



2003

PARLIAMENT OF TASMANIA

PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS

Fuel Distribution on King Island

Laid upon the Tables of both Houses of Parliament

The Committee was appointed under the provisions of section 2 of the Public Accounts Committee Act 1970 (No 54)

MEMBERS OF THE COMMITTEE

LEGISLATIVE COUNCIL

Hon *A. W. Fletcher* (Chair)
Hon *C. L. Rattray*
Hon *J. S. Wilkinson*

HOUSE OF ASSEMBLY

Ms L. T. Giddings
Mr P. C. Gutwein (from 28 August 2003)
Mr G. L. Sturges

By Authority: Government Printer, Tasmania

The Background

Following a request by a member, the Public Accounts Committee agreed to investigate the reason that fuel prices on King Island were significantly higher than the dearest price on mainland Tasmania.

Members of the Committee were aware that the purchase, storage and distribution of fuel on King Island was a function of the King Island Ports Corporation (KIPC) a wholly owned subsidiary of the Hobart Ports Corporation (HPC) which in turn is wholly owned by the State Government.

It was further suggested that as HPC is a Government owned corporation the Government could influence the price of petrol at the pump on King Island if it considered that it was a matter of good public policy.

The Parliamentary Standing Committee of Public Accounts, at its meeting on 6 March 2003, resolved to seek information regarding the costs associated with the purchase, storage and distribution of petrol and diesel on King Island. On 14 March 2003 the PAC wrote to the Chairman of the Board of HPC in the following terms.

'Reference: KIPC - Fuel Prices on King Island

The Parliamentary Standing Committee of Public Accounts, at its meeting on 6 March 2003, resolved to seek information regarding the costs associated with the purchase, storage and distribution of petrol and diesel fuel on King Island.

The Committee believes that when Government is involved in the distribution of consumables, the components of cost leading to the price charged to consumers should be open and transparent.

The Committee has noted that the price at the pump for fuel on King Island is regularly +/-20 cents per litre above the dearest price on mainland Tasmania and on one occasion recently unleaded petrol was retailing at \$1.30 per litre on King Island.

To enable the Committee to reach an independent judgement regarding the efficiency and equity of fuel distribution on King Island, we request your response to the attached questionnaire.'

Questionnaire to Hobart Ports Corporation : King Island Fuel Prices

1. *With regard to purchasing:-*
 - (a) *What is the King Island Ports Corporation policy regarding the purchase of the various classes of fuel;*
 - (b) *What is the source/sources of the various classes of fuel;*
 - (c) *What quantity of the various classes of fuel was imported to King Island in the financial year 2001 – 2002;*
 - (d) *What is the estimate of the quantity of the various classes of fuel to be imported to King Island in the financial year 2002 – 2003;*
 - (e) *What is the mechanism determining the price to be paid by King Island Ports Corporation for the various classes of fuel; and*
 - (f) *What is the cost per litre, for each of the classes of fuel, of the last 3 purchases made from source?*

2. *With regard to Freight:-*
 - (a) *How are the various classes of fuel transported to King Island;*
 - (b) *What is the transport cost per litre for each of the classes of fuel received into storage on King Island; and*
 - (c) *What is the cents per litre cost of transport for each of the classes of fuel on King Island, which is included as a component of the price charged to the consumer?*
3. *With regard to Storage:-*
 - (a) *What is the capital value of tanks and other storage infrastructure specifically used for the storage of the various classes of fuel on King Island;*
 - (b) *What costs associated with the storage of the various classes of fuel on King Island are components of the price charged to the consumer Distribution; and*
 - (c) *What is the cents per litre cost of storage for each of the classes of fuel on King Island which are included as a component of the price charged to the consumer?*
4. *With regard to distribution:-*
 - (a) *Does King Island Ports Corporation distribute fuel to both retailers and individual or corporate consumers;*
 - (b) *If so, are different prices charged to retailers and consumers; and*
 - (c) *What other costs associated with the distribution of the various classes of fuel on King Island are components of the price charged to the consumer?*

A copy of the letter and questionnaire was forwarded to the Minister for Infrastructure Jim Cox MHA who after consideration of the matter responded on 31 March 2003 in the following manner:

"The Chief Executive Officer of the Corporation, Mr Dick Knoop, has contacted me regarding your request for the Port to provide to the Standing Committee answers in writing to a number of issues regarding fuel prices on the Island. Mr Knoop has advised me that the information requested by the Standing Committee is commercial-in-confidence and as such the Corporations preference would be to meet with the Committee and provide its response in camera."

The PAC noted the Minister's comments and moved to call Mr. Richard Knoop, Chief Executive Officer of Hobart Ports Corporation and Mr. Russell Vokes, Administrator, King Island Ports Corporation to appear before it on 15 May 2003.

Mr. Knoop and Mr. Vokes outlined to the Committee the background to the Ports Corporation becoming the distributor of fuel on the Island.

An explanatory excerpt from the transcript of evidence of that presentation is provided as an Appendix to this Report.

Mr. Knoop proceeded to provide argument as to why the PAC should accede to his request that further evidence be heard 'in private' as commercial-in-confidence.

