



MANILDRA GROUP

Commitment to Excellence

IPART
Sydney NSW 2000

28 November 2016

Dear whom it may concern,

Submission to the *Review of a maximum price for wholesale ethanol: Draft report*

Thank you for the opportunity to respond to IPART's recent draft report, in relation to your review of a maximum price for wholesale ethanol in automotive fuel blends.¹

I would like to take this opportunity to express our appreciation at the process employed by the Tribunal for this review. Manildra has found the process to be professional, thorough and open towards understanding both the processes and the means by which wholesale and retail fuel markets operate, as well as the implications for a maximum price for wholesale ethanol.

Given the unusual circumstances under which the terms of reference for this review came about – particularly, a ‘behind closed doors’ finding that Manildra has substantial market power – we are generally comfortable with the Tribunal's findings in relation to ethanol and retail petrol markets, ie:²

1. That the degree of consumer choice in the retail fuel market is relatively high and there is emerging competition in the eastern Australian wholesale ethanol market.
2. That the current degree of consumer choice for retail fuel, the extent of competition in the wholesale ethanol market and the level of petroleum prices support a light-handed approach to a recommended maximum price.

¹ IPART, Review of a maximum price for wholesale ethanol in automotive fuel blends | Other - Draft report, October 2016 (the “draft report”)

² IPART, Draft report, page 13.

Further Manildra is comfortable with IPART's draft recommendations that it:³

- establish a recommended maximum wholesale price based on an ethanol import parity price (IPP) methodology that includes relevant excise tax; and
- monitor and report annually on the degree of consumer choice in the retail fuel market and the extent of competition in the wholesale ethanol market, to ensure that its recommended approach to recommending the maximum price remains appropriate over time.

In the circumstances, these recommendations represent a sensible outcome and reflect the highly competitive nature of Australian and NSW fuel markets – in which Manildra has no market power.

Of particular assistance in achieving this outcome was the framework developed by the Tribunal for assessing the appropriate approach to be applied in its recommended maximum wholesale price of ethanol in NSW – as described in Figure 1.1 of the draft report, and noting that:

- the degree of consumer choice for retail fuel (demand side constraints) and extent of competition in the supply of wholesale ethanol (supply side constraints) are distinct considerations; and
- only one of these two forms of constraint needs to be operating effectively for no regulation to be required.

Manildra accepts the draft recommendation that a light-handed approach to setting maximum price of wholesale ethanol is appropriate, on the basis of IPART's assessment that there is:

- a *relatively* high degree of consumer choice for retail fuel, with motorists having the choice of E10, RULP or PULP;
- emerging competition in the wholesale ethanol market; and
- the significant risk that regulating wholesale ethanol prices would hamper the development of competition in the wholesale ethanol market.

Notwithstanding, we have three particular observations on these findings that may assist IPART in discharging its future monitoring role. These are:

- that the degree of consumer choice in retail fuel markets is yet greater than recognised in the draft report, and we submit that IPART should keep open that it may be appropriate to consider a future recommendation that a maximum price for wholesale ethanol is no longer required;
- on the cost of transporting ethanol within Australia, we have information that should assist IPART in refining aspects of its proposed import parity price ceiling; and
- finally, we comment on the Tribunal's suggestion at the public forum that it may be appropriate to use US ethanol prices to set the import parity price.

³ IPART, Draft report, page 2.

Degree of consumer choice

Manildra accepts that, for the present time, the degree of consumer choice in the retail sale of petrol acts as a more rigorous constraint on wholesale ethanol prices than the number of domestic wholesale ethanol producers. IPART's assessment as to the degree of consumer choice is therefore the most significant aspect of the application of its framework for assessing the appropriate form of wholesale price regulation and, indeed, whether there is a need for regulation at all. For example, at page 4, the draft report states – correctly – that if consumer choice was 'unrestricted', there would be no need for regulation at all.

However, in its assessment of the degree of consumer choice, IPART appears to qualify its assessment of the degree of consumer choice – by finding it is 'high', but not 'unrestricted' – with two observations, ie:

- that the degree of consumer choice may be dependent on the current low level of petroleum prices (page 5); and
- that information collected by NSW Fair Trading indicates motorists have a high (but not unrestricted) degree of fuel choices at NSW service stations (page 16).

We have three observations on this analysis, each of which suggests there is room for a yet stronger conclusion as to the degree of consumer choice in retail fuel markets. In particular:

- there is no reason to believe that whether (global) petroleum prices are high or low affects the availability of different fuel types (or their relative price) and so the degree of consumer choice at service stations;
- that wholesale ethanol represents a small fraction of the NSW automotive fuel market (currently, approximately 2 per cent of the market with the mandate targeting a 6 per cent market share) and so the producers of ethanol are price-takers that are incapable to exercising any 'market power'; and
- the analysis cited from NSW Fair Trading makes no mention of the availability of PULP, which is a closer substitute for E10 than RULP – PULP has RON 95, and E10 has RON at least 94, whereas RULP only has RON 91.

