



Submission to the Inquiry into the

LIQUID FUEL EMERGENCY AMENDMENT BILL 2007

**Federal Parliament
(Senate Economics Committee)**

19 April 2007

INTRODUCTION

About AIP

The Australian Institute of Petroleum (AIP) was established in 1976 as a non-profit making industry association. AIP's mission is to promote and assist in the development of a sustainable, internationally competitive petroleum products industry, operating efficiently, economically and safely, and in harmony with the environment and community standards.

AIP member companies play various roles in each segment of the fuel supply chain. They operate all of the petroleum refineries in Australia and handle a large proportion of the wholesale fuel market. However, AIP member companies directly operate and control only a relatively limited part of the retail market.

AIP is pleased to present this submission on behalf of the AIP's four core member companies:

BP Australia Pty Ltd
Caltex Australia Ltd
Mobil Oil Australia Pty Ltd
The Shell Company of Australia Ltd.

AIP and its member companies have actively participated in the process of public consultation on the effectiveness of the LFE legislation and its operation. As members of the National Oil Supply Emergency Committee, AIP and its member companies have also participated in discussions with all governments, about the currently proposed changes to the LFE legislation.

This submission addresses key issues associated with the amendments to the Liquid Fuel Emergency legislation and its revised operational arrangements.

Contact Details

Should you have any questions in relation to this submission, or require additional information from AIP, the relevant contact details are outlined below.

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PURPOSE OF THE LIQUID FUEL EMERGENCY LEGISLATION

The purpose of the Liquid Fuel Emergency (LFE) legislation is to establish the role of government in assisting with the management of a very significant and extended disruption to liquid fuel supplies in Australia. This legislation addresses one facet of Australia's energy security framework, ie the operational aspects and day-to-day management of a very significant disruption to normal liquid fuel supplies. The legislation is not designed to address longer term structural changes to fuel supplies, or fuel switching strategies. These issues are covered by other government policies and measures.

The Australian downstream petroleum industry supports the need to update and revise the LFE legislation, and has been extensively consulted at all stages of the review of the current legislation and the preparation of the current amendments to the legislation. The industry believes the current legislation package will provide a balanced approach to handling a potential significant liquid fuel supply emergency. Given the magnitude and complexity of the liquid fuel supply task in Australia, the legislation seeks to utilise industry expertise to the maximum extent, while providing a clear basis for government to assist in a supply disruption that is beyond the capacity of industry to manage.

MANAGING A LIQUID FUEL EMERGENCY IN AUSTRALIA

There are a variety of potential supply problems which may arise from time to time, but very few of these problems will require activation of the LFE legislation.

Normal 'technical' supply problems (eg shipping delays, refinery problems, road or rail transport disruptions, pipeline leaks, compressor break downs) are capable of being managed by the industry using market-based measures and well established supply management procedures. These situations are not expected to require intervention through the LFE legislation.

In the case of more significant events impacting on liquid fuel supplies, close co-operation between industry and governments would be essential to manage the fuel supply issues and to determine whether circumstances required activation of the LFE legislation. It is important to appreciate that:

- Most significant supply disruptions (eg catastrophic equipment or pipeline failure/fire, shipping accidents, natural disasters, and strikes) would trigger normal commercial safety management response mechanisms
- In the event of a terrorist attack on an offshore or onshore facility, established risk assessment, risk mitigation and crisis management mechanisms are in place outside the coverage of the LFE legislation.

In the case of such an incident, AIP member companies would seek to establish whether steps can be taken to ensure a seamless supply from other sources and then determine whether there is really a significant issue for consumers. In assessing supply problems there are two related criteria:

- The magnitude of the undersupply, and
- The length of the disruption (dependent on the circumstance of the disruption, the opportunities for overcoming the supply disruption and the magnitude of the draw down of stocks in the supply chain).

Fuel supply market measures and supply management procedures would be the normal mechanism for handling the supply response. It is industry's understanding that the LFE legislation would only be considered for activation in an extreme situation where industry and government were in agreement that very substantial fuel rationing was required over an extended period and was beyond the capability of the industry to manage on its own.

It is the AIP's view that there is a role for government in an extended event which necessitates retail rationing for non-essential users and the selective allocation of supplies to other users, including essential users. In other cases direct government intervention is likely to exacerbate the supply disruption (eg through actions which encourage panic buying or limit the effectiveness of price adjustments as a demand management tool).

