

ACCC INQUIRY INTO THE PRICE OF UNLEADED PETROL

Public hearing – Melbourne, 13 September 2007

Time: 10am

Address: CQ Functions
123 Queen Street

Room: Conference room 6 (level 12)

Time	Witness	Submission
10 am	The Shell Company of Australia Limited Russell Caplan. Grant McGregor Chris Midgley	23
	Australian Automobile Association Mr Michael Harris	24

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TRANSCRIPT OF PROCEEDINGS

AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

MR GRAEME SAMUEL, Chairman
MR JOHN MARTIN, Commissioner
DR STEPHEN KING, Commissioner

PETROL PRICE INQUIRY HEARING

**CONDUCTED AT: CQ FUNCTIONS
MELBOURNE**

DATE: 10.00 AM, THURSDAY, 13 SEPTEMBER 2007

THE CHAIRPERSON: I declare this hearing open. My name is Graeme Samuel. I'm the Chairman of the ACCC and Chair of this public inquiry into the price of unleaded petrol. I'm joined by Commissioner John Martin on my left and Commissioner Stephen King on my left. This hearing is convened under Part VIIA
5 of the Trade Practices Act, pursuant to the Federal Treasurer's approval for the ACCC to hold an inquiry into the price of unleaded petrol. The terms of reference for the inquiry have been published on our website, together with an issues paper and public submissions that have been received. We have also published notes for witnesses of this inquiry which outline the procedures followed by the ACCC at
10 public hearings. The names of the witnesses appearing today have also been published on the ACCC's website.

Witnesses appearing today will be questioned by counsel assisting the ACCC. Counsel appearing today are Simon Marks of Senior Counsel, together with Fiona
15 Forsyth. Some witnesses will also be represented by their own lawyers.

The conduct of the inquiry is within the discretion of the inquiry Chair. Anyone using insulting language or otherwise disrupting the hearing may be excluded. The ACCC may wish to question witnesses about information that has been provided
20 on a confidential basis. The ACCC can take evidence in private if a witness objects to giving evidence on a confidential basis in public and the ACCC considers it appropriate to do so. If this occurs, it may be necessary for all other persons to leave the room for parts of the hearing. We intend to hold hearings in public as far as possible. We do want to be able to ask witnesses about matters that are
25 commercially sensitive. This means we may need to close the hearings at certain points.

A transcript of this hearing will be taken and made available on the ACCC's website as soon as possible after the hearing. However, evidence given in private will be
30 recorded and transcribed but will not be made available on the website. With those matters dealt with, I propose to begin by asking the witnesses from Shell to state, for the record, their name and position.

MR MIDGLEY: I will start. My name is Chris Midgley. I'm the general manager
35 for supply in Australia.

MR CAPLAN: I'm Russell Caplan, and I'm chairman of the Shell companies in Australia.

40 MR MCGREGOR: I'm Grant McGregor and I'm the sales and operations manager for Shell's retail business.

MR DEEGAN: I'm Clayton Deegan and I'm a strategic portfolio analyst from Shell.

45 THE CHAIRPERSON: Thank you. You have some legal representatives with you today. Could they announce their appearance, for the record?

MR RYAN: Mr Chairman, Pat Ryan, Allens Arthur Robinson.

MR WESTON: And Peter Weston, general counsel for Shell.

THE CHAIRPERSON: Thank you. Could I inform the witnesses about some of the rules regarding giving evidence at this inquiry? Firstly, it is an offence to refuse to
5 answer a question that you are required to answer by the inquiry chair. Secondly, it is offence to give evidence that you know is false or misleading or omits any matter or thing without which it is misleading.

10 You may give your evidence under oath or affirmation if you believe an oath would not be binding or for religious reasons you are prevented from swearing an oath on the Bible. I will ask each of you, in turn, whether you wish to give evidence under oath or affirmation, and then I will take the oath or the affirmation, as the case may be.

15

<CHRIS MIDGLEY, SWORN

[10.04am]

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<RUSSELL CAPLAN, AFFIRMED

<GRANT McGREGOR, AFFIRMED

25

<CLAYTON DEEGAN, AFFIRMED

THE CHAIRPERSON: Mr Marks?

30 MR MARKS: Gentlemen, I have a number of questions that I want to ask Shell relevant to the matters the subject of this inquiry. In circumstances where there are four of you, I think the procedure that I will adopt is to generally direct my questions to you, Mr Caplan, and I'll ask you to answer them. There will be occasions, no
35 doubt, when there might be someone better qualified than you to answer, but I want to avoid a situation where we get into a forum discussion on something. It makes it difficult both practically and subsequently when the evidence comes to be considered.

40 A number of the questions I ask you will be directed to matters which you have dealt with in the documentation that you have kindly already provided to the Commission. In that respect, let me tell you we have the following documents, and just make sure we're all on the same page here: We have an open submission from Shell which is dated, or undated, but is marked July 2007; we have a confidential submission,
45 Mr Caplan, which is essentially an attachment to that document; there is then Shell's responses to the notices which were provided under section 95ZK of the Act; and we thereafter have some documents which have been provided to us by way of attachment to those section 95ZK answers. So that's the material we have, and my questions will be predominantly directed, but not entirely directed, to that material.

The last thing I wanted to say before I commence is this: As the Chairman has already pointed out, there are matters we will wish to examine that may go beyond the matters Shell desires to express views or answer questions about in open session. To the extent that it is necessary, I will ask you questions in a closed session which
5 will follow this open session. There are some matters that I already have marked to ask you in that session. If, however, matters I ask you in open session in your view warrant confidentiality, then please say so, and that way we can decide how we will deal with it. The most likely scenario, we will try and deal with it in a way which accommodates Shell, but just so you know where we are coming from here.

10 Those things said, I want to start, please, by asking some general questions, Mr Caplan, to pick up on where Shell's present marketing position of strategy is. I want to ask you about the position prior to the alliance with Coles, to understand what the position was before that alliance was started.

15 Now, can you tell me, or just clarify for me, prior to the alliance Shell, of course, had a direct retail presence in the market in Australia. It operated a number of sites Australia-wide directly, as well as through owner operator modus operandi. Can you tell us, just briefly, please, how the retail structure was set up prior to the Coles
20 alliance?

MR CAPLAN: Just let me understand the question. When you say "operated directly", you mean with our own employees?

25 MR MARKS: Yes, I want to understand really - well, I want to understand generally how - what retail presence in the market Shell had prior to the Coles alliance, what form it took.

MR CAPLAN: Yes, okay. Two - sorry, three predominant forms. We had, and still
30 have, supply arrangements with dealers who own their own service stations. We owned a network of our service stations which, prior to the alliance, were mostly operated by multiple site franchisees, although there were some - a small number - and Grant might know the answer to this - of individual franchisees or leaseholders. Have I forgotten any class?

35 MR MCGREGOR: CVRO.

MR CAPLAN: Yes. In addition, we had, and still have, a small number of what we
40 call commercial vehicle refueling outlets which are principally in the provincial areas and normally attached to depots. They are there largely for the purpose of selling diesel to large customers, so 85 or so per cent of what they sell is diesel, maybe more than that, and the vast majority of the business that they do is done with people who have Shell cards and they don't buy at retail. Is that an answer to your question?

45 MR MARKS: Yes, that is helpful. Thank you. Can I just ask you a couple more things. Insofar as the structure you have described is concerned, first of all, the Shell owned and operated sites, can we take it that at those sites Shell sets the price?

MR CAPLAN: I don't know whether prior to the alliance we had any Shell-owned and operated sites. I think the answer to that is, no, we didn't have any.

5 MR MARKS: None at all? They are all franchisees.

MR CAPLAN: All franchisees.

10 MR MARKS: That's helpful. Is it the position that at the franchisee sites, Shell did not set the price, or at least not directly?

MR CAPLAN: Correct.

MR MARKS: Now, were there any commission agent sites?

15 MR CAPLAN: I think the answer to that is not. Sorry, Grant is better able to help.

MR McGREGOR: I think prior to the alliance there may have been one or two, I couldn't be absolutely specific, but I do recall, in the history leading up to the alliance, that there was one or two.

20 MR MARKS: And did Shell set the price at those sites?

MR McGREGOR: I imagine they would have, either the commission agent or agent, yes.

25 MR MARKS: Then there was the independently branded sites?

MR CAPLAN: Yes.

30 MR MARKS: Shell did not, I imagine, set the price at those site; is that so?

MR CAPLAN: Correct.

35 MR MARKS: Did those sites enjoy the benefit of some price support arrangement?

MR CAPLAN: No.

40 MR MARKS: No? All right. Are you able to tell me what percentage of the retail market Shell-branded sites had then, Mr Caplan, just prior to the alliance?

MR CAPLAN: Yes, something in the area of 16 per cent to 17 per cent.

45 MR MARKS: And are you able, just to give us the complete picture, to tell us about what percentage of - and just approximate will be fine - what percentage of the total volume of retail sales Shell sites were responsible for immediately prior to the alliance?

MR CAPLAN: I'm sorry, let me make sure I understand the first question. Your first question related to the percentage of sites or the percentage of sales?

5 MR MARKS: No, the question I just asked you was what percentage of the total volume of sales were Shell sites responsible for.

MR CAPLAN: That's what I meant by 16 per cent to 17 per cent.

10 MR MARKS: All right. And my question prior to that was what was the Shell percentage of sites?

MR CAPLAN: I don't know the answer to that.

15 MR MARKS: You don't know the answer to that. Does anybody in the team know the answer to that?

MR McGREGOR: The percentage of sites would have been approximately 9 per cent.

20 MR MARKS: Nine per cent.

MR McGREGOR: Somewhere in that range, because that's what it is today and we really haven't changed the total number of sites to a marked degree.

25 MR MARKS: All right. Let's move to the position today, then. The alliance was struck in 2003 and became fully operational by March 2004, is that right?

MR CAPLAN: Correct.

30 MR MARKS: As part of that operation, are we right in thinking that Shell transferred the operation of all of its franchisee-operated sites to the alliance?

MR CAPLAN: Yes.

35 MR MARKS: Just tell us what happened. The sites are still owned by Shell, are they not?

MR CAPLAN: Yes.

40 MR MARKS: But they are now leased to Coles?

MR CAPLAN: Yes.

45 MR MARKS: How many in number?

MR CAPLAN: Approximately 600.

MR MARKS: There are, are there not, a residual number of dealer-owned and operated sites still are there not?

MR CAPLAN: Yes.

5

MR MARKS: Are they predominantly in regional areas or metropolitan areas, where are they located?

MR CAPLAN: In both, but I'd say the balance is in favour of regional areas.

10

MR MARKS: Just to complete the picture, at those dealer-operated sites now, is any form of price support provided?

MR CAPLAN: No.

15

MR MARKS: There are no dealer-operated sites that enjoy price support?

MR CAPLAN: Not from Shell.

20

MR MARKS: All right. Do the dealer-operated sites enjoy any other form of retail support from Shell, and, if so, what is it, please?

MR CAPLAN: Brand support. They carry the Shell brand, for which they pay a fee. So - - -

25

MR MARKS: They carry the brand, but apart from the brand, are there any retail support mechanisms, apart from the traditional price support mechanism, which they enjoy on an ongoing basis to help them compete in the marketplace?

30

MR CAPLAN: Are you referring to financial support?

MR MARKS: Any support? Financial support, it might be product merchandise support, it might be - - -

35

MR CAPLAN: That's what I meant by branding. I apologise, that's - - -

MR MARKS: Not at all. That's fine. Anything financial beyond that?

MR CAPLAN: No.

40

MR MARKS: All right. Shell, under its present arrangements, still has its commercial vehicle operation sites; there are still about 30 of those, we understand?

MR CAPLAN: 40.

45

MR MARKS: 40, okay, and they're principally located in country areas?

MR CAPLAN: Yes.

MR MARKS: And they service the same sort of market that you were describing a few moments ago?

MR CAPLAN: Yes.

5

MR MARKS: That's a very significant change in business model since the alliance, isn't it, Mr Caplan?

MR CAPLAN: Yes.

10

MR MARKS: Can you tell us why Shell made the change? Shell itself really said, "We are out of the retail market now." Tell us why that happened, please.

MR CAPLAN: We didn't think we were very good at it. It cost us a lot in overheads and the profitability wasn't satisfactory to us.

15

MR MARKS: What was it driven by? Was there any feature of the market - it's very self-deprecating of you to say, "We didn't think we were very good at it", but was there any particular feature of the market which drove Shell to make the decision? Was it the position of Woolworths and Caltex? Is there anything you can point to?

20

MR CAPLAN: Not in particular. We were driven by outcomes as we perceived them. So, at the end of the day, you would want to have high profitability, below average costs, and the operation that you present to the customer as good as or better than that presented by your competitors. We didn't think we had any of those.

25

MR MARKS: I see. So Shell made a decision to put all of its retail eggs into the Coles Express basket, in effect?

30

MR CAPLAN: Correct.

MR MARKS: I don't want to oversimplify it but the position really is this: Shell still has a direct retail presence, in the way you have described, the CVROs and so on, and it has an indirect retail presence through its alliance with Coles and its alliance, if I can describe it that way, with the dealer-owned and operated sites?

35

MR CAPLAN: Correct.

MR MARKS: Now, can I just ask you this, just to understand this picture that we're now seeing with Shell: What was Shell's average annual gross profit from its retail operations in the year prior to the alliance being struck, that is, I think it's probably right, in the financial year 2003; could you help us with that?

40

MR CAPLAN: I can't help you with that. As I said to you, I can find the answer to you - what was the profit that we made in retail in the year 2002/2003; that's the question?

45

MR MARKS: Yes, that's the question.

MR CAPLAN: We will find the answer to that.

MR MARKS: If you take it on notice, we will follow it up, and we will want to know also not just the average gross margin but also the average net margin Shell found itself enjoying that year. Is the position then this, that Shell, in the end, decided that wholesale - this was at the time the alliance was struck, Mr Caplan, or immediately prior - that wholesale really was a more profitable sphere of operation for Shell?

MR CAPLAN: Yes, by exclusion of retail, which wasn't profitable.

MR MARKS: So that if one took the Shell family of operations in the period immediately prior to the alliance being struck and compared the retail and wholesale operations and so on, the answer was that the wholesale operations were performing more profitably and, in the end, it was down that road that Shell decided to go?

MR CAPLAN: Not quite.

MR MARKS: Tell us what the position was.

MR CAPLAN: Because our assessment was that by combination of the rent that we charged for our properties, the wholesale margin that we got for our sale of fuel to our wholesale customers, and our ability to reduce, almost eliminate, all of the operating costs that we bore to conduct the retail part of the business, we would have a better integrated outcome than we enjoyed beforehand.

MR MARKS: Shell was finding that the retailing costs, which were obviously high, were not justifying the return from retail that Shell was getting; is that what you are really saying?

MR CAPLAN: Correct. Not only the retailing costs but the associated overheads.

MR MARKS: Yes, I see.

MR CAPLAN: And that's an important part of the equation. If I can just explain, retailing costs comprise direct and indirect components. Those costs that occur on the service station, they occur today pretty much, whoever is responsible for them. The costs associated with marketing, with merchandising, with advertising, with administering and employing the people involved in that, those are the sorts of costs that I call overheads, some more closely aligned with the business than others.

MR MARKS: Yes.

MR CAPLAN: And it was those overhead costs, or our ability to exclude those, that made a difference to us.

MR MARKS: Yes, I see. All right. That's helpful, thank you. Can I turn, then, to ask you some questions about refining, importing. You've included some

information about this in your open submission. There is some further information that Shell has provided us with. I want to ask you some general questions, first of all. Am I right in saying that so far as Australia is concerned, it is largely - at the present time, Mr Caplan, it is largely, but not entirely, self-sufficient in petroleum production?
5

MR CAPLAN: Largely.

MR MARKS: But not entirely, was my question.
10

MR CAPLAN: But not entirely.

MR MARKS: Yes.

MR CAPLAN: So, yes.
15

MR MARKS: If I have read the Shell materials correctly, it is probably right to say it's - the figure is about 90 per cent self-sufficiency at the present time across all petroleum products?
20

MR CAPLAN: Chris, would you - - -

MR MIDGLEY: Probably around 85 per cent.

MR MARKS: Let me just tackle that with a few more questions. In the submission at page 2 - - -
25

MR CAPLAN: Open submission?

MR MARKS: Yes, please. In the open submission at page 2 you say that the total capacity of the seven refineries is 42,970 million litres per annum. That figure may be out of date. It appears - I'm not sure about this, Mr Caplan - but it appears to have been taken out of the ACCC 2006 submission to the Senate inquiry, and if that is so, because it is identical to it, it represents the figure in 2004-05. Now, the capacity has obviously changed since then. I suspect it has marginally increased since then, along with fuel standard change, reinvestment in infrastructure and so on. Can you tell me, please, what is the current figure?
30
35

MR CAPLAN: I can't. I can tell you what ours is but - it is - - -
40

MR MARKS: Where did you get this figure from?

MR CAPLAN: It was drawn from the ACCC. We regard them as an authority on the figures.
45

MR MARKS: More authority than Shell?

MR CAPLAN: On many matters, because they have access to more information than we do.

MR MARKS: About petrol matters.

5

MR CAPLAN: About lots of matters.

MR MARKS: All right. If you accept those figures for 2004-05, then so, too, would you accept that in 2004-05, refineries produced about 17.6 million - I'm sorry, I will say that again 17,600-odd million litres of the total of about 19,800 million litres that were consumed by motorists at that time. Now, just accepting that those are the figures also drawn out from the ACCC submission to the inquiry at that point, it would suggest that the daily petrol consumption by Australian motorists was around 55 million litres a day. Looking at Shell's figures, Shell is responsible for a significant percentage of that total volume. I think it's around 27 per cent; is that so?

10

15

MR CAPLAN: We think our branded market share is - - -

MR MARKS: About that?

20

MR CAPLAN: About that, yes.

MR MARKS: Is that accurate to today, or does that, likewise, to be taken to be a figure that is a couple of years out of date?

25

MR CAPLAN: I wouldn't be looking at Shell's branded market share by ratioing it to refinery production, which I think you were just doing, unless I misunderstand you.

30

MR MARKS: What would you be doing?

MR CAPLAN: I would be looking at the published data. I know what we sell. I would be relying on the government data to determine what the total market was of sales, and I would be doing it that way.

35

MR MARKS: All right. Let me look at Shell's position in a bit more detail, and you refer to this under the same heading. So far as Shell is concerned - I had better just make sure I'm right about this - there are, are there not, essentially three sources for the petrol that is sold or wholesaled by Shell on the Australian market? And I'm thinking here of obviously petrol which is produced or refined at Shell's refineries. There is then petrol which is imported by Shell - and I'm thinking Shell directly here - and then, of course, there is petrol that is obtained by Shell from its buy/sell arrangements. They are the three sources I'm thinking of. Am I right about that?

40

45

MR CAPLAN: Yes.

MR MARKS: Let me ask you a little bit about each of them. Firstly, Shell's refining. Shell has the two refineries, you say the one in Geelong that presently has a capacity of 110,000 barrels a day?

5 MR CAPLAN: Yes.

MR MARKS: Is that figure up to date?

10 MR CAPLAN: It is the nameplate capacity of the refinery. The question of whether
- - -

MR MARKS: What does that mean, please?

15 MR CAPLAN: It means it's capable of producing 110,000 barrels a day. Whether it
does produce 110,000 barrels a day times 365 days per year depends on how reliable
it is principally and depends on the configuration of the refinery. You made a point
earlier about quality specs, and somehow you are aligning with that an increase in
capacity. It's our experience that in order to produce products at the specs which we
20 are now obliged to do, the result is a lower capacity at the refinery rather than a
higher one - you have to run the kit harder, effectively, to produce products of that
quality. So that's tended to have a negative impact on the productive capacity of at
least our two refineries.

25 MR MARKS: Okay. Now, let's nail that down a little bit. The nameplate capacity
is a daily capacity multiplied by 365, is it?

MR CAPLAN: Yes.

30 MR MARKS: It doesn't take into account shut downs and other operational
exigencies?

MR CAPLAN: Absolutely.

35 MR MARKS: Then there are the fuel spec changes. You say Shell has invested a
great deal of capital in complying with fuel specifications and that has, insofar as
Shell is concerned, impacted adversely to some extent. What impact has it had in
terms of volume capacities daily?

40 MR MIDGLEY: It is probably about a 4 per cent reduction in our capabilities
around gasoline production.

MR MARKS: What is that - is that about 6,000 barrels a day or something?

45 MR MIDGLEY: Of gasoline, it's more like around 4,000.

MR MARKS: So that's affecting both refineries?

MR MIDGLEY: Correct.

