CORRECTED VERSION

ENVIRONMENT AND NATURAL RESOURCES COMMITTEE

Inquiry into the production and/or use of biofuels in Victoria

Melbourne — 4 September 2006

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Mr W. Frilay, manager, government business, BP Australia.

The CHAIR — I welcome Mr Bill Frilay, manager, government relations from BP Australia. Thanks for your time today. I inform you that all evidence is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, comments made outside the precincts of this hearing are not protected by parliamentary privilege. Hansard is recording all evidence taken today, and you will receive a proof version of the transcript within a couple of weeks. We have until 4 o'clock. Could you make your presentation to us and leave about 15 minutes or so for questions, if that is all right?

Mr FRILAY — Thank you, Chair, and thank you for giving me the opportunity to speak to you. I have to apologise first up because I have been travelling and I do not have a formal presentation. I will speak about some of the things we are doing, relate them to your terms of reference and open it up for discussion. I think we could say that BP has been a leader in biofuels, but I have to say that this has been in other states. Why that is will become clear.

We first became interested in ethanol in 2001. We focused on our refinery state, in Brisbane in particular, and market trialled E10 at six of our Brisbane service stations starting in May 2002. Sales went very well. There were no technical issues, either with cars or with the equipment, and the product quality was carefully monitored and controlled at 10 per cent. But in December 2002 public concerns were raised about ethanol fuel in Sydney. It became a media issue. Our trial, although very successful and 1100 kilometres away, was brought into it indirectly, because we were the only company using ethanol signage, which meant good copy for public affairs programs. We decided to cease the trial in February 2003. Basically the trial had been a technical success, but in the furore at the time we decided to hold for a bit.

Later that year we decided to try again in Queensland, and we chose Mackay. Because it is a sugar town, we believed there would be consumer empathy with ethanol, and we commenced the trial there in association with our distributor. That proceeded for about 12 months, and then we re-looked at things. We did a market survey and we found that there were a couple of things that were obstacles in the way. Firstly, there was still quite a lot of consumer negativity to it, even in a sugar town; secondly, some people were not even aware we were doing it; and thirdly, people were not aware of the regional or environmental benefits.

We did a marketing program, which was based in part on those messages. We advertised on the radio and on television. For instance, the television showed a tanker coming out of a cane field to get the connections. The Queensland government provided a lot of support. Its ethanol ambassador, Jack Brabham, did the launch of the marketing program. We put three key messages on the front of this green brochure — that is, that ethanol is great for Australia, better for the planet and backed by the BP fuel guarantee. That BP fuel guarantee was to address the doubters. We said, 'We stand behind this fuel. If you have a problem with your car related to this fuel, our BP fuel guarantee supports it'. All of those were quite positive factors, and sales started to grow quite well in Mackay. We also had the Queensland government sales contract. The government was seeking to have E10, and we cooperated with that and provided them with it, and there was plenty of dialogue between the two us.

Then things moved into further gear about 15 months ago, following a federal government round table in Canberra. We decided we would take this a lot further. We sought tenders of interest to supply biofuels to us, both in the short term and in the long term. This was basically in Queensland still, but we are also interested because we have a refinery in Western Australia. We are choosing the refinery states because in those states we have refineries, terminals and all the assets. In effect we are more advantaged to act in those areas, plus Queensland had the raw material in many respects, and the government was very supportive. So there were factors behind our decision.

We were seeking tenders-to-supply in both the short term and the long term. We were seeking short-term supply because — and this touches on one of the points in your terms of reference — there are really only three suppliers in Australia at the moment: CSR, which has only geared up its plant in the last month; a little place called Rocky Point just south of Brisbane, which has a small production; and Manildra, near Nowra in New South Wales, which has the most capacity. But beyond that, we were not wanting to limit it to that because we were looking at greenfield plants, and no greenfield plant is going to come on stream until 2008 or beyond, because it will take two years to build. So we were looking both in the short term up till then, and then in the long term.