Industry Supply Management Procedures

AIP member companies seek to ensure regular, reliable supply of fuel products throughout Australia. This involves simultaneously managing all aspects of the supply chain from crude and/or product shipments, refinery throughput, and terminal and distribution capabilities. Different points in the supply chain will be subject to different constraints, such as pipeline capacity or the availability of transport.

Normally AIP members would expect to meet all requests for fuel purchases at the terminals. However, circumstances may arise where demand exceeds supply when, either actual demand exceeds forecast demand or there is a supply disruption. When a potential supply problem is emerging AIP members will attempt to meet demand using all available supply alternatives (including drawing on the significant stocks held by the company at that location, sourcing supplies from other parts of the company's supply chain, from other companies' supplies in Australia, and from other supplies from outside Australia).

If it then transpires that the ability of AIP members to ensure continuing supplies is at risk, the chief mechanism for managing supply is 'allocations' at the terminal. When 'allocations' are imposed, customers receive a proportion of their usual demand profile which is usually determined by their term contracts. When supply is subject to 'allocations', spot sales are not conducted and may result in an uncontracted purchaser being declined supply by a particular company at a particular time and location. Supplies may be available from other suppliers in the area. Spot sales currently account for only a very small proportion of sales in the normal course of business.

'Allocations' are used where the actual demand exceeds supply and oil company stock levels are expected to be drawn down at an unacceptable rate. 'The use of 'allocations' ensures an equitable distribution of available supplies over the duration of the event. In more severe supply events, 'allocations' can also be used to ensure that sufficient stocks are maintained for essential users.

THE EFFECTIVENESS OF MARKET BASED MECHANISMS

AIP member companies believe that consumers are best able to make decisions about their need for liquid fuels and the way they use those fuels based on information about price and availability. Consumers (particularly business customers) are also able to make decisions about how they will manage the risks of a supply disruption so that their economic and social interests are handled in the way that best suits their interests. Some business consumers may invest in extra stockholdings while others may change the way they do things to avoid possible disruptions.

Based on knowledge of consumers needs for various petroleum products in locations across Australia, the petroleum industry is able to develop and operate an optimally efficient refining and supply chain.

The effectiveness of this market based approach will of course improve through removal of barriers and constraints to its operation. From the petroleum industry perspective, potential constraints include

- The level of dialogue between consumers and suppliers about unusual levels of demand for particular products
- Perceptions that consumers need only hold very limited stocks on the basis that stocks will be held by suppliers, or governments will intervene to protect consumers' interests if supplies are not forthcoming
- Perceptions that a much broader range of consumers consider themselves to be essential users and that they will get preferential supplies during a supply disruption

- The existence of price control legislation in some jurisdictions, which discourages consumers from considering the potential impacts on business and lifestyle of high fuel prices during a significant supply disruption.

AIP supports the views of the Government that consumers, particularly bulk users and those that consider themselves to be essential users, should bear a responsibility for

- Identifying fuel demand in a timely manner which enables the supply chain to respond accordingly
- Assessing the costs to their businesses and activities of supply disruptions of varying extent and degree
- Assessing the risks of those circumstances arising, and
- Taking action to insure against some or all of those costs impacting on their activities.

AMENDMENTS TO THE LEGISLATION

AIP sees the current amendments to the legislation providing

- a better balance between the need for governments and consumers generally to be aware of emergency supply arrangements, and the need for non-essential fuel users to take appropriate action to look after their interests.
- increased clarity about who would have priority access to available fuel supplies in an emergency
- an increased level of certainty about the nature and extent of directions that Ministers might issue to the petroleum industry, as reflected in the planning and preparedness processes
- Greater Ministerial flexibility in being able to respond quickly to changing supply and demand circumstances across the very extensive fuel supply network in Australia.

The amendments establish a clear legislative model which requires guidelines to be established for all major operational actions under the LFE legislation before any Ministerial directions can be issued to industry or fuel consumers. AIP believes this process will strengthen consultation between industry and government on the expected content of directions and enable effective planning and preparation of detailed response activities which meet industry and government needs. The petroleum industry will know in advance how key parts of their operations are likely to be impacted during an emergency. This consultative process also underpins the more effective decision making steps during, and in the lead-up to, an emergency, when Ministerial directions issued in accordance with the guidelines will not be subject to disallowance by the Parliament.

Importantly, the legislation model also envisages that unintended consequences can be quickly rectified during an emergency, and directions can be varied, within an established framework, as circumstances unfold. Given the close relationships between actions in Parts I, II and III of the legislation, the amendments anticipate that guidelines issued under the various Parts of the Act will be consistent.

