



B A R A

Board of Airline
Representatives
of Australia Inc

The **leading** voice of airlines

SUBMISSION TO
HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON
ECONOMICS
INQUIRY INTO AUSTRALIA'S OIL REFINERY INDUSTRY

November 2012

Executive summary

The Board of Airline Representatives of Australia (BARA) is the industry organisation that represents the interests of international airlines operating to and from Australia. BARA's membership currently comprises 29 scheduled airlines, which presently provide over 90 per cent of international flights (passenger and freight).

BARA's member airlines depend upon the reliable and cost competitive supply of aviation jet fuel. Jet fuel currently represents about one third of total airline operating costs.¹

Improvements in the pricing and reliability of supply of this major cost item will improve the commercial opportunities for international airlines to provide passenger and freight services to customers in Australia. Given the competitive nature of international travel, reductions in input costs are ultimately passed onto customers through lower fares and freight rates.

A lack of effective competition between jet fuel suppliers at Sydney Airport

BARA's principal concern with the supply of jet fuel in Australia is the lack of effective competition between suppliers to international airlines at Sydney Airport. International airlines are estimated to purchase over 1.2 billion litres of jet fuel at Sydney Airport each year, costing over \$1 billion.

For a number of years many of BARA's member airlines have complained that, when they tender for the supply of jet fuel at Sydney Airport, there is little or no competition between existing oil company suppliers. BARA has not formally sought to thoroughly investigate the competitive situation at other major airports (especially Melbourne and Brisbane), but anecdotal evidence from member airlines indicates that similar problems currently exist at these ports.

The decision by Shell and Caltex to convert their refineries into fuel import terminals means that NSW will rely on imported fuel. The critical objective going forward should be to promote effective competition between all potential importers of fuel. In addressing its terms of reference, BARA considers that it is crucial for the House of Representatives Standing Committee on Economics (the Committee) to consider both the physical capacity of the current infrastructure supply chains and whether its ownership and access arrangements promote effective competition between all potential suppliers.

The Caltex Pipeline and Sydney Joint User Hydrant Installation

At Sydney Airport, BARA considers that the lack of effective competition between jet fuel suppliers is due to the ownership of, and access to, key components of the jet fuel infrastructure supply chain, namely:

1. the pipeline that transfers jet fuel from offsite storage facilities at Port Botany, operated by Vopak Terminals Australia (Vopak), to Sydney Airport, currently provided by Caltex (the Caltex Pipeline), and

¹¹ International Air Transport Association (IATA), *Fact Sheet: Fuel*

2. the Sydney Airport Joint User Hydrant Installation (the Sydney JUHI), which stores and distributes jet fuel at the airport, currently a joint venture between the major oil companies, with Qantas as an additional participant.

In September 2011, in response to the lack of competition, BARA sought declaration under Part IIIA of the *Competition and Consumer Act 2010* (the CC Act) of the Caltex Pipeline and the Sydney JUHI. In considering BARA's applications, the National Competition Council (NCC) found:

- (a) that the market for the supply of jet fuel was not characterised by effective competition and nor was there is a vigorously competitive tender market, and
- (b) that it was uneconomic to duplicate the infrastructure.

Despite these findings, the NCC concluded that declaration was unlikely to promote additional competition due to capacity constraints. The NCC also considered that opportunities for greater competition should emerge once Caltex upgraded the capacity of its Pipeline and Shell closed its refinery.

No improvements in competitive conditions between jet fuel suppliers

A recent survey by BARA of its member airlines has found that there is still little competition between jet fuel suppliers at Sydney Airport. For the members that responded to BARA's survey, the majority of potential suppliers chose not to bid on their tenders, and usually only one supplier could meet all of the airline's jet fuel needs.

BARA is particularly concerned that, given its applications for declaration were unsuccessful, it has facilitated a situation where it is possible for:

1. the Sydney JUHI to draw out the time taken for new parties to join the JUHI over an excessive timeframe, reducing the ability of these potential new suppliers to win supply contracts with airlines, and
2. Caltex to not significantly increase the transfer capacity of its pipeline offered to third parties and, further, to design the tendering process such that it continues to suppress competition between jet fuel suppliers. BARA would also be concerned if Caltex restricted its proposed tender process for third party transfer capacity to existing members of the Sydney JUHI.