We had a lot of meetings. We learnt a lot about ethanol and biofuels. About 12 months ago we had about 30 service stations selling ethanol in various parts of Queensland. In October last year we opened three sites with E10 in Canberra. In February this year we opened an ethanol blend plant in Mackay, which was a key step in taking our north Queensland strategy forward. Then in March we announced the largest contracts in Australia. We signed for

23 million litres over the next two years, starting a month ago, with CSR. We signed a long-term contract for tallow from Colyer Fehr, which is a tallow trading company in Queensland, to provide tallow to produce 110 million litres per annum of renewable diesel, which will be treated at our Bulwer Island refinery in Queensland starting from mid next year. This will be blended in at 5 per cent with our diesel production from there, so all of our diesel production will have a renewable content — all, or virtually all — at about the level of 5 per cent. In a way that has increased our diesel capacity, but it is also using this tallow which hitherto has been exported.

The third thing we did was sign a memorandum of understanding with Primary Energy, one of the potential ethanol producers, for us to take the whole output of an ethanol plant that they are going to build in Kwinana in Western Australia. That output is 80 million litres per annum, and we have negotiated to take the lot. That was part of the analysis. We thought that rather than take small bits you can reduce the risk for everybody if you can virtually guarantee all of the output. That was a very big set of announcements in March.

In May we tested our marketing strategy in Mackay — that is, to replace unleaded petrol with E10, which we have now labelled ‘new unleaded’, which is in this brochure. Basically we are looking to turn E10 into a mainstream product, not a niche product. That has major significance for ramping up the volumes. In June our parent — our group — announced a US$500 million commitment to an energy biosciences institute over the next 10 years. Basically it said that we are going to go for biofuels, but the reason for the biosciences institute is that there needs to be a second generation of biofuels which takes us from the current generation, and which takes it to a much more economic and much more efficient level. I am trying to recall things accurately here. I think that one of our people from London, who was out here a couple of months ago, made the point that 20 per cent of the US corn crop is used to make ethanol and, from memory, produces less than 1 per cent of the gasoline. So you can see that there needs to be something more if we are going to take this industry on. It really becomes a mainstream thing.

The second thing is on the process. Maybe the processing needs to be improved to make it more economic as a fuel. Our parent announced a second thing in June, a week later. We announced a partnership with DuPont to develop biobutanol, which is the first of these second-generation fuels. I am happy to provide you with press releases and details on this, but basically it has about 50 per cent more energy than ethanol, has various environmental and other advantages and is seen as maybe the next step in the process. We have an agreement with DuPont to develop the first plant in the UK. We might be talking about five or six years down the track, but I am happy to say that it does necessarily mean that current ethanol plants would be made redundant, because the technology is such that it can be retrofitted to an existing ethanol plant. That was in June. Then in August we commenced our contract with CSR, which we announced in March and which was for 23 million litres of ethanol from them over two years. That commenced in August with the completion by CSR of its investment. That is being rolled out to 52 service stations — 49 in Queensland and 3 in the ACT at present. Half of these service stations have been converted. The unleaded petrol has been taken out, and E10 — or the new unleaded, as we call it — has been put in there. So the volumes are quite large; they are not a niche fuel. That is proceeding quite well.

About a week later, since we were moving from virtually stage 1 to stage 2 of our strategy — where we were having an eightfold increase in volumes — we offered 3 cents a litre. I have here a discount card which we have made available to all these service stations, and that is to offer consumers an incentive to buy fuel with ethanol. At this stage I have not heard of our sales, but we are actually looking to buy more volumes. We are planning to seek further volumes over the coming months. We are also looking at these long-term commitments that we have been talking about. The commitments we announced in March meet over half of the federal government’s 2010 target for the industry. One company alone is doing that, and we are not necessarily stopping at that point. I might also say that when I referred to the second-generation fuels, the renewable diesel is, in a sense, a second-generation fuel that we will be producing. In 2008 we will see our sales of E10 increase by 100 times what they are at present, and that does not include the renewable diesel. We are doing all of those things.