MR MARKS: Realistically then, at about the same amount, at about the same level? So Clyde, if we forget the nameplate capacity for a moment, look, the real capacity, it might be 106, or something like that, and - - -

5 MR CAPLAN: Mr Marks, in closed session we can give you the exact production of both refineries, if that would help.

MR MARKS: That would be helpful, but generally speaking for now, and just bear in mind, gentlemen, this inquiry is also for the public record. Some of the questions I
10 ask you in private I will be asking you in public, albeit that they may be in a more general sense. This information is important public information. So far as Shell can say publicly, is the position that its Geelong refinery now has an operating capacity of about 106,000 barrels a day?

15 MR CAPLAN: I would say 100 is a better - - -

MR MARKS: Is a safer estimate, is it and can I ask you likewise about the Parramatta Clyde refinery, please? What is its actual capacity, forget nameplate.

20 MR MIDGLEY: It's 85,000 barrels a day of clean fuels, to distinguish - which is the lighter products at that refinery, so it's excluding fuel oil and bitumen.

MR MARKS: So, if I said a total Shell capacity of around about 200,000 barrels a day, would I be somewhere in the ballpark?

25 MR CAPLAN: Somewhere in the ballpark.

MR MARKS: All right. I want to, then, ask you about a couple of other general points you make in open submission. You say the refinery supply, about 27 per cent
30 of the product. Can I just ask you a bit more generally: The refineries, located as they are in Victoria and New South Wales, can I call Victoria and New South Wales Shell's home states, or home refinery states? I want to call them that to ask you this question. Can the Commission assume that Shell has a competitive advantage over other majors who don't have a refinery in Shell's home refinery states?

35 MR CAPLAN: I think, yes.

MR MARKS: And the answer is obviously, yes, isn't it? Indeed, it is upon that premise that much of Shell's strategies for marketing and so on are built, is it not?

40 MR CAPLAN: Yes.

MR MARKS: Can I ask you, then, to tell me a little bit about imports, the second category I mentioned to you. In the open submission, I think, Mr Caplan, again at
45 page 2, you say in the first half of 2007 Shell's imports accounted - it may be over the page, yes, just at the top - for about 12 per cent of its total unleaded petrol volumes. That compared to about 11 per cent in 2006. Can I presume that what is being talked about there is petrol sold by Shell at wholesale?

MR CAPLAN: Including sold in the buy/sell arrangements.

MR MARKS: I see, yes. Very well. That's helpful. Thank you. So if you were to translate that into numerical terms, it looks to me as if Shell is, in fact, importing
5 around 1.5 million or 1.6 million, 1.7 million litres of fuel a day on to the Australian market?

MR CAPLAN: I haven't done the math, but - - -

10 MR MARKS: Does that sound - well, you will know - one of you gentlemen will know - does that sound about right, about 1.6 million litres a day being imported by Shell from outside Australia?

MR MIDGLEY: It's in the right ballpark, yes.

15 MR MARKS: Can I just mention the buy/sells - I will come back to these in a moment - but how much of Shell's total annual volumes, then, are collected by it or purchased by it under buy/Sell arrangements with other Australian refineries?

20 MR CAPLAN: We can get the answer to that.

MR MARKS: You can find out. That will be very helpful, thank you. Can you tell us in open session, does Shell have another major refiner that it regards as its major buy/sell partner, in the sense that - and the only sense I want to ask it is that it buys
25 most of its buy/sell purchased fuel from that partner?

MR CAPLAN: At any one time, the answer to that will be yes. But it changes, so that the buy/sell arrangement is typically negotiated - renegotiated - every six months, and it may change from period to period.

30 MR MARKS: I see. And does it, in practice, change from period to period, given that most other things do not? The geography - - -

MR CAPLAN: It does change from period to period. Perhaps a bit of background
35 will help you.

MR MARKS: It would be very, but what I might do, if you don't mind, is I will come back to that because I want to ask you a bit about the buy/sell. But before I do - perhaps if I try and do it in some kind of order - can I go back a step and ask you
40 a few questions about Shell's refinery? Are we right in thinking - and please correct me if I'm wrong - that refined petrol produced at Shell's refineries is from imported crude?

MR CAPLAN: Yes - not always, no. We buy crude from - from the west of
45 Western Australia.

MR MARKS: Let's understand that a bit more. Tell us the picture: How much in your ordinary year - and I know that's a little hard - it may be hard to pinpoint, it may

not - how much of the crude that Shell uses is imported, how much is produced or obtained locally and so on?

5 MR CAPLAN: If you don't mind, that's Chris's core area and he is better placed to answer that question.

MR MARKS: I'm happy for Mr Midgley to help us.

10 MR MIDGLEY: It's difficult to give you specific numbers. It will vary from year to year, based on the crude - open crude market. I would say looking at it over a five year period, I would say around about 40 per cent would be crudes which are from Australian fields, such as the North-West Shelf, Gippsland Crude.

15 MR MARKS: Now, are those crudes different in constitution, Mr Midgley? Are they lighter or sweeter or tastier, or - how do we differentiate them?

MR MIDGLEY: Our lighter crudes?

20 MR MARKS: Yes.

MR MIDGLEY: It depends whether our - you know, again, that's the mode of operation of the refinery and the present economics of the day will determine which are more attractive to us.

25 MR MARKS: Does that mean that lighter crudes from Australian sources can be used in refined petrol?

MR MIDGLEY: As part of the crude - but not on their own.

30 MR MARKS: They are mixed in somewhere, are they?

MR MIDGLEY: Not on their own.

35 MR MARKS: I see.

MR MIDGLEY: Our Australian refineries are what we call cracking refineries, they like heavy crudes to load the refinery up. Therefore, we need to source more heavy, sweet crudes to always keep the refinery loaded up.

40 MR MARKS: So it wouldn't be possible to exclusively use Australian crude at any time in refining operations; is that a fair statement?

MR MIDGLEY: It would be difficult.

45 MR MARKS: You would have to make alterations to the refineries' production?

MR MIDGLEY: You can complement it with what we call long residue, partial refined heavy end products - - -

MR MARKS: The sixty-forty breakdown that you identified a few moments ago, you said it changes from year to year, it can depend - I would like to know the typical breakdown, please, if you can help us. What's the typical breakdown been over the last 10 years in Shell's refineries?

5

MR MIDGLEY: I would have to take that on notice.

MR MARKS: You don't, broadly, know? I'm not asking you - and I will be glad if you can provide me with the precise figures, it will be very helpful, but in open session, can you give us a broad idea? Is sixty-forty typical, or is that quite high for use of locally produced?

MR MIDGLEY: I think over the last five years, Geelong was fairly reliant on Gippsland Crude, which used to be a much more heavy, waxier crude. That's now become a very light crude, so over the five years we have reduced - the fuel has reduced, it has become lighter, and therefore our ability to take Australian crude has reduced over that period. To give you exact numbers, I would have to take that on notice. It doesn't vary significantly. Around about forty-sixty would be a fairly good indicator, but it has reduced over time because of our less reliance on the Gippsland Crude.

MR MARKS: All right. Can we take it that Shell can obtain Australian crude more cheaply than it can obtain internationally-sourced crude?

MR MIDGLEY: No.

MR MARKS: Is it the other way around and, if so, why do you use Australian crude?

MR MIDGLEY: That's what determines which crude and what our crude mix would be. So, the lighter crudes can have very attractive values - manufacturers where they like the light properties of that crude. So each of the crudes trades on the Singapore market. From day-to-day we require - - -

MR MARKS: But, presumably, you have to order or engage your crude suppliers on a longer term basis than day-to-day. What I'm trying to understand is how Shell makes its decisions on a long term - how it forecasts its volumes of locally-produced and overseas-produced crude. Now, can you explain that?

MR MIDGLEY: We like to have a mix of term crude and spot crude. At any time when we are looking at a term crude, we're taking an assessment as to whether we can acquire it more effectively on the spot or whether we need to secure it because it's a significant part of the diet that's required for the refinery, and that will vary.

MR MARKS: What is the forecast? Is it a six-month forecast that has to be made or - - -

MR MIDGLEY: We tend to be working on a planning basis on a three-month forecast. For term crudes, it may be a six-month term or a 12-month term.

5 MR MARKS: What does Shell try to negotiate, a shorter or a longer term?

MR MIDGLEY: It very much depends on the third party and the price.

MR MARKS: I see. So it's about 60:40 at the moment, is it?

10 MR MIDGLEY: I would say it's around that but I would need to take that on notice to give you specifics.

MR MARKS: Could I presume from the fact that it's 60:40 at the moment that the 40 per cent is obtainable by Shell at a competitive price, at or below, perhaps I can
15 put it that way, the price it is paying for internationally available crude at the present time? Is that a fair proposition?

MR MIDGLEY: We would choose the most attractive crudes.

20 MR MARKS: So it follows, does it?

MR MIDGLEY: I think it's important to distinguish whether you are distinguishing the price of the crude or the value that we see in the crude. The value is the yield of products that we get out of that crude versus the price of the crude.

25 MR MARKS: And I imagine that, in the end, the value would include price, would it not? One would encompass the other.

MR MIDGLEY: Absolutely.

30 MR MARKS: All you are saying to me is just be careful to understand that when you are talking about obtaining at an advantage, if I can put it that way, one as against the other, you need to look at value beyond just price; is what you are saying?

35 MR MIDGLEY: Correct.

MR MARKS: That is what Shell does and that is what leads Shell to make decisions on short and long term contracts and you say spot also. Can I assume that your spot arrangements are directed to ensuring that Shell has a flexibility available to it to mix
40 and match and change on an as needs basis?

MR MIDGLEY: Both flexibility and also to respond to the changes in the market value of the products that can be yielded out of each of those crudes.

45 MR MARKS: Is it the position that so far as crude is concerned, it is much cheaper for Shell to import crude into Australia than it is for it to import refined petrol? Perhaps, Mr Caplan, I should go back to you.

MR CAPLAN: The answer is that - the answer to that has to be yes - - -

MR MARKS: It has to be yes - - -

5 MR CAPLAN: - - - because otherwise we would be importing refined petrol and we would be leaving our plant idle.

MR MARKS: Exactly so. My next question therefore logically follows: What is the general difference - talk to me, if you will, in dollars per barrel - what is the
10 difference in price, broadly, between the cost associated with importing crude and the cost associated with importing refined petrol?

MR CAPLAN: I think - I don't know the exact number, but the principles behind it must be that transporting crude occurs for us in larger vessels, dirtier vessels. The
15 technical term "dirtier" - I don't want any environmentalists to suddenly leap up - and, therefore, the cost of transportation of crude is lower than the cost of transportation of product, which makes a difference as well. We have a lot invested in refining, which of course continues to carry significant fixed costs, whether or not it's being used. So whatever we do to import product and not to use our refineries,
20 therefore, has to carry the impost of fixed costs that nonetheless are incurred at our refineries.

MR MARKS: Yes, but just to go back a step. I asked you a question and you said you couldn't really talk about it in dollar terms. I don't think it's a great secret. There
25 is obviously a significant difference, it is a huge difference, and necessarily there has to be because Shell has to pay its costs of production and so on out of the difference.

MR CAPLAN: Correct.

30 MR MARKS: We know - it's not a secret at all. I am sure everyone in Australia knows - - -

MR CAPLAN: Well, Mr Marks - - -

35 MR MARKS: Is the general figure \$4 or \$5 a barrel? Where is it around? I mean, we have a broad idea, obviously. Can you tell us from Shell's perspective - either now or on notice, if you like.

MR CAPLAN: On notice. No - - -

40

MR MARKS: You would be able to tell us the exact figure?

MR CAPLAN: Yes.

45 MR MARKS: We would like to know the difference over a series of years to give us some idea of what Shell's refining position and its cost base is. Could you do it perhaps for the last financial year and the four financial years prior to that, to give us a feeling of what the difference is?

MR CAPLAN: Yes, we could do that.

MR MARKS: That would be very helpful. Thank you. We will then understand, won't we - and please tell me, because you know far more about this than I do - but
5 the Commission will then be in a position, won't it, to understand really the - at the refinery level, the local refinery level, the available purse that Shell has to meet its costs of production. Would that be a fair proposition?

MR CAPLAN: Yes.

10

MR MARKS: Yes. Now, can I then just move on to go through this little category of sources that I asked you in general terms a moment about a moment ago. Can I ask you about imports in a little more detail, Mr Caplan. Firstly, can you tell the Commission, so far as Shell is concerned at the moment, what are Shell's sources of
15 international - and I'm not talking about crude, I'm now on to refined petrol - what are the sources of supply to Shell on the international market for Australia at moment? Obviously, there is the Shell refinery at Bukom in Singapore. We obviously know about that one. That is the main source. I think Shell says that that accounts for about - is it about 55 per cent of Shell's imports at the present time?

20

MR CAPLAN: Yes.

MR MARKS: What are the other sources? Can you tell us about those?

25 MR CAPLAN: I believe that about 45 per cent of the product that we imported in the last year came from third parties, that is, not from the Shell refinery. Chris, can you help with the sources of that product?

30 MR MIDGLEY: The origin would be from Korea, Taiwan. There are some products brought in from the Middle East. In general - - -

MR MARKS: Japan?

35 MR MIDGLEY: Not so much from Japan, no, when you are talking on gasoline. The majority of the product would be lifted out of Singapore, where they break bulk
- - -

MR MARKS: I see. That would be the last port of call, if you like?

40 MR MIDGLEY: That would be where they break bulk as the main trading hub. So, such they would then become commingled in storage in Singapore.

45 MR MARKS: Does that mean that, at a practical level, all of Shell's overseas supplies are through Singapore? In other words, all the ordering is done through Singapore?

MR MIDGLEY: We have a trading arm in Singapore.

MR MARKS: I understand. Is that - - -

MR MIDGLEY: It's Shell Trading International Eastern Company. They source our requirements from a variety of sources.

5

MR MARKS: Yes, and that - it is Shell Trading International that you deal with for your entire - Shell deals with for its entire overseas petrol supply needs?

MR MIDGLEY: Yes.

10

MR MARKS: What you then say is that Shell Trading International will, in turn, obtain fuel for Shell's benefit under contracts with Bukom, which is Shell's family company in Singapore, and then a variety of other sources, the origin of which you say may extend to Korea - I think you said Taiwan - and perhaps - what about India and China?

15

MR MIDGLEY: India is a growing market. At the moment, there is very little gasoline coming out there. There is a large refinery being built which will probably, in the next one or two years, start exporting gasoline. At the moment, it's not a net exporter. China is a net importer of gasoline. So we then have to move to the Middle East, or even occasionally into Europe, where products may flow into the east and Singapore.

20

MR MARKS: Let me ask you, then, with those answers in mind: Are imports that Shell draws through Singapore purchased in effect at IPP? Or at least at an IPP-related price?

25

MR MIDGLEY: All trades in Singapore are done off - off a Platts basis. Platts is effectively what we would call a free onboard price, so it's - it's more like an export parity price basis, Singapore.

30

MR MARKS: Explain that if you would, please?

MR MIDGLEY: Platts' quote is based on a trader making a 30,000 tonne cargo available to be lifted in a lifting window, a period of five days, by another trader out of Singapore. So that's product in tank available to be lifted on to another trader's ship.

35

MR MARKS: Is that petrol already refined to Australian Standard?

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MR MIDGLEY: The Platts quote does not reflect the Australian Standard at all. So, therefore, the Platts trades will often be based against a Platts specification, as opposed to an Australian specification.

MR MARKS: My question is slightly different. I understand your answer, but the actual petrol that is sourced through these trades, is it petrol which has already been refined to Australian Standard?

45

MR MIDGLEY: We would require to lift product that met the Australian Standard.

MR MARKS: Thank you. What you say, though, is don't take that as meaning that the Platts trade is necessarily at that standard, it is not?

5

MR MIDGLEY: Correct.

MR MARKS: And some variation to the Standard needs to be made.

10 MR MIDGLEY: Yes.

MR MARKS: To go back to my question, is the answer then, yes, trades are purchased at a price based upon but not exactly the same as Platts? Let me go into that in a little more detail. Mr Caplan, I am directing these questions to you but I'm happy for Mr Midgley to answer them, if that is appropriate. First of all, I assume, therefore, from what you say, that there is a basic IPP standard which is applied in the ordinary way as a marker of what the available spot price is for the fuel being purchased?

20 MR CAPLAN: Could you rephrase that so I can understand what you are getting at?

MR MARKS: I'm going ask you in general about the make-up of the price. I want to understand exactly how it works so that I know what Shell is paying and what it comprises, and then we'll get onto the Australian mainland.

25

MR CAPLAN: Okay. In answer to your question, I would say that the IPP is a creature of Australia. The Platts quote is a creature of Singapore, and so, in answer to your question, the Platts quote, which Chris described, represents a component of what subsequently becomes an IPP.

30

MR MARKS: I should have put it that way, and I'm so sorry, it's confusing the way I put it. What I'm really ask you is the Platts quote a component? You are saying yes, it is. Is it the basis, and I imagine what you are saying is yes, it is.

35 MR CAPLAN: Yes.

MR MARKS: And then it becomes necessary to consider the other features. What are they? Let's go to the Australian Standard feature, or premium, first. That is added on is it? How is the Standard effectively struck, please?

40

MR CAPLAN: The Standard is struck by adding recognised components reflecting the various product specification changes that have occurred so that you end up in a position which takes you from the base to a result which is broadly reflective of what the market will pay for a product of a particular standard.

45

MR MARKS: Okay. There have been a couple of different things gathered together there. I need to understand them. There is a difference, isn't there, between a price struck by reference to what the market will pay - - -

MR CAPLAN: Yes.

MR MARKS: - - - and a price struck by reference to or reflective of the costs associated with obtaining the requisite standard?

5

MR CAPLAN: Yes.

MR MARKS: You have brought in both concept together here. I want to understand them. You say there are acceptable ingredients that make up or go to make up the Standard. What I wanted to understand is this: Is the Standard a reflection of the cost associated with the international refiner refining the available petrol to Australian Standard, and if it is a reflection of the cost, how closely is it a reflection of the cost, please?

15 MR CAPLAN: Yes, it is a reflection of the cost. It is not identical, and the reason is this: The state - the government sets a standard. We have to then manufacture to that standard or import product which meets the standard. In order to manufacture it, as you see from our submission, we have incurred various expenses, both operating and capital expenses. We seek to recover those. So there is, if you like, a cost
20 component that we seek to recover. Whether or not we can recover depends on the market. So we seek to pass on our costs. The only ways that we have of recovering our costs are in the terminal gate price, the TGP.

MR MARKS: Sure, but before we get anywhere near the Australian mainland, I just
25 want to make sure - you will say to me there are costs, by the time we get to the mainland there are costs. I understand what you are saying, and you are going to say we seek to recover them - - -

MR CAPLAN: No. If you will let me finish the question, I'm not yet talking about
30 the cost of getting it to the mainland, I'm simply talking about the quality differential.

MR MARKS: That's all I'm talking about, Mr Caplan.

MR CAPLAN: So we're talking about the same thing, and the point that I want to
35 make to you is that we may or may not be able to recover the full quality differential, depending on what our customers are prepared to pay. That's the only point I was trying to make.

MR MARKS: I understand. So at times you might not recover the entire
40 differential?

MR CAPLAN: Correct.

MR MARKS: At times you will recover the entire differential. At other times, do
45 you recover the differential plus a bit more?

MR CAPLAN: It could be the case.

MR MARKS: Tell me, just on that - and I know this is moving into the Australian market, which I wanted to resist for a moment - but just generally speaking, on the fuel standard, is there a premium - perhaps that's putting the wrong word - is there a margin built into that standard at all? So, accepting what you say, that there is a component of cost that may or may not be entirely met but in some cases it is, is there any component which is not directly associated with cost but is associated with the recovery of some margin?

MR CAPLAN: We seek to recover the cost.

MR MARKS: I understand that.

MR CAPLAN: We do not seek to recover a margin, I believe, on the quality premium. We are unsuccessful in recovery of the full cost, I think, when looked at overall.

MR MARKS: Is the premium which you pass on the same premium as you are charged?

MR CAPLAN: Is the premium that we pass on?

MR MARKS: Is the amount which you pass on, in the form of a premium, the same amount, in effect, as you are charged?

MR CAPLAN: So - for the petrol that we import, that's where we are charged a premium.

MR MARKS: Yes, that's right. That's all I'm talking about at the moment.

MR CAPLAN: So we do not set the price that we seek by trying to match what we pay. So we set our prices according to a set of references that we'll probably discussed later, the mechanism for setting terminal gate price. In that, there is a premium component. We can - we seek to recover that premium component in the prices that we charge, whether we are successful in getting full recovery or not, and in that there is no margin component in the premium. Is that right, Clayton?

MR DEEGAN: So premiums are - because I don't have - I'm not related to the supply element, and of course, the premium that you might pay at any time does change. So it's hard for me to give a complete answer.

MR MARKS: But is that simply saying what Mr Caplan has already said, that an endeavour will be made to recover the cost, at times that will be successful, in times it will be entirely successful, or is it going beyond that and saying, well, that is true, but so, too, is it right to say that there is a small component of margin built into the ultimate premium charged? That's my question.