BARA would expect that both Caltex and the Sydney JUHI will vigorously criticise BARA's concerns. However, the Committee could seek to confirm the status of the access arrangements to the monopoly infrastructure directly from the Sydney JUHI and Caltex. In particular, BARA would urge the Committee to request from:

1. the Sydney JUHI - the status of applications from new suppliers to join the JUHI, including when the applications were first received. BARA understands that applications to join the JUHI by two potential new suppliers were made over 22 months ago and 15 months ago, respectively, and that the suppliers still have not obtained the necessary access. Such time is considered excessively long to complete the commercial

arrangements, with BARA being advised that similar commercial arrangements sought at overseas ports typically take no longer than 3 months to finalise,

2. Caltex – detailed information on its proposed tendering of access to its Pipeline, including: those suppliers invited by Caltex to tender for access (BARA would be particularly concerned if the tender was only available to those parties that are currently a member of the JUHI); any suppliers that were refused access; the amount of transfer capacity made available in the tender; if suppliers can obtain access for a longer period of time if they are prepared to pay a higher price for the transfer capacity; and how Caltex will assess the tenders.

If the Committee finds that there has been no material improvement in the access to the Sydney JUHI and Caltex Pipeline, then clearly the market is not developing in a way envisaged by the NCC. Instead, competitive conditions are not improving, which is consistent with the continued poor responses to tenders for jet fuel by international airlines.

The Australian Government can promote more competitive conditions

BARA considers that the Australian Government should play an active role in developing an environment that encourages effective competition between jet fuel suppliers at Sydney Airport.

The first requirement is open access to the Sydney JUHI. BARA considers that this can best be achieved by Sydney Airport Corporation Limited (SACL):

1. ending the lease over the JUHI with the current JUHI joint venture participants, then
2. re-leasing the facilities to a party(s) that does not supply jet fuel to the airlines (eg Vopak or airlines), or alternatively, operate and maintain the facilities themselves (with the assets included as ‘aeronautical assets’ for prices monitoring purposes).

To promote this outcome, the Australian Government should require SACL to include plans for the competitive supply of jet fuel as part of its current review of its Master Plan.

The preferred solution for new suppliers to transfer jet fuel from Port Botany to the Sydney JUHI is a competing pipeline from Vopak’s storage facilities to the Sydney JUHI. However, it is currently not ‘privately profitable’ for another party to build a competing pipeline before the Caltex Pipeline approaches capacity, currently estimated at around 2023.

To enable the delivery of a competing pipeline the Australian Government can, as a start, facilitate the planning approvals for the pipeline. This would reduce the time and cost for another party to deliver the project.

One potential option is for the Australian Government to encourage SACL to build a competing pipeline. To the extent that part of this investment is unprofitable, that amount, possibly, could be included in the asset base used in setting aeronautical prices charged to airlines. That is, the airlines could be inclined to support the profitability of the pipeline by accepting higher aeronautical prices to cover an agreed amount of pipeline costs. BARA would be prepared to consider facilitating the necessary commercial negotiations with SACL.

1 Introduction

Australia's petroleum industry is undergoing significant structural change. When the former Industry Commission (now the Productivity Commission (PC)) previously reviewed the industry in 1994, Australia exported petrol and did not import jet fuel. At that time the PC also noted that Australia's refineries compared favourably with overseas refineries of similar size and age.²

The industry is now very different. Once the Clyde and Kurnell refineries have closed the NSW economy will rely on imported fuel, either from overseas or other refineries in Australia.

With all of NSW's fuel needs being imported – and over time likely the majority of fuel across Australia - it is timely for the House of Representatives Standing Committee on Economics (the Committee) to be inquiring into Australia's oil refinery industry. How Australia's petroleum industry develops over the next five years is likely to determine the efficiency by which Australia imports its fuel needs for decades into the future.

The Board of Airline Representatives of Australia's (BARA) submission to the Committee focuses on point 2 of its terms of reference and, in particular, whether the current infrastructure supply chain promotes the competitive supply of jet fuel at Sydney Airport.

BARA considers that, in examining the 'effectiveness' of the supply chain, the analysis needs to consider both the capacity of the infrastructure and whether the ownership of it and the applicable access arrangements promote effective competition between all potential suppliers of fuel. Australia needs to obtain its imported fuel at lowest possible cost. This will only occur if the market is structured so that all potential suppliers (importers) of fuel have the ability compete effectively. If the available capacity is restricted to a small number of suppliers, end users will pay more for their fuel.