I will go on and relate my comments to the terms of reference. As I said, all these comments relate to Queensland and WA. We have no refinery and no terminal here, so we have limits to what we can do, as we are dependent on other suppliers. Were biofuels available, I think we would be an interested or willing buyer. The only way we could supply it ourselves would probably be from Western Australia in a couple of years time.

On the issue of the potential environmental, economic and social impacts of biofuels, in a sense that touches upon the key criteria we adopted for biofuels. Basically we want fuel supply; we want the economics to be right; consumers have to buy it; operability wise, it has to be okay — in other words, cars have to be able to take it, and I think we have got over those issues; and environmentally it has to be okay. We basically have ticks against most of those issues. We would not be doing it if we did not think this could be made economic, at least for us. In the broader term it has to be said that the excise differentials help with making ethanol potentially an attractive thing for us.

The economics are critical for us. Obviously there has to be a return on this for us to take the risk to go into it, and the risk-to-reward ratio has to be right. One of the imponderables of this as a long-term project is what is going to happen to the price of crude oil. We are looking at it taking two years before a project can come on-stream. The crude oil price is actually dropping. It is about $70 now, and you have to make a judgment as to what it will be in a couple of years time. That is one of the key economic viability issues facing an organisation in our position or even, obviously, an ethanol producer. We are basically a buyer of ethanol at this stage. We are seeking to buy from greenfield producers or existing producers. Turning to the impact of biofuels by reducing reliance on imports, they will have some impact, potentially up to 10 per cent. That all helps, but I would say imports will still be a feature of the purchasing of fuel in Australia.

I turn now to the barriers to and incentives for the increased use of biofuel. In a funny way the availability of supply is a bit of barrier. We would like to buy more in Queensland. We are seeking other supplies within Australia, but until new big greenfield plants come on-stream, there actually is a limit on how much ethanol can be used. Another barrier is of course consumer attitudes. I do not know the consumer attitudes down here, and I am not sure what they are in Sydney. I am hopeful there will be a positive response in Queensland where our mainstream sales are.

There have been quite a lot of incentives for ethanol and biofuels, including producer grants by the federal government. The excise differentials and how they have been applied have also provided some incentive. There is also the recent package by the federal government which has given assistance to service stations for changeovers, which I think will be useful. I might say that at the state level the Queensland government has been supportive of us both in a marketing program and also in encouraging changeovers at service stations. Recently a couple of states have suggested mandates. We do not support mandates. We think biofuels can make it like any other commodity, and there are willing buyers and willing sellers. That is a bit ad lib, but I am happy to take questions.

Mr HILTON — When ethanol is produced, do you know how much greenhouse gases are produced as a result of that manufacturing process compared to the amount of greenhouse gas which is produced in the manufacturing of petroleum?

Mr FRILAY — I think it is a 5 per cent reduction generally, although I know of one project which CSIRO has had a look at, and it is claiming somewhere between 8 and 12 per cent.

Mr HILTON — So there is less greenhouse gas produced?

Mr FRILAY — Yes, provided it is done the right way. If you do it the right way, you will get less. If you do it in some ways, I think it comes out the other way. That is one of the criteria for any project we look at: it has to have a positive greenhouse benefit.

Ms LOVELL — I would like to ask you about your new unleaded fuel, which is the E10 blend. Do you feel that has given you a market advantage over your competitors, and is it cheaper than ordinary petrol or is it only cheaper with the discount card?

Mr FRILAY — The answer to the second question is yes. It has 3 cents off.

Ms LOVELL — Is that only with the discount card?

Mr FRILAY — Yes.

Ms LOVELL — It is not 3 cents off before that?

