

ACCC INQUIRY INTO THE PRICE OF UNLEADED PETROL

Public hearing – Melbourne, 5 September 2007

Time: 10am

Address: CQ Functions
123 Queen Street

Room: Conference room 6 (Level 12)

| Time | Witness | Submission |
|-------------|---|-------------------|
| 10am | BP Australia Dean Salter, General Manager, BP Retail Australia. Mark Sturgess, Australasia Business Manager, Integrated Supply & Trading, Eastern Hemisphere. Brett Davidson, Retail Pricing Manager. Rebecca McGrath, VP, Australia and Islands Operations. | 35 |
| | Liberty Oil Pty Ltd Mr Paul Edmends, General Manager. | |

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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, WEDNESDAY, 5 SEPTEMBER 2007

THE CHAIRPERSON: I declare this hearing open. My name is Graeme Samuel. I am the Chairman of the Australian Competition and Consumer Commission and Chair of this public inquiry into the price of unleaded petrol. I am joined by Commissioner Stephen King and I hope in a few minutes by Commissioner John Martin. As Chair, I welcome you all and declare this hearing open.

The hearing is convened under Part VIIA 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. Results of the ACCC's inquiry will be reported to the Treasurer by 15 October 2007. Unless directed otherwise, the ACCC must make the report public after 28 days. The terms of reference for the inquiry have been published on the ACCC's website, together with an issues paper and all public submissions that have been received. The ACCC has also published notes for witnesses at this inquiry which outline the procedures followed by the ACCC at public hearings. The names of the witnesses appearing today have also been published on the ACCC's website. If time permits, following the questioning of scheduled witnesses, I may invite others here today to give evidence, but as with scheduled witnesses, anyone planning on giving evidence to this inquiry will need to be sworn in and subject to questioning under oath.

We understand the price of petrol is of tremendous concern to all Australian motorists. It will greatly assist us in the efficient and effective conduct of hearings if participants confine their remarks to the critical issues and not simply provide commentary on the price of petrol. Witnesses appearing today will be questioned by counsel assisting the ACCC. Counsel appearing today are Simon Marks of Senior Counsel, assisted by Fiona Forsyth. Some witnesses will also be represented by their own lawyers.

I would also note that 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 on a confidential basis. The ACCC can take evidence in private if a witness objects to giving evidence of a confidential nature 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. The ACCC intends to hold hearings in public as far as possible, but we do want to be able to ask witnesses about matters that are 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. Evidence given in private will be 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 BP Australia to please come forward and, for the record - if you would come and sit here.

Could you, for the record state, your name and position?

MR STURGESS: Mark Sturgess, and my position within BP is the manager of our integrated supply and trading business within Australasia.

5 MS McGRATH: My name is Rebecca McGrath. I am Vice-President of operations, BP Australia, for Australia Pacific.

MR DAVIDSON: My name is Brett Davidson. I am the retail pricing manager for BP in Australia.

10 THE CHAIRPERSON: Thank you. Could I inform you about some of the rules regarding giving evidence at this inquiry. Firstly, it is an offence to refuse to answer a question that you are required to answer by the inquiry chair. Secondly, it is an offence to give evidence that you know is false or misleading or omits any matter or thing without which it is misleading. You may give your evidence under oath or
15 affirmation if you believe an oath would not be binding or if, for religious reasons, you are prevented from swearing an oath on the Bible.

20 <BRETT DAVIDSON, SWORN [10.06am]

<REBECCA MCGRATH, SWORN

25 <MARK STURGESS, SWORN

THE CHAIRPERSON: Do you have legal representation here today?

30 MS McGRATH: We do.

THE CHAIRPERSON: Could you identify yourself for the record?

35 MR WANG: Mr Wang, solicitor from Clayton Utz. With me is Megan O'Brien, senior legal adviser of BP Australia Pty Ltd.

THE CHAIRPERSON: Mr Marks?

40 MR WANG: Can I --

MR MARKS: Mr Chairman, just before I commence, my friend Mr Wang has asked if some amendments could be made to answers which have been provided by BP to the 95ZK notice. It's a matter for the commissioners as to how you handle this, but given the confidential nature of those answers it might be appropriate if the written
45 form of the amendments were provided and then that can be incorporated into the transcript.

THE CHAIRPERSON: That would be the easiest way to do it, rather than clearing the room and having it done orally and then bring everyone back again.

5 MR WANG: Yes. The minor amendments are not sufficiently confidential to warrant closing the court.

THE CHAIRPERSON: I think it would be easier, as a matter of logistics. Do you have them all in writing or - - -

10 MR WANG: They have just emerged overnight so I was proposing to read them on to the transcript now, if that's convenient with you.

THE CHAIRPERSON: That's fine.

15 MR WANG: Just a minor matter of housekeeping initially, a letter of 31 August 2007 was provided by BP to the Commission, providing four additional net profit calculations. We sought confirmation that that would be treated confidential, as part of BP's confidential submission.

20 THE CHAIRPERSON: We are happy to do so.

MR WANG: In relation to the BP response for the 95ZK response, could I draw your attention to page 12, in what is the third paragraph. There is a bold heading which reads "The Bottom of the Cycle". In the second last line, after the words
25 "wholesale, or", the word "Term" should be inserted. The last expression would then read "Term, terminal gate price (TGP) for that market". On page 13 of that same response, under the first heading "Price Support Offered by BP", after the first sentence the additional sentence should be included "Only three sites claim price support".

30 DR KING: Only three sites "claim"?

MR WANG: Correct. I draw the Commission's attention then to page 25. In the response to question 22 - in the first line of the third paragraph, at the end of that first
35 line there is a reference to unleaded petrol to three single site franchisees.

DR KING: Sorry, Mr Wang, can you state again, question 22?

MR WANG: Question 22, in the third paragraph, which commences, "BP currently
40 provides temporary price assistance for unleaded petrol to three single site franchisees." That is the reference which is necessary to correct on page 13. While there are four sites, as it were, entitled to price support, there are only three that claim.

45 DR KING: Thank you.

MR WANG: Can I now turn to the open submission by BP which is dated 3 August. Can we go to page 21. In paragraph 3.1.2, in the first line there is a reference to 340

privately owned sites. That figure should now be amended to read 344 sites,
privately owned sites. We seek to correct then the second sentence by adding at the
beginning of that sentence the word "of", and after the word "sites" a figure of 333.
That amendment is made necessary because the breakup is now in fact a total of 344
5 sites, 333 are BP branded and there are 11 unbranded sites.

I turn to the following paragraph, 3.1.3. In the last sentence, which commences "BP
has 14 distributors", that figure is now 12. In the second line, there is a phrase, "BP
has a minority equity stake". The word "minority" should be deleted and
10 "50 per cent" should be substituted. On page 22 - - -

DR KING: Just to make it clear, BP has 12 distributors operating around the
country, of these BP has a 50 per cent equity stake in 2? So the 2 are included in the
12?
15

MR WANG: That's correct. On page 22, in the last paragraph, which reads
"Discounts to TGP apply to all BP customers under a supply contract", we add the
words to that sentence, "except in Victoria". The reason for that is that there is no
discount of the spot TGP in Victoria. On page 23, in the third paragraph, the second
20 sentence, it reads "BP adjusts its TGP". After "BP" we add the word "generally".

Then finally, on page 35 - this is not an amendment but we just seek to draw the
attention of the commission that when looking at the graph, one should go by the
bold dots, rather than the bottom of the cycle pointed to by the arrows. What has
25 occurred is in shrinking the graph, the arrows don't correctly line up with the dots.
You also see, in relation to the third box from the right, entitled "Easter", there is
what I would call a horizontal bracket and that is, as it were, embracing the incorrect
top of the cycle. It's the one with the dots.

30 Those are the only housekeeping matters. Chairman, we do apologise for the
unavailability of Mr Dean Salter, whose wife went into labour early this morning, but
I understand that BP has notified counsel that Mr Dean Salter can be made available
at a later time, should that be necessary.

35 THE CHAIRPERSON: We wish Mr Salter and his wife well. I must say I am
relieved that you have not tried to change Christmas Day and Boxing Day to a couple
of weeks earlier than 25 and 26 December. Mr Marks?

40 MR MARKS: Thank you, Mr Chairman. Mr Davidson - or perhaps, Mr Sturgess,
can I start with you. You said you were or are currently the Australasian business
manager; is that so?

MR STURGESS: Yes.

45 MR MARKS: That is in relation to international supply terminals, is it?

MR STURGESS: It's in relation to supply and trading activity to work with our
marketing and refining businesses in Australasia.

MR MARKS: So you would be able to answer questions related to refining and, I take it, wholesale matters as well.

MR STURGESS: Rebecca will talk about wholesaling.

5

MR MARKS: Rebecca, your position is Vice-President, operations, Asia-Pacific; is that so?

MS McGRATH: That's right.

10

MR MARKS: What responsibilities does that entail?

MS McGRATH: All wholesaling terminalling and distribution. I will also endeavour to cover matters generally relating to retail, and will be assisted by my colleague, Brett Davidson, who is well prepared to answer detailed questions regarding retail pricing.

15

MR MARKS: Mr Davidson, I think you said you are the retail pricing manager for Australia?

20

MR DAVIDSON: That's correct.

MR MARKS: What does that position involve, generally?

25

MR DAVIDSON: I am responsible for a team of individuals that set retail fuel prices at those BP branded outlets where we actually have an arrangement to set fuel prices, and by that I mean primarily the company-operated outlets.

MR MARKS: I want to start, if I may - this will be your area, I suspect, Mr Sturgess, but I don't want to bridle the appropriate answer coming from the appropriate place, but I will direct my questions to you. Can I talk a little bit, please, with you firstly about Australia's petroleum business. At paragraph 8 of your opening submission, you say that Australia's capacity is presently 718,000 barrels a day, answering to an overall demand of around 800,000 barrels a day; is that still the position?

30

35

MR STURGESS: That is broadly correct, yes. I mean, refinery throughputs on any particular day would be variable, but the sentiment that there is more demand than production holds, yes.

40

MR MARKS: Is the reference to 718,000 barrels a reference to all petrol products?

MR STURGESS: That - the way that is calculated, that's a reference to the amount of crude that is throughputted through the refineries, and the basket of products produced through refining.

45

MR MARKS: Does that suggest that, effectively, about 90 per cent of Australia's oil product can be satisfied from production within Australia; is that so?

MR STURGESS: I think what it is suggesting is that Australia is net deficit in refined product and therefore is structurally importing products.

5 MR MARKS: It is definitely suggesting that. I'm asking a little more than that. Is it to say that about 90 per cent of Australia's products are satisfied in effect from production or oil production - crude oil, I should say - within Australia?

10 MR STURGESS: Sorry, let me check to see if I understand. Are you referring to the amount of crude oil that's produced relative to the amount of refinery capacity?

MR MARKS: No, are you saying that, as I understand the position, effectively all of the crude oil is imported for production in Australia? Can you clarify that?

15 MR STURGESS: Okay. So the way - certainly from a BP perspective, the way we would look at refinery economics, we would make decisions to purchase crudes on the basis of what products we are trying to produce through our refineries and what crudes we deem to be the most economic crudes to use at any particular point in time. So depending on international prices, the value of local crudes versus the local imported crudes, we will make choices on a regular basis to purchase sometimes
20 locally produced crudes and, other times, internationally produced crudes. So we tend to look at the crude market as a global market, and don't necessarily differentiate between locally produced crude as opposed to internationally produced crude. So the amount of locally produced Australian crude that we may or may not refine at any point in time will be a matter of economics.

25 MR MARKS: When you talk about the refinery production capacity at 718,000 barrels a day in Australia, you are referring to the ability to produce from crude oil, are you?

30 MR STURGESS: Yes.

MR MARKS: And the 718,000 barrels is the total capacity of what?

35 MR STURGESS: Of the Australian-based refineries.

MR MARKS: What is that production figure reflective of - is it crude oil or something else?

40 MR STURGESS: It's a reflection of how many barrels of crude oil would be fed into the Australian refineries on an average daily basis.

45 MR MARKS: That's clearer. I wanted, then, just to reflect a little on motor spirit, or petrol. You say that Australia's demand for gasoline is about 424,000 barrels a day; is that so?

MR STURGESS: Correct.

MR MARKS: What proportion of that figure would comprise unleaded petrol?

MR STURGESS: I can't answer that question specifically off the top of my head, but unleaded petrol is a significant proportion of our overall demand.

5 MR MARKS: Do you have any idea, just roughly? You are saying that overall the demand is at about 434,000. We are just trying to get an idea of what unleaded makes up of that.

10 MR DAVIDSON: We can answer from BP's retailing perspective. Regular unleaded petrol makes up around about 70 per cent of the total sales of motor spirit through the BP network.

MR MARKS: And the remainder?

15 MR DAVIDSON: The remainder are other grades of petrol. Primarily - - -

MR MARKS: Just go through them. There is premium unleaded.

20 MR DAVIDSON: Premium unleaded at 95 octane, and in BP's case, BP Ultimate at 98.

MR MARKS: And are you able to give me any idea as to the proportions of those two grades?

25 MR DAVIDSON: It does vary from place to place, but in a broad sense I would say that Ultimate is approximately 20 per cent and Premium would be about 10 per cent. As I said, that's through our BP retailing network. That doesn't necessarily represent our wholesaling figures.

30 MS McGRATH: The wholesaling figures would reduce those other percentages down, overall. So in the wholesale channels, the sales of the premium higher grade products would be slightly lower, reducing the averages slightly down.

MR MARKS: So the averages will be not quite reflective?

35 MS McGRATH: Exactly.

MR MARKS: Mr Sturgess, can you tell me, please, what is Australia's capacity at the moment in terms of the production of unleaded petrol overall; do you know?

40 MR STURGESS: I think, on average, I would say the industry is probably importing about 20 per cent of its requirements.

MR MARKS: Is that unleaded petrol?

45 MR STURGESS: Yes.

MR MARKS: All right. So it fairly closely reflects, does it, the import figure more generally as to petrol products?

MR STURGESS: Yes, so I guess what I'm saying is that about 80 per cent of that is produced locally and about 20 per cent is imported.

5 MR MARKS: That's for unleaded, not all petrol products?

MR STURGESS: The premium grades we tend to produce locally.

10 MR MARKS: My point though is this: As I understand the figures, about 20 per cent of the product overall for Australia's needs is imported across all products. My question to you really is this: When you are talking about unleaded, are you talking about the same proportion?

MR STURGESS: From a BP perspective, we import - and it does vary - - -

15 MR MARKS: That's a different question. I want to ask you about that, but my first question is can you tell me - and perhaps you may not be able to tell me - but can you tell me if you know what proportion of Australia's ULP petrol needs are currently imported?

20 MR STURGESS: I cannot answer that question off the top of my head but I can take it on notice.

25 MR MARKS: All right. I would be grateful if you would. We would be helped by that answer. Then, as you were going to go on and say - can you tell me, so far as BP is concerned, what are its import statistics for ULP?

30 MR STURGESS: Our import statistics, I think we provided details of our actual imports by cargo-by-cargo basis in one of the appendices in our submission, and you will see that they vary over time, depending on our - we have had periods of heavy refinery shutdowns over the last few years so - - -

35 MR MARKS: But what you can tell me, I take it, is what your average deficits have been, and perhaps if you could give us those for the last two financial years, that would be helpful.

40 MR STURGESS: Yes, on average, we would be looking to import - and I can answer that question several ways, so I don't know what's helpful, but we import, on average, probably one to two cargoes of unleaded probably every quarter. Each of those cargoes is roughly about 40 megalitres.

MR MARKS: Accepting that that gives you an annual importation figure - - -

MR STURGESS: 300 megalitres.

45 MR MARKS: What's that as a percentage of your overall production?

MR STURGESS: Again, I don't have the numbers right at the top of my head but - - -
-

MR MARKS: Perhaps if you could tell us that, too, it would help us pitch the capacities and the importation levels at about the right level. The reason I am asking you those questions is I am trying to get a bit of a feeling for the broader question, which is the extent to which Australia is currently short on product and the extent to which that shortage is relevant to ULP. I don't want to just focus on ULP but I want to make sure we understand that in the context of this inquiry. At page 9 of the submission it is said that Australia is generally short on product. It is also said - and I think you have picked up this point more generally - that, overall, about 20 per cent of Australian product demand is supplied by imports.

MR STURGESS: Yes.

MR MARKS: But it is also said that the majority of the product imported is diesel.

MR STURGESS: Correct.

MR MARKS: And that is destined to supply demand from the resources industry and so on. I want to make sure we have a clear picture of the extent to which you say Australia is short of ULP product.

MR STURGESS: Yes, relatively speaking, the majority of importation is diesel. However, there is still a deficit of ULP that does require importation. But the majority of the deficit is diesel, true. That's right.

MR MARKS: If you would be good enough to help us with those figures on notice, we would be grateful.

MR STURGESS: Yes.

MR MARKS: Let me ask you, then, some questions just around importing generally, just to make sure I have understood where the thrust of your submission is going. You say at paragraph 2.2.1 - if I have it right - that there is a substantial refining capacity across the Asia-Pacific region. I'm just looking at this area of your submission now. I think you are saying, in effect, that there is - in this part of the submission that there is of the order of 24 million barrels a day being refined in the Asia-Pacific region and of course that is - I pick that up from page 8 - and that is very many times what is being refined and is available in Australia.

MR STURGESS: Correct. I think, to help put it in perspective, roughly the Australian refinery capacity is about 5 per cent of the region's capacity. That's sort of - - -

MR MARKS: That's about what it is?

MR STURGESS: Yes.

MR MARKS: As I understand the context of that statement, it is this: There are substantial opportunities to import, you are saying?

MR STURGESS: Correct.

MR MARKS: I just wanted to understand that proposition so that we get a better feeling for what the Australian market is actually doing. Can I start by talking about
5 just the position of the majors for the moment, so that we understand them. Clearly, the oil majors all have the facility and the opportunity to import; would you agree? They need to do so?

10 MR STURGESS: To varying degrees, yes.

MR MARKS: No doubt, to varying degrees.

MR STURGESS: Yes.

15 MR MARKS: But those degrees are nevertheless substantial, if it is required?

MR STURGESS: Perhaps I can elaborate. From a BP perspective, we don't have any regional refinery capacity other than Australian refining. To that extent, we are relying on our supply and trading capability here in Australia and Singapore to go to
20 the market to purchase our requirements to cover the importations.

MR MARKS: All right. I understand your point. Let me break it down a little bit, so that I can pick up the balance. The other oil majors all have parents or related corporations in the region; is that so?

25 MR STURGESS: That's my understanding.

MR MARKS: It's no secret. Mobil presumably has Exxon Mobil in Singapore. Shell has Shell in Singapore. Caltex has Chevron in Singapore. They have all
30 related corporations in the region. What you are really saying is we don't.

MR STURGESS: Yes.

MR MARKS: But you do have supply arrangements, open supply arrangements, and
35 by that I mean ongoing supply arrangements, with a number of regional refiners, do you not?

MR STURGESS: Correct. We have a mixture of what I would call spot or ad hoc relationships, where we can look to the purchase of a particular cargo and some
40 product where we have on a more term or ongoing basis.

MR MARKS: I understand. Let me break that down a bit. Forgive my breaking all these things down a bit. Take each - perhaps I can do it differently. I will take it by location. As I understand it, you have supply arrangements with Chevron in South
45 Korea?

MR STURGESS: We have. Yes, that's correct.

MR MARKS: Is that a spot or a longer term supply arrangement?

MR STURGESS: I would prefer to talk the details of that sort of nature and more on the contractual relationships in a closed session perhaps. From my perspective, it is probably straying closer to what I would consider as commercially sensitive. If that is okay.

MR MARKS: Let me say this to you. I want to make two points. The first is you may find that a number of my questions require you to consider whether you want to give answers in an open hearing. We will endeavour to accommodate you to the extent that you do not. We do want to conduct the majority of the hearing, though, in an open forum. The second point I want to make is that I will, though, consider myself open to ask you questions which relate to matters in your open submission or the comments you have made. If there are, though, on an ongoing basis matters you think are confidential, we will try and note them down and come back to them. If we can do it on that basis, we would be grateful.

Suffice it to say for the moment that BP has a number of supply arrangements in the region. You say that they vary from spot arrangements to long term supply arrangements. The point really is, though, that BP has wide access to supply, at least insofar as availability of refined fuel is concerned.

MR STURGESS: That is correct. Either directly from a refiner or through blending operations, correct.

MR MARKS: Can I then refocus a little bit. What about the independents in the Australian market? What is the position - before I get to the mainland and start talking about terminals and things like that, what is the availability generally - you might say to me, look, it's impacted eventually by what is on the mainland in terms of storage and supply arrangements and so on, but do the independents have the same availability as the majors or are they restricted by the realities of relationships between the majors and so on?

MR STURGESS: Well, I guess in a way I am straining perhaps to understand a little bit more about how they might view the world, but my opinion would be that without the supply and trading capability that someone like BP would have, the way that an independent who wanted to go into the international market and acquire a product, they would normally go to what we would call a trading company. So a trading company would then provide that supply and logistical and trading expertise to link up, if you like, the independent with being able to access all of those opportunities in that market. That would be the way that I would see it fitting it into - - -

MR MARKS: That's the direction they would go in. My point is slightly more refined than that. It is, when you look at the realities of supply in the region and the affiliations - take Singapore. Singapore is the obvious first port of call for refinement of Australian Standard petrol. In Singapore we have Exxon Mobil, we have Shell. These are affiliated refiners. Just from your experience, does the independent have

the same open access to those refineries and to the capabilities that they offer as the majors have?

5 MR STURGESS: I would say yes, on the assumption that an independent will always find it easier to create a relationship with a trader who will bring those relationships and all that accessibility that a major would have.

10 MR MARKS: Sure, but no doubt that would occur at a fee and eventually would make the independent less competitive; it may be marginally so. I'm really thinking here - - -

15 MR STURGESS: My comment on that would be that our own supply and trading capability has a cost as well. So in actual fact, the cost associated with acquiring the support of a trader may in actual fact be quite compelling versus your own internal overheads that go with having an ongoing supply and trading - - -

MR MARKS: Are there differences in the nature of the costs?

20 MR STURGESS: I think what you are comparing is - we have it as part of our own internal structure as supply and trading capability, whereas an independent is really just basically insourcing and outsourcing that on an as needs basis. I wouldn't think that an independent would be cost disadvantaged by having to buy in, if you like, trading and supply capability just to cover their requirements.

25 MR MARKS: Can I focus a bit more sharply then on a few more issues that may or may not impact on the ability of independents to bring fuel into Australia and just get your comment. If you want to add anything, feel free to do so. The first one that occurred to me was the impact of the fuel standards. What impact, if any, would the current state of the fuel standards have on the ability of an independent to access fuel from an international refinery to Australian standards at the present time?

30

MR STURGESS: I don't think that it's actually - I don't think that it's a problem. We see independents - we see traders buying Australian quality standard. We see independents buying Australian quality standard. We have had lots of times, through refinery unavailability, that we have had to go into the market at very short notice and acquire product ourselves, so I don't see any evidence to suggest that there is a difficulty in acquiring Australian specification products in the market. Obviously, if this is an unplanned event or at quite short notice, there may be logistical difficulties that mean it is not available at a moment's notice. Normally, these things are done over a fair bit of time horizon to allow for production and shipping, et cetera. So I think, initially, when the spec changes were made, there is obviously a teething period within trying to understand what refineries in the region have the capability - -

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40

45 MR MARKS: To do.

MR STURGESS: Conversations with those refineries on being able to segregate Australian quality in their own tankage, that's sort of the logistical operation that's usual in teething.

5 MR MARKS: Tell me about the standard, because it is relevant. The standards were promulgated progressively, it would appear, from about January 2002 through until about January 2006. The standards vary in dimension. Can you tell us from BP's perspective what were the dynamics of the availability of supply through the 2002 to 2006 period, given the staggered promulgation of the standards?