MR CAPLAN: And the answer to that is there is no margin built into the premium.

MR MARKS: Okay, thank you. Can I then just more broadly ask you - I have talked about the position in Singapore. It picks up, as I understand Mr Midgley's comments, trades you do with Bukom. What you, in effect, are saying is you don't do trades with Bukom directly, you do it through this intermediary Shell company; is that so? What is the relationship, more broadly, with Bukom? How does Shell use Bukom?

MR MIDGLEY: The other Shell refinery?

MR MARKS: Yes.

MR MIDGLEY: Well, we use the trading part of the company in order to optimise the Bukom barrels into the Asian market versus the openly traded barrels off the Singapore spot market.

MR MARKS: Yes, I see.

MR MIDGLEY: So there is a direct relationship with Bukom where the optimal choice of supply is from the refinery.

MR CAPLAN: Can I add to that some remarks?

MR MARKS: Yes.

MR CAPLAN: We take, as a company, great benefit from the scale afforded us by the Shell Global Trading Network, which is the company we deal with, because they are - if they are not the largest trader in the world then they must be pretty close to the largest trader in the world, and at any one time they are involved in so many trades, and their knowledge of the market and what is available and their ability to do deals is used on our behalf, we believe. Our alternative would be to have our own less capable group, I think, and have to deal with the world market through a much smaller lens.

MR MARKS: Yes, all right. Just before we leave the Singapore position, just picking up what you were saying, Mr Midgley, a moment ago about the Platts benchmark, are we right in assuming that the Platts benchmark, that spot sale price quote, has built into it a margin - essentially, it's really a margin for the Singapore refiner - for the work he does in producing that petrol?

MR MIDGLEY: No.

MR MARKS: It doesn't? It must have. It's a price at which the Singapore refiner will sell.

MR MIDGLEY: It's an open - on an overseas market if you price discovery - - -

MR MARKS: It is what?

MR MIDGLEY: Platts as an agent is a price discovery agent.

MR MARKS: What do you mean an agent?

5 MR MIDGLEY: Their role is to discover what is the value of gasoline through traded deals on the market. That is both commodity deals and looking at derivative deals in order to determine where they believe the price of gasoline sits. A consequence of that will generate part of the refiner's margin.

10 MR MARKS: But without going into semantics, the reality is that all the Platts price is an average price quote. For spot sales of, in the case of unleaded fuel, it is unleaded premium, unleaded something is slightly different - but it's simply a benchmark price available as an average, reflective of what refiners will sell for and reflecting actual trades?

15 MR MIDGLEY: It's reflective of what trades - - -

MR MARKS: That is correct isn't it, Mr Caplan? It is has to be correct. It follows as night follows day. So, too, does it follow, I suggest to you, that if you accept it is
20 the price at which refiners are prepared to sell, so, too, must you accept that there is built into their prices, as naturally there would be, a margin for the refiner in return for the work he does?

MR CAPLAN: No, I don't accept that, because over history, that - unless you
25 include in that negative margin.

MR MARKS: Of course.

MR CAPLAN: If that is so - - -
30

MR MARKS: Of course, I am including negative margins.

MR CAPLAN: Then you are correct.

35 MR MARKS: It includes a return which, at times, will be negative.

MR CAPLAN: Yes.

MR MARKS: But one hopes and one runs a business based upon the reality that it is
40 generally positive.

MR CAPLAN: Correct.

MR MARKS: If it wasn't, there would be big trouble for refiners?
45

MR CAPLAN: Correct.

MR MARKS: Let's work on that assumption. You say at page 3 of the open submission that there is an enormous challenge for Australian refinery operations to remain cost competitive, for otherwise they wouldn't survive, you say, against the alternative of imports. That's a very high level statement. It would appear to be
5 undeniably true. Do we take it, therefore, that what Shell is really saying is that Shell must be vigilant to ensure that its costs are competitive in Australia with the costs and the operational costs and so on of the international refiners?

MR CAPLAN: Correct.
10

MR MARKS: So that, as you say, just picking up on that answer, at the end of the day it can do business as well in the market?

MR CAPLAN: Correct.
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MR MARKS: Now, that, I imagine, entails knowing and understanding on an ongoing basis what, firstly, the Australian costs of operation are; is that so?

MR CAPLAN: Yes.
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MR MARKS: And they would be very closely monitored?

MR CAPLAN: Yes.

25 MR MARKS: And likewise knowing, I suggest, what the costs associated with international refining are, probably most often gleaned from the experience within the Shell family in Bukom and so on?

MR CAPLAN: Yes.
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MR MARKS: So Shell in Australia would take very careful notice of that on an ongoing basis, would it not?

MR CAPLAN: Yes.
35

MR MARKS: Can you tell us at the present time - and we may need to go back a little here, Mr Caplan - but what is the average gross margin which the Singapore refiner earned in, let's take the 2007 financial year?

40 MR CAPLAN: I don't know the answer to that.

MR MARKS: Do you know it approximately?

MR CAPLAN: I don't. Chris, can you help?
45

MR MIDGLEY: The data is available - Singapore? Shell - are you asking Shell Singapore?

MR MARKS: Yes, indeed. I'm really focusing on what I know you are likely to tell me.

MR CAPLAN: I don't know the answer to that.

5

MR MARKS: Can you find that out, please, so that at the end of the day we have an idea, and we will need to go back, I think - let's do 2007 through to 2000 - go back five years, as we have, so that we can get an idea of what Shell Singapore's gross margin is. That may or may not be reflective of wider margins in the Singapore and other Asia areas but it will give us some real guide.

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MR CAPLAN: Perhaps you can return to that question in camera and we can discuss it more.

15

MR MARKS: Certainly. If there are other issues - you just signal them to me we will be able to pick them up. I am grateful to you. What I will also want to ask you - again, I might take this up, if you will forgive me - is to tell us about the Australian refiners' cost position so that we can get a broader perspective on the whole refining position. I will take that up, too, if you don't mind.

20

MR CAPLAN: Yes.

25

MR MARKS: Can I then go back to this question of standards, and forgive me for jumping around a bit here. I will try and do it as little as possible but I want to ask you some questions about this. You say that in recent years - and I'm looking here, Mr Caplan, at page 3 of the open submission - you say in recent years Australian fuel standards have been tightened to be largely in line with Euro3 specifications, with one major exception, and then you set out what that exception is relating to MTBE. We understand that difference. You say, then, the hybrid nature of the Australian fuel standards makes it more difficult to obtain supply as it is not readily available from many refineries in the region. I wanted to ask you: Does that proposition still hold good in this 2007 market?

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MR CAPLAN: I think the answer is, yes, it does, when you add to that a supply at a competitive price.

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MR MARKS: Yes, I see. So - yes, I see. So you say, I think, that despite this - I'm just moving on a line - despite this, there are several options in the international market for acquiring Australian specification fuel. Mr Midgley has helped us broadly with an understanding of where Shell might look to obtain its fuel. You have said just take on board the reality that when you are talking about obtaining it, you are not really talking about the availability of it, you are talking about the availability at a competitive price. Now, building that in, that reality in, what is the position at the present time? Is there, on the international market, available to purchasers Australian-grade fuel at a price which would be said to be competitive with prices which can be obtained for fuel here in Australia?

45

MR MIDGLEY: No.

MR MARKS: All right. I am sorry go ahead. I was just going to say - I might have cut you off. I'm sorry, Mr Midgley. What, then, is the position? What's the differential we're talking about?

5 MR MIDGLEY: The differential would vary from time to time based on what available market - - -

MR MARKS: Clearly so. What is the range, can you tell me?

10 MR MIDGLEY: It depends what you are marking them against. I mean, can you be a bit more specific?

MR MARKS: What do you mean by that? It depends on what?

15 MR MIDGLEY: You asked for what the premia would be.

MR MARKS: Of course it will depend a little bit, depending upon what grade and so on. But let's take unleaded petrol at the standard level. Can you tell us what the range of differential might be, just at the present time, if we were going out into the marketplace and we were looking for internationally refined fuel at a competitive price, what differential in range would we expect to see?

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MR MIDGLEY: Each of the individual specifications has a premium associated. But the range, I think, for what you are - the key differential is the lower MTBE and the lower benzene is probably the biggest one, it will have a range of \$1.50 to \$2.50 per barrel.

25

MR MARKS: For both?

30 MR MIDGLEY: For both.

MR MARKS: Both, together - I'm with you. You have put a broad barrel price. Can I take it that that answers my question about range, namely, that, broadly speaking, you might expect to see a difference of around - somewhere around \$2.50 a barrel, given that reality? Is that what you are saying?

35

MR MIDGLEY: For key specification, which differs from the readily available gasoline.

40 MR MARKS: Let me go back a step. Accepting that that reflects the differential for the key specification, can you tell me more generally, if you would, what differential, picking up all of the differences - and as you and I know, there are many; they are only two of perhaps 10 or 15 differentials - what is the range of differential that I would expect to find if I went on to the international market to purchase fuel now?

45

MR MIDGLEY: I don't think there is a specific answer to that. It is such a volatile market, because it is a more boutique quality specification. So it is very much about when you go into the market - - -

MR MARKS: Tell me, then, what the average might appear over the last six months?

MR MIDGLEY: I would have to take that on notice.

5

MR MARKS: Could you do that for me? I would be very grateful. Thank you. That would be very helpful. I take it that when you say it's not a comparative price - and as I understand it, Mr Caplan - I am sorry for cutting across here, Mr Midgley, forgive me - it can be more generally said that Shell - Shell's position, is it not, is that it is costly at the moment to import Australian Standard fuel. When Shell says it's costly, I have taken Shell to mean that vis-à-vis other options or alternatives, it is a more costly or more expensive option; am I right?

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MR CAPLAN: Correct.

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MR MARKS: When you talk about competitive, that's really what you are saying?

MR CAPLAN: Correct.

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MR MARKS: Can I then just ask you a couple of associated questions, if you don't mind. It's touching really on something you said earlier, Mr Caplan, that I just wanted to pick up. Tell me a little bit more about how the necessity to comply with Australian Standards, which have been foisted upon Shell and others, has affected the production abilities? I know you spoke about this at a high level, but I was interested in it - could you tell me a little bit more about what impact it has, not just at present but how you expect the impact will trend out in terms of Shell's operations and capacities into the future?

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MR CAPLAN: The immediate impact on us was to lower the production capacity of both refineries.

30

MR MARKS: Yes, you mentioned that.

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MR CAPLAN: And also in the way that we operate our refineries to make them more vulnerable to a - if I use the technical term - glitch in any component. The reason is that our refineries have to operate in a more integrated way to produce the outcome demanded by the specs. Therefore, a breakdown in any part of the integrated cycle has a more significant knock on effect than hitherto.

40

MR MARKS: Yes, I understand.

45

MR CAPLAN: That's difficult for us. Our need to deal with breakdowns in our supply chain then puts us in a position where we have, on occasion, and we may in future need, to go out and secure supplies on the open market in a less than optimal fashion because we have not planned for it.

MR MARKS: Yes, I understand.

MR CAPLAN: That's a feature of doing business that, increasingly, we have to contend with in our system. Indeed, it's one of the reasons why I believe Mr Midgley has said "It depends", when answering your question on the margin, because when we are in need, the supplier may not be ready to supply.

5

MR MARKS: Or he may be very ready but at a different price.

MR CAPLAN: That's exactly right. So - then the question, for completeness, depends upon how commonly available will Australian grade product become in the region if it isn't commonly available today?

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MR MARKS: Yes.

MR CAPLAN: And I think the answer to that is increasingly commonly available over the years as the different countries in the region themselves improve or increase their requirement for environmental quality standards. Just when, I don't know, but every time a new refinery comes on it will doubtless be configured better to be able to make the more modern specs.

15

MR MARKS: Now, tell me, accepting for a moment that the standards have broadly come on from around January - the standard changes in Australia - have been broadly introduced since about January 2002, had a greater impact since January 2004, can Shell tell us what it has discerned, thus far along the continuum, as to the availability of fuel? Have other countries tended towards producing more fuel which would match or nearly match Australian grade?

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MR CAPLAN: I think the answer to that is marginal, but for them it becomes a business proposition. So if the buyer, ie, Australia, or Shell in distress in Australia, is prepared to pay, then maybe someone is going to be prepared to make, and that's the bargain that seems to be struck.

30

MR MARKS: Sure. My point was accepting that, is there nevertheless a trend toward a higher standard fuel because of the growing requirements of countries in the Asia-Pacific region for a higher standard to accommodate political or other ends?

35

MR CAPLAN: In the period that we're talking about it's not discernible.

MR MARKS: Yes, I see.

MR CAPLAN: But our anticipation is that it will become so.

40

MR MARKS: All right. Is the corollary of that anticipation that Shell would expect that there would be some impact upon its ability to recover the premium associated with refinement to that level?

45

MR CAPLAN: That would depend on whether the market prices all of the investment and operational changes that other refineries in the region have to make. So it could go one of two ways --ie, modern quality, if I call it that way, petrol

becomes fungible and, therefore, cheap all over the place; or all of the boats rise so that everybody attempts to recover the cost of making that. I don't know and I can't predict that outcome.

5 MR MARKS: You can't predict it from what is presently happening in the market?

MR CAPLAN: Not really.

10 MR MARKS: In terms of just Shell outputs, and perhaps we will ask a little more about this later, there has been a present capacity drop. You have said that Shell needs and has some - well, it's problematic trying to go through with growing possibility of production shutdown because of a more highly integrated refinery. That all speaks well in theory. What about in practice? Is the production breakdown
15 experience a much more significant one now and, if so, can you numerically calculate its impact in some way?

MR CAPLAN: Yes. In camera we can do this more exactly, but for the purposes of the public hearing, we had a disastrous period in 2003-04 with totally unacceptable
20 reliability. It's improved significantly since then, and all of our efforts are to continue to improve the reliability so that we can get as close as possible to the productive capacity of the refineries.

MR MARKS: Was it a glitch in 2003-04 or was it - - -

25 MR CAPLAN: Many.

MR MARKS: Many glitches?

30 MR CAPLAN: Many things.

MR MARKS: But the experience has been a much more palatable one since?

MR CAPLAN: The experience has been significantly better since, but inside my
35 company we regarded that period as totally disastrous, from our point of view.

MR MARKS: Yes, I see. Can I just ask you a couple of questions about the position of international refiners, just so the Commission understands it. We know - and the
40 reality is there - that there are a number of international refiners in the region, and we have already had helpful answers to questions about where they might be and where fuel might come from. I'm really just trying to understand a bit better what that means, though, in our market here in Australia. Is there a real prospect - I know there is a theoretical prospect - but is there a real prospect of an international refiner independently supplying fuel on to the Australian market at the present time? By
45 that, I really mean in competition with the existing majors.

MR CAPLAN: It's evident that it's not happening. It's therefore evident that the local refineries are, for the moment, competitive enough to satisfy the needs of the buyers.

MR MARKS: Accepting that that must broadly be true, is the reality that for an international refiner, the costs of production to Australian Standard and the costs of landing fuel and so on here would make them quite uncompetitive in the current market?

5

MR CAPLAN: Yes.

MR MARKS: And - I mean, you don't need to be Einstein to know they don't have a refinery here, they can't enjoy any of the advantages of refining crude locally or refining crude here, as we talked about earlier. It would be a much more expensive proposition for them, wouldn't it?

10

MR CAPLAN: Otherwise it would be happening.

MR MARKS: I only ask that because it is important for the Commission to understand - it's second nature to you gentlemen - but it is important for us to understand what the alternative source position really is and whether there really is realistically, as opposed to in theory, that prospect. The answer is, in this market, no, is it not?

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MR CAPLAN: It is, in this market, no, in my view, but it has been the case in the past that imports have come in. It may be the case in the future that imports will come in, and the product flows globally are such that they will find a way in if there is a cheaper source of supply from outside than inside. They will do that. Chris mentioned before that a refinery is under construction in Jamnagar in India. That refinery has the same productive capacity as all seven Australian refineries put together.

25

MR MARKS: That's been mentioned a number of times.

30

MR CAPLAN: And our anticipation is that the cost per litre out of that refinery will be far below what we can produce or can see any of the Australian refineries produce. When that opens, there will be a new reality in that region. How the market reacts to the new reality, we will see how it plays out.

35

MR MARKS: When might that reality crystallise?

MR CAPLAN: We think somewhere end of 08, before the second half of 09.

MR MARKS: Will the reality be, though, that the petrol which is available from that refinery, if it is to find its way on to the Australian market, would do so really only through either the majors or perhaps some independents presently in Australia?

40

MR CAPLAN: How else might it get in?

45

MR MARKS: It might get here by an international refiner itself taking up - perhaps the refiner concerned, taking out, through a subsidiary or family member of its own, production in Australia.

MR CAPLAN: Why mightn't that happen?

MR MARKS: I'm asking you might it happen?

5 MR CAPLAN: Of course.

MR MARKS: My question is not it won't but, rather, might it?

MR CAPLAN: Of course, it could.

10

MR MARKS: Is that in the family of possibilities that you are thinking about when you think about the crystallisation at the end of 2008?

MR CAPLAN: Yes.

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MR MARKS: It's a possibility?

MR CAPLAN: Yes.

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MR MARKS: All right. Is it the position, though, that you say, look, we can't, in terms of the impact on price, tell you what that might mean at the moment for Shell or for customers?

MR CAPLAN: That's absolutely correct.

25

MR MARKS: All right. Now, it is an important possibility, though, isn't it?

MR CAPLAN: Yes.

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MR MARKS: And from Shell's perspective as a refiner and business entity, it is important, I would suspect, for Shell to understand that possibility and to have predicted the possible outcomes; is that not so?

MR CAPLAN: Yes.

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MR MARKS: Has Shell done that?

MR CAPLAN: Yes.

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MR MARKS: In closed session or on notice, would Shell be prepared to share with us that information?

MR CAPLAN: Yes.

45

MR MARKS: We would be grateful. Thank you. Can I ask you then, if you might help a little further - I want to come now on to the mainland and talk about where Shell is and where it sits in the market. Can I start, Mr Caplan, please, by just asking you some clarification questions about terminalling and so on. On page 3 of the

submission you say right up the top, look, there are many terminals into which fuel can be imported into Australia, and shell imports fuel into a number of different locations, including some that are independently owned. I'm sorry if this seems a little tedious, but just to make sure that the Commission is fully cognisant, in its
5 endeavours to get to the bottom of all this, of what the picture is, can I ask you these questions. I know that some information has been provided to us. I am cognisant that that is in what I would describe as a confidential section of the information. If I trespass into that territory, help me, if you will, but I'll try not to. Can I ask you, first of all - I might do this, if you don't mind, on a state by state basis. Can I pick up
10 Victoria first. Shell has the Geelong refinery in Victoria. Can I just ask - and forgive my ignorance - does that refinery supply - let me work from the top down - does it supply all of Victoria's petrol requirements?

15 MR CAPLAN: It - structurally, yes; in practice, no. With - - -

MR MARKS: I hope you understood my question to mean insofar as Shell is concerned.

20 MR CAPLAN: Yes, I do. That is to say - - -

MR MARKS: What do you mean by that difference?

25 MR CAPLAN: The difference is, for instance, we might import a cargo into Geelong if there is a glitch in the refinery or something of that nature.

MR MARKS: I'm accepting that as read.

MR CAPLAN: Yes.

30 MR MARKS: Subject to that operational reality, does the Geelong refinery supply all of Shell's Victoria petrol consumption requirements?

MR CAPLAN: Yes.

35 MR MARKS: Now, can I just go on from that. Shell does have some terminalling space in Victoria, though, outside the Geelong refinery, does it not?

MR CAPLAN: Newport.

40 MR MARKS: Tell me quickly about Newport. Can we talk in open session about its capacities?

MR CAPLAN: I would prefer not.

45 MR MARKS: All right. Can you just give me a signal about its capacity? Is it significant? How important is it for Shell?

MR CAPLAN: It's significant, but it is barely adequate to meet the operating needs of Shell. So we are - I wouldn't say that we're entirely hand to mouth, but the tank turns in Newport and Geelong are very frequent.

5 MR MARKS: Yes, I see. I will come back to that, if you don't mind, a bit later. But if there is importation into Victoria, is it into Geelong or into Newport?

MR CAPLAN: By us?

10 MR MARKS: By Shell.

MR CAPLAN: It could be into either.

15 MR MARKS: You have got import, wharf facilities and so on for either location?

MR CAPLAN: Yes.

20 MR MARKS: Thank you. The difficulties or the constraints, perhaps to put it more accurately, are they size related, are they wharf size related? Are you able to give us any indication in open session as to just what broad constraints beset Newport and, if so, Geelong?

25 MR MIDGLEY: The wharf limits the size of the ship that we can bring in and how laden it is. The tankage significantly constrains the quantity that we can bring in.

