers) Bill 2008 and National Fuelwatch (Empowering Consumers Consequential Amendments) Bill 2008

5 August 2008

1. INTRODUCTION

BP Australia Pty Ltd (BP) is pleased to make a submission to the Senate Economic Committee's Inquiry into the National Fuelwatch (Empowering Consumers) Bill 2008; National Fuelwatch (Empowering Consumers) (Consequential Amendments) Bill 2008.

BP's submission focuses on three core issues associated with Fuelwatch: the proposal to improve pricing information for consumers; the proposal to fix prices for 24 hours; and operability of the draft legislation. There is benefit in this submission being read alongside the submissions lodged by the Australian Institute of Petroleum, of which BP is a member, as these submissions also provide broader context of operations of the petroleum industry in Australia.

2. BACKGROUND ON BP'S OPERATIONS

BP's operations in Australia consist of:

- two refineries, one in Queensland and the other in Western Australia, which are critical to the production and supply of fuel products in Australia, including to the resources and aviation sectors, as well as for general transport and motoring;
- partnership in the Woodside North West Shelf LNG operation which accounts for over 40% of Australia's oil and gas production;
- a solar module manufacturing plant at Sydney Olympic Park which is the largest solar module manufacturer and the only commercial manufacturer of solar photovoltaic technology in Australia;
- around 260 company owned and operated retail service stations and over 1,000 service stations independently operated under the BP brand;
- approximately 5,000 employees; and
- payment in excess of $A500M in taxes each year.

In Australia BP is a fully integrated refiner-marketer of petroleum products. This means that BP imports both crude oil and refined product, operates and stores product in terminals, sells products at the wholesale and retail levels and manages a distribution network. BP's operations cover the full range of products, including bitumen for our roads, jet fuel to supply our military and civil aviation industry, and diesel, which is used primarily in the resource sector.

While BP's submission only deals directly with those elements of BP's operations that are affected by the proposed Fuelwatch scheme, given the integrated nature of the business, the scheme has the potential to impact the entire business and thus any long run impact should be considered in the context the impact on the economy generally and Australia's overall energy security goals.

3. BACKGROUND ON HOW BP PRICES FUEL

Given that a key part of the Fuelwatch proposal concerns pricing it is helpful to understand how BP prices fuel in Australia.

Broadly speaking, for fuel that is expected to be sold in the retail market, BP pricing occurs at three levels:

- Sales ex-refinery. The price is based on the landed price of Australian fuel grade standard product, the Import Parity Price (IPP). If a refinery tried to sell product above the IPP other companies would simply import product. Thus refinery sales and margins in Australia are governed by international refining margins as reflected in the IPP. Ex-refinery sales are also known as Buy-Sell because refiners buy and sell from each other, as well as import their own refined product. (Ex-refinery sales can also be made to other customers who have their own terminal facility.) Given the long distances but small size of the Australian market buying locally from another refiner is more efficient than each refiner transporting their own refined product to markets where they don't have their own refinery. The term Buy-Sell does not indicated any reciprocity in contracts with each being negotiated on commercial terms.

- Wholesale sales, ex-terminal. This pricing is based on a Terminal Gate Price (TGP). BP sets a TGP at each of its terminals. This is a build up of IPP plus all costs to and including terminalling plus a wholesale margin plus excise and GST.

- Retail sales. BP sets the price at the retail level for around 260 sites that BP owns and operates. Approximately a further one thousand sites carry the BP brand where prices are set by the operators, not BP - it would contravene the Trade Practices Act if BP were to intervene in this process.

In addition, BP negotiates large volume contracts with commercial businesses, such as those in the mining, manufacturing and transport sectors.

BP believes that the petroleum industry in Australia is highly competitive, contestable at all levels, and price build-ups are amongst the most transparent of any industry in the country. There is nothing to be gained, and much to be lost by price regulation in BP's view and any proposal to regulate fuel prices is not supported on the basis that this is more likely to reduce rather than increase competition in the industry.

4. FUELWATCH

BP will operate within whatever regulatory framework is set by government. This has been demonstrated in Perth over the past seven years where BP has been able to continue to operate successfully under the Western Australian Government's Fuelwatch regulation. However, BP cannot see any justification for the proposed legislation given that the ACCC, in its December 2007 report *Petrol Prices and Australian Consumers*, noted that "Using all this gathered evidence we are able to conclude that the unleaded petrol industry in Australia is fundamentally competitive" (page v).

Improving Pricing Information for Consumers

While BP does not understand fully why further consumer information measures are required in a fundamentally competitive market, BP does not oppose those elements of Fuelwatch which seek to improve the availability and timeliness of pricing information for consumers. BP is of the view that well functioning markets foster competition in the interests of consumers and a more efficient industry. Providing consumers with more price information is consistent with that belief.

With technology available today it would be possible to provide consumers with real-time, location specific pricing information direct to their mobile phone or other hand held device. Such an approach would provide better information for consumers while retaining the ability of fuel retailers to discount their prices during the day.

From BP's perspective the only requirement of this or any other approach to improving consumer information is that all participants must face equal costs. This is currently not the case with the service provided by Informed Sources where only a limited number of fuel retailers, albeit covering a large segment of the market, elect to pay for this service.

Regulating prices (the 24-hour rule)

BP cannot predict accurately what impact Fuelwatch would have if introduced nationally as each market is different. However, it is worth noting that BP has continued to operate in Perth with the Fuelwatch scheme in place in that market. There is no evidence that BP's business has suffered in Perth relative to other markets where Fuelwatch was not in place. Indeed BP does not believe that Fuelwatch has had any impact on retail prices in Perth.

Any argument by third parties that BP's opposition to Fuelwatch is because it will reduce profits is wrong. Rather BP is opposed in principle to those elements of Fuelwatch which regulate how and when individual businesses can change the price for the goods that they sell.

To date there has been no compelling analysis put into the public domain which makes the case for regulating prices. Certainly, no market failure has been identified. And prices are among the lowest in the OECD. In fact, as noted above, the ACCC concluded that the unleaded petrol industry in Australia is fundamentally competitive.

While it is true that the ACCC suggested that Government consider benefits of introducing a national Fuelwatch scheme and expanded pricing information for consumers, the ACCC noted that "…in time available it was not possible to fully review all the options…". The ACCC also noted that "a detailed assessment addressing these issues would have to be made before government could confidently embark on any one of the suggested options". Notwithstanding the additional analysis released by the ACCC, BP does not believe that the preconditions specified by the ACCC for introducing Fuelwatch have been met.

However, as the Prime Minister has noted on several occasions, the ACCC is the "only Government agency which has done the economic modeling" (interview on Sunrise Program, Seven Network, 30 May 2008). It is this very fact that concerns BP given that in its report the ACCC noted with regard to its econometric analysis, "These results have important caveats…" (page 247).

BP is of the view that these caveats are important to understanding whether or not Fuelwatch caused prices to fall in Perth relative to capital cities on the east coast. In particular, BP believes that the failure of the ACCC to include the differentials in the cost of freight by State is fundamentally important when assessing the robustness of their analysis. This is because freight is a key element of the Import Parity Price which, as noted in section 3 above, is central to the wholesale price at which petroleum products are sold in Australia.

BP has observed that since 1998 the cost of freight to transport product from Singapore to Perth has not risen as fast as the cost of shipping the same product to the east coast of Australia. In addition, the higher cost increases for the east coast apply to a higher base price than the relatively smaller increase in the cost of shipping to Perth.

As the ACCC noted in its report (page 252) "Any impact from transport or port charges is likely to be small as it would need to entail a significant change in the relativity between Perth and the other capitals, not simply a change in the level for Perth." And BP believes that that caveat is exactly what has occurred. BP has observed that shipping costs have increased significantly and contends that they are therefore quite material to any analysis of the impact of Fuelwatch on the Perth market. This could easily have manifested itself in the appearance of prices in Perth becoming relatively cheaper than prices on the east coast, as concluded by the ACCC, without necessarily being correct if changing differentials in shipping charges by State are excluded from any such analysis.

Given the exclusion of changing differentials in shipping charges by State from the ACCC analysis, which is a key component of the Import Parity Price (and hence wholesale prices), BP believes that further detailed analysis of the impact of Fuelwatch should be undertaken by the Government before proceeding to implement any proposal to regulate prices.

If such analysis has already been undertaken then it should be made public. As the ACCC noted in its report, "there are potential benefits and potential costs of adopting a national price commitment arrangement that need to be carefully considered". Further analysis should be undertaken and/or made public on both the benefits and costs of the proposal to fix prices for 24 hours.

Intra-day Pricing

BP has noticed a shift over time in the Government's public explanations – or at least emphasis - of its rationale for introducing Fuelwatch, including but not limited to the shift from lowering petrol prices to removing intra-day price movements.

This rationale seems at odds with the December 2002 report *Terminal Gate Pricing Arrangements in Australia and other Fuel Pricing Arrangements in Western Australia* in which the ACCC concluded (page 3) that "Contrary to widely held perception, petrol prices are relatively stable on average within a day. In Perth during the period 16 October 2000 to 12 November 2000 (i.e. prior to the introduction of the 24-hour rule) the average number of changes was only 1.18."

BP cannot understand how reducing a fuel retailer's ability to lower prices during the day can benefit consumers. With the weekly discount cycle in place in most east coast markets the vast majority of intra day price movements are downwards. Indeed BP there is generally only one price increase per week. In an average week BP has observed that prices may be reduced in more than 90% of cases, with less than ten per cent of price change in a typical week being a price increase.

Consumers who are most price sensitive are already aware of this and thus have the most to lose from a policy which may change the well-established weekly price cycle. Coles, Woolworths and Nuemann all gave evidence to the ACCC inquiry showing that they sell more fuel at the bottom of the price cycle (ACCC report p175).

As stated by Coles, retailers rely on averaging their retail margins between the high and low points of the cycle. Any dampening of the amplitude of the price cycle will be noticed immediately by consumers who currently align their purchases to take advantage of the deepest discounts (ACCC report, p171).

Similarly, if there is a move nationally away from a weekly price cycle, as has occurred in Perth, this could disadvantage consumers who need fuel on a weekly basis and currently purchase in line with the weekly discounting cycle.

Impact on small business

While most people's experience of BP is as a fuel retailer, a much bigger part of BP's business is as a fuel wholesaler. In addition to around 260 service station sites owned and operated by BP there are around a further one thousand sites that carry the BP logo. It is in this context, as a major fuel wholesaler, that BP is concerned about the impact that Fuelwatch will have on our dealers and distributors who own and operate or supply BP branded sites.

BP has a long established relationship with many of these small businesses and from this perspective is concerned at the disproportionate impact that Fuelwatch is expected to have on smaller operators. For example, a requirement to lock in prices for 24 hours provides the greatest risk to operators of the fewest sites. A single site operator who guesses wrongly and sets their price too high has their entire income stream locked out of the market for 24 hours. If the price is set too low they risk making insufficient margin to cover long run costs and, worse, running out of product, which damages their reputation as a fuel retailer. In contrast, the greater the number of sites operated the greater the ability to spread risk by pricing across the expected market range.

Operational issues

While BP does not believe that sufficient public justification has been made to introduce Fuelwatch nationally, if the Parliament passes the legislation BP would nonetheless like to see some changes made to the Bills as drafted. As noted above, BP has continued to operate in Perth with the existence of a Fuelwatch scheme in that market which is essentially the same as that proposed to be introduced nationally. The views below are therefore based on the understanding gained from operating under Fuelwatch. The changes suggested aim to increase compliance while keeping to a minimum any additional costs, which are eventually passed onto motorists in the form of higher prices.

Firstly, BP has been able to operate in Perth with the requirement that prices on the console and main display board at retail sites must be changed at 6am, no earlier and no later. This has largely been possible due to the small size of the Perth market and time difference with the east coast. To replicate this nationally will require more staff, including extra staff at retail sites and in the main BP office in Melbourne prior to 6am seven days a week.

Extra staff will be required at sites because it is physically impossible to change the main price display board and the console within the 60 second window provided under the legislation. (BP has been challenged in the past for not changing prices by 6.02am.) Also, if a staff member is changing over the main display board they necessarily have to leave the console which means that they must stop serving customers and potentially poses an extra security risk. As a company committed to the health and safety of our number one asset, our people, BP now employs two staff at each of our sites in Perth for this changeover period. We would expect this to be replicated across the 260 sites we own and operate nationwide if legislation is passed in its current form.

Additionally, extra IT and support staff will be required to be rostered on and/or on-call much earlier than usual to deal with the inevitable computer glitches which, if not fixed immediately, require the site to be shutdown.

If the Government is committed to fixing prices – an approach BP believes is bad for consumers – moving the time required to change prices from 6am to 10am would minimise compliance costs as 10am is a slower time during the day for a site, but generally more than one person at site, so there are no additional labour costs or safety concerns. Also, at 10am there is generally a site manager or assistant site manager on duty with access to the office if there are IT issues which require manual entry of the price.

Additionally, a window within which to change prices e.g. 10 to 10.30am would assist compliance and reduce costs. As indicated above, it is physically impossible to changeover the console and main price display board simultaneously. At present head office staff and the operations team in Perth spend time chasing up details to respond to breach notices that may relate to the board being changed at 6.05am, when it can legitimately take that long for a service attendant to accept the price change and head outside with the board numbers. This all adds costs to the process, which inevitably is passed onto consumers in the form of higher prices.

Finally, as drafted, section 10(2) is too prescriptive in that it imposes a positive obligation to sell fuel (even where we may have none for sale due, say, to a stock out). This is quite distinct from an obligation, if an offer to sell is made, to sell at the notified price. The WA legislation makes it clear that it is only if a retailer offers fuel for sale that they must sell it at the notified price.

5. CONCLUSIONS

BP does not believe that there has been sufficient evidence made public that fixing prices for 24 hours will result in lower petrol prices for Australian consumers, who already receive some of the lowest prices in the OECD. On the contrary, BP believes that the regulation of prices is generally bad for competition and thus may even result in higher prices over the longer term.

The Prime Minister has stated that the ACCC “did the economic modeling … that was the advice upon which the Government acted” (interview with Lyndal Curtis, ABC AM program 30 May 2008). BP is concerned that the analysis undertaken by the ACCC included several caveats which do not appear to have been addressed in any subsequent analysis. In particular, BP believes that changes in the relative freight cost between Singapore and Perth and between Singapore and the east coast is significant.

While BP will endeavor to operate within whatever regulatory framework is set by government, given the conclusion from the ACCC that the petroleum industry is fundamentally competitive, the exclusion of shipping costs from the ACCC analysis, and the lack of public analysis available justifying the regulation of prices, BP would like to see further analysis on the potential costs as well as benefits that fixing retail prices for 24 hours will have on competition and prices.

bp

Gavin Jackman

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2 September 2008

John Hawkins
Committee Secretary
Senate Economics Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear John

At the request of the Committee at the hearing in Melbourne on 7 August, I attach a copy of the report from Access Economics dated 4 July 2008 that was commissioned by BP Australia Pty Ltd (BP) in February 2008.

Following the interchange with the Committee Chair, BP has considered the nature of the report and is comfortable that the information contained within it is not commercially sensitive to BP. However, the initial agreement with Access Economics when the report was commissioned back in February was that the report would be confidential, but would be able to be shared with others by BP on that confidential basis. As such, BP is requesting that the Committee treat the report as confidential. Per our evidence to the Committee, the report has previously been provided to the ACCC and is the subject of ongoing discussions and analysis.

I also attach a further report by Access Economics, dated 18 August 2008, also being provided on the same confidential basis. This report is also being provided as, while it is consistent with the approach of the first report, it provides a clearer explanation of the analysis undertaken and clarifies several points raised in discussions with the ACCC. These are discussed below for the information of the Committee.

Firstly, the report of 18 August 2008 makes clearer reference to the impact of the differential change in freight costs by consistently adjusting landed prices for fuel premiums. (The ACCC had asked for explanation of the difference in the 1.9cpl saving from FuelWatch in their analysis compared to Chart 3 in the 4 July report which referred to a difference of 0.4 cents per litre over time. The answer is that 0.4cpl was not adjusted for the difference in fuel premiums, meaning that there was a lack of consistency in the reporting of the gaps in margins and as such it would not be correct to compare the 1.9cpl and 0.4cpl figure as this would not be a like-with-like comparison). As the revised report makes clear, the difference in landed costs in Perth versus the average for four

other States capitals was small at the time that FuelWatch was introduced, but has averaged 1.4 cents a litre since early 2004.

Secondly, the analysis in the 18 August report now covers the exact same timeframe as the ACCC analysis (whereas the earlier analysis dated 4 July covered an additional six months, for which some monthly time series data was used rather than weekly data).

Thirdly, the revised report splits out the results in the 4 July paper into two – comparisons of margins in Perth versus those in the (weighted average of) four State capitals, and comparisons of margins in Perth versus those in Sydney. The 4 July version of the paper included results from both these types of comparisons, but did not make that clear. The results of the comparison with Sydney strongly show FuelWatch as irrelevant to margins, while the comparison to the four State capitals shows a differential freight impact of 0.8 cpl, with the remaining 'FuelWatch effect' only seen from 2004 onwards (that is, timed to Coles entry to the market, rather than necessarily attributable to FuelWatch).

Notwithstanding the submission of a second, clearer report from Access Economics, BP would like to draw the Committee's attention to the conclusion, consistent with our evidence, that FuelWatch in Western Australia has had no material impact on reducing the price of fuel in WA relative to those prices experience on the East Coast of Australia.

While we ask that the Access Economics reports be kept confidential, there are a number of quotes drawn from the 18 August report that we provide for the explicit use of the Committee.

'Access Economics has performed the same basic regression as the ACCC report, but has adjusted the margins in each market by the relevant freight costs faced in that city.[1]' 'When comparing average weekly prices, the ACCC analysis suggested FuelWatch had a downward impact of 1.9 cents per litre, whereas these results suggest that half of the matching results estimated by Access Economics was caused by changes in relative freight costs.[2]'

'Moreover, even the remaining effect allocated to FuelWatch assumes that the introduction of Coles to the Perth market has no effect on relative margins.[3]' To quote directly from the report, 'attributing the final impact on margins to FuelWatch is not correct[4]'.

Subject to the potential impact on the analysis of the change in the timing of Perth's retail cycle from one to two weeks, the Access Economics report found that 'When comparing minimum weekly prices, the ACCC analysis suggested FuelWatch has had a downward impact on margins, while results here suggest FuelWatch have, if anything, lifted margins in Perth.[5]'

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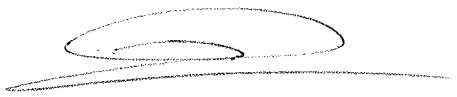
[1] Access Economics, *Fuelwatch Analysis,* 18 August 2008, p.10.
[2] Access Economics, *Fuelwatch Analysis,* 18 August 2008, p.13.
[3] Access Economics, *Fuelwatch Analysis,* 18 August 2008, p.14.
[4] Access Economics, *Fuelwatch Analysis,* 18 August 2008, p.14.
[5] Access Economics, *Fuelwatch Analysis,* 18 August 2008, p.13.

If you or any members of the Committee have any queries regarding this report, please contact me at gavin.jackman@bp.com or on 03 9268 3854, noting that I may need to refer to Access Economics any detailed queries on methodology or analysis.

I have copied this letter to Chris Richardson, Director, Access Economics, for his information.

Yours sincerely



Gavin Jackman

SUBMISSION BY BP AUSTRALIA PTY LTD

ON

THE PRICE OF PETROL IN AUSTRALIA

TO

SENATE ECONOMICS LEGISLATION COMMITTEE

2 AUGUST 2006

Executive Summary

- The Australian downstream petroleum industry has a very long history of intervention by governments through extensive and rigid price and operational regulation. In the past decade or so, the level of state control has started to gradually unwind as governments acknowledged the role a more dynamic and market driven industry could play in sustaining a competitive, secure and growing national economy.
- The move to more market based policy settings in the downstream sector matches those initiatives in other key energy areas of national energy policy. Each step of market reform has been supported by numerous public inquiries (see Attachment 1).
- The lynchpin of Australia's energy policy has been the move to allow petroleum markets to reflect the real cost of product based on international pricing of crude oil and petroleum products.
- As a result,
    - petrol pricing in Australia is one of the most transparent of all commodities;
    - Australia has one of the most competitive retail market environments in the OECD; and
    - The market is subject to competition at every stage of the supply chain from crude oil to the petrol pump.
- Perceptions of the industry's competitiveness are often clouded by populist commentary and some questionable analysis.
    - The recent Consumer Affairs Victoria report on Automotive Fuel Prices in Victoria, which received some media coverage, used incorrect data in its analysis of Terminal Gate Pricing (TGP) margins and therefore drew wrong conclusions
- The metropolitan price cycles reflect competition in the market. Consumers take advantage of the cycle and buy more at the low end of the cycle.
- BP's direct retail activities in regional Australia are almost non- existent. For regional areas, BP generally sells product to distributors at TGP and they supply and onsell BP product to the regional and country markets.

The Government has put in place a sound market based pricing policy to deliver competition, efficiency and security. BP supports this policy.

1. Introduction

Petrol price controls were imposed during World War II and remained in place for some 30 years before there was any loosening. As the Australian economy grew in the 50s and the 60s – and with it the spread of the suburbs – retail competition was conducted largely by building more service stations. Price competition was prevented because prices were fixed. Price and other regulatory changes occurred to cater for the development of Bass Strait, but this was focussed on ensuring that that development occurred. It was only during the early 1970s, during the first oil shock when government could no longer contain prices, that it commenced to change this policy. And with price competition, a long period of site rationalisation commenced.

Since the 1970s, petrol pricing has undergone a gradual process of regulatory reform in Australia – from one where it was heavily regulated to one where – with some exceptions – regulation is largely encompassed within the Trade Practices Act. (See history of this at Attachment 1).

Attachment 1 essentially commences with the Industry Commission Report of 1994. This was a landmark report because it recognised that it was time that governments withdraw from a heavy regulatory control and allow market forces to work to produce efficiencies in this industry.

Part 3 of that Attachment lists conclusions and recommendations of the many inquiries related to petrol pricing over the last 12 years. Almost without exception the trend of their recommendations has been in favour of price monitoring in place of regulation.

Federal direct pricing regulation ceased in 1998 when the ACCC lifted its maximum intervention wholesale price. There remains regulation in WA and to some extent in Victoria.

Within the industry there have been major changes associated with this freeing up of the market:-

- The unilateral move by BP in 2002 to cease refinery exchange (where refiners exchanged product in different capitals on a tonne per tonne basis, and which was instituted by government), and replace it with full buy/sell arrangements. Other companies followed.
- The introduction of Terminal Gate Pricing (TGP) by BP in 1998
- Moves by oil companies to open access to terminals in 1998
- Much greater transparency by oil companies on pricing, and continued monitoring by bodies such as the ACCC
- The decision by BP to effectively cease price support starting from 1998.

The outcome of this is:-

- Petrol prices are now more transparent than prices of any other commodity – both in the final product and in the supply chain

- Their relationship with crude and international prices appears to be more understood by the public
- While price cycles continue, they can be to the consumer's advantage. Our sales are greater in the lower part of the cycle. The perception that prices are higher at long weekends is a furphy – the cycles occur and to varying extents regardless of long weekends.

2. How Petrol is Priced

There are three major, contestable and largely transparent markets in the build up of the pricing of petrol.

First there is the Singapore Product Price .

- Petrol and diesel are regionally priced and traded commodities. Australia is inextricably linked to the regional trade. 23% of product consumed is now imported.
- The Singapore market is the regional terminal market for petroleum products in Asia (cf New York and Rotterdam terminal markets in their respective regions) and forms the benchmark price. The relevant quote used is MOPS 95[1]

Its dominant influence is the crude oil price (the price of which is determined in its own market), but the Product market is a market of its own[2], and crude price is not the only determinant.