10 MR STURGESS: I can only speak from the period - personally from the period 2004 onwards, because prior to that time I was not in this current role. But I believe it was really, as I said before, an issue of understanding who had capability and understanding of how we could blend, and through that period it was done in a way
15 that I don't believe resulted in any particular issues in terms of ultimately being able to supply the Australian market. But it was just very much what I would call a transition time.

MR MARKS: Practically speaking, as the standards were promulgated, Australian refined fuel took on a different dimension.
20

MR STURGESS: Yes.

MR MARKS: It might have been benzene content, it might have been sulphur, it
25 might have been something else. With the consequence that, at least so far as available imports are concerned, petrol refined in the overseas refineries would not necessarily satisfy that standard and would need further refinement.

MR STURGESS: A lot of the higher quality, like as Australian spec in the region is
30 actually blended as well, so there are large blending operations within Singapore. If you understand what the recipe of the end product you are looking for, your components can then change. So, to some extent, I wouldn't want to say it's a simple process, but by actually understanding if this is what I have got to make then I can take different components and blend them to sell.

35 MR MARKS: Are you saying that the consequence of that is that you can really adapt quite quickly?

MR STURGESS: Yes.

40 MR MARKS: If that is so, why is it that we are hearing consistently in submissions that the fuel standards and their promulgation over time made it difficult for a period of time - some players say it is still difficult - to obtain fuel at the Australian spec?

45 MR STURGESS: Well, I would need to understand more about the specifics of why they found that difficult, but from a BP perspective and again from where I sit in understanding how the industry works, I can appreciate a period of trying to

understand how to perhaps change my supply or who of my suppliers can make these qualities, but I don't understand why people still find it difficult.

5 MR MARKS: I think the way BP has put it is to say that for structural importers, it was relatively easy specifications. Do I take it from that that you are talking about the majors?

10 MR STURGESS: I think "structural" would imply that people who have a large enough demand for product such that they are able to secure economic parcel sizes, so there is a certain economy of scale around being able to bring in - to be able to negotiate a deal with a supplier, you would want to have a material amount of product that you would want to import. You would need to have a material amount of product to import to make the shipping economics work. So I think "structural" is more around material - - -

15 MR MARKS: Economies of scale and so on. I understand. I take it that those sorts of issues would also impact upon the price, have a considerable impact on the price, say, when one compares available supplies to an independent of small or medium stature in the market in Australia at the moment and, say, one of the majors?

20 MR STURGESS: I think there is evidence to suggest that there are several independents who are of a scale that they are now able to import - and I believe are importing - through the process I outlined before, which is by - - -

25 MR MARKS: Let me ask you about that. I know you did say it and I was going to have you then, but you say you think or you believe that there are a number of independents who are currently importing on to the Australian market. Can you tell us who they are?

30 MR STURGESS: I understand that Gull actually import, WA, through - from Mobil in Singapore.

MR MARKS: You are right about that.

35 MR STURGESS: And I understand that also recently United have struck a deal to import through a trader from North Korea.

MR MARKS: Are there any others that you can think of?

40 MR STURGESS: There may well be, but off the top of my head - - -

MR MARKS: There may well be, but my question to you really responded to your proposition a few moments ago, which was that there are a number. I just wondered whether there is a number that you know of, or whether that is a wide statement.
45 There are two that you know of?

MR STURGESS: I believe that, in the past, Neumanns in Brisbane have had structural arrangements or arrangements to import as well.

MR MARKS: Can I then pick up this importing issue at the mainland and ask you some questions about terminalling and available storage. I need to find the precise location in your submission, but I think it was around pages 18 and 19 where you discuss this issue. You say at pages 18 and 19 that there is terminalling space owned
5 and operated by the independents. The impression that one gets, and it may be misstated, but the impression one gets when reading this is that BP's view is really there is plenty of terminalling space and the terminalling opportunities are not really an issue. Firstly, do I have that basic proposition right? Is that the thread of what is being said?

10 MS McGRATH: If I could pick up that question, our view is that on the basis that over the last recent years, a number of independent terminals have either commenced operation or have acquired infrastructure, that that would indicate that there is increasing access to and has been increasing availability to independents to either
15 own, acquire or use terminalling infrastructure in Australia.

MR MARKS: Can we perhaps delve into that a little more deeply? Firstly, can you tell me what - perhaps we will do it location by location. What terminalling facilities are available for independents? If you don't mind, I will go through this region by
20 region.

MS McGRATH: Sure.

MR MARKS: Can I start in Sydney. Apart from Vopac, what terminalling space
25 opportunity is available for independents?

MS McGRATH: You have already mentioned Vopac, obviously. That's the main independently owned operated terminal, so that is the basis of independent terminalling in Sydney. However, I can't comment on availability, but from time to
30 time, other terminals, industry-owned terminals, may have capacity to host others.

MR MARKS: Let's take each of those in steps. Firstly, Vopac. Vopac's present terminalling space - Vopac is an entirely independent terminal, as we know, it is not aligned to anybody, but it has no terminalling available to independents - in Sydney I
35 am just talking about, not Darwin for the moment. It is entirely taken up by terminalling to the majors. Can I put Vopac in Sydney to one side. Is there anybody else in Sydney who has independent terminalling space, do you know?

MS McGRATH: There is none that I'm aware of, no.
40

MR MARKS: I take it you agree that Vopac - I'm putting to you a proposition that Vopac doesn't have terminalling space in Sydney, as far as I'm aware that is right, but do you know?

45 MS McGRATH: I'm not a party to that information. They may well have, or not - -
-

MR MARKS: We have spoken to Vopac but I wondered if you - - -

MS McGRATH: - - - but I wonder whether they would be the ones to best answer that question.

5 MR MARKS: Can I come down to Melbourne. We know about Hastings and Trafagura, and Trafagura's position. Apart from Hastings, are there any other terminalling opportunities or any other independent terminalling space in Melbourne, the Melbourne region, that you are aware of?

10 MS McGRATH: Apart from Hastings, there is none that I'm aware of.

MR MARKS: Tasmania?

15 MS McGRATH: Yes, in Tasmania, there is an independent operating company called Mastelle, and Mastelle recently purchased Mobil's share of a Bell Bay joint terminalling agreement which Mobil and BP have.

MR MARKS: What is the consequence?

20 MS McGRATH: Mastelle is now an independent terminaller in Tasmania.

MR MARKS: To what capacity?

MS McGRATH: Are you asking me the size of the terminal capacity?

25 MR MARKS: Yes. I'm assuming that, with the benefit of that information about Bell Bay, you are able to tell me, you may not, what Mastelle and Bell Bay jointly are capable of providing Mastelle in terms of terminalling capacity.

30 MS McGRATH: I don't have the numbers at hand. That terminal is one of many in Tasmania, so it would not be - I don't have the numbers at hand. I'm saying it wouldn't be - it is not one of two or three in Tasmania.

MR MARKS: No, but it's the only independent that I'm aware of.

35 MS McGRATH: That's correct.

MR MARKS: And that's what I'm asking.

40 MS McGRATH: We could provide that information based only on historical information of when we were a party to that operation.

45 MR MARKS: I understand. What about Brisbane? We know that Neumanns have a small terminal capacity. But apart from that - and that has various limitations, including wharfage size and all sorts of things, but putting that to one side, is there any other independent terminal capacity facility in Brisbane?

MS McGRATH: Not that I'm aware of at the moment, no.

MR MARKS: Adelaide, with Port Stanvac gone, anything else?

MS McGRATH: None that I'm aware of, no.

5 MR MARKS: Let's go to Darwin. We know about Vopac. Vopac has a small, limited amount of present independent terminal capacity. There is no other that we are aware of; do you know of any?

10 MS McGRATH: I'm not aware of any other independently owned terminal in Darwin. A number of majors participated, at I believe state government request, to rationalise out of a certain area of Darwin and, therefore, the Vopac terminal as an industry solution became an obvious option.

15 MR MARKS: Yes. What about Perth? We know about Coogee and we know about Gull. Apart from them, are there any other independents in Perth that you are aware of? I'm not, but maybe there are.

20 MS McGRATH: No. Coogee Terminals in Kwinana is the only one that I'm aware of in WA. I would like to mention, however, that across I think the east coast, I believe, there is a company called Pacific Terminals who have been investing in tanks and tank farms.

MR MARKS: Where are they, did you say?

25 MS McGRATH: I don't know exactly where they are.

MR MARKS: Do you know anything about what they are doing?

30 MS McGRATH: I do. I was just going to say I do know that most of their core business or their business today is based around chemical and biofuel feedstocks. So it is fair to say that they are not currently, we believe, operating storage for, for example, unleaded petrol, but they do have the capacity, not unlike Vopac, to be able to handle other products, bulk petroleum, petrochemical products.

35 MR MARKS: I think I have gone through the major capital cities and major areas where there is terminalling space. Are there any that I have missed in that for independents?

40 MS McGRATH: No, only the ones that, as I mentioned, are emerging more around the petrochemical - I think there's one - - -

MR MARKS: At the moment, they are not figuring on things but you are saying let's keep an eye on them.

45 MS McGRATH: There is one that's under construction in Corio Bay in Victoria, and that is, I believe, predominantly petrochemical storage but could, likewise, with access to Corio Bay, be used for petroleum products in the future. I'm not party to any information. That's purely speculation on my part.

MR MARKS: With that summary, then, it would be fair to say, would it not, that the available storage capacity in Australia would make it very difficult for any independent to seriously - by that I mean in any substantial way - import fuel into the country?

5

MS McGRATH: I wouldn't agree with that in the way you have phrased it, because I believe the only barrier to entry is economic. Companies like Trafagura, like Vopac, big multinational or international terminalling companies, have seen Australia as a market they wish to invest in, and so the only barrier I would see is economic, that terminal investments are in the order of \$50 million and one has to have an access to funds and a confidence about the market to make such an investment. That's, to me, the main barrier, or the only barrier.

10

MR MARKS: You can call it economics, you can call it something else, but the fact of the matter is, as matters presently stand there is not terminalling space. Terminalling space is critical, is it not, for importation in sufficient loads to make economies of scale work; would you agree?

15

MS McGRATH: No, I wouldn't. I would say that terminalling capacity in Australia is appropriate and various companies are investing ahead of or as a part of demand in both the diesel market and in the unleaded market.

20

MR MARKS: If I was to take an independent and get them to bring in a shipload of 40 million litres - that's about the going cargo - tomorrow, where would I be telling them to go?

25

MS McGRATH: That would depend on a number of factors, including the market that the independent wished to place that product, and - - -

MR MARKS: Assuming - and I understand those real physical questions, but is there a location in Australia where a 40 million tonne load for an independent on short notice could be dropped? The answer is no, isn't it?

30

MS McGRATH: My colleague was just pointing out that Hastings would, we believe, have that capacity. Again, without the facts but my belief is that Hastings is what you could call somewhat underutilised. So I believe Hastings may provide an answer to your question in the immediate sense, but that - - -

35

MR MARKS: Hastings is about to be sold, isn't it? Trafagura has it up for sale?

40

MS McGRATH: But it's in business, we believe, at this present time.

MR WANG: Chairman, there are certain factual propositions that are tending to be advanced without a question at the end. It is not clear from the transcript whether the witness is agreeing or disagreeing with the proposition.

45

THE CHAIRPERSON: If I'm not mistaken, the transcription can pick up the inflection that will provide the question mark. I think it's a style that counsel have

used in a number of matters. I'm pretty sure the transcript will be able to pick up the question mark. But, Mr Marks.

5 MR MARKS: Thank you, Mr Chairman. Please, ladies and gentlemen, take my propositions as questions, if you would be so kind, because I am inviting your response. It is your response that we are interested in. The terminalling issue is an important issue generally, isn't it? I think, to go back to you, Mr Sturgess, terminalling is an issue of central importance when one thinks of the economies of scale that are necessary to obtain and import fuel into Australia; would you agree?

10 MR STURGESS: Yes, I think the way I would perhaps look to describe importing in terms of it being an economic or a viable business to be in is that to import, you firstly need to have a large enough customer base to have what we could call in the business to have a short, in other words, a customer demand that you are fulfilling.
15 Therefore, you would also need to have some opportunity of where you would actually store that material when you are discharging your vessel. So if I was entering into the business of importing, securing a terminal in which to discharge my cargo would be of critical importance to me. I think the point we are trying to make is that the only barrier is one of saying, well, if I'm going get into that business then I
20 need to make an investment, not unlike any other business of saying there is a certain investment in infrastructure to set up a business. If I'm in the business of importing, I need to have access to the terminals. So, in that sense, I am answering your question by saying, yes, it is important.

25 MR MARKS: Taking both of those issues, in terms of what you call short, I think you said that is really just customer demand at the end of the day.

MR STURGESS: Yes.

30 MR MARKS: The market in Australia, if you go to retail, a very substantial portion of the retail market now seems to be captured - although I don't want to use that word pejoratively, but gathered, in any event, by the alliance that the major supermarkets have with two of the majors, would you agree? I think the figure is around - I'm not sure, but do you know what the total by volume share of the retailers, the two main
35 retailers, Coles and Woolworths, is in Australia at the moment?

MR DAVIDSON: The answer is we don't know the exact share.

40 MR MARKS: What about the approximate share?

MR DAVIDSON: We have heard numbers anywhere between 40 per cent and 60 per cent.

45 MR MARKS: Do you have a feeling at BP where the right number probably is?

MR DAVIDSON: Probably closer to 40 than 60.

MR MARKS: Going back to you, Mr Sturgess, in terms of short, your decision as to whether economically it might be viable to have large imports would be influenced by that fact, wouldn't it, if you were coming on to that question anew?

5 MR STURGESS: I think I would be considering whether or not I was able to be a wholesaler. I think there is a distinction between whereabouts in that whole value chain you would be looking to make your contribution.

10 MR MARKS: My point was more broadly made. If you were coming in as a wholesaler and you knew that the alliance was capturing a significant proportion of the wholesale market because of the affiliation I have just described to you, that would impact on your decision, would it not?

15 MR STURGESS: Yes, the impact - I would be trying to understand what percentage of the market could be made available to me.

20 MR MARKS: Yes, I understand. To take your other point about terminalling and capacity, can I approach that a little differently and just ask you this: From BP's perspective, is terminalling and the available terminalling space an important issue for the company at the moment?

25 MR STURGESS: I would say it is an important question for us, because as demand in total continues to grow, leaving aside petrol, but an importation overall continues to grow, we are continually in the process of evaluating where is that demand and what is the infrastructure required to most economically bring in importation. So, terminalling and infrastructure is always something that's under continual review for us.

30 MS McGRATH: I would just add that it would be under particular review over recent years and looking ahead, given the considerable growth in demand of diesel products, which is quite unlike the flat demand in motor spirit product. When we talk about terminalling and our plans and our investment, our focus, the - the implications of the increase in demand in diesel is much greater in terms of our action planning than the state of the unleaded petrol market.

35 MR MARKS: So there is a particular emphasis because of the prediction as to the growth of diesel. But so far as unleaded and petrol more generally is concerned, do we take it that BP's knowledge of the reality that we are product short or short product, whichever way it is correctly put, that that will not change, that that problem will become more rather than less of an issue in coming years, do I take it that they are impacting and impacting as important issues for BP in the foreseeable future in terms of terminalling?

45 MS McGRATH: Yes, they are important issues for BP in the foreseeable future, given the short in unleaded and that short which has grown over the last 10 years. I would say if we wound back the clock, the industry, be it independents or majors, were - had a different mind-set about potentially the importance and priority of terminals 10 or more years ago.

MR MARKS: This terminalling issue is not such a hard point, even from a layman's perspective. If you are a refiner or if you are an independent and you know that in the future you are going to be increasingly relying on imports, and you know that there are optimum parcels of shipping and so on that you can bring into Australia that seriously impact on your bottom line margin then it's an important consideration for you, isn't it, Mr Sturgess?

MR STURGESS: Yes.

MR MARKS: What are the realities? Just give us some factual example, if you would, what are the margin issues that might be involved in the difference between importing an optimum parcel and importing a non-optimum? You could be talking about millions of dollars annually, couldn't you?

MR STURGESS: Correct.

MR MARKS: You have provided us with some figures about that, which are helpful, but just in this open session, I want to put the proposition to you nevertheless it's a very important issue, isn't it?

MR STURGESS: Correct. It is an important issue.

MR MARKS: And likewise for an independent who is planning his future in the market, trying to see how he is going to handle it, terminalling is a critically important issue for him, isn't it?

MR STURGESS: I agree.

MR MARKS: To be able to land optimum parcels, either alone or in combination with others, into terminally space in Australia is critically important to the independent?

MR STURGESS: Correct. The one thing I would say, in reference to a point you made before about when I think you said importing being a problem, I think actually having an industry where there is a combination of importing and local production is actually a good thing, because in the interest of security of supply, it is important to have several supply links. I wouldn't like you to think that being in a position where we never imported was actually a good thing, because then you are totally reliant on your own refinery system. So I think having that combination of refining and import is actually a good thing in terms of security of supply.

MR MARKS: If you project that beyond BP as a major into the independent category of the market, the point holds good, though, doesn't it?

MR STURGESS: Yes.

MR MARKS: From an independent perspective, in the present market, independents are predominantly reliant on the majors; would you agree, Mr Sturgess, for supply?

MR STURGESS: My observation is that there is a mixture of relationships with local refiners, a relationship with regional major refiners and relationships with other refiners through traders. So I think there is a - sort of a mixture of relationships.

5 MR MARKS: Yes, but my point was not to ignore that there is a mixture but rather to put to you that the predominant source of supply was from Australian refiners.

MR STURGESS: And I would offer that why that is an observed fact is that one of the advantages for an independent to have a relationship with a local refiner is
10 regular, secure supply, eliminating issues of importing and working capital issues. So there is a natural kind of attraction, I would argue.

MR MARKS: Could you expand on that a little? From the independent's
15 perspective, tell me about the importance of security of supply. How critical is it?

MR STURGESS: Again, it's always difficult to speak on behalf of someone else, but I think - - -

MR MARKS: You have a very considerable knowledge of the refinery end and the
20 wholesale end of the industry.

MR STURGESS: Yes.

MR MARKS: Tell me what your view is.
25

MR STURGESS: My view is that one of the exposures, if you like, that an independent would have, when looking at importing as opposed to being able to look at a local issue such as weather, for example, or delays to shipping can be quite significant. If you were trying to run at very low working capital, just in time-type
30 approach so you are not tying up quite a lot of money in stock, you would tend to be looking to have not a lot of room for ships to be delayed. You would be wanting to have your tanks empty when the ship came in and so on. So I think again by having a local supplier would eliminate a lot of that risk.

35 MR MARKS: At the moment, though, really it is the other way around, isn't it? The independents predominantly rely on local supply and use imports, to the extent they do at all, really as a fall back to accommodate them in positions where the local refiner may not be able to or to give them some source of breathing space?

40 MR STURGESS: Yes, and I think the other consideration obviously that must be considered is also price. Clearly, if you are an independent, the local offer needs to be competitive with the import so that your choice is, hopefully, one around a balance of saying what is more my appetite for risk as opposed to it being a price issue.

45 MR MARKS: Could I ask you a few questions from BP's perspective about importation and so on. I asked you before, just broadly, about how much of BP's ULP requirements it imports, and we discussed that. I wanted to ask you whether

you knew broadly - and it may not necessarily be an immediate correlation - how much of BP's requirements of fuel it sources from other oil majors in Australia under buy/sell arrangements?

5 MR STURGESS: Sorry, were you looking for specific numbers?

MR MARKS: If you could give me a percentage, that would be very helpful. If you can't and the question is one you have to take on notice, then - - -

10 MR STURGESS: My preference would be to give you an accurate number on notice. But I think there is a significant amount of volume that is bought and sold internally through the buy/sell arrangement.

MR MARKS: So far as BP's perspective is concerned, is it more buy or more sell?
15 Is it a net buyer from the majors or a net seller?

MS McGRATH: I think the conversation we are having would indicate that we are speculating so we would rather not speculate.

20 MR MARKS: Can you take that on notice, too, please?

MR STURGESS: Yes.

MR MARKS: It may be answered or captured in the other question I asked you, but
25 if it is not, if you could tell us that, too?

MR STURGESS: Yes.

MR MARKS: I glean, though, that these buy/sell arrangements now take the place
30 of the old exchange arrangements across all sectors of the wholesale market?

MR STURGESS: Correct.

MR MARKS: What consequence, if any, has the change from the old exchange
35 arrangement to these new buy/sell arrangements had for BP?

MR STURGESS: I think the consequences for us are twofold. Initially, the compelling argument for refinery exchange was one of basically saving freight, because by being able to exchange a molecule of product in one location with
40 someone else who had a molecule where you wanted it then you were both saving - ships passing in the night, if you were. So I think that was the attraction of refinery exchange. But what we, as BP, found with refinery exchange, it was never very clear, or as clear to us as we would have liked the actual value of our product in each location. So, by moving to more transparent commercial arrangements of actually
45 selling our products in our own location and buying product that we required in other locations, it became easier for us to understand what our cost of product was and therefore it would make it easier and more help for us to make business decisions around where we were competitive and where we were not competitive and,

therefore, where we should be looking to grow our markets and where we should perhaps be looking to withdraw. So I think to answer your question, the overall consequence of buy/sell for BP was that we had a much more transparent understanding of our sources of value and therefore we were able to become more efficient.

MR MARKS: Has it improved BP's returns?

MR STURGESS: I would hope so. I would hope that we have become more efficient.

MR MARKS: That is certainly true but what about - let me ask you the question differently. As part of the buy/sell arrangement, is there a margin which is built in?

MR STURGESS: I'm sorry, I don't understand.

MR MARKS: Does BP get a margin on its buy/sell sales to other refiners?

MR STURGESS: The - there is - we are - the contractual relationships are pretty much exchanging at fair value.

MR MARKS: Does "fair value" mean a value reflected in costs?

MR STURGESS: Versus the alternative. So we would sell at a number close to an alternate - we would sell at a number closer to our counterparty's import alternative.

MR MARKS: But that doesn't mean there isn't a margin. I accept that what you say is so. My question really is essentially this - it may be one that you would rather tackle in private session and, if so, please tell me, but under the buy sell/arrangements, when BP sells fuel to other majors in Australia, does it get a margin on the sale?

MR STURGESS: What we are saying is our ex-refinery, we will sell at that import parity number, so it goes into the refinery margin - - -

MR MARKS: So it's collected in the refinery margin?

MR STURGESS: Yes. I guess, it is kind of difficult, off the top of my head, to answer your question because refinery margins tend to be a product of the environments. Refinery margins are quite volatile. So, to say what would our refinery margins have looked like in a refinery exchange environment versus in a buy/sell environment it is difficult to do, because you don't have a steady state of crude prices and product prices to compare, to make that comparison.

MR MARKS: No, but you would have averaging over, say, an annual period where you would be able to judge, would you not - I'm not talking now about gross margins, I'm talking about real margins. You would be able to judge the two

positions comparatively and say pre- and post the introduction of the new arrangements, this is what it looks like; am I wrong about that?

5 MR STURGESS: Again, if we wanted to, we could do some detailed analysis to try and establish what that was worth.

10 MR MARKS: Has that been analysis - when you say you could do - I would have thought that is analysis BP would have done and probably done often. Am I wrong about that?

MR STURGESS: I have not seen anything recently on that. But, again, if there was something specific that you wanted to see, I am sure that we could make some attempt to answer that.

15 MR MARKS: What I would like to know - and again it may be something you can take on notice - is what margin or whether you make a margin and, if so, what the margin is on buy/sell sale arrangements and - - -

20 MR STURGESS: Relative to a refinery exchange environment?

MR MARKS: No. First of all, straight out, that is without reference to any comparison. Secondly, by reference to the comparison, what difference, if any, there is; and they would need necessarily - so we would understand them to be net margins, not margins inclusive of costs. In also picking up that information, can I ask you to give consideration to BP's buy arrangements and tell me whether BP pays a margin - and I presume it will be generally reciprocal - on petrol that it buys. Is that something that could be done?