MR MARKS: All right. Apart from those two facilities, is there any other terminalling that Shell has in Victoria?

30 MR MIDGLEY: No.

MR MARKS: Then can I just go next door to Tasmania. Can you just tell us firstly - this might be quite wrong - but so far as Shell is concerned, does the supply into Tasmania all take place from the Geelong refinery?

35 MR MIDGLEY: Predominantly.

MR MARKS: What do you mean by that?

40 MR MIDGLEY: For Shell's needs, it predominantly comes from Geelong when it's operating well. However, we can also optimise to bring it from Sydney, and occasionally via imports. So it would be an economic decision.

45 MR MARKS: But you will have always that option, that, if you like, family of choices.

MR MIDGLEY: Correct.

MR MARKS: But in terms of its day-to-day operation, you said "predominantly".
What do you mean by that?

MR MIDGLEY: The most effective supply is from Geelong - - -

5

MR MARKS: Clearly so, but forgetting what is most obviously is the case, what, in terms of practical volumes - is it 95 per cent comes from Geelong in an average year? Can you give us some indication so that we can understand it?

10 MR MIDGLEY: About 90 per cent on a year where the refinery runs well.

MR MARKS: Is operating, so, so maybe significantly less in a bad year?

MR MIDGLEY: It has been significantly less over the last couple of years.

15

MR MARKS: Might it fall to as low as 70 per cent?

MR MIDGLEY: I don't have an exact figure at this time.

20 MR MARKS: Can I quickly then ask you about Tasmanian terminalling space.
There is Devonport, isn't there?

MR MIDGLEY: Correct.

25 MR MARKS: That's open - Devonport is shared with Caltex; is that so?

MR MIDGLEY: That's correct.

MR MARKS: Is that a significant terminalling space for Shell?

30

MR MIDGLEY: None of the terminals in Tasmania are significant, from the point of view of ability to import sufficient cargoes; they are adequate for the supply cycle for Tasmanian demands.

35 MR MARKS: But does that mean that Shell would not have any available space there to offer terminalling facilities to anyone else? I take it that the position in Victoria is that; can I safely also do so in Tasmania?

MR MIDGLEY: Yes.

40

MR MARKS: There is also in Tasmania some facility in Hobart, is there? Is it terminalling - the joint terminal with Caltex?

MR MIDGLEY: Correct.

45

MR MARKS: Is that the same position there?

MR MIDGLEY: Yes.

MR MARKS: Just tell me about Bell Bay. What's the position at Bell Bay? Is that Mobil?

MR MIDGLEY: That's now been taken over by Mastelle.

5

MR MARKS: From who?

MR MIDGLEY: From Mobil.

10 MR MARKS: Might that offer - you don't know in the future, but in terms of size and location, might Bell Bay be a possibility for Shell?

MR MIDGLEY: It's a possibility, yes.

15 MR MARKS: That's not that helpful. Do you want to take me a bit further along that? That is unlikely or - - -

MR MIDGLEY: With the current terminal infrastructure we have, we would not have a requirement for Bell Bay. But we are constantly tight - - -

20

MR MARKS: Have you got any wharfage constraints there?

MR MIDGLEY: Not wharfage constraints. The size of ships that are bringing in - - -

25

MR MARKS: What are the size ships that you - is it still the 30 - - -

MR MIDGLEY: About 30,000 tonne to 35,000 tonne vessels.

30 MR MARKS: Is that only for Victoria and Tasmania, or is that the average size cargo that Shell is working on all around the Australian mainland?

MR MIDGLEY: Yes.

35 MR MARKS: The latter?

MR MIDGLEY: Yes.

40 MR MARKS: Can I then ask you a slightly different question, but it's related - apart from itself, and its own needs, does Shell in Tasmania supply either of the majors that do not have a refinery in Victoria?

MR MIDGLEY: Yes.

45 MR MARKS: With fuel?

MR MIDGLEY: Yes.

MR MARKS: Which or both, is it? If it's not both, can you tell me which, please?

MR MIDGLEY: We supply - it varies - it's through the buy/sells, so it will vary
5 from buy/sell cycle to buy/sell cycle. So over the last two to three years, we have
supplied all of the majors. Mobil - - -

MR MARKS: Exclusively?

MR MIDGLEY: At times exclusively. At times, they have been supplied by two of
10 the majors. So it will change around the buy/sell negotiations, in terms of the best
economics that apply.

MR MARKS: Is it exclusive at present?

15 MR MIDGLEY: No.

MR MARKS: Can I then jump up to New South Wales. That's a home refinery
state. Mr Caplan, generally speaking, New South Wales requirements for fuel from
20 Shell, are they satisfied from the Clyde refinery?

MR CAPLAN: Yes.

MR MARKS: Can I take it that the position is broadly similar to that already
25 described in relation to Victoria, namely, subject to shut downs and aberrations in the
operation, they will satisfy the predominant need?

MR CAPLAN: Yes.

MR MARKS: Does that again equate to about 90 per cent, on average, of the need
30 in, say, an annual period?

MR CAPLAN: Yes.

MR MARKS: There are in New South Wales some other options, of course, in
35 Shell's family of choices. There is the Vopac terminal, isn't there, in Sydney. Shell
has an ongoing right to space at Vopac, does it not?

MR CAPLAN: Yes.

40 MR MARKS: Can you tell us in open session, without going to figures, is that a
substantial storage space?

MR MIDGLEY: For gasoline, no.

45 MR MARKS: For diesel, is it different?

MR MIDGLEY: Diesel is limited. It's only for jet fuel that we have, I would say,
substantial terms.

MR MARKS: Does Shell use Vopac for gasoline?

MR MIDGLEY: Yes.

5 MR MARKS: It does? On an ongoing basis?

MR MIDGLEY: Yes.

10 MR MARKS: Then there is Newcastle, isn't there? What's the position at Newcastle?

MR MIDGLEY: Newcastle is fed by pipeline from either the Caltex refinery or from the Clyde refinery.

15 MR MARKS: From where? You will need to speak up.

MR MIDGLEY: Either from the Caltex refinery or from our refinery.

20 MR MARKS: That terminal, is it jointly owned?

MR CAPLAN: It's a Mobil refinery, jointly with Mobil.

25 MR MARKS: Thank you. Now, the imports of fuel - I didn't ask you about Melbourne; perhaps I should. The imports of fuel into Sydney/New South Wales, where are they to? There is the Shell refinery itself. I imagine it has storage facilities there. You can import into those facilities?

30 MR MIDGLEY: With difficulty. The Shell refinery is fairly unique in being almost land locked and supplied by a single pipeline from Gore Bay, which carries both dirty products, so the crude and feedstocks which feed the refinery, and has the ability to do clean products. But it's a logistically difficult operation to import clean products through.

35 MR CAPLAN: We don't like importing products, as opposed to crude, into our refinery at Clyde. It presents us with all manner of operational difficulties.

MR MARKS: I see. All right. Does that mean that you will have to avoid it at all cost, or is the reality that it always happens?

40 MR CAPLAN: The reality is not that it always happens. We try to avoid it - but we are not always successful in avoiding it.

45 MR MARKS: Is the reality, then, that the Newcastle option - is there any other option in New South Wales, apart from Vopac?

MR MIDGLEY: Newcastle doesn't have the capability to be imported.

MR MARKS: Is the reality, then, that there isn't a great import facility in New South Wales for Shell?

MR MIDGLEY: Yes.

5

MR MARKS: If it does import into New South Wales, is it always from Singapore?

MR MIDGLEY: I don't - - -

10 MR CAPLAN: It's always via Singapore - what we described earlier. The product could come from anywhere.

MR MARKS: Okay. And would Shell - I think Shell has provided some information about imports. That information will provide us with the import source.

15

MR CAPLAN: Largely, mostly, it would have come from Geelong - imported to Sydney, but - - -

20 MR MARKS: But from local. Let's go up the coast, then, into Queensland. Now, this is a non-refinery state?

MR CAPLAN: Yes.

25 MR MARKS: What's the position here? First of all, let me take Brisbane. Shell's supplies of fuel into Brisbane, where do they come from?

MR MIDGLEY: Probably through our buy/sell negotiations.

30 MR MARKS: Is there a particular partner in the buy/sell arrangements that services Shell's Brisbane needs?

MR MIDGLEY: No.

35 MR MARKS: What about Shell terminals? Can you import - before I leave Brisbane - can you import into Brisbane?

MR MIDGLEY: Yes.

MR MARKS: Without constraint?

40

MR MIDGLEY: Other than tankage constraints, the wharf can take an MR.

MR MARKS: A what?

45 MR MIDGLEY: Can take an MR, a 35,000 tonne vessel.

MR MARKS: Then what about regionally? You have Townsville?

MR MIDGLEY: Correct.

MR MARKS: That's a joint terminal with Caltex, is it not?

5 MR MIDGLEY: Yes.

MR MARKS: Is that a substantial import destination for Shell?

10 MR CAPLAN: Not for petrol.

MR MARKS: Not for petrol? Any available storage space there, or do you have limited space?

15 MR MIDGLEY: Yes.

MR MARKS: Then there is Gladstone - what's the position in Gladstone?

MR MIDGLEY: Very little gasoline, and, again, very small storage.

20 MR MARKS: Mackay? Same?

MR MIDGLEY: Same.

25 MR MARKS: Then - there is some space in Cairns, is there not?

MR MIDGLEY: We have storage in Cairns, yes.

MR MARKS: Is that shared or - - -

30 MR MIDGLEY: That's our own.

MR MARKS: Is that - what's that like in terms of capacity?

35 MR CAPLAN: All the same.

MR MIDGLEY: The tonnage is based on the supply cycle.

MR MARKS: Pinkenbah is rather larger, isn't it?

40 MR CAPLAN: Brisbane.

MR MARKS: That is Brisbane, of course. I should have mentioned that in the Brisbane context. Is that a principal import designation for Shell, if necessary?

45 MR MIDGLEY: Not for gasoline.

MR MARKS: Not for gasoline. What is it principally used for? It's quite a large storage space.

MR MIDGLEY: In comparison to our other terminals, it's large but that's really a reflection of the market demand in the Brisbane area. We do import some of our more speciality products into there. It's a broader availability of products.

5 MR CAPLAN: Principally, our Brisbane supplies come via the buy/sell.

MR MARKS: Does that mean that there is in practice not much capacity at Pinkenbah? Is it all used?

10 MR CAPLAN: It's all used for operational purposes.

MR MARKS: Just quickly, WA, what's the position there? First of all, the Perth market .

15 MR CAPLAN: Yes.

MR MARKS: Shell buys on a buy/sell its principal Perth needs, or does it obtain by imports?

20 MR MIDGLEY: Buy/sell.

MR MARKS: I take it there is some importing into Perth?

MR MIDGLEY: Very seldom.

25

MR CAPLAN: Minimal.

MR MARKS: What's Shell's terminalling ability in Perth?

30 MR MIDGLEY: Very limited on gasoline.

MR MARKS: Is the practical reality that it does not import?

MR CAPLAN: Yes, that's the practical reality.

35

MR MARKS: Then what about, a little more broadly, in Western Australia, I think there is Fremantle, there is Geraldton. Can you tell us a bit about Esperance and maybe Port Hedland? Can you just tell us about the terminalling space there?

40 MR MIDGLEY: Esperance has no capacity at all. The rest of the terminals it's a - are all very, very small.

MR MARKS: You will need to speak up. The transcript needs to pick this up.

45 MR MIDGLEY: They are predominantly there for gas demand or diesel demand for those areas driven by the mining and offshore operations.

MR MARKS: Yes, I understand. Is there any third party storage in Western Australia?

MR MIDGLEY: Yes.

5

MR MARKS: Available to Shell?

MR MIDGLEY: Yes. Coogee is a terminal that could - - -

10 MR MARKS: That's Gull?

MR MIDGLEY: Gull has their own terminal as well. Both of those terminals, in theory, are terminals - - -

15 MR MARKS: What about in practice, does Shell use them?

MR MIDGLEY: No.

MR MARKS: Anything else in the Western Australian region that Shell - no?

20

MR CAPLAN: Yes, there is the Verve --there are independent tanks in Perth which are - - -

MR MARKS: Who is that, Mr Caplan?

25

MR CAPLAN: V-E-R-V-E, which are associated with Western Power, so they have those tanks for their own needs and, as I understand it, are available to be used.

MR MARKS: Thank you. Do you know anything about their capacities?

30

MR CAPLAN: No.

MR MARKS: Thank you. South Australia, Port Lincoln, I think, and there might be another one. Can you just tell me the South Australian position, please? Again it's a non-refinery state.

35

MR CAPLAN: Yes.

MR MARKS: Does the fuel that Shell supplies in South Australia come predominantly from buy/sells, from imports? What's the position in South Australia?

40

MR MIDGLEY: A combination of imports and buy/sells. Again, limited tankage for gasoline, albeit, of course, there is Port Stanvac, the old refinery tankage, which - - -

45

MR MARKS: Is that utilised?

MR MIDGLEY: It's not, it's in mothballs, but in theory, tankage could be available in future.

5 MR MARKS: But not utilised at the moment by anybody?

MR MIDGLEY: No.

MR MARKS: What about Birkenhead? There is a substantial storage - - -

10 MR CAPLAN: That's Adelaide.

MR MARKS: That's Adelaide itself. Is there a substantial - is that joint? I think that terminal is - - -

15 MR MIDGLEY: Mobil and Shell.

MR MARKS: Does Shell have a substantial capacity, storage capacity there, any constraints?

20 MR MIDGLEY: Constrained by the import cycle. The tankage is about matched to the import cycle.

MR MARKS: I see. So, it's adequate?

25 MR MIDGLEY: Adequate, yes.

MR CAPLAN: This answer has been given several times. I just want to make sure that you have understood what he is trying to say. The size of the tankage and the adequacy is totally proportional to the number of times you come to fill it up. So it is what it is in terms of capacity. But the small tanks have to be filled up a lot if the demand is big. That's basically what he is saying. So, by definition - - -

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MR MARKS: Given the type of tankers, the 35,000 tonne tanker that's predominantly used, you said, the import, there is a match. I took that to mean that, in terms of tankage, there was adequate storage to mean ongoing tankage import occurrences?

35

MR CAPLAN: I think that's the point. In case you have concluded that the tankage is adequate for the full discharge of a 30,000 tonne, it's not.

40

MR MARKS: It's not? That's important.

MR CAPLAN: So, you are going to have to do milk runs and drop bits and pieces.

45 MR MARKS: So what does Shell do, in practice?

MR CAPLAN: We do that.

MR MARKS: How? You say you do milk runs. What does that mean?

MR CAPLAN: We do a multiple port discharge, if necessary.

5 MR MARKS: In that place to where?

MR MIDGLEY: If you take Tasmania, that will be one vessel will go with a mix of three different products, or probably four products, which will be dropped off into three terminals. So it will go from one to the other to the area. Similarly for South
10 Australia, it may be two drops, it may be into Esperance and then into Adelaide. It is capable of taking a single MR of mixed products. I think if you wanted to quantify better what you would call adequate, it's probably best to reflect the number of times there has publicly been issues around supply availability. I think in South Australia it would be fair to say that there have been two or three occasions this year. In
15 Tasmania, regular occasions where there has been concern about supply and availability. So that tends to give you an indication of how adequate that storage is. It is just about adequate. You have your supply.

MR MARKS: Thank you. Just going Darwin, can you tell us what the position is
20 there? Obviously, the Vopac terminal, that's what Shell uses, is it not?

MR CAPLAN: Yes.

MR MARKS: Shell has no independent terminalling - Shell itself has no
25 terminalling in Darwin apart from the Vopac facility?

MR CAPLAN: Correct.

MR MARKS: Shell imports into Darwin?
30

MR MIDGLEY: Yes.

MR MARKS: Does it import all of Darwin's needs, all of Shell's needs?

35 MR MIDGLEY: For Shell needs, yes.

MR MARKS: What about the Northern Territory, more generally, can you help me?

MR CAPLAN: There is very little additional. Darwin is pretty much the
40 predominant market.

MR MARKS: Does Shell also supply the other majors in Darwin?

MR MIDGLEY: Yes.
45

MR MARKS: Is it right to say that the other majors that operate in Darwin obtain all their petrol needs in that city from Shell?

MR CAPLAN: We would have to get back to you.

MR MIDGLEY: I will take that on notice, if I can.

5 MR MARKS: I would be grateful if you would. I would be grateful also if you could include within that question the independents. United operates in Darwin. If Shell supplies United in Darwin we would be glad to know, and if there are any other parties that operate in Darwin, if Shell supplies them we will be glad to know, please.

10 Mr Chairman, would it be a convenient time to have a short break?

THE CHAIRPERSON: I'm sure that Mr Caplan and his colleagues would probably appreciate it.

15 MR MARKS: If we said till perhaps 12 o'clock?

DR KING: You still have open session questions, Mr Marks. do you not?

MR MARKS: Oh, yes, I certainly have.

20

THE CHAIRPERSON: We will break till 12.

ADJOURNED

[11.52 am]

25

RESUMED

[12.03pm]

30 THE CHAIRPERSON: Mr Marks?

MR MARKS: Thank you, Mr Chairman.

35 THE CHAIRPERSON: I perhaps should just say that if there is a point in time when you feel like a break, just signal.

40 MR MARKS: Thank you for your answers thus far. Can I just tie up the question of terminals with a couple of further questions, one just picking up something you said. There is some - is it in Perth, Kwinana, some terminalling space in Perth that you have but don't use, is that correct, or access to you have but don't use?

MR CAPLAN: The Coogee, the Gull, they're active terminals.

45 MR MARKS: Yes, but is it Kwinana?

DR KING: Sorry, I think it was Coogee actually.

MR MARKS: It may have been Coogee. When you say they are active but you don't use them, what does that mean.

MR CAPLAN: Others use them.

5

MR MARKS: Is there some reason why Shell doesn't use them? Is it just because there is no need or?

MR CAPLAN: Because there is no need.

10

MR MARKS: I gleaned that that is really what you had already said. I just wanted to clarify it. Can I ask you some broader questions about terminalling just going beyond Shell, just so that I understand what the terminalling issue really is all about. It sounds, Mr Caplan, from what Shell is saying in answer to my questions that terminalling space is at a premium for Shell?

15

MR CAPLAN: Yes.

MR MARKS: Shell's capacities are less than adequate in a number of different locations?

20

MR CAPLAN: Yes.

MR MARKS: They are adequate in others but may not always be adequate?

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MR CAPLAN: Yes.

MR MARKS: Is the position that Shell effectively has no terminalling space in Australia available for use by any other party such as an independent?

30

MR CAPLAN: Yes.

MR MARKS: Is it likewise true that that position is unlikely to change in the foreseeable future?

35

MR CAPLAN: Yes.

MR MARKS: Is it the position that Shell is however itself constantly considering its terminal infrastructure?

40

MR CAPLAN: Yes.

MR MARKS: And that Shell may make changes to that infrastructure in the future to accommodate its own needs.

45

MR CAPLAN: Yes.

MR MARKS: And I might ask you some further questions about that later. Picking up on that, can I ask you some more questions. Is it right to say, do you think - and I only want your view based on your knowledge - that quite apart from Shell there is in any event inadequate terminalling facilities in Australia to enable independents to effectively import?

MR CAPLAN: Yes.

MR MARKS: Is it true to say that as a consequence of that there is at least at the present time very little, if any, opportunity for even the large independents - and I'm thinking here of United and the like - to import petrol on to the market?

MR CAPLAN: Yes.

MR MARKS: You might say to me, look, in the end there is an economic question for the independents as to whether they want to provide or obtain terminalling space, but just as things presently stand there is no terminalling availability? I took for granted your qualification. Everybody has the opportunity to invest.

MR MARKS: The only reason I even mentioned that qualification, as obvious as it means, is because it is in Shell's submission and I thought I ought to do justice to it.

MR CAPLAN: That's very kind of you.

MR MARKS: Is the reality that the independents are really obtaining and can only obtain their fuel from the majors?

MR CAPLAN: Yes.

MR MARKS: And the consequence of that, therefore, is that they are in a sense beholden to the majors for their - all of their wholesale supplies?

MR CAPLAN: Yes.

MR MARKS: That places them in a position of natural disadvantage, does it not, when they endeavour to compete as wholesalers on the Australian market?

MR CAPLAN: I would only - I would comment that they have the possibility of taking supply from domestic refineries and majors and importing.

40

MR MARKS: Yes.

MR CAPLAN: So to the extent that domestic refiners would compete for the business of the major independents.

45

MR MARKS: Yes.

MR CAPLAN: There is competition takes place there. To the extent that the major independents wish to procure supplies from outside the country, they would have to resolve their terminalling issues to do so. So what suffers there is time.

5 MR MARKS: Yes, but there is another point, too, isn't there, and that is that the reality you have just described affects the ability of the independents to negotiate prices with the oil majors?

MR CAPLAN: It may do.