Given that PULP is almost universally provided by service stations, the inclusion of PULP in the assessment of the availability of different fuel types at service stations would demonstrate that consumers have yet more choice than that suggested in 3.3.1 of the draft decision. It follows that, rather than consumer choice being merely 'high', in Manildra's view:

- every service station has the option of offering RULP, and so it can be presumed that those which do not (being the inverse of the NSW Fair Trading percentages cited by IPART) are responding to consumer demand, rather acting so as to limit consumer choice; and

- in any case, the ubiquity of PULP means that, in fact, consumers have unrestricted choice.

Transport cost component of import parity price (IPP) for ethanol

We note that the draft report provides a number of estimates for the cost of transporting ethanol from port to the wholesale terminals at Banksmeadow and Silverwater and Parramatta. In our experience, these estimates do not reflect the current short-haul cost of road transport of ethanol. Importantly, fuel transportation companies impose a number of fixed (minimum) charges that increase the per kilometre cost of transporting fuel over short distances.

That said we note that the draft report uses a 1 cent per litre cost of transporting ethanol from port to the wholesale terminal for the purposes of estimating the IPP. In our opinion, this value is likely to be below current transportation prices, however, we note that domestic wholesale ethanol price is unlikely to approach the IPP for fuel grade ethanol in the foreseeable future. In our opinion, further investigation of the cost of transporting ethanol from port to the wholesale terminals would be warranted if the domestic wholesale ethanol price converges with the IPP.

IPART IPP based on US v Brazilian ethanol prices

At the public forum, IPART staff presented preliminary analysis the ethanol import parity price (defined in the draft report as the ex-GST delivered price to the wholesale fuel terminal) using both US and Brazilian, publicly available, mill-gate ethanol prices. Importantly, we note that IPART's proposed approach to derivation of this prices is to *estimate* an IPP for fuel grade ethanol because there are currently no imports of fuel grade ethanol to NSW.

The IPP for ethanol is derived by the following formula:

$$\begin{aligned} \text{IPP} = & \text{International mill-gate ethanol price} + \text{local freight and export terminal} \\ & \text{charges} + \text{Freight (exporting port to Sydney)} + \text{insurance and loss} + \text{Wharfage} + \\ & \text{landing costs (excise and import duties)} + \text{Storage \& handling at import terminal} \\ & + \text{transport from port to wholesale fuel terminal} \end{aligned}$$

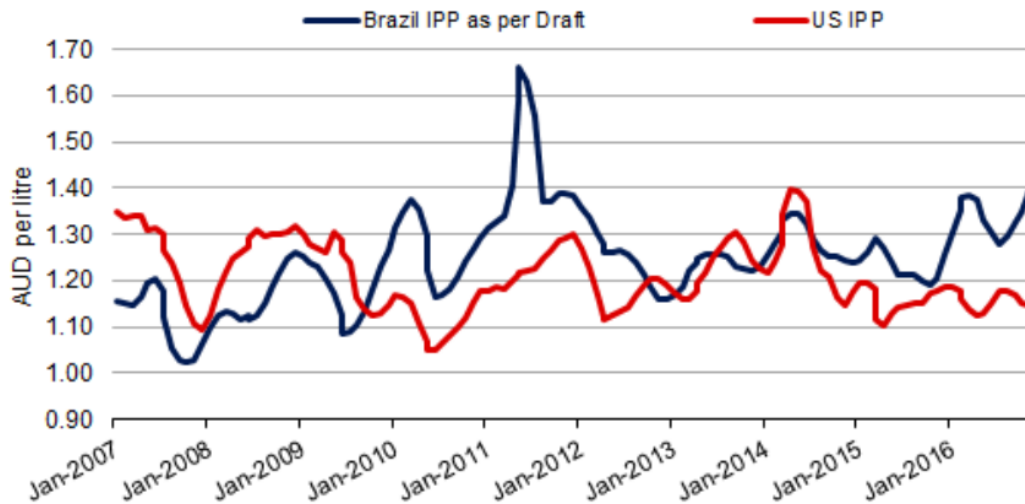
The proposed data sources for calculating the IPP from Brazil were outlined in the draft report. However, no similar information has been provided for the calculation of the US IPP, other than the use of the weekly average ethanol mill-gate price from the nine top producing states published by the US Department of Agriculture. We look forward to engaging further with the IPART in relation to how it proposes to convert this mill-gate ethanol price to a delivered price to a NSW wholesale fuel terminal.