PREPAREDNESS FOR AN EMERGENCY

Since the majority of sales by refiners are to bulk customers, the legislation establishes streamlined processes for identifying these customers and for the preparation of approved procedures for the allocation of available fuel to these customers in an emergency. AIP supports these changes to the legislation.

The LFE legislation also provides for the identification of which ultimate users of fuel should have a primary access to available fuel supplies. The amendments make it clear that

essential users are those involved in activities essential to the health, safety and welfare of the community. These groups within the community can be identified in advance and their fuel supply requirements more clearly identified by industry. At the same time, those groups not identified as essential, will be aware at an early stage of their status for access to fuel during an emergency, and will be able to better plan strategies to manage their fuel needs during an emergency. Governments will also be better placed to consider alternative strategies to assist non-essential users. AIP believes these changes will also assist with the development of better fuel access arrangements for essential users and for service stations during an emergency. Discussions are well advanced between Commonwealth and State/Territory governments to develop an agreed schedule of essential users.

STRATEGIC STOCKS OF CRUDE OIL AND FUEL

The petroleum industry currently holds commercial levels of stocks that reflect commercial considerations, including a regular assessment of the operating conditions throughout the supply chain and the risks more likely to be encountered by refiners and others in operating the supply chain. The LFE legislation provides for Ministers to direct industry to establish and maintain strategic levels of petroleum reserves. These requirements have been streamlined in the amendments.

Consideration of the issue of strategic stocks needs to take account of their likely role in any fuel supply emergency in Australia. Their primary role would be to provide a buffer for a limited period of time until normal supplies are regained. Unlike stocks held in other countries, any Australian strategic reserves would be unlikely to be large enough to exercise any significant impact on prices in the market, or to meet normal supply requirements for more than a short period of time.

Through a combination of crude oil and product stocks, and domestic crude oil and condensate production, Australia currently meets the IEA's 90 day stockholding requirements. An increase in stock levels would place additional costs on the supply system that would ultimately be passed on to the consumer unless government were to underwrite these costs.

PRICE CONTROLS

Of particular concern to AIP member companies is the continuing belief by some governments that it is still necessary to retain legislation to impose price controls in a supply emergency. The existence of these provisions discourages consumers from taking actions and decisions which would minimise the risks to their own activities from spikes in product prices.

The existence of price control legislation also influences the range of options available to fuel suppliers during a significant supply disruption, if there is limited ability to recover increased costs (eg increased crude oil purchase costs or increased transport costs).

Industry experience from other parts of the world indicates that the existence of price controls in one jurisdiction and not in another can create arbitrage opportunities and in the extreme can move product out of a price-controlled region into a neighbouring region (or indeed distant region if the arbitrage was sufficient). Meanwhile, border areas of the price-controlled region can experience elevated demand due to cross border purchases by business or private consumers.

AIP notes that some governments in Australia and in other countries have recognised the deficiencies of price control mechanisms, and have clarified the basis on which these governments would act to protect the interests of disadvantaged segments of the community and essential users. AIP continues to encourage governments with price control legislation

still in place to introduce measures which are more market based in approach, and which send more relevant risk management signals to all consumers.

It is AIP's view that once a supply disruption has been declared under the LFE legislation, normal fuel pricing policies would apply, with wholesale and retail prices continuing to reflect import parity prices for those fuels in the Asian region and local costs associated with getting fuels to consumers. The ACCC would be expected to be monitoring prices during a supply crisis to ensure that Australian price movements were consistent with international price movements and local costs.

COMPENSATION ISSUES IN THE EVENT OF A DIRECTION UNDER THE LFE LEGISLATION

Where an oil company is directed to undertake actions under the LFE legislation that increase the costs of supplying fuel to consumers, AIP believes there must be a clear policy to enable the company to recoup those additional costs from either the governments issuing the directions or from consumers. The amendments to the legislation envisage

- The Commonwealth Government providing compensation for increased costs associated with directions under the planning provisions of Part II of the legislation
- Additional costs incurred during an emergency will be able to be recovered from consumers.

The Intergovernmental Agreement supporting the LFE legislation indicates that those States wishing to retain price cap mechanisms will only use them as a last resort (ie if prices move significantly out of alignment with international prices, adjusted for reasonable additional costs incurred in Australia). The amendments also clarify the basis on which compensation would be calculated.

AIP considers that these proposed changes will improve the level of certainty in relation to Part II cost issues. While the approach to Part III cost issues appears to be workable, AIP believes the lack of certainty about how some state governments may utilise price capping powers is likely to lead to conservative approaches to emergency fuel supply responses.