10

MR MARKS: May do?

MR CAPLAN: Well, it depends on how badly any one oil major wishes to have the business versus another oil major. That's the qualification.

15

MR MARKS: Yes, I see. But in truth in a market where price is based on alternative supply, and there is no realistic alternative supply save and except for another Australian major, they are at a significant competitive disadvantage insofar as they are endeavouring to supply fuel on to the wholesale market; would you agree?

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MR CAPLAN: Yes.

MR MARKS: Do you think that disadvantage has been accentuated by the imposition of the fuel standards?

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MR CAPLAN: Yes, I do.

MR MARKS: Do you think that that reality of the fuel standard imposition will endure and on an ongoing basis place them at a significant disadvantage or do you think it might change?

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MR CAPLAN: We addressed that question earlier. Over time I think that the Australian Standards will be less unique in the region than they are today, and to the extent that happens then the product that they seek will be more readily available at an equal price as far as the quality component is concerned.

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MR MARKS: My question was a little differently focused. I accept that we did have that discussion, but that was really about the availability of fuel as you have just confirmed. My question is really a broader one and incorporates the disadvantage they enjoy in infrastructure and terminalling capacity. There may be fuel that becomes more and more available on the market. They may have no more access to it than they do now because they don't enjoy the terminalling infrastructure. My question therefore on that premise is this: will that disadvantage endure, do you think, by reason of the size of the Australian market, the economies of scale that are - must inevitably be taken into account or might it change?

45

MR CAPLAN: Sorry, I thought you were asking a question about product quality differential last time around. I believe that the logistics disadvantage and the storage disadvantage will endure unless and until somebody builds more storage.

5 MR MARKS: Is that realistic? It has been. Vopac built storage. Vopac built storage in Darwin. Vopac at the time built storage ahead of the current demand. So if history is any guide it's not impossible.

10 MR MARKS: Vopac's present facilities are taken up almost exclusively, are they not, by the majors' requirements? Vopac extended its present facility, has the capability of further extending the present facility. And you'd have to ask Vopac what they want to do, but my understanding is that they previously extended on the basis of business they thought they were going get, which has turned out to be a sensible decision by them.

15 MR MARKS: If we understand Vopac's position correctly, and it was put in open session, Vopac would only increase its terminalling space in the event that, say, an independent, was prepared to commit on an ongoing basis to utilisation of that facility. That's a very difficult decision for an independent in this market.

20 MR CAPLAN: It certainly is.

MR MARKS: Can I suggest to you that logic dictates it will become a growingly difficult decision for an independent in the Australian market, would it not?

25 MR CAPLAN: Why?

MR MARKS: Having regard to the size of the market, having regard to the economies of scale, having regard to the availability of Australian produced fuel and so on, do you not agree with that? Or you don't know?

30 MR CAPLAN: I simply don't know. And the reason I say that is at any stage when independents have appeared in our market or where terminals have appeared, these have been brave decisions by the entrepreneurs involved. And I simply don't say that won't happen in the future.

MR MARKS: But if you look at the market - I know this question is necessarily at a high level, but it is helpful to have your view it. If you look at the trends in the market, you have a trend for gasoline which is, I don't want to say stagnant, but it's not growing rapidly.

40 MR CAPLAN: Mhmm.

MR MARKS: You have a different trend for other products?

45 MR CAPLAN: Mhmm.

MR MARKS: You've got the realities of environmental constraints. My question really is built on those realities. Is the position that whatever the difficulties infrastructure wise that independents currently face, they are likely to get worse rather than better in the future, would you agree?

5

MR CAPLAN: I can see how you could come to that conclusion. And I wouldn't have any basis for saying that's a bad conclusion.

MR MARKS: Let me move on. I want to ask you some questions about buy sell now, which is the next source, if you like, of fuel for Shell to satisfy its volume requirements. You have made some statements about the buy sell arrangements - they are necessarily perhaps, but in any event, very high level statements on page 3 and on to the top of page 4 of the submission. There are some other statements that Shell has made and I want to ask you some broad questions without trespassing too much into sensitive territory. Can I just ask you, first of all, some questions, which I might describe as of a more generic kind that are not necessarily limited to Shell, and see if you can help me. Just in terms of the public's understanding of this, as well as the Commission's, can you describe to us how buy sell operations work, and perhaps I will ask you a few questions. First of all, are buy sell arrangements exclusively the province of the refiner marketers?

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MR CAPLAN: Yes.

MR MARKS: And why is that?

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MR CAPLAN: Taken from Shell's - well, let me think about qualifying the answer "Yes" that I gave you earlier. I think the reason is this: in any one location, we look to - where we have a refinery - we look to quit the product of the refinery. We wish to fully utilise the refinery. We can do that through selling through our own channels, retail, et cetera; selling to competitors, that is, buy sell; or exporting; or any combination of those. We look to use the combination that makes the most economic sense for us in the location.

30

Where we are in an environment where we don't have a refinery but we have a market, we either buy from a competitor, we transport product from our own refinery, which is distant, or we import, and we take the course of action which makes the most economic sense to us. That might change from time to time. And Mr Midgley and his organisation are charged with continuously looking at what makes most economic sense for us in a sustainable way. So that qualification I included, because now to your question are buy sells limited to the majors, simply as a definition, yes, we do buy product from and sell product to majors as part of our suite of procurement or sales possibilities. Does that make sense to you?

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MR MARKS: Yes, indeed it does, but the buy sells really are - there is a reciprocity about them, but they are exclusively buy and sell arrangements, aren't they?

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MR CAPLAN: Yes.

MR MARKS: And they operate separately as buy and separately as sell?

MR CAPLAN: Yes.

5 MR MARKS: Now, why then in practice - they might not be buy arrangements between Shell and, say, an independent, but could there nevertheless not be sell arrangements on a buy sell basis between Shell and, say, another player, an independent in the market?

10 MR CAPLAN: Whenever we sell anything to anybody, we try to do the best we can out of the sale. So we have negotiations with big independents and we sell to them - - -

MR MARKS: But not on buy sell?

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MR CAPLAN: Well, just let me finish. The price that we get from the big independents might or might not be equal to the buy sell price, and in a - in a closed session we can give you - we can give you data on that. As you know, we have given to the Commission our contracts with major customers and our buy sell contracts, so the data is in there to enable the exact answer to that question.

20

MR MARKS: Thank you. We have that information. The reality is, though, that Shell has never entered into a buy sell arrangement, as such, with other than another refiner marketer, has it?

25

MR CAPLAN: That's the reality. Since a non-refiner has nothing to sell us.

MR MARKS: Of course. But it has - I'm just saying - I asked you a moment ago and I said they were exclusively - although they are called buy sell, they are different creatures, there are buy arrangements and sell arrangements?

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MR CAPLAN: Correct.

MR MARKS: Perhaps I should have tightened my question. Shell has never entered into a sell arrangement, in a buy sell sense, with anybody but a refiner marketer, is that so?

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MR CAPLAN: With who? And then I'm not understanding the question, because we have sell arrangements to major independents.

40

MR MARKS: Of course, you do. Let me put the question differently. What Shell says, doesn't it, is that it has a family of arrangements which have similarities with but are exclusive, in that they have differences called buy sell arrangements that it enjoys with the other refiner marketers, would you agree?

45

MR CAPLAN: Yes.

MR MARKS: That suite of arrangements is exclusive to the refiner marketers, is it not?

MR CAPLAN: Yes.

5

MR MARKS: The purpose of the arrangements, you have said, are to ensure that Shell - in the selling sense, but more broadly as a refiner, has adequate supplies of product in locations where it does not have a home refinery?

10 MR CAPLAN: Yes.

MR MARKS: And it is one of the options available in a suite of options to the refiner in a non-refinery state and the others of which are transport and import?

15 MR CAPLAN: Yes.

MR MARKS: Just tightening up the questions a little, from Shell's perspective, does that mean that Shell is principally a seller in its home refinery state - or states of New South Wales and Victoria under its buy sell deals?

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MR CAPLAN: Yes.

MR MARKS: And therefore - or it follows, I suspect, that it's principally a buyer in its non-refinery states, such as Perth and South Australia and so on, and that's the position, isn't it?

25

MR CAPLAN: Yes.

MR MARKS: Darwin is a little different. It's principally a seller in Darwin, is it not, under its buy sell arrangements?

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MR CAPLAN: Yes.

MR MARKS: In fact, I'm not sure that it's a buyer at all in Darwin. That's something I think you were going follow up for me.

35

MR CAPLAN: Yes.

MR MARKS: But I'll assume that for the moment. Can I ask you a little bit more about these arrangements just at a fairly generic level for the moment. The buy sell arrangements are replacing, effectively, the old exchange agreements that used to exist. Why were those changes introduced, can you tell me, and who was responsible for their introduction, Mr Caplan?

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MR CAPLAN: I don't know who was responsible for their introduction, but within our company we came to the conclusion that the buy sell arrangement was more transparent and took away the notion of volume reciprocity which had been a cause of concern to external parties, and constantly - - -

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MR MARKS: Who do you mean by "external parties"?

MR CAPLAN: In this Commission and others, constantly the question of whether or not embedded in that reciprocity was something sinister, was one that we were called
5 upon to answer, and I think, as far as I can see, never succeeded in putting that issue to bed. And so, from our point of view, to have separate arrangements without volume reciprocity with each transaction valued by international benchmarks was more transparent and more easily explainable.

10 MR MARKS: All right. When you say "valued by international benchmarks", can I just take up that point. These arrangements, they would appear to incorporate elements which are, broadly speaking anyway - and you will have to help me here - similar to the arrangements or the components, to more correctly describe them, of pricing in the market more generally at wholesale?

15 MR CAPLAN: Yes.

MR MARKS: For example - and if I'm wrong about this, please tell me - they incorporate the regional Platts benchmark?

20 MR CAPLAN: Yes.

MR MARKS: Do they do that by picking up that benchmark as the base determining price?

25 MR CAPLAN: Yes.

MR MARKS: Is that the case in all buy sell arrangements between the parties?

30 MR CAPLAN: Yes.

MR MARKS: And then is the relationship or the similarity this, that likewise, they pick up - in having picked up the benchmark price, they pick up other components, such as freight and wharfage and these other things that are features of the wholesale
35 price?

MR CAPLAN: Yes.

MR MARKS: All right. Now, can I ask you just a few more detailed questions
40 about these matters. But my questions are generic, if you will forgive me, and then I may ask you some more specific questions about Shell later. Can I, first of all, ask you about the benchmark. Just help me here. Is the grade benchmark the - in buy sell contracts, the 95 benchmark, the 92 benchmark or both?

45 MR CAPLAN: In our case, it's both.

MR MARKS: All right. Apart from reciprocity, that is, other refiners and Shell, do you know if the other refiners also use both or if they use the 95 benchmark?

MR CAPLAN: We don't know.

MR MARKS: You don't know. Is there, in Shell's case, a reason that you can tell us publicly why both rather than one is used?

5

MR CAPLAN: Yes. Each buy sell arrangement is a bargain between two parties, and the outcome depends on the negotiation. So, in some cases, the outcome of that negotiation is a 95 benchmark; in others, it's a 92 benchmark. I would add to that it doesn't matter, because you finally get to the price, so the price is either
10 92 benchmark plus a quality premium, or 95 benchmark plus a different quality premium, each equalling the same outcome. So, in our sense, it doesn't matter very much - in fact, it doesn't matter, never mind "very much" - whether you start at 92 or whether you start at 95, you are adding a different quality premium to get to the
15 outcome.

MR MARKS: Just to pick up the point in the public record, in the 95 case it might be the benchmark plus X; in the 92 case it might be the benchmark which is - - -

MR CAPLAN: Plus X plus a bit.

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MR MARKS: Plus X plus a bit?

MR CAPLAN: Correct.

25 MR MARKS: The final amount, though, might be exactly the same?

MR CAPLAN: Correct.

30 MR MARKS: If that is so - and I accept what you say about it - then how does - you say, look, it's part of an outcome of negotiation. If price is not a consideration, then what is the consideration in negotiation for one or other benchmark, from Shell's perspective?

35 MR CAPLAN: From Shell's perspective, the outcome is depending on what our alternatives are. So that sets, if you like, the level - we have to beat the alternative in our negotiation with our counterparty, which might be bring it from our own source or import it. So we know what those two values are. In our negotiation with our counterparty, we try to do better than that, otherwise we would take the other alternatives. What affects how we treat that is how badly we want to sell or how
40 badly we want to buy where we haven't got it. In a sense, that's just a normal commercial deal. So, if we have very poor alternatives, we are disadvantaged in relation to a negotiation which we might have with a counterparty who is trying to sell us something, and we fully expect our counterparty in each transaction is trying to maximise his own position.

45

MR MARKS: Does Shell have preference for one or other - let's take its sell negotiations. Does it have a preference for either benchmark and, if so, could you just help us with why that is so?

MR CAPLAN: We - in fine distinction, given that we think the outcome will end up the same, whichever the starting point, we think 92 is a more liquid market and therefore you see more trades and therefore you have more data points on 92 than 95. But it's really just a fine distinction, in our view, so - - -

5

MR MARKS: But what does more data points mean? Does it mean although there may not be much difference, there might be some difference?

MR CAPLAN: Not in value, just in numbers of transactions, which therefore mean that the Platts quote is refreshed more regularly for 92 than it is for 95. Simply, there are more trades at 92 than there are at 95. That would - don't take me then to be saying that you can't have entirely usable data for 95, because I think you can. It is not as if there are no trades of 95. It is just that there are more trades of 92. So, at the end, we are indifferent between the two, given the equation that I described about reaching the end point.

15

MR MARKS: All right. Insofar as you can help me in open submission, though, and the question really is this: in its sell negotiations, does Shell have a preference between one or the other?

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MR CAPLAN: We prefer 92.

MR MARKS: All right. In its buy negotiations, does Shell have a preference for one or the other?

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MR CAPLAN: We prefer 92.

MR MARKS: So it's the same in that sense. That's helpful. Thank you. Can I then ask you to tell me a bit about another component of the price, and that's ocean freight. Again, I'm really just thinking in the buy sell context here. In the buy sell context, is the ocean freight component calculated by reference to a world scale flat quote?

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MR CAPLAN: Yes.

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MR MARKS: Is that the way it always happens?

MR CAPLAN: Yes.

MR MARKS: Is the world scale flat quote the journey from Singapore to Japan or is it the journey from Singapore to Australia, in the buy sell context?

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MR CAPLAN: In the buy sells, Chris will tell you.

MR MIDGLEY: I think you are slightly confusing the flat versus the world scale. So the flat is based on what we believe will be the actual voyage, so Singapore to Geelong; that doesn't change. The world scale points, which is the traded Platts quotes, is based on the Sing-Aus quote, as opposed to the Sing-Japan quote.

45

MR MARKS: That's really the focus I did have. Thank you for drawing that to my attention. You say it's based on the Singapore-Australia quote. How long has that been the position in the buy sell context? Has it changed recently?

5 MR MIDGLEY: That has changed over the last couple of years.

MR MARKS: Be a bit more specific, if you would. These are six month deals. Tell me when the change happened and whether it occurred in all of Shell's buy sell deals?

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MR MIDGLEY: I'd have to take that on notice, to be absolutely sure.

MR MARKS: I want to know precisely, insofar as it's possible, when the movement in buy sell from the Singapore-Japan route to the Singapore-Australia route occurred.

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MR MIDGLEY: I can't give you the precise date but what I can give you is the journey that happened going from Sing-Jap to the Sing-Aus quote, which was that back in 2004, as with the shut down of Port Stanvac and with Australia becoming net short of product, the Sing-Aus quote started becoming a liquid quote because import cargoes were coming into Australia. Prior to that, there was limited liquidity in that quote and, therefore, a proxy basis had to be used using the Sing-Japan quote. So from that period, the Sing-Aus freight basis has progressively moved to becoming the basis for the buy sell negotiations.

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25 MR MARKS: All right. What is the difference in the charge? I imagine it's a per tonne charge, is it?

MR MIDGLEY: It's a - world scale is a percentage which is a multiple of the flat rate. So, in the past - - -

30

MR MARKS: What does it work out to in cents per litre or in an amount per tonne? I would have thought it - - -

MR MIDGLEY: It depends on which port you are going into.

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MR MARKS: You had better tell me both or - could we do that, because we would like to know what the real difference means, both for the buyer or seller at the buy sell level and then on from there.

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MR CAPLAN: Sure.

MR MARKS: Now, then can I ask you - I am sorry to be a bit laboured about this, but it's very helpful, I am grateful to you. Can I go to the premium standard and just ask you, in the buy sell context, I take it that there is a premium built in for that standard - - -

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MR CAPLAN: Quality premium?

MR MARKS: I am talking about the quality premium. Is there any other standard premium apart from the quality premium?

MR CAPLAN: No.

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MR MARKS: Has there ever been?

MR CAPLAN: I can't answer the question.

10 MR MARKS: Let me put the question a bit more precisely. Has there ever been a quality premium that does relate to quality but it does not relate to the changes in standards that were introduced in 2002 onwards? You see the point that I am making?

15 MR CAPLAN: I see the point that you are making, yes. In the buy sells, I think you are very specific about the specification that you are buying from your counterpart. So, in that sort of a deal, you are trying to place a very - price a very specific standard. You know, I had in mind some sort of reversion to the previous standard, where you are buying gas oil and you're selling petrol, et cetera, but now the
20 principal quality premium is to enable you - - -

MR MARKS: Go on, sorry, Mr Caplan. The principal?

MR CAPLAN: The principal quality premium, as far as I can see, is to get you from
25 a Singapore market to an Australian quality grade.

MR MARKS: I will take it, unless you tell me otherwise, that that's the only premium that is built into - or the only premium component that is built into quality. Now, just on that point, though, before I leave it, what is the premium? You don't
30 have to tell me the precise but if you could just give me a broad idea of it, across not just Shell but I want across the buy sell arrangements. These are generic questions at the moment. What is the range of premium and how is it determined?

MR CAPLAN: For our buy sell - can I introduce the term "the asking price"?
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MR MARKS: Yes.

MR CAPLAN: Because you just might not get the asking price from your
40 counterparty.

MR MARKS: Is this in a sell arrangement?

MR CAPLAN: Yes. So, what we would have in the asking price, if you like, is the
45 same quality premium that we have described in the submission that would be the quality premium we put in our terminal gate price, et cetera. That's the same. Whether you get it from your counterparty or not depends on the relative negotiating strengths of the two parties to the buy sell agreement.

MR MARKS: Are there any other matters in the buy sell context, is there any intermediate storage charges or is there anything like that that we've left out of the components we should know about?

5 MR MIDGLEY: We try to keep the terminalling element completely out of the buy sell.

MR MARKS: Okay. So the answer is no.

10 MR MIDGLEY: There has been an exception in the past, where a small terminal may have been included in WA. That has now been removed.

MR MARKS: Is the position then, Mr Midgley, that across buy sell arrangements, there may be some sort of intermediate terminalling storage charge, but so far as
15 Shell is concerned, in its arrangements, there are none at the moment? Is that what is being said?

MR MIDGLEY: Correct. Yes.

20 MR MARKS: I think you said earlier that there isn't any margin, Mr Caplan, as such. Do you want to say anything more about that? Now we're on the Australian shore now and we're in a buy sell context, and we're not dealing with exchange or out of exchange agreements; these buy sell arrangements are done on a commercial basis.

25 MR CAPLAN: Absolutely.

MR MARKS: Shell has made perfectly clear and, with respect, it follows logically that it is out to do as well out of buy sells as it can. That immediately makes me
30 cognisant of the reality that there is likely to be a margin arrangement and I want to understand it from a seller's perspective and a buyer's perspective. First of all, I assume there is. Can you explain it to me and then I will ask you about the range of margins.

35 MR CAPLAN: Yes. We have a variety of customers which include Coles, which include major independents and which include competitors. The price that we're able to charge each of them depends on the commercial negotiation that we achieve. We always attempt to get a margin. Our preference is to sell the most we can in the channel that gives us the biggest margin. As far as buy sell is concerned, where we
40 have something to sell, we attempt to get a margin. Whether or not we succeed is a question of the outcome of the commercial negotiation.

MR MARKS: You only enter into these commercial negotiations once every six
45 months?

MR CAPLAN: Yes.

MR MARKS: Can I understand, please, what your average margin is? I'm not sure whether that's something that you are prepared to share with us in open submission, but if not I want to take that up with you.

5 MR CAPLAN: Yes, not in open session.

MR MARKS: Certainly, but we'd like to do that, please. And what I want to understand is what the average gross margin is and what, in the end, the average net position is. Now, might that position - I'm just guessing here - might it differ from
10 state to state or location to location? Or is it - - -

MR CAPLAN: I simply don't know how to answer the question without going and doing some research on it, because I don't think about our business in terms of the margin we get from buy sells. I don't think I would ever preferentially go chase a
15 buy sell deal. It's almost - it's inconceivable to me that buying from or selling to a competitor would be more profitable to us than buying from - than selling to a - one of our normal channels.