Second there is the Terminal Gate Price, which is the wholesale price ex-terminal for product in Australia

- This comprises three major components:-
    - The Import Parity Price which is the landed price of Australian fuel quality standard petrol at the relevant port in Australia

> Import Parity Price for unleaded petrol = Singapore Platts MOPS 95 + premium + shipping + wharfage+ Insurance & loss (all converted to A$)
>
> Shipping = applicable flat rate times Platts (Sing-Aust clean) WorldScale
> Premium accounts for quality and other premiums.

[1] *MOPS 95 = Mean of Platts Spot price for 95 octane Motor Spirit on a particular day. While this is a benchmark regional price, the legislated Australian standard for petrol is a higher quality than that for MOPS 95. So a premium has to be added to this to determine a price for Australian petrol. This premium has increased over the past few years as the legislated Australian standard has increased each year since 2003. Anyone buying Australian standard petrol in the region would therefore pay MOPS 95 plus the premium.*

[2] *The key influence other than crude price is refinery availability. If refinery capacity is insufficient at a time, then the differential between product and crude price will rise. Similarly, in times of surplus refinery capacity – as occurred between 1998-2004, the differential can be thin (and have on occasion been negative).*

        - Our refineries compete against this landed price (see Section 3.A)
    - Wholesaling costs (transport and storage to and in the terminal) and including a wholesale profit margin if available
    - Federal Excise and GST
- BP's TGP for all of our terminals is shown on our website (www.bp.com.au/tgp/)
- Most sales to dealers and distributors are at TGP

How Markets are contestable at every level	
• **Crude Price**	determined by world markets
• **Singapore Product Price (MOPS 95)**	determined by regional/world markets
• **Shipping Rates**	determined by international shipping market
• **TGP**	determined by market
• **Domestic Transport**	determined by domestic transport market
• **Retail Price**	determined by retail market

Third, there is the retail price

- BP sets this price at only those BP sites that we own and operate, or where the franchisee operates under a commission agency. This amounts to 250 sites nearly all of which are in capital cities or some major highway sites
- The remaining 1150 sites that BP supplies (mainly through its rural distributors) are in both urban and rural areas. Although most are BP branded, these are privately owned sites and each sets their own retail prices
    - BP would be contravening the TPA were we to intervene
- BP does not, except for some very minor exceptions, provide price support, having opted for a simple pricing approach in 1998
- Within capital cities there is the price cycle phenomenon, which sees prices fluctuate on a weekly or fortnightly cycle (although this is not always predictable). At least to the extent of the amplitude of the cycle, this is relatively unique to Australia. But it brings out the competitive dynamics of the Australian market, which is consistently one of the lowest price markets in the OECD.

The preceding table shows that every step in the chain is competitively contestable.

3. Specific Aspects of the Terms of Reference

The Committee's Terms of Reference are:

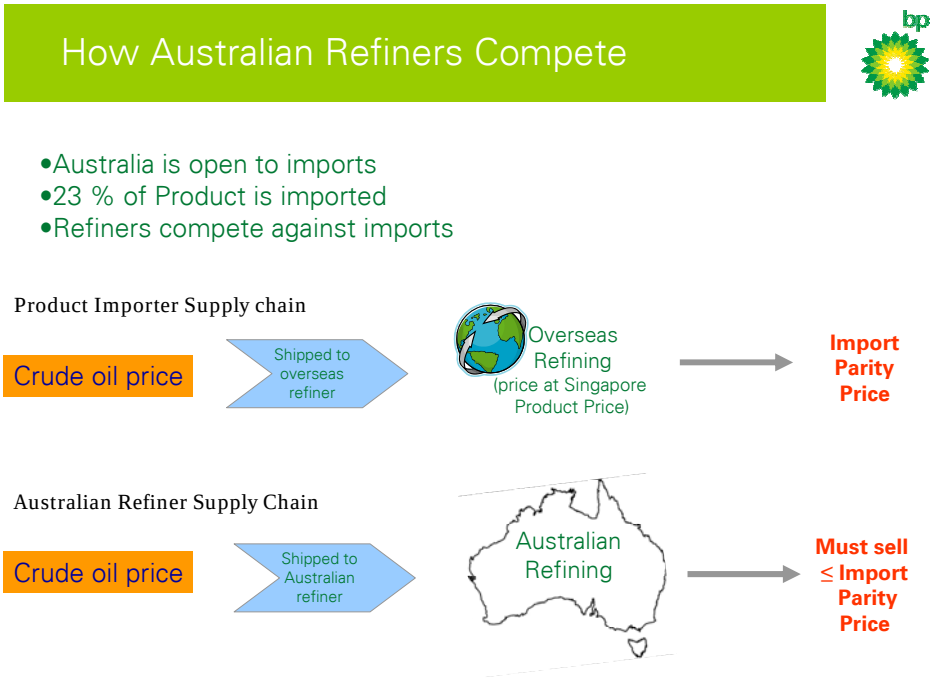
a. the relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol;

b. regional differences in the retail price of petrol;
c. variations in the retail price of petrol at particular times;
d. the industry's integrated structure; and
e. any other related matters.

A. The Relationship Between The Landed Price Of Crude Oil, Refining Costs, The Wholesale Price And The Retail Price Of Petrol;

The key benchmark for regional pricing reference is the Singapore Product Price. This was recognised in the late 1980s by both the PSA (now ACCC) and the industry in the determination of the PSA's Intervention Price. The reason for this is that Australian production had (and has) to compete with the price of imported product as landed in Australia. And this was the measure - adjusted to Import Parity Price to allow for quality premia, shipping and insurance - adopted by the PSA in its intervention pricing.

The appropriateness of this has increased over time as Australia's imports of product have increased – currently about 23% of consumption. There is no practical way that Australia can avoid being part of the regional or global market, and import parity price for product is the appropriate benchmark.



The wholesale price – or Terminal Gate Price (TGP) – is the landed price of product (or Import Parity Price (IPP)) plus wholesaling costs including excise and GST and profit margin.

The landed price of crude and refinery capital and operating costs define Australian refinery costs. The challenge for Australian refiners is that their total costs plus profit margin must be less than the IPP with which they compete. If the costs are greater, then the refinery is operating at a loss. There have been long periods in recent years when refineries have been unprofitable or marginally profitable eg in the period 1998-2004. And, in consequence, there has been one mothballing of a refinery in recent years. Because refining margins have recovered from their long depressed period, most would be currently viable, but this is a cyclical industry, and the cycle will again turn.

The relationship between TGP and the retail price of petrol is defined by both costs and the market. Typical metropolitan retail margins are around 4-5 cpl. All transport and retail costs are included in this. Returns in the retail sector are modest due to high competition in this sector.

Box 1: Why Shouldn't Australian Product Pricing be linked as a direct mark up to crude pricing?

The above issue is raised from time to time. The reasons why it shouldn't are:-

- It would lead to a dual pricing system (23% of product is imported at the world price) which would be unmanageable
- While this could conceivably work when refinery margins are high, to be equitable it would require major subsidies to refineries when refinery margins are low, which may lead to other, including WTO, issues
- If corresponding subsidies were not available, there would be a rapid rundown of the Australian industry due to unsustainability. This leads back to IPP anyway
- It would discourage investment.

Import Parity Price on petroleum products is the only logical outcome. Crude oil and petrol are commodities which have their own commodity markets and are subject to international forces. It is the same as for a host of agricultural and mineral commodities which Australia produces and exports, except that in this instance we are a net importer. A similar process applies in petroleum and there are sound economic and supply security reasons to continue the current practice.

B. Regional Differences In The Retail Price Of Petrol;

(a) Between the five major capital cities

Each city is its own market. Its price cycle may have different timings and characteristics to others. While they can be compared in many ways, a common fault is to compare them at any point in time. This can lead to wrong conclusions, as one market may be high on the cycle and another at a low point. Over time, the capital city pricings are comparable.

(b) Rural Australia

Apart from setting TGPs at its provincial terminals BP does not market directly in regional Australia. BP sells to its distributors who then onsell to rural outlets, or sell through distributor owned outlets.

We do not have significant data on regional prices or regional price differentials. The following factors can impact rural pricing vis a vis metropolitan pricing:-

- Low throughputs and low convenience store sales need high retail margins to be sustainable. We believe throughputs in rural sites to be about 1/3 that in urban sites.
    - A comparison may be made with the price of, say, a jar of vegemite or a loaf of bread at a corner store to that in a supermarket. Petrol in rural areas could be, say, 10 cpl (i.e. about 6%) higher than in urban areas. The proportional price differentials for food items between high volume and low volume outlets is likely to be far higher than that for petrol, but are much less obvious.
- Lower competition in smaller towns
- Transport costs.

C. Variations In The Retail Price Of Petrol At Particular Times;

The more general variations relate to the fundamental matters such as world prices for product – largely dependent upon crude prices – exchange rates; and shipping rates.

BP's TGPs closely follow movements in these.

BP only changes its TGPs at most twice a week. The TGPs do not show the major weekly variations that are reflected in the metropolitan retail price cycles.

The continuation of the price cycle – or at least its amplitude - is relatively unique to Australia. The cycle has been evident for perhaps 20 years. Whatever the causes – and notwithstanding a more logical pricing system in evidence today – the cycle continues.

We make the following points about it:-

- It is an expression of competition and of a dynamic market.
- The price cycle is typically saw-toothed. Prices gradually reduce through competition to the point where service stations are at best marginal or not

making adequate returns. Then one or more competitors raise prices. And the process starts again.
    - It can be likened to children playing at staying under water the longest – there comes a point when someone comes up for air, and others follow too.
- It is not entirely predictable. Lifts do not always occur, especially when competition is very intense.
- Consumers have become attuned to the price cycle. Greater volume of sales occur during the lower part of the cycle. BP's sales in Sydney over the past 3 months have been greatest on Mondays and Tuesdays – which are days at the low end of the cycle.

The cycle itself – the dynamism of price competition - is evidence of competition. Any part of the cycle reflects a reconciliation of two fundamental aspects of competition (a) you must make sales to stay in the market and (b) you have to make a profit to stay in business.

We believe the best recommendation the Committee can make is to endorse the moves by ACCC, and RACV, NRMA etc to encourage consumers to buy when prices are low – because petrol is bargain priced at these times. That may serve to temper the amplitude of the cycle.

There are three other points to make about price cycles

- Long weekends
- Transparency
- The WA legislation

(i) "Prices go up on long weekends" – A Misconception

The "prices go up on long weekends" is a common misconception in Australia.

It is wrong.

The reality is that the cycle occurs regardless of long weekends. An observer examining historic prices would be unable to distinguish long weekends from normal weekends.

(ii) Transparency

No other commodity is so openly priced as that for petrol. This is good for competition and the consumer. The paradox is that by being so open the industry is commonly criticised – unfairly – for its practices.

The oil companies' industry body - Australian Institute of Petroleum (AIP) - has itself financed for many years a pricing survey which puts in place a price information survey covering petrol prices in metropolitan and major regional towns in all States.

(iii) The WA Legislation

As set out in Attachment 1, in 2001, WA established a comprehensive regulatory framework for pricing of petrol and diesel. Chief components were:

- A terminal gate pricing system for spot sales;
- A maximum wholesale price;
- A 24 hour rule, limiting intra-day price movements;
- Pricing information systems for public awareness;
- A 50/50 rule, under which retailers could source half their supplies from sources other than their primary supplier.

The stated objectives of the regulatory framework were to improve competition at wholesale and retail levels, increase transparency, reduce the volatility of city prices, and reduce the country-city differential.

The WA moves were a major move towards re-regulation of prices. Accordingly, there have been a number of subsequent inquiries that have reviewed the merits of the WA regulations, as part of their deliberations.

Subsequently, these arrangements have been considered by the ACCC and a number of States and Territories.[3] However, none of these found merit in the WA system, except in the area of public awareness of prices.

Most recently, a similar conclusion was reached by the Queensland Parliament Report of April 2006 on the Impact of Petrol Pricing which recommended "*that the Queensland Minister for Fair Trading not introduce legislation to control prices in Queensland based on the Petroleum Products Pricing Act (1983) WA."* In its response of June 2006, the Queensland Government supported this recommendation.

BP also does not advocate the WA initiatives.

D. The Industry's Integrated Structure

There are major benefits in integration. Australia benefits by having a refinery industry – one that is competitive, adds to GDP, adds to employment, adds to energy security, and enables us sovereignty over our fuel standards.

And we believe it is only through integration that Australia would have a refining industry. BP only operates refineries where it has a marketing business.

Yet Australia has actually worked against this by severely limiting the role of refiners in marketing through the *Petroleum Retail Marketing Sites Act*. By limiting direct retail involvement for refiners, this has actually discouraged refinery investment in Australia. In so doing it has restricted competition in the market and therefore benefits to consumers.

Petrol market reform – which is currently before Parliament – will address this anomaly if passed.

[3] For more information see Attachment 1, pp25-7

Notwithstanding integration in the industry as a whole, in terms of pricing, the changes made in recent years have largely de-integrated the industry:-

- The move away from refinery exchange to buy/sell has been key. It has fully monetised the supply chain. Other initiatives such as the TGP and pricing transparency at several key points (Singapore product prices; TGPs) have promoted moves to de-integration.
- In all markets except WA and Qld (where BP has refineries) BP is not integrated. We have to buy product or import it like most other players. The same can be said for other oil companies in capital city markets where they do not have a refinery.

E. Any Other Related Matters.

(i) Consumer Affairs Victoria (CAV) Study

Released in June 2006, this has claimed that in the period 2003 to 2006 wholesale margins in Victoria have risen substantially, with resulting major profits accruing to oil companies.

In this important respect, the report has used the wrong data and accordingly drawn wrong conclusions.

We met with CAV on 26 June, a few days after it was released. The report fails to take into account increased fuel standards set out in the accompanying table in each of the years 2003-2006 which led to increased wholesale costs. This was acknowledged by CAV, which we understand is revising the figures.

This is set out in the AIP press release of 25 July (Attachment 2).

How Australian Petrol Standards have changed

ALL GRADES

	2003	2004	2005	2006
Sulphur (mg/kg max)	500	500 150(PULP)	150	150
Benzene (%max)	5	5	5	1
Olefins (%vol max)	NR*	20	18	18
Aromatics (%vol max)	48	48	42	42
Distillation (Deg C max)	NR*	NR*	210	210

NR* = Not Regulated

The reality is that for BP there was no increase in wholesale (or TGP) gross margin over the period. And there was no windfall profit.

4. The Australian Market Considered against Competition Criteria

The Australian market meets all the characteristics of a competitive market:-

- There is no tariff protection. There is a free flow of imports (23% of product in 2004) and exports
- Profits are not excessive. While refinery margins are currently good, this must be seen in the context of the long period of very low profits or losses. Retail profits have been modest for a long period
- Capacity for change and new or progressive ideas. Shopper dockets and discounting, convenience stores, new products such as Ultimate, Optimax and biofuels, self serve are examples. The number of initiatives for selling biofuels is another example.
- Competitive prices and efficiency. The position of Australia as amongst the lowest prices in the OECD verifies this (Attachment 3).
- A number of competitors. Apart from the 4 oil companies, there are the supermarkets and a range of independents.
- Freedom of entry and exit. Coles and Woolworths have entered the market. At least one independent has grown significantly in recent years.

5. Conclusions

The conclusions of this are:-

- There has been a gradual trend away from heavy regulation to monitoring or at most light regulation over the past 20 years. This has been supported by the findings of nearly all of the many inquiries over this time.
- Petrol Pricing is directly and inextricably linked to world and regional prices. Even more so now given that Australia now imports significant volumes of petroleum products
- There is no case to move away from this linkage to world pricing through Import Parity Pricing
- The market based approach shows competition at every stage in the supply chain
- Petrol pricing and its components together make it the most transparent of all consumer commodities. This is due to moves from both the industry and government.
- Because of this transparency, they are very much in the public eye. A consumer will readily know the petrol price, but not the price of bread. This makes petrol prices more subject to comment when there is any movement.

- All of this results in an efficient and fiercely competitive market – evidenced by Australian metro pricing being consistently amongst the lowest in the OECD
- The only characteristic unique to Australia are the price cycles in the major capital cities. The cycles reflect a dynamism in the market. And low points of the cycle offer bargains for consumers.
- The fact that greater volumes are sold at the low end of the market reflects consumer awareness and responsiveness. Consumer advice by ACCC and auto associations assists here.
- Continued price monitoring by the ACCC is an acceptable outcome
- The CAV study analysis of TGP margins is wrong
- There is no case to expand regulation such as that imposed in Western Australia.
- An integrated industry benefits Australia by providing a marketing basis for our refining industry. Without this integration, our refining industry would be jeopardised. In terms of petrol pricing, the competitiveness and transparency aspects at every link in the chain effectively lead to de-integration.

BP has no concerns about continued monitoring of prices by the ACCC.

BP strongly supports the TGP concept and supports the proposed legislated requirement within the proposed Oilcode that would require oil companies to both publish TGPs and to offer wholesale customers the option of their purchase being at TGP.

CONTACT
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ATTACHMENT 1

REGULATORY REFORM IN THE PETROLEUM PRODUCTS INDUSTRY

A REPORT FOR

BP AUSTRALIA PTY LIMITED

Prepared by UMAC CONSULTING

July 2006

CONTENTS

1 REGULATION OF THE PETROLEUM PRODUCTS INDUSTRY AN OVERVIEW

Refinery Intake of Indigenous Crude Oil

Following the commencement of crude oil production from the Moonie field in 1964, the Commonwealth Government instituted a system for the mandatory intake of indigenous crude by Australian refineries. The allocation was based on each refinery's share of imports, at a fixed price based on world crude prices at the time. As new fields came on stream, such as the Bass Strait fields, new prices were negotiated for these. The allocation system was changed to one based on sales in 1969.

In 1975, the concept of import parity pricing was established for new fields.

In 1983, in response to increasing Bass Strait production, the Government allowed the export of two shipments of Bass Strait crude, and in the next year the Government announced a partial allocation scheme with exports allowed over a defined minimum intake by refineries. This resulted in a lengthy debate on the merits of full deregulation, with an important factor being the imminent decline in Bass Strait production.

In 1987, the Government announced deregulation, to end the mandatory intake by refineries of indigenous crude under the crude allocation system, to take effect from 1 January 1988.

Control of Prices of Petroleum Products

During World War II, the Commonwealth Government instituted a pool arrangement for the sale of petroleum products, under one brand and with prices based on a maximum wholesale price. This pool arrangement lasted until 1948.

Following the end of Commonwealth controls, State Government price controls of wholesale prices remained in place, but by 1954 all States had also ceased controls with the exception of S. Australia. The S. Australian price controls were based on maximum cost-based wholesale prices plus country freight differentials. This system was generally adopted by the industry in other States, on a voluntary basis.

In 1973, the Commonwealth Government re-entered the fuel price control arena, through the Prices Justification Tribunal (PJT). Maximum wholesale prices were set on the basis of costs, and were adjusted in the light of submissions by individual companies to the PJT. Country freight differentials were retained. This PJT process replaced that of S. Australia.

The PJT was abolished in 1981, and the Commonwealth Government established in its place the Petroleum Products Pricing Authority (PPPA), with the same role and function of setting maximum wholesale prices.

However, parallel to this, a number of States instituted their own control of retail prices of petrol and diesel, beginning with NSW in 1981. This was followed by S. Australia and Victoria, and W. Australia in 1983.

The resulting confusion and duplication led to a newly formed Commonwealth body, the Prices Surveillance Authority (PSA), taking over the setting of maximum wholesale prices of petrol and diesel, and country freight differentials, from the PPPA. State Governments agreed to relinquish their roles in price controls of petroleum products. The PSA set prices by reference to the import parity crude price. In 1988, this was replaced by a combination of spot prices for petrol and diesel in Singapore and other regions.

In 1996, the Australian Competition and Consumer Commission (ACCC) assumed the fuel pricing responsibilities of the PSA.

In 1994, the Industry Commission recommended the termination of price surveillance of petrol and diesel. This recommendation was repeated by the ACCC in 1996. In response, the Commonwealth Government moved to terminate price surveillance by the ACCC in 1998. The ACCC retained a residual monitoring role.

Subsequently, two States have enacted legislation on the pricing of petrol and diesel. In 2000, Victoria instituted a mandatory system of terminal gate pricing, under which suppliers were required to publish wholesale prices at the terminal gate; however, there was no control of the actual price levels.

In 2001, W. Australia established a comprehensive regulatory framework for pricing of petrol and diesel. Chief components were:

- A terminal gate pricing system for spot sales;
- A maximum wholesale price;
- A '24' hour rule, limiting intra-day price movements;
- Pricing information systems for public awareness;
- A '50/50 rule, under which retailers could source half their supplies from sources other than their primary supplier.

Subsequently, these arrangements have been considered by the ACCC and a number of States and Territories. However, none of these found merit in the W. Australian system, except in the area of public awareness of prices.

In summary, with the exception of one State, Australia has moved over time to deregulation of price controls.

Market reform

During the late 1970s, the service station sector of the industry was undergoing major restructuring as a result of overcapacity. In the process, there were considerable concerns held by resellers over price discrimination by fuel suppliers against lessee dealers.

In response, the Commonwealth Government in 1981 enacted two pieces of legislation:

- The Petroleum Retail Market Sites Act (the Sites Act); and

- The Petroleum Retail Market Franchise Act (PRMF Act).

The Sites Act restricted the ability of refiner-marketers to vertically integrate by limiting the number of sites that they could operate. The PRMF Act regulated the contractual arrangements between franchisor and franchisee in the industry – for example on minimum tenure, assignment rights and disclosure to prospective franchisees.

In 1989, a self-regulation mechanism, Oilcode was established by refiner-marketers, distributors and retailers. This provided further guidance on the contractual arrangements and a dispute resolution system.

Both the Industry Commission in 1994 and the ACCC in 1996 recommended repeal of the Acts. However, in spite of several moves by the Commonwealth Government to repeal the Acts in exchange for a strengthened Oilcode, the Acts remain on the statute books.

2 REGULATION OF THE PETROLEUM PRODUCTS INDUSTRY A TIMELINE

Year	Mandatory intake of indigenous crude	Price Control Federal	Price Control State	Vertical Integration	Reseller Relations
1970	100%		All (by SA)		
1971	100%		All (by SA)		
1972	100%		All (by SA)		
1973	100%	PJT	All (by SA)		
1974	100%	PJT			
1975	100%	PJT			
1976	100%	PJT			
1977	100%	PJT			
1978	100%	PJT			
1979	100%	PJT			
1980	100%	PJT			
1981	100%	PPPA	NSW, SA	Sites Act	PRMF Act
1982	100%	PPPA	NSW, SA, Vic	Sites Act	PRMF Act
1983	Exports allowed	PSA	NSW, SA, Vic, WA	Sites Act	PRMF Act
1984	100%	PSA		Sites Act	PRMF Act
1985	Partial	PSA		Sites Act	PRMF Act
1986	Partial	PSA		Sites Act	PRMF Act
1987	Partial	PSA		Sites Act	PRMF Act
1988	Deregulation	PSA		Sites Act	PRMF Act
1989		PSA		Sites Act	PRMF Act
1990		PSA		Sites Act	PRMF Act
1991		PSA		Sites Act	PRMF Act
1992		PSA		Sites Act	PRMF Act
1993		PSA		Sites Act	PRMF Act
1994		PSA		Sites Act	PRMF Act
1995		PSA		Sites Act	PRMF Act
1996		ACCC		Sites Act	PRMF Act
1997		ACCC		Sites Act	PRMF Act
1998		Deregulation		Sites Act	PRMF Act
1999				Sites Act	PRMF Act
2000			(Vic TGP)	Sites Act	PRMF Act
2001			WA, (Vic TGP)	Sites Act	PRMF Act
2002			WA, (Vic TGP)	Sites Act	PRMF Act
2003			WA, (Vic TGP)	Sites Act	PRMF Act
2004			WA, (Vic TGP)	Sites Act	PRMF Act
2005			WA,(Vic TGP)	Sites Act	PRMF Act
2006			WA, Vic TGP)	Sites Act	PRMF Act

3 PETROLEUM PRODUCT MARKET REFORM AND PRICING INQUIRIES

1994 - 2006

The Industry Commission (IC) Report *Petroleum Products* of 1994 represented a watershed in attitudes towards regulation of the petroleum products industry. Up to that time, the industry was characterised by regulation. Since that time, there has been a slow and sometimes bumpy move towards deregulation.