30 MR STURGESS: So when we look to buy, we would obviously go to - and we are looking to buy in a location where there is another refiner, we would obviously go to them and ask them through the buy/sell negotiation more - more of a negotiation, I would say, than an arrangement, but it is a negotiation process. We would look to say this is how much we are looking for, do you have any to sell? Then we would look to negotiate a price. The basis for that price, knowing - with our seller knowing full well our alternative is either to ship from our own location or import, so that you very quickly come to an import parity number which is quite transparent. So, the negotiation will be around an import alternative. Our own supply and trading people would be in the market, understanding what premiums the market would be demanding for the quality of fuel we would be looking to buy. And that's fairly well established. Those premiums are in the market. So it's quite - it's quite clear what people's alternatives are because the market is quite transparent.

45 MR MARKS: My question to you about margins nevertheless remains, and we would be grateful to have that information on both bases, if you could.

MR STURGESS: Yes. The detail around our buy/sell contracts, the next level of detail would be something we would want to do in confidence.

MR MARKS: Yes, I understand. You have mentioned import parity pricing a few times in this context. Can I ask you a little bit about that. Import parity pricing - firstly, can you tell us what import parity pricing is precisely and, secondly, how it differs from the old export parity pricing?

5

MR STURGESS: Import parity pricing is basically saying that, you know, the - to import product from - into Australia from the region, one would be buying it in the market and the price which you would pay would be based on a Singapore benchmark, and you would pay a quality premium for the difference between that Singapore benchmark quality and the Australian quality, and then you would be - there would be a freight component or, should I say, a shipping component to bring that to a particular location, and there would be other costs, small costs associated with that operation. So it is basically saying this is, on any particular day, the theoretical cost to import product into any location from the market, using Singapore as sort of the market starting point.

10

15

MR MARKS: How does that compare to export parity pricing?

MR STURGESS: If you were in an environment where, say, in taking, for example, Australia, where Australia was producing a lot more product than it had demand for, then at the margin the value of that incremental product would be what we would call export parity. It would be saying it's the value in Singapore minus the freight component back to the source.

20

25

MR MARKS: The change from the export to import parity model, which occurred in the late 1970s or - can you tell us - - -

MR STURGESS: As the market moves from being surplus to deficit, the model would tend to change. So, depending on whether you are in a deficit or surplus environment, the value of product in a particular location would be very much either import parity or export parity.

30

MR MARKS: Is the model essentially built on a notion of Australia being subject to international competition?

35

MR STURGESS: So, in the absence of Australian refining, you would be importing - Australia would need to import all its product, hence the value of the product in this country is based on that. And Australian refineries, because they need to compete in those international markets, have chosen that model.

40

MR MARKS: When you say in order to compete in international markets - and that's a comment that we have seen or picked up in the open submission - what precisely do you mean by that? For example, at 2.2 on page 10, you say that refiners compete against imports.

45

MR STURGESS: Correct.

MR MARKS: What do you mean by "compete against imports"?

MR STURGESS: Any buyer of refined product has the alternative to buy locally produced or imported product, so that is in the conversation around what are my choices to secure product, that is the competition.

5 MR MARKS: Any - who did you say - - -

MR STURGESS: If you are looking to buy a product, your choices are locally produced or internationally produced.

10 MR MARKS: At page 12 you say, in answer to the proposition put by the bullet point, why do we use import pricing, you say 20 per cent of demand has to be imported anyway, and refineries compete against imports. What do you mean by 20 per cent has to be imported anyway?

15 MR STURGESS: I think what that is saying is that to satisfy local demand for product, Australian refineries can only produce 80 per cent of what is required.

MR MARKS: But Australian refiners have effectively the dominant market in Australia - there is not much doubt about that, is there, for fuel?

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MR STURGESS: Sorry, I don't understand.

MR MARKS: The Australian majors dominate the Australian market for sale of fuel to all levels, don't they?

25

MR STURGESS: I don't understand the question. Are you talking about which level of - - -

30 MR MARKS: I'm talking right through. The importing/refining level - the Australian refiners refine the majority of the fuel?

MR STURGESS: Correct.

35 MR MARKS: You have already agreed with that. Down the supply chain to wholesale and import, they also dominate the picture, don't they? The majority wholesaler and retail sales are vastly, by majority, from Australian-sourced refined fuel; would you agree with those propositions?

40 MR STURGESS: Yes, I guess I was uncomfortable with the word "dominate".

MR MARKS: But would you agree with the propositions I have just put?

45 MR STURGESS: There are certain companies that have significant levels of activity here and I guess that's why they are referred to as "the majors". They are - obviously, only so many companies have refineries, et cetera, but I think when you said all the way down, I would defer to my colleagues to perhaps say that the retail space has a slightly different profile in terms of the companies that refine versus the companies that retail.

MR MARKS: Is there any international refiner that might be viewed by the Australian majors at the moment as a potential competitor?

5 MR STURGESS: Where we have customers whose - all of our customers have the choice to import, and we do see some of our customers actually importing from other Asian refiners. So, in that sense, they are live competitors, as we speak.

10 MR MARKS: But in terms of substantial competition - and by that I mean - I think BP said in its submission that there are a lot of refiners out there who could produce a lot of fuel. Am I right in saying that as time goes on, fuel to the Australian Standard will become more and more available in the Asia-Pacific region? That has been the thread I have taken in BP's submission.

15 MR STURGESS: Correct.

MR MARKS: My question really builds upon that, to ask you this: Is there any particular Asian refiner who BP sees, either now or in the near future, as presenting as a substantial competitor to BP in Australia?

20 MR STURGESS: I think we - I think I would see all of them. Anyone who has the capability to produce Australian - - -

MR MARKS: Let us take that as read. Is there any one in particular?

25 MR STURGESS: I wouldn't single anybody out, no.

30 MR MARKS: In your submission at pages 11 and 12 you have spoken about the import parity model and then you said that hence, Australian refiners - this is at 2.2.3 - you said that Australian refiners are competing against other suppliers in the region as well as each other. Then you say that if IPP is the highest price an Australian refinery can expect to obtain for their products, it makes sense that refineries will sell product at a price very close to IPP. Can you elaborate on that, please, Mr Sturgess?

35 MR STURGESS: Yes, I guess what that is saying is that a refinery is in the business to - a refinery is in the business of maximising its profit and, therefore, it will always look to price its product to return the best it can on that investment. So if the alternative is import parity then that is probably pretty close to where its margin aspiration is.

40 MR MARKS: Does that really mean that it's going to charge the highest price that it can as against IPP in all the circumstances?

45 MR STURGESS: What it is saying is, as I said before, a refiner will look to maximise the money it can make in a particular margin environment, and IPP is the alternative purchase price for a buyer ex the refinery. So a refiner being a good businessman would look to get the maximum value it can for its product.

MR MARKS: In IPP, though, there are already margins and so on. We know IPP is broadly reflective or it's an average price, it will necessarily be reflective a significant degree, you would hope, of the costs associated with the production of fuel and so on, but it also includes a refiner margin and so on at the Singapore level;
5 would you agree?

MR STURGESS: If I can get where I think you are going with this, I think the thing that gives me confidence that we are - certainly from a BP perspective, that we are charging an appropriate price ex our refinery is that we do have contractual
10 relationships with independents who have in the past demonstrated their willingness and capability to actually import. So the fact that they see us as an alternative and in fact we have entered into contractual arrangements from time to time with these, gives me confidence that where we are looking to sell at is an appropriate match for the real alternative.
15

MR MARKS: Yes, I see. So you really say, look, when the importer wants to import, this is what it's going to cost him. We're going to price as near to that cost or as near to that price as we possibly can?

20 MR STURGESS: Correct.

MR MARKS: Even though the reality is that many of the - some of the costs - I don't want to overstate it - some of the costs which are referable to the IPP may be only notional in the context of the Australian refinery.
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MR STURGESS: Sorry? Is there a question there?

MR MARKS: The point I'm really making is that there is built into - this is not really a criticism, it is just to ensure we understand the position - there is built into
30 the reality of charging an IPP price, when you are an Australian refiner, various costs and so on that are notional, in the sense that they are not actually incurred by the Australian refiner?

MR STURGESS: Yes. Freight is the obvious one.
35

MR MARKS: It's the obvious one, but it's not the only one.

MR STURGESS: That's the compelling argument for having a refinery, in that you can actually invest in a refinery, invest heavily in infrastructure to meet changing
40 standards, run your business on the basis that this is a going concern, because it can compete against the alternative, which is freight. So that is basically why a refinery can operate in Australia. That's how it turns on its investment.

MR MARKS: Really that is underpinned by this import parity price notion, isn't it?
45

MR STURGESS: Yes, it is underpinned by it - it has to freight its crude in, it has to operate its refinery and then there is a value ascribed to the product that the market is willing to pay for it, and that generates the refinery margin.

MR MARKS: Yes. If you are an Australian refiner and you are looking at the economics of all of this, you would be very interested to know, wouldn't you - would you - as to how much cheaper it might be to refine crude than to refine imported - refine petrol?

5

MR STURGESS: Sorry?

MR MARKS: I am sorry. I will start again. I think I put that incorrectly. What I meant to say is you would be very interested to know the difference between what it would cost you to import crude and what it would cost you to import refined petrol?

10

MR STURGESS: Absolutely. I mean, that's the basis of how we run our refineries. On a regular basis, if not many times a day, we are looking at what is the cost of crude, what is the cost of bringing the crude in, what does it cost to operate the kit, what is the value of the product we can generate, therefore, how do we run this refinery in a way that maximises that margin. So, yes, those data points are critical.

15

MR MARKS: They are indeed. I'm sorry I put that question incorrectly. Let me ask you this: Can you now, or in closed session, tell us what the difference - perhaps the easiest way is to describe it in dollars per barrel - the difference between the cost to BP of importing crude and the cost to BP of importing refined petrol?

20

MR STURGESS: That's a very interesting question and one that if I gave you an answer, I would be giving you one data point in time. Because, for example, just on refinery margins, we have seen a lot of commentary in the press recently about crude pricing and where that's heading. It's well established that we all know that crude prices are quite high. At the same time, we are observing Singapore product prices going down. At the moment, if you were to ask me what would be the refinery margins for producing petrol, I would say they are probably zero or probably close to negative, because we are seeing an observed phenomena at the moment where world crude prices - - -

25

30

MR MARKS: A convergence, yes - - -

MR STURGESS: - - - are going up, and because of - primarily because of the end of the northern hemisphere summer and driving season, we are seeing Singapore benchmark petrol prices plummeting, mirroring pump prices here, such that - - -

35

MR MARKS: Obviously, we are not interested in a point in time, we are interested in a picture, in a range. Would you be able to provide - and I can ask you about this further perhaps in a closed session - but we do want to know the answer to that question.

40

MR STURGESS: So, in a closed session I could probably start to give you some more indicative longer term numbers, but what I would like to say is that it's often said at the moment that refinery margins are good and I think, relatively speaking, that is true. But I think what one has to understand, with the nature of refining, it is a very cyclical business, it always has been and always will be, because - - -

45

MR MARKS: I understand. You have made that point in your submission.

MR STURGESS: Yes, and I think at the moment we are seeing probably the best refinery margins we have seen for quite a long time, which is good news for refining
5 because they have invested heavily in the last few years to be able to meet the Australian specs and recover from negative refinery margins in the past. So I think it is important that when we start trying to understand refinery margins that we are take a reasonable snapshot in time to understand the kind of sustainability of refining, as opposed to saying what might be your margins this year or today.

10 MR MARKS: Or yesterday.

MR STURGESS: Yes.

15 MR MARKS: I understand. I want to ask you some questions about margins a little later. I just want to pick up there, when you talk about refinery margins, are you talking about gross margins or are you just talking about the difference between IPP and the cost of crude or are you talking about - - -

20 MR STURGESS: Gross.

MR MARKS: When you talk about the performance and say you need to understand this, are you talking about gross margins?

25 MR STURGESS: For the most part, we tend - we internally tend to talk about gross margins.

MR MARKS: If I can ask you one follow-up question. You have talked about the change - you do it in your submission - at a very high level and say that things are
30 better now than they used to be. Can you give us, even at this stage, just a clearer picture about that? In terms of the last five or six years, what has been the change in the refiner margin position, from BP's perspective? Let's go back to 2002, the time the fuel standards were first promulgated. What has been the difference or the change from 2002 till now?

35 MR STURGESS: Do you mean in terms of what has been the size of the change or what has been driving the change?

40 MR MARKS: What's been the direction of the change, first of all?

MR STURGESS: Well, I would say directionally, we have seen over the last five years refinery margins have improved, definitely.

45 MR MARKS: So the curve or the line has constantly been on the up since 2002 or has there been a - - -

MR STURGESS: Yes, I mean, the overall trend has been up and that is very much driven on the well understood resource boom. I mean, most of that margin has been driven by the diesel margin, not on that - - -

5 MR MARKS: Has it?

MR STURGESS: Yes. We tend to talk about refinery margins in terms of the totality of all of the products that we sell. But you can roughly - not accurately, but you can roughly ascribe, so what is creating that margin, is it the - is it the diesel that
10 you are producing or is it the petrol that you are producing? We do produce other products but they are the main two. I would say that the increasing of refinery margin that we have experienced over recent times has been primarily underpinned by diesel margin as opposed to petrol margin.

15 MR MARKS: If you had to excise the petrol margin out of that picture and look at it separately, what would you see?

MR STURGESS: I would probably need to take that question on notice, but I don't think it would be the - as sharp as diesel, no.

20

MR MARKS: I am wondering, would the curve still be going up over time?

MR STURGESS: I would - my instinct would say it's probably quite flat. But, again, I would like to take that on notice, to really give you a more definitive answer.

25

MR MARKS: All right. Can I ask you then about the - can I ask you about one other thing I read in your submission, it's on the same topic but just to make sure we understand it. At the top of page 11, you have said every refinery in Australia must compete against imports when bidding for sales to the Australian market. Is that
30 some term of art or did you intend any particular meaning by those words, "bidding for sales"?

MR STURGESS: I can't lay claim to the actual words that were used but I - - -

35 MR MARKS: Perhaps I can ask you more generally: What do those words mean?

MR STURGESS: I think what it really means is when you are offering your products for sale. See, the way I interpret that is when you are offering your product for sale you must be competitive. Does that help?

40

MR MARKS: All right. When this talks about bidding for sales to the Australian market, what then are you saying, just being competitive with other Australian refiners?

45 MR STURGESS: Well, I'm saying competitive against the market.

MR MARKS: Which comprises?

MR STURGESS: The market is those who are buying, and those that are buying, you are ultimately competing against who else they could buy from, which would be another local refiner or an importer.

5 MR MARKS: Can I, then, just ask you about the fuel standards premium. Firstly, can you just, in short compass, tell us, Mr Sturgess, what it relates to?

MR STURGESS: Okay, so would it be helpful to go a little back towards Platts and - is that - - -

10

MR MARKS: Sure. As you see appropriate to explain it.

MR STURGESS: The base price for unleaded petrol is, as I have said before, referenced back to a Platts benchmark. Platts, as you may be aware, is an assessment agency that on a daily basis makes an assessment of the value of petrol in Singapore, based on transactions on a daily basis within that market. That Platts quote, whether it be the 92 or the 95, has a certain number of qualities associated with it. Those qualities would vary from the Australian Standard. So, when a contract is entered into and a contract is negotiated, normally that contract will have as its benchmark or its basis either the 95 or the 92 - more predominantly the 95 - as the benchmark and then there will be an acknowledgment that because the Australian fuel is a different standard, to actually produce or blend to that standard requires incremental cost and uses components that have a higher value. So, on that basis, when a contract is entered into, you will - to buy a higher standard, will attract a premium to that benchmark.

25

MR MARKS: And how is the premium determined?

MR STURGESS: By negotiation. So, as a buyer, you would have the responsibility to understand the value of the components that it would take to actually give you - to meet the Australian Standard, and as a seller you would need to understand what it would cost you to actually either change the way you operate your refinery, change the way you have your infrastructure, change the way your operation is to understand the real cost to you of actually producing something that is to a higher standard. So it's through negotiation one tends to get an understanding - sorry, not an understanding but you get a mutual kind view of where one is happy to strike a deal based on your agreement that that is a fair number to charge and a fair representation of that value difference.

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35

40 MR MARKS: Is the reality that at the present time, and looking forward, more and more refiners in the Asia-Pacific region either are able or are growingly able to provide petrol refined to the Australian Standard?

MR STURGESS: Correct.

45

MR MARKS: Is the consequence of that that as more petrol of the Australian Standard comes online, as we will describe it, the premium or the chargeable premium associated with the purchase of that fuel will diminish?

MR STURGESS: I guess you are asking me to speculate, but - - -

MR MARKS: Well, perhaps ...

5 MR STURGESS: So I will offer you a person opinion. I think that that - if we were
in a situation where more became available, that that could manifest itself in several
ways in the marketplace. You may see an actual overall reduction in the base
benchmark and/or a combination of that. Plus a reduction in the premium. But that
would depend very much - - -

10 MR MARKS: Insofar as you are not speculating, and you can speak from BP's
perspective, BP charges a premium on fuel that it sells?

15 MR STURGESS: Correct.

MR MARKS: What is the current premium? I know it's different in every case but
what is the range for the fuel standard?

20 MR STURGESS: I think it's of the order of, say in round numbers, \$3 a barrel.

MR MARKS: If I said 3c a litre or something approaching 3c - - -

MR STURGESS: Yes, that's about right.

25 MR MARKS: When BP - - -

MR STURGESS: That's changed - sorry, that's versus the 95 - - -

30 MR MARKS: That's vis-a-vis the 95 Mogas. I understand. Can I pick up on that, if
you were to use the 92 Mogas benchmark - and I know BP does on occasion - what
is the premium applicable there?

35 MR STURGESS: We haven't got a lot of data points around that but, you know, I
would say it's probably equivalent to the differential between the 92 and the 95
quote. So I guess the absolute price I wouldn't expect to change. So people - if you
were selling to me happily on a 95 basis and I were to ask you to sell to me on a 92
basis you would probably add on the difference between the two quotes. I think, on
average, those quotes tend to be \$1, \$1.50 a barrel or 1 cent to 1.5 cents a litre. So
40 moving from a 92 quote to a 95 quote as a benchmark, my opinion would be that we
probably wouldn't see an overall change in the absolute price. We would just see a
larger premium to acknowledge the fact that there is even a further gap differential
between 92 quality and the Australian quality.

45 MR MARKS: Is the philosophy behind the charging of that premium built in in any
way on the cost to BP of refining fuel to that standard, or is it rather built on the
availability of alternative sources?

MR STURGESS: It is both. We, and I am sure others, have invested heavily in terms of our infrastructure to be able to meet the higher standards, so there has been an added increase in the cost of production for us.

5 MR MARKS: Is BP - by charging that standard premium that is charged, does it see that as a cost recovering exercise amortised into the future, or is it looked at more simply?

10 MR STURGESS: When we look to the - when we looked in the investments we needed to make, I guess we made an estimate of the value we could extract from the product, and that was factored into the overall economics of that investment.

15 MR MARKS: Just going back to the point that I started to ask you about before, at page 16 it is said in the open submission that the reality - and this is the second paragraph under 2.3 - the reality is that there is much capability in the Asian region to produce fuel at Australian Standards, either directly through refining or by blending components.

20 MR STURGESS: Correct.

25 MR MARKS: Then you go on to say, or the submission does, that similar fuel standards apply in a number of Asian countries and other countries are moving towards these standards. Going back to the earlier question, is the reality that, as a consequence of those facts and as a consequence of the increasing availability of fuel refined to the standard, that that premium will be eroded in terms of its share in the overall price of petrol?

MR STURGESS: That is one potential consequence of that, yes.

30 MR MARKS: Can I take it beyond the potential into the actual? Has BP planned, in its future strategies, for the reality that it will - that the fuel standard will diminish as part of the overall price over time?

35 MR STURGESS: Sorry, have we taken in?

MR MARKS: Have you taken into account that the - that part of the price referable to the fuel standard will diminish and eventually evaporate over time?

40 MR STURGESS: We are mindful that that could occur, yes, but I mean I'm not - - -

MR MARKS: Beyond that, you can't answer.

45 MR STURGESS: - - - it - I mean, at the end of the day, what happens is that if you were to speculate and say that the premium disappeared completely because of - that would then have an influence on your refinery margin.

MR MARKS: But it's a very significant premium. I know it sounds smallish, but it's a huge - we are talking about 3c a litre here. This is an enormous premium, in terms

of BP's overall returns. I'm wondering whether BP anticipates that premium will be available to it for the foreseeable future as part of the price?

5 MR STURGESS: In the overall context of refinery margin, you are talking about a \$2 to \$3 a barrel potential change between a base price. But what you need - what might be helpful to understand is that the actual base benchmark price could move by \$10 or \$20 a barrel in that time as well. So if you are talking about absolute price - I mean, the refinery game is very much a floating margin game - - -

10 MR MARKS: I'm talking about as a percentage of the price.

MR STURGESS: I don't think it's that significant. The other thing that I also think needs to be factored in is that when we look towards the future, I guess BP has a view that there will be - the standards will probably look to change even further. I don't think it's a fair assumption to say that we have seen an end to the changes in the standards. So, as fuel standards continue to change then I suspect we may find that as Asia catches up with our current standards in terms of availability, we may already be at a point where we have leapt to the next level. So that needs to be kind of, I guess, factored into any speculation around what might - what that might be and, therefore, our attention needs to be focused on what investments, what further investments we may need to make to meet those new standards as well.

25 MR MARKS: In terms of the present premium, are you able to say whether it broadly is reflective of the costs that BP has incurred associated with the improvements and efficiencies that have been necessary to attain it, the refinery level?

MR STURGESS: Could you repeat the question?

30 MR MARKS: It may be one that you would prefer to answer in a confidential sense, but I am wondering to what extent it is reflective of the cost. Is the present premium broadly reflective of the costs which are or have been till now associated with attaining the standard?

35 MR STURGESS: To answer that question I probably will take that on notice so we can do some analysis to see - because I mean, in our investments, in the decisions to invest we have made some assumptions around what the differentials would be to base prices that we can look to - so if I could take that actually on notice.

40 MR MARKS: We would be grateful. Thank you.

MS McGRATH: Probably, if I could add, it is worth noting that these sorts of changes to our refining infrastructure to meet standards can be in the order of hundreds of millions of dollars. These are major pieces of upgrade, kit upgrade, and cost hundreds of millions of dollars.

MR MARKS: And no doubt BP will be able to tell us - again, this might be in a private context - but what its costs incurred to date in satisfying all of the premium standard upgrade requirements from 2002 to 2006 upgrade are.

5 MS McGRATH: We would like to be able to do that in a private session but we wouldn't have that information with us today. On notice definitely. We can certainly
- - -

10 MR MARKS: I am presuming that that is the case. Please forgive me, I should have made it clear. It is just something that we would like to understand, in trying to gather our thoughts about just what the impact of the standards are.

15 MR STURGESS: And there would be sort of broadly two components to that. One would be the investment, and one would be the ongoing operational costs associated with having the higher standards.

20 MS McGRATH: If I could also add, we are aware of the fact that one of our competitors has actually had to operate its refinery at a lower capacity to meet standard compliance in it - to meet the Australian Standards. So there is an example of impacts on configuration.

MR MARKS: Is that because that refinery is not undertaking investment upgrades or is it because - - -

25 MS McGRATH: I am not aware exactly what they have chosen to invest in or not, but I am aware - industry knowledge has made me aware that their capacity as a result of that has reduced.

30 MR MARKS: I understand, but you not able to say whether it has reduced because they have chosen not to undertake the costs associated with substantial investment or whether it is simply because there are other - - -

MS McGRATH: I don't have that information here.