The Public Accounts Committee Act 1970 provides, under Section 7, for the Committee to hear evidence 'in private' where in the opinion of the Committee there is good and sufficient reason and the evidence relates to a secret or confidential matter.

Mr. Knoop mounted the following argument to support his request that the specific detail contained in answers to the questionnaire be heard 'in private'.

Mr KNOOP - From there on in, Mr Chairman, we would ask that the specific questions we have to answer as it involves margins and contractual arrangements - we have already talked to the Hydro and the distributor and the service stations and they did not want their margins publicly exposed. Because we don't have any third party control over margins and in fact we cannot induce or talk margins to any of our suppliers because if we do we contravene the Trade Practices Act, so that when we find that we talk to BP they will not talk to us about margins nor will they talk margins to anybody, they run a mile. We also believe that if those margins got out into the general public domain, potentially you would introduce third party entrants into the market who would only have a short-term operation and then leave potentially King Island very vulnerable to having no fuel supplies at all. In the end, we suspect the facts will get lost as a political football while people will kick those margins around and no-one would understand what the true delivery costs of fuel are. But we are happy to supply the Committee with all the details we can, but we don't want them going public.

This argument was further expanded by the witnesses who were cross examined by the Committee. The Hansard record relating to this part of the evidence is available on the internet.

The Committee deliberated, accepted the argument of the witnesses and advised them accordingly.

The Committee examined the witnesses 'in private' and were able to obtain specific answers to the questions submitted as well as additional relevant information.

After considering the evidence the Committee was of the view that it needed further details and wrote to the Chairman of the HPC asking for additional financial information about the KIPC and the HPC relating to the 2002-03 financial year.

The updated accounts to 30 June 2003 were received on 5 September and were received and considered by the PAC 'in confidence'.

The PAC summary:

Evidence which is received by the Committee 'in private' cannot, according to the legislation, be disclosed. The following, therefore, is a summary of the Committee's deliberations.

1. The Committee considered the comprehensive history and reasons for the KIPC being involved in the purchase, storage and distribution arrangements of fuel on King Island as presented by the Chief Executive of Hobart Ports Corporation (Mr R. Knoop) and the Manager of King Island Ports (Mr R. Vokes).
2. The Committee considered the management reports and the financial reports of the King Island Ports Corporation for the year ending 30 June 2003.

3. The Committee cross-examined the representatives of the corporation both in public and 'in private'.
4. The Committee considered all the evidence.

The PAC concludes that:

1. The documents and verbal information provided 'in private' by the KIPC regarding the costs associated with the purchase, storage and distribution of petrol and diesel fuel on King Island are valid and accurate accounts which have enabled the PAC to reach a fair judgement about the fuel distribution and sale operations.
2. There are considerable operational and commercial risks in the provision of fuel to a micro market such as King Island.
3. The inherent "costs" including taxes relevant to supply are significant.
4. KIPC purchases fuel at a competitive rate and prices on the Island vary only marginally before these largely "inherent" costs are included.
5. The KIPC is one part of the fuel supply chain and does not itself control prices.
6. The fuel supply contracts operating on King Island are of a commercially sensitive nature and disclosure may endanger or disrupt the King Island market.
7. The provisions of the Trade Practices Act prevent the KIPC from seeking to set or influence the margins that apply to fuel distribution and retail.
8. Allowing for the cost of production of fuel plus a wholesale margin, plus Government taxes at over 40% (excise and GST) only a relatively small margin per litre remains to cover transport, equipment hire, handling, insurance, storage, distribution and retail.
9. The GST has a disproportionate effect as it applies on top of all other costs including State and Federal taxes.
10. Each link in the fuel supply chain is subject to competitive pressure.
11. Both the fuel division and the ports division of the KIPC are managed in a responsible manner.
12. It is necessary to ensure the sustainability of both the long-term supply of fuel to the Island and the maintenance of the strategically important port infrastructure.
13. The rates of return are both reasonable and commercial.

14. Any profit or loss from the fuel division transfers to the consolidated account of the KIPC and impacts on the Corporation's reported financial outcome.
15. Any such transfer of funds to the consolidated account is reasonable and would be considered standard practice in similar trading corporations.

Recommendations:

The Committee recommends that:

1. There is no case for Government to override the market influences that establish the price of fuel on King Island.
2. The State Government, the Port Authority and the King Island Council should identify the synergies that co-operation in program delivery could bring.
3. The Port Authority develop a more open and transparent manner of financial reporting that makes all information not genuinely classified as commercial-in-confidence available to the community. Such reporting should include details of the profit/loss outcomes of each of its trading units.

Parliament House, HOBART

12 December 2003

Hon A W Fletcher

CHAIRMAN

APPENDIX - KING ISLAND FUEL DISTRIBUTION

Excerpt from evidence to the Public Accounts Committee 15 May 2003.

Background to the current arrangements for fuel distribution on King Island.