The Position in 1994

Until the IC report, the industry was dominated by comprehensive regulation covering pricing, relations between refiner-marketers and their retailers, and operational aspects of service stations.

The regulatory framework had been put in place largely in response to government concerns that competitive forces in the industry were insufficient to safeguard the public interest, and that there was an imbalance in contractual power in the industry which could lead to 'unfair' trading. In addition, certain parts of the framework were in place to support particular interest groups in the industry.

Key elements of this regulatory framework were:

- Commonwealth price controls, through the setting of capital city maximum wholesale prices for petrol and diesel – the intervention prices - by the Commonwealth Prices Surveillance Authority (PSA). The intervention prices applied to the five declared companies (Ampol, BP, Caltex, Mobil and Shell). The PSA set the price daily, based on an estimate of an import parity price (the Singapore petrol price, plus estimated costs for sea transport, insurance, loss and wharfage), plus a 'local component' to cover costs from the wharf to the terminal gate, plus excise and State franchise fees.
- State price controls. Six of the eight States and Territories retained legislation covering fuel prices. However, by 1994, the States had passed responsibility for fuel price controls to the Commonwealth PSA, and did not apply their own legislation.
- Control of additional charges for servicing non-metropolitan areas, though a complex system of 4000 regulated freight differentials, set by the PSA. Due to certain Ministerial Directions, the freight differentials did not fully reflect the additional costs of servicing many non-metropolitan areas, resulting in an effective subsidy of these non-metropolitan areas by metropolitan areas.
- Limitation on vertical integration. Under the Petroleum Retail Market Sites Act (the Sites Act), declared companies - the refiner-marketers – were prevented from operating more than 5 per cent of the overall number of service stations. The Commonwealth Government allocated the permitted approximately 400 service stations between the declared companies.
- Regulation of contractual relations between oil companies and resellers, through the Petroleum Retail Market Franchise Act (PRMF Act). The PRMF Act formed

the basis for franchise agreements, providing a nine year assignable tenure, conditions for termination and assignment, and flows of information to prospective franchisees. The PRMF Act was supplemented, and in some areas duplicated, by a tri-partite voluntary Oilcode which included a mediation procedure.

- State regulations on service station operations. These varied widely between States, covering in particular:
    - Controls on the number and location of service stations (S. Australia)
    - Siting of outlets (primarily, the ACT)
    - Hours of operation (primarily, W. Australia)
    - Range of products sold, and allowable retail floor space for non-fuel products (primarily, the ACT and Queensland)
- Access to oil company terminals. Access was restricted not by regulation, but by an agreement which arguably had the effect of regulation. The Laidely Agreement between the Transport Workers Union and the Australian Petroleum Agents and Distributors Association (APADA) restricted the ability for third-party tankers to access oil company terminals to load fuel.

The Industry Commission Report

The IC carried out a comprehensive review of industry, focussing on the economic conditions and efficient market outcomes in the industry, commercial relationships, the framework of regulation, transport and taxation.

The key finding of the IC Report was that there was effective competition in most petroleum markets in Australia most of the time. Indications of this were the low barriers to entry and exit at the wholesale and retail levels, the continuing threat of imports, and the volatility of retail prices. While the IC recognised that local circumstances in some country areas could weaken competitive pressures, the city-country price differentials were explained by normal commercial economic factors, such as lower sales volumes and additional supply costs.

With effective competition in the industry, market forces could be expected to deliver the most efficient outcome and to deliver the adjustment necessary for the industry to continue to perform at an efficient level. Conversely, regulation would distort economic efficiency. The IC therefore concluded that there was no need for continuation of price controls in the industry, and recommended the termination of the PSA surveillance of prices and the repeal of the residual State price control legislation.

The IC also noted positively the development of self-regulation in the industry through Oilcode, which supplemented the general provisions of the *Fair Trading Act*. The IC concluded that the PRMF Act and Sites Act increased costs in the industry and impeded industry adjustment to changing economic conditions; this would distort the industry away from the most efficient economic outcome. The IC therefore recommended the repeal of the Acts.

Similarly, the IC found that the State regulations and the Laidely Agreement imposed extra costs and reduced efficiencies. Accordingly the IC recommended the repeal of the State legislation and negotiations to negate the Laidely Agreement.

Developments 1995-1999: the end of Commonwealth price controls

The main developments in the next five years were the first major movements towards deregulation of the industry. The key components in this move towards deregulation were the Australian Competition and Consumer Commission (ACCC) *Inquiry into the Petroleum Products Declaration* in 1996, which led on to the Commonwealth Government's industry reform package in 1998.

The ACCC found that the four oil majors had substantial market power. Factors behind this were the high concentration levels in the industry, barriers to entry, and the depth and breadth of vertical and horizontal relationships – such as refinery exchange – in the industry; the market pressures from independents were correspondingly weak. However the ACCC considered that there was a good prospect for the market power of the four declared companies to be undermined in the near future by independents increasingly accessing product and by the spread of imports.

The ACCC accordingly recommended the revocation of the declaration of the four major oil companies under the *Prices Surveillance Act.* The ACCC supported the development of price monitoring programs to increase price transparency in country areas. The ACCC also recommended the repeal of the PRMF and Sites Acts.

Following on from the ACCC recommendations, the AIP worked with the Australian Automobile Association (AAA) and the price surveying company Informed Sources to put in place a price information survey covering petrol prices in metropolitan and major regional towns in all States. The cost of the survey was met by the AIP member companies. This survey is still in place at the current date, although the AAA is no longer involved and the format and surveying bodies have changed.

In 1998, the Commonwealth Government launched its reform package for the petroleum products industry. The Government accepted the ACCC recommendation to terminate price surveillance of the industry, but demanded that the declared companies improve access to their terminals by third party tankers. The AIP member companies established an access regime that was satisfactory to the Government, which included the AIP Driver Passport scheme and a mediation process to examine any complaints on access. The AIP Driver Passport training and accreditation scheme covered all tanker drivers – oil company and third party – and within a short time 4000 passports had been issued.

Formal price surveillance of maximum wholesale prices of petrol and diesel ceased in 1998. However the ACCC continued to monitor prices.

The Commonwealth Government also accepted the recommendation of the ACCC to repeal the PRMF and Sites Acts. This repeal was subject to the fuel suppliers and resellers reaching agreement on a revised Oilcode, expanded to ensure that reseller rights were adequately protected. Extensive negotiations between the fuel suppliers and

resellers followed, under Government auspices. However agreement was not reached, and, in spite of a report from the Senate Rural and Regional Affairs and Transport Committee supporting repeal, the Government subsequently withdrew the proposed repeal legislation.

In this five year period, there were also a number of State inquiries into petrol prices. These included inquiries in NSW, Tasmania, and the ACT. The primary outcome of the Tasmanian and ACT inquiries was the institution of price monitoring by those State governments. The key recommendations of the 1995 NSW report were:

- A mandatory requirement for service stations to display petrol price boards;
- That the NSW State Government refer the accepted recommendations of the report to the Commonwealth (in recognition of the primary role of the Commonwealth on the issues).

The latter recommendation was the start of move by State governments in this period to terminate specific state regulations regarding service stations. By 2000, most of the State regulations covering service station operations had been terminated.

Overall, by the end of the decade, many of the IC Report recommendations to deregulate the industry had been put in place. The main outstanding issue was the market reform package centred on repeal of the PRMF and Sites Acts.

Developments 2000 onwards

In the new decade, fuel prices have trended upwards and have continued to be a community concern. In response, there have been a number of moves by State Governments to regulate price setting systems.

Victoria: Terminal Gate Pricing

In 2000, the Victorian Government introduced a mandatory requirement for fuel suppliers to publish Terminal Gate Prices. The aim was to improve the transparency of prices and to provide access to product at terminals at competitive wholesale prices for all distributors and retailers.

Western Australia

In 2001, a Select Committee of the W. Australian Legislative Assembly examined petrol pricing in the State, with a focus on the country-city price differential. The Committee's Report was critical of the degree of competition in country areas, and considered that the major oil companies controlled retail prices at their franchise sites. The Committee made a number of recommendations, most of which were subsequently legislated. The primary components of the new State regulatory framework were:

- A ban on intra-day price changes at service stations – sites could charge only one price for each fuel product in a day ('24 hour rule');
- Establishment of a fuel price monitoring system, under which consumers could ascertain daily retail prices at particular service stations;
- Mandatory price boards at service stations
- Establishment of a Terminal Gate Pricing system, incorporating a maximum wholesale price. No spot sales were to be allowed at prices over this maximum.

- '50/50' legislation, allowing a retailer to buy up to 50 per cent of their fuel from sources other than their primary supplier.

The stated objectives of the regulatory framework were to improve competition at wholesale and retail levels, increase transparency, reduce the volatility of city prices, and reduce the country-city differential

ACCC and other State inquiries

The W. Australian moves were a major move towards reregulation of prices. Accordingly, there have been a number of subsequent inquiries that have reviewed the merits of the W. Australian regulations, as part of their deliberations.

There were two relevant ACCC inquiries. The first report, *Reducing fuel price variability*, found that price cycles generally benefit consumers on average, and supported moves to increase consumer awareness of petrol price cycles. The report found that the 24 hour rule in Perth may have contributed to limiting the average variation in price cycles and resulted in higher average prices. The ACCC recommended that options such as the 24 hour rule, limiting price increases to a certain amount each day, or regulation of wholesale and retail prices not be implemented.

The second ACCC report, the 2002 Report *Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia*, reviewed the effects of the W. Australian regulations. The ACCC found that the effects were generally negative and objectives not achieved. In particular:

- The maximum wholesale price system had inhibited spot sales, and so reduced competition;
- There had been no significant effect on the duration and variation in the fuel price cycles.
- Country-city price differentials had increased;
- Perth petrol prices had increased compared to relevant benchmarks. While other issues, such as State specific fuel standards, were a factor in this, some of the increase was probably due to components of the new regulatory framework such as the 24 hour rule.
- Investment in the industry had been negatively influenced.
- Price transparency had increased, but the manner of the publication of prices had produced some distortions in the market.

With regard to terminal gate pricing, the ACCC could not identify any significant impact of the Victorian arrangements.

The 2001 ACT Independent Competition and Regulation Commission found that competitive pressures were present in the ACT market, and that the ACT should not attempt to set prices independently of other States. The Commission specifically reviewed the components of the W. Australian regulatory framework and found no merit in introducing them in the ACT. The Commission supported the continuation of a national approach, and that therefore the ACT should take a regulatory approach consistent with any national regulatory action.

The Northern Territory conducted an Independent Fuel Inquiry into fuel prices in the Territory. The inquiry report identified the reasons for the higher prices in the Territory. It noted that increased competition was likely to drive prices in Darwin down, aided by the new fuel terminal and increased public awareness of prices. The Territory Government accepted the report's recommendations, which included:

- Mandatory price boards at service stations;
- Implementation of a public awareness program for fuel prices, and extension of fuel price monitoring by the Territory;
- Support for repeal of PRMF and Sites Acts;
- Multiple fuel cards for Government vehicles.

The most recent inquiry is that of the Queensland Legislative Assembly into petrol pricing. The inquiry found that the fuel retailing industry was highly competitive in South East Queensland, but less so in other areas. The inquiry considered that the presence of independents was an important factor for a competitive and efficient market, and that there were a number of developments in the market that were disadvantaging independents, such as shopper dockets. It recommended accordingly that Oilcode should provide adequate protection for independents.

The inquiry also found that W. Australian legislation had disadvantaged independents in that State, and recommended against Queensland introducing regulation of petrol prices along the lines of that in W. Australia. The inquiry was also not convinced of the efficacy of mandating the publication of terminal gate pricing.

The Position at the current date

The move to deregulate petrol prices, as envisaged by the 1994 IC Report is essentially intact. W. Australia did move against the trend in 2001. However reviews by the ACCC of the W. Australian regulations have found generally negative effects, and other States and Territories have seen no merit in following the W. Australian example.

States and Territories have in general continued to deregulate in this area, and to leave regulation as required to the Commonwealth. The main exceptions in this have been W. Australia, and to a lesser extent Victoria with regard to terminal gate pricing.

The recommendation for market reform, based on repeal of the PRMF and Sites Acts, has had a more difficult path. The matter is again under Government consideration, and there have been very recent developments towards deregulation in this regard.

4 PETROLEUM PRODUCT MARKET REFORM AND PRICING INQUIRIES

SUMMARIES OF KEY FINDINGS AND RECOMMENDATIONS RELATING TO PETROL PRICING AND REFORM OF THE PETROLEUM PRODUCTS MARKET

Year	Inquiry	Key Findings	Key Recommendations
1994	Industry Commission: *Petroleum Products*	• There is effective competition in most petroleum markets most of the time. • There is a continuing threat of imports. • Collusion in refining would be difficult. • At the wholesale and retail levels, low barriers to entry and exit point to strong competitive pressures • Volatility of retail prices in major metro markets is indicative of vigorous competition. • The strong competition means that the PSA wholesale maximum is not a constraint on prices, rather a target. • In most country markets, there is effective competition, but local circumstances in some country towns combine to weaken competitive pressures. • City-country price differentials are explained by the additional costs of supplying country markets and the higher retail margins in the country, the latter due to low volumes and low non-fuel sales and to local factors. • Wholesale price controls, particularly freight differentials, complicate competition. Competition in country areas would be enhanced by removing	1. Commonwealth Government should withdraw Ministerial directions and terminate price surveillance of petroleum products. 2. State and Territory Governments should refrain from regulating petroleum product prices.

	Industry Commission (continued)	price controls. • Wholesale price controls are not providing the reassurance sought, and prevent prices from guiding investment and resources to the most efficient use. • Should Governments favour monitoring of the industry following withdrawal of price surveillance, the monitoring should be focussed and temporary. The ACCC would be the appropriate body to monitor the industry. • Restrictions on access to terminals (such as the Laidley Agreement) can inhibit efficiency • Terminal gate pricing through regulation is neither necessary nor practical. • Vertical integration can bring significant. commercial benefits. Divorcement is not a realistic option. • Self-regulation through Oilcode has been a positive development. • Repeal of the PRMF Act would benefit industry adjustment. • State regulations tend to increase barriers to entry, reduce competition and impede structural adjustment.	3. The Laidely Agreement should be withdrawn. 4. The Petroleum Marketing Sites Act should be repealed. 5. The Petroleum Marketing Franchise Act should be repealed. 6. A review committee should explore strengthening Oilcode. 7. S. Australian Government should repeal the Motor Fuel Distribution Act. 8. Restrictions on trading hours, the retail area, and the range of goods sold at service stations should not be applied as a means of protecting other businesses.

1995	Commission of Inquiry into Petrol Prices in Rural NSW	• Higher prices in country areas are due to factors such as freight costs, lower volumes, less non-fuel costs, lower levels of local competition, absence of discounting. • Commonwealth is the appropriate jurisdiction.	1. Petrol price sign boards to be mandatory 2. Recommendations of the report that are accepted by Government should be referred to the Commonwealth.
1995	Legislative Council Select Committee into Petrol Pricing in Tasmania	• Petrol prices in Tasmania consistently higher than in mainland States.	1. Price monitoring
1996	Australian Competition and Consumer Commission (ACCC): *Inquiry into the Petroleum Products Declaration*	• The four oil majors have substantial market power derived from high concentration levels, barriers to entry and the depth and breadth of the vertical and horizontal relationships between market participants; market pressures from independents is correspondingly relatively weak. • Overall price competition between the majors is not high; while overall demand is price inelastic, demand for any one company's product was highly elastic. • There is a good prospect that the market power of the four declared companies would be undermined in the near future by independents increasingly accessing product, and the growth and spread of imports. • Prices oversight could be entirely removed once	1. Revocation of the declaration of the four major oil companies in relation to the supply of petrol and automotive distillate under the *Prices Surveillance Act 1983.* 2. Development by motoring organisations of monitoring programs focussing on increasing the transparency of competitive conditions in country areas where petrol prices appear excessive. 3. Repeal of the Petroleum Retail Marketing Franchise and Sites Acts. 4. Simplification of new franchise agreements with oil companies. 5. Consideration by State

	ACCC (continued)	independents had developed as a viable competitive force.	Governments of mandatory display of price boards at service stations.
1997	ACT Legislative Assembly Select Committee on Petrol Prices in the ACT	• Concern at the differential between Sydney and ACT prices	1. Encouragement of the establishment of independent service stations in the ACT. 2. Price monitoring
2001	W. Australia Legislative Assembly Select Committee, Pricing of Petroleum Products: *Getting a Fair Deal for WA Motorists*	• The impact of high fuel prices is greater in the country than the city. • The gap between country and city fuel prices has widened since deregulation in 1993. • The major oil companies dictate and manipulate retail prices at franchisee sites. • The way GST is applied on fuel discriminates against country consumers. • Retail competition is limited to the city. • Freight is not a major factor in the price differential between city and country prices. • Country motorists paid considerably more for their fuel, due principally to high wholesale costs and not because of retailers' margins, higher freight costs or lower volumes. • The major reasons for difference in prices between larger country locations and those in metropolitan Perth are: lack of price support; lack of discounting; limited competition at wholesale and retail levels; high wholesale margins; sometimes high retail margins.	1. Legislation to require retail sites to advertise and charge only one price for each fuel product daily. 2. Establishment of a Prices Advisory Committee and procedures for price control of petrol and diesel in country W. Australia. 3. Establishment of an ongoing transparent fuel price monitoring system, whereby consumers can access daily retail prices. 4. All retailers to be required by law to display adequately sized price boards for all their fuel products. 5. Further evaluation of the USA divorcement and anti-trust legislation relevant to the petroleum industry.

	W. Australia Legislative Assembly Select Committee (continued)	• World parity pricing can increase fuel costs independently of production costs, resulting in windfall gains for oil majors. • The petrol market in W. Australia is not characterised by healthy processes of competition at all levels. Genuine competition will deliver the lowest possible prices into the future. Both the wholesale and the retail levels require a greater degree of genuine competition. A true TGP pricing policy would introduce competition at the wholesale level. • Retailers should be legally entitled to purchase a substantial part of their stock from the supplier of their choice.	6. State Government request Commonwealth Government to conduct and review of world parity pricing and supply arrangements. 7. Government establish a true TGP system, incorporating a Maximum Wholesale Price (MWP), set by the W. Australian Government. No spot sales to be allowed above the MWP. 8. Legislation amendment to allow discretionary 50% purchasing.
2001	ACT Independent Competition and Regulation Commission	• Multiplicity of fuel supply arrangements indicates that competitive tensions are at work in the market, such that the majors cannot currently control prices. There is no evidence that oil majors are controlling retail prices. • Competition in refining, marketing and retailing sectors is such that margins and profitability are low, possibly unsustainably so. • Price cycles are not caused by oil companies attempting to capture monopoly profits, but by competitive price discounting cycles. • The ACT should not attempt to set fuel prices independently of other States.	1. The ACT Government not introduce any new fuel pricing regulation before the conclusion of the ACCC inquiry into price variability. 2. Following the ACCC inquiry, the ACT should take a regulatory approach that is consistent with any national regulatory action.

2001	ACCC: *Reducing Fuel Price Variability*	• Volatility in retail prices is generally confined to the major metropolitan areas. Price cycles in these areas are fairly regular and frequent. • Average size of the variations more than doubled in Sydney, Melbourne and Brisbane 1998-2001. • The 24 hour rule in Perth may have contributed to limiting the average variation of price cycles, and may also have resulted in higher average prices. • Petrol prices are relatively stable on average within a day. • On average, 60% of petrol is sold at prices below the average, and 40% above the average. • Diesel retail prices do not display price cycles. This is due to: oil majors not providing price support for diesel retail sales; major diesel sales are to commercial users on agreed contracts which may include a discount on pump prices; most diesel sales occur in regional areas. • Consumers on average benefit from price cycles. • Increasing consumer awareness of petrol price cycles would have two main benefits: a greater understanding by consumers would reduce their concern and frustration on price cycles; consumers would have more information to help them take advantage of lower prices.	1. A consumer awareness initiative to increase consumers' awareness of petrol price cycles, and to enable consumers to time their purchases so that they can buy petrol at times when petrol prices are relatively low. 2. Government should consider holding discussions with all industry participants to further reform in the petroleum industry. 3. Current terminal gate pricing (TGP) arrangements in W. Australia and Victoria should be monitored closely before a final conclusion is made on TGP. 4. Other options to limit price cycles (such as limiting price changes to only once in 24 hours, limiting price increases to a certain amount each day, and price regulation at the retail and wholesale levels) should not be implemented. 5. Fuel pricing arrangements in W. Australia should continue to be monitored closely.

2002	ACCC: *Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia*	<u>Western Australia Arrangements</u> • The W. Australia 24-hour rule is likely to have reduced rather than increased competition. • The W. Australia MWP arrangements have not been working as intended since they were introduced in April 2001. The MWP arrangements are likely to have had a negative effect on competition at the wholesale level by reducing supply available to the spot market. • Perth prices have increased relative to price benchmarks. • The Fuelwatch website has increased price transparency for consumers and the industry. • The 24-hour rule has had minimal effects on the variation and duration of price cycles in Perth. • The W. Australia city-country price differential has increased since the introduction of the new fuel pricing arrangements. • On the basis of these findings, it is hard to conclude that the W. Australian fuel pricing arrangements have been successful. The combination of these arrangements and tighter fuel standards in the State have significant implications for the nature of competition and the level of investment in the market. <u>Victorian Terminal Gate Pricing (TGP)</u> • The impact of the Victorian TGP arrangements is not clear. Transparency objectives appear to have been achieved. • It appears that TGP has had minimal effect on the	

	ACCC (continued)	price cycles in Melbourne. • TGP has coincided with an increase in average retail prices compared to the import parity benchmark. One factor in this might be the reduction in discounting linked to TGP.	
2005	Northern Territory Independent Fuel Inquiry	• The Territory's relatively small population and remoteness leads to higher fuel prices. • Price changes in the Territory can lag behind other areas of Australia, which can happen in locations without a refinery. This can lead periods of inflated prices discrepancies between the Territory and other regions. • Increased awareness can help drive petrol prices down. • Increased competition in Darwin is likely to drive prices down. • The new Vopak terminal will have a positive effect on the potential entry of new competition.	1. Mandatory price boards at service stations. 2. The Territory to support the Australian Government in repealing the PRM Franchise and Sites Acts. 3. The Territory to extend fuel price monitoring. 4. Consideration be given to multiple fuel cards for Government vehicles. 5. Government to implement a consumer awareness program. 6. Instances of 'unreasonably high' prices to be referred to the ACCC.
2006	Queensland Legislative Assembly Inquiry into Petrol Pricing in Queensland	• The fuel retailing industry appears to be highly competitive in SE Queensland • However competition can be severely lacking in the fuel markets in other areas of Queensland, due to more limited choices and ability to price shop. • In addition to the lack of competition, there are four aspects of the fuel industry that are not conducive to a competitive and efficient market: vertical integration of the oil majors; the introduction of	1. Queensland should not introduce legislation to control petrol prices based on the *Petroleum Products Pricing Act (WA)* 2. Investigation of viability of petrol cooperatives to improve competition in rural and regional areas. 3. Queensland to seek assurances from the Federal Treasurer that

	Queensland Legislative Assembly Inquiry (continued)	tougher fuel standards; the lack of transparency in fuel pricing; the reduction in the number of independent operators. • There is a concern that the short-term savings from supermarket fuel discounts shopper dockets could be overshadowed in the long-term by the loss of independents. • Section 46 of the Trade Practices Act needs to be strengthened, either through an 'effects' test or a prescribed offence for predatory pricing. • Oilcode needs to provide adequate protection for independents to compete fairly against oil majors and supermarket retailers. • W. Australian legislation has impacted adversely on independent fuel retailers. • The Committee is not convinced of the efficacy of mandating the publication of refiners' terminal gate prices.	the Oilcode will contain adequate provisions to combat anti-competitive behaviour and abuse of market power in the petroleum industry.