Mr FRILAY — It is only with the discount card, but we are not hiding it. At every service station that markets the stuff, we are quite happy to make it well known. If you went into one now and you just filled up, you could pick up the card and immediately get the discount. It is not as though you have to fill in any form. BP is actually funding this. One of the reasons for this is that we do not operate all the service stations that stock it, but we will pay this discount, and this is one way of guaranteeing that the discount gets through. It was also something we could do pretty quickly to get it up and running. I cannot remember what your first question was.

Ms LOVELL — Whether you feel it gives you any market advantage overall.

Mr FRILAY — We will probably be better able to tell that in a few months time, because it is only in the last four weeks that we have really ramped up and done this. Then we will be able to ask, 'How are these service stations going? Are they getting really good sales? Are sales the same or are they the other way?'. I do not know, but I am quietly confident it will be okay.

Mr DRUM — The federal government gives you a subsidy, but you only hand it on to some customers; is that how it works?

Mr FRILAY — What subsidy?

Mr DRUM — The federal government gives you a subsidy for using biofuel with ethanol.

Mr FRILAY — They give that to the producer.

Mr DRUM — To the producer?

Mr FRILAY — In a sense basically the producer is the one that has to pay the excise, I think. I will check that.

Mr DRUM — So it is cheaper for you to purchase E10 than it is for you to purchase straight-out normal fuel?

Mr FRILAY — If it was not cheaper, if there was not something commercially in it, we would not do it, like any business. We are looking at something and asking, 'Is this worth doing?'. If the answer is yes, in a cold way obviously we will take the risk and try it. In talking to the producers, we would say, 'You have no excise at present, but that is going to rise. Are you going to be able to carry that increase?'. So that falls upon them, if you get what I am saying.

Mr DRUM — Sure.

Mr FRILAY — What we are saying to the producer is, 'This is the contract we are paying. All the excise bit it your issue'.

Mr DRUM — I heard on the radio the other day that ethanol plants in America are coming on-stream at an unbelievable rate. Are you aware of that rate at all?

Mr FRILAY — I have heard they are coming on-stream.

Mr DRUM — It could have been something like one a day. It is absolutely enormous. I just did not know if you would understand, with the price of petrol in America being so much cheaper than it is here, what the big attraction is over there for ethanol.

Mr FRILAY — The big attraction is probably a bit like here, that there are incentives offered to ethanol producers. I am saying that because if in fact you take away the various incentives, the ethanol price is higher than the petrol price, so there must be some form of incentive in place there. I am saying this partly because from time to time I look at the Chicago prices for ethanol versus petrol and they tend to be a bit higher. I cannot comment in detail on the various regimes in the various states within the US, but I suspect there are incentives in various places for people to take up ethanol.

Mr DRUM — Our first speaker, Ron Bowden, spoke about the very clear diminishing resources of natural petroleum in the world fields. Is that driving oil companies to look at ethanol as an extending fuel additive? Are oil companies around the world saying, 'We have been on a good wicket and we are going okay at the minute, but we have very much a diminishing outlook. We are approaching peak oil at whatever date that is going to be'? Is that what is driving you? You are taking some enormous contracts out here — 80 million litres at one set at Kwinana.

Mr FRILAY — That is a memorandum of understanding at this stage.

Mr DRUM — Sure, but you are taking some enormous steps here as an oil company in Australia to secure the future sources of ethanol, and you are doing that when financially it may or may not be advantageous to you. I am trying to understand. Are you being driven and are all the oil companies being driven by fear of reaching peak oil?