“Mr KNOOP - Just to go back a bit, in 1999-2000 there was a coastal bulk depot at Naracoopa, and it was operated by Mobil. At that stage Mobil were taken over by Exxon, and Exxon, because of the Valdez issue in Canada, decided that they would review all their operations including the method of delivery of fuel to King Island. They did that. The process at Naracoopa at the time was that the ship would come in usually about twice in 18 months and would float a pipeline ashore. The ship would be fixed to moorings supplied by King Island Ports. The pipeline was floated ashore and attached to the manifold and the product pumped into the bulk depot.

Mr VOKES – The bulk depot has 4 000 tonnes of diesel and 800 tonnes of motor spirit.

Mr KNOOP – So it was quite a sizeable depot because it used to supply the scheelite mine when they used to have ship visits about every three to four months. That was a risky operation by any standards. Exxon reviewed that operation and determined that they would not continue with a floating pipeline; that is, they wanted an alternative. In the meantime, King Island Ports had put about ten to twelve options to Exxon-Mobil about how they could continue to operate at Naracoopa. They were not taken up because it was just seen as too risky. The option then was of course to bring fuel via isotainers through Grassy and deliver it to some sort of depot that had to be established. At that stage we reviewed the operations and offered to Mobil to lease some land in Grassy to set up a bulk depot. They were not interested in investing in a bulk depot and suggested that somebody else do it. No other company that we came across at the time would invest in a bulk depot, although they were all prepared to offer prices for delivery of fuel to King Island. We spoke to BP, Shell, Liberty. The only company that offered to help in any way was BP. They were prepared to supply a second hand depot – upgraded – for King Island Ports to take over and us to have a leaseback amortisation arrangement whereby at the end of the term we own the facility.

It is a very attractive deal for King Island; a wonderful deal. No one else could have got them that deal and no other operator would have spent the \$1.5 million or \$2 million to set up a bulk depot. At that stage the Government were interested in the logistics of fuel to King Island because obviously King Island could run out of fuel. They asked us to stop and go no further, although they had an idea of the logistics that we proposed. They engaged a company called Shell Engineering. We have a copy of the report available but we would need to run a copy off or you could get it from DIER who actually engaged Shell, and they would be the proper people to get that report from. We reviewed our logistics and came up with the same conclusion. The only difference was that their costings – and that was demonstrated in the report – for delivery of fuel by isotainers is nearly double the rate we achieved.

That is the background. After that, the Government said, 'Well, someone has to provide a depot.' Shell were not prepared to do it and nor were Mobil. BP were prepared so King Island Ports negotiated with the Hydro, as the major user, to see if they would enter into a contract for us to actually have a customer at the end if we were going to invest \$1.5 million.

Mr VOKES – *It should be noted too that King Island Ports were not too keen to do it either.*

Mr KNOOP – *No one was too keen to do it because it is a very risky exercise.*

King Island Petroleum in the meantime, who were a distributor and had been the distributor for Mobil on the Island all the time, approached King Island Ports saying that they no longer wanted to be in the business, no longer wanted to invest in a bulk terminal and did not need to invest in a bulk terminal, and that their terminal at Currie, which was the only terminal on the Island and a very small terminal –

Mr VOKES – *It is a depot; you would not really call it a terminal. It was just a depot with a 50 000 litre tank.*

Mr KNOOP – *Obviously it could not meet the capacity by the change in arrangements and it could not meet any environmental requirements while operating under a temporary licence. So they offered to sell their distributorship to King Island Ports because there was nobody else in the market for that distributorship. They wanted to retire and they did not want to invest in a new depot. They obviously knew that the only place a depot could go to be efficient was, in effect, in Grassy, as demonstrated in the government inquiry by Shell. Any other depot anywhere else introduces another element of travel and distance and cost for anybody that wants to distribute fuel on the Island. Someone might have said, 'Why don't you use the old bulk terminal?' The bulk terminal is a 4 000 tonne tank. Obviously you cannot fill that by isotainers coming out with 26 000 litres per time.*

Mr VOKES – *The other important issue with the isotainer delivery: anything outside the port confines of Grassy would mean we would not be able to turn the isotainers around on the same day as a ship. So, instead of having to have 7 isotainers or 8, you would need 14 or 16 isotainers because you would have to keep 7 or 8 on King Island. That is why we picked Grassy. We can turn 7 or 8 isotainers around in one day, which halves the cost of isotainer hire.*

Mr KNOOP – *So in the end we proceeded with BP and they supplied the bulk installation and BP and they supplied the bulk installation and we've now been in operation – and Russel will give you the capacity of the pulp installation in a second – but for about 18 months supplying fuel to King Island.*

Mr VOKES – *The Grassy one has been going for about 18 months. We ran the Currie depot for about 12 months but that was basically a stopgap. Unfortunately, the Government getting Shell Engineering to undertake a report and putting us on hold threw everything out of kilter and nothing happened. We did nothing for about three or four months so by the time we then had to crank it up and do something we were well behind the eight ball so we had to get a special licence taken out for the Currie depot and they only had a storage capacity of 50 000 litres of diesel and our storage capacity at Grassy is 260 000 litres which gives us about a 28-day storage capacity, given just normal average usage. So we went through a 12-month ad hoc period of putting ISO containers and leaving them around the area and having a lot more on there until we got the facility at Grassy up and running which, as I said, has been running for about 18 months now or 16 months."*