35 MR STURGESS: I think what I would say is that they chose a path of investiture that as - one of the consequences was less capacity. Again, I am sure you will have the opportunity to ask them in more detail specifically.

40 MR MARKS: Can I pick up again, Mr Sturgess, whilst we are on this refining level - we touched on this before, the difference between the 95 Mogas standard and the 92 standard. I wanted to clarify a couple of points through BP. The 95 standard, we are told, is the prevailing standard, at the moment.

45 MR STURGESS: Sorry, when you mean "prevailing" - - -

MR MARKS: I was going to ask you.

MR STURGESS: When you mean "prevailing", do you mean in terms of the preferred or the most commonly used benchmark?

5 MR MARKS: The most commonly traded - I mean two things. Firstly, the most commonly traded benchmark. Secondly, the most - the relevant benchmark or most traded, in the Australian context. Am I right about both of those propositions?

MR STURGESS: In the context of the regional market, the 95 quote is more traded.

10 MR MARKS: Is it?

MR STURGESS: In other words, in our industry we would say there is more liquidity. Are you familiar with that?

15 MR MARKS: I see. Why is that?

20 MR STURGESS: Just because there is a lot of gasoline in the region that is close to that specification and a lot of people trading that, and so there just happens to be, by the nature of the market, a lot of activity in that quote. So of the two quotations, if you were to talk to Platts, they would tell you that there is more activity in their trading window around 92 than there is activity around their 95 window, just by the nature of the region. But there is still activity in both trading windows.

25 MR MARKS: The 95 benchmark, though, is the one that seems to most often be relied upon in the Australian context.

MR STURGESS: Yes.

30 MR MARKS: You have already gone into that in part.

35 MR STURGESS: Yes. I think the historical context to that was that at the time of trying to establish what the value and what the price would be through our supply and trading activity, we very quickly saw that sellers of that standard in Asia were very reluctant and had a preference for pricing against the 95 to reflect some of the - although the fact that the octane is not close, there are other qualities, particularly motor octane, et cetera, which means that the 95 was a better match. That's kind of the history as to why 95 became a - - -

40 MR MARKS: The preferred - - -

45 MR STURGESS: Because when you look at the totality of the quality components of Australian spec, that was felt to be the one that the sellers were more comfortable to sell against. Having said that, some trades - we do import, and have imported, as you will see in our submission, on a 92 basis.

MR MARKS: Yes, I discerned as much. What is the reason for that? Is it just availability of a particular product?

MR STURGESS: Yes, just a preference for the seller for whatever reason. It might be against their alternative. Their alternative might have been selling to someone on a 92 basis and they didn't want to have the exposure between the two quotes. There can be a whole raft of reasons. As a general comment, BP are somewhat open to
5 alternative benchmarks because I think, at the end of the day, it is not going to change the overall price. It is just the relativity would change if you chose a different benchmark.

MR MARKS: Can I change topics and ask some questions about wholesale, please.
10 At page 20 - - -

THE CHAIRPERSON: Do you want to take a break, Mr Marks?

MR MARKS: Just a short break.
15

THE CHAIRPERSON: We will take a quick break and grab a cup of tea.

ADJOURNED [11.59 am]
20

RESUMED [12.10pm]

25 THE CHAIRPERSON: Mr Marks, when you are ready.

MR MARKS: I wanted to ask some questions now about wholesale and, firstly, if I could ask you about - I'm not - I wanted to ask about the terminal gate price. That part of your submission starts at 3.2 on page 21. I just want to clarify just what you
30 mean here. You say at 3.2 that the price at which BP wholesales its fuel to customers - I take it you mean its wholesale price - is known as its terminal gate price? Is that correct?

MS McGRATH: That's correct.
35

MR MARKS: By that I take it you are not saying that that is the price at which you actually sell but it is rather the price which will be the basis for any price that is ultimately struck between BP and the customer; is that so?

40 MS McGRATH: Yes, but I go a bit further to say that it is the price at which we are prepared to do spot business and it is the basis, as you said, for a contractual terminal gate price or term terminal gate price that we may enter into with a wholesaler.

45 MR MARKS: When you say that it is the price at which you are prepared to do spot business, is the consequence of that that it's effectively the door or the rack wholesale price which BP will charge someone who walks in the door to buy without a contract?

MS McGRATH: That's correct. If we were approached by a party who wanted to make a one-off purchase, that purchase would be unplanned for on our behalf, particularly in a location where we were not - the benefit of a, for example, a refinery. And the administration of doing business on a one-off basis is implied in that as well.

MR MARKS: When you break that down to layman's language, does it mean you say the price at which you will do business outside a contract and on an on-the-spot basis, when you haven't got any notice and so on, does it really mean that's the maximum price you would expect to get from a wholesale deal?

MS McGRATH: That's correct. It's the maximum price.

MR MARKS: That's why I called it the rack rate. It's what the person who knocks on the door gets without any relationship with BP?

MS McGRATH: With BP, exactly.

MR MARKS: Does BP do much wholesale trade on a spot basis?

MS McGRATH: In the last couple of years BP has done no trade on that basis. I would like to augment that by saying, building on my colleagues' comments earlier, security of supply being so important to wholesalers and resellers that the nature of the industry - I would go so far as to say it is very unlikely that resellers and wholesalers, it is not common that they would want to do a one-off spot deal given they have commitments of their own to meet further down the supply chain. Having said that, we are prepared, capable and ready to do business at that price. It is relevant and meaningful in that respect.

MR MARKS: How long is it since BP has done a spot deal at TGP?

MS McGRATH: I would say definitely not in the last three years. And since TG was implemented by BP in '98 I would have to check to see if we - - -

MR MARKS: Could you count the deals on the fingers of one hand?

MS McGRATH: I don't know. But since I have been in this position for approximately four years we have not done any spot business. That is not to say that we haven't been asked. But the buyer has not acted on that, on that opportunity.

MR MARKS: I accept that. You are just simply saying there have been no concluded agreements?

MS McGRATH: No transactions, that's correct.

MR MARKS: As far as you are aware, that probably goes back to 1998 when it was introduced?

MS McGRATH: I couldn't speculate, but I could check those facts and come back to you.

5 MR MARKS: Like all of these other things where we will come back, these thoughts are being gathered but we would be grateful if you could do that.

MS McGRATH: Very happy to. Very easy to do.

10 MR MARKS: Assuming there were no spot deals, BP wouldn't be Robinson Crusoe in saying that there hadn't been too many spot deals, what's the point in having a published terminal gate. Putting the regulation aside for one moment of terminal gate pricing and just looking at it more generally for a moment, is there really a point in having a terminal gate price as such?

15 MS McGRATH: BP actually believes that terminal gate price is very important and it is really the cornerstone for our wholesaling business. I say that because we probably deal with more independent resellers than any other of our competitors, I mean, in absolute numbers of individual companies that we deal with. It reflects the customers' import alternative and it is - - -

20

MR MARKS: What do you mean by that?

MS McGRATH: It reflects what the customer might otherwise pay if they sought to do a transaction of that scale in that market as an alternative.

25

MR MARKS: "As an alternative" meaning someone else?

30 MS McGRATH: As an alternative to import or someone else. It is based on very clear formula, which is set out on page 22 of our submission. Cost of product, terminal cost, wholesale cost, wholesale margin, excise and GST. We do that - we put a lot of rigour and effort into actually making sure that the TGP is current, is competitive and it is the basis on which many of our customers do business and have done for many years.

35 MR MARKS: But what you are really saying is that the TGP enables BP to strike a wholesale price derived from a formula built on IPP?

MS McGRATH: That's correct.

40 MR MARKS: And you say that's a convenient way of selling at wholesale?

MS McGRATH: It's not only convenient but it's competitive.

45 MR MARKS: I accept that. It is convenient. Because it's competitive and for other reasons as well, it's a convenient wholesale sales mechanism for BP?

MS McGRATH: It is convenient for BP and for customers.

MR MARKS: When the customer sees the terminal gate price he sees a price which is built upon and he knows is built upon the IPP formula that you refer to in your submission.

5 MS McGRATH: Yes, we very clearly communicate that in any transaction or term arrangements.

MR MARKS: He knows therefore that there will be IPP plus the taxes, plus the other components, plus a wholesale gross margin?

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MS McGRATH: That's correct.

MR MARKS: He will appreciate that componentry but he won't know how much of the price he is paying is reflective of margin and how much is reflective of cost, will he?

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MS McGRATH: He may be able to ascertain and, if necessary, we would be comfortable with defining some components of that cost. Some of them are absolutely transparently available in the market, anyway.

20

MR MARKS: If the customer asked you what the wholesale gross margin was on the transaction would you tell him?

MS McGRATH: The wholesale gross margin will change regularly depending on competition in a given TGP market.

25

MR MARKS: I understand. But when a customer comes and strikes a TGP based price and says to you what component of that price is made up of the wholesale margin, would he be provided with an answer?

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MS McGRATH: Typically no. Typically he doesn't ask.

MR MARKS: Right. That wasn't my question. The answer is typically no, is it?

35 MS McGRATH: Typically no.

MR MARKS: It may be the reason why he doesn't typically ask is - you just don't know. But I am asking you: Is the answer that he would not be provided with that information?

40

MS McGRATH: That's correct.

MR MARKS: Can I go back to the basis description. Is the reality that with no spot deals terminal gate price very rarely reflects the actual price of fuel obtained by a customer of BP?

45

MS McGRATH: That's correct, in absolute terms, yes.

MR MARKS: What the position is in reality is that contract by contract deals are struck where there are different prices that are broadly referable to a terminal gate formula? It might be a discount it might be an add-on, I'm not sure.

5 MS McGRATH: I would like to clarify my previous statement. In Victoria the terminal gate price or the spot prices as we referred to earlier is the same as any contract price that we do enter into with a term deal. So there is no differential between spot and the term TGP in Victoria.

10 MR MARKS: So are you saying that the base price is the same but the price may be worked upon by the terms of the particular contract?

MS McGRATH: No, I am saying that the vast majority of the term contracts we have in Victoria are absolutely the spot TGP price as posted.

15

MR MARKS: So that means there are a number of customers in Victoria that actually pay the terminal gate spot price?

MS McGRATH: There is a vast majority, yes, that's correct.

20

MR MARKS: Earlier on in the explanation of some changes were made, I think it was then the point was made that that is the position in Victoria?

MS McGRATH: Yes, that's correct.

25

MR MARKS: It differs in other states?

MS McGRATH: Yes, it differs in other states.

30 MR MARKS: And why, please?

MS McGRATH: It differs in other locations between I believe a range of cents depending on - largely depending on BP's cost of accessing additional product in that location. So to clarify my terminology, "term" is about a long-term commitment of three to five years where BP and the buyer can commit to each other about volumes and create certainty about commitments that we make with other parties.

35

MR MARKS: Is the practical position then that with contracts of three to five-year duration - are there any contracts of less than three-year duration?

40

MS McGRATH: Not that - I believe not, but I wouldn't want to be absolute in that. I believe not.

MR MARKS: So generally the contracts are of three to five-year duration in Victoria, they tend to be a terminal gate price?

45

MS McGRATH: That's right.

MR MARKS: When I say "tend to be", are there exceptions?

5 MS McGRATH: The terminal gate price, as I said earlier, is the basis for the vast majority of the transactions. Terminal gate price is the basis for some exceptions to that. And I would be very happy to go into that in a confidential session if you so wish.

10 MR MARKS: Very well. But just at this broad level, are the exceptions that you are thinking of really customers who would purchase substantial volumes, or is it a volume based exception, basically?

MS McGRATH: It's not purely volume based, but obviously those that bring volume give us more certainty as well.

15 MR MARKS: So it's predominantly volume based, the exceptions?

MS McGRATH: No, not predominantly volume based, but volume does come into it.

20 MR MARKS: In the other states what tends to be the position - just picking up BP's refinery's position, you have two refinery terminals in Australia, they are in - - -

MS McGRATH: Perth and Brisbane.

25 MR MARKS: Can I take those two markets?

MS McGRATH: Yes.

30 MR MARKS: What is the TGP, the broad position vis-à-vis contracts in Perth?

MS McGRATH: Again, there is a - as I said earlier, there is a spot published TGP price and there is also a term TGP price, which all of those dealers or distributors will be paying that are under contract, which has a small differential. But I would also like to point out that the spot and term price always move in unison.

35 MR MARKS: Are you able to tell us in private session what the differential is?

40 MS McGRATH: Yes, I am, in the private session, certainly. And it is in our confidential submission already.

MR MARKS: Can you take the Brisbane position.

MS McGRATH: Yes.

45 MR MARKS: A similar arrangement there, there is a TGP price and a term TGP?

MS McGRATH: That's correct.

MR MARKS: Again, is the difference that we are talking about between one and the other the same in the two locations.

5 MS McGRATH: Do you mean the two locations being Brisbane and Perth?

MR MARKS: Yes, the two refinery locations.

10 MS McGRATH: No, they are not and that more relates to the WA price legislation such that prices can only be changed once a day.

MR MARKS: Does that mean that the difference is greater or lesser in Perth than in Brisbane between the two figures?

15 MS McGRATH: The difference is greater, yes.

MR MARKS: Now, what about the other non-BP refinery states apart from Victoria, can you just tell us what the position is broadly there, please?

20 MS McGRATH: The position in Darwin, as we mentioned earlier, is linked to co-mingling through the Vopac terminal, and BP is contractually committed over a period of time to its usage of that facility. So there is a differential between spot and the term TGP in Darwin which reflects that. There is a differential in Tasmania which reflects the same circumstances I described earlier on; and where else, Adelaide, they are the main capital cities. We spoke about Sydney.

25 MR MARKS: Yes.

30 MS McGRATH: And then there are in addition to that - depending on our terminal infrastructure positions, there are a small number of what you call a regional terminal gate price, and the same would apply in those locations.

35 MR MARKS: You say at page 22 of your submission that in times of intense discounting, BP may choose to reduce its wholesale margin and hence its terminal gate price.

MS McGRATH: Yes.

40 MR MARKS: And discounts to terminal gate applied will be applied to all BP customers under a supply contract. Can you explain that, please, in the context of what you have just said?

45 MS McGRATH: The terminal gate price, as I said earlier, we put significant effort into making sure it's relevant and competitive. On that basis, we don't move the terminal gate price with anything like, say, you might move the - the frequency of that which you might move a retail store price. So, the movement will be based on a sustained period of intense period activity, if we assume we are talking about a movement downwards for a moment. Over a period of weeks, I would say in most instances we would gather evidence both from our dealer customers, from our own

observations and from our access to competitor TGPs that are published, and we may from time to time move - structurally move the TGP in that instance and that would reflect the same movement in a term TGP.

5 MR MARKS: But in terms of the comment that discounts to TGP apply to all BP customers, is that meant to mean that depending upon a particular contract and particular relationship between the parties, a discount is available to all customers?

10 MS McGRATH: I think I misunderstood your question. Yes, if you take the Sydney market, the term TGP is paid by all customers. That's correct. Yes.

MR MARKS: I wanted to ask you who your principal wholesale customers are. Is that an answer you would prefer to give in - or are you happy to give it openly?

15 MS McGRATH: BP has two categories of wholesale customers. We have a large number of dealer customers, dealers being independent operators who own and operate their own service station. I believe at the start of the session we mentioned there are 344 of those individual sites. Some of those are owned in common by what we call a multi-site dealer. The other part of - significant part of BP's wholesale
20 business is selling, again, at TGP or, I should say, term TGP, to its BP branded distributors. We mentioned earlier in the submission that we have 12 BP branded distributors currently operating in the marketplace.

25 MR MARKS: What about independent chains; do you sell to independent chains?

MS McGRATH: When you say "independent chain", do you mean non-BP branded, because all of those are independent businesses. What I have just described, they are all independent businesses.

30 MR MARKS: Are any of those businesses chains?

MS McGRATH: Chains, yes. Yes, there are a small number of chains that are - 20 to 40 sites. A larger number that - where a dealer might own two or three sites. But we do a substantial amount of business with independent one-site dealers.
35

MR MARKS: Can I ask you, that breakup, has that changed in terms of the proportion of the particular categories, has that changed at all in recent times or is it relatively steady?

40 MS McGRATH: It's changed in the dealer business, that is, the operators who own and operate their own sites, in that we have seen a number of dealers, both existing BP and new to BP dealers, investing in new locations. So the change largely related to so-called new to BP but also new to industry. If you go back a couple of years earlier, then the change would have been a downward trend, as both the dealer and
45 distributor operators would be on record as saying, and have said to us, that the introduction of the supermarket alliances had a significant negative impact on their volumes. I think you can see that in the total BP wholesale sales that we submitted in our submission.

MR MARKS: Is it possible for BP to give a range to give us some idea of the available discount, if you like, and using that word very broadly, to terminal gate that is available to its contract customers?

5 MS McGRATH: I'm sorry, I don't understand.

MR MARKS: What is the range of variation, if you like, in the price that is ultimately available to contract customers on three to five-year contracts?

10 MS McGRATH: Within a market there is virtually no difference, there is no range. And the markets have different TGPs because of different price buildups.

MR MARKS: In other words, it is all built into the ultimate TGP that is struck in a particular location.

15

MS McGRATH: Yes, and I should add this point, there are a couple of exceptions to that. I am speaking in generality but there are a couple of exceptions but they are less than you could count on one hand.

20 MR MARKS: Is there a difference between, say, a branded and non-branded?

MS McGRATH: No, absolutely not. We do business with unbranded dealers who pay term TGP as to a BP branded dealer, and I think we provided you with an example of one of those.

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MR MARKS: All right. Can I ask you some questions about retail. You have broadly - I perhaps want to clarify some structure questions based on your submission as amended. BP appears to have about 260 branded - you described them as COCO sites, company owned, company operated sites.

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MS McGRATH: Yes, that's correct.

MR MARKS: Am I right in thinking those are predominantly in metropolitan areas?

35 MS McGRATH: Yes, they are all virtually in metropolitan areas.

MR MARKS: In your submission, you said they make up between 4 per cent and 14 per cent of all fuel outlets in the capital cities. Can I ask you, please, is it possible for you to break down where - in more detail for us now, where the 260 sites are located, for the large part? For example, if a large number of the sites were located in metropolitan Perth, could you tell us - - -

40

MS McGRATH: The largest proportion of that 260 are in Sydney.

45 MR MARKS: Any idea of numbers?

MS McGRATH: About 80 to 90.

MR DAVIDSON: I think it's a little lower. If I could refer you back to the point about the range between 4 per cent and 14 per cent, the 4 per cent number was our estimate of the proportion of BP-operated stores, BP company operated stores in the Melbourne market compared to our understanding of the total number of retail petrol outlets in the Melbourne market. The 14 per cent was the other extreme, and that is in Perth, where we operate - I think the current number is 50 sites.

MR MARKS: Thank you for that. Let's go through, if we can, quickly the capital cities.

MS McGRATH: I can't give you absolute numbers but we have that information somewhere here. Of 260 - - -

MR DAVIDSON: Certainly Sydney is our largest. I think we have something - it sort of depends on where you actually end the boundaries of Sydney.

MR MARKS: Just broadly.

MR DAVIDSON: Broadly, between 6 on and 70. That may include Newcastle, actually. South-East Queensland is approximately 50. And Victoria, I think we actually put it in our submission - I think there is 31 in metropolitan Melbourne. There is 20 or so in metropolitan Adelaide, and the rest of them are sort of scattered around. We have a few here and there.

MR MARKS: How many are there in Perth?

MS McGRATH: 50 in Perth.

MR DAVIDSON: Just also a point of qualification on those 260. Not all of those are actually company owned and company operated. That actually includes our truck stop network as well. That's a network of facilities that BP actually owns, but they are operated by a franchisee.

MR MARKS: How many of them?

MR DAVIDSON: I think the number is 12 or 14.

MR MARKS: It's a small number.

MR DAVIDSON: It's a small number but they are included in the sites where we set retail prices, because that franchisee has entered into a commission agency agreement with us. We own the fuel at those facilities and we set prices.

MR MARKS: We can take it then that of the 260 BP branded COCO sites, BP is setting the price at all of those sites?

MR DAVIDSON: Correct.

MR MARKS: Can I then talk about the 344, is it?

MS McGRATH: That's right.

5 MR MARKS: 344 which are BP branded but they are privately owned sites.

MS McGRATH: If I could pick up there, there is 333 that are BP branded and 344 that are supplied.

10 MR MARKS: Thank you. In that category, it is presumably the owner that sets the price but in any event it is not BP?

MS McGRATH: In none of those locations does BP set the petrol price.

15 MR MARKS: Then there are quite a large number of branded distributor or independent party owned and distributor supplied sites. I think there are about 860-odd?

MS McGRATH: Yes.

20

MR MARKS: Presumably, that's where BP on sells the petrol and the operator sets the price?

25 MS McGRATH: Yes. There are two stages in that chain. The distributor may well own the retail outlet and they set the price or they may, in turn, then on supply to what I call a country independent store or site where that owner sets the price.

MR MARKS: They are predominantly in rural areas?

30 MS McGRATH: Rural areas and what I would call regional centres. So Albury, Townsville, et cetera.

MR MARKS: What about distributors? BP has about 14 distributors?

35 MS McGRATH: At the time we wrote the submission there were 14. There are now 12.

40 MR MARKS: Thank you. that was mentioned this morning. Of that 12, I think there was some suggestion that BP has an equity stake in two.

MS McGRATH: That's correct. BP has an equity stake in two of those 12.

45 MR MARKS: The COFO sites - the acronym you used there - company owned and franchise or agent operated, they pick up the branded truck stop sites, do they? The truck stop across the mainland sites, do they pick those up?

MR DAVIDSON: That's referring to those truck stop sites, so it's company owned and franchisee operated.

MR MARKS: Does it also pick up some BP sites that are managed under franchise agreements where they are not struck stop sites? I think I read there were a few of those.

5 MR DAVIDSON: Very few of those.

MR MARKS: Do you know how many, so we can complete the picture. There are only three or four?

10 MR DAVIDSON: I think the total number is actually six, but there is only three of those that are under an arrangement where they currently come to - that is where the possible confusion between those ...

MR MARKS: I see. There are three that get or may get or are eligible for price - - -
15

MR DAVIDSON: There are four that are eligible to claim temporary price assistance in relation to motor spirit. There are only three that are currently claiming price assistance for us. The other two are not eligible.

20 MR MARKS: Do I have that broad categorisation correctly?

MS McGRATH: You have that right, absolutely.

MR MARKS: Can I ask you, then, a couple of broad questions. In terms of BP's
25 retail sales - I'm now thinking of sites supplied by BP just broadly, is it possible to say what percentage of the national market that comprises by volume?

MS McGRATH: I couldn't even speculate what that is, because there is no basis on
30 which for us to get that information.

MR MARKS: What about COCO sites, are you able to tell us what proportion of sales by volume of the market come out of COCO sites?

MS McGRATH: It's the same problem. The market, no.
35

MR MARKS: So you would not be able to tell us of the total by volume petrol sold at retail in Australia, what percentage of that is sold from BP COCO sites?

MS McGRATH: Sorry, yes, now I understand your question. Yes, we would but we
40 don't have that information to hand right now.

MR DAVIDSON: Actually, if I could - what proportion of BP's total sales, yes, we would be able to provide that, given time, but if we take your question to mean the total retail market, we don't have a view on that. We don't see any reasonable
45 industry statistics on what the actual size of the retail motor spirit market is in Australia.

MR MARKS: But you would be able to tell me what proportion of the total sales volume which is sold in Australia by retail is sold from BP-owned sites, whether it's 10 per cent or 2 per cent or 8 per cent, or you could tell us in percentage terms?

5 MR DAVIDSON: If I take your question to mean the total retail market of all brands?

MR MARKS: Yes.

10 MR DAVIDSON: The answer to that is no because we don't know how large that market is.

MR MARKS: You don't know how large that market is?