In considering the prices paid by end customers for fuel, BARA cautions the Committee on placing excessive reliance on the cost data provided by oil companies. This data seeks to justify existing prices through a 'bottom up' examination of costs. The Australian Competition and Consumer Commission (ACCC) has cast doubt over such cost data and BARA holds similar concerns over whether it reflects the efficient cost of importing fuel into Australia. A more meaningful measure of the potential to secure Australia's fuel needs at lowest cost would be found in the observed change in pricing behaviour from a sustained change in the competitive market conditions between fuel suppliers.

Jet fuel supply at Sydney Airport

BARA's submission to the Committee details the lack of effective competition between jet fuel suppliers at Sydney Airport. While jet fuel demands at Sydney Airport represent a small fraction of NSW's total fuel needs, it highlights the critical influence of the ownership and

² See Industry Commission (1994) *Petroleum Products*.

access arrangements to the infrastructure supply chain on the competitive environment in which fuel is purchased by end customers.

Structure of the submission

- Section 2 briefly describes jet fuel demands at Sydney Airport.
- Section 3 describes the current level of competition when international airlines tender for jet fuel at Sydney Airport.
- Section 4 provides an analysis of the Sydney Airport jet fuel infrastructure supply chain.
- Section 5 describes the outcomes of BARA's applications for the declaration of the Sydney JUHI and Caltex Pipeline under Part IIIA of the *Competition and Consumer Act 2010*.
- Section 6 covers the information BARA considers that the Committee should seek from the Sydney JUHI and Caltex to establish the change, if any, in the level of access to the Sydney jet fuel infrastructure supply chain.
- Section 7 contains BARA's recommendations for creating the environment for effective competition to emerge between suppliers of jet fuel at Sydney Airport.

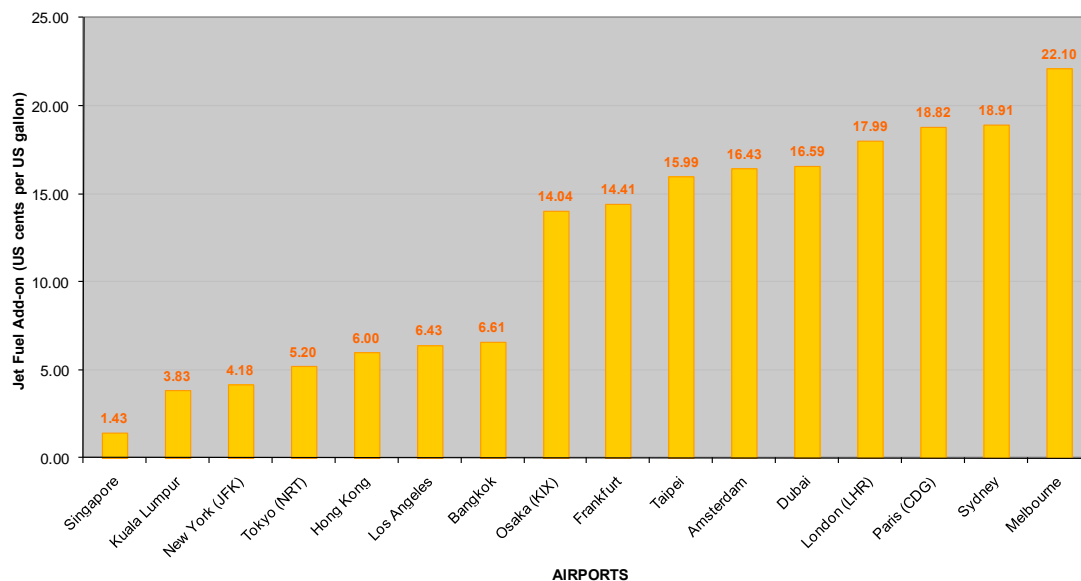
2 Sydney Airport's jet fuel demands

Sydney Airport is Australia's largest airport, currently serving about 35 million passengers per year. The direct value of this trade is currently estimated at about \$8 billion per year, or some 6% of the NSW gross state product.³ The number of passengers served is expected to more than double by 2029, to almost 80 million.