ATTACHMENT 2

Australian Institute of Petroleum

MEDIA RELEASE

Tuesday July 25, 2006

Oil companies wholesale margins have not increased - CAV report flawed

Contrary to a recent report published by Consumer Affairs Victoria (CAV), wholesale margins for petrol in Victoria have not increased as suggested in the report, the Executive Director of the Australian Institute of Petroleum (AIP), Dr John Tilley, said today.

"The report claims that wholesale margins for petrol at the terminal gate in Victoria have increased by 2.5 cents per litre since 2003. This claim simply ignores the fact that fuel quality standards in Australia have improved substantially in that period", Dr Tilley said.

"Over the period since 2003, the Australian community and the environment have been the beneficiaries of substantial improvements in national fuel quality standards for both petrol and diesel, which help reduce air pollution from vehicles", Dr Tilley said.

- Over the past few years the sulfur content in petrol has been reduced from 500 parts per million to 150 parts per million. At the same time the sulfur content for diesel has been reduced from 500 parts per million to 50 parts per million.

- Further improvements in petrol quality have been delivered by the industry through several other changes to standards, including reduction in benzene content from a maximum 5% to a maximum of 1%. This is a large reduction in benzene content and has required the adoption of special technology at Australian refineries to achieve this improvement.

"Following the release of the CAV Report, BP Australia (an AIP member) met with the CAV and made it clear that tighter fuel standards have not been adequately considered in the CAV's report and calculations", Dr Tilley said.

"If the price effect of tougher fuel standards were taken into account it would be evident to CAV that wholesale margins have not increased since 2003. This calculation error has unfortunately then been used by CAV to draw incorrect conclusions about the implied 'additional profits' accruing to the industry over that period from increases in margins that do not exist. This error could have been avoided through consultation with the industry prior to the release of the report", Dr Tilley said.

"AIP and its member companies are more than happy to meet with the Minister or again with CAV and of course with the ACCC to discuss any aspect of this report and fuel pricing. AIP and its member companies will also be making submissions to the Senate inquiry into petrol pricing in Australia", Dr Tilley said.

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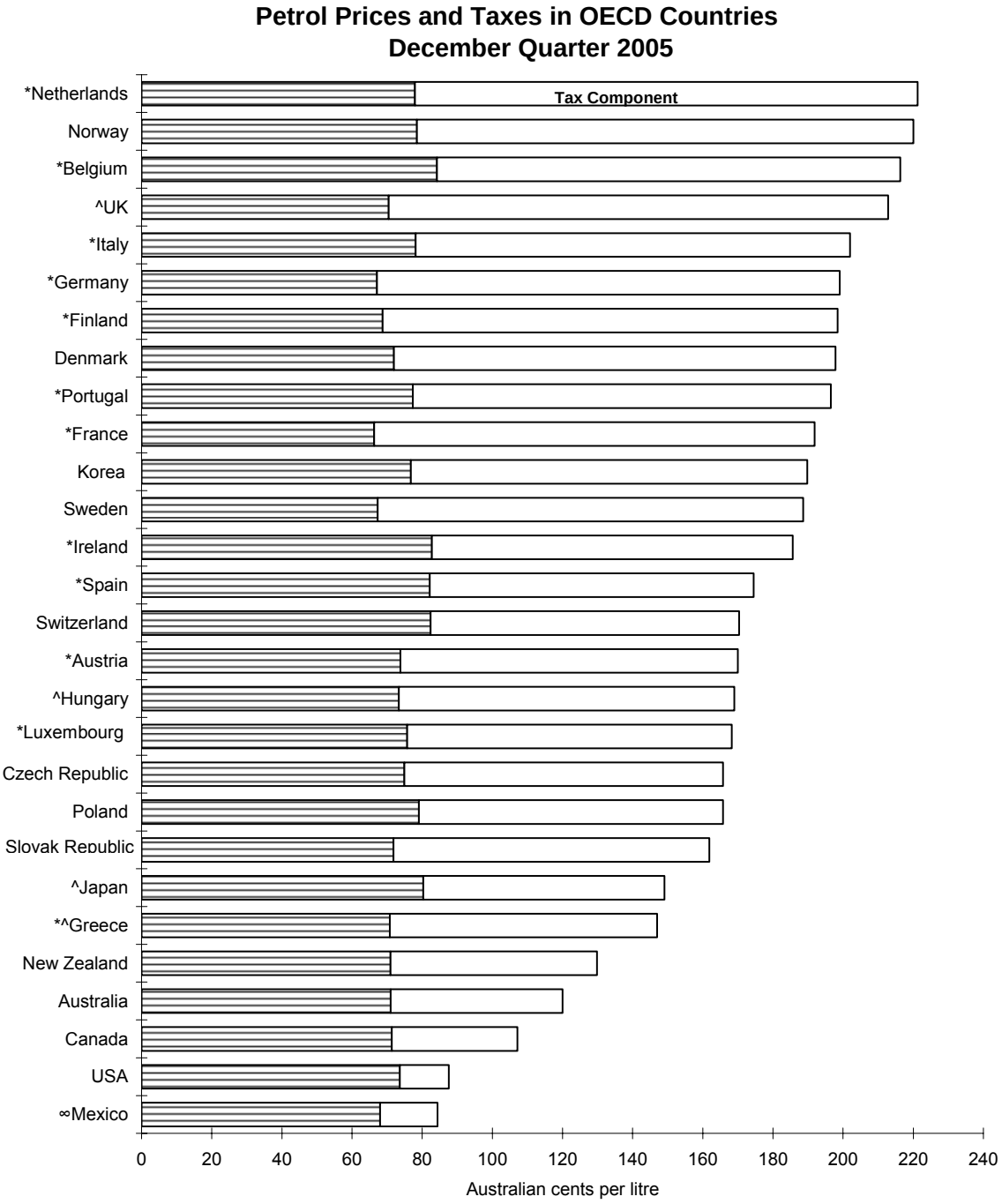
ATTACHMENT 3



SUPPLEMENTARY SUBMISSION

BY

BP AUSTRALIA PTY LTD

ON

THE PRICE OF PETROL IN AUSTRALIA

TO

SENATE ECONOMICS LEGISLATION COMMITTEE

26 SEPTEMBER 2006

Ethanol and e10

At the time of lodging our main submission on 2 August, an announcement by BP Australia Pty Ltd on e10 pricing was in prospect and we deliberately avoided reference to biofuels because of this.

Subsequent to this, on August 10 we announced our biorewards Program which offers 3 cents a litre discount on biofuels (Attachment 1).

This is now in place at the 51 BP branded service stations that market e10 (now branded as New Unleaded on BP sites). The biorewards program has been facilitated by the larger volumes and better logistics associated with the coming on stream of our first major ethanol contract (with CSR).

Our progress on ethanol sales has been:-

- Up till July 2006, we were marketing e10 at the rate of about 1 million litres a month (or 1.2 million litres of ethanol per annum) at about 30 sites in Queensland and 3 in the ACT.

- With the coming on stream of the CSR contract as from August 2006, sales has increased to 80 million litres of e10 per annum (7 million litres a month) currently at 51 sites (Attachment 2).

- At about half of the BP e10 sites in Queensland, e10 has now replaced standard grade unleaded petrol (ULP) as the main product. These will therefore be very high volume e10 sites and e10 will be the main product (compared with that of a niche product at many of our competitors' sites).

- Expansion will continue. (Attachment 3 is a press release of 15 September detailing further progress on biofuels.)

Addressing some issues raised in Other Submissions

Examination of other submissions indicates three major issues. These are discussed briefly below.

1. Why have retail prices risen more than crude prices?

The build-up of the petrol market all the way through to the retail market is simple in concept, but there are so many factors that can complicate the price.

Apart from crude prices (the market for which is influenced by an array of international forces), there are the following factors:-

- The petrol refinery margin, which is the difference between the Singapore or regional product price (known as MOPS 95) and the Tapis crude price. This can vary widely. In January 2005 it was close to zero. In February 2006 it was negative. In June 2006 it was close to 7 Aus cpl. By August it had fallen again. Like the crude price, this is set by international market forces.

- Shipping rates can also vary. They rose sharply after Hurricane Katrina, and have generally increased in the past 2 years. Again, these are set by international market forces.

- Australian fuel standards have increased over the past few years. This has meant that the quality premium over the Singapore MOPS 95 benchmark (which has remained unchanged in terms of quality), has risen each year since 2003. The quality premium is established by the market.

- The wholesale margin can vary in the short term due to lags and competition at the wholesale level. But overall, this has remained unchanged, despite increasing working capital costs.

- The retail margin is determined by competition in the local market. Like any active market, this has its variations, apart from that of the weekly price cycle in the five major capital cities. This is clearly shown in Chart 4.2 on p 40 of the ACCC Submission.

There are many forces acting on petrol prices:-

- All of them are subject to market competition
- Several are internationally related (crude, product, shipping, quality, and exchange rate)
- The markets can rise and fall
- Specific comparisons by time or by place can hide the true picture
- It is the sum of all of the component factors which yields the price at a particular time.

2. At the wholesale level, the Consumer Affairs Victoria report of June 2006 suggests that wholesale margins have increased by some 2-3 cents a litre since 2003.

The Consumer Affairs report is seriously flawed. It failed to incorporate cost increases due to Australian standard quality improvements over this period. It also did not factor in increased shipping costs. This accounts for the "missing" 2-3 cents, and this has been pointed out by the ACCC.

BP's Gross Wholesale Margin in Melbourne (and elsewhere) has been basically flat over this period. And this is despite increasing working capital costs.

Consumer Affairs would not have reached its wrong conclusions if it had consulted with the industry and with other parties such as the ACCC.

3. According to the Australian Automobile Association (AAA) submission, the WA Commissioner for Consumer and Employment Protection advised AAA that their analysis had shown that retail margins had increased in Perth by 2-3 cpl compared to the April and June quarters of the last two years.

If the matter is looked at the matter broadly, the following is apparent:-

- Coles Express entered the Perth market in March 2004. This led to retail margins falling to unsustainable levels.
- Around 12-15 months later, margins returned to sustainable levels
- By contrast, margins in other capitals remained relatively static.

So what happened was that (a) there was market entry by a major new competitor, (b) this resulted in low margins for a prolonged period, to the benefit of the consumer, (c) in due course, margins returned to more sustainable levels.

The analysis by the WA Department, as with the Consumer Affairs analysis, failed to comprehend the full picture. As such, both yielded the wrong conclusions.

An unintended consequence of flawed analyses is that they receive media attention at the time of release, but little or no coverage is often given a sound analysis of the data.

Contact: Bill Frilay

Manager, Government Relations

BP Australia Pty Ltd

03 9268 3880

Save 3¢ per litre with BP's ethanol blended fuel

Release date: 10 August 2006

BP Australia announced today that it has commenced the rollout of a program that will save motorists in Queensland and the ACT three cents per litre on its ethanol blended fuel. The offer will be made available from Monday, August 14th.

Today's announcement follows the first deliveries from a supply contract between BP and CSR that will see 23 million litres of ethanol blended into e10 over two years.

By the end of August, BP will also have increased the total number of BP branded sites selling ethanol blended fuel to 50, making the savings more widely accessible.

"As a result of this initiative, BP is providing motorists with the ability to save money and at the same time reap the rewards from a fuel that is good for their vehicle and good for the environment," said Mike McGuinness, BP Australasia's Vice President Fuels Management.

"The ability to pass through these savings is the result of considerable work by BP over a number of years. Our investments in biofuels have now led to a secure source of supply close to market and we are making good on our promise to deliver the resulting benefits to consumers," he said.

"This initiative is due in no small way to the policies of the Federal and Queensland Governments. By incentivising ethanol instead of mandating it, they are ensuring that the benefits will be passed on to consumers," Mike McGuinness said.

Notes to editors:

How do I get the three cents per litre discount?

Simply fill up your petrol at a BP site offering ethanol blended fuel.

An updated list of BP locations at which motorists can purchase e10 is available online at www.bp.com.au/biofuels.

The customer will receive a 'biorewards card' that will entitle them to a discount on ethanol blended fuel. Terms and conditions will apply.

BP's ethanol blended fuel (BPe10)

BP e10 is a high quality, specially formulated, regular unleaded petrol blended with up to 10% renewable ethanol.

BP e10 will perform in an engine, similar to traditional petrol with the benefits of lower emissions.

Ethanol blended fuel is not new for BP, in fact BP first commenced marketing e10 in Queensland in 2001 and has already 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 23 million litres of e10 without recording a single vehicle complaint.

BP Australia is firmly in the front line of those companies working to significantly improve the environment through the introduction of clean fuels.

About BP

BP is of one of the world's largest energy companies with operations across 100 countries worldwide.

BP has worked in Australia since 1920 and today we're involved in a whole range of activities, such as exploring natural gas and crude oil resources. We also refine and market petroleum products, produce lubricants, and help to generate a significant amount of solar power.

We have a network of almost 1,400 service stations throughout Australia, including a number of 24-hour truckstops on the country's major highways. Our focus on superior locations and cleaner fuels, as well as the fresh food and coffee we provide through our Wild Bean Cafés, have made us a strong competitor in both the fuel retail and convenience sectors.

Additional information may be found at www.bp.com.au/biofuels

BP drives eight-fold increase in Queensland sales of e10

Release date: 15 August 2006

BP Australia announced today that it has commenced a further rollout of e10 which will see its sales in Queensland increase this month by a factor of eight

This follows the successful completion of CSR's investment in new ethanol production facilities at Sarina in Queensland and the commencement of a contract between BP and CSR for the supply of 23 million litres of ethanol over two years.

These initiatives will see BP supply 8 million litres of ethanol over the next twelve months, with this figure rising to 15 million litres the following year.

"We announced this contract in March and we are delighted that it has now commenced. This new supply arrangement allows BP to move to the next – and much larger - stage of our biofuels expansion," said BP Australia President, Mr. Gerry Hueston.

BP has marketed ethanol blended fuel in Queensland since 2001 and is moving to make the fuel available at 49 BP branded service stations by the end of this month.

"We now have more volume to offer at more outlets. Not only is ethanol blended fuel now more available to Queensland motorists but they can also purchase this fuel at a 3 cents a litre discount as we announced last week," said Mr. Hueston.

"We are seeking to further expand our sales of e10 in Queensland and are in negotiations with current producers to secure additional supply.

"We are preparing to move to the next stage in the supply of ethanol blended fuel. This would involve the purchase of the entire output from a large scale east coast ethanol plant, and from this a large scale supply of e10 into the Queensland market.

"We again express our appreciation to the Queensland and Federal Governments for their continued support for biofuels," said Mr. Hueston.

ENDS
Notes to editors:

BP's ethanol blended fuel (BPe10)

- BP e10 is a high quality, specially formulated, regular unleaded petrol blended with up to 10% renewable ethanol.
- BP e10 will perform in an engine, similar to traditional petrol with the benefits of lower emissions.

- Ethanol blended fuel is not new for BP, in fact BP first commenced marketing e10 in Queensland in 2001 and has already 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 23 million litres of e10 without recording a single vehicle complaint.
- BP Australia is firmly in the front line of those companies working to significantly improve the environment through the introduction of clean fuels.

BP's biofuels initiatives in Australia

- Investment to allow production at BP's Bulwer Refinery in Queensland of 110 million litres per annum of renewable diesel 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.

Further information:
Name: Chandran Vigneswaran
Phone : 03 9268 3534 or 0410 479 002

Websites:
Download the latest list of participating sites (pdf 43KB)

BP to surpass Federal Government biofuels target

Release date: 15 September 2006

BP Australia today announced its plans to surpass the Federal Government's 2010 national biofuels target at least one year ahead of the scheduled delivery date.

BP's plans include three further initiatives that will see the company delivering over 400 million litres of biofuels per annum, a volume greater than the Federal Government's target of 350 million litres.
The initiatives include:

- An agreement to double the capacity of a new ethanol plant to be constructed by Primary Energy in Kwinana, Western Australia. The plant's capacity will be increased from 80 million litres to 160 million litres per annum and construction is expected to commence in early 2007.

- Separate MOUs to secure the supply of ethanol from one or more new plants with Primary Energy (Brisbane and Gunnedah) and CSR (Eastern Australia). The total level of supply sought is expected to be greater than the new output from the proposed Kwinana ethanol plant.

- The purchase from Manildra of 3 million litres of ethanol over one year commencing in November of this year. Negotiations have also commenced to secure a further 12 million litres of ethanol from Manildra over the same period.

BP Australia President, Mr. Gerry Hueston said "BP was the first serious player to market biofuels in Australia and now we are the first to ensure that it will be supplied on a large scale.

"This is a clear signal of our intention to make sure that biofuels play a role in Australia's fuel supply both now and in the future. It is a plan that is good for motorists and good for the future of the biofuels industry."

ENDS

For any media inquiries please contact:
Chandran Vigneswaran on 03 9268 3534 or 0410 479 002

Notes to editors:

Previously announced BP biofuels initiatives in Australia

- On August 10 2006, BP announced that it will provided motorists in Queensland and the ACT with a 3 cents per litre discount on ethanol blended fuel.

- On August 15 2006, BP announced that it had commenced a further rollout of e10 which will see its sales in Queensland increase month by a factor of eight. This announcement followed the successful completion of CSR's investment in new ethanol production facilities at Sarina in Queensland and the commencement of a contract between BP and CSR for the supply of 23 million litres of ethanol over two years. These initiatives will see BP supply 8 million litres of ethanol over the next twelve months, with this figure rising to 15 million litres the following year.

- In March 2006, BP announced three initiatives that would see it meeting over 50% of the Federal Government's target on biofuels by 2008 including:

  - Investment to allow production at BP's Bulwer Refinery in Queensland of 110 million litres per annum of renewable diesel 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. This supply of ethanol from this contract has already commenced and is being sold into the Queensland market.

Submission to Senate Rural and Regional Affairs and Transport Committee Inquiry into Australia's Future Oil Supply

BP Australia Pty Ltd

Introduction

(a) BP plc

BP Australia Pty Ltd is a wholly owned subsidiary of BP plc which is a major international energy explorer, producer and marketer. BP plc has major global interests both in hydrocarbons and in developing alternatives and renewable energy.

While BP plc believes that traditional hydrocarbons will continue to play a major energy role for many years, the company recognizes the need to look to alternatives, and has taken major steps accordingly.

Major steps in this regard have been:-

- The swing to more low carbon production eg natural gas and LNG, with lower greenhouse emissions. These have been largely for stationary power uses (eg power stations)
- Developments in photovoltaic energy (solar energy)
- The creation of BPAlternative Energy which will manage an investment programme in solar, wind, hydrogen and combined-cycle-gas-turbine (CCGT) power generation, which could amount to US$8 billion over the next ten years.(Attachment 1)

(b) BP Australia

BP Australia Pty Ltd is a major oil refiner and petroleum products marketer in Australia. BP is also Australia's leading PV solar manufacturer. Particular aspects of BP's business relevant to this inquiry are:-

- BP operates two refineries – at Kwinana in Perth and Bulwer in Brisbane
- BP produces, imports and markets roughly 25% of our liquid fuel requirements
- BP markets product across Australia
- BP has led the way on producing clean petrol and diesel in Australia
- Almost all of the crude oil for the refineries is imported.

a. projections of oil production and demand in Australia and globally and the implications for availability and pricing of transport fuels in Australia;

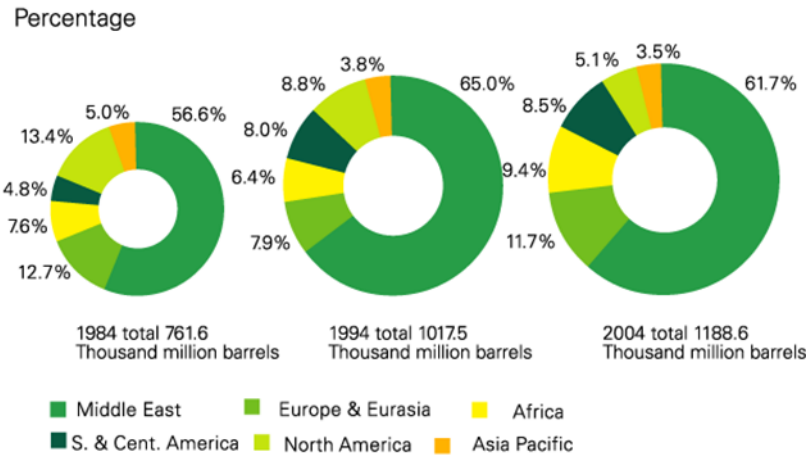
Apart from its one sixth interest in the NW Shelf (which is primarily a liquefied natural gas operation), BP produces no hydrocarbons in Australia and we have no supply projections for hydrocarbon production in Australia. We believe that Australia remains a

prospective area, especially in terms of gas. Australian petroleum products demand is about 45 billion litres pa and is growing at around 2% pa.

Globally, the following charts (mostly sourced from BP's 2005 Energy Statistical Review) show:-

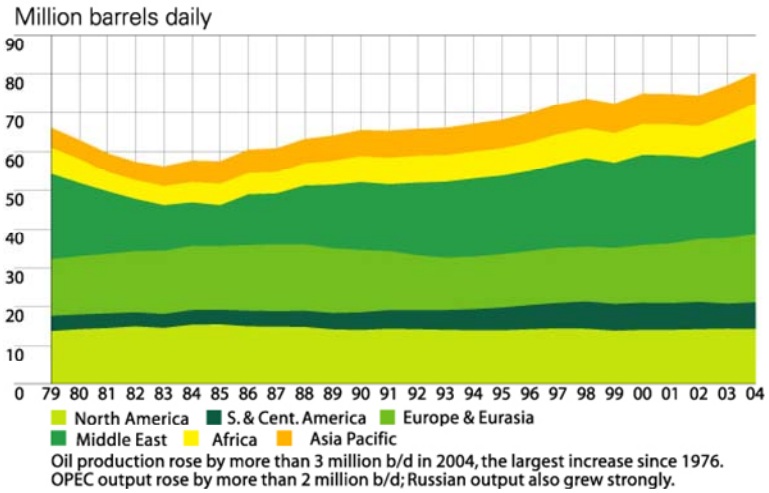
- world reserves of oil have increased from 771.6 thousand million barrels in 1984, to 1017 thousand million barrels in 1994, to 1187 thousand million barrels in 2004

Distribution of proved (oil) reserves 1984,1994, 2004



- world production has increased from 67 million barrels per day (bpd) in 1994 to 77 million bpd in 2004 (consumption has followed a similar trend)

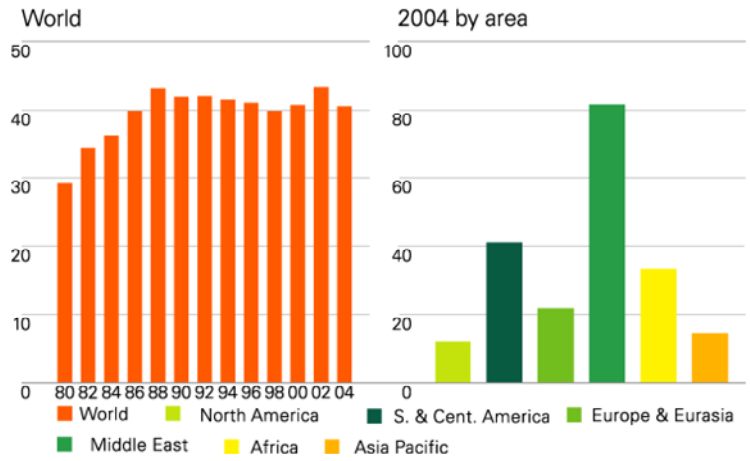
Oil production by area



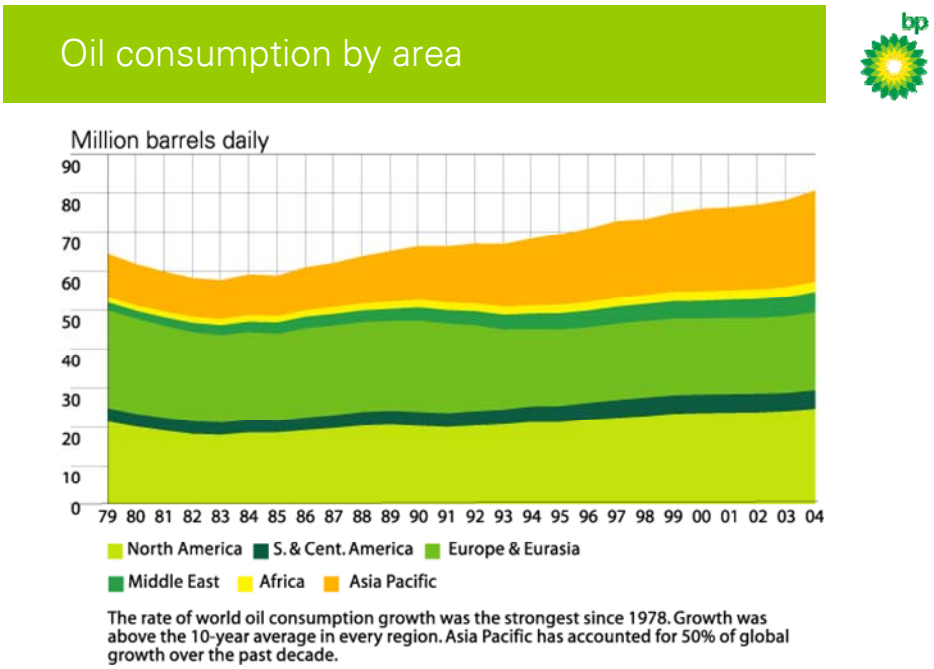
Oil production rose by more than 3 million b/d in 2004, the largest increase since 1976. OPEC output rose by more than 2 million b/d; Russian output also grew strongly.