15 MS McGRATH: There is single data point any more in existence that gives us that information. I believe there previously was - is that right?

MR DAVIDSON: We may be at a loss here. These statistics might exist but we are not aware of them. The last industry statistics that we based any of our knowledge
20 on was based on throughput through terminals. We have no idea, when we hear of other people's throughput through their terminals, where that fuel ends up ultimately, whether it is going to a distributor, whether it's going to a retail outlet or whether it's going to a commercial customer site.

25 MR MARKS: Can I change the topic again and ask you some questions just about the feature of the retail market that we are particularly concerned about, and that is price cycles. I'm not sure who the best question to address these questions to is.

MS McGRATH: If you are asking about specific price cycles on specific dates, then
30 my colleague, Mr Davidson, is best.

MR MARKS: I have a number of more general questions, and feel free to answer them. If one of you could answer, that would be helpful. Price cycles, clearly from what we can see, exist in the major capital cities, with the exception, it would appear,
35 of Darwin and there doesn't appear to be a cycle in Tasmania. Can I ask you - we are in Melbourne - perhaps about the Melbourne market and then I will ask you whether it's typical. Do you have a view about what is causing the cycle that we are presently seeing reflected on a weekly basis?

40 MR DAVIDSON: Our view is what is causing the cycle is price discounting. It's various competitors in the Melbourne market actually matching and undercutting each other over a period of time. And we certainly see that after a period of discounting, prices are at a point where margins are - wouldn't actually sustain the operations of the business and one or other competitor in the marketplace puts their
45 prices back up to a profitable level and others then follow.

MR MARKS: I wanted to draw a distinction here between what may a feature of the cycle, on the one hand, and what causes it, on the other. It may no doubt be a feature

of the cycle that you see discounting and then an eventual return to, or at least prices going to high levels, the cycle starting over again and you see a repeat of that. My question, though, was directed more fundamentally to what you see as causing that. You said it's caused by price discounting. Price discounting goes on in other markets
5 where there is no price cycle. Do you have a view about what is actually causing the cycle as opposed to the features of it?

MR DAVIDSON: I still hold the view that it's actually discounting that is causing it. I accept that discounting occurs in other markets as well. Perhaps what is different in
10 our industry is that the discounting is rapid and very reactive. That discounting will be led by retailers trying to increase their market share at a particular point in time, and other retailers actually reacting to that very quickly.

MR MARKS: I accept all of that, but is the quick reaction that you are talking about
15 simply a fact or a feature of the weekly nature of the cycle, or is the quick reaction that you are talking about causing the cycle? I just want you to focus on that distinction.

MR DAVIDSON: No, I will hold what I said. I think the discounting is actually
20 what causes it.

MR MARKS: You have chosen Melbourne as your example market. At page 26 of the submission, after saying where BP sets petrol prices in Melbourne, you say that BP has no influence on the pricing. Let me ask you about the Melbourne market.
25 What is the typical low point day in the Melbourne market cycle; are you able to say?

MR DAVIDSON: Firstly, I would just clarify that somewhere in that question you said BP has no influence on pricing in Melbourne. That's not what we actually said
30 in our submission.

MR MARKS: I'm sorry if I said that. I didn't mean to. I was really meaning to make the point that you say you have no influence over particular sites, the COCO outlets, not that you have no influence over pricing generally.
35

MR DAVIDSON: Given that, can you perhaps ask the question again?

MR MARKS: I will ask you the question again. What is the low point day of the week, do you think, in the Melbourne market in the cycle?
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MR DAVIDSON: Our observations over recent times is that the low point in prices in the Melbourne market has been Wednesday morning.

MR MARKS: Wednesday morning. Is there a particular time that you have in
45 mind?

MR DAVIDSON: No, not a - - -

MR MARKS: What happens on Wednesday morning?

MR DAVIDSON: Are you talking about from BP's perspective or from the market?

5 MR MARKS: What happens in the market on Wednesday morning?

MR DAVIDSON: What we have observed in recent times - this is not actually every time, but talking about Melbourne, over recent times we have actually - - -

10 MR MARKS: What do you mean by "recent times"?

MR DAVIDSON: I can't tell you, off the top of my head, at what point the Melbourne discount cycle moved towards a Wednesday, but I can certainly say in my experience in this organisation and looking at petrol pricing, Wednesday hasn't
15 always been the low point in the Melbourne cycle.

MR MARKS: You are not able to say since what time it has been, to put some rigour into what you are saying?

20 MR DAVIDSON: Perhaps 18 months or two years. I would need to actually look back over records.

MR MARKS: In this time period, 18 months to two years, you are saying Wednesday morning is the key lowest point in the cycle time? What happens in the
25 cycle on Wednesday morning?

MR DAVIDSON: What we have observed - in recent times, on Wednesdays after - after a period of discounting, typically one or another entity setting fuel prices in Melbourne will actually lift prices at some or all of their sites.
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MR MARKS: In the Melbourne market, is that entity frequently BP?

MR DAVIDSON: From time to time, it's BP. I wouldn't necessarily say it's frequently. We have actually observed - and when you say BP, you need to actually
35 recognise the fact that BP, as we have said in our submission, only controls fuel prices at 31 - - -

MR MARKS: I have asked you those questions. We understand that.

40 MR DAVIDSON: It has been known that BP outlets other than those for which we set prices have lifted prices first. That's not that common.

MR MARKS: Let me ask you the question generally. I have asked you is it BP that often does it. You have said you have not happy about using that terminology. How
45 often - in the space of a period, whether it's six months, let's agree on a period, say, take the first half of 2007 - in the 2007 first half, did BP - let's talk about BP generally for a moment - move upwards on prices in the Melbourne market at the end of the cycle and, if so, how frequently?

MR DAVIDSON: Let me answer that by saying that BP's general pricing position is such that when we find ourselves in a situation where prices are providing margins for us that are lower than what will be - what we would need to operate a sustainable business, we will always be looking for opportunities to increase our prices.

5

MR MARKS: I accept all of that. How often does BP lead the price cycle up?

MR DAVIDSON: The question was how often has BP moved first over that period? I couldn't actually give you a definitive answer without going back through our records over any particular period.

10

MR MARKS: I accept that.

MR DAVIDSON: The question you asked before, was it frequent, I think the answer to that would be yes. Is it exclusively BP that moves first in the Melbourne market, absolutely not.

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MR MARKS: I'm not asking you that. I'm just asking you whether it is frequent and you say the answer to that is yes. What do you mean by "frequent"? Is it - let's divide it up. In the first half of the year, there are a number of cycles. Let's broadly say there are 20. There are obviously a few more. What percentage - can you give us a feeling for what you mean by "frequent"?

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MR DAVIDSON: I wouldn't like to give you an absolute number because as I said - -

25

MR MARKS: I understand. I'm not asking for an absolute number.

MR DAVIDSON: But in general terms, perhaps between a quarter and a third of the time.

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MR MARKS: That's helpful. That gives us an idea. If I can go back a little further in time has that position changed in Melbourne much in terms of BP's lead, has it changed much in the last couple of years?

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MR DAVIDSON: Over the last couple of years, I would say probably not.

MR MARKS: Can I just get a feeling, please, if I can, for other markets. Is the pattern and BP's role similar in other capital cities?

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MR DAVIDSON: I'm not too sure that I actually understand your - your proposition about BP's role?

MR MARKS: You have said - you have given me some answers. Let's not get too excited about tying this down. We really want to get an idea. You said in Melbourne in the first half of this year we had a role in lifting prices, and we did that frequently. I asked you what "frequently" meant. You said, well, I don't want to get too carried away by what it all means but perhaps 20 to 30, or some reasonably

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large percentage of the time but certainly not all of the time. What I want to know is, is that comment one that can be lifted from the Melbourne market and applied fairly to the other price cycles, Sydney, the other predominant capital city price cycle markets? Is it yes or is it no?

5

MR DAVIDSON: The answer is - the answer in absolute terms is no. With respect to markets outside of Perth, the answer would be yes.

10 MR MARKS: Let's take the Perth position and we can complete the picture. What is the Perth position?

MR DAVIDSON: The Perth position, as we have found over recent years, is that in most instances, not all but in most instances, we have found ourselves in the position of actually lifting prices before other organisation have lifted theirs.

15

MR MARKS: Is there something peculiar about Perth that leads to that consequence, do you think?

20 MR DAVIDSON: The only thing peculiar I would say about Perth that leads to that is that some of our key competitors seem to behave differently in Perth than what they do in other markets.

MR MARKS: Are you able to elaborate on that a bit for us, please?

25 MR DAVIDSON: If you are asking me to explain that further, what I am saying is that in other markets we frequently, if you like, see Coles Express, for example being the first company to lift their prices, and we don't - - -

30 MR MARKS: What markets are those? Sorry to cut in on you. I don't mean to, but to try to - - -

35 MR DAVIDSON: I would say in all the other markets, with the exception of Brisbane. Probably less likely - or our observation has been that they are less predominantly in Brisbane. But certainly in Sydney, Melbourne and Adelaide they are quite often the first, or frequently. That's not our experience in Perth.

MR MARKS: What's your experience in Perth?

40 MR DAVIDSON: Our experience in Perth is that once or twice over the past 18 months Coles Express have lifted before us. Once or twice they have actually lifted on the same day as we have. Most other times they have actually lifted prices at their sites one or two days after we have actually made a move.

45 MR MARKS: You have answered my question in the Perth context by saying, look, we do what we do in Perth a little differently because others do. I wanted to ask you whether that was absolutely accurate, whether you do what you do in Perth because BP has a different strategic position in Perth in the market than it has in other states.

MR DAVIDSON: My answer to that is no. Our strategic position, our approach to pricing in Perth is the same as it is in any of the other major markets in which we operate. That is that we - as I said before, when we find ourselves in a position where our margins are completely unsustainable, we will be prepared to actually shift
5 our prices up to a point that we find more comfortable, and we will do that in any of the markets in which we operate. By the same token, we are actually prepared to lead markets down in any of the markets in which we operate. Our Perth strategic position is no different to what it is in the other markets.

10 MR MARKS: It's no different?

MR DAVIDSON: It is no different.

15 MR MARKS: You have obviously a refinery in Perth, so your petroleum supplies are more readily available.

MR DAVIDSON: I would agree, yes.

20 MR MARKS: And you also have - how many sites did you say COCO sites, 50?

MR DAVIDSON: The number I used was 50.

25 MR MARKS: That's a larger proportion, is it not, of the total number of retail sites in Perth than the proportion which BP enjoys in other states?

MR DAVIDSON: That's true.

30 MR MARKS: Do you think those factors and your market position in Perth as a consequence dictate in any way the way BP responds to prices and pricing?

MR DAVIDSON: No, the answer is no. I have to state categorically that the existence or nonexistence of a refinery in any market has absolutely no impact on our day-to-day pricing decisions.

35 MR MARKS: All right. I want to then ask you, please, about - just to go back to Melbourne, I'm sorry to jump around here but it may be the easiest way to do it. Going back to Melbourne, BP plays a broad role in the cycle on the upward movement, as you've described it. I wanted to get a feel in a little more detail as to what the pricing policy is. How does BP determine, when it leads the market up, on
40 the percentage of occasions you have broadly outlined, what price it will go to? How does it do it?

45 MR DAVIDSON: We have actually made some points about this in the confidential part of our submission.

MR MARKS: I appreciate that.

MR DAVIDSON: In terms of getting into absolute detail on BPs tactical and strategic pricing decisions, I would probably prefer to actually leave that to a confidential session. But I will say in broad terms our pricing policy - and with respect to - if we find ourselves in a position where we are leading our prices up, the
5 sorts of things that we will take into consideration are our - how our stores are currently performing, in terms of volume and margin performance. We will certainly take into consideration what we see as being our cost of product at any point in time. We take a view on our understanding of historical behaviour of our competitors as well. And all of these things go into the mix, if you like, for us to make a - a
10 judgment on what price point we will actually set. I will actually - I will actually say that there is no fixed rule or formula within the BP pricing system as to what price we will set at the top of any cycle, if that is what the point of your question?

MR MARKS: You say that it depends on a number of factors?
15

MR DAVIDSON: Correct.

MR MARKS: Just staying with the Melbourne market for a moment, you have mentioned Coles. Are there any other players in the Melbourne market that you
20 would identify as being in the upward part part of the movement, people who you often see leading the price, first movers?

MR DAVIDSON: Mobil and Caltex.

MR MARKS: I know the percentages are difficult, we're just trying to get the feeling for it. Are you able to say who the predominant player is who leads prices up
25 in Melbourne?

MR DAVIDSON: No, I couldn't say that.
30

MR MARKS: Is it just that it's not obvious?

MR DAVIDSON: No, it's not.

MR MARKS: You watch it very closely, obviously.
35

MR DAVIDSON: I do watch it very closely but they are not the sorts of statistics I carry around in my head. As I said, we could go back and as far as we can from the historical records we have, we could actually attempt to answer that question. I
40 understand that the Commission may actually be getting similar or getting data from Informed Sources that may help it to answer that question as well.

MR MARKS: Does BP have available to it ongoing data from Informed Sources?

MR DAVIDSON: Yes.
45

MR MARKS: Do you utilise that data in your pricing decisions?

MR DAVIDSON: Absolutely.

MR MARKS: I will ask you some more questions about that in a different context. The point you have just made broadly is that you don't identify or can't identify any
5 particular leader of the cycle in the Melbourne market, is that a statement which holds good for the other capital cities where there is a cycle - leaving Perth to one side.

MR DAVIDSON: Leaving Perth to one side, yes, in general I think it would.
10 Brisbane is a little different in that - and I said before Coles Express, in our experience, has perhaps less frequently been the first mover in leading prices up in Brisbane. We would see - this has been over a long period of time. We would see Caltex as probably being more predominant in Brisbane. If I was to narrow things down, I would say perhaps Caltex and Coles Express more frequently in Sydney than
15 perhaps Mobil. If I was pushed on Melbourne, I might say Mobil more frequently than others, but that might actually be a hang over from my view in history. I have been involved in this for quite some time. If we go back far enough, it was probably Mobil or Shell, we are talking four or five years ago, who were usually the first or more frequently the first. But as I said, I would need to actually go through.

20 MR MARKS: I understand. Adelaide?

MR DAVIDSON: Adelaide - this year has actually been particularly odd in Adelaide anyway. As a general rule, I would say that we probably find ourselves
25 moving up more frequently in Adelaide. But Mobil and Caltex.

MR MARKS: When you say "more frequently", do you mean more frequently than the others?

30 MR DAVIDSON: Than the others. But as I said, I mean, that is just a feeling we have, coming back. Now, this year that feeling has probably been exacerbated by the fact that we have seen quite a number of weeks in Adelaide where there hasn't actually been a sustained upward movement in prices at all.

35 MR MARKS: Can you explain that?

MR DAVIDSON: My explanation of why that - why that has happened is that some significant players in the Adelaide market have not moved their prices up. The reality of our business is that - we have discussed price sensitivity and elasticity and
40 the like of our customers in our submission. The reality is for us to have our prices at a high point when a significant proportion of the market doesn't have their prices at that point, we actually start to feel that in our business pretty quickly. We will bring our prices back down again.

45 MR MARKS: But if the fact is that the cycle has this year in Adelaide - or in the first part of this year stalled almost, because you say it's not been led up in the same way as has traditionally happened, do you know or do you have a view about why that is so?

MR DAVIDSON: I don't know. I absolutely don't know. Our observation of the Adelaide market in particular through the Christmas and January period this year - and there was another period a little later on - I can't remember, I think it might have been about April or May or thereabouts, was that it appeared to us - and this is only
5 from observing where - the data where we see Coles Express outlets in the same vicinity as Woolworths outlets - it appeared to us that Coles Express and Woolworths were having an extended price war.

MR MARKS: I see. That may explain it?
10

MR DAVIDSON: That is the only explanation that we actually had. But as I said, do we know? No, we don't. Nor would we know why that would be actually taking place.

MS McGRATH: Could I add, in that discussion you were having about Adelaide and Melbourne, they are quite, I suppose, important markets to point out, from an external observer point of view, that we have, in those two markets particularly, more BP branded outlets that are wholesale - or independently owned than we do BP owned. So when people make observations about what BP did with a site with a BP
20 brand, in both markets we have less BP company owned sites where Brett sends them the price than we do wholesale dealers who set their own price. So observations about movements in price around brand, that needs to be taken into account.

MR DAVIDSON: That's a particularly important point for Adelaide, because we have seen weeks this year where BP branded sites operated by an independent dealer have lifted their prices before we have. So, yes, as Rebecca has said, looking through data that attributes behaviour to particular brands, that can actually be quite misleading, especially when we talk about averages as well. Averages across a brand
30 in a city might be meaningless in some instances.

MR MARKS: Which is why we asked you the question about the structure of your sites, because we need to understand that properly.

MS McGRATH: Absolutely.
35

MR MARKS: Just focusing on a slightly different aspect, what about the role of independents? Again, you can use Melbourne as an example but I would be pleased to have a broader understanding. What role do the independents play or do you see
40 they play in the upward movement of the cycle that you see in the major capitals?

MS McGRATH: Can we clarify the term "independents"?

MR MARKS: You certainly can. I don't want to include within the definition of
45 "independent" the supermarkets. I am really just talking about the chains - like United and so on.

MS McGRATH: But not the BP branded independents?

MR MARKS: Not the BP branded independents.

MS McGRATH: So nonmajor branded independent retailers?

5 MR MARKS: Exactly.

MR DAVIDSON: To put names to them, you are talking about United and Liberty, Fuel Zone or some other - - -

10 MR MARKS: Gull, Matilda, whatever it might be. There are a whole group of them. They are the ones I am focusing on. What role, if any, do they play in the upward movement of the cycle?

MR DAVIDSON: As to first mover, if you like, if that's what you are talking about,
15 leading prices up, I would say their role is limited, if at all. As to their role in where a price leap may consolidate - we use the word "consolidate" loosely because prices are never static in our market. We see in some areas some of the independents actually lift their prices a little later than some of the major brands and in some instances they lift them to slightly lower points, but that's not a rule as such. That's
20 just a general feature.

MR MARKS: Can I just ask you, then - I should ask you one more thing,
Mr Davidson. Is that typical? Are you talking really across all of the cycles when
you make those comments? I presume that you are.
25

MR DAVIDSON: Yes, I would say it's typical, but I would also say that some of the
pricing information that we have for independents is a little bit scattered and
somewhat more delayed. Some of our observations of independent movements are
actually a function of the time we got the information rather than actually seeing
30 what they have really done. Some of it is from our own personal observations. We have had periods of time when our store managers have driven around and phoned in competitor prices. There is obviously an inherent delay in some of that information as well.

35 MR MARKS: Just to pick up the one last point I wanted to ask you about the upward movement of the cycle and trying to understand it, you say in your submission - well, it may not appear in your submission and I'm not certain, it may have been from broader discussions - that you believe that retailers with the largest networks lead the prices back up. I think the reason might have been broadly stated
40 as that the margin or the return on margin had to be obtained. Is that broadly right? Do you hold to that proposition, that those with the major networks in particular areas tend to be the players who will move prices up at the end of the cycle, the reason that they are engaging effectively in the margin recovery exercise?

45 MR DAVIDSON: No, I don't think - I don't think I necessarily hold that view. We talked about Melbourne earlier. We have a relatively small network. If we are talking about BP's branded - the BP outlets where we actually avail ourselves of the retail margin, it's a relatively small proportion of the Melbourne retail space. But we

still actually have to operate our business at a profitable level, so we are prepared to put our prices up, and we do. But that's not just in Melbourne, that's in other markets as well. It may be that some smaller operators don't feel that they have any market power or market influence or that they - if they went up earlier, no one else would take any notice of them. But you really have to ask them.

MR MARKS: Thank you. Can I just ask you about the downward movement in the cycle, which we see week to week across the major metropolitan areas. Just quickly, firstly, the role of the independents, do they play a role in the downward movement of the cycle and, if so, what is that role?

MR DAVIDSON: Yes, they do. I would say as a typical - as an observation of typical behaviour, some independents, but not all, some independents actually do play an active role in undercutting their competitors.

MR MARKS: Is that more frequent in some of the capitals than the others? Do you see the independents feature more, if you like in the downward movements in the cycle in some of the capitals than might be the case in others?

MR DAVIDSON: No, I don't think I do. But I'd actually have to - I'd have to temper my statements on this by saying that we're particularly concerned - our observations of our markets are particularly concerned about those competitor sites are that around our outlets. We only set prices for 260 outlets around Australia. The way we go about doing that is by observing our competitor prices and set reference sites around each of those outlets. So we are acutely interested in the behaviour of our director competitors in those particular localities. We try and build up a historical understanding of - as to how those competitors have actually behaved in the past. But that leaves actually big holes in our knowledge. We don't actually purport to understand what happens in particular markets as a whole.

When we talk about the Melbourne market, we actually don't set fuel prices for any stores in the north-west areas of Melbourne or the western suburbs of Melbourne. So, there are huge tracts of Melbourne where we really don't have any real market observation. There are areas through Oakley and East Bentley where there are a lot of independents at play. When I have driven through there myself, I've - "Jeez, these prices are cheap. These guys must be going to head to head", or something. We don't collect any data on those sorts of areas. So any observation I make about the behaviour of independents is really only what we have gleaned from the independents that are actually in direct opposition to us. Now, as I said, there are large areas of some cities where we don't actually operate company-operated stores. We have actually chosen to rationalise our network. Some of those areas we have got out of because they were so competitive that we couldn't actually run a viable business, or the way we wanted to run it.

MR MARKS: Take Melbourne, for example, where you said that you do - BP sometimes does move up prices. What triggers that move, as a rule?

MR DAVIDSON: What triggers our decision?

MR MARKS: What triggers your decision?

MR DAVIDSON: What triggers our decision is a desire to run a profitable business.

5 MR MARKS: Are you wanting to put price up so that you can recover margin?

MR DAVIDSON: Absolutely.

10 MR MARKS: Is there some reason why you do it on the Wednesday? We know it happens all the time on the Wednesday. Can you just explain that?

MR DAVIDSON: No, not really. As I said - - -

15 MR MARKS: Is that just habitual? Why Wednesday?

MR DAVIDSON: It is at the moment. I mean, it's - as I said, the only thing we have got to go on is historical behaviour in the market. Recent history has shown that if we lift prices on a Wednesday, there may be some chance that other organisations might be feeling the same degree of pain on Wednesday morning that we are. But since I've been in this role - and I came into this role in May 2002 - we have actually seen prices lift in various markets on every single day of the week. The discount cycle has wandered around. It's a question that the Commission is very interested in. It's a question that people within BP are very interested in as well. I get asked that question a hundred times, why does it lift on a Wednesday? The answer is I don't know.

MR MARKS: In answer to my question, which is why does BP move on Wednesday, is the answer that it can, with some degree of success, move on a Wednesday; it may not be able to do so successfully on other days of the week. Is that the answer?

MR DAVIDSON: No, that's not the answer. When we lift our prices we have no - we have no belief or expectation of success that anyone else will actually respond.

35 MR MARKS: That's just not so, is it? You talk about expectation. You would have an expectation that if you did raise BP's prices on a Wednesday, others may follow. If you did it on a Sunday, others probably would not. That's the true position, isn't it?

MR DAVIDSON: I would have a hope, if I raise my prices, that others would follow. I do not have any expectation. And that is actually - how could I have an expectation when we have seen markets like Sydney in July, like Adelaide in January, where we have lifted our prices, even on a Wednesday in Adelaide when we have lifted our prices and there has been no response. We can't have an expectation.

45 MR MARKS: Mr Davidson, I won't argue with you about it. I really am interested in your genuine answer. If the reality is that, exceptions and aberrations aside, there is a weekly cycle to which buyers and sellers are broadly faithful, it would be reasonable, would it not, to draw the conclusion that if BP makes a decision to move

on Wednesday - that's not to say that it necessarily will - but if it does, it is because its expectation is that that is the day when others are most likely to follow?

