Oil Market Report: February 2019

Civil Servants are not normally known for their alacrity and consequently are often ridiculed for their inactivity. Indeed, the popular BBC Comedy Series "Yes Minister" was basically a long, drawn-out joke on how Civil Servants spend their entire careers ensuring nothing actually ever gets done ("there are two types of files in this Ministry…'Under Consideration' means we have lost the file. 'Under Active Consideration' means we are trying to find it…!").

So there is obviously something in the water at the Department of Transport (DfT), because the current speed of legislative change around biofuels is nothing short of cyclonic! Up until 2018, the amount of biofuels permitted in diesel and petrol (ie, road fuels) was 4.75% and it had been set at that level for the previous 5 years. But in April of last year, the DfT mandarins started to take their legislative amphetamines! Firstly, they increased the biofuel obligation to 7% and within that, they introduced a crop cap of 4% (so that there is a limit to how much fuel can be generated from food producing crops). Then on January 1st of this year, the biofuel level was increased again to 8.5%. But this still wasn't enough for the DfT, who simultaneously introduced a 0.1% Development Fuel requirement (0.1% of fuel must now be derived from 100% waste). And then finally for good measure, they chucked in the Greenhouse Gas (GHG) tariff on all road fuels. Woah…guys…slow down!!

Some of these new targets are really, really difficult to understand and are usually based on comically complicated measurements, such as "Grams of CO2 equivalent per Megajoule of Energy" (gCO2e/MJ)! But in their simplest form, the new rules seek to reduce the greenhouse gas intensity of road fuels versus a Government set baseline. So if we take standard (neat) diesel for example, this grade of fuel has an average Greenhouse Gas intensity of around 95 gCO2e/MJ. The initial 2019 target set by Government is that road fuels should have an intensity of 90gCO2e/MJ, which means that suppliers have to blend a higher volume of lower Greenhouse Gas fuels - which at present, means biofuels.

Simply blending fuel to the required biofuel minimum is not enough however, to generate sufficient GHG savings. In fact, "standard" bio blending only meets between 60% to 70% of the GHG target. Therefore it logically follows that to meet the GHG objective, extra biofuels have to be blended into the UK fuel pool. That sounds all well and good, until you realise that fuel suppliers are not actually legally permitted to blend excess levels of biofuels - because this would make their fuel "off-spec" and thus invalidate engine warranties. The legally permitted biodiesel maximum in the UK is 7%, even though the mandated target is 8.5% - go figure!! Such "impossible" specification requirements not only complicate fuel pricing structures, but they can also make a mockery of the new legislation. To address this, the DfT will allow fuel suppliers to pay a GHG "buy-out", which is basically a direct tariff of 0.70 pence per litre (ppl) on petrol and 1.27ppl on diesel. There is also another "impossible" problem in relation to the 0.1% Development Fuels target. On the surface, this sounds a further progressive step in diversifying biofuel supplies towards lower carbon waste solutions. But the fairly fundamental flaw here, is that these fuels literally do not exist in sufficient quantity anywhere in the world - confined as they are to the development stage of laboratory experiments. Which once again means that suppliers are forced to opt for the Government buy-out. On Development Fuels, this is 80 pence multiplied by the number of litres that make up 0.1% of fuel sales. Phew…we did say it was complicated!

Add all of this together and you have a painful end-result for fuel consumers. Step 1; increase biofuels content of fuel = price rise of circa 1.00ppl (because biofuels cost more than diesel and petrol). Step 2; force suppliers to pay the Development Fuel buy-out because the fuel doesn't actually exist = price rise of 0.10ppl (80p x 0.1%). Step 3; set the GHG target higher than is possible to achieve through legally permitted biofuel blends, thus requiring a further payment to Government = price rise of circa 0.50ppl (0.70ppl / 1.27ppl levy minus the credits generated by bio-blending). Result = a total price rise of circa 1.60ppl. Multiply that by the total annual consumption of road fuels in the UK (48bn litres) and you have an overall increase in cost to the British Motorist of £770m. If ever there was a better example of a stealth tax, then we'd like to see it!

Nonetheless, Portland is mindful to go easy on the Department of Transport. The whole point of setting tough targets is to incentivize fuel suppliers to produce innovative new fuel solutions. Furthermore, in a climate where most Government Departments are taking a Brexit induced holiday ("we will have to defer action on that issue, until we know the outcome of Brexit"), credit must go to the DfT for at least trying something! And if you consider that the most common refrain of green activists at the moment, is that "nothing is being done" on the environment, then nothing could be further from the truth when it comes to alternative fuel legislation. More thought may still be needed to remove technical contradictions, but in this corner of North Yorkshire, we say hats off to the DfT for implementing a bold and ambitious programme of change.