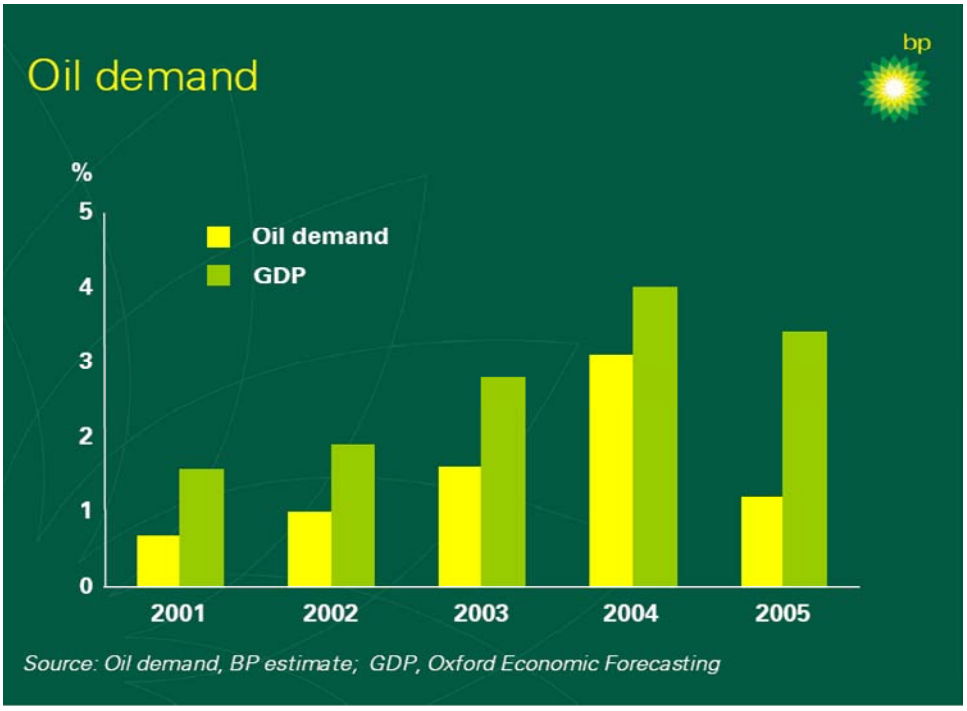
- reserves to production ratio has increased from 30 to about 40 (i.e. 40 years known reserves at current production rates) since 1986.

Oil reserves-to-production (R/P) ratios

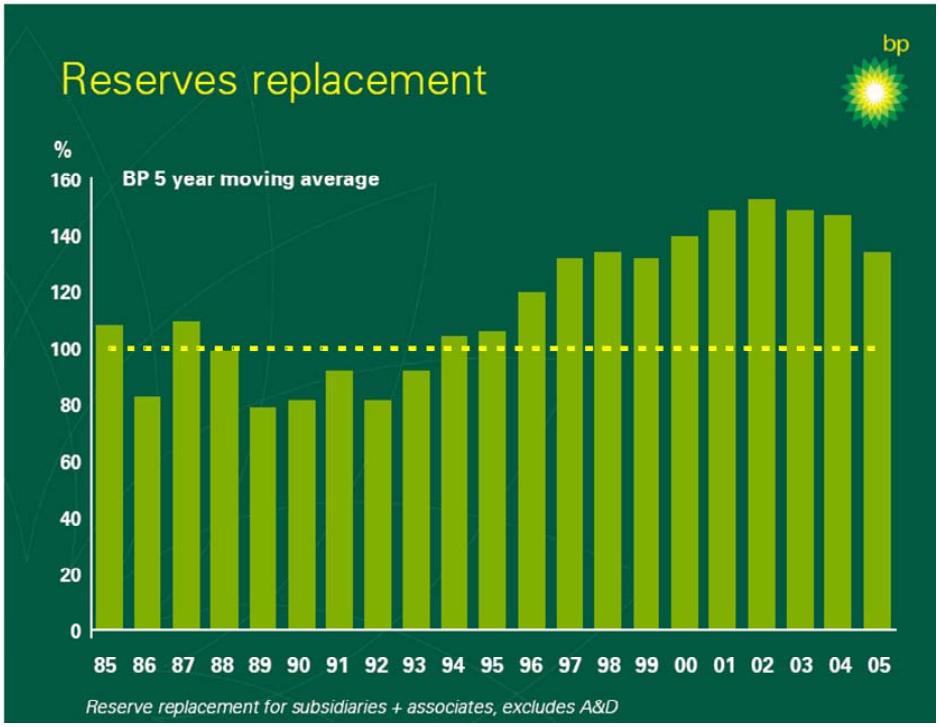


The world's oil reserves-to-production ratio fell to 40.5 years in 2004, down from 43.3 in 2002. Reserves have continued to increase and now stand 17% above the 1994 level; production is 20% higher.





As far as BP is concerned, 2005 was the 13th consecutive year that we have replaced 100% or more of our production.



To quote Lord Browne, CEO of BP plc in a recent speech: "(There is a) myth, which is that oil and gas are running out, and that we are walking towards the edge of the cliff……

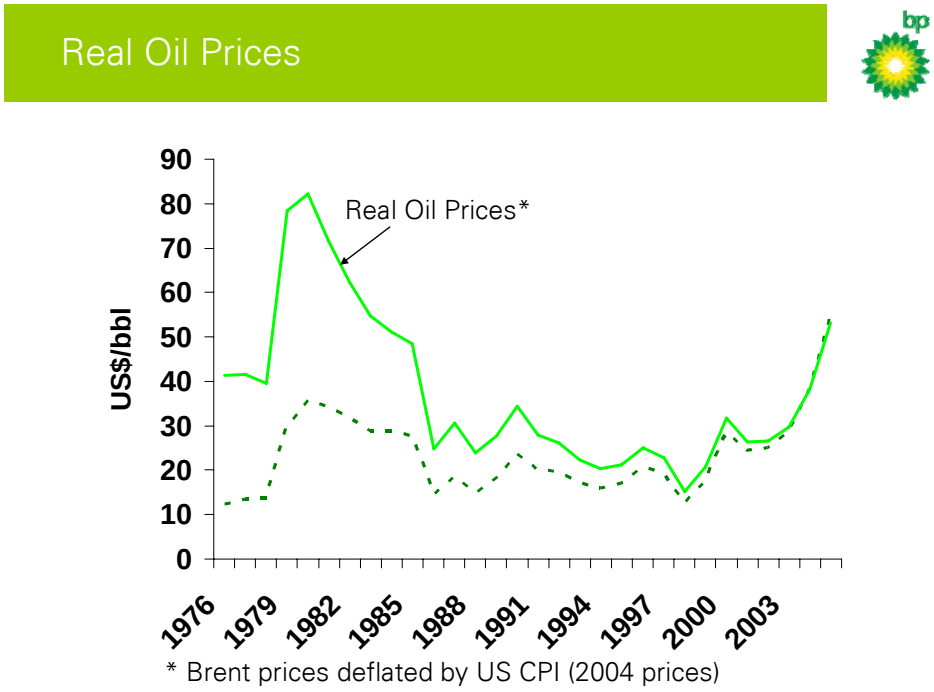
The idea that oil is running out is simply untrue. There is no physical shortage of oil or gas.

The reality is that the physical resource base is strong, and the amount which we can recover from that base is being expanded by technology all the time.

BP believes there is no direct issue about availability. Oil – whether crude or product – is a mature internationally traded commodity. BP has imported virtually all of its crude over the past 20 years, and we cannot recall any major issue of availability during this period.

Implications for pricing of transport fuels in Australia

Australia is already inextricably linked to world and regional product prices for both crude and petroleum products. This is the more so given that Australia now has to import products. However, there is a presumption in the terms of reference that prices will increase. While there were major increases in prices in 2005, this does not mean that this trend will continue. The following graph shows how prices declined in the early 80s and were basically stable for much of the 90s.



Price is a matter of the market and supply and demand, stockholdings and supply capacity. It can also be influenced by other factors – world events, terrorism, hurricanes etc.

As for the future of prices, it is very difficult for anyone to predict these. In a recent speech, our Group Chief Economist forecast a band of US$50-60 for this year for Brent crude.

b. potential of new sources of oil and alternative transport fuels to meet a significant share of Australia's fuel demands, taking into account technological developments and environmental and economic costs;

BP believes:-

- Traditional hydrocarbons will continue as the mainstay for transport fuels
- Biofuels represent a very useful extender. BP has just made a major announcement in this regard.

Attached is a press release of 31 March 2006 announcing two major contracts and a Memorandum of Understanding in respect of biofuels.

We will elaborate on these matters at the hearings.

c. flow-on economic and social impacts in Australia from continuing rises in the price of transport fuel and potential reductions in oil supply; and

This assumes that there will be continuing rises in the price of transport fuel and potential reductions in oil supply.

This is not necessarily the case. It is very hard to be definite on these matters as the preceding graph shows in respect of price.

d. options for reducing Australia's transport fuel demands.

There are a number of options here, including:-

- increased vehicle fuel effciency
- greater use of public transport.

These could be discussed further at the hearing.

Attachment 1

BP forms BP Alternative Energy – 28 November 2005

BP today announced that it plans to double its investment in alternative and renewable energies to create a new low-carbon power business with the growth potential to deliver revenues of around $6 billion a year within the next decade.

Building on the success of BP Solar - which expects to hit revenues of $1 billion in 2008 - BP Alternative Energy will manage an investment programme in solar, wind, hydrogen and combined-cycle-gas-turbine (CCGT) power generation, which could amount to $8 billion over the next ten years.

"Consistent with our strategy, we are determined to add to the choice of available energies for a world concerned about the environment, and we believe we can do so in a way that will yield robust returns," said BP chief executive Lord Browne.

"Our recent experience, particularly with solar, has given us the expertise and confidence to develop new products and markets alongside our mainstream business. We are now at a point where we have sufficient new technologies and sound commercial opportunities within our reach to build a significant and sustainable business in alternative and renewable energy."

Browne said the first phase of investment would total some $1.8 billion over the next three years, spread in broadly equal proportions between solar, wind, hydrogen and CCGT power generation. Investment will be made step by step, and will depend on the nature of opportunities and their profitability.

"We are focusing our investment in alternatives and renewables on power generation because it accounts for over 40 per cent of man-made greenhouse gas emissions, the biggest single source. It is also the area where technology can be applied most cost-effectively to reduce emissions.

"As the pricing of carbon develops through trading schemes and other initiatives, the market will grow rapidly as low-emission technologies displace less clean forms of power generation."

Investment in solar over the next three years is planned to boost BP's leading position as a leading manufacturer and supplier of photovoltaic systems. In a field where technology improvements and higher productivity are causing costs to decline, BP currently has 10 per cent of the global market which is growing at 30 per cent a year, faster than any other form of renewable energy.

BP currently has more than 100 megawatts of solar manufacturing capacity in the US, Spain, India and Australia, with a plan to double its capacity before the end of next year. BP recently signed a strategic joint venture to access China's expanding solar market and provide local manufacturing capacity and is exploring similar opportunities elsewhere in the region.

Investment in hydrogen fuels will include the world's first commercial project - at Peterhead, in Scotland - to turn natural gas into hydrogen by stripping out carbon dioxide and pumping it into depleted oil reservoirs.

The hydrogen will be used at a power station in Peterhead to generate 350 megawatts of 'clean' electricity, and the carbon dioxide re-injected into the offshore Miller field. BP is looking at a similar sequestration scheme to make hydrogen from low-value coke by-products at a US refinery which would be used to generate 500 megawatts at an adjacent new-build power plant.

Investment projected for wind represents a significant step up in this area of power generation for BP. The company currently runs two wind farms alongside existing oil plants in the Netherlands. It also owns industrial land in open, high-wind regions of the US, away from residential areas, providing the possibility to build the first large-scale US wind farm generating up to 200 megawatts in 2007. The company has identified enough US sites to accommodate wind turbines with a total capacity of 2,000 megawatts.

Projected investment in CCGT will be spent mainly in the US where the company already has significant co-generation capacity and is currently finalising plans for a new $400 million scheme at one of its major plants that will deliver 100 megawatts of power to the plant, and 420 megawatts to the local electricity grid.

BP Alternative Energy will be based in Sunbury, Middlesex and initially employ some 2,500 people around the world. It will be headed by Steve Westwell, reporting to Vivienne Cox, chief executive of BP's Gas, Power & Renewables division.

press release

31ST MARCH 2006

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

For any media inquiries please contact:
Chandran Vigneswaran on 03 9268 3534 or 0410 479 002

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.

Energy Security – Trends, Challenges and Solutions
Gerry Hueston, President BP Australasia

May 3rd 2006
Australian British Chamber of Commerce – Business Lunch
The Park Hyatt, Melbourne, Victoria

Ladies and Gentleman,

Thank you, I am delighted to be here. In fact, I think that this is going to be one of the highlights of my day. I started the day after delivering my daughter to school and, then got held up on the Monash Freeway. If that wasn't bad enough, I then arrived in the office and my PA said to me "Happy Anniversary". I said, "What's that for?", and she said "Its thirty years for you at BP today." What she was too polite to say, but I suspect probably thought, was that when I started at BP she was in pre-school.

The other unfortunate thing of course is the timing of this event. You agree to do these sorts of presentations well in advance and, of course what you can't predict is what happens to the price of oil in the interim. The price of oil spiked in Perth last year when I made a speech, and people attending the event were not particularly interested in what I had to say unless it was in relation to the price of oil. Of course, today we have the price of oil now at a record high.

Today I do want to talk to you about the trends and the challenges of energy security. However I will make a couple of comments to satisfy people upfront about the price of oil. I say that because I won't satisfy people. I can give you some warning of that in advance.

I make two points. The first point is that I have no idea what the price of oil will be. If that's not enough, anyone who says that they do - and that's the second point – they will be wrong.

There is absolutely no logic in where oil is today. The day to day oil price is driven by events and, very current events. There is a lot of fear in the market at the moment. There is a lot of speculation. Because we have got a very tight market it is very difficult to calibrate what is going to happen. In BP, our view is that the intrinsic value of oil is exaggerated at the moment as a result of the way the market is. In the medium to longer term the value of oil will be a lot lower than it is today.

There has been 600 billion dollars invested by oil companies over the last few years into increased production. I can assure you that none of that has been predicated on 70 dollars plus oil. Its been predicated on a lot lower than that.

I don't know when the medium term starts. I'm not going to make any predictions. I'm not going to make any predictions about the price of oil. But it is inflated by fear, speculation and a very, very tight situation overseas today.

I would now like to move on to the challenges for energy security. In doing so let's just think about Australia for the moment. Australia enjoys a very high level of energy security. I am sure that we can all think of an incident where energy hasn't been supplied to the level that it has been expected to. However, I think that the energy industry in general has done a remarkable job of making sure that energy, and low cost energy at that, has been supplied to a sparsely populated large land over many, many years.

In Australia, we do have an abundance of energy resources. We have got a lot of coal and a lot of gas. There has also been a lot of press recently about the fact that we have got a lot of uranium. We don't have as much crude oil, but we have got a reasonable amount of crude oil.

We have also got a level of infrastructure that meets today's needs. It's questionable however whether this infrastructure can meet tomorrow's needs. I think that point is particularly important, because at the moment we are a growing economy and we are predicted to grow significantly in the future. We spend about 60 billion dollars a year on energy. That level is expected to increase by about 50% by the year 2020. So, you can see we are going to need a substantial amount of investment to make sure that the infrastructure we look after today is looked after tomorrow.

There has been a lot of good work done in the area of Australia's infrastructure needs. The Business Council of Australia has done tremendous work in this area and has had the agenda largely taken up by COAG. There has also been a lot of activity going on in the electricity sector.

On the oil and oil products side there certainly needs to be considerable more investment in infrastructure. I'll give you some examples. About four years ago, Australia was long on refining capacity. With increases in demand, the total amount of refineries are now short. While we imported no cargos of refined product a few years ago, last year we imported over 100 cargos. By 2010 it's going to be 300 cargos, and it just escalates from there.

When you reach a tipping point, the infrastructure required for importing cargos of fuel are quite different to the infrastructure you need for importing crude oil. So you can see that even fairly dramatic changes are happening in our industry.

Of course the specifications have also changed. Rightfully, this has been a result of changing expectations from the Australian public, the government and us I might say. We must move in line with global specifications to make sure that the fuel that we have is the best available for the public. That means that we have had to invest significant amounts in our refineries, and that has meant that they are potentially more susceptible than they have been in the past. There are a lot of things that can conspire to mean that we have a number of challenges ahead of us.

I think the interesting thing for us is that just because we own refineries in Australia, we are discriminated against on how we go to market by existing legislation. I will talk about policy a bit later on, however the Federal Government is to be applauded for introducing legislation that effectively will reduce that ridiculous anomaly that allows providers of infrastructure to be discriminated against.

That's a little bit about Australia, but energy security is really a global issue. I don't think we can sit back here and say, well we're actually not badly placed and we can look after ourselves. Australia is essentially a trading nation. The world is a trading operation. The solution is therefore not to secure a price for ourselves and rely on our own resources.

Energy security is also a long term issue. The question many people ask is when is oil going to run out? when is gas going to run out? when is coal going to run out? It could be said that William Knox D'Arcy, the person who founded BP, saw the beginning of the oil age as we know it. Maybe today we are seeing the end of the oil age as we know it.

But the oil age is not going to end tomorrow. More pointedly, we don't believe its going to end in the near future. We believe that while energy supplies are finite, there is still a long way to run. For example over the last 20 years we have managed to ensure that there is always 40 years of oil supplies left to meet today's demand. In other words, we have managed to not only replace our production every year, but we have managed to increase it to meet the increase in demand. With increases in technology, in terms of where you find the oil and what you can extract, we believe that this trend will continue. We don't see oil running out in the immediate future and we don't subscribe to the peak oil view that it's doomed tomorrow and it's going to run out. We also

don't see that these short term market aberrations are any indicator of long term value or shortages or otherwise of oil. Moving beyond oil, there is also sufficient evidence that suggest that gas has got 60 years and coal has more than 150 years.

I mentioned the short term price of oil, and it is easy to understand why people are vexed about it. There is an incredibly tight market out there. The rapid rise in demand from China and the lack of investment in the late 90s have both worked to produce the tight market we have today. With the high crude oil prices, some people are reading into that perhaps a bit more than they should do. We do have heavy dependence on politically sensitive parts of the world such as the Middle East, and as the Europeans recently discovered with gas in Russia. Some exporting nations are pretty unstable. Venezuela would be a case in point. On top of all this we also have the fears about peak oil – are we going to run out of the stuff.

We don't believe that people need to be in despair about it. We believe there are good grounds to be optimistic about the future. But we need to face some realities. One of those is that short term events have dictated the terms about security. But one thing I can assure you is that short term fixes are not going to mean a long term solution. And energy security is a long term issue.

Growth in demand for energy is going to continue. Whether we like it or not, we can't roll it back. It is also unrealistic to think that we can constrain the growth in prosperity in developing countries, (and energy is the lifeblood to growth in prosperity) any more than you think you could actually wind back prosperity in Australia.

Another reality is that if you think that supply is relatively concentrated today, the all we need to do is look ten years down the track where we will see that 80% of the additional production or growth in supply is going to come from just three areas of the world – West Africa, Russia and the Middle East, with the predominance from the Middle East. I don't have to describe the potential implications of that when it comes to energy security.

The other item that has brought energy security up to be a mainstream issue around the world is the issue of climate change. The impact of fossil fuels on the environment may well be a bigger issue in the long term than the provision of the product in the first place. BP has a very public view on climate change. We believe that while the science is incomplete and always will be, as a company with views on taking risks and rewards, we think that there is sufficient evidence out there to suggest that precautionary action should be taken.

Recently, BP carried out some research and published a report in conjunction with five other major Australian companies and the ACF. The report looks at evidence that suggests that the impact on Australia could be particularly dramatic in an environmental and an economic sense. This research also suggests that the costs of early action may not actually be that high.

Globally BP is advocating a very broad based set of precautionary actions that will allow the world to try and stabilise CO_2 emissions and, try to maintain the global increase in temperature to an acceptable level. Recent actions, such as government initiatives with AP6 that includes the major emitting Asia Pacific economies, is a great step in the right direction.

Climate change is an issue that is going to impact on energy security as we go forward. The solution is not to going to be that we can't use energy, but that we have to find ways to use energy that are more sustainable than we do today.

So how do we respond to the big realities that I have described? We believe that there are some real challenges out there, but we don't believe it's impossible. One of the key elements may be an increase in the diversity of supply. We don't want to be held hostage to a select few parts of the world where supply will come from. We need more diversity in the products that we are using. And, we need diversity in technology. As you can see there is not one silver bullet that is going to

solve the energy security issues that we will face in the future, or in fact any of the issues that are emerging as a result of the release of carbon into the atmosphere.

We do believe that we need that energy needs to have a far lower carbon footprint in the future. We also don't want to tradeoff economic wellbeing for security of supply. In order to achieve this we need to be thinking about the long term now, and not waiting for a crisis to occur. I know some people have declared today a crisis with the price of oil. We don't think it is. But we do need to be thinking long term. And this is not simply thinking five years ahead. This is thinking about a horizon closer to 2020 and beyond.

The sorts of things that we need to be thinking about for the long term include infrastructure. We all know that power stations have a life cycle that goes well beyond 50 years. So do oil refineries. Technology research and development has a long term horizon. Policy settings also need to be such that they encourage things to happen. As a result, government and business both have a role to play. We believe that if you have a combination of the right policy settings, the right investment in technology and the right investment in infrastructure into the longer term, plus an open and competitive local and global market – then you have got all the ingredients needed to maintaining our prosperity in a sustainable way into the future.

If we think about technology as an example. Apparently a lot of the alternatives are seen as long horizon, and not yet proven in an economic sense. However let's look at solar for example. It's not currently economic to produce baseload electricity from solar. But if you look at solar on the rooftops in the Western suburbs of Sydney fuelling air-conditioning systems at 4 o'clock in the afternoon, then solar is economic against electricity. These are the sorts of examples that we need to make sure we have the right policy settings to enable. We must make sure that we have level playing fields in the future, with policy settings that drive these things. It's not about government picking winners; it's about government making sure that there is the right environment for ultimately the market to pick the most optimal winners in the future.

Good policy is policy that encourages sustainability, policy that encourages the right investment in technology, policy that encourages the right investment in infrastructure, and ultimately allows the market to pick the winners.