Mr FRILAY — Yes and no is the answer. I do not think we quite agree with Ron Bowden that peak oil is imminent. There is actually a 40-year supply of crude at current rates, but we also think alternatives have a role to play here. We do not consider ourselves just a petroleum company, although petroleum is our main game at the moment. We consider ourselves an energy company, and it is important for us to get into these other areas, whether they be biofuels, solar power, which we are in, or stationary power and areas like that. We are thinking ahead to what fuels will be important in 2030 or whenever so that we move on as a company. Obviously we see the traditional oil gradually being taken over some day by other fuels, not necessarily because the traditional oil has run out, but for various other reasons, which might be environmental or whatever. Basically we still see traditional hydrocarbons as being the mainstay for quite a while. You ask what drove us. It can be opportunity. There can be risk and opportunity as well. This may be a good path to travel, but not every oil company will look at this exactly the same way. So that is an approach we have taken.

Mrs COOTE — Can I talk to you more about the infrastructure? You spoke about the refineries in each of the other states. One of the drivers behind establishing in Queensland and I think you might have said in South Australia is that you have got the refineries and you have got the expertise to distribute it. Could you tell me how you do ethanol at the same time as you refine the petrol? Can you use the same equipment or is it because you have just got that site? How symbiotic are they?

Mr FRILAY — There is a reasonable level of that. How we would do it in Queensland and Brisbane, we would actually try to optimise the process around Brisbane, where we would sort of make at the refinery the gasoline to such a point where when you blend in the ethanol — which is immediately post refinery — that it is 91 octane and everything is just right, if you get what I mean. At present, for instance, when we do it up in Mackay when we use the existing, ordinary unleaded now — we are putting the ethanol onto it — we actually end up with about 93 or 94 octane, so in a sense there is wasted octane. Where possible we would try to sort of optimise the flow chart to squeeze the benefits out of what is there with ethanol with what we are producing now. We can do that where you have got a refinery. It is a bit harder in the more remote areas where actually at this stage anyway we would propose just simply to use ordinary, existing unleaded and blend it with that as one thing. But it is not as though you have got to completely restructure your refineries.

Mrs COOTE — Fine, that was my question. In Queensland you are bringing it from Mackay, you are making the ethanol on-site and you are taking it down to — —

Mr FRILAY — CSR is making the ethanol.

Mrs COOTE — And you are bringing it down to your refinery and blending it. That is the procedure in Brisbane?

Mr FRILAY — To our terminal, which is close to the refinery. It is being blended at the terminal and it is being blended at Mackay terminal. Mackay terminal looks after our sort of central Queensland — we have got terminals in Brisbane, Gladstone, Mackay, Townsville and Cairns, so it is looking after that area. We are also interested in buying from other people or we will sell E10 to others too. The trouble is at the moment we are using all we can make ourselves.

Mrs COOTE — Do you envisage seeing that type of blending happening here in Victoria in the short term?

Mr FRILAY — It depends on other players really.

Mrs COOTE — Five years? Ten years?

Mr FRILAY — I think I would probably — I am not sure. Other companies do not necessarily tell us what they plan to do, for very good reasons. It is a commercial game.

Ms DUNCAN — What other players are you referring to for Victoria?

Mr FRILAY — The other oil companies.

Ms DUNCAN — So if no one else is producing in Victoria, BP would not get into that?

Mr FRILAY — Into?

Ms DUNCAN — Producing, mixing, selling blend in Victoria?

Mr FRILAY — We do not have a terminal in Victoria, so we have a little bit of a problem.

Ms DUNCAN — Also, your guarantee to promote the sales in Queensland — I think it was called the ethanol guarantee or — —

Mr FRILAY — The BP fuels guarantee.

Ms DUNCAN — Do you offer that on all cars?

Mr FRILAY — I think it is on all cars that are rated to use ethanol. I think some cars still are not, but that is pretty few in the whole scheme of things.

Ms DUNCAN — They cannot use E10?

Mr FRILAY — Their manufacturers say it should not be used. But I cannot remember which ones they are, off the top of my head.

Mr DRUM — Did you have many claims?