MR MARKS: Yes. All right. I'm not sure that - my question was really a bit more
20 general, but there are buy sell arrangements.

MR CAPLAN: Yes, there are.

MR MARKS: Whether you chase a buy sell or not they are a - - -
25

MR CAPLAN: Yes, it is sort of a residual outcome. I would have to go to do the maths to determine what the margin was by a sort of process that deducts our overall margin, looks at what we get from our various other channels and seeing what is left
30 over, if anything.

MR MARKS: But from Shell's perspective, Shell says, look, buy sell negotiations are important. They are aimed at securing the lowest cost, they're aimed at putting Shell in the best position it can be. That obviously applies across the breadth of buy
35 and sell arrangements.

MR CAPLAN: Yes.

MR MARKS: It is more than a passing interest that Shell would have in buy sell
40 outcomes.

MR CAPLAN: It is, but the buy sell is an enabler.

MR MARKS: Of course.

45 MR CAPLAN: It enables us to do our business with our real customers, and in order - also, it enables us to use our facilities, our refineries, to the maximum. And so that's the reason I'm answering the question in the way that I am. We're not undertaking buy sells for the purpose of doing buy sells and, therefore, making a

margin on buy sells. We're undertaking them to reduce our costs to enable us to be competitive in the other things that we do, and that's where we take our margin.

MR MARKS: Yes, I suppose my focus is really more on the sells than the buy sells.
5 You were talking about them a bit more globally. My focus is really - from Shell's perspective I am asking this - and indeed from any refiner's perspective - the focus is more on the sell arrangements, that you want them to be the optimal arrangements possible. My question really was that you take more than a passing interest in the possible outcome under a sell arrangement, and that's why - it's part of what Shell
10 does.

MR CAPLAN: That's a hundred per cent true.

MR MARKS: All right. Now, I want to then ask you some more specific questions
15 about Shell's position. Would you prefer that I asked you those in a confidential session?

MR CAPLAN: Are these questions about buy sells?

MR MARKS: About Shell's buy sell arrangements and about specific features of
20 Shell's arrangements.

MR CAPLAN: If you don't mind doing that in confidence, yes.

MR MARKS: I am happy to do that. Can I then move on to some different matters,
25 please, Mr Caplan. I want to ask you, really, some questions that are more focused on the wholesaling distribution level of Shell's operations.

MR CAPLAN: Yes.
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MR MARKS: First of all, just to pick up from submissions made here, as you said, Shell has wholesale a number of customers, wholesale customers. Can I just understand the position. Shell's major customer is Coles Express; is that right?

MR CAPLAN: Yes.
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MR MARKS: Now, can I ask you in relation to Shell's overall position, excluding for a moment the sale of fuel to other oil majors under buy sells and so on, can you tell me what percentage of Shell's overall wholesale sales are to Coles Express?
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MR CAPLAN: About 65 per cent.

MR MARKS: Has that figure increased or decreased from the time that the arrangement was consumated in March 2004?
45

MR CAPLAN: It's been quite - quite level, really. It hasn't changed very much.

MR MARKS: Has it? So we're not seeing an increase, we're seeing a fairly level - do you want to take that question on notice?

MR CAPLAN: Yes, I think we would.

5

MR MCGREGOR: Timing - just trying to understand the timing in your question.

MR MARKS: My question to you was what percentage of the overall volume sales. You said look, it's about 65, and I said, can you tell us how that is - you understood that that.

10

MR CAPLAN: I understood - - -

MR MARKS: Would you be able to give us that?

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MR CAPLAN: Yes, I can.

MR MARKS: I would be grateful. In terms of actual volume of fuel sold to Coles in the last financial year, can you tell me that figure?

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MR CAPLAN: I can tell you that in camera.

MR MARKS: Now, can I ask you, please, apart from Coles, about the identity of your other wholesaler - really just your major wholesale customers, is that something I can ask you about in open session?

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MR CAPLAN: Sure.

MR MARKS: I want to make sure we're broadly in the loop. United is one?

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MR CAPLAN: Yes.

MR MARKS: Are you able to tell us what percentage of Shell's overall wholesale sales in 2007 were to United?

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MR CAPLAN: Again, in camera we can do that.

MR MARKS: Could you do that, please?

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MR CAPLAN: Yes.

MR MARKS: Then there is 7 Eleven; could you do that also for us?

MR CAPLAN: Indeed.

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MR MARKS: Shell supplies Matilda in Queensland?

MR CAPLAN: We do.

MR MARKS: The same applies - - -

MR CAPLAN: Yes.

5 MR MARKS: - - if you would be so kind?

MR CAPLAN: Yes.

10 MR MARKS: Then there is - is it Chippen Holdings?

MR CAPLAN: Yes.

MR MARKS: Are you able to put their position?

15 MR CAPLAN: Yes, we can. Sure.

MR MARKS: There are a few others. I take it that they would be smaller. Do you mind if I just mention them? I think there is Australian Fuel Distributors?

20 MR CAPLAN: Yes.

MR MARKS: We would be glad to know that. There is APCO then.

MR CAPLAN: Yes.

25

MR MARKS: And I think there are - I know of Scotts, and there is one other, at least, that I know of - - -

MR CAPLAN: Horizon.

30

MR MARKS: Have I covered most of the - I might have missed one or two, I don't know.

MR CAPLAN: No, I don't think you have.

35

MR MARKS: So that's the second category. I'm thinking of Coles Express, and then I am thinking of those independents. Now, I suppose the third category would be the branded independents, or what I call the dealer operators.

40 MR CAPLAN: Yes.

MR MARKS: There are still some, is it, 300-odd dealer sites?

MR CAPLAN: 350.

45

MR MARKS: So they're a separate category, I suppose. Have I missed a category of customer?

MR CAPLAN: No.

MR MARKS: No.

5 MR CAPLAN: Other than that very minor commercial vehicle refuelling outlet, but that's a tiny quantity.

MR MARKS: Yes, okay. Thank you. Then I wanted - perhaps just before I do -
10 Mr Chairman, I'm going turn to another topic. I just thought I would ask you what the Commissioners' intentions about business a lunchbreak were.

THE CHAIRPERSON: How long do you think you will be? What's the other topic?

MR MARKS: I have a number of other topics. I'm going to be the bulk of the day
15 with Shell. I make that perfectly clear now. Certainly, by the time I complete what I will describe as closed submissions, we will be seeing the evening, I think, at the rate we are going now.

THE CHAIRPERSON: Why don't we adjourn till 1.30, so take a 40 minute break
20 for lunch. I think I will advise the other scheduled witness, who is Mr Harris from AAA, that it looks unlikely that you will get to him today. I think that's right?

MR MARKS: I think that's quite right.

25 THE CHAIRPERSON: A couple of us here have deadlines of 5 pm or 5.15, or thereabouts.

MR MARKS: I think, on that basis, your observation is perfectly correct.

30 THE CHAIRPERSON: If you are happy with that, let's adjourn till 1.30.

MR MARKS: Certainly. Thank you very much.

35 **ADJOURNED** **[12.52pm]**

RESUMED **[1.40pm]**

40 THE CHAIRPERSON: Mr Marks?

MR MARKS: Thank you, Mr Chairman.

45 Now, Mr Caplan, just before I commence, I understand that there was some point you wanted to clarify?

MR CAPLAN: Yes, thank you, Mr Marks. There were two points I wanted to clarify. I think perhaps you would have understood this from my answer, but just for the record, you asked about independents being disadvantaged in terms of access to terminals.

5

MR MARKS: Yes.

MR CAPLAN: And, for the record, I just wanted to say that the Coogee, the Gull terminal, the Hastings terminal in Victoria, the Vopac terminal in Sydney at the end of a contractual period are either available today or will become available or being contested and, therefore, independents will have their opportunity to either use or to assume use of those terminals. That's just in addition to the points that I made earlier.

15 MR MARKS: Yes, but presumably to the extent that they become available, they will have to bid for any terminal space just the same as anyone else?

MR CAPLAN: Correct, that's correct.

20 MR MARKS: Just picking up that point, so far as Hastings is concerned, the position is this, is it not, that the Trafagura terminal at Hastings is up for sale?

MR CAPLAN: We believe so.

25 MR MIDGLEY: Yes.

MR MARKS: It may or may not be about to be sold, and the future of Hastings might, therefore, be something about which no comment at the moment can be made.

30 MR CAPLAN: No comment by us certainly.

MR MARKS: No. It is just that you raised Hastings and said it would be one of the ones - I am not sure that is right.

35 MR CAPLAN: Indeed, that's true. There is a second point. In - - -

THE CHAIRPERSON: Just before we move on to that point, I just want to check one thing - the contractual relationship in respect of Vopac, Sydney.

40 MR CAPLAN: Yes.

THE CHAIRPERSON: Can you tell us what that is? That is, the timing?

MR CAPLAN: Could we do that in confidence?

45

THE CHAIRPERSON: Yes, do it in confidence.

MR MARKS: Your second point?

MR CAPLAN: The second point is in relation to the buy sell arrangements. I think I said that I regarded them as enablers for us to do our business, but I think I also said, or you may have taken me to say, that in margin terms they were last cab off the rank, so to speak, compared with other things that we might want to do. I just
5 wanted to say that whether or not we engage in a buy sell arrangement versus anything else we might do depends on how badly we want to sell product in any location and how badly we want to buy product from a competitor in any location compared to our alternatives; and so the economic value to us of buying and selling with competitors is one of the matters in the mix, just like the economic value to us
10 of selling to United or Coles. So I just wanted to clarify, in case I was taken to say that in all cases, the buy sell arrangement was the last cab off the rank for us.

MR MARKS: Yes. Does the reciprocal nature of the buy sell arrangement mean - and this is necessarily a general question - that whatever you get, you will have to
15 give?

MR CAPLAN: Not dollar for dollar, but it does mean that I - I anticipate that if I am going to deny a potential - a refiner access to my refinery product, I could anticipate that that refiner might want to do that to me in another place, and I have to take that
20 into consideration in the buy sell negotiations.

MR MARKS: And is the reality that these matters may also be reflected in the price?

25 MR CAPLAN: Certainly. Yes, indeed.

MR MARKS: Let me ask you one question, while we are on that. You talked about one of the options being exporting, in the plethora of options available which you are considering in these circumstances. I just wanted to ask you: Does Shell, in fact,
30 export?

MR CAPLAN: Yes.

MR MARKS: How much of Shell's volumes of petrol annually are exported?
35

MR CAPLAN: It's a small proportion. We periodically export to New Zealand and we periodically export at times of unexpected length of product.

MR MARKS: Let me take - okay, so let me take - the different things. Let me take
40 New Zealand first. Is New Zealand - when you talk about exporting to New Zealand, and I understand why you put it that way, but in practical terms, is supply into New Zealand treated as really supply to another - I don't want to say another part of Australia, but it's not treated really - it is part of Shell's Australian operation, is it not?

45 MR CAPLAN: It is not part of Shell's Australian operation.

MR MARKS: It doesn't have an Australasian operation, in that sense?

MR CAPLAN: We do not. Chris is responsible to procure supplies for the New Zealand market for Shell, and no doubt he thinks about life in terms of a supply envelope which comprehends Singapore, Australia, New Zealand and, in that sense, tries to do the best he can across that spectrum.

5

MR MARKS: We will want to understand and know how much of Shell's volumes are exported to New Zealand and to other destinations annually, on average. I think the best way to do that is ask you for the amount over the last five years.

10 MR CAPLAN: I'm sure we can give you that.

MR MARKS: Thank you very much. They were the matters that you wanted to mention. I will go back - - -

15 MR CAPLAN: Thank you.

MR MARKS: It's my pleasure, Mr Caplan. I will go back, if I may, to really where I wanted to commence this afternoon. I wanted to ask some questions about Shell's wholesale price generally, so I'm conscious of the difficulties - and you will have to bear with me, Mr Caplan - asking you questions which might move into areas that Shell would rather respond to confidentially, because I am conscious of our obligation, which is to do as much of this on the public record as we can. I am going to ask you these questions, some of them will no doubt just cover ground such the wholesale context that we have already covered. Can I start by asking you some questions which are aimed at getting an understanding of Shell's, or the basis for Shell's terminal gate price. First of all, Shell publishes a terminal gate price regularly, does it not?

20 MR CAPLAN: Yes.

30

MR MARKS: It does that in accordance with its obligations at law?

MR CAPLAN: Yes.

35 MR MARKS: It does it twice a week?

MR CAPLAN: Yes.

40 MR MARKS: Apart from that published terminal guide price, does Shell have some other wholesale or terminal reference price which it calculates periodically?

MR CAPLAN: Yes.

45 MR MARKS: And what does Shell call that?

MR CAPLAN: Wholesale list price.

MR MARKS: Shell's negotiations and deals with its customers - and I have in mind that category of customers, or the basket of customers I asked you about before lunch - are those deals done on the basis of Shell's published terminal gate or are they deals done on the basis of Shell's wholesale list price?

5

MR CAPLAN: Some are done at one and some are done at another.

MR MARKS: Can I ask you, firstly, about the terminal gate price. I take it that the terminal gate price is comprised of a number of components, and this is going to - this will perhaps mirror, to some extent, what we have discussed in the refining and purchase context already. There will be the Singapore marker, which Mr Midgley has already identified?

10

MR CAPLAN: Yes.

15

MR MARKS: That is the substantial component of the price, is it not?

MR CAPLAN: Yes.

MR MARKS: That is based on a seven-day average of product quotes on a spot basis for, is it, TGP, is it Mogas 95 or - - -

20

MR CAPLAN: 95.

MR MARKS: 95.

25

MR CAPLAN: Yes.

MR MARKS: Is it always Mogas 95 TGP, from Shell's perspective?

30

MR CAPLAN: Yes.

MR MARKS: So there will be that component. There will then be the fuel standard premium?

35

MR CAPLAN: Yes.

MR MARKS: Shell has provided us with some figures in its confidential material as to that premium, and I wanted to ask you, if you would, just to confirm this - this is in the confidential submission at page 4?

40

MR CAPLAN: 4, yes.

MR MARKS: I take it that they are applicable at the present time?

45

MR CAPLAN: Yes.

MR MARKS: The range of premiums as stated?

MR CAPLAN: Yes.

MR MARKS: Now, I'm going to assume there is no other product quality
adjustment unless you tell me otherwise. There is, though, I take it, again, the ocean
5 freight component?

MR CAPLAN: Yes.

MR MARKS: Again, that is based on the Platts, is it, point of world scale,
10 Mr Midgley, that you were talking about earlier?

MR MIDGLEY: Correct.

MR MARKS: Not to be confused with a flat scale. I have learned that lesson. I take
15 it that has traditionally been, in the TGP quote, the Singapore-Japan route. You say
in your open submission - I just want to pick up on this, if I may, make sure I haven't
got it incorrect - that it is moved from the Singapore-Japan quote to the
Singapore-Sydney quote; is that so?

MR DEEGAN: Are you talking about points of world scale?

MR MARKS: Yes.

MR MIDGLEY: Singapore-Australia, not Singapore-Sydney.
25

MR MARKS: I'm sorry, Singapore-Australia is what I meant. It has changed from
Singapore-Japan to Singapore-Australia has it not?

MR DEEGAN: Yes.
30

MR CAPLAN: Yes.

MR MARKS: You say that until recently - this is in the open submission - until
recently, the specific index used was based on the quoted Singapore to Japan voyage
35 for a 35,000 tonne vessel. Although a number of Singapore to Australia quotes were
available, the market was too thin, hence the use of the Singapore to Japan reference.
Then you say since the beginning of 2007, Shell believes. It goes on to say that the
market for freight from Singapore to Australia had increased sufficiently to warrant
using a Singapore-Australia quote as the basis for its ocean freight calculations. Do
40 we take it from that the following, firstly, that Shell is endeavouring - perhaps let me
put it slightly differently - that from the beginning of 2007, Shell changed its view
about the appropriate ocean freight quote?

MR CAPLAN: Excuse me - sorry, Mr Marks, could you continue to ask the
45 question?

MR MARKS: Yes, I was just asking this: Is it correct that - and does this confirm -
since the beginning of 2007, Shell has taken the view that it can obtain in the market

for ocean freight the Singapore-Australia quote instead of the Singapore-Japan quote?

5 MR CAPLAN: I would like to answer that question in camera. The reason is that I would prefer not to have public our view of what is recoverable.

MR MARKS: I understand. We will pick that up and I will ask you some other questions pertinent to it.

10 MR CAPLAN: Thank you.

MR MARKS: Can I then ask you about wharfage. Again, we have been helped, albeit in a confidential context, with some information about wharfage. Can I just ask you - again, if it's appropriate to answer or not to answer, please tell me - does 15 the charges which I am seeing here, the information that Shell has given us, mirror in effect - I'm not sure with freight whether it's a Port Authority charge or - that's what I would have thought it would be.

MR CAPLAN: Yes.
20

MR MARKS: Is it designed to mirror those charges?

MR CAPLAN: Yes.

25 MR MARKS: And does it in fact?

MR CAPLAN: Yes.

MR MARKS: Can I then, without going to the specific figures, go on and ask you 30 this question: Does the Shell terminal gate price have built into it any amount for intermediate storage costs?

MR CAPLAN: Yes.

MR MARKS: All right. When I say "intermediate storage costs", for the public 35 record, I am referring to costs which are - or they may be notional costs for the Australian produced product - that are based on actual delivery into port storage and then costs associated with storage itself and transport and so on. Are we on the same page, Mr Caplan?

40 MR CAPLAN: Yes.

MR MARKS: So there is a charge in the terminal gate for intermediate storage so 45 defined?

MR CAPLAN: Yes.

MR MARKS: On top of that, is there also a terminal margin - I take it that there is - which is imposed.

MR CAPLAN: Yes.

5

MR MARKS: The margin, broadly speaking, I take it, is applied to the Singapore quote to cover Shell's terminalling costs and so on, costs of infrastructure and the like, what I might term its operational costs, and in addition to that, to return Shell a premium for a return on its investments?

10

MR CAPLAN: Yes.

MR MARKS: Thank you. Can I ask you in open session whether that terminal margin is - in the terminal gate context - is a fixed margin?

15

MR CAPLAN: Yes.

MR MARKS: And is it fixed by reference to state or locality in any way and, if so, how, please?

20

MR DEEGAN: Let me ask a question - fixed by location?

MR MARKS: Yes. When you say that, I'm immediately thinking of by state, at the very least. Is it fixed by state or is it more specifically location targeted?

25

MR DEEGAN: More specifically.

MR MARKS: Yes, all right. Can you explain that, please?

30

MR DEEGAN: So we may choose to provide a different level of margin at a different location, different terminal.

MR MARKS: Different terminal.

35

MR DEEGAN: Yes.

MR MARKS: That's what you mean by location?

MR DEEGAN: Yes.

40

MR MARKS: Then I imagine that one has to take into account exchange rates and the like. Are we to understand that there is a - I had better ask it - is it correct to say that Shell uses a seven-day rolling average of US-Australian dollar hedged exchange rate?

45

MR DEEGAN: Yes.

MR MARKS: Is that still the rate published by Reuters?

MR DEEGAN: Yes.

MR MARKS: We have covered, then, have we, Mr Caplan, the components of the Shell terminal gate price?

5

MR CAPLAN: Yes.

MR MARKS: Let me move to the wholesale list price.

10 MR MIDGLEY: Can I make a small point of clarification. When you talked about the quality premia which we provided you and asked if there was anything else there, the quality premia you were referring to in our confidential submission was in Melbourne. There will be other quality premia to take into account different specifications by state.

15

MR MARKS: Yes, okay. Let me ask you - and I understand and accept that point, thank you - but that flows into this question: In states where there is no difference in the fuel standard requirement, is the quality premia the same?

20 MR MIDGLEY: Correct.

MR CAPLAN: Yes.

25 MR MARKS: All right. Can I then ask you about the list price. I'm thinking now - and tell me if I'm wrong - about Shell customers who might be coming to Shell to - perhaps I better go back one step. Is the list price in any way applicable to spot sales?

MR CAPLAN: No.

30

MR MARKS: So I'll assume that terminal gate would apply to spot sales. Moving from that, customers that are not buying on spot, I take it, would either be buying on short or long term contract or outside contract?

35 MR CAPLAN: Yes.

40 MR MARKS: Taking those customers, you say in the open submission - and I'm now looking at page 5 and into page 6 - that the arrangements that Shell has with its customers are based on terminal gate, may incorporate additional charges and I take it - and I think you identify there delivery and brand and credit and the like, which are the ones that we are familiar with. Some customers, I think you say, are offered discounts to attract or maintain their business, and the discount level will be largely driven by the volume that the customer is contracting to purchase.