It's also about cleaning up local and international markets. It is important that markets work freely as they are working relatively well today to make sure that supplies can come in. When we think about the disruptions that have occurred over the years, the market has worked. The market has worked today, its worked in the past, and we believe it could be allowed to work in the future.

In terms of policy options it is also important that energy options that have the potential to have a material impact are enabled. I have talked about solar and photovoltaics in peak demand. I mentioned before some curious regulation that if you are a refiner and importer you have one set of rules and if you don't refine then you have another set of rules. Those are the sort of things that need to be wiped away if you want to have the right sort of investment in the future.

Now I would like to talk about what BP is doing. Perhaps on this topic it's best to start of with where we are coming from philosophically. We start with the view that the purpose of business is to satisfy human needs and in so doing make a profit for investors. For BP that means providing energy so that we can fuel human progress and economic growth. But it also means satisfying a need for a sustainable environment. BP doesn't have a future unless the products it sells are sustainable. That sets the background as to why BP is doing what it does in a global sense.

More practically our approach at BP is two fold – Firstly, we are spending a lot of money delivering increases in supplies of our traditional fuels to meet energy demands of today. And secondly we are investing in technology that will allow a low carbon energy of the future.

If we think about investing in supplies, I said earlier that over the last few years the industry has invested over $600 billion in bringing new developments into the market place. This means that there is a huge amount of investment going on today that will meet the supply shortages that we are facing tomorrow.

BP is in places like Azerbaijan, Gulf of Mexico, Trinidad and Angola. We have gone into deeper waters. We have gone into arctic and colder climates. And, we have opened up markets that have been closed for 80 odd years such as the BTC pipeline out of Azerbaijan into Europe.

Of course in Australia we are a participant in the North West Shelf Project which if you go back one year and go forward two years, it will have tripled in size. We are looking very seriously at the Browse basin which is another potential LNG project into the future, and we have invested well over half a billion dollars in our refineries and our terminals to make sure that we can meet the demand of the Australian consumer into the foreseeable future.

We are also investing heavily in technology. In 1997 BP came out quite categorically and said that there was sufficient evidence to take precautionary action on climate change. Since then we have been doing a lot of work to clean up our own backyard as well. For example, our direct emissions from our operations have decreased from 95 million tones in 1998 to 78 million tones in 2005. Some great examples in Australia include up at Karratha where we've led a 400,000 tonne emission reduction with new solvent technology. We have also invested in cogeneration at our refineries, delivering another 100,000 tonne reduction. We have introduced a scheme whereby consumers can completely offset their greenhouse emissions by paying a price premium on the cost of their fuel.

We established a company called Alternative Energy late last year that is heavily focused on the power sector. It is focused on decarbonised fuels, solar and wind. Over the next few years we intend to invest approximately $8 billion in the development and deployment of those technologies.

Looking at one example: We have two projects that are being developed as we speak that are going to take a fossil fuel and convert it into CO_2 and Hydrogen. The project will then put the hydrogen into a power station to generate electricity and the CO_2 will be sequestered to remove any carbon from going into the atmosphere. So effectively, these are power stations with a zero carbon footprint. These are what we call scale demonstration plants, that as we move forward we would expect to become part of the norm around the world.

As part of Alternative Energy we have the biggest solar manufacturing facility in the southern hemisphere based in Sydney. We are also the biggest exporter of renewable energy that Australia has.

While only 20% of energy demand is in transportation, there is also lot of work going on in this sector as well. Cleaner fuels need to be developed that are intrinsically more efficient and have a lower carbon footprint as well. On this ground we are working on biofuels and we recently announced a few projects that will see BP effectively meet more than half the national target for biofuels by 2010. That's just BP by itself. And in the longer term for biofuels we are doing a lot of research and have established pilot plants globally to take this fuel to the next step. Second generation biofuels are where you start to turn plant waste like cellulose into ethanol and you are not actually impinging on the food chain.

So there is a lot happening, and I suppose I have presented you with a bit of a potpourri of what is going on. But obviously there is a lot more to do. Energy security is a global issue, and Australia acting by itself shows leadership, but is not the ultimate solution. There is no simple silver bullet. But the climate and the world's resources are something that we all share. I think that global cooperation is necessary. And government and businesses cooperating with the right policy settings are going to play a key role.

Ultimately diversity – diversity of supply sources, diversity of products and diversity of technology are going to be some of the key enablers supported by the right policy frameworks. Along with that we need to make sure we have the appropriate investment and infrastructure, and that we have the right policy settings to make sure that trade is as good as possible.

From BP's perspective it feels like a challenge. One of the reasons I have stuck with BP is that it's always a challenge, and I mean that in a positive sense. We do look forward to being pat of the answer. I think it's an exciting time to be involved. After all providing energy and energy security is part of our business.

Thank you

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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

…/2

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.

The Changing face of energy and role of the IOC

Speaker:	Iain Conn
Title:	Chief Executive – BP Refining and Marketing
Speech date:	23 September 2008
Venue:	Sanford Burnstein

Cautionary Statement

Forward Looking Statements - Cautionary Statement

This presentation and the associated slides and discussion contain forward looking statements, particularly those regarding continuing operational momentum; expected growth in resources and production; expected start up and timing of projects; expected improvements in competitive performance; expected growth in hydrocarbon demand; and expected headcount and corporate overhead reduction. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will or may occur in the future. Actual results may differ from those expressed in such statements, depending on a variety of factors, including the timing of bringing new fields on stream; future levels of industry product supply; demand and pricing; operational problems; general economic conditions; political stability and economic growth in relevant areas of the world; changes in laws and governmental regulations; exchange rate fluctuations; development and use of new technology; changes in public expectations and other changes in business conditions; the actions of competitors; natural disasters and adverse weather conditions; wars and acts of terrorism or sabotage; and other factors discussed elsewhere in this presentation.

Cautionary Note to US Investors

The United States Securities and Exchange Commission permits oil and gas companies, in their filings with the SEC to disclose only proved reserves that a company has demonstrated by actual production or conclusive formation tests to be economically and legally producible under existing economic and operating conditions. Certain terms are used in this presentation, such as "resources" and "non-proved reserves", that the SEC's guidelines strictly prohibit us from including in filings with the SEC. US investors are urged to consider closely the disclosures in our Form 20-F, SEC File No. 1-06262, available from us at 1 St James's Square, London SW1Y 4PD. You can also obtain this from the SEC by calling 1-800-SEC-0330.

September 2008

Ladies and gentlemen,

Good morning. It is a great pleasure to have the opportunity to talk to you today. I know that many of you would have heard Andy Inglis - my colleague who runs BP's E&P business - speak at this conference last year. I hope to complement and build on some of the themes he examined then.
My focus is "The changing face of energy and the role of the IOC".

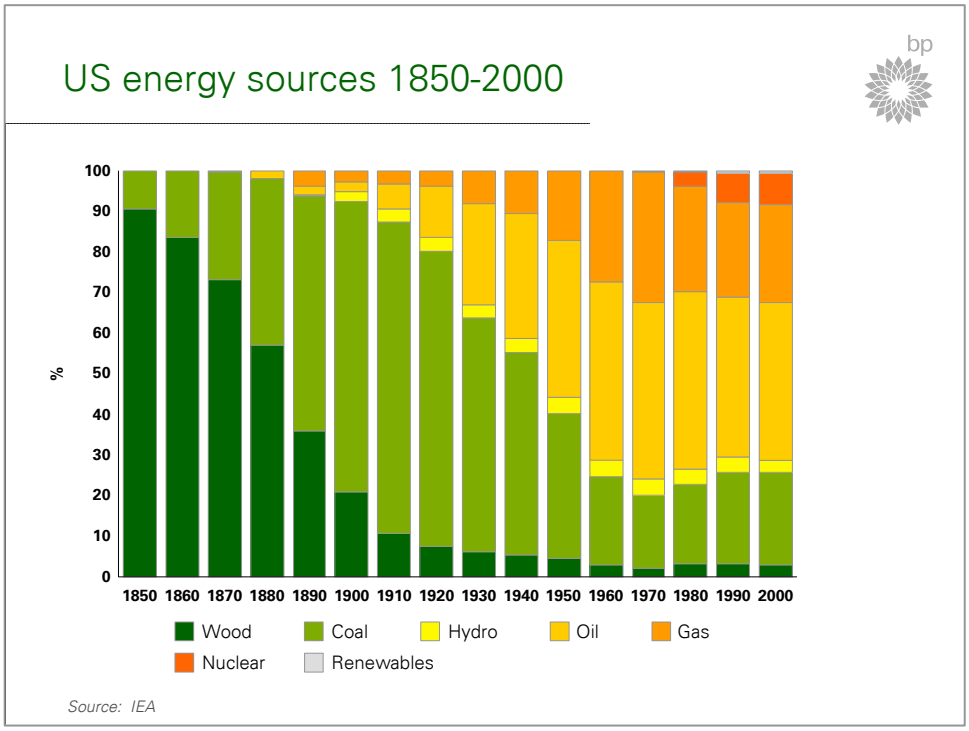
I am acutely aware that there is unprecedented interest in the status of our industry, the nature and paradoxes of the current global energy situation, and the relevance and role of International Oil Companies going forward. And, of course, specifically for you this morning, in the distinctive position and potential of BP.

I intend to cover three things: major drivers which are changing the energy landscape; the unique role of the IOC; and, lastly, BP's prospects as one of those IOC's.

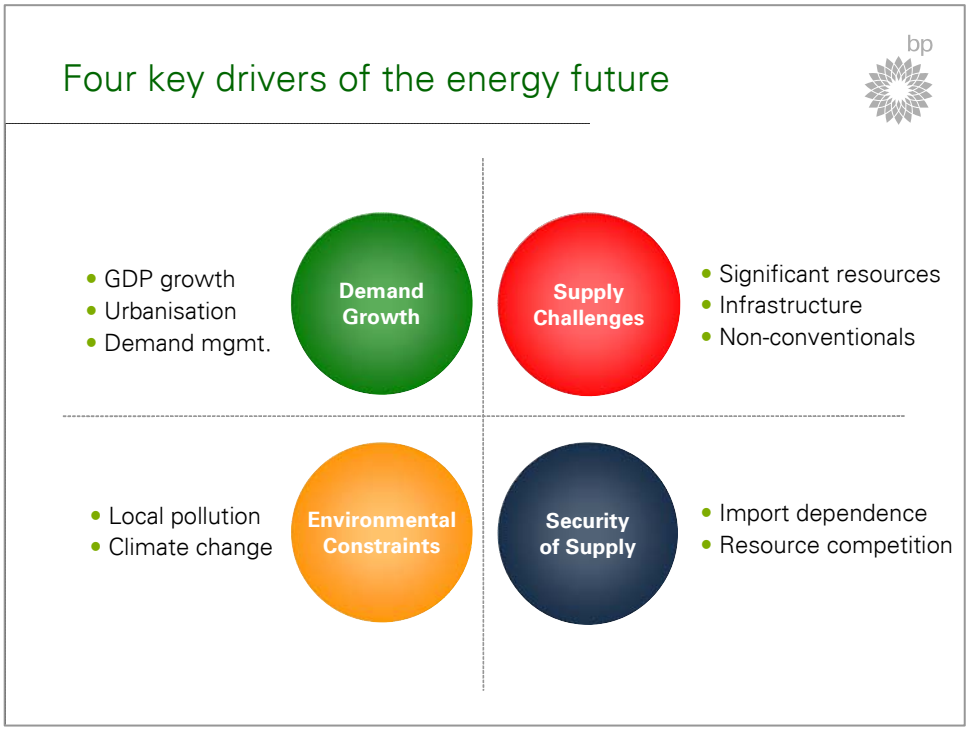
Let me start with the energy landscape.

Today it is a truism to say that the world of energy is changing. Some describe what is happening as unprecedented. Some define it as a crisis. People point to rising demand and are concerned about the finite supply of hydrocarbon resources to meet it, and yet they fear the impact of carbon use on global warming. Public concern has been further crystallised by record prices and this has, in the eyes of some, legitimised political pressure on energy companies. My purpose this morning is to go beyond the headlines, to put it all in some context, and to emphasise some of the realities of the situation we face.

The French have an expression which I am sure most of you are familiar with: "Plus ça change, plus c'est la même chose" the more things change, the more things stay the same. You could say the same about energy, as shown by this chart of US energy use over the last 150 years.



The energy landscape has always been changing. At the time of the US Civil War almost all of the country's energy came from wood, with only about 10% from coal. As the industrial revolution was completed, coal displaced wood and then, at the beginning of the Twentieth Century – when BP was founded - oil displaced coal. Other sources such as nuclear have been developed more recently. Two things are important from this chart. First, energy change is slow, driven by changes in technology and politics, but moderated by the forces of incumbency of the installed base and risk aversion of politicians to radical and painful policy shifts. Second, the realities of the pace of energy change mean that the world's dependence on carbon-based energy will continue for many years to come.



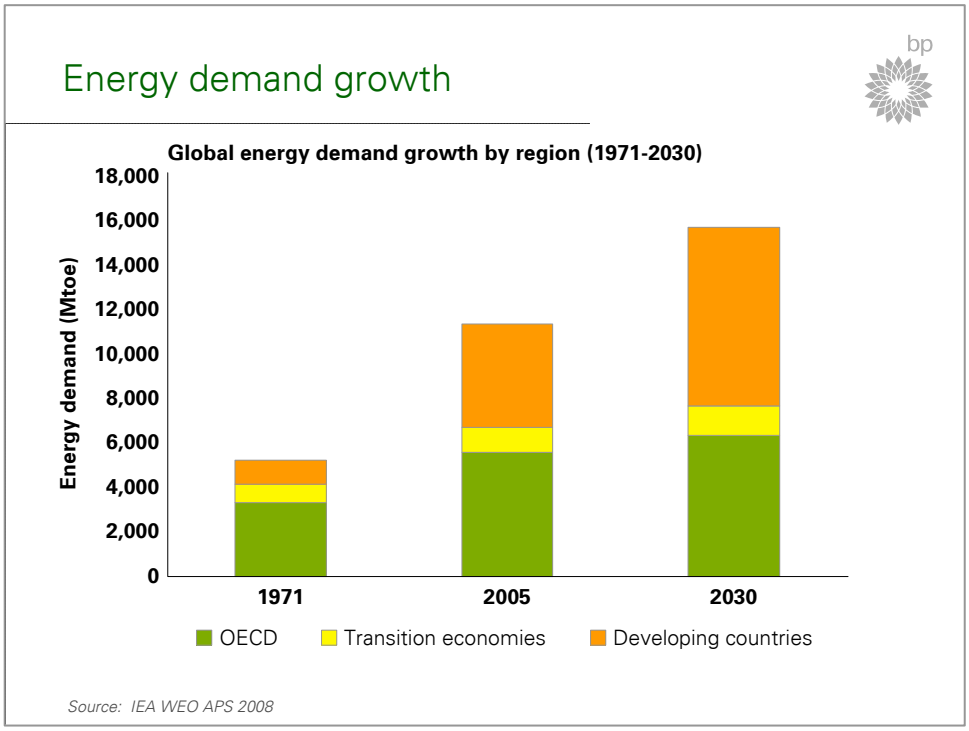
So what are the key drivers of change in energy?

- First, the growth in demand
- Second, the operational challenge to provide energy supplies to fulfil that demand efficiently and competitively
- Third, the need for secure sources of energy
- And finally, the concerns for the environment and the recent emergence of climate change as an issue.

These four drivers have been present since at least the 1970's when the issues of security of supply and the environment really took hold. But today, they have all reached a new level of intensity.

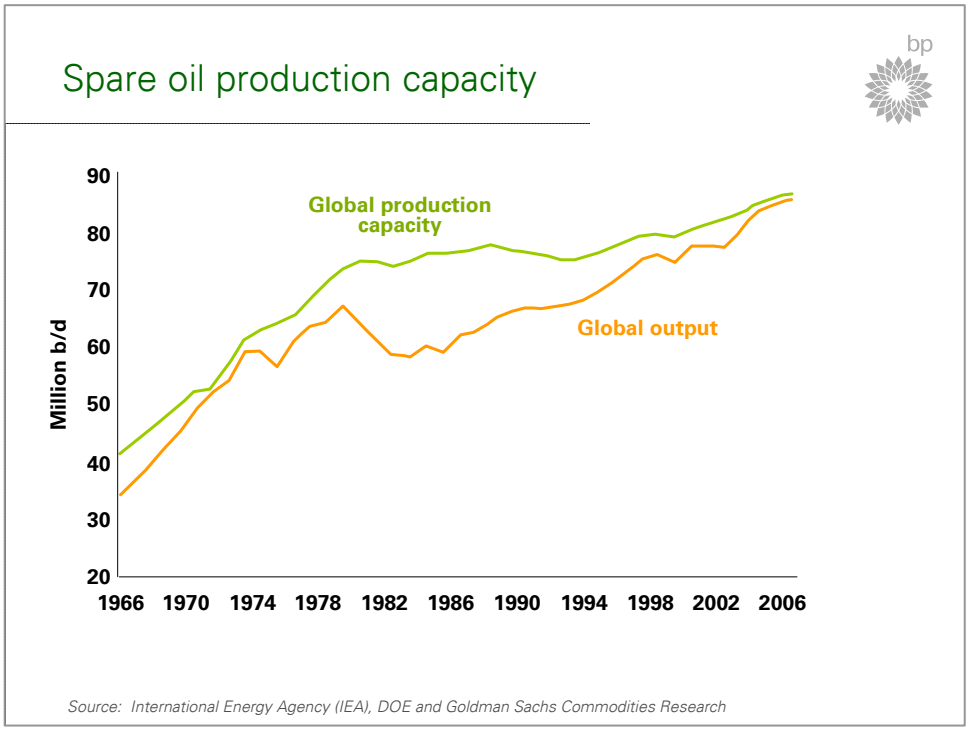
Looking at these in turn there are a few points worth noting:

First, demand growth. I am sure you are familiar with this, but it is always worth restating. The demand for primary energy is expected to grow by at least a third by 2030. The majority of this increase will be met by fossil fuels.



As this chart shows, the demand growth is shifting from the OECD to the new emerging and growing economies - China, India and the oil producing nations themselves. Energy use in China and India is still relatively low on a per capita basis. But this will change as these societies transform from a rural to an urban way of life. As a result, increasing power needs will be a key driver of energy demand growth. It will continue to account for around 40% of global primary energy needs and yet half of the power capacity required by 2030 is yet to be built. Most of this will be met through more hydrocarbon-based power generation. In contrast, the OECD energy demand growth forecast is small as illustrated by the green bar.

So, turning now to the second driver, supply. Supply has failed to respond adequately to rising demand. This is due to a range of factors which are mostly to be found above the ground rather than below it: OPEC's production cuts, political risks, operational challenges, supply-chain bottle-necks and tough environmental specifications in the case of refining capacity.

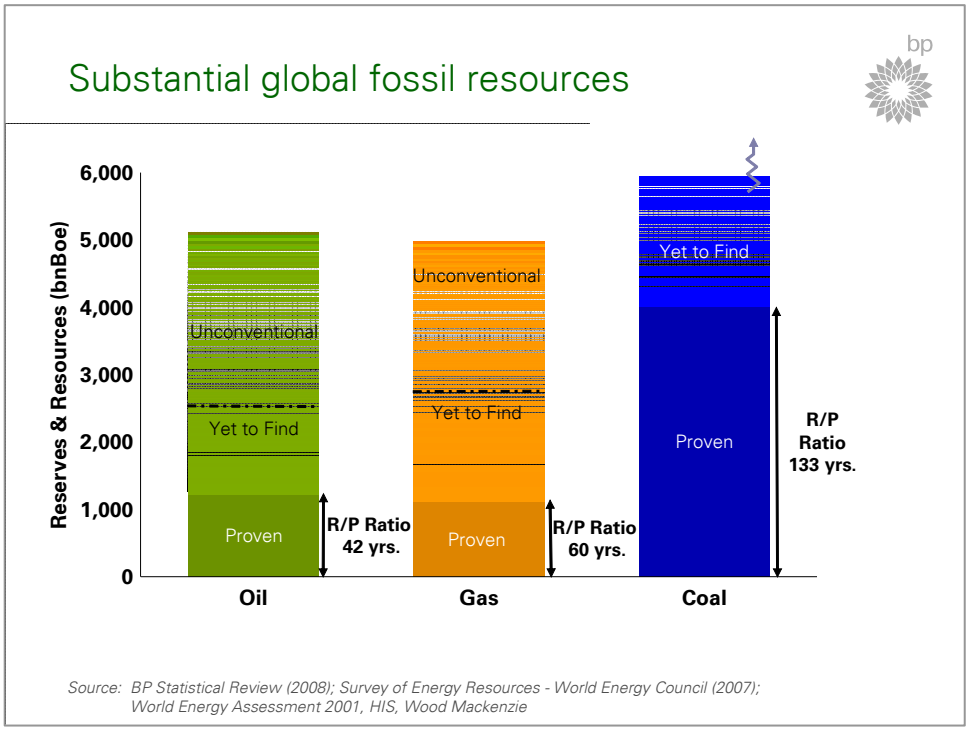


This chart shows available oil production capacity vs actual output over the last 40 years. The bottom line is that although the world is adequately supplied with oil resources, the market is a lot tighter than it was, say, 15 to 20 years ago, when there was spare production capacity of between 15% and 25%. There is consequently an urgent requirement for investment into new capacity. Indeed, the IEA estimates $22 trillion of new investment in energy generally is required by 2030.

The fall in the oil price since the summer happened primarily not because the supply situation has improved, but because demand has slackened significantly. Consumers, notably in the US and Europe, have responded to high prices by reducing consumption, and declines in the rate of global economic growth have also had an impact.

These trends in demand and supply are a key factor in explaining why the price of oil is higher and more volatile than in recent years, and why we expect it to remain so.

However, despite the concerns over price in the short-term, the fact is the world is not running out of hydrocarbons.

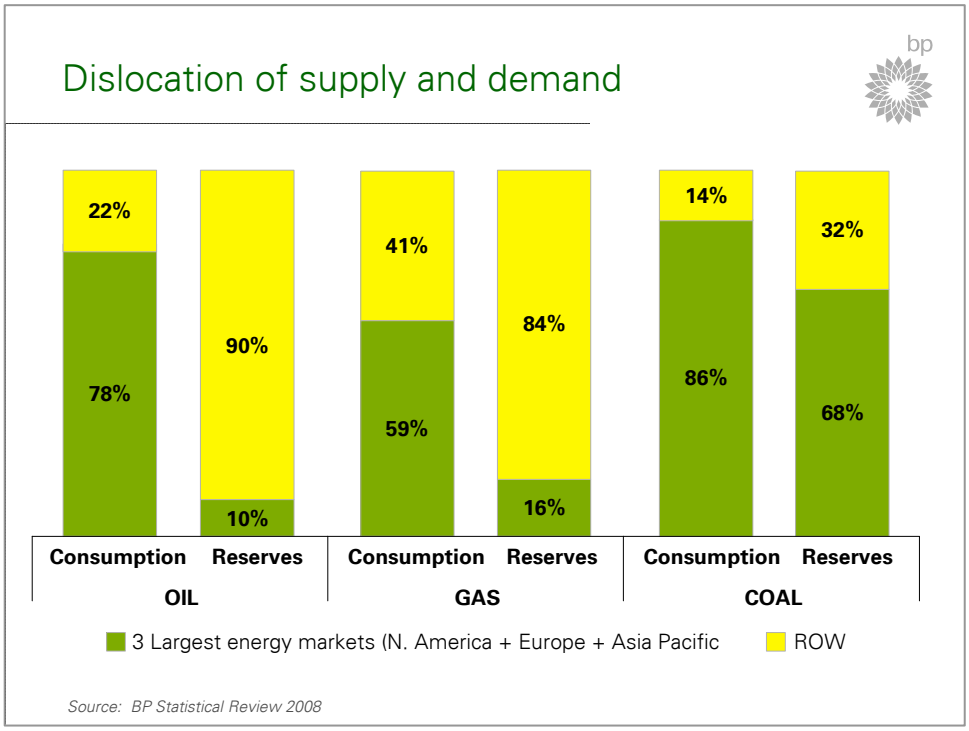


Working from today's official data, we believe there is 42 years' worth of conventional oil reserves at the current production rates and 60 years of natural gas. In addition, there are significant yet-to-find reserves and potential unconventional resources.