MR DAVIDSON: No, as I said, I don't agree with that.

5

MR MARKS: Are you saying that you move prices on a Wednesday for no real reason other than by Wednesday you want to improve your margins? Is that what you are saying?

10 MR DAVIDSON: Largely, yes, but as I said - I can see where you are going with this question. We actually are students of history as well, and if there has actually been - we have recognised a pattern of behaviour over a period of time, then that might actually influence our decision, but I take expectation at your word "expectation" because we don't have an expectation.

15

MR MARKS: Mr Chairman, I think that may be a convenient time to stop for a short break, from my perspective. Would that suit the Commission?

20 THE CHAIRPERSON: What, say, we call for lunch and come back, say - are you happy with 40 minutes?

MR MARKS: Even less. We would be perfectly happy with just 20 minutes.

25 THE CHAIRPERSON: I will give you 25.

ADJOURNED [1.21pm]

30 **RESUMED** [1.48 pm]

THE CHAIRPERSON: Mr Marks, we will start.

35 MR MARKS: Mr Davidson, I have been primarily directing my questions to you on the price cycle issues. I want to get through them as quickly as I can, with your help. Can I ask you, please, do you know - or do you have a view - about whether the amplitude of the cycles that you have observed in recent times have increased or decreased?

40

MR DAVIDSON: I have a view.

MR MARKS: What is it?

45 MR DAVIDSON: Over the period for which I have actually been involved in retail pricing, from May 2002, the amplitude of the price cycles has actually increased.

MR MARKS: Do I take it that when you refer to "amplitude", you are talking about a high point and low point of the cycle?

5 MR DAVIDSON: I'm talking about the spread between the high point and the low point of the cycle.

MR MARKS: The range?

10 MR DAVIDSON: Yes.

MR MARKS: Why do you think that the range or amplitude has increased over a period?

15 MR DAVIDSON: I don't actually know the answer to this. Once again, I'm talking about a view rather than any perfect knowledge, and that is that the amplitude has increased - this might sound like I'm answering a question by asking the same question - the amplitude of the cycle has increased for two reasons. One is that we have seen the high point of some of the lifts go higher relative to terminal gate price than had historically been the case. In some instances, we have also seen the low
20 point being somewhat lower than terminal gate price than has historically been the case. By that I mean that there is competition at price points below terminal gate price.

25 MR MARKS: How long or for what period have you discerned that price competition at a point below terminal gate has been occurring?

MR DAVIDSON: That has actually been occurring for all the time that I have actually been in this role, so longer than five years.

30 MR MARKS: It is not the fact that the cycle is going below terminal gate that you refer to when you are identifying this amplitude point; it is the fact that it is going even lower below terminal gate than it used to?

35 MR DAVIDSON: At times, yes.

MR MARKS: That's the change at the bottom of the cycle that you have discerned.

MR DAVIDSON: Yes.

40 MR MARKS: Have you discerned this increasingly over time? We are talking about a four or five year period. Can you give us a better indication?

45 MR DAVIDSON: I think it's more frequent, but that's a relative term. It's not necessarily happening every week.

MR MARKS: Take 2007; what have you discerned in terms of the low point in the amplitude? What have you discerned in 2007?

MR DAVIDSON: We have seen some weeks in 2007 where the low point has actually been lower relative to TGP than I have ever seen before.

5 MR MARKS: How does that compare to 2006?

MR DAVIDSON: I don't discern any real difference. If I went back through the statistics, I might actually find a number but it doesn't feel that it's necessarily been any worse in 2007 than in 2006.

10 MR MARKS: I will put those two years together. 2005?

MR DAVIDSON: My memory is probably too cloudy to answer that question.

15 MR MARKS: So you are not able to really tell us where within that time frame that you have just identified this change has occurred?

MR DAVIDSON: No.

20 MR MARKS: But you are able to say in recent times, pricing below terminal gate happens and the gaps, if you like, between the lowest price in terminal gate are greater?

MR DAVIDSON: Greater than I can remember being in the past.

25 MR MARKS: How frequent do you think it is in 2007 that you have seen the prices falling below terminal gate?

30 MR DAVIDSON: Prices - retail prices in the market fall below our terminal gate price on a very frequent basis.

MR MARKS: At that low end of the cycle, is there a player in the market who you can identify as being the leader downward?

35 MR DAVIDSON: No, I couldn't identify a particular player. I can perhaps make some statements about what people or what brands you actually find down at those points, but I couldn't really give you any definitive answer as to which organisation or which particular sites were the first to get down there. It might be - we will observe from the data that we get or from our own physical observations that there may be - for illustrative purposes, there may be a Coles and a Woolworths and a
40 United store down at those levels, but I couldn't say definitively which of those three stores actually got down there first.

45 MR MARKS: We have asked other people these same questions. People haven't had had much difficulty in identifying who they see as leading down to the bottom of the cycle, particularly at that point where it is below cost for many people. I am asking you the same question to give you an opportunity to answer it. Take the Melbourne market, to start with. Is there a player who you see as being the predominant player in leading the price below the terminal gate?

MR DAVIDSON: No.

MR MARKS: What about in Sydney?

5 MR DAVIDSON: No.

MR MARKS: What about in any other city? You have not seen a dominant player?

10 MR DAVIDSON: In recent times in Perth, I would say United, but United are only a recent entrant to Perth, so that may be something about getting their name out there. In answering that question, I'm not trying to say that we don't actually analyse the market, because, as I said before, we do. We analyse it particularly around those stores that are in direct competition for us because that's how we actually set our prices.

15 MR MARKS: That's all I'm asking you.

MR DAVIDSON: But in terms of identifying one particular player in any market, I think the answer is no.

20 MR MARKS: What's the role of the supermarkets? Can you see anything emerging from the way they set prices or react to prices?

25 MR DAVIDSON: With respect to the - to below TGP pricing?

MR MARKS: How often do you see one of the major supermarket chains taking the price below terminal gate in Melbourne?

30 MR DAVIDSON: What I would say is that when there is below cost or below terminal gate pricing occurring in Melbourne and in other markets, it would be rare to not find a supermarket store down there actually matching the prices.

35 MR MARKS: Leaving matching to one side, what about leading the prices? Do you see the supermarkets frequently leading the prices down below terminal gate?

40 MR DAVIDSON: From our data, I think we would find it pretty hard to say, as I said before, who out of any particular set of competitors actually dropped down to that particular point first. So could I say that the supermarkets are definitely leading prices down there? I could not say that.

MR MARKS: Do you have any view about whether the supermarkets have increased the amplitude of price cycles in recent times, particularly in a downward direction?

45 MR DAVIDSON: I could say that insofar as there may be other players in a market place that have a strategy of always being the cheapest in the marketplace and that the supermarkets, in my observation, tend not to want to have anyone else cheaper than them, maybe that has actually become an effect. I think - do you understand

what I'm saying there? If, for example, a particular independent store wanted to be a cent cheaper than everyone else in their marketplace but a supermarket brand had a policy of matching the cheapest in their marketplace and doesn't have a position at which they are prepared to stop or is prepared to go to a very low price point, then
5 their existence and their preparedness to go to low price points may have actually increased below cost selling. What I am not saying is that the supermarkets themselves are definitely driving the first moves down into those areas because I don't actually have that knowledge. It may be that they are.

10 MR MARKS: You say at page 39 of the submission that the amplitude of the price cycles might be lower if below cost selling was prohibited. Is there any particular point that you were making in saying that?

15 MR DAVIDSON: Only really an arithmetic point.

MR MARKS: I was going to say it is strikingly obvious, but I was wondering whether there was something in there that I was not seeing. Clearly if below cost selling was prohibited, the amplitude of the cycle would not go below cost, but I was wondering if there was some point that you were seeking to make beyond that?

20 MR DAVIDSON: No, not really.

MR MARKS: Can I ask you about the Perth position in particular because it is a little different. Do you have any opinion as to why the Perth cycle is a two-week
25 cycle? I shouldn't say to you - I take it you are aware of the fact that it is not a weekly cycle in Perth?

MR DAVIDSON: I am aware of that, yes.

30 MR MARKS: And two-weekly seems to be the typical length of the cycle; would you agree?

MR DAVIDSON: Yes, I would agree.

35 MR MARKS: Do you have a view as to why that is so?

MR DAVIDSON: My only personal view as to why that may be the case?

40 MR MARKS: BP's view.

MR DAVIDSON: Well, BP's view then is that the WA price legislation that actually prevents intra-day movement, so restricts retail discounting decisions to be made to just once a day, has affected the rate of discounting in the Perth market.

45 MR MARKS: Why do you surmise it's done that?

MR DAVIDSON: We surmise it's done that just through observation of what has happened in the market, and that's clearly the major difference between Perth and any other market in Australia.

5 MR MARKS: Are you saying by that that from the time the legislation was introduced, there was a change in the Perth cycle from a cycle which typified the rest of Australia to one which did not, is that what you are saying, and thus attributing it to the legislation?

10 MR DAVIDSON: No, actually. I would correct myself and say no, that's not the case, because the fortnightly cycle that we currently observe in Western Australia, that's hasn't been the case since the introduction of the WA legislation.

15 MR MARKS: I am wondering then what you rely upon in order to say that the legislation has somehow impacted upon the duration of the cycle in the way you just did?

20 MR DAVIDSON: Let me say - and I probably have confused myself in trying to answer that question - I don't think the cycle itself - sorry, I don't think the legislation itself has actually predetermined any or actually led to any predetermined outcome of the cycle being over 14 days. Your question said has - if I heard part of your question there correctly, would the legislation have any effect on the operations of the cycle? I think the answer to that is yes, but we saw - and that particular piece of legislation predates my time actually in this role so I don't know exactly what
25 happened immediately after the WA legislation was introduced. But we have actually seen the WA price cycle, the discounting rate wander around quite a bit over the years.

30 MR MARKS: I am really focusing on one point. I asked you whether it was a two-week cycle. You accepted it was, and I said why a two-week one in Perth rather than one which is typical in the other capital cities? What is your answer to that question?

35 MR DAVIDSON: I can't give you an answer.

MR MARKS: You can't give an answer?

MR DAVIDSON: No.

40 MR MARKS: Can I ask you what your view is about the publication requirements under the Perth legislation - do you think that the 24-hour rule is a good one for consumers?

45 MR DAVIDSON: Is a good one for consumers?

MR MARKS: That's my question.

MR DAVIDSON: I'm not a consumer in the Perth market, so I don't know how it would affect me if I was. I have heard it said, and Fuel Watch obviously has made plenty of statements itself, or the Department of Consumer Employment and Protection in Perth, that it is a good rule for consumers. That is a decision for him to
5 make comment on - - -

MS McGRATH: Could I just add to that that - and I think it's amongst our submission, that we do make mention of the fact that by having that very specific state structure and limited frequency of price change, companies like BP who set
10 prices in specific sites have set up specific structures to deal with that legislation and treat WA differently, or Perth differently, and those costs, therefore, are in addition to our normal operating costs and are, therefore, recovered in the market.

MR MARKS: Viewed more generally perhaps than from BP's perspective, does BP
15 see the Perth laws, the 24-hour rule in particular, as being good or bad? Are they laws you support or don't support?

MR DAVIDSON: We don't particularly support it. We see it as interfering with the way that we generally go about competing and that is to make decisions based on
20 what our local competition is and setting our price in accordance with that, which is what we do in every other market in Australia. We are making hundreds of pricing decisions each day in each market. In Perth we are not able to make rapid reactions - if we find ourselves in a position where a direct competitor and one that we have identified actually has a material impact on the performance of our store, if we find
25 ourselves in a position, when we open up the WA website and find out that this guy is 2 cents a litre cheaper than us, we can't actually make an immediate decision to go down and actually match that price. So that interferes with our normal mode of competition. To that regard, no, we don't actually find it particularly helpful.

MR MARKS: Correspondingly, it may well place you in an advantageous position
30 on a particular day, because you have gone to a price which, as it transpires, is more attractive.

MR DAVIDSON: Indeed.
35

MR MARKS: So, would it level itself, from B's perspective?

MR DAVIDSON: We try and level it out from BP's perspective through an analysis
40 of our competitor's behaviour over a period of time. I am sure everyone understands that it actually puts us in a guessing game. We try - we do whatever analysis we can to try and get better at guessing than what we otherwise would have. But we are still guessing.

MR MARKS: Everybody in the market is guessing.
45

MR DAVIDSON: Everybody in the market, yes.

MR MARKS: I'm trying to understand, from what you are saying, whether there is anything in particular - and we know about that reality - but is there some particular thing that BP would say makes the WA laws and the 24-hour rule a bad thing, from BP's perspective?

5

MR DAVIDSON: Specifically around the 24-hour price change legislation, no, other than what we have just said.

MR MARKS: From the consumer's perspective, I suppose the advantage is that people have a much better idea, they are not all subject to the same benefit - they don't all have the benefit of the same information and knowledge that you have in the marketplace, but it gives them, as consumers, a better idea of what is happening in the marketplace, doesn't it?

15 MR DAVIDSON: It would seem to, yes.

MR MARKS: What do you mean by "it would seem to"? It clearly would.

MR DAVIDSON: Okay, yes.

20

MS McGRATH: They plan their purchase, yes. If they are a consumer who is particularly price-conscious that plans their purchase, yes, but that's only a segment of the market.

25 MR MARKS: But it's a system which is available to all.

MS McGRATH: Absolutely.

MR MARKS: From that perspective, it is probably a good thing for consumers.

30

MR DAVIDSON: As I said, I'm not putting myself in the place of a WA consumer but the Western Australian Government claims it's a good thing for consumers and they claim to have plenty of research to say the consumers say it's a good thing.

35 MR MARKS: What effect does it have on your margins that impact on them adversely?

MR DAVIDSON: No, I don't think so. I don't think it has any particular material effect.

40

MR MARKS: It doesn't sound like it's such a bad thing at all then.

MR DAVIDSON: As I said before, it is a bad thing, in the sense that it actually causes us to put ourselves in perhaps a more uncertain position. We are actually having to get what things are going to happen in the marketplace in advance rather than actually acting in a normal mode of operation, which is to actually constantly analyse what is happening in a particular marketplace and actually react to that.

45

MR MARKS: Perhaps the bottom line, Mr Davidson, is that there is a little more guessing from BP's perspective and a little less guessing from the consumer's perspective.

5 MR DAVIDSON: You may put it that way.

MR MARKS: Would you agree with me if I did?

MR DAVIDSON: I guess so, yes.

10

MR MARKS: All right. Can I ask you, then, about the amplitude of the cycle in Perth, just before I leave this topic. Is there anything you want to tell me about that? Has the amplitude of the Perth cycle been impacted on, do you think, by the legislation or is there nothing peculiar about it?

15

MR DAVIDSON: No, I don't think the legislation in itself has actually had any material effect on it.

MR MARKS: Just testing this a little further, is what you are saying then that if you were to look at the amplitude, look particularly at the low end for the moment, you are not seeing more frequent moves to prices below terminal gate, or deeper moves in that direction? Is that what you are saying?

20

MR DAVIDSON: Sorry - I lost train on that one. Could you repeat the question again? Sorry.

25

MR MARKS: I am sorry, my questions are perhaps too long. I'm just trying to understand - you said you don't discern there has been any difference in terms of the amplitude of the cycle, following the legislation?

30

MR DAVIDSON: I thought your question was do you think the legislation has had any effect on the amplitude?

MR MARKS: Yes, and I think you said - - -

35

MR DAVIDSON: I don't think the legislation in itself has had.

MR MARKS: Is it right, then, to say that the amplitude of the Perth cycle is typical of the other states?

40

MR DAVIDSON: No, I think at times the data has shown that the amplitude of the Perth cycle is perhaps a little lower than what it has been in some other states at some times.

45 MR MARKS: Do you have any view about why that is so?

MR DAVIDSON: Not - no, not really.

MR MARKS: Do you think that that's benefited consumers?

MR DAVIDSON: Having a lower amplitude?

5 MR MARKS: Yes.

MR DAVIDSON: In Perth? I think it possibly has. I mean, if - one of the things that consumers actually constantly complain about is wild swings in fuel pricing. If they are lower in Perth, for whatever reason, then maybe that's a benefit to the consumers. It doesn't actually stop consumers complaining about fuel prices in Perth.

MR MARKS: Do you regard price cycles generally as being beneficial to consumers?

MR DAVIDSON: Generally - only insofar as some price-sensitive consumers are actually aware of those cycles and avail themselves of opportunities to buy fuel at very, very good value. In a general sense, I'm not too sure that the price cycle is of any real benefit to the consumer.

MR MARKS: Do you have a view, more generally, as to whether prices might, on average, be higher or lower in the absence of a cycle?

MR DAVIDSON: No, I don't.

MR MARKS: You don't? At page 27 of the submission, under the question of the discount cycle, the behaviour is described as not being unique and having no compelling logic, but a reference is made generally to a paper by Michael Noel, concluding, at least from the Canadian market perspective, mark-ups are 1.02 cents a litre higher under sticky pricing regimes than under price cycle regimes, and to the extent that consumers can purchase to periods of low prices, the gain is even greater. Is that your point, or is that someone else within BP's point?

MR DAVIDSON: I made that point.

MR MARKS: What is the point you wanted to make?

MR DAVIDSON: I wanted to make a number of points there. One is that the price cycle, as it is, is not unique to Australia.

MR MARKS: Just about the extent of benefit is what I'm focusing on.

MR DAVIDSON: The extent of benefit? The point we wanted to make there was that at least one economist has actually done some analysis on this and come to a conclusion. I'm not actually necessarily making a point that I hold his view about the market ups being 1.02c a litre higher. That was a result of a whole heap of analysis that that particular economist did, that, frankly, I couldn't hope to replicate. But the

second point I think we have already made, to the extent that consumers can at times purchase at periods of low prices, there is a gain to consumers.

5 MR MARKS: But you don't necessarily want to adopt that proposition; you are putting it in from the perspective of observation?

MR DAVIDSON: I adopt the second point. I think, as I said, we have actually made that point. To the extent that consumers - - -

10 MR MARKS: I accept that. What about the first point?

MR DAVIDSON: The first point about mark-ups are generally higher under a sticky pricing regime, that was that economist's findings. I'm not actually adopting that point and applying it to the Australian market.

15 MR MARKS: I notice that BP doesn't operate in the Darwin or Hobart market. Does that affect your ability to distinguish in terms of benefit between markets where there is a cycle and markets where there are not?

20 MR DAVIDSON: It absolutely does affect it. As I said before, my understanding of behaviours and competition in the Australian marketplace is predominantly around those stores where we set prices. Given that we don't set prices through - I don't have any view on Darwin or Hobart - - -

25 MR MARKS: Is the answer to my question yes?

MR DAVIDSON: I don't have any view on Darwin or Hobart.

30 MR MARKS: Is the answer to my question yes?

MR DAVIDSON: What was your question?

35 MR MARKS: My question was BP does not have any retail outlets in either Darwin or in Hobart and I was wondering whether that reality affects your ability to make a judgment as to whether price cycles are beneficial or not?

MR DAVIDSON: Yes. The answer is yes.

40 MR MARKS: Can I ask you some questions about price support. Are you the target?

MR DAVIDSON: You may.

45 MR MARKS: Ms McGrath may want to expand. BP engages, does it not, in active price support but only in relation to a limited number of locations?

MR DAVIDSON: By price support - we actually want to make the distinction we are talking about temporary price assistance. We only offer temporary price assistance for petrol at four locations in Australia.

5 MR MARKS: I think in those locations you offer price assistance on the basis of, effectively, a guaranteed gross margin?

MR DAVIDSON: It's probably a little bit simplistic to say that, because we don't guarantee a margin at any particular point or at every particular point in a cycle or at every particular - in every particular circumstance.

MR MARKS: Without wanting to oversimplify it - and I don't want to delve too deeply into this, I just want to get a feeling - is the overall effect of the price assistance you offer to guarantee, in broad terms, a margin for the participants over the life of the support?

MR DAVIDSON: Over the life of that support, yes, I guess that is an effect, yes.

MR MARKS: I think you say in your submission at 4.3.7 that price support has a negligible impact on your pricing. I wanted to just ask you a couple of questions about that. It is true, is it not, that BP has restructured its market operations - and I think you might have done that back in 1998 or 1999 - away from the old single site franchise agreement that was more predominant under the Sites Act regime and headed in the direction of differing agency and other arrangements. That said and understood, I wanted to ask you some more general questions about price support and its use. This may be necessarily be there for price support by others. To take an example, Caltex has a very significant price support regime. It may not be the only example. But what impact does price support have on price cycles? Are you able to say?

MR DAVIDSON: No - are you talking about in the market generally?

MR MARKS: Just in the market generally.

MR DAVIDSON: Clearly, from BP's perspective, we don't feel it has any impact whatsoever.

MR MARKS: Let me clarify: Are you saying that BP itself does not provide any price support to any meaningful level and thus, from BP's perspective, price support is not a tool which it uses to influence price in any way?

MR DAVIDSON: I would say absolutely.

MR MARKS: I accept that. I'm asking you something different now. Is price support a tool used by other major refiners to influence the price at retail level?

MR DAVIDSON: I can't answer that question. I think you would need to ask whoever used price support whether they use it as a tool.

MR MARKS: I don't have any view, from BP's perspective, as to whether, say, Caltex in the way it utilises price support is in effect using supports a means or a tool by which to influence prices. Do you have a view about that?

5 MR DAVIDSON: No, I don't.

MR MARKS: No view whatsoever?

MR DAVIDSON: No.

10

MR MARKS: Do you know how Caltex uses price support?

MR DAVIDSON: No.

15 MR MARKS: Does anybody in the BP team know the answer to that question?

MS McGRATH: I don't know in the way that Brett doesn't, I don't know how they use it. I would assume that they use it to support profitable operations of their franchisees. So, profitable operations over a period of time, not in any given day or
20 time.

MR MARKS: In the days of the Site Act regime, the price support was used as a means by which the majors could regulate price, was it not? "Regulate" is really not the right word, "influence" is a better way to describe it.

25

MS McGRATH: I couldn't answer as I wasn't participating in the market at that time.

MR MARKS: I accept that, but do you have a view about it? It was not that secret. Price support was, for many years, in a non-vertically integrated market but a market which was bound by the provisions of the Sites Act, one means of enabling the major oil companies to influence the price being charged by franchisees. Has that not - - -

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MR DAVIDSON: No, I think I can say - - -

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MR MARKS: I was directing my question to you, Ms McGrath, because you had given me the previous answer and I continue to do that, please. Do you have a view?

MS McGRATH: I wasn't in this business at that time, but I would say - I would accept your point, qualified by in addition to ensuring profitability of single site franchisees. So, a combination of activities, a combination of outcomes, but I would not say - and I would not support that it was purely there to influence pricing in the marketplace.

40

45 MR MARKS: Is the reality, though - perhaps I will put it differently. Was one of the reasons why BP has restructured its operations the demise of the Sites Act? Is anybody able to answer that question from knowledge, as opposed to speculation?

MS McGRATH: Has?

MR MARKS: Was the demise of the Sites Act a reason for BP restructuring its operations?

5

MS McGRATH: The demise of the Sites Act was one reason which impacted BP's decision. Other reasons were consistency of offer and an ability to impact standard and the quality of the offer to the customer.

10 MR MARKS: And that's an answer that you have knowledge of?

MS McGRATH: Yes, I do.

15 MR MARKS: Thank you. Mr Davidson, I'm sorry, I interrupted you before. Was there something you wanted to add to that?

MR DAVIDSON: I was just going to clarify that temporary price assistance - certainly the way we operate temporary price assistance, and this is our understanding of the franchise act under which it was offered, we only offer price assistance to those who request it, and we actually offer it in good faith in order for that particular franchisee to compete with their local competitors. As such, we weren't offering price support - or providing price support with the intention that that particular franchisee would undercut the local competitor, because we couldn't do that. And we still do offer temporary price assistance. You are aware - we have talked about the three sites that are currently claiming it. We still actually operate this and we do have knowledge of how this system works. We do not tell those franchisees what price they are to set. To that extent - your question presumed that we were actually regulating, I think, or that the oil industry was using this tool to regulate prices, and I think - - -

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MR MARKS: I said to influence prices. In any event, let me ask you this question: Under your current arrangements for price support, does BP have the ability to withdraw price support at any time?

