

27 May 2021

Monitoring of wholesale and retail markets for fuel ethanol
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
SYDNEY NSW 1240

Dear Tribunal Members

Re: IPART Approach to determining wholesale ethanol prices

Thankyou for the opportunity to provide comment on the NSW Independent Pricing and Regulatory Tribunal (IPART) Draft Report on the *Approach to determining wholesale ethanol prices*.

The Australian Institute of Petroleum (AIP) presents this submission to the Independent Pricing and Regulatory Tribunal (IPART) on behalf of AIP's core member companies:

- AMPOL Limited
- BP Australia Pty Ltd
- Mobil Oil Australia Pty Ltd
- Viva Energy Australia Pty Ltd.

AIP member companies operate across all or some of the liquid fuels supply chain including crude and petroleum product imports, refinery operations, fuel storage, terminal and distribution networks, marketing and retail. AIP members are significant suppliers of fuel ethanol to NSW consumers as wholesalers and retailers and have been actively engaged in biofuel policy for many years.

IPART methodological approach

AIP notes IPART is assessing whether there have been changes in the markets for petrol or wholesale ethanol that warrant a move away from its current approach and its conclusion that it proposes to continue to use its existing framework for determining wholesale ethanol prices.

IPART's rationale is that:

- the current approach reflects a high degree of consumer choice in fuels
- the choice limits the price suppliers can charge for ethanol because if the wholesale price of ethanol was too high, the retail price of E10 would rise relative to other fuels and customers would switch fuels
- this, in turn, protects customers from higher prices

IPART also notes that it does not intend to:

"impose an additional constraint on prices through our determined wholesale price. Instead, we set wholesale prices based on the imported price of ethanol, which is a price that is already available to local wholesalers. This approach reduces the risk of the determined wholesale price being set too low, which could impact the financial viability of ethanol suppliers and discourage new entry" (page iii).

Previous AIP Feedback on Methodology

In its submission to IPART's June 2016 *Review of a maximum price for wholesale ethanol in automotive fuel blends* Issues Paper, AIP encouraged IPART to develop and recommend a methodology that is market driven and market reflective. To achieve this, the methodology needed to the greatest extent possible, provide for:

- linkages to international pricing
- low barriers to market entry
- market transparency
- price discovery and price flexibility
- low transactions costs for market operators
- a transition to a well-functioning ethanol market with fully market determined prices.

AIP considered that IPART's proposed approach, based on the available options and subsequently adopted, exhibited as many market characteristics as possible consistent with AIP's preferred approach. While the Import Parity Price (IPP) approach was most appropriate, AIP considered that the methodology would not be capable of delivering wholesale ethanol at a sufficient price discount necessary to meet the 6 percent mandate.

AIP has maintained this position in subsequent IPART reviews.

Comments on the 2021 Draft Report

AIP considers that there have been three key developments in the ethanol supply chain that are worthy of consideration in terms of their impact on IPART's methodology:

- COVID impacts on supply and demand fundamentals in the fuels and ethanol markets
- Wholesale ethanol selling at a premium to wholesale ULP
- The closure of the United facility leading to diminished local supply and competition between ethanol producers.

The COVID period, dating to March 2020, has been a particularly challenging period for the fuels industry, which led to significant demand destruction particularly in gasoline and jet fuel. The Australian fuels industry, and indeed the industry globally, is yet to fully emerge from these challenges. This in turn makes it difficult to make an informed assessment of the supply and demand parameters and associated pricing movements in both petroleum and bio-based fuels.

The Draft Report notes that the price of E10, reported at the Terminal Gate Price (TGP), has been greater than the U91 TGP over this period. It is too early to determine whether the discounted price differential for wholesale ethanol will return to pre-COVID levels, or whether there will continue to be an ongoing structural break. This will not only be determined by the anticipated rebound in crude oil and petroleum product prices and agricultural feedstock prices, but alternative uses for ethanol such as sanitisers and other medical applications.

It is, however, clear that the higher wholesale ethanol price has required fuel retailers to lose significant margin on E10 sales since the start of COVID which continues today. The impact of this lost margin has been exacerbated by the loss in not only overall fuel sales volume, but the declining proportional share represented by E10 sales and the flow on impacts of underutilised E10 infrastructure at sites.

The Draft Report also notes that retailers have not sought exemptions based on price (i.e. for exceeding the maximum wholesale price) as a basis for supporting the current IPART methodological approach. This is

largely because retailers have tended to seek exemptions based on the more simplistic exemption approach around E10 availability.

In short, while it is true that consumers have not been exposed to relatively higher ethanol prices, this has been at the expense of fuel suppliers and retailers as they have been required to discount E10 to achieve any meaningful level of sales volume.

At the wholesale level, AIP continues to be concerned with the lack of competition in the wholesale ethanol market, particularly with the closure of the United facility in Queensland. It remains the case that the excise regime is a genuine barrier to the importation of ethanol and the introduction of additional competition into the wholesale market. While AIP agrees that the IPP approach provides for a simplicity and transparency, there will unlikely be sufficient competition until there is parity between domestically produced ethanol and imported ethanol and petroleum products.

That said, AIP considers that it is too early to determine whether these changes in market dynamics would warrant a different approach and therefore AIP believes IPART's methodology continues to be appropriate. The methodology strikes an appropriate balance between wholesaler, retailer, producer and consumer interests. This is best represented in the statement on page 17 that:

In determining the wholesale ethanol price, we considered whether we should set it equal to either the wholesale costs of ethanol, or a price that could increase demand for E10 while maintaining retailer viability. These are more intrusive price setting approaches. Under our framework, our assessment that competition is sufficient to protect customers from abuse of monopoly power means that the costs associated with these approaches would outweigh the benefits.

AIP supports the view that a less intrusive price regulation model remains appropriate at this time and that the model used by IPART continues to be fit for purpose.

I would be happy to further discuss any matters raised.

Yours sincerely

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Peter Gniel
General Manager, Policy