IPART's preliminary analysis suggested that for the period 7 November 2016 to 4 December 2016, the:

- Brazil IPP: 140 AU c/litre
- US IPP: 115 AU c/litre

At the public forum IPART also produced the following figure of the IPP from Brazil and the US over time.

Figure 1 – US and Brazilian ethanol IPP

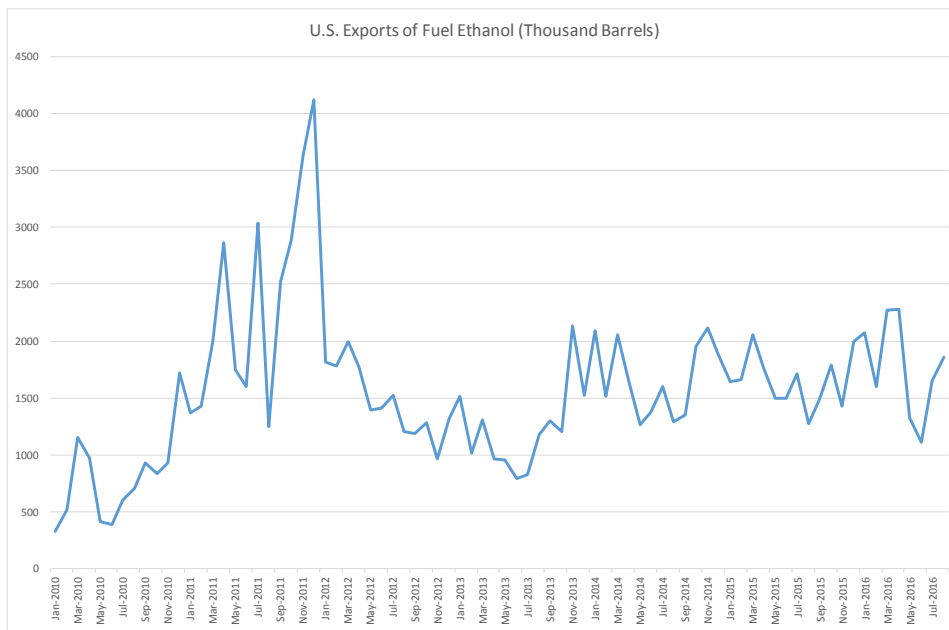


Source: IPART Public Forum, 22 November 2016.

The finding of such a substantial difference in the IPP derived from two different ethanol exporting nations since late 2015 is surprising. On its face, these data suggests that, for significant periods over the nine years of data, it would have been uneconomic for anyone to purchase export ethanol from Brazil, and that most or all international ethanol importers would purchase US produced ethanol. Further, there have been other time over the same nine year period when the reverse would have applied.

However, a cursory examination of the US ethanol export data does not support such a conclusion.

Figure 2 – US exports of ethanol



Source: US Energy Information Administration – Fuel Ethanol (Renewables) Exports by Destination

These export data show that, despite the data presented by IPART implying that US producers have had a substantial price advantage over Brazilian sourced ethanol in many years, there has been no increase or changes in the level of US exports.

These US export data highlights some of the limitations of estimating a IPP from a spot ethanol mill-gate price – whether sourced from the US or Brazil. The absence of any apparent response in the level of US ethanol exports despite periods with a significant estimated price advantage over Brazilian ethanol could indicate one or more of the following problems with the estimated IPP:

- issues with the reliability of the published mill-gate ethanol prices;
- problems with the estimated local freight and export terminal charges and freight charges from Brazil and/or the US;
- potential transportation bottlenecks that limit the ability of US ethanol from being sold on international market, which causes a difference between the mill-gate price and FOB price of ethanol; and/or
- a structural price difference between the contract market (under which most ethanol exports is sold) and the domestic spot price of ethanol in Brazil and the US.

Manildra urge IPART to examine carefully these potential issues with the estimated IPP before committing to finalisation of the index to be applied in setting a maximum price for wholesale ethanol in NSW.

We also acknowledge that a thorough examination of issues arising in the IPP calculation may not be possible before its scheduled implementation on 1 January 2017. In the event of continuing unresolved questions, we suggest that a preferable approach may be to adopt an average of the different information sources, rather than to rely on whichever happens to be the lowest at any particular point in time. Such an approach would involve an appropriate degree of caution, without the risk of any detrimental impact since the domestic wholesale ethanol price is unlikely to approach the IPP for fuel grade ethanol in the foreseeable future.

Kind regards,

John Honan
Managing Director