35 MR DAVIDSON: Yes, at our discretion.

MR MARKS: Is that consistent with the arrangement as it existed under the old scheme?

40 MR DAVIDSON: Yes.

MR MARKS: Can I then ask you just a couple of questions about shopper docket arrangements and what impact you think they may have had on the market, because that's an important matter for us at the moment. Is it best if I address my questions to you, Mr Davidson? I will do that, but, please, Ms McGrath - - -

45

MS McGRATH: Perhaps to me.

MR MARKS: I will certainly do it to you. At 4.4 of your submissions, or the BP submissions, you have said that the entry of the supermarkets into the retail petrol - into retail petrol sales had an impact on BP network volumes when they first commenced. The impact varied by site, and you say over time, volumes have
5 returned to the network. Flowing from that, please, what was the 2003 impact? I have no doubt there will be an overall figure that you can refer to. I'm just interested really in a percentage drop or a percentage impact to overall volume of sales. Then I would like you to go on to say to what extent, building upon that reality in 2003, volumes have recovered?

10 MS McGRATH: As the implementation of the supermarket offers was done market by market, only when all markets were operating in that model could the impact be felt across all our businesses. As the supermarkets entered a market, they generally took, from our view, a similar stance about their entry and their price position, but to
15 degrees they were more or less aggressive. The overall impact, if I could take a point in time when all those markets were operating in that model that we operate in, as the company operations business, was in the vicinity of about 4 per cent to us. And I say that from a - yes, that's our company-operated impact to our sales.

20 MR MARKS: That's the volume to company-operated sales?

MS McGRATH: And I believe it would be accurate to say that the impact across the dealer and distributor channels would be the same, if not greater. Based on the typical or average quality of real estate and location at that time, a number of those
25 sites had lived in a world where price was their main drawback, not location.

MR MARKS: What about moving forward? You say that volumes have slowly returned to the network. That doesn't tell us that much. What has been the degree of recovery?

30 MS McGRATH: There is a chart - I won't flick through all of the paper right now - in one of the documents we submitted, it could be the confidential one, that shows BP's total sales volume over that period. I think it is fair to say that in the last year, which must be 06, we have virtually recovered, or close enough to recovered.

35 MR MARKS: So you are about back to where you were?

MS McGRATH: Right, at the scale of the numbers you could say in that vicinity, yes.

40 MR MARKS: I wanted to quickly ask you about BP's responses. If I am incorrectly identifying these responses, please feel free to tell me. As I understand it, BP has over time responded to the shopper dockets of the large supermarket chains in a number of ways. I wanted to quickly ask you, firstly, about your Mastercard offer.
45 Was the purpose of that offer really just to attract volume?

MS McGRATH: I suppose the purpose was twofold. One was after a purposeful decision not to participate in supermarket alliances, we watched the impact over

time, we measured it and we looked at ways and opportunities that we could recover our position. It's fair to say that our branded retailers, our independent retailers, particularly, as I said, who in some instances had felt the impact even more astutely, were very keen to see BP make an offer to consumers that would allow them to be
5 seen to be competitive or better than the prevailing 4 cents off.

MR MARKS: Has the offer worked?

10 MS McGRATH: The offer was launched last year.

MR MARKS: That's obviously a subjective question.

MS McGRATH: It's new and - so it's - you are talking about a credit card industry, not an oil industry measure of success, and I would say that both partners would say
15 it's been successful, but it's new. So it's met our expectations, if that's reasonable. Both parties' expectations.

MR MARKS: Is another initiative, from BP's perspective - I don't want to
20 oversimplify this - the E10 rollout?

MS McGRATH: No, that's got nothing to do with - - -

MR MARKS: Nothing to do with the response to shopper dockets?

25 MS McGRATH: Absolutely nothing.

MR MARKS: E10 is becoming an increasingly popular alternative fuel source.

30 MS McGRATH: Yes.

MR MARKS: What is are BP's intentions vis-à-vis E10 in future? Is it going to
expand its sale of E10?

MS McGRATH: Yes. I mean, we have made announcements recently about our
35 intentions to expand that, both driven by state mandates - for example, New South Wales - and also where it is - where it is economically attractive and consumers are interested in the proposition, we will do it elsewhere beyond those such mandates, and we have done that.

40 MR MARKS: There was a bio rewards program of some sort. Can you tell me very quickly about that and whether you think that's been a successful response? I take it that that's a response to the shopper docket scheme, is it?

MS McGRATH: No, the bio rewards scheme, I'm just looking for the page - bio
45 rewards scheme was not at all related to the shopper dockets program. It was really a recognition of the structural price position of E10 in that market at the time when it was introduced and the benefit that we wanted to pass on to customers, and incentivise and show our support, particularly in regions where the people felt

strongly that E10 was a good product. In the last two years, it's very clear that in some markets it's been endorse and in other markets consumers have been highly suspicious about E10.

5 MR MARKS: What about - is it going well, the bio rewards scheme?

MS McGRATH: The bio rewards scheme has met our expectations.

10 MR MARKS: How does that work? It's a 3 cent a litre discount, is it?

MS McGRATH: That's right.

15 MR MARKS: What about convenience store business? Has there been a changed focus and, if so, is it in any way a consequence of the supermarket activities in the marketplace?

20 MS McGRATH: BP's investment and focus on being a convenience retailer in its 260 stores is in no way related to the supermarket 4 cent offer. It's very much about investing in a part of the market which consumers find more and more attractive, given lifestyles and access to 24-hour convenience items.

25 MR MARKS: You say it's in no way related. Is the reality, though, that it's the market in which shopper dockets have had a significant impact in which this change has been made?

MS McGRATH: I would say that the impact of shopper dockets on our convenience market is negligible. I should also point out that a convenience shop or convenience store customer of ours I think at least half the time doesn't buy fuel, anyway.

30 MR MARKS: But half the time he does. In a market where fuel is being sold at pretty low margins, there is the opportunity in the convenience store environment to take advantage of the profits from the convenience store activities. I am wondering whether the move into that model has flowed from or been a consequence of the supermarket shopper docket scheme?

35

MS McGRATH: No.

MR MARKS: You say you would have already moved in that direction anyway.

40 MS McGRATH: We were already moving in that direction before the supermarket schemes came into the market.

45 MR MARKS: Are there any other schemes that are, properly said, the consequence of shopper dockets?

MS McGRATH: There are schemes that have been associated with BP branded outlets that our independent dealers have entered into. Some of these, Independent Servo Savers, IGA I think has one, but those are decisions made by independent

retailers that carry our brand. We have no involvement with, we have no financial or other involvement. We don't encourage them or discourage them. So the consumer may make an association between various discount schemes in the market - that we have no view on or no participation in.

5

MR DAVIDSON: Further to that, in our submission we did actually point out a trial we conducted in Perth last year where we provided some fuel discounts dependent on what type of convenience items customers bought. That was purely a trial.

10 MR MARKS: You didn't follow that?

MS McGRATH: We didn't continue it, no.

15 MR MARKS: It may be that you have other trials in mind, I don't know, but I was wondering whether there is any other response to shopper dockets that we have not known about but that would be useful for the Commission to understand in assessing the impact of - and into the future of the shopper docket schemes?

20 MS McGRATH: In terms of offers, programs, structural exchanges, I would say no.

MR MARKS: The reality is that it would appear, anyway - I don't know - the shopper dockets seem to have resulted in the supermarkets growing a very large share of the retail market sales by volume. Whether you say it's 40 per cent, 43 per cent or somewhere between 40 per cent and 50 per cent, they now have, do they not, a very substantial share of the retail market for petrol by volume.

25

MS McGRATH: They do.

30 MR MARKS: Can I ask you, then: What is BP's view about the shopper docket scheme? Does it see it as just an inevitable part of the market environment? What views do you have and what responses might in the future be forthcoming?

35 MS McGRATH: Well, we are now in a phase in the last two years where all markets have seen that offer as the normal way of life as it was phased in. We have questioned, I suppose internally, how robust that model will be into the future. As I have said in our - as we said in our submission, we have from time to time questioned the possible cross-subsidisation that may occur to proliferate or continue that arrangement, given particularly some of the comments made earlier, or the dialogue between yourself and Mr Davidson about low points in the market.

40

MR MARKS: Do you see the schemes as continuing? Assuming no step is made to rein them in in any way, do you think that they will continue in the market?

45 MS McGRATH: I don't know if they will continue. I only know what is publicly available about the structure and the longevity of those deals.

MR MARKS: You say that the future of the shopper dockets is uncertain. The economics of petroleum retailing are such that the discounts are highly likely, you

say, to require cross-subsidies. You say it's likely that the shopper docket discounts will come under pressure in the future. I am wondering what BP sees as the future of shopper dockets.

5 MS McGRATH: The future, from our perspective, is that we are not participating in that type of alliance. The future for others I can't say because I'm not a party to their strategies.

10 MR MARKS: No, but if you are trying to look at where BP is going and understanding what you are going to do in the market, do you think you are going to be competing in a market where shopper docket discounts will continue?

15 MS McGRATH: For the foreseeable future, it is only responsible for me and my colleagues to assume that they will remain. But that's only guesswork on our part.

MR MARKS: I wanted to, Mr Chairman, now ask about some matters in private forum. Before I do that, I'm not sure if there are any other matters that the Commission would want to follow up.

20 THE CHAIRPERSON: There are perhaps one or two.

25 DR KING: One very minor matter - just taking you back to page 39 of your submission where you note that - Mr Marks took you to this sentence - the amplitude of price cycles might be lower or if below cost selling was prohibited, however such an approach would remove short-term consumer benefit. Mr Marks took you to that. As I understood it, your answer is that you are simply making the point that if below cost selling were prohibited then the bottom part of the cycle would be stopped in those times when otherwise it would go below cost?

30 MR DAVIDSON: That is the obvious part of that, but there is an unsaid bit in there as well - and we have heard other people speculate that it might be driving - that the below cost selling might actually be driving people's decisions as to what price point they set at the top of the price cycle as well. We don't actually have a firm view on that because we don't know what is in the other people's minds. But that is part of
35 that statement as well.

40 DR KING: Given that, can I take you to Perth, where, as I understand it, BP often is the leader up, if I can put it that way in the Perth market. I think that's what your evidence was earlier today.

MR DAVIDSON: Yes.

45 DR KING: I know you have answered already but just to remind me, because I don't have the advantage of the transcript here, but how often is that? Most of the time? All of the time?

MR DAVIDSON: Let's say nearly always.

DR KING: That means somebody in BP is sitting there on a morning - which day does it tend to go up first, do you know off the top of your head?

MR DAVIDSON: We make our pricing decisions about Perth on various days.
5 Over the last couple of years, we have lifted our prices on a Sunday and Monday or a Tuesday.

DR KING: How does BP decide which day in Perth to lift the price?

10 MR DAVIDSON: A large factor in actually making that decision for us is what our current margin position is in the market at a particular time. If we find ourselves in a position where we are actually selling at very low margins for some days, we might make actually a decision to lift our prices earlier than what we do. I mean, it's partly an outcome of the margin position we find at any particular point.

15 DR KING: In a sense, you look at how low the price has gone and then, using that information, you decide when you want to move the price back up?

MR DAVIDSON: That is an important consideration.
20

DR KING: How does BP determine how far to lift it up?

MR DAVIDSON: As I said before, one of the - there is a number of considerations in that. The primary consideration for us is actually the ongoing profitability of our
25 business, and so - and over time we have actually come to some conclusions about average margins in a marketplace and the rate of discounts in a particular marketplace, and so that is obviously an input to us. The cost of product at the time and our view of our cost of product at the time is a consideration; and the historical behaviour of our competitors as well. We have obviously got in the back of our
30 mind what things have actually happened in the past, but not the least of which is a consideration for us is BP's reputation in the marketplace.

DR KING: Can I take you, then, first to your view of average margin. Again, as I understand your answer - when we were talking about moving the below cost price,
35 can I take it that BP would look at, let's say the market over the previous few days in Perth, and if the price had been very low, for example, below cost or below BP's view of cost, then BP would raise the price to a level where it believed it could recover that loss?

40 MR DAVIDSON: Our position is slightly different on that, because we actually - some of this I would really prefer to expand on in private session.

DR KING: In that case, I might hold these questions off until the private session.

45 MR MARKS: I was planning on asking some questions about pricing.

THE CHAIRPERSON: I think, Ms McGrath, you said in relation to Fuel Watch that it imposed extra costs - or was it Mr Davidson? I think you said it imposed extra costs over and above those incurred in other states. Can you just elaborate?

5 MS McGRATH: When we have a team of people pricing each market, we have specific extra protocols, training and processes in which we have to treat WA differently, and that's what I meant.

10 MR DAVIDSON: If I can expand on that a little bit, we have almost developed an industry within our pricing team to ensure that we don't have a problem between the pricing from a - from the price instructions we have actually sent to our sites and the price instructions we have actually sent to the Western Australian Government. We have had to introduce a lot of checks and balances in there to make sure that we don't trip ourselves up on that.

15 We have some further issues around the auditing that we conduct on our stores at the opening of the Perth - the new price window, if you like, in Perth, which is 6 am Perth time. We conduct some special audits of our pump prices across those stores at that time to ensure that they are also in accordance with the prices that we submitted
20 to the Western Australian Government. There are some technical issues around some of that. The Western Australian Government actually quite often asks us to provide extensive proof of what our - not only what our posted prices are but what our sale prices were are for particular transactions in Perth, which involves our systems people trawling through journal information at stores, et cetera. Yes, there is
25 actually, as I said, a bit of an industry around - and that's just from the retail perspective. There are other issues around the wholesaling price regulations in Perth as well, which I'm not really equipped to comment on, but - and we don't do that for other markets.

30 MS McGRATH: For any other markets.

THE CHAIRPERSON: Mr Davidson, I wanted to ask a couple more questions about these price cycles. I think you have indicated that the price cycles probably benefit a few consumers or some consumers - I don't think you used the word "few" - some
35 consumers who will buy at the bottom of the cycle. What is the position overall for consumers, is the price cycle beneficial overall or to their detriment?

MR DAVIDSON: My only - I would suspect that there is a marginal benefit to consumers. My reason for saying that is that more than 50 per cent of our fuel sales
40 to non-card customers are made below the median price of any price cycle. It is not a huge difference but there appears to be a marginal skew towards cheaper prices in a cycle than more expensive prices in a cycle. That's the only reason I would say there appears to be a marginal benefit to the consumer. As I said before, and I would reiterate the point, for those consumers who are particularly price-aware, they are
45 taking great advantage of it. For example, we sell something in the order of 18 per cent of our regular unleaded sales then on a Tuesday, whereas if you evenly rated our business across a week, you would expect that to be about 14 per cent.

THE CHAIRPERSON: I guess as consumers become more aware and more price conscious, that will mean more consumers would marginally benefit from the cycle?

5 MR DAVIDSON: I think, although I don't have any real statistics to back this up, I think that has actually been the case in recent years. We note the efforts of the ACCC to actually - and various motoring organisations - to raise awareness of the cycle and when the cheapest days of the week are.

10 THE CHAIRPERSON: Do they benefit or disadvantage the suppliers?

MR DAVIDSON: By the suppliers, do you mean BP?

THE CHAIRPERSON: BP.

15 MR DAVIDSON: I think we are largely indifferent to it. It is what it is. There is some marginal logistic issues with us of not having volume of sales evenly rated across a week. Obviously, we have to take that into consideration for stock holdings at stores. A lot of our stores are ridiculously busy on a Tuesday afternoon, to the point that it actually causes capacity problems for us, and not so busy on a Thursday
20 afternoon. So there are some efficiencies around labour usage and whatnot that we don't find particularly helpful around the price cycle, but we haven't actually done any economic analysis on that. Because it is what it is. We don't see that - we are reacting to a market as we find it. We haven't actually done any real analysis as to the benefits or disbenefits of the price cycle.

25 HIS HONOUR: I guess you prefer to react to movements in market price, as assisted by Informed Sources and the almost realtime information you pick up there, than having to guess 17 hours or 18 hours beforehand what the price might be tomorrow, which is the Fuel Watch concept?

30 MR DAVIDSON: I guess - yes, I would say we prefer to do that because that's our normal mode of operation for most of the markets we work in. Perth is an aberration. I guess if all of Australia was like Perth, except Perth, or except Melbourne, for argument's sake, and Melbourne was the only market where we were
35 actually allowed to do real life pricing then we might a different view.

THE CHAIRPERSON: Back I think in 2000, 2001, or thereabouts, Caltex made a significant effort to either dampen or flatten the price cycle in Adelaide, and it met stiff resistance from all the others, including BP. Do you have an explanation for
40 that?

MR DAVIDSON: That's actually an interesting point that you make. Was it that long ago that they actually did that? The only reason I ask is because there was a period there a number of years ago where we observed a different behaviour from
45 some Caltex outlets in the Adelaide market and we scratched our heads for quite some time to try to figure out what was going on and get a bit of analysis of it.

THE CHAIRPERSON: I might have my dates wrong but I think it was 2001 and I think they tried for two or three years.

5 MR DAVIDSON: If they persisted, that would actually correlate with the period that I'm talking about. That explains some things that we observed at the time.

THE CHAIRPERSON: And BP weren't happy with that? They didn't take advantage of the possibility of flattening the cycle?

10 MR DAVIDSON: As I said, we weren't actually aware that this was a particular drive from Caltex, as you say, to try to eradicate the price cycle. We are operating in a market where Caltex wasn't the only competitor. In looking at those - at that particular behaviour, we did a fair bit of analysis on it at the time. As I said, we noticed the change in their behaviour, or we noticed that they were behaving at some
15 locations differently to the rest of the market and we looked to try and understand why that was the case and what impact that may actually be having on us. We found that it wasn't at all Caltex sites, and we also found that the stores that were actually behaving differently to the rest of the market, in terms of the rate of discounting and the reaction to price lifts, were not in the large direct competitors to the 20-odd sites
20 that we actually set prices for in Adelaide at the time.

So we noted a difference in behaviour but we didn't really notice a difference in its impact on our performance. Because what - I think I said this before. How we go about setting our prices, we actually have a set of reference sites around each of our
25 locations. Insofar as some of those actually had one of these Caltex outlets that were behaving differently, they weren't the price setter in that particular locality. They were actually sitting above that. Now, we were - our policy was to try and actually be as competitive as possible with the relevant competitors and the relevant competitor in that area, it may well have been Caltex beforehand but all of a sudden
30 that Caltex site became less relevant because the Mobil site or the Shell site at the time or the United - in that particular locality was still actually discounting and we still actually felt compelled to compete with those locations. So some sites in a market actually behaving completely differently, clearly, the outcome, as you see now, it just didn't - but did BP actually have a particular response to? It wasn't
35 actually particularly relevant to us.

THE CHAIRPERSON: We will move into closed session, if those not associated with BP or its advisers could vacate the room.

40 **PUBLIC HEARING ADJOURNED** [2.53pm]

45 **PUBLIC HEARING RESUMED** [4.13pm]

<PAUL EDMENDS, SWORN

THE CHAIRPERSON: I see you have legal counsel here.

MR EDMENDS: Mr Zaven Mardirossian and Matthew Lees from Arnold Bloch Leibler.

5

MR MARKS: Could you state your full name, please? I didn't hear it?

MR EDMENDS: Paul John Edmends.

10

MR MARKS: Can you tell us what your full position is? You are the general manager, are you?

MR EDMENDS: Correct.

15

MR MARKS: In that stated position, what is your role?

MR EDMENDS: The role is the responsibility for daily operations of Liberty Oil.

MR MARKS: Is that Australia wide?

20

MR EDMENDS: Correct.

MR MARKS: I am going to ask you a series of questions. We want to do most of them in open session. There will be some I know in the answers you have given to the questions asked you of you under 95ZK you have reserved some of the answers as being confidential and we understand that. If there are matters that you want to answer only on a confidential basis please say so and we will endeavour to accommodate by reserving some time at the end to accommodate those matters.

25

30

I wanted really to start by asking you to describe Liberty's operations in the petrol market generally.

MR EDMENDS: Liberty is a wholesaler of fuel. We purchase product from two main suppliers. That product is then on-sold to individual service stations with a number of them operating under a Liberty brand and a number of them just operating under their own brand. And we are also supplying a number of other resellers.

35

MR MARKS: Are you able to identify for us both geographically and numerically where the sites are?

40

MR EDMENDS: Yes. We operate in all states but the Northern Territory. Liberty has in Victoria approximately 40 branded sites, in Victoria. We have approximately 40 in South Australia or Adelaide. 25 in WA. New South Wales, approximately 14 to 15, and around about the same number in Queensland. And six down in Tasmania. Also, there are a number of unbranded locations in those states as well.

45

MR MARKS: The only one I did not pick up was Queensland.

MR EDMENDS: Queensland, approximately 13 to 14.

MR MARKS: They are all branded sites?

5 MR EDMENDS: Yes.

MR MARKS: When you say "unbranded", Liberty wholesales to a number of retail operations. And - when you say unbranded what's the general position of these unbranded, do they have their own brand name?

10

MR EDMENDS: Yes, they will have their own brand name.

MR MARKS: I want to ask you about who your non-brand customers are. Are you able to say that in open session?

15

MR EDMENDS: Yes.

MR MARKS: Would you please identify them for us?

20 MR EDMENDS: Some of the major ones are Refuel Zone, OzFuel and then the majority of the rest would be just under their own local name.

MR MARKS: You say the "major ones", how big is Refuel Zone and how many sites does it have?

25

MR EDMENDS: It has four sites.

MR MARKS: What about OzFuel?

30 MR EDMENDS: OzFuel has seven.

MR MARKS: Thank you. Are there any non-brand customers that have by number greater than seven sites?

35 MR EDMENDS: No.

MR MARKS: You said in your answers that Liberty does not - and you reiterated in your response orally - it does not operate itself as a retailer.

40 MR EDMENDS: Correct.

MR MARKS: Has that always been the position?

MR EDMENDS: Certainly under this group of companies, yes.

45

MR MARKS: That is going to naturally lead me to ask you about what previous structural realities there were. Was there a pre-existing structure?

MR EDMENDS: Liberty as a group hasn't operated retail sites for over six years.

MR MARKS: Is there a reason - I'm thinking now that goes back to about 2001. I don't want to hold you to that but it's about 2000 to 2001. Is there a reason why
5 Liberty moved out of retail operations to concentrate on wholesale operations?

MR EDMENDS: Liberty had a commercial deal with Woolworths which saw the release of some 69 sites across to Woolworths and a part of that negotiations were that we would not be involved in retailing.
10

MR MARKS: I see. Were they right across Australia, those 69 sites?

MR EDMENDS: Yes, I think all but Northern Territory.

15 MR MARKS: Did that happen in 2002?

MR EDMENDS: That happened in July 2001.

MR MARKS: July 2001. My friend suggests to me and is no doubt correct that you weren't at Liberty at that time. How long have you been at Liberty?
20

MR EDMENDS: I have been at Liberty around two years, eight months.

MR MARKS: When did you start?
25

MR EDMENDS: January 2005.

MR MARKS: Who was your predecessor?

30 MR EDMENDS: Mark Kevin.

MR MARKS: Can I then ask you, please, to give us a broader idea of what Liberty's present wholesale operations involve? Firstly, what petroleum products does Liberty wholesale? ULP, obviously?
35

MR EDMENDS: Yes.

MR MARKS: Diesel?

40 MR EDMENDS: Correct.

MR MARKS: E10?

