

26 May 2006

Peter Hallahan
Committee Secretary
Senate Economics Legislation Committee
Suite SG. 64, Parliament House
Canberra
ACT 2600

Dear Peter,

**Fuel Tax (and related bills) Bill 2006
Potential Impact on the Viability of Australia's Biodiesel Industry**

Transfield has recently committed to make a substantial investment (potentially upwards of \$30m) in the Australian Biodiesel industry. We hope our involvement in this industry, as with others that we have been involved in over the years, will contribute to the growth and well being of Australia.

Important to our decision to invest was the Governments policies in this sector. Fundamentally we saw the policy of providing full excise relief up until 2011 and then phased down to 50% relief by 2015 as very sensible. It gives the most assistance in the early years when the new industry faces all sorts of uncertainties and high investment requirements and phases down to a more sustainable level at a time when the industry should have worked through its growing pains.

The Government should be proud that its policies have so effectively stimulated the development of an industry that, undoubtedly, will have the capacity to produce at least the targeted 350ML of biofuels by the end of this year, with substantial further expansion next year.

However, all this good work will be undone if the above Bill becomes law without amendment, or without compensating legislation.

We are aware that the Treasury and Government have attempted to take some cognizance of the changes on this industry, but we believe that the potential impacts on the industry have been very much underestimated. To explain our position we have looked at the three distinct markets for Biodiesel in Australia. These are:

- The large, long distance trucking companies that we understand consume more than 90% of the on road diesel in Australia. (Heavy On-Road Users)
- The off road users of diesel that include the farming, mining and marine users, and which are very substantial users of diesel. (Off-Road Users)
- The light vehicle (less than 4.5 tonne) private and business market, which we understand currently uses less than 10% of on road diesel. (Small Users).

We estimate the impacts of the Bill on these sectors as follows.

Heavy On-Road Users

This group is key to the development of the Biodiesel Industry. They use nearly all the diesel sold for on road use and have extensive company storage and distribution facilities that make the distribution of a new and different fuel logistically easier and independent of the major oil companies. Their knowledge of the performance of their vehicles and the desire to cut fuel costs to the minimum make them particularly interested in using B20 (20% Biodiesel, 80% conventional diesel) and higher blends. But only after they have conducted detailed trials and tests.

Such trials have been increasingly conducted over the past year or so, all of which have been successful. This has led to a rapid uptake by this sector, particularly B20 and above.

This sector buys in bulk and receives significant discounts from the oil majors. Therefore deep discounts (usually 10 to 20 cents/L) have had to be offered to encourage this sector to conduct the trials and accept greater logistical complexity (blending etc).

As illustrated in the table below, the proposed phasing out of the Energy Grants (Credits) Scheme will render biodiesel uncompetitive within two years in the heavy vehicle sector, or more rapidly if the present historically high oil prices decline. The table assumes a Biodiesel sale price of \$1.05, but often a higher discount is required as discussed above.

	June 06		July 06	July 07	July 08	July 09	July 10
Petro-diesel		Petro-diesel					
Purchase price	135	Purchase price	135	135	135	135	135
Rebate	(19)	RUC**	20	20	20	20	20
		Excise rebate	(38)	(38)	(38)	(38)	(38)
Effective price	116		117	117	117	117	117
Biodiesel		Biodiesel					
Purchase price#	105	Purchase price#	105	105	105	105	105
EGCS*	(18.5)	EGCS*	(14.8)	(11.1)	(7.4)	(3.7)	(0)
		RUC**	20	20	20	20	20
Effective price	86.5	Effective price	110.2	113.9	117.6	121.3	125
<i>Biodiesel Advantage</i>			6.8	3.1	(0.6)	(4.3)	(8)

Note: All prices are in cents and indicative examples only. *Energy Grants (Credits) Scheme. **Road User Charge. #Assumes price after application of biodiesel manufacturer excise rebate.

The declining competitiveness of Biodiesel in this sector as shown above will be very discouraging to investors. Maintaining the Energy Grants (Credits) Scheme at its present level for the next five years (or replacement with a similar mechanism) would go some way towards ameliorating this effect and we recommend the Committee give serious consideration to this.

Off-Road Users

This is another large potential market segment for Biodiesel. The logistics of blending and storing alongside conventional diesel and relatively low production to date have meant that the market has hardly been touched.

It will remain that way if the proposed Bill is accepted without amendment because there will be no commercial incentive for it to consider using Biodiesel.

We accept that the current arrangements need amending because there is no doubt an unintended 'double dipping' exists that highly favours Biodiesel. Under current arrangements, off-road users pay an effective price of around \$0.85 for conventional diesel (after GST and fuel excise rebate has been rebated and if they use a 49% blend of biodiesel, additional rebates mean an effective price of \$0.71, or a 14 cent per litre saving over conventional diesel.

The amendment proposed by the Bill will no longer allow for diesel blends of up to 49% to be classified as 'diesel' (and thus claim the excise rebate), and therefore all the price advantage to off-road users of using biodiesel will be removed. We understand that conventional diesel will continue to be available for about \$0.85/L, but that Biodiesel blends will cost off road users between about \$0.90 and \$0.95/L.

It is almost certain that the other advantages of Biodiesel will not offset this price disadvantage and that this market will never develop to its potential.

We recommend that the Committee give consideration to an amendment that would at least allow Biodiesel to compete with conventional diesel in this market.

Small Users

Small users typically obtain their fuel from service stations, which are mostly supplied by the major oil companies. They often have concerns about the quality of the fuel and are not normally as knowledgeable or equipped to trial fuels that might be considered 'experimental'. Hence this group is most likely to be introduced to Biodiesel via a B5 blend which meets the 'diesel standard' and therefore raises no issues with vehicle warranties etc.

The combination of the low blend ratio and the smallness of this market, means that the Australian Biodiesel industry will struggle to achieve critical mass.

Even this struggle will be to no avail if, as is likely, the oil majors follow BP's lead and capture this market by hydrogenating fats and oils in their conventional refineries and claim the excise exemption granted to Biodiesel at this level of blend. The Bill has already been amended in the House of Reps to permit this and attached is a copy of a letter from the Managing Director of Transfield to the Prime Minister warning of the consequences of this.

We recommend the Committee take out the amendment allowing the 38 cent/L reduction on diesel made in conventional refineries from fats and oils.

In conclusion, we see the Bill as a terminal threat to an industry which we believe is in Australia's interest to develop. We would welcome the opportunity to provide additional information and evidence to you the Committee's hearings.

Yours sincerely

David Iverach
CEO Transfield Investments