For coal, the R/P (Reserves/Production) ratio is at least 133 years ……and nobody has really gone exploring for coal yet.

However these resources are increasingly difficult and costly to access – often from remote and challenging locations. It is here that the role of IOC's are especially important and I will come to that in a moment.

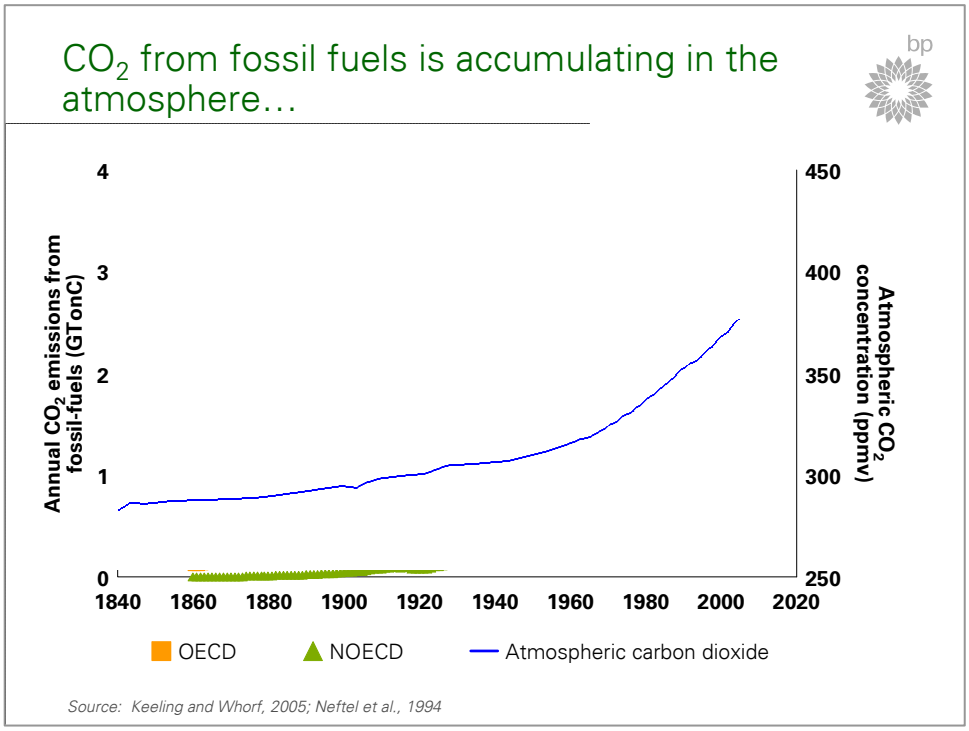
Supply plays directly into the third driver - energy security.



There is a huge mismatch between both consumption on the one hand, and resources on the other. The green bars on the chart show in total the three large consuming regions – North America, Europe and Asia – and their consumption and reserves of oil, gas and coal. As you can see, they account for about 80% of world oil demand but only have 10% of the conventional reserves. A similar disparity exists in gas – although for coal the situation is different. Not only are resources abundant, they tend to be conveniently located near the point of consumption.

Unless the geologists succeed in finding new, unidentified provinces, consumers in ten years' time will be materially dependent on supplies of oil from just three regions – West Africa, Russia and, most important of all, the five states around the Persian Gulf, led by Iran, Iraq, and of course Saudi Arabia. More and more oil and gas will move internationally in the future. No wonder energy security has featured so prominently in the US Presidential Election campaign.

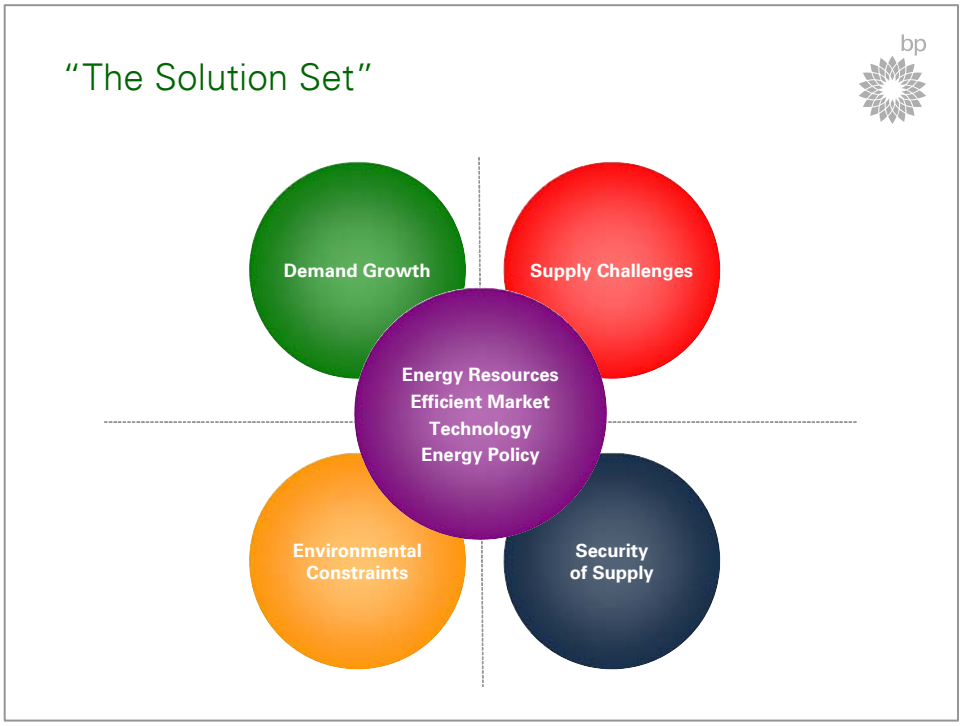
The final driver of the energy market is the environment and recently the issue of climate change. There are differing views and some strong prejudices on this issue. There are however two stark facts.



Over the last century, atmospheric concentrations of CO2 - the blue line on this chart - have risen to their highest levels for over 650,000 years and this increase is almost certainly due to our use of fossil fuels. OECD and non-OECD emissions are now about equal. Secondly, global temperatures have also been rising. There is very high confidence that the net effect of human activities since 1750 has been one of warming. So although there is some small residual uncertainty, there is a palpable sense that we must take decisions now to mitigate the risks of climate change.

The reality of current energy demand projections suggests that we will double the demand for primary energy by 2050 relative to 1990. But in July 2008 the G8 issued a statement which supported a target of reducing global greenhouse gas emissions by 50% by 2050. That scenario means that by 2050 we need to reduce the carbon intensity of the world's energy by a factor of four. However, we start from a place of huge dependence on hydrocarbons, and energy demand increases are projected to continue to be met predominantly from them. This suggests an urgent need for more investment in technology and the right energy policies to shape and drive a transition.

So, what are the solutions? What is the required response to these driving forces?

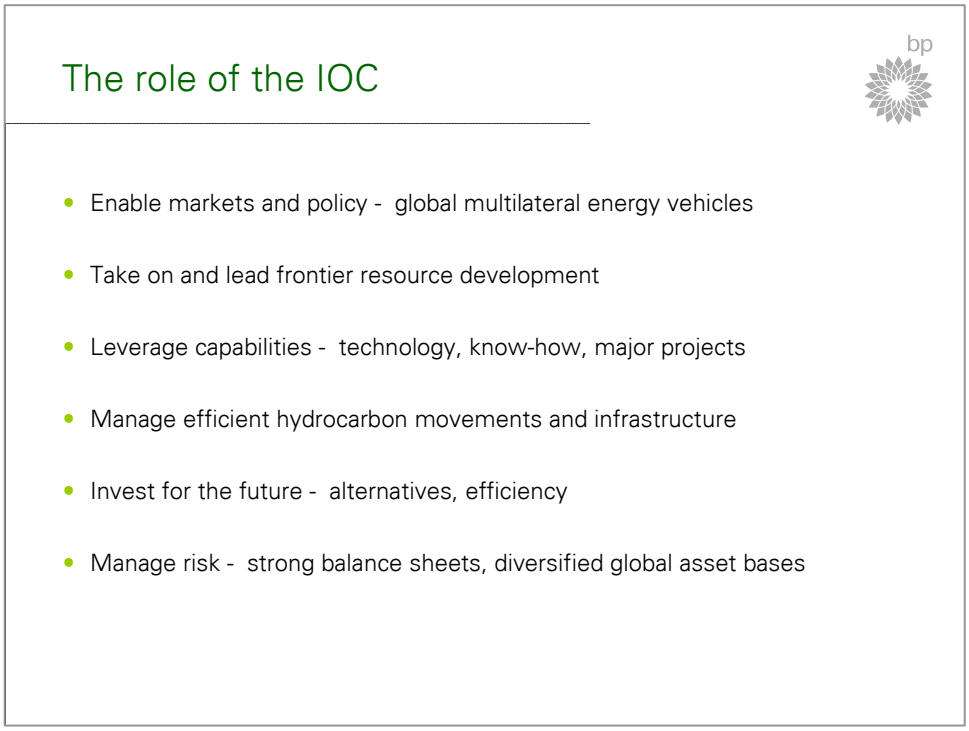


There are four elements to the "solution set".

- First, the efficient and timely development of energy resources;
- Second, the efficient functioning of the energy market, matching resources with consumers. It is this market - the international trade in fossil fuel energy - which has deepened and become more liquid almost every year since the 1970s and is a key pillar of energy security;
- Third, driving and harnessing the continuous improvements and efficiencies provided by technology;
- And fourth, the application of a balanced energy policy to shape the regulatory regime within which everything else operates.

It is these four elements which will provide the resolution to the challenges of the energy market.

The question is - who is best equipped to materially contribute to all four of these elements in an effective way? In my view the International Oil Company (or IOC) is uniquely positioned. In fact, this is why we emerged as an asset class and why we are still here. If the IOC did not exist, you would have to invent it. Why?



I believe there are 6 reasons; each in my view very persuasive:

- IOC's shape the oil and gas markets and make them work. They are the only global multilateral energy vehicles. They form the bridge between producing and consuming nations. They are involved in the energy policy dialogue with all of the key resource holding Governments and consuming nations.
- They lead the efficient resource development of oil and gas, working on the frontier of the energy industry.
- Only the IOC's (and one or two NOC's - Saudi Aramco, Petrobras, Gazprom) have the skills, technology, know-how and balance sheets to execute effectively multiple complex and risky projects simultaneously, and apply the learning from them globally to drive efficiency.
- In terms of logistics, IOC's are the largest movers of hydrocarbons and most efficient managers of fuel infrastructure
- They are pioneering investors into alternative energy solutions and energy efficiency.
- And they have strong diversified global asset bases not overly exposed to any single geopolitical risk.

In short IOC's are uniquely involved in all four elements of the solution-set. It is what we do.

As a result, I believe that while some would like the IOC to disappear, in fact not only is this unlikely, it would leave an "IOC-shaped hole" in the world energy market. Who would fulfil this role if the IOC did not?

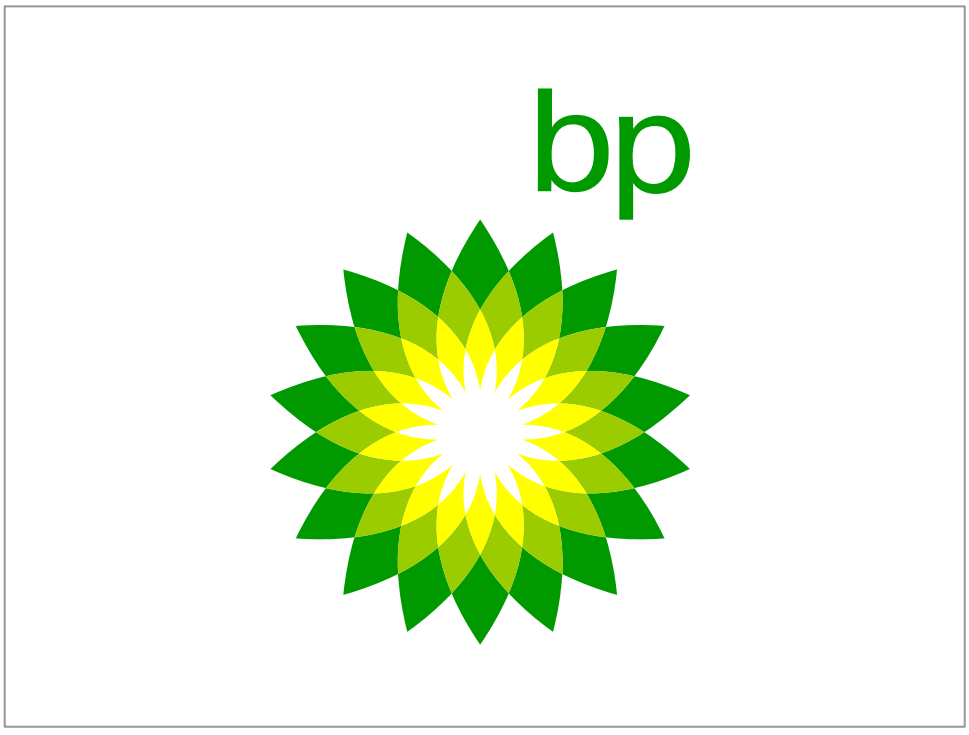
Some NOC's may fill part of the space. However, most NOC's are by nature aligned to particular Governments and partisan, and it is hard for them to be even-handed and multilateral. Their relationships tend to become Government-to-Government, as opposed to market-based. Most NOC's are not truly global, and most don't have the

broad-based technological capability or infrastructure to join the resources of the world to international consumers.

I believe the bottom line is that the IOC is not only necessary, but is well-equipped to provide many of the energy solutions globally which the world expects.

And what about the business model? For decades, IOC's have been deploying their strengths through partnerships – with host Governments and their NOC's - and they have done so for a small proportion of the overall rent. Through the cycle, this rent delivers a reasonable return on capital for the material risks IOC's take on. Governments take the significant majority of the rent through production taxes, royalties, sharing agreements, duties and income tax. Why would Governments want to abandon or replace this relationship? It makes economic sense, both to them and to us.

The current changes in the energy landscape will require more and more of the IOC's skills. For all of these reasons, as an asset class I would assert IOCs will be here for some time to come.



So, now let me turn to BP. What do we and our brand represent? It would be arrogant to say we are in a class of our own. But I would like to remind you of some of our relevant achievements.

- We have a strong exploration track record, and have reported reserves replacement over 100% for 14 years
- We have a resource base which can at least sustain production at 4mmboed (at an oil price of $60/barrel) out to 2020 without more of this exploration success or new access.
- We are known for developing some of the most challenging projects - technologically and geopolitically - including BTC and the Azeri fields, the

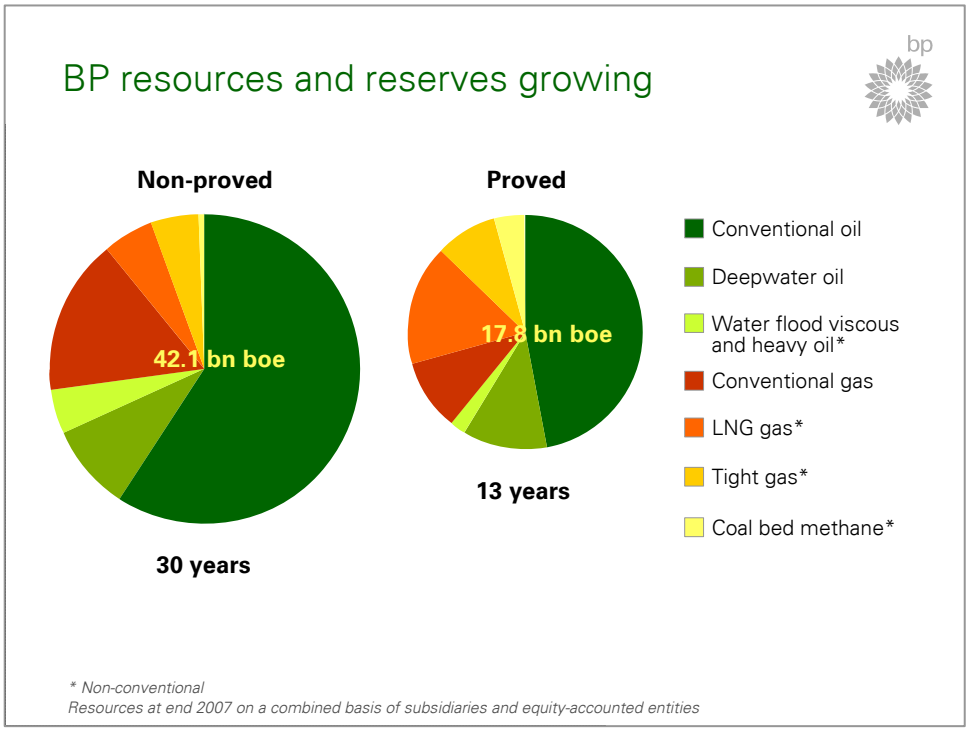
Colombian oil fields and the OCENSA pipeline, Thunderhorse and other deep water developments, and in earlier times the key projects in Alaska and the North Sea.

- We are the largest foreign integrated oil and gas participant in Russia, a country with one of the greatest hydrocarbon resource bases in the world.
- Along with Shell we are the leading foreign energy investor in China.
- We are the leading oil and gas producer in the US and the largest investor in US energy development.
- We are the largest integrated refiner/marketer in Germany.
- We are one of the leading investors in alternative energy sources.
- We are one of the world's largest energy traders.
- And we are a leading and trusted energy partner with Governments in both resource-holding, and consuming, nations.

There are a lot of "leadings" and "largests" in that list. In short, when set against the demands of the world and the critical role of the IOC, BP's track record speaks for itself. BP is extremely well-positioned to be a leader.

Beyond our role as a leading IOC in meeting the demands of governments and consumers around the world, BP must also satisfy another group of key stakeholders – our investors.

That leads me to the final part of my presentation - BP's performance and prospects.



Let me begin with the powerhouse at the centre of BP: our Exploration & Production segment.

Our upstream strategy is focused on exploration in the world's most prolific hydrocarbon basins, building leadership positions in these areas, and managing the decline of existing producing assets.

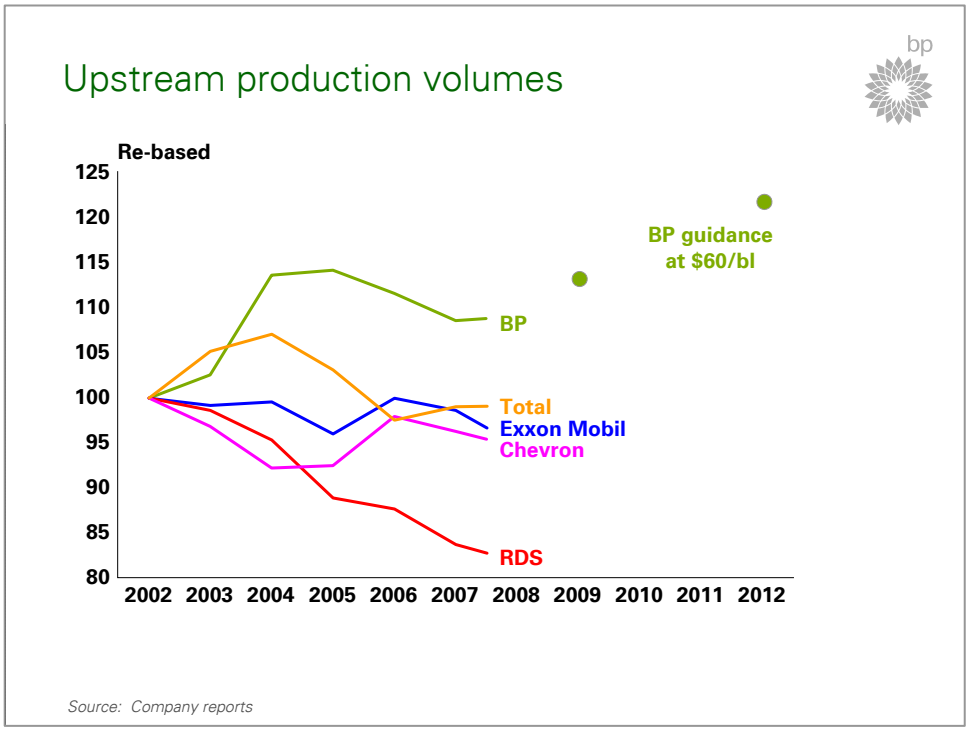
The successful execution of that strategy means that, as I mentioned earlier, in 2007 we achieved the 14th consecutive year of reporting a reserve replacement ratio of greater than 100%. And we have a growing resource base of 60 billion barrels of oil equivalent with a total resource to production ratio of 43 years. This resource base increased by 1 billion barrels of oil equivalent last year.

This resource base is expected to grow and the total resource to production ratio to lengthen further with the addition of Canadian heavy oil, with access to Oman and with the recent agreement to acquire new shale gas acreage positions in Arkansas and Oklahoma.

Our challenge is to convert this strong base into growth in production and cashflow over the next few years at the same time as looking to longer-term renewal.

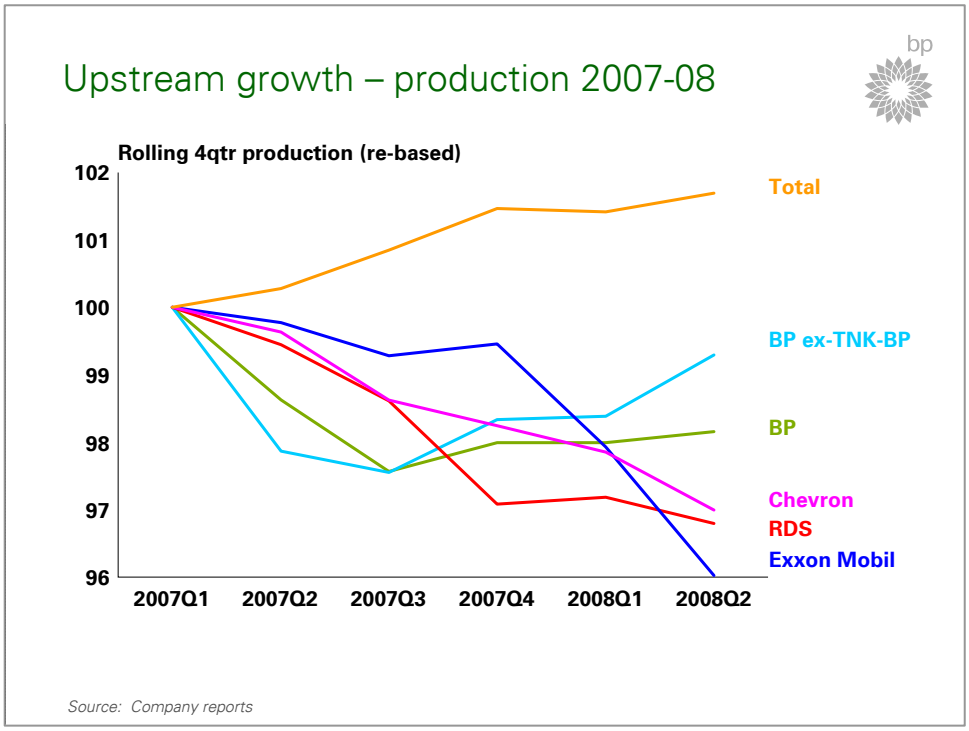
In addition to our ability, at an oil price of $60/barrel, to at least maintain 4 million barrels of oil equivalent per day out to 2020 with no exploration success or new access, our plan for near term production growth is strong. We remain confident that the pipeline of major projects we have in place will enable us to meet our production guidance of above 4 mmboed in 2009 and 4.3mmboed in 2012, again at an oil price of $60/barrel. In practice, of course, reported production will be impacted by production sharing contract effects and at $100/barrel as we outlined in February the impact is expected to be between roughly 100 and 170 thousand barrels per day in the near term, reducing to around 100 thousand barrels per day to 2015.