MR EDMENDS: Correct, yes, in most states.
45

MR MARKS: I will come back to that. But what others?

MR EDMENDS: PULP, and that is it. LPG, sorry.

MR MARKS: LPG?

MR EDMENDS: Yes.

5 MR MARKS: Are you able to say what proportion of your total sales are made up of the wholesale sales of ULP?

MR EDMENDS: Approximately 65 per cent.

10 MR MARKS: The remaining 35 per cent, can you just identify as accurately as possible what that is made up of?

MR EDMENDS: E10 would be around 1 per cent. PULP, or premium unleaded, would be approximately 9 per cent, and diesel would be 25 per cent. And LPG really
15 wouldn't - half a per cent.

MR MARKS: Thank you. The petroleum products that you sell at wholesale, are they obtained from your major supplier?

20 MR EDMENDS: Correct, major suppliers.

MR MARKS: Let me ask you about that. You have got in your answers that - if this requires a confidential answer please feel free to say. It's not marked as confidential in your submission - that Liberty's major supplier is Caltex. Is that correct?
25

MR EDMENDS: Over a long period of time Caltex have been the major supplier.

MR MARKS: Does that mean that it's still the major supplier?

30 MR EDMENDS: Currently it's fifty-fifty.

MR MARKS: Who is the other supplier?

MR EDMENDS: Mobil.
35

MR MARKS: So presently fifty-fifty. When you say that, is that across all products or is it skewed in some way?

MR EDMENDS: No, that would be fairly consistent.
40

MR MARKS: Your current arrangements with each of Caltex and Mobil - can I ask you some questions about those?

MR EDMENDS: Yes.
45

MR MARKS: Again, please feel free to caveat your answers if you desire to do so. Firstly, can I ask you about Caltex. In terms of the supply of unleaded petrol, where does Caltex fit into your picture? You said to me, "We've got a number of sites

across a number of locations." Are you able to tell us how you rely on Caltex for supplies generally?

5 MR EDMENDS: Basically in all capital cities we purchase product from Caltex's seaboard terminals in the metropolitan areas.

MR MARKS: Do you have any sites in regional locations?

10 MR EDMENDS: Yes, we do but the product is sourced from metropolitan terminals.

MR MARKS: And then there are distributor arrangements?

MR EDMENDS: Yes.

15 MR MARKS: Caltex in all capitals?

MR EDMENDS: Except the Northern Territory.

20 MR MARKS: Except NT. What about Mobil, please?

MR EDMENDS: Mobil, the same.

25 MR MARKS: Under your arrangements with both the major suppliers - are you able to - do you have flexible arrangements which enable you to pick and choose based on a price you can get at any particular time? How does it work in practice?

MR EDMENDS: We have minimum and maximum volumes with both suppliers.

30 MR MARKS: Do those ranges give you much flexibility to go to what might be described as the more competitive alternative?

MR EDMENDS: To a certain degree, yes, because they are based on forecast numbers. So we can certainly forecast ...

35 MR MARKS: Do you in fact utilise your supply arrangements in that way?

MR EDMENDS: Yes, within the tolerance of the volume requirements.

40 MR MARKS: Let me ask you some questions more generally about the market in which you are presently operating. Firstly, does Liberty, apart from the two major suppliers you have identified, does Liberty import any product into Australia?

MR EDMENDS: No.

45 MR MARKS: Has it ever done so?

MR EDMENDS: No.

MR MARKS: Has it ever considered doing so.

MR EDMENDS: We have certainly reviewed it over a number of years.

5 MR MARKS: When you say that, does Liberty periodically review the possibility of overseas supply arrangements?

MR EDMENDS: Yes.

10 MR MARKS: Does Liberty use the possibility of overseas supply arrangements as an alternative in negotiating pricing with either or both of its major suppliers?

MR EDMENDS: That's something we consider when we are renegotiating.

15 MR MARKS: Do either or both of your major contracts have provisions in them enabling wholesale pricing reviews to take place?

MR EDMENDS: The answer is no. But the price does get reviewed on certain components at certain intervals.

20

MR MARKS: Just understanding that, is the reality that under your contracts you do have periodic price review provisions but they are governed or the parameters of those provisions mean that certain aspects of the price can be renegotiated periodically?

25

MR EDMENDS: The components that can be reviewed are under a structured review process.

30 MR MARKS: Can you tell us what the nature of the periodic review is? Is it six monthly, 12 monthly?

MR EDMENDS: Yes, six monthly.

35 MR MARKS: Is it the same under both contracts?

MR EDMENDS: Yes.

40 MR MARKS: You have said to me in answer to questions that you - that Liberty does use the potential availability of overseas imports as a tool - I have used that word, not you - in its negotiations, its price review negotiations with its major suppliers?

45 MR EDMENDS: We do it as a review of our internal checking of where our price or pricing formula sits on a world scale. So it's not used as a negotiating tool as such.

MR MARKS: But is it nevertheless correct to say that when you are negotiating both your initial prices and subsequent variation in the prices for wholesale with your

major suppliers, that your major suppliers will set price or wish to set price determined by reference to available alternative opportunities for Liberty supply?

5 MR EDMENDS: I'm unable to speak on behalf of our suppliers, but I assume so.

MR MARKS: Do you assume so because it follows as a matter of logic that they would?

10 MR EDMENDS: Correct.

MR MARKS: Likewise, as a matter of logic it seems to me that Liberty would want to know what alternative supply arrangements are available to it both within and outside Australia when it negotiates initial prices and pricing reviews with its major suppliers. Is that the position?

15 MR EDMENDS: Yes.

MR MARKS: Does Liberty, then, on an ongoing basis monitor and observe the international market for importation of fuel into Australia?

20 MR EDMENDS: No.

MR MARKS: What does it then do when it wants to or when a period of review comes up to obtain the information necessary for it to understand what it could buy petrol for on the international market?

25 MR EDMENDS: We will normally go to a major trader and get some feedback.

MR MARKS: Assuming that, do you have available to you through a major trader or through a network of traders that information on an ongoing basis?

30 MR EDMENDS: Ad hoc.

MR MARKS: When you ask for it?

35 MR EDMENDS: Yes.

MR MARKS: Do you pay for that information?

40 MR EDMENDS: No.

MR MARKS: Are you able to say from the position you have just described what the position is in terms of the availability of international supply of unleaded petrol were Liberty to desire to obtain it at the present time?

45 MR EDMENDS: No. We have never gone that next step.

MR MARKS: Do you have terminalling, storage or other facilities available to you in Australia which would enable you to import fuel were you desired to do so?

MR EDMENDS: Not directly.

5

MR MARKS: What about indirectly?

MR EDMENDS: I assumed you would go to Vopac or Trafagura and try to lease facilities.

10

MR MARKS: If you were planning on doing that you would go to Vopac and Trafagura because they are the obvious independent terminallers who an independent such as Liberty would look to?

15 MR EDMENDS: Yes.

MR MARKS: Have you ever done that?

MR EDMENDS: Not to my knowledge.

20

MR MARKS: Are there other available potential storage facilities for Liberty apart from those independents?

25 MR EDMENDS: Given that we have never really gone that next step, we have not gone and sourced.

MR MARKS: We know that obviously those independents have facilities in Darwin and Sydney and, in the case of Trafagura, it currently has a storage facility in Victoria but that's limited.

30

MR EDMENDS: Yes.

35 MR MARKS: Can I ask you this. In making the observations that Liberty has made about the ongoing availability of international refined fuel which you have just explained to me occurs on an ad hoc basis, are you able to say from Liberty's perspective whether the availability of fuel on the international market refined to Australian Standards has been affected or was affected by the introduction of the fuel standards?

40 MR EDMENDS: No, given that we haven't been to that market before we wouldn't have a benchmark to say whether it's increased or decreased.

45 MR MARKS: Can I ask you a different question, then. In making the decision that you make or that you thus far made in the current market to go with two major suppliers for all your needs, is security of supply a critical consideration for you?

MR EDMENDS: Yes.

MR MARKS: And, if so, could you explain what you take that to mean or what you mean by that?

5 MR EDMENDS: We basically look to ensure that we have a basic crossover of contracts so that the two do not expire or end in the same period of time, so that we always have at least one contracted supplier in play.

10 MR MARKS: Is that practically what happens? You always have one? At the moment you have got two?

MR EDMENDS: That's the case, yes.

15 MR MARKS: Again, if you are sensitive about answering this question in open session, please feel free to say so. What is your immediate intention in terms of ongoing - the continuation of ongoing supply arrangements with your two major suppliers?

MR EDMENDS: To continue.

20 MR MARKS: Can I ask you this question again at a higher level. Is one of the supply arrangements better for Liberty than the other?

MR EDMENDS: Yes. However - - -

25 MR MARKS: Judged by reference to what?

MR EDMENDS: Price and trading terms. However, the other supplier has realigned and renegotiated a part of that contract given the movement of volume.

30 MR MARKS: Does that mean in practical terms that you are at present getting a similar deal from both?

MR EDMENDS: Correct.

35 MR MARKS: I wanted to ask you about the breadth of your wholesaling arrangements and really focus in particular on whether they have changed with changes in the structure or the position in the retail market. My particular focus is to ask you about the impact of the shopper docket arrangements. I want to ask you whether the advent of the shopper docket scheme over time has impacted on your
40 wholesaling customer base and, if so, how?

MR EDMENDS: Our wholesaling base has been affected at I guess a second level, where individual sites that we supply the average volume has decreased. However, we have been able to maintain our market share by increasing our customer base.

45 MR MARKS: All right. Now, do I take it from that that the answer to my question is that there was an impact, it was an adverse impact, was it?

MR EDMENDS: The impact - - -

MR MARKS: Initially in any event.

5 MR EDMENDS: No. The volume that has decreased has been replaced at a continuous ...

10 MR MARKS: I was asking you initially. You made that point and I accept it. But I was trying to break that down. Firstly, as to the initial impact, it may have been an adverse impact if volume had fallen away and then over time there might have been a beneficial impact. I am just trying to understand the position.

15 MR EDMENDS: The volume wasn't lost quickly and it wasn't gained back quickly. It was basically replaced like for like.

MR MARKS: So there was a gradual reduction for a period?

MR EDMENDS: Yes.

20 MR MARKS: Over what period, are you able to tell us?

MR EDMENDS: No.

25 MR MARKS: I know you only go back to 2005, I am conscious of that reality. But just answer the question as best you can.

30 MR EDMENDS: The volume has been consistent month on month, year on year. But the amount of customer base has increased significantly to achieve that same volume.

MR MARKS: Let me ask you about that because that doesn't surprise me. Tell us about the change in the customer base. You have lost presumably some customers but you have gained a different type of customer, can you explain?

35 MR EDMENDS: Correct. What has happened is that the average site litrage customer that we have has decreased significantly. The smaller independents have actually come looking for a supplier brand partner, which has obviously led them to a company like Liberty.

40 MR MARKS: What does Liberty offer that sort of customer that the majors do not?

45 MR EDMENDS: Well, in most cases - obviously every case is different, site by site - but in most cases it is a brand. It is the support through I guess almost buying power and flexibility. Flexibility could be delivery size, delivery frequency. And service.

MR MARKS: In terms of service, is that a feature of Liberty's supply offer? Does it offer service of a different and greater kind to that which an independent might hope to obtain from one of the majors?

5 MR EDMENDS: Our service is probably more communication.

MR MARKS: When you talk about service, are you talking about a relationship?

MR EDMENDS: Yes.

10

MR MARKS: Again, if I'm going beyond what you want to answer in open session please say so, but is the broad policy of Liberty to have a close relationship with its customer base?

15 MR EDMENDS: It's to have a fair and friendly relationship with our customer base.

MR MARKS: Can I ask you, then, to focus for a moment on your relationship with your existing suppliers. On what - can I take each one. Firstly, your relationship with Caltex. Are purchases by Liberty from Caltex based upon a terminal gate price?

20

MR EDMENDS: No.

MR MARKS: Can you tell us how they are based and what the effective price is which Liberty can buy at?

25

MR EDMENDS: For unleaded it's from a Mogas 95 marker.

MR MARKS: Is that the same for both?

30 MR EDMENDS: Correct.

MR MARKS: When you say it's on the basis of Mogas 95 I assume you gathering into that the fact that your price is based on an IPP price?

35 MR EDMENDS: Correct.

MR MARKS: With various add-ons for wharfage, insurance and the like?

MR EDMENDS: Correct.

40

MR MARKS: That will give a price or a whole add-up. There will then be a margin, presumably?

MR EDMENDS: Correct.

45

MR MARKS: And that will lead to a figure?

MR EDMENDS: Correct.

MR MARKS: Is that figure something different from - in the case of Caltex - it's terminal gate price?

5 MR EDMENDS: From the information that we gather, yes.

MR MARKS: Is it more aligned to the Caltex reference price?

10 MR EDMENDS: The answer is that it is different. But we aren't aware of the Caltex reference price. We are aware of what the Caltex reference price is used for, given previous backgrounds in the industry. But we don't know what it is.

MR MARKS: So you can't judge the price you are getting by a sort of a comparison with the reference price because you don't know it?

15 MR EDMENDS: Correct.

MR MARKS: You do know the terminal gate?

20 MR EDMENDS: We know the listed terminal gates, yes.

MR MARKS: Are you able to tell the Commission either now or in private session what relationship the end price that you have agreed bears to the terminal gate?

25 MR EDMENDS: It differs from state to state.

MR MARKS: But does it differ in a consistent fashion in the sense that you could tell us state by state what it is?

30 MR EDMENDS: We don't monitor it that closely. We monitor it to basically ensure where our price sits against it, but we don't do an analysis over a period of time.

35 MR MARKS: So how broad would your answer to that question be? Would you be able to give us some broad idea about how much above or below the current Caltex or the average Caltex terminal gate price was for a period?

MR EDMENDS: As in a number?

MR MARKS: Yes.

40 MR EDMENDS: I would prefer not.

MR MARKS: I understand, but you would be able to give us that information in closed session?

45 MR EDMENDS: It would be more of a guesstimate. We don't tally or analyse that over a period of time.

MR MARKS: I have no doubt about that. But you would be able to give us an estimated guesstimate, would you not?

MR EDMENDS: Yes.

5

MR MARKS: We will come back to that. Having regard to the answers you have given me, for which I am grateful, it helps our understanding, can you tell me what you see as the relevance, if any, of a published terminal gate price from Liberty's perspective - I should make it clearer. In terms of your purchasing of petrol from Caltex, no doubt the same would apply to Mobil, what relevance really to you as a purchaser is the published terminal gate price that Caltex publishes?

10

MR EDMENDS: In the relevance to our price, there is no relevance. We use it as a benchmark.

15

MR MARKS: It is useful to you in that sense?

MR EDMENDS: Correct.

MR MARKS: Thus the requirement upon Caltex to publish it on a daily basis is of utility?

20

MR EDMENDS: Yes, and that differs state by state.

MR MARKS: What do you mean it differs state by state?

25

MR EDMENDS: It is more meaningful in some states than others.

MR MARKS: Is it? Why is that?

30

MR EDMENDS: There seems to be a different mechanism that drives that price.

MR MARKS: Does that mean in practice that in some states your price is typically correlated and in other states there is no price correlation?

35

MR EDMENDS: I would not be able to answer that with a correct response. We look at it on a daily point, so I wouldn't be able to give an average of whether it moves in line with ours or doesn't.

MR MARKS: I want to turn to the Liberty wholesale price.

40

MR EDMENDS: Yes.

MR MARKS: And ask you some questions about that. Again, please feel free to answer this in the open session to the extent you can. What is Liberty's general position in terms of the setting of wholesale prices? I imagine it's determined - wholesale prices are predominantly determined by reference to Liberty's buy price?

45

MR EDMENDS: Correct.

MR MARKS: The obvious proposition, how does Liberty set its prices?

5 MR EDMENDS: Liberty sets their price, whether it be their terminal gate price or individual wholesale prices, by cost of our major supplier over that period of time, which has been Caltex, plus a margin.

10 MR MARKS: Is the practical consequence of that, though, that prices to customers can still be different?

MR EDMENDS: Between customers?

15 MR MARKS: Yes.

MR EDMENDS: Each individual customer has an individual price unless they choose the terminal gate.

20 MR MARKS: Is the price to a customer based to a small or large extent on volume?

MR EDMENDS: Volume is a large component.

25 MR MARKS: Will the margin that Liberty insists upon customer to customer differ or do you always seek to recover a similar margin?

MR EDMENDS: The margin will differ depending on the commercial relationship we have with that individual customer.

30 MR MARKS: So in reality the customer may get a discount from what I might describe as your wholesale price, Liberty's wholesale price, depending upon relationship, volume and perhaps other matters?

35 MR EDMENDS: Given that we price cost plus margin, we don't utilise the word "discount".

MR MARKS: You collect the concept of discount to the extent that that is even relevant, you collect it in your margin?

40 MR EDMENDS: Correct.

MR MARKS: Does Liberty acquire petrol from its suppliers at a price that enables Liberty to be competitive in the wholesale market?

45 MR EDMENDS: The prices that we put out certainly are competitive to those that have similar circumstances - what we would believe similar circumstances to ourselves.

MR MARKS: Would there be a good reason, for example, why a customer might purchase from Liberty as opposed to, say, buying from one of the majors at its spot price?

5 MR EDMENDS: Is there a good reason?

MR MARKS: Yes. Would it come in at below that?

10 MR EDMENDS: We would believe over a period of time, yes.

MR MARKS: So you would say that competitive pricing needs to be considered by reference to the contractual time frame?

15 MR EDMENDS: Yes.

MR MARKS: Changing topic a little bit now. I know that Liberty doesn't do any retailing as such, but I wondered whether you had a view on - and you can express it in short terms if you do - upon a couple of features of the retail market that the Commission is looking at. One of them is price cycles. Can I ask you in short terms:
20 Does Liberty have a view about what drives the price cycles in the metropolitan markets where it features?

MR EDMENDS: Liberty doesn't have a view as such as we don't play in it. We also don't gather data on the retailing board price as such.
25

MR MARKS: No, but Liberty has a number of customers who trade in that market and whose businesses are impacted by it.

30 MR EDMENDS: Correct.

MR MARKS: What I am trying to understand is, viewed from Liberty's perspective as a wholesaler, what do you see as the cycle? Do you have a view as to what causes it?

35 MR EDMENDS: Not in such a clear definition of "this is the reason". I mean there is obviously a whole number of factors that someone could throw up as possibilities for the making of the cycles.

40 MR MARKS: There are markets that don't have it. Darwin, I don't think, is so relevant from your perspective.

MR EDMENDS: No.

45 MR MARKS: But is Tasmania relevant?

MR EDMENDS: We have a number of retail sites that we supply in Tasmania.

MR MARKS: Six. What about that market? It doesn't have a price cycle. Any views on why?

5 MR EDMENDS: I would say that that market has changed recently over the last six months.

MR MARKS: Tell me about that, please, how has it changed?

10 MR EDMENDS: With the introduction of United into that market.

MR MARKS: What impact has that had?

MR EDMENDS: It has seemed more variable on price?

15 MR MARKS: Has that impacted on your wholesale supply into Tasmania.

MR EDMENDS: No.

20 MR MARKS: Is that because your wholesale supply arrangements are on contract?

MR EDMENDS: No, it's mainly because we buy at a price and sell at a price. So it doesn't impact us directly.

25 MR MARKS: The other matter just quickly I wanted to ask you about was the impact on the retail market - and I had referred this to you some time ago but I wanted to come back to it. The shopper docket arrangements - the impact has been substantial, hasn't it, in terms of retail sales by volume?

30 MR EDMENDS: By individual location.

MR MARKS: As we understand it, the supermarkets together are responsible by volume for over 40 per cent of retail sales. Is that a figure with which you are familiar?

35 MR EDMENDS: We put it at a figure of around 40 to 45 per cent.

MR MARKS: That reality means, does it, that in a practical sense a large part of the retail market is aligned to major oil companies?

40 MR EDMENDS: Correct.

MR MARKS: So that the balance of the market is fighting for the balance of the share?

45 MR EDMENDS: Correct.

MR MARKS: Now, that has happened over time, but I wanted to know how that has impacted upon Liberty. You gave me some general answers before, but I wanted to

understand it a bit better. Are you able to describe whether there has been any impact that you have discerned since January 2005 when you commenced with Liberty?

5 MR EDMENDS: The impact has been at an individual site level.

MR MARKS: What does that mean?

10 MR EDMENDS: The impact to Liberty has been that our customer base has needed to grow to actually maintain the same position that we had before 2005, et cetera.

MR MARKS: Does that mean that the exposure, if I can broadly describe it that way, that Liberty has through its customers to retail sites has changed in this way, that there are - there is a large customer base.

15 MR EDMENDS: Yes.

MR MARKS: But are there a smaller number of sites or are the number of sites about the same?

20 MR EDMENDS: As in the number of sites that are our customers or the market as a whole?

MR MARKS: The number that are your customers.

25 MR EDMENDS: We have a larger number of individual sites that we supply now than we did two years ago.

MR MARKS: How much has that growth been?

30 MR EDMENDS: The growth as a number?

MR MARKS: As a number.

35 MR EDMENDS: The number would be approximately 25 each year.

MR MARKS: It has been growing steadily?

MR EDMENDS: Since 2005.

40 MR MARKS: Do you expect it to continue to grow?

MR EDMENDS: No.

45 MR MARKS: Do you think you have stabilised?

MR EDMENDS: There is less opportunities of individual sites to pick up.

MR MARKS: The source of your growth till now has come from where?

MR EDMENDS: From independent retail locations.

5 MR MARKS: Have there been any site closures that have been the consequence of -
--

MR EDMENDS: Not a large number of closures.

10 MR MARKS: We know about Liberty. Liberty holus-bolus sold a whole series of sites But putting that to one side, have there been any other site closures as opposed to site changes that Liberty has seen as a consequence?

15 MR EDMENDS: The customer base that we had two years ago, the volume that we have lost were the sites that have been - are no longer supplied by Liberty, the majority of them are still in the market but under a different brand or supply arrangement.

20 MR MARKS: I understand. Can I then just ask you, as I said I would, I want to come back to E10. What is the position with E10 in terms of the direction that you see - there are two parts that I want to ask you. The first is to ask you to comment on the likely demand for E10. Secondly, if you could tell us what Liberty's intentions are in terms of the supply of E10 to its customers.

25 MR EDMENDS: Currently we offer E10 in Brisbane, Sydney, Melbourne and Adelaide. The supply of ethanol is by a customer's choice wishing to put that as part of your product mix. As in the growth of ethanol - it is growing each month. Or E10.

30 MR MARKS: Is that right?

MR EDMENDS: I should use the word E10.

35 MR MARKS: Is that growing right across your customer base?

MR EDMENDS: No. State performances are different.

40 MR MARKS: The only reason I ask that is you have differing state performances, you also have a couple of large customers and then a number of smaller ones. I am just trying to get an indication of where the popularity is.

MR EDMENDS: It is really a site by site position.

45 MR MARKS: Is there any philosophy, is the demand for it on site by site being driven by anything?

MR EDMENDS: A lot of it is availability within that local market area.

50 MR MARKS: Of E10 generally and thus a need to acquire it in order to compete.

MR EDMENDS: Correct, given that not all sites offer that product.

MR MARKS: At the moment I think you said that it's at about 1 per cent of total
wholesale sales by volume?

5

MR EDMENDS: Yes, correct.

MR MARKS: Do you anticipate that that will increase and, if so, at what rate over
the next five years?

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MR EDMENDS: It will increase. It will be a guesstimate of the number and it will
depend on what other competition comes in and offers that.

MR MARKS: Mr Chairman, they were the matters that I wanted to ask Mr Edmends
in open session. There are a couple of matters that I want to follow up in closed
session, subject to any further questions the Commission might have.

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THE CHAIRPERSON: Let's go into closed session.

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WHEREUPON THE PROCEEDINGS MOVED IN CAMERA [4.52pm]

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