The airlines operating to and from Sydney Airport currently purchase about 3 billion litres (GL) of jet fuel per year, worth about \$3 billion. International airlines are estimated to account for about 40% of total jet fuel purchases. To support the projected growth in traffic volumes, the supply of jet fuel at Sydney Airport will also need to almost double, to over 5.6 GL per year by 2029. Anticipated further improvements in aircraft fuel efficiency mean that the growth in jet fuel demand is expected to be lower than total passenger growth.⁴

The additional costs associated with providing jet fuel at Sydney Airport above its production price (termed the 'differential') is one of the highest in the world (see Figure 1). While part of this difference can be explained by higher transport costs, it highlights the competitive disadvantage airlines have in maintaining and expanding routes between Australia and overseas countries.

Figure 1 Jet fuel differentials, US cents per US gallon, July 2010



Source: Data provided by the International Air Transport Association of Australia.

Since about 2009, the total demand for jet fuel at Sydney Airport has begun to consistently exceed existing local refinery production (provided by Caltex and Shell). The decisions by Caltex and Shell to close their oil refineries and create fuel import terminals will mean that all future jet fuel needs will be met through imports.

³ See *Sydney Airport Master Plan – Annexure 2*

⁴ See Sydney Jet Fuel Infrastructure Working Group (SJFIWG) Report (2010), *Infrastructure for the Provision of Jet Fuel at Sydney Airport for the Period to 2029*.

3 Problems with jet fuel supply to airlines at Sydney Airport

For a number of years, many of BARA's members have raised concerns that, when they tender for the supply of jet fuel at Sydney Airport, there is little or no competition between the existing oil company suppliers. This lack of competition can be traced to difficulties faced by new suppliers in obtaining access to the jet fuel infrastructure supply chain between Port Botany and Sydney Airport (see section 4).

The suppliers of jet fuel at Sydney Airport are currently limited to three of the four main oil companies (namely Caltex, Shell and BP - BARA understands that ExxonMobil withdrew from the market in 2010), with Qantas undertaking a limited amount of 'self supply' through Q8 Aviation. BARA also understands that when tendering for jet fuel, some airlines may seek bids from potential suppliers not currently providing jet fuel to airlines at Sydney Airport.

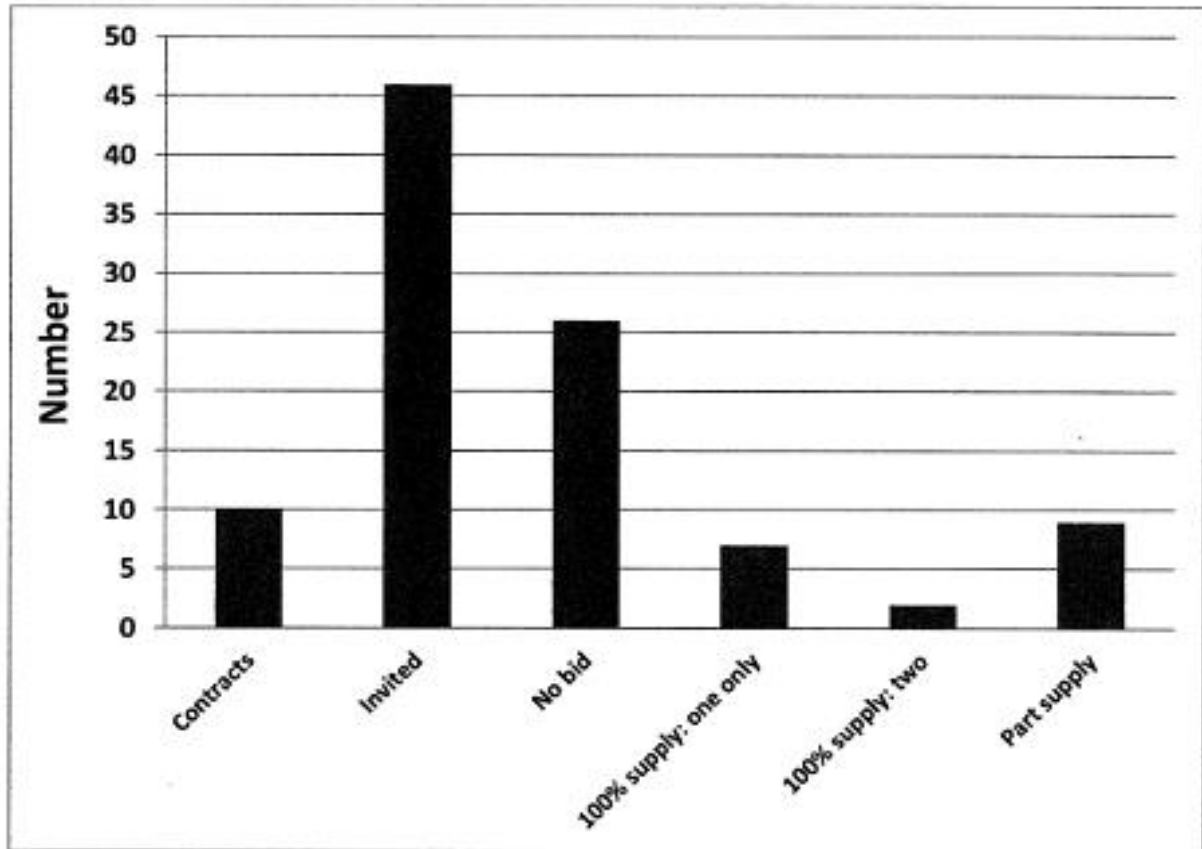
As evidence of the lack of effective competition, BARA has requested its members to provide information on the number of suppliers that bid on their tenders for jet fuel at Sydney Airport. This information is provided by member airlines on a strictly confidential basis to BARA's legal representative (HWL Ebsworth). BARA has not sought to access the data and no data has been shared between airlines. HWL Ebsworth provides a high level summary of the information for use and publication by BARA.