So how are we doing relative to our competitors?



This chart shows BP's historical actual production and our public guidance going forward expressed at $60/bbl. I think we all know that the industry track record in delivering sustained production growth is poor. BP's track record since 2002 is mixed, but in aggregate is better than many of our competitors.

Looking at the recent period, this next chart shows BP's rolling 4 quarter production vs competitors re-based to the first quarter 2007.



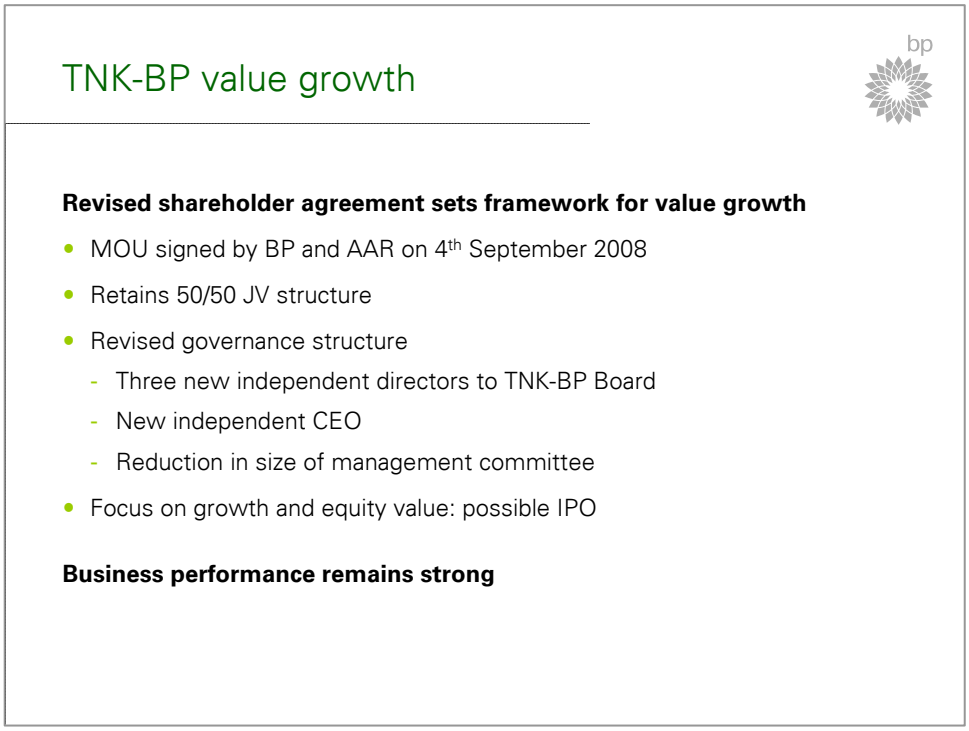
As you can see the direction of Total's and BP's profiles recently stand out from the pack and from the 3rd quarter last year we have seen a change in BP's short-term relative profile and we can see some real momentum building. Excluding TNK-BP the growth is greater.

Momentum is being provided by a series of major projects that started up in late 2007; the start-up of a further 4 projects in the first half of 2008; and later this year the expected ramp-up of Thunder Horse, a major project in the Gulf of Mexico for which we have already commissioned the first well. The base is delivering and prospects are coming through.

Specifically looking at our last reported quarter, volumes were flat vs. 2Q '07 on a reported basis. However this masked strong underlying production growth of 6% after adjusting for the impact of the high oil price on entitlements under production sharing agreements.

So whilst it is still early days …..we are pleased with our progress .

At this point let me say a few words about TNK-BP.



As I am sure you noticed, this has been in the headlines recently following a rather public spat with the Russian shareholders about corporate governance and strategy.

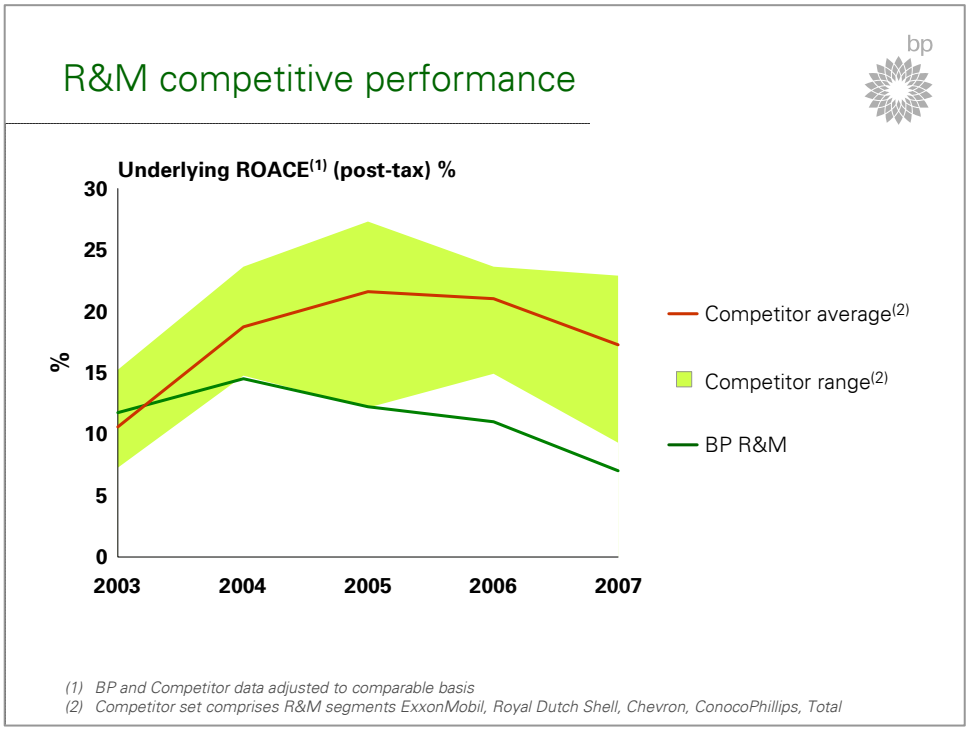
We have now signed a Memorandum of Understanding to settle that dispute, which we believe will put TNK-BP on track to continue as a very good piece of business for us.

Building on the platform of the JV's 50/50 shareholding structure, the agreement sets out a framework for change which makes some important changes to the governance of the JV and considers improving the transparency to the market of the value created in TNK-BP through a possible IPO.

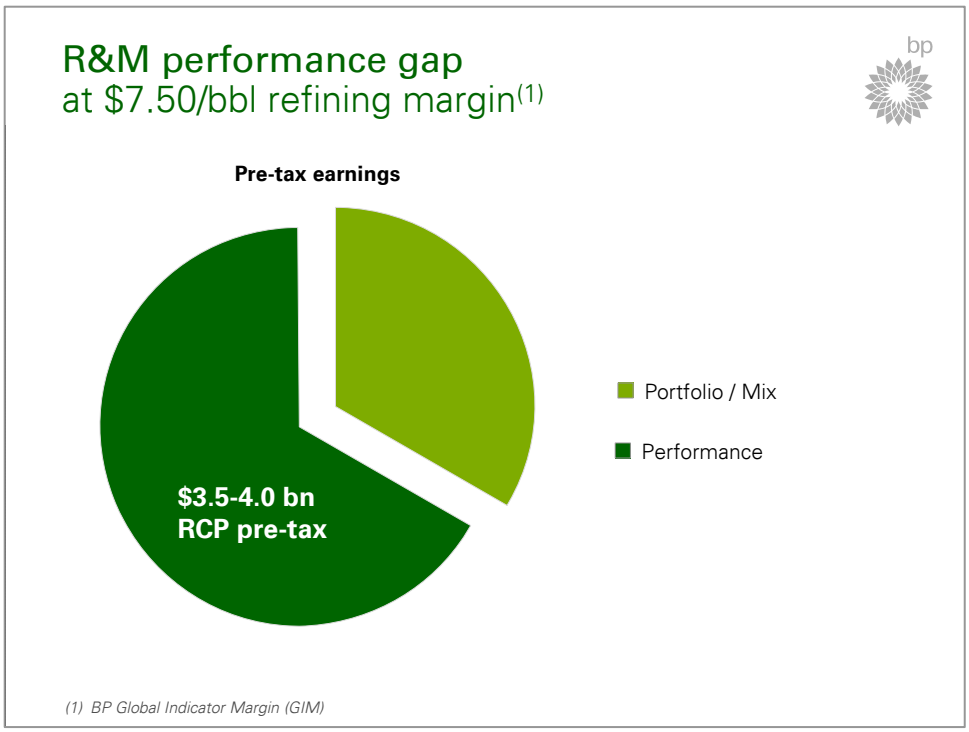
It is a sensible, pragmatic outcome and we look forward to fruitful conclusion of detailed negotiations.

One thing which is worth constantly restating is that the performance of TNK-BP has been, and continues to be, excellent. 2008 year to date performance implies that this year could well be the company's best ever. Net Income to BP was $2.1bn in 1H'08, up 148% vs. 1H'07.

Now let me turn to my segment of the business, Refining & Marketing.

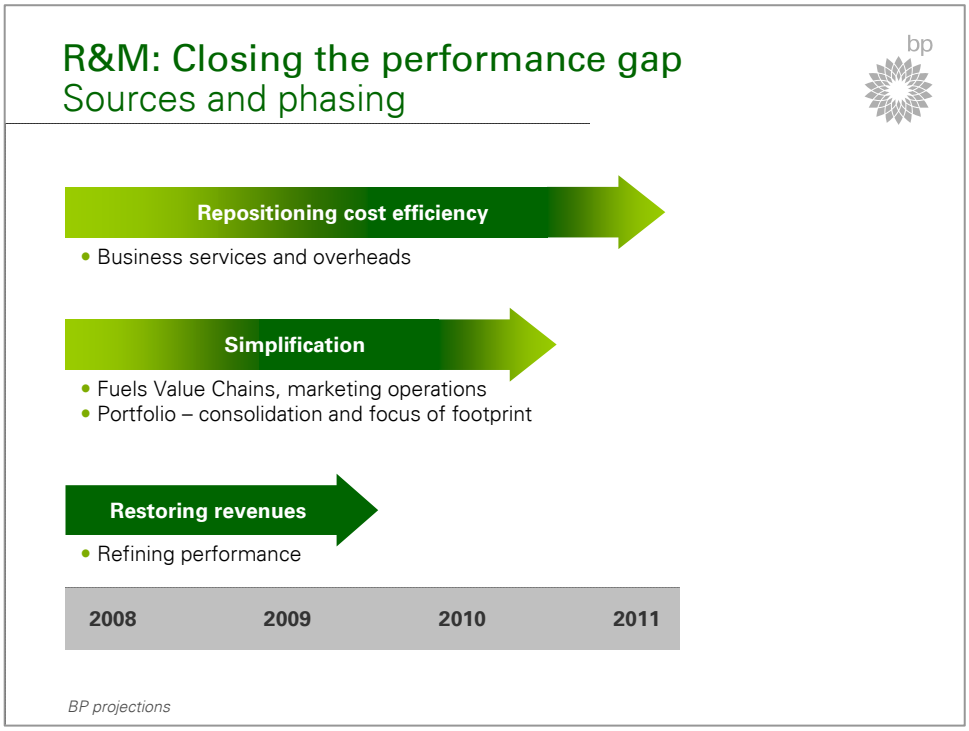


As this chart shows, on a returns basis, BP materially underperformed the competition from 2004 through 2007. This was particularly exacerbated by a period of high refining margins because BP is relatively underweight in refining and, as you are clearly aware, we have had major parts of our refining system down over the last three years.



This chart is one I used in February, and shows the estimated 2007 earnings gap vs our competitors at $7.50 refining margins. We estimate about a third of this earnings gap arises from the difference in the mix of business and geography of BP's Refining & Marketing. The remainder is due to performance and this is a gap we intend to close.

We estimated that this represents an opportunity of about $3.5-4.0 billion pre tax at $7.50 refining margins, and beyond delivering safe operations and improvements in process safety, closing this gap is the top priority for me and my team.

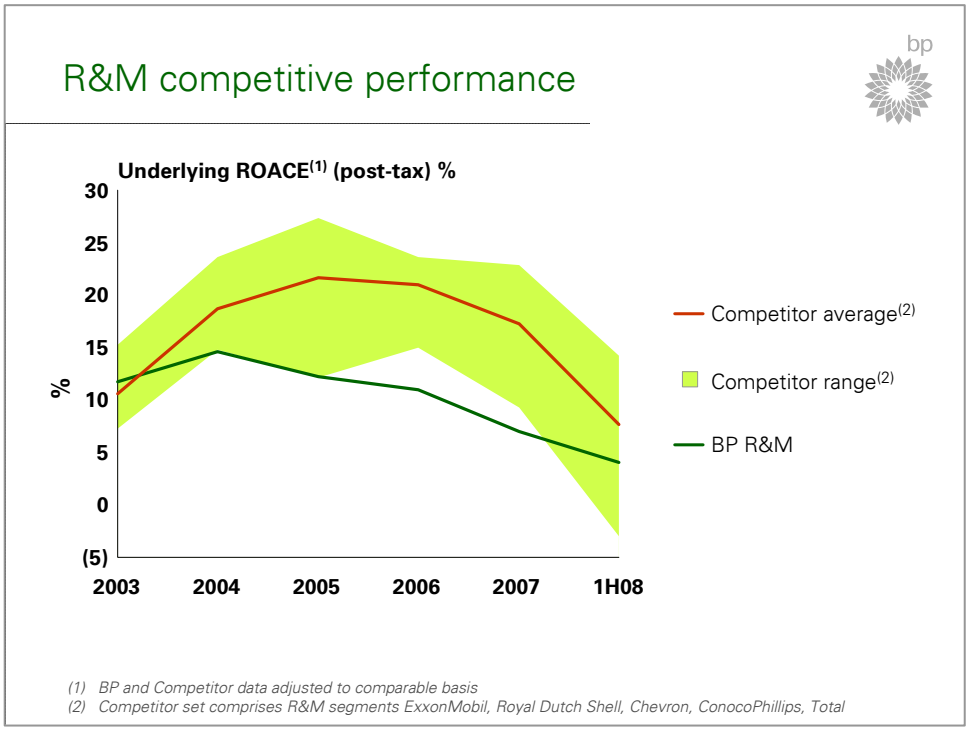


This chart shows how we intend to close the gap. Our actions focus on three main areas:

Firstly, restoring revenues and operating performance, mainly in refining, which should deliver about half the improvement required.
Secondly, simplifying and re-focusing our marketing businesses.
And thirdly, repositioning our cost efficiency.

The accrual of these benefits in each of the next three to four years is expected to be phased, with earnings momentum from refining up front and the more fundamental shifts in efficiency towards the end of the period. I indicated that about half of the improvement would be delivered in the first two years.

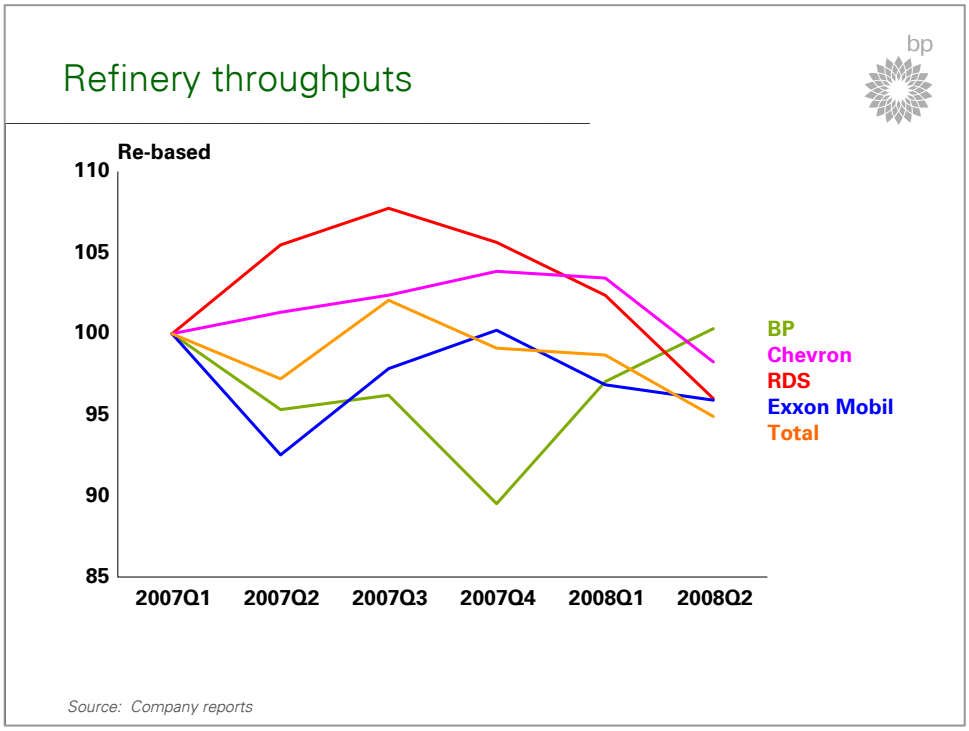
I am pleased to report that we have already made substantial progress in all areas.



This updated chart shows progress relative to our competitors in the first half of 2008. You can see that on a relative basis we have begun to close the gap on returns. In absolute terms we estimate that in the first half of 2008 alone, our underlying performance was $600m better than the same period in 2007.

That momentum continues to build. I am pleased with progress to date and we remain very much on track to at least close half of the performance gap by the end of 2009.

Our refining performance is a key driver of the R&M turnaround and in US refining both the Whiting and Texas City refineries have been restored to full crude processing capability. US refinery throughputs were up 19% in 2Q08 vs. the same period in 2007.



This chart of rebased refinery throughputs shows clearly how that recovery positions us relative to our competitors.

Simplification of the business is also on track.

Thus far, we have re-focused the core building blocks of our business around six integrated fuel value chains, all of which are now in place and fully-functioning, and we have eliminated or simplified many internal interfaces within them. We have reduced and focussed our marketing footprint in aviation and in lubricants, and in US convenience retail have moved 260 out of 800 sites to a franchise offer so far. I am very pleased with how that transition is going.

As outlined in February, efficiency measures are expected to result in a net reduction in overall headcount of 2,000 by mid 2009, and the senior leadership of R&M will be reduced by at least 15% and that is net of a large number of new hires. This is in addition to the reduction of more than 10,000 site staff in convenience retail. All of these outcomes are on track.

Corporate simplification

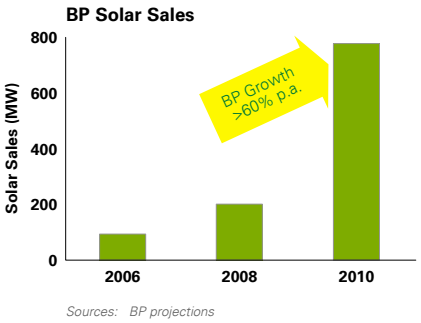
Continued focus on costs and efficiency

- Reduction in corporate overhead by 15-20%
- Headcount reduction on track
- 20% of senior positions removed
- Stronger linkage between performance and reward

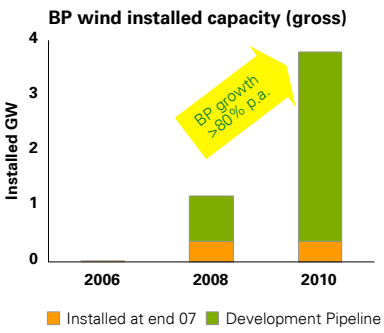
Some of these efficiency improvements in Refining & Marketing point to an even bigger agenda within BP to drive competitive performance - a programme of corporate simplification that we call our Forward Agenda. In essence this aims to reduce complexity and costs.

Our objective is to reduce corporate overheads by between 15 and 20%. We are ahead of schedule at present, with headcount reduction on track to reach 5000 by mid 2009 and 20% of the most senior management positions have already been removed. We should soon begin to see the first financial benefits from lower overheads.

Alternative Energy



Sources: BP projections



Sources: BP projections

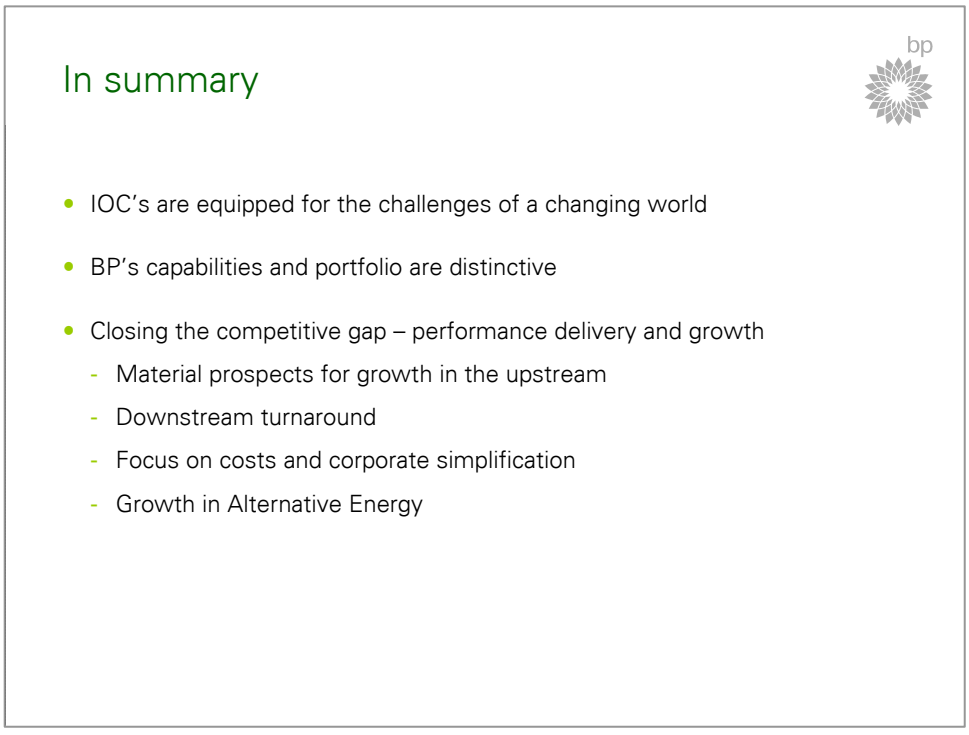
- BP Solar investment was ~$150m in 2007 and will double in 2008
- Wind: ~$0.8bn invested so far, 2008 investment ~$0.6bn

Finally, let me say a few words about our growing low carbon businesses in Alternative Energy for which we have a rapid growth agenda.

Solar and wind are well established businesses that form a key part of the portfolio. This chart shows the projected growth rates for both businesses. In Wind we expect to have installed over 3GW of gross capacity by end 2010 whilst in Solar we expect to achieve 800MW sales by the same time frame, showing growth well in excess of the market.

In Biofuels, Hydrogen Energy and our CCS (Carbon Capture Sequestration) business, we are focusing on proving the business models and have made important strides with the entry into Brazilian biofuels and with development plans for a hydrogen power plant in Abu Dhabi.

We remain committed to investing around $8bn over a 10 year period in these activities and our intention is to find ways to expose the value in this unique growth option for the benefit of our shareholders.



In summary, to return to my overall theme this morning, the world of energy is changing, again. Change is something we're used to in this business.

Those changes leave the IOC business model more relevant than ever, and as a fully-equipped IOC, BP is constantly adapting to meet the challenges it faces.

But the BP proposition goes further than the generic.

As I have outlined, BP has a track record, capabilities, strong relationships and portfolio which are distinctive, and looking forward we are particularly excited about our outlook:

- First, we have material prospects for growth in our industry-leading Upstream segment.
- Second, we are well advanced in turning around our Downstream.
- Third, we are harnessing benefits from our programme of corporate simplification and cost reduction.
- And finally, we are committed to exposing the value in our fast-growing Alternative Energy business.

BP is, in conclusion, very well positioned for the future.

Ladies and gentlemen, thank you very much and I will now be happy to take questions.