45 MR CAPLAN: Yes.

MR MARKS: That said, can I just pick up the position, for the record. By saying, as you do, that the arrangements with those customers, who I've described are based on

terminal gate, do I take it to mean no more than that the components of the price which they will be asked to pay upon a concluded and successful negotiation will have - will be similar to terminal gate, they will be based substantially upon it but they may differ in some respects?

5

MR CAPLAN: Yes.

MR MARKS: In addition to that, they may also include costs or charges for credit costs?

10

MR CAPLAN: Yes.

MR MARKS: If appropriate; for distribution costs, if appropriate; for brand value cost, I take it, if appropriate, and so on?

15

MR CAPLAN: Yes.

MR MARKS: That said, can I just ask you a few more general questions. If one, in this discussion, were simply to work on the basis that as things presently stand in the Australian market around about 90 per cent or a little less, if Mr Midgley's assessment be accepted, of the fuel that is required is locally produced, accepting that is so, can I just ask you these questions. First of all, so far as the Platts quote is concerned, is it fair to say that the refiner who prices at the Platts quote or based on the Platts quote, as all the Australian refiners are doing at the moment, it would appear, will enjoy the benefit in that quote of the international refiner margin on fuel that is locally produced?

20

25

MR CAPLAN: Yes.

MR MARKS: So, too, is it correct to say that he will, at the end of the day, also enjoy the benefit of the local refiner margin - and when I talk about that, I'm talking about the margin that refiners normally think about in gross terms, that is, the margin that may or may not follow, depending upon production, and the time between the price of crude and the price - the sale price of refined petrol?

30

35

MR CAPLAN: Is your proposition that those two sums are additive?

MR MARKS: Well, I'm talking about them quite separately. In the Australian refiner margin context, the Australian refiner who produces locally refined petrol will enjoy a margin at the Australian refinery level represented by the difference between the quote price and the price of crude.

40

MR CAPLAN: No, I don't see it that way. I think in the - - -

MR MARKS: You don't see it that way?

45

MR CAPLAN: No. The reason I don't see it that way is I think your proposition is mixing price and cost, and if I - if you are trying not to do that then I'm

misunderstanding you. The price of refined petrol at Singapore versus the price of crude into the refinery in Singapore sets the refiner's margin in Singapore.

MR MARKS: I understand that.

5

MR CAPLAN: The price of refined petrol in Singapore sets the price available for petrol in Australia.

MR MARKS: Likewise, I understand that.

10

MR CAPLAN: Whatever the cost of manufacturing in Australia. Is that - - -

MR MARKS: I completely understand that.

15

MR CAPLAN: So that's why I asked - and I, therefore, didn't understand your question, because I took you to be suggesting that those two things were additive and that's why I asked - - -

20

MR MARKS: No, they are totally separate. I'm talking here about locally produced fuel and saying to you, one which you have already agreed, namely, that the local producer enjoys the benefit if he prices at the international Platts quote of a - the margin that the international refiner will enjoy in respect of the petrol refined.

MR CAPLAN: Yes, that's true.

25

MR MARKS: But quite apart from that - because we know that an international refiner who refines and prices at the Platts quote will have a margin involved. That goes without saying, as we said earlier. Now, the Australian refiner also has, does he not - forgetting that altogether, he has a local margin - you say - - -

30

MR CAPLAN: No - that's - unless I'm missing the point, he doesn't. He has the same margin available to him as the international refiner has. That's where I made the point about costs. How much of that margin he accesses would depend on his costs.

35

MR MARKS: Yes, but for the majority - well, that is true. But accepting that he is refining in Australia at an amount significantly - and it would want to be significantly below what it would cost him to import, there is a margin that you say overlaps with the international margin?

40

MR CAPLAN: Yes.

MR MARKS: I might come back to that a little later, if you will forgive me, but then just going forward, for Australian-produced fuel, there is then the application of these other components of the price, and I just want to understand how they are working for the Australian refiner and how he is making his dough, if you are with me. If I take ocean freight first, is it the position that for locally produced fuel, the

45

freight cost upon which the charge you've described to me earlier is levied is necessarily a notional cost?

MR CAPLAN: Yes.

5

MR MARKS: It's a cost which is, insofar as locally produced fuel is concerned, not actually incurred?

MR CAPLAN: Correct - well, it might actually be incurred for any particular voyage but it is a notional cost overall.

10

MR MARKS: It's a notional cost insofar as - I'm not talking here about the cost of importing crude. I'm talking about the ocean freight cost associated in the price.

MR CAPLAN: That's correct.

15

MR MARKS: For locally produced fuel, that is a notional cost, isn't it?

MR CAPLAN: Yes.

20

MR MARKS: One thing I didn't ask you about - there is also a cost, is there not, for loss and insurance?

MR CAPLAN: Yes, there is.

25

MR MARKS: Again, for locally produced fuel, that is notional, is it not?

MR CAPLAN: Yes.

MR MARKS: Now, can I ask you about, then, the international - I'm sorry, the intermediate storage component. Again, for locally produced fuel, there is a notional element to that charge, is there not? I'm thinking immediately of the delivery - because it's an international delivery charge, there is none; there are actual costs associated with that component as well, aren't there?

35

MR CAPLAN: Yes.

MR MARKS: But I've accurately described the intermediate storage cost, then, have I not?

40

MR CAPLAN: What happens is that if product comes from a ship, is unloaded at the wharf and goes into terminal storage, or product comes from a refinery and goes through a pipeline into a terminal, there is some intermediate storage. So there is a real element of intermediate storage in either case.

45

MR MARKS: Yes, that's, I think, to reflect exactly what I asked you. Now, it is the combination of all of those realities that I have just asked you about that, really, the local refiner enjoys. It's those notional - it's the fact that many of the costs are

notional in the local production context that improves the margin position overall of the local refiner - - -

MR CAPLAN: Yes.

5

MR MARKS: - - - would you agree? And indeed it is the fact that the costs I've described to you are in a local context notional costs that makes it attractive for the Australian refiner to refine; would you agree?

10 MR CAPLAN: Yes. By comparison with imported.

MR MARKS: With imported, exactly.

MR CAPLAN: Yes.

15

MR MARKS: Now, what I want to do but - if you are so minded, I will do this in a closed session, is to ask you what in real terms, when you add together - I mean, I have done it and I have a view about it but no doubt you have done it many more times than I have. I want to understand what the real margin in average terms, a cent per litre basis, if you like, is for the refiner when properly viewed in light of the realities I've just described for locally produced fuel. Now, is that something that you would prefer to help me with in a more private session?

20

MR CAPLAN: Yes.

25

MR MARKS: Very well. We will put that to one side for the moment. Can I then ask you, please, about just Shell's position more broadly, its profit position, a couple of general questions, and I will ask you these in open session because you have already given us some figures in relation to Shell's profits before interest and tax in 2006 and I just wanted to get these on the record, if you wouldn't mind.

30

MR CAPLAN: Yes.

MR MARKS: You say that Shell's profits before interest and tax in 2006 equated to 2.3 cents per litre for fuel?

35

MR CAPLAN: Yes.

MR MARKS: Can I ask you, please, whether you are able to tell us what the profits before interest and tax in 2006 were for unleaded fuel?

40

MR CAPLAN: I can't. Not because I won't, but I just haven't done that - we don't think about our business in those terms.

45 MR MARKS: You don't divide it up in that sense?

MR CAPLAN: No.

MR MARKS: So you wouldn't be able to tell me immediately, anyway, what proportion of the profit the business makes might be referable to a grade, as I understand?

5 MR CAPLAN: I think in our submission, or perhaps it was in our 95ZK, we tried to respond to that proposition.

MR MARKS: I understand.

10 MR CAPLAN: So much of a refinery is common to all products - the barrel of crude oil from which the refined products are derived is an integrated barrel. Allocating the cost across the spectrum to a particular product is something that we find impossible and simply never do. Therefore, you have to approximate it with one or other theoretical calculation, and we gave you a couple but we don't regard either of
15 those as meaningful and we simply never do it.

MR MARKS: Yes, I see. I didn't want to raise that with you in open session but I'm grateful for your explanation. Now, in open session, though, I would like to ask you what your profits before interest and tax were in the year just gone. Can you tell us
20 what that was in cents a litre of fuel, please?

MR CAPLAN: I think 2.3, if you regard 2006 as the year just gone.

MR MARKS: I wasn't so regarding, but is that the most recent year - - -
25

MR CAPLAN: Yes.

MR MARKS: - - - for Shell?

30 MR CAPLAN: We work on a calendar year.

MR MARKS: Sorry, yes, indeed, you do. Are you able to tell us what your profit was for the half year to June 2007?

35 MR CAPLAN: No. We don't declare a profit publicly. But we can give you that information.

MR MARKS: That would be helpful. Otherwise, you have said that over the years leading up to 2006, it's averaged around 1.8 cents. Is there a trend? Has it been
40 going up over time? If I was to ask you to tell us what it has been over that five-year period, would you see an upward trend?

MR CAPLAN: Yes, in fact you would see a stepped change. Because, as I said earlier, we regarded 2004 as a total disaster for us, so almost anything has to be an
45 improvement on 2004.

MR MARKS: Well, I asked you essentially for that reason. It sounded to me like there was an aberration into that average that needed to be taken into account. I want

to get a more accurate idea. Could you tell us, please, what the figures were for each of the five years leading up to 2006?

MR CAPLAN: Yes, we can.

5

MR MARKS: Thank you very much. I then want to ask you one more question in a wholesale context but it may be something that you wanted to respond to in a private session. I want to ask you about the basis of Shell's wholesale price to Coles Express, being its principal customer. Would you prefer me to ask you those questions in private session?

10

MR CAPLAN: Yes, please.

MR MARKS: All right. Just excuse me one moment. Just picking up one matter, before I move on, that I asked you about earlier. In the answers you gave me before, Mr Caplan, you mentioned that one of the options was to export fuel, if necessary, and that Shell sometimes did so. I think you said that Shell might export, even perhaps does export, when it's long on product. I just wanted to ask you: Is there a reason why Shell would export rather than sell when it's long on product into the Australian market?

20

MR CAPLAN: We - there is no particular reason. We would look to what is the best economic course of action in each case when that happens. If we are unexpectedly long on product, if any of our commercial customers can take it at a price which we regard as appropriate - so exporting is an economic decision.

25

MR MARKS: Essentially, it's a decision driven by price.

MR CAPLAN: Exactly.

30

MR MARKS: I wanted to move on, then, and ask you some questions about retail. Now, Shell says in its submission to the Commission that it is not involved in retail, and I asked you some questions about that. I take it that your answers to my questions still hold. Shell does still have some degree of involvement in retail and a considerable indirect involvement; would you agree?

35

MR CAPLAN: Yes. The direct involvement in retail being limited to the 40 CVROs in which we set - I think 17 of them - a retail petrol price.

40

MR MARKS: That's right, and the indirect involvement, involving, as it does, the sales through Coles Express which are Shell's dominant sales by volume, the sales through branded independently owned outlets, and I think that's probably pretty well it.

45

MR CAPLAN: And the sales to independents.

MR MARKS: And the sales to independents. Let me, though, just ask you - and the reality is Shell has a very acute interest in the retail market, does it not?

MR CAPLAN: Yes.

MR MARKS: For obvious reasons. It is selling a very large amount of its total volume through the Coles Express retail chain, with whom it has the alliance that we
5 know about.

MR CAPLAN: Yes.

MR MARKS: Its raison d'être, I suggest to you, is to maximise to the extent
10 absolutely possible its volume of sales through that alliance.

MR CAPLAN: Yes.

MR MARKS: That is not only its raison d'être now but will continue to be in the
15 foreseeable future; is that so?

MR CAPLAN: Yes.

MR MARKS: That means, does it not, that Shell would take an intense interest in
20 what is happening in the retail market and that would include price cycles and all the other features of the market?

MR CAPLAN: Yes.

MR MARKS: Can I ask you, then, and on that basis, just a few questions about price
25 cycles, because it is, as you know, Mr Caplan, a matter that the Commission has to deal with and, therefore, is interested in. Can you tell me, in Shell's view, what is the driver of the price cycle in the metropolitan cities or locations or wherever it occurs?

MR CAPLAN: Fundamentally, I think it's driven by the need to maximise volume
30 through the whole supply chain, and the impression that doing so is facilitated by offering a keener price than your competitor, and given the transparency of pricing information available to both customers and suppliers through price boards, Informed
35 Sources and other mechanisms, the inability to sustainably steal a march on your competitor from a price point of view, and the recognition that if you try and do that for too long, you simply run out of oxygen and you have to come up for air. So my view is that if the industry did that once or twice or three times and learned that it didn't actually work all that well, because everybody saw what you were doing, it can only habitual, as far as I can see, since I am unaware of the fundamental economic
40 driver for price cycling.

MR MARKS: Do you think it might be that the cycle is a bit of a throwover from
the days when the independents played a larger role in pricing in the market?

MR CAPLAN: Yes.

MR MARKS: And when you say habitually, is that what you really mean, that
having become accustomed to price cycles in the metropolitan area, the players in the

market continue periodically a pattern of behaviour that, while once the province of independents, is no longer?

5 MR CAPLAN: I'm not sure that I would agree that it's no longer the province of independents, but I do believe that the origins were in the condition that you described, and I do believe that it is habitual ever since, with pretty much everybody participating in one way or another.

10 MR MARKS: What then do you see - you picked me up on the independent point - what do you see now as the role of the independents, if any, in the perpetuation of the cycle?

15 MR CAPLAN: No more or less, in my view, than the role of anyone else in the game. In other words, they periodically, or regularly, depending on their own strategies, depending on how big they are as independents, try to assume a position in the market and they do so for as long as it appears sustainable to them, and when it's not sustainable, either they change their price or they expectantly hope that somebody else does, so that they can come up under cover of that rise.

20 MR MARKS: The independents that we have heard from at these hearings - not meaning to say necessarily they are speaking with one unanimous voice - but the general position would seem to be that they don't have the same ability to drive prices in the cycle down the way they used to because the whole market and structure of the market has changed; is that a view you share?

25 MR CAPLAN: Yes, it is.

MR MARKS: Why is that?

30 MR CAPLAN: I think there are fewer and larger sites that characterises the market generally. The - all of the sites are more competitive, it seems to me, now. All of the sites have higher throughputs, and therefore there is a lot more at stake for a major operator to allow an independent a margin on the price board. It's no longer expected by the customer. It's - so my observation would be that the industry overall and all of
35 the players are less tolerant of allowing a competitor to get a price break.

MR MARKS: How do you see the impact of the shopper docket discount that Coles and Woolworths drive as impacting the cycle?

40 MR CAPLAN: Has impacted the cycle?

MR MARKS: Has impacted the cycle?

45 MR CAPLAN: I don't particularly see any impact on the cycle from the shopper docket.

MR MARKS: You don't see any impact on the cycle?

MR CAPLAN: I don't.

MR MARKS: Okay. Do you have a view about who, in practice, is driving it up and who, in practice, is driving it down in the metropolitan areas in this cyclical fashion?

5

MR CAPLAN: Periodically, we pull data, very, very publicly - not publicly but commonly available data. For instance, was interested in reading the transcript of the Commission's session with Mr King of Caltex, where the Commission was zeroing in on a particular time in Sydney when prices continued to be depressed and it didn't cycle. It was particularly interesting to see Mr King's description of what he saw was driving it. So, when I asked Grant to pull the data, we came to a completely different conclusion of what was driving it.

10

MR MARKS: What was your conclusion?

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MR CAPLAN: Our conclusion was that the data was incomplete, so it didn't show what the independents were doing, because you don't see that. But from what we could see, we came to the conclusion that it tended to be Mobil that was holding the prices down at that time, just from the averages. But the point I wanted to make is that it is entirely possible that neither Mr King nor I are correct, but you are driven by your perception to do things in the market. So, he has explained to the Commission, as I see in the transcript, what he thinks was happening. I have given you a sense of what we observed was happening, and they're completely different. Now, Coles, of course, who sets the retail price in that environment at that time, would have had its own view of its reality and would have reacted. But it is - this common availability of data doesn't lead to common perceptions of what is happening.

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MR MARKS: No, but whilst that may be so in any particular instance you want to raise - - -

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MR CAPLAN: Yes.

MR MARKS: - - - you chose the July 07 movement, which was not a bad example - conversely, it could be said, could it not, that generally, however, one can discern and discern well patterns of conduct on a longer trend, would you agree, from the available independent data?

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MR CAPLAN: I certainly think the data is available. You can make judgments in any particular place at any particular time who is leading and who is following. I think that is - - -

40

MR MARKS: But more generally even, with the benefit of that, and you have acknowledged it, it is possible, is it not, to determine more broadly who the movers in the market are, or are likely to be; would you agree?

45

MR CAPLAN: That could be the case.

MR MARKS: Shell has all of this information available to it and we know that obviously, it's not a big secret, Shell makes that clear. What I want to understand is what Shell's view is. My question to you really is: What do you think or who do you think, more accurately, is driving the price up in this cycle in the metropolitan
5 markets? And if there are - it may be that it's an individual, it's harder to put that into all the different markets, but it may be that it's a kind of individual. For example, you may not be able to say it's BP here or it's Mobil there, but you might be able to say to me, look, the trend is that it's the nonaligned majors who are driving it up.

10 MR CAPLAN: Yes. I don't know. Grant, do you have a view on whether there is a general across all capital cities or a particular capital city or - - -

MR MCGREGOR: In general, it tends to be the players with the larger network. So I - - -

15 MR MARKS: What do you mean by "the larger network"?

MR MCGREGOR: So, it could be a major oil brand or it could be a major supermarket brand.

20 MR MARKS: But let me break that down, if I may. You talk about a network. Take the case of a refiner who has a refinery in a particular location, let's just say the Sydney market or the Melbourne market. That might be a consideration, might it not?

25 MR CAPLAN: It might, except it won't be to Shell.

MR MARKS: Forget Shell.

30 MR CAPLAN: I wish I could.

MR MARKS: Shell says we don't set prices, Mr Marks, Coles does that. We have got to ask these questions within the environment in which we're operating. I'm asking them more generally for that reason. You can take the Melbourne market but
35 you could, equally, take the Brisbane market, the point can still be made. Do you see a pattern of conduct whereby, for example, the nonaligned majors are lifting the price periodically in the cycle?

MR MCGREGOR: No, I've never really looked at it that way, although one
40 observation I would make about one market in particular that jumps out to me is BP are often quite high in WA.

MR MARKS: Let's take WA. It's an obvious example. It's a good one. It's a little different, though, because of the way the market works. There is an overlaying
45 regulatory impact on that market, isn't there?

MR MCGREGOR: 24 hour rule.

MR MARKS: But accepting that, let me ask you some questions. It is the position, is it not, it seems to be inarguably the case, that BP drives the price up at end of the cycle in Perth?

5 MR MCGREGOR: I would agree with that.

MR MARKS: Now, BP has a refinery in Perth? Would you agree?

MR MCGREGOR: Yes.

10

MR MARKS: Just working down your network point, BP also has a large number, by proportion, of the retail sites in Perth, does it not?

MR MCGREGOR: Yes, it does.

15

MR MARKS: I suggest to you that both of those factors combined would put BP into a position in Perth where if it is to lift the price on cycle day, it can do so in the legitimate expectation that others will probably follow; would you agree with that?

20 MR CAPLAN: I would put it this way - sorry - - -

MR MARKS: Sorry, I was directing my question - I will give you an opportunity, Mr Caplan. It is just that you were helping me, Mr McGregor - - -

25 MR MCGREGOR: Could you help me - - -

MR MARKS: It was a long one. I will do my best. My question to you was this: Is it right to say that with the benefit of a refinery, a home state advantage, if you would like to call it that, and, in terms of network, a large proportion of the retail sites in Perth, BP can lift prices on lift day in the legitimate expectation that others will follow?

30

MR CAPLAN: Yes.

35 MR MARKS: Would you agree, too?

MR MCGREGOR: Yeah, I think that that would present an opportunity for the others to follow.

40 MR MARKS: An opportunity? A bloody good opportunity, I'd suggest to you. Is that not a fair comment? Yes. Does the same rule - although Perth is a very good example of it, because Perth is so obvious and transparent, is the truth that that rule plays a wider game? It operates in all of the markets, the metropolitan areas that we see in Australia; would you agree with that?

45

MR CAPLAN: Yes.

MR MARKS: So that home ground advantage and network availability are very significant factors in answering the question as to who it might be that will lead the price up and why they would do it, namely, why they would hold a legitimate expectation that were they to make a move in the market, it would hold?

5

MR CAPLAN: Yes.

MR MARKS: Not necessarily that it would hold but that it would quite likely hold?

10 MR CAPLAN: Yes.

MR MARKS: Now, can I then just ask you, Mr Caplan, a couple of other questions around this cycle. I know there are different issues at play here, but let me come away from Western Australia and the fortnightly cycle for a moment and just look at the eastern seaboard. These weekly cycles, I have asked you why they occur, but having regard and paying attention to what you have just said, can you explain why they are weekly.