The outcomes of the most recent survey (September 2012) are shown in Figure 2 on the following page. In summary, when international airlines tender for jet fuel at Sydney Airport, the majority of potential suppliers choose not to bid and usually only one supplier can meet all of the airline's jet fuel needs. Of those airlines that responded to BARA's survey, only about 12% of the tendered jet fuel attracted bids from two suppliers that could meet all of the airline's jet fuel needs.

These tendering responses mean international airlines are generally faced with near monopoly supply for jet fuel at Sydney Airport. Box 1 contains further information on the issue of effective competition between jet fuel suppliers. Box 2 contains statements from individual airline members about the state of competition between suppliers of jet fuel at Sydney Airport.

BARA also notes that infrastructure supply capacity has not been a constraint in the recent past. International airlines have always been able to obtain increased supplies of jet fuel to meet their growing demand, albeit principally from only one supplier. This situation highlights the critical influence of the ownership and access arrangements over the available jet fuel infrastructure supply capacity on the level of competition between suppliers.

Figure 2 Jet fuel tendering outcomes for international airlines (Sept 2012 survey)



Source: Summary information supplied by HWL Ebsworth.

Box 1 What constitutes effective competition between jet fuel suppliers?

Airlines are likely to obtain prices for jet fuel consistent with effective competition when:

1. there are multiple existing suppliers able to meet the entire jet fuel needs of individual airlines, and/or
2. existing jet fuel suppliers consider that entry by new suppliers will occur if they seek to obtain excessive prices (low barriers to entry).

RBB Economics, in a report prepared for Caltex, argues that individual airlines adopt a ‘winner take all’ approach to tendering for jet fuel and this form of competition is likely to encourage bids from jet fuel suppliers:

We have found that the majority of tenders for the supply of jet fuel (more than 70 per cent) are very asymmetric and usually allocated on a “winner takes all” basis. We also find less than 15 tenders account for 75 per cent of all volumes tendered in a given year. In addition, a large fraction of total volumes supplied is up for tender in any given year. This in turn implies suppliers would lose a significant share of current volumes in the event that they failed to compete effectively with rival suppliers, with consequent adverse effects for overall profitability. As a result, suppliers have an incentive to compete for the business tendered. Source: RRB Economics (13 February 2012), *Assessing the Impact of Tendering on Competition for the Supply of Jet Fuel at Sydney Airport*, p. 3

Box 1 Cont.

A key measure of the level of competition is, therefore, the number of suppliers that can meet 100% of an individual airline's jet fuel needs. If only one supplier can meet all of an airline's jet fuel needs, the airline effectively faces monopoly supply of this critical cost input.

Given the 'winner take all' strategy often used by airlines, bids from suppliers that can only meet part (say 25% or 50%) of an airline's jet fuel needs arguably do not constitute an effective bid. This is especially so if the part bids received cannot meet the airline's total jet fuel needs.

Box 2 Observations by individual airlines on jet fuel supply at Sydney Airport

In supporting BARA's applications for declaration (see section 5) BARA's member airlines made the following observations regarding the level of competition between suppliers of jet fuel at Sydney Airport.

Emirates:

Emirates enjoys good relations with all our jet fuel suppliers in Australia. However, our experience during recent tenders at Sydney, Melbourne and Perth Airports indicates that competition for the provision of jet fuel is very limited at these Airports. It is particularly limited at Sydney Airport, which is effectively a near monopoly market. The pricing levels at Sydney, Melbourne and Perth airports remains significantly higher than prices offered at competitive markets globally.

Cathy Pacific:

Over the years, Cathay Pacific has observed an uneven playing field emerge in the Sydney Jet Fuel Market a) between fuel suppliers subject to inequitable infrastructure access terms to the main fuel infrastructure into Sydney airports and b) between local and international carriers being charged varying differential costs despite the purchased fuel being supplied through the same infrastructure.

Etihad:

At SYD market, Etihad encounters the following constraints

- 1 Not many fuel suppliers available to respond to our fuel tenders (either a monopoly market or limited competition)
- 2 If at all we received bids, in the initial phase of tendering process, bids for 100% of our required volume would be a challenging factor (product constraints)
- 3 High differential (significant high cost to our Airways)

Box 2 Cont.*United Airlines:*

The overall lack of competition combined with supplier ownership of the fuel supply infrastructure has produced a situation of artificially high jet fuel prices in SYD combined with unreliable supply.

Korean Air:

Korean Air has not seen enough number of suppliers for soliciting fuel tenders and in consequence experienced difficulties and inability to achieve desirable outcome from negotiating with suppliers out in the field.

United Parcel Services:

Our last two jet fuel tenders for SYD occurred in 2009 and 2011. The same two jet fuel suppliers made offers each time, and no other suppliers made offers. As a result of this limited competition, we experienced a significant increase in our SYD product differential this year.

Cost-based jet fuel supply and import parity price estimates

BARA's member airlines consider that there is a lack of effective competition between jet fuel suppliers at Sydney Airport and this leads to inflated prices for jet fuel. It is, however, difficult for BARA to quantify the extent of overcharging. This is because there is no 'counter factual', or period where there was vigorous competition between suppliers on which to observe changes in pricing behaviour.

As one would expect, the existing jet fuel suppliers have vigorously defended the current arrangements, arguing that there is strong competition between suppliers and efficient, cost-based prices. Such a position was put forward by the oil companies during BARA's applications for declaration.

One piece of information that is usually produced during inquiries into fuel pricing is the import parity price (IPP). The argument is essentially that, if end prices can be largely explained by an examination of underlying costs, then there is no evidence that suppliers are charging inflated or excessive prices.

Table 1 on the following page is reproduced from the Caltex submission on BARA's applications for declaration. It provides Caltex's estimate of some of the cost elements of the jet fuel 'differential' (ie the amount above the Mean of Platts Singapore (MOPS) price), consisting of freight, insurance and loss and wharfage.

Table 1 Components of the jet fuel differential for July 2010

Component	Figure	Source and calculations
Freight	\$3.68 US/barrel	Platts assessments are a % of the annual Worldscale flat rate agreed upon in open market transactions to charter a ship. ⁹² This figure is based on a Worldscale figure of 13.15 USD/mt and a Platts factor of 222.82: $13.15 \times 222.82\% = 29.30083 \text{ USD/mt}$ $29.30083 \times 0.1256 = 3.68 \text{ USD/barrel}$
Insurance and loss	\$0.32 US/barrel	Generally calculated at 0.35% of MOPS + freight $(86.6368 + 3.68) \times 0.35\% = 0.32 \text{ USD/barrel}$
Freight, insurance and loss subtotal = \$4.00 US/barrel = 2.95 Acpl		
Wharfage	0.16 Acpl	Figure provided by Sydney Ports
Freight, insurance & loss, wharfage subtotal = 3.11 Acpl = 10.03 USc/g		
Notes: Figures based on: MOPS price of \$86.6368 USD/barrel (Platts prior month average) Conversion rate of 158.9870 L/barrel or 42.00 US gallons/barrel or 0.1256 mt/barrel Exchange rate of 0.8532 (prior month average hedge settlement rate (HSRA))		

Source: Caltex's initial submission on BARA's applications for declaration, p. 40

This sort of cost data can be used to develop a Sydney Airport jet fuel IPP, or the theoretical amount it costs to import jet fuel into Sydney (excluding the cost of then transporting the fuel from the port to final customers, including a retail margin).

The underlying problem with the IPP is that the data may be more notional than actual (even if sourced from well known and used sources) and may not represent the actual efficient cost of transporting fuel from a foreign port to Sydney. The underlying issue with fuel IPPs was highlighted by the Australian Competition and Consumer Commission (ACCC) in its 2007 inquiry into unleaded petrol prices, stating that:

All this is compounded by the import parity pricing (IPP) policy—the policy of pricing locally refined petrol on the basis of the cost of importing refined petrol. IPP is the base for all wholesale prices that feed into pump prices. IPP is based on the notional cost of an imported equivalent product rather than the actual cost of domestic refining or even the actual cost of imports. If significant independent importing occurred, import parity pricing would more accurately reflect the true cost of importing. But as has been indicated, this is not currently the case and without this pressure there is little reason for the refiners to compete down the price with each other to the actual cost of imported petrol. Instead the IPP can be inflated beyond actual cost.⁵

⁵ ACCC (Dec 2007), Petrol Prices and Australian Consumers: Report of the ACCC Inquiry into the Price of Unleaded Petrol, p. v

A more meaningful measure of pricing efficiency would be to examine the change in pricing behaviour associated with sustained changes in the underlying level of competition between suppliers. BARA considers that, in the case of jet fuel at Sydney Airport, the extent to which prices can be driven down won't be known until a more competitive environment between jet fuel suppliers is created. Until this occurs, users are reliant on notional cost-based data, rather than actual competitive market conditions to assess the reasonableness of jet fuel prices.

By creating an environment for increased competition between jet fuel suppliers at Sydney Airport, the Australian Government can gain valuable insights over the impact of a sustained increase in competition on the final prices paid for fuel by end users. BARA's recommended approach to obtain this sustained increase in competitive conditions is contained in section 6.

4 The jet fuel infrastructure supply chain

The lack of effective competition between jet fuel suppliers at Sydney Airport can be traced back to problems with access to key components of the jet fuel infrastructure supply chain.

The supply chain is summarised in Figures 3 and 4 and may be briefly described as follows:

Figure 3 Jet fuel infrastructure supply chain

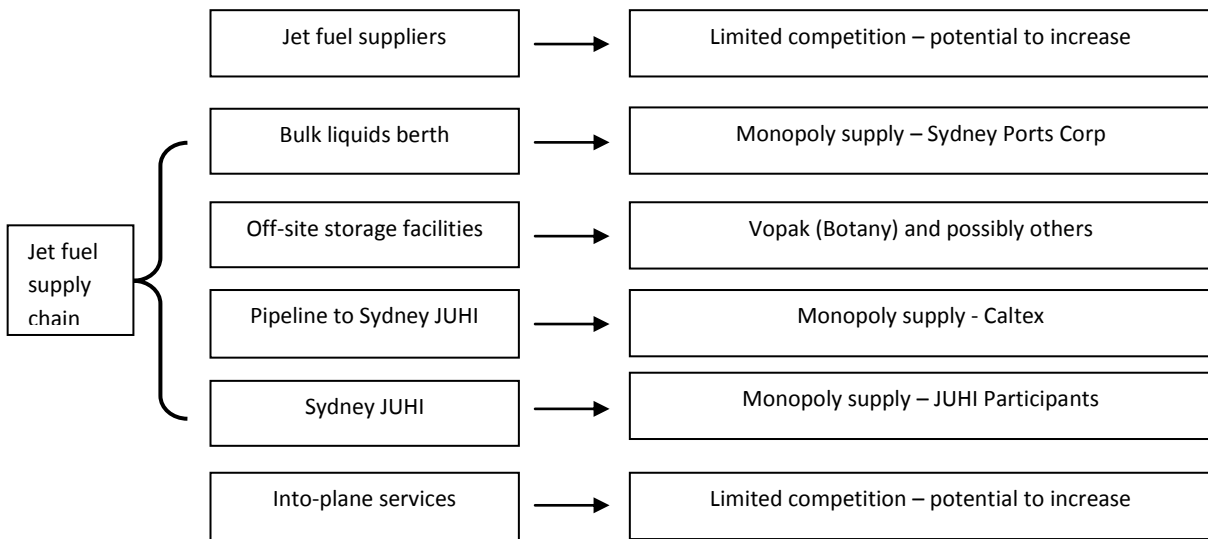