Mr FRILAY — For E10? None. I do not think we do. We did have a problem when we had some diesel a few years ago, about 5, 6 or 7 years ago. We had to stand by it and it cost us a lot of money. But we felt we should do it. It is always difficult to tell was it the fuel or was it an old car? Sometimes there are issues there.

Mr SEITZ — When the government subsidies stop in about 2010 or 2011 for producing ethanol here, will it be then more commercially viable to import it, and how would that place your company, BP, in that situation?

Mr FRILAY — That is a good question. I think we have to be in a position so that if imports do come our contracts are still competitive. That is something that we need to bear in mind. Actually that is one of the issues facing us. It is all very well to be first, but if you have got it badly wrong then you have just lost the game. So one of the issues is: what is a viable price and what is a good price here that works for the producer, that works for us, that works for the service station and works for the customer? You have got to get something that works across all of those to make it work. Your question is at the core of a lot of what we were doing. If we sign up a long-term contract and then immediately find that another one of our competitors has signed up one significantly cheaper, we have just got it wrong. So your point is very important commercially. I think we just have to bear in mind that we have to be able to compete with imports if they come.

Mr SEITZ — The risk of doing business?

Mr FRILAY — Yes.

The CHAIR — Could I just ask to go back to the 3-cent discount? Is that more of a marketing tool that BP is using? I would have thought that if the ethanol product was reflecting the energy content then it would be cheaper anyway.

Mr FRILAY — That has been argued by many. We were selling at the full price until August. I might say that when it is low volumes and the logistics are not right, the cost structure was not wonderful. That started to change when CSR opened its plant and we started to get better logistics and much bigger volumes. I think we are both able to offer a discount, but also I think it is a bit of both actually;. it is a marketing tool as well. On the energy content, that is 2 to 3 per cent basically lower energy, but then some people think this is a green fuel. There are all sorts of factors that go into price and there are various other factors associated with it. The pricing is something that you have to make a decision on, whether you selling petrol or whether you are selling anything.

The CHAIR — But the excise being charged would not be as great, would it, on the ethanol content of petrol?

Mr FRILAY — No, but that is an issue for the producer. The excise is out of it as far as we are concerned. I will check that. If I have got that wrong I will come back to you.

The CHAIR — Thank you.

Ms LOVELL — But is your wholesale price per litre lower for the ethanol blend fuel than it is for a non-blended fuel?

Mr FRILAY — No.

Ms LOVELL — Do you pay exactly the same per litre?

Mr FRILAY — The price? If you bought it off us?

Ms LOVELL — No, you, from the producers. If you are buying ethanol unleaded petrol from your producers — I do not know what your wholesale price is, but say your wholesale price is $1.30 — are you buying the E10 blend at $1.30 as well, or are you buying that at $1.27?

Mr FRILAY — The buyer pays the same price, but at the retail level we will refund 3 cents.

Ms LOVELL — No, you, not your purchaser — your cost price. Is that exactly the same for the E10 blend as it is for an unblended, unleaded fuel, or is there a different price that you buy at?

Mr FRILAY — I do not think there is a situation where we actually — where we are selling it, we own the fuel. We made the fuel. So it is not as though we are buying it from anybody. I am not sure I am getting your point.

Ms LOVELL — Is the cost of production exactly the same? What we are trying to work out is: is your mark-up exactly the same on the two fuels? I do not know. Everyone says there is no mark-up on fuel, but if your mark-up for instance is 5 cents on a non-blended fuel and your cost of production is $1.40, you are selling it for $1.45 at the pump; or if it is on the blended fuel, is it $1.37 and you are actually having an 8-cent margin to sell it at $1.45, which gives you the ability to give the 3-cent discount?

Mr FRILAY — My costs are confidential, but we are not in this to make it a loss-making operation. We want to make it profitable. If it is not profitable nobody will do it. The 3 cents is something that I think at this stage we can afford to offer. I really think I will probably leave it at that.

The CHAIR — We will leave it at that. Thank you very much for your time today.

Witness withdrew.