15

MR CAPLAN: No?

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MR MARKS: Is there any logic around the weekly? Is it margin recovery? Is there anything that you can attribute it to?

MR CAPLAN: The fact that there are cycles at all is about margin recovery, in my view. So, assuming that the retailers are trying to find an adequate margin overall, they have to do something to try and compensate for the periods when they are discounting very heavily, and that means that there has to be at least an equal and opposite reaction. Why weekly or any other period, I have no logic.

25

MR MARKS: Can I ask you, then, this: Are you able to explain - and there might be a very good explanation, I'm not sure - why in some of the cities - and I'm thinking obviously of Darwin and Tasmania, Tasmanian cities and the like, there is no cycle and yet I take it you would tell me there is a competitive market?

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MR CAPLAN: Yes.

35

MR MARKS: Can you explain that difference?

MR CAPLAN: I can't explain exactly other than to say that in Darwin or Hobart, the average throughputs in the sites there would be very much lower than the average throughputs in the sites in Sydney, Melbourne, Brisbane. The volume margin effect leading to value is different in Darwin or Hobart, so you simply have to get more margin per litre for the product that you sell, the less product that you sell, in Darwin, in order to make a living. So the drive for volume, which is never absent anywhere, is critical in Sydney and I think the difference between fuel income and shop income - it's a long time since we've been in the retailing game and, therefore, been very intimately involved in differences between shop and fuel, but I would assume that the gap between nonfuel income and fuel income in Darwin is different than that in

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Sydney. So you are more reliant. So, overlaid is this issue which, in my view, is not explained by logic but is explained by habit that I believe is present in the cities where this weekly cycling occurs. But I, for the life of me, can't see the logic.

5 MR MARKS: I accept what you say but I'm wondering whether it's the full story. If
you take Darwin, for example, you say, well, there are these differences, look at the
volume and so on, but does something more than that explain the absence of a price
cycle in, say, Darwin, to just use it as an example. Darwin has one supplier of fuel.
That is Shell. Shell into Vopac, distributes it to other major players and all the major
10 players know that fact, they know the price. They know the realities of the market.
That extends, I imagine, to independents as well, certainly to United. Is the reality
that in that market, there is not the same degree of competition between the players
and not the same drivers as there are in the other states where that cannot be said?

15 MR CAPLAN: I would agree with that.

MR MARKS: Would the same reality explain the position in Hobart?

MR CAPLAN: Yes, in my view.
20

MR MARKS: All right. Can I ask you a couple of more general questions. From
Shell's perspective, is the price cycle a good thing, do you think? Accepting - - -

MR CAPLAN: From Shell's perspective, we're indifferent to it.
25

MR MARKS: Are you indifferent to it? You don't think that - I'm putting Shell's
targets, in my mind, in a volume context. If you are volume-driven, which you are,
do you think your position is advantaged or disadvantaged by cycles? Are you
indifferent?

MR CAPLAN: Indifferent.
30

MR MARKS: So your view is - and I take it that it follows - that in terms of sales
volumes, there is little to be said for a cycle, from a sales perspective?

MR CAPLAN: Yes, that's what I would - from our perspective, and I'd say that our
volumes, in my view, are most dependent on the competitive position of our retailer,
Coles. So that's whether or not the cycle is at a high point or a low point, whether
the prices are even or any other; Coles will sell most if it succeeds in attracting
40 customers by being both price competitive and not annoying them when they come
in by dirty toilets, all that sort of stuff. So Coles, or by the way, any other retailer,
has to consider that when presenting its offer. So that's going to be about whether it's
perceived never to move down, whether it's perceived always to sit above the market,
whether it's somehow perceived well or not well by both the price-sensitive customer
45 and by those customers who might not be so price sensitive. That's a much more
important factor, in my view, than any particular price cycle.

MR MARKS: But from Shell's perspective, I wonder have you ever considered, accepting what you say and adding on to it, that Shell is essentially driven by volume and is essentially right behind Coles in its endeavours to achieve it, have you ever considered whether Shell would be better off in its alliance with Coles were there to
5 be no cycle and were Coles to be able to use its shopper docket and whatever other schemes it can come up with in a no-cycle environment?

MR CAPLAN: I'm not sure that we have. I have never participated in a discussion
10 like that.

MR MARKS: What about competitor price perceptions and all these very important matters that Shell pays constant attention to - have you not considered it in that context?

15 MR CAPLAN: No.

MR MARKS: No? All right. Can I ask you then more generally just about this strategy that Shell has. I know - a bit hamstrung here - I know you've given us some answers about - yes, I know you have given us some answers in the confidential part
20 of your materials about - I think you do touch on some of these issues. I want to ask you some questions about Shell's strategy in the context of shopper dockets and so on. Will you be more comfortable if I asked you those questions in the private session?

25 MR CAPLAN: Yes, please.

MR MARKS: There are a number of things I'm going have to come back to, Mr Caplan. I would like to ask you about some other features, though, of Shell's retail position. Again, I'm really thinking here of its position with Coles, although of
30 course it's not exclusive to Coles, but I think these issues might be. Can I ask you some questions about price support?

MR CAPLAN: Yes.

35 MR MARKS: I think I ought to be able to ask you these in public session but if I cannot, please tell me and we will have to come to a view about how we deal with it. You have provided us with a number of documents on this issue. We have looked at those documents and endeavoured to glean how the arrangement works. I want to make sure we do understand - we have asked Coles, you will understand, about this
40 as well. Are you happy for me to ask you these questions in open session?

MR CAPLAN: I don't know what the questions are, so try - - -

45 MR MARKS: I'm going ask you - I think I have made it plain - how your price support mechanism with Coles works.

MR CAPLAN: I certainly want that to be discussed in camera.

MR MARKS: Mr Chairman, with your leave, I'll take that up in camera also.

THE CHAIRPERSON: Just remind me, Mr Marks, to what extent was that done in public session by Coles?

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MR MARKS: I think it was in part public and in part private, Mr Chairman. I wouldn't like to demark too - which is why I thought I would raise it. There was a public element but it was also asked about in private. I'm happy to take it up, if the Commission is happy for me to do so.

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THE CHAIRPERSON: That's fine in that event.

MR MARKS: Now, I also - and I take it the answer might be the same - I want to ask you about two other mechanisms that form part of your arrangements. One, of course, is a [confidential]. Would you like to deal with that also - - -

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MR CAPLAN: They're attached.

MR MARKS: They are inextricably linked, in a sense, although they are different. Likewise I do want to ask you about the [confidential] and so on. Will I do the same?

20

MR CAPLAN: Please.

MR MARKS: That, Mr Chairman, will necessarily mean that the remaining questions I want to ask, which will be built upon those questions, will be questions of a confidential nature. Might I say also that, apart from the other matters that I'm wanting to follow up, there are some further topics relating to Shell's future directions that I would also like to ask Mr Caplan about. In those circumstances, that brings me to the end of what I want to ask publicly. Subject to any other matters the Commission wants to raise or take up, I would ask that the commission go into private session.

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THE CHAIRPERSON: I had one matter I wanted to pursue a little further and that's the issue that you raised twice, that is, at the beginning of this current session after lunch and then subsequently, and that's the issue of Shell's decision to export quantities of fuel if it was long. Perhaps I want to break that up and find out if the issue of being long in fuel was also a factor that also impacted on the exports to New Zealand.

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MR CAPLAN: Yes, it may do. I mean, structurally, we are not set up to export. Structurally, we are an importer; albeit that we structurally import to the north of Australia and we carry product around the coast from the south-east of Australia. Periodically, at a particular refinery for a particular circumstance, we may have some unexpected length. At that stage, we have to do something about it and then we work out what's the best economic avenue for us to follow.

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THE CHAIRPERSON: In making an economic decision - you may want to deal with some of this in private - in making that economic decision, you will compare the pursuit of a buy sell arrangement with others?

5 MR CAPLAN: No, because the buy sell arrangement will be set on a six-monthly basis. This short or length might be not instantaneous but very short-term, so the buy sell arrangement might not be affected. We may or may not be embarrassed by a certain length of product instantaneously, but there we have to do something. Perhaps we are going to sell it through our system if we can, but it mightn't have a
10 variable demand that would enable us to do that, or we send it to Tasmania, or we do something with it that - and in extremis, we slow the refinery down, which we don't really want to do.

THE CHAIRPERSON: I take it you say that transmission to Tasmania is exporting?
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MR CAPLAN: For this purpose it is exporting.

MR MIDGLEY: I think it may be worth adding a slight distinction that Australia has, in the fact that the length of the supply chain in Australia means that our
20 customers look to have supply security and, therefore, lock in their volumes in a buy sells or a six-monthly period. So it is trying to plan on a long period, and as such, therefore, Australia doesn't have the spot market that you would see in many other markets - it's very difficult in the short term to be able to dispose of product, just as it is in the short term to acquire product.

25 THE CHAIRPERSON: I suppose you can always dispose in Australia at a price?

MR MIDGLEY: It is difficult to generate demand if the consumer - if the end consumer is not buying it.

30 THE CHAIRPERSON: So what you are suggesting is you - I don't want to overstate this but, in effect, you can't give it away because the end consumer, the motorist, is not there to buy it?

35 MR MIDGLEY: Correct.

THE CHAIRPERSON: Are there occasions when you will choose to export when the issue is not that of the ultimate demand by the end consumer but, rather, that it may deplete the price in Australia below what you would consider to be an economic
40 level relative to the price that you would obtain net of freight of exporting overseas?

MR CAPLAN: That would be part of the consideration.

45 MR MIDGLEY: The objective of the make buy - make import or buy sell is to optimise your barrel effectively and avoid the need to export. But the export may become the next best economic route to maximise our margin.

THE CHAIRPERSON: You may want to answer this in private but in terms of exporting - I am talking about the freight costs and other costs of exporting - are you able to give us some idea of cents per litre involved in those costs? In other words, what I'm trying to understand is the economic differential between "dumping" it or
5 placing it in the Australian market versus exporting it to some overseas jurisdiction, be it New Zealand or perhaps up north.

MR MIDGLEY: It is very variable because your optimisation is to first put it - if you take the Victorian context, into Tasmania, then into Adelaide, which are the two
10 major short markets that you will put into first. Then you would then offset imports later on.

THE CHAIRPERSON: When you give us some details, as you are going to do afterwards, as to the volume of exports - I think you are perhaps suggesting here that
15 export, to you, is exporting from a particular refinery to elsewhere potentially around the country?

MR MIDGLEY: That would be our objective.

MR CAPLAN: That would be the main thing. Exporting from Australia is a very
20 rare event for us.

THE CHAIRPERSON: I'm pleased we clarified that, because I think what we are more interested in is exporting from Australia, rather than redistributing around the
25 continent itself. That is right, Mr Marks?

MR MARKS: Yes, it is, Mr Chairman.

THE CHAIRPERSON: So exporting for your purpose means moving it around the
30 continent. I think we are perhaps more interested when you would export outside Australia, for example, New Zealand or elsewhere.

MR MIDGLEY: You would - with Australia being a short market, I would fail to do my job effectively if I ended up exporting to New Zealand. The only time that that
35 would occur is we do have vessels which bring dirty product into Australia. If we have a bit of length in the ships going back, they're empty, it's an optimisation we may choose to do because the economics are favourable at the time. But it's not the planning basis that we would aim to have as an optimal solution.

MR MARTIN: The only area that perhaps we have not looked at - and this would be a public issue - is on the distribution side, we've been talking, in some of the regional
40 centres, that there appears to have been a move to closing down of depots and discussion about the mode of more direct transportation. What has been the general trend with Shell in terms of that and have you disposed of these depots?

MR CAPLAN: We are in the process of doing that, Commissioner. And we are
45 doing that, again, because we judged - and by the way, our - many of our customers told us that we weren't doing this part of the business very well. So for small, remote

customers - and there are thousands of them - we're stepping back from that. We're doing that by means of placing a minimum order quantity. That minimum order quantity means that those customers are going to be better served by an intermediary. We are introducing them to an intermediary. They're not obliged to buy from that intermediary but we don't want them to be inconvenienced and not have any supply.

That intermediary will be - if the bargain is struck, will sell fuel, it won't be Shell branded fuel. That intermediary, in some but not all cases, will buy fuel from us but will on sell the fuel to the small customer as the intermediary's fuel. The consequence of that is that we will significantly reduce our need for inland depots and trucks and people associated with that and we will basically retire to the capital cities and serve a smaller number of larger customers, who then will on sell to the many thousands of small remote customers that we attempted to serve directly in the past.

DR KING: Just returning to the export issue, just to clarify this from my perspective - just take the period of the last five years. During the past five years, has Shell exported product to New Zealand?

MR MIDGLEY: Over the last five years, the market structure of Australia has changed significantly with the shut down of Port Stanvac, so Australia used to - Geelong in particular used to export to New Zealand - - -

DR KING: Let's reduce the time frame. Port Stanvac was closed about three years ago?

MR MIDGLEY: Yes, in the last three years.

DR KING: Since Port Stanvac has closed, since we have had a reduction in refining capacity in Australia, so we will say over the last three years, if you take that time frame, has Shell exported to New Zealand?

MR MIDGLEY: Yes.

DR KING: Unleaded petrol?

MR MIDGLEY: Yes.

DR KING: Has it exported elsewhere to other than New Zealand?

MR MIDGLEY: No.

DR KING: So just to New Zealand in the last three years. Do you work out a domestic equivalent price that you would be - I'm not going ask for it now, unless you could remember off the top of your head - but does Shell work out a domestic equivalent price for that fuel that it exports to New Zealand? So basically working out, effectively, we're exporting at X cents a litre, that's the equivalent of what we would be getting in Australia or have to think about in Australia to break even?

MR MIDGLEY: We would look at it from a net back value into New Zealand, and netting that back to determine whether the incremental refining margin to produce those extra barrels in order to keep our refinery full makes sense. Sometimes that may be driven because of demand for another product. So if diesel product is high, it
5 may be that some of the gasoline becomes surplus because of a - a spike in demand drives that. Generally, it is driven by looking at increment of the margin that it generates.

DR KING: I can understand that you are going to be looking at the incremental
10 refiner margin to work out if you want to produce the fuel at all or slow down the refinery - - -

MR MIDGLEY: Correct.

15 DR KING: - - - but that's not really the relevant margin for the export decision? Surely the margin for the export decision is what could we get if we were able to place it in the Australian market versus what would we get by exporting to New Zealand? Do you do that comparison?

20 MR MIDGLEY: Yes, but I think, as I said before, there isn't really a spot market per se in Australia. So the first is to optimise your barrels inland. The second is to optimise it to the nearest alternative port. The third would be to export, if there is any margin left to do that.

25 DR KING: I must admit I sort of wondered. I'm not an expert on the retail petrol market, although I'm learning fast. In most other markets, if there is an excess of supply by a particular manufacturer, they will get on the phone and they will ring around. There is always somebody willing to take a product. It may be a small
30 person, you may have to break it up over a number of purchases, but there is always a - or there is always an independent who is willing to take a bit of extra. Why doesn't that work here?

MR MIDGLEY: Australia is relatively unique in the fact that it probably has the
35 lowest amount of tankage in any country. So the ability in most countries would be to take the product, put it into tankage at a discount and use it in the next month. Storage in Australia is down to almost less than a week in most metropolitan areas and, as such, you don't afford that luxury.

DR KING: When you talk about the low levels of storage, are you talking about
40 storage just at terminalling facilities or are you including in-ground storage at retail outlets?

MR MIDGLEY: Yes, that's very small in today's terms but at terminals I guess is the
45 - you could do both.

MR CAPLAN: Or at customers' premises. Customers don't have the ability to buy forward for a month, for instance, and if they did, then what do you do the next month in trying to sell them something?

DR KING: Although they don't have to be your customers. They could be somebody else's.

MR CAPLAN: No, that's true, but on average.

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MR MIDGLEY: Again, with Australia being short, our customers look for supply security first and therefore have term contracts with obligations to lift.

10 DR KING: If I can clarify a couple of points from earlier on - so I can jump through a couple of points. I think, Mr Midgley, this was a point that you were referring to. You talked about - in response to Mr Marks' question, you talked about a quality premium of \$1.50 to \$2.50 per barrel related to the different fuel standards in Australia. If you can remember that line of questioning. I just wanted to check up, when you referred to that quality premium - and I understand you are going to be
15 providing us with more information - when you referred to that quality premium at \$1.50 to \$2.50 per barrel, what were you using as the base that you were comparing that to? Was it the Euro 3 standard or something else?

20 MR MIDGLEY: When I referred to that, I was showing an indicative type of premium just for the MTB and the benzene proportion of it. If we want to go to the breakdown of each of the specific differences, the final boiling point and the RVP difference, I can break that down in camera in a little bit more detail. That was just to give an indication of what is probably the two major outlier specifications that make it very difficult to acquire the product off the Singapore marketplace.

25

DR KING: If we can just think of the MTBE difference for the moment, when you are saying it's the MTBE to get it down to 1 per cent, which I understand is the Australian requirement, that's compared to the Singapore standard, if I can call it that; you are not comparing it to, say, the Euro 3 standard, which I think is
30 15 per cent MTBE, you are referring to the Singapore standard?

MR MIDGLEY: Which can have 15 per cent MTBE.

35 DR KING: I just wanted to make sure I understood what you were talking about there. Just on your imports - and this comes back to your public submission, if I can just refer to page 3 of your public submission, in 2006, for example, 44 per cent of Shell's imported unleaded petrol came from trading with third parties. Shell has a nice big refinery in Singapore where you get the other 56 per cent of petrol from. Are you saying from this that 44 per cent of the time you can actually get a better
40 price off somebody else than you can off your own refinery?

MR CAPLAN: We ask our trading affiliate to procure Australian spec product for us when we import. We don't ask them to procure it from any particular place. They make the judgments about where they get it from, which might be Singapore or
45 which might be somewhere else or which might be a blend, and so we're indifferent to where they get it from, and we're indifferent to their particular economics for preferring to get it from Bukom, or preferring to get it from Taiwan or preferring to get it from anywhere. I believe they will be determining what's the best thing to do

on the day that they're doing it, which might be taking advantage of somebody else's disadvantage.

5 It could be that something's happened in Taiwan that makes product available, at that moment, cheaper than it might be available from Singapore or from Korea. And that's what we have as our advantage in dealing with them, because they can scan the field of opportunities for them and determine which makes most sense for them. And so that's what happens. When we get back and look at where did the product come from, we can see that part came from Singapore and that part had its origin
10 somewhere else.

DR KING: I can understand there would be occasions when there would be opportunities to get cheap fuel from Taiwan for the relevant quantity or that you would be able to blend it with some Singapore fuel to bring it to the relevant quality,
15 but 44 per cent seems to be a bit more than opportunistic or lucky purchasing.

MR MIDGLEY: Maybe I could just - I think you are making the assumption that our Bukom refinery is able to make Australian grade fuel.

20 DR KING: I am, indeed.

MR MIDGLEY: Which is incorrect. Actually, only a certain proportion of its production is capable of meeting the Australian specifications, and that is, you know, through investments that we have made in the last two years to be able to provide
25 some Australian grade.

DR KING: Of the Australian grade petrol that's produced, does all of that come to Australia or - because, as I understand it, Australian grade fuel, similar to Californian grade fuel, for example, but not the same - - -
30

MR MIDGLEY: It then comes back to Mr Caplan's point of view of which is the best optimal place of disposition for those barrels, and provided the quality premia justifies producing it to Australian Standards versus the alternative of acquiring it from then spot market, it would find itself into the Australian marketplace.
35

DR KING: Sometimes the Bukom refinery - if I can put it this way - will say to traders, "Quite frankly, go and get it somewhere else. We're producing a different quality or a different grade at moment and, quite frankly, we don't think it is worthwhile producing the Australian stuff."
40

MR MIDGLEY: We try to work closely but that is a choice that they may have at times.

45 DR KING: I think that's all the questions I have.

MR MARKS: Mr Chairman, just one matter. Mr Midgley, perhaps could you tell me: Is Shell selling any fuel at spot these days?

MR MIDGLEY: Probably best to refer to Clayton.
50

MR DEEGAN: We've had chances where we've had short-term using to buy spot. I'd define that as less than one month we have done it, but in this year I've only known of one circumstance of a very short period, so one month or less.

5 MR MARKS: So, it is a rare occurrence, is it?

MR DEEGAN: Very, very rare.

10 MR MARKS: I see. Thank you. Thank you, Mr Chairman. I wonder if it would be convenient if we went into private session but before we did that if we just had a five-minute break.

15 THE CHAIRPERSON: Given that both your estimates of time and mine tend to be somewhat lax, let's make it a quarter past 3.

MR MARKS: I'm not going to admit to anything but I will come back at a quarter past 3.

20 **WHEREUPON THE HEARING PROCEEDED IN CAMERA [3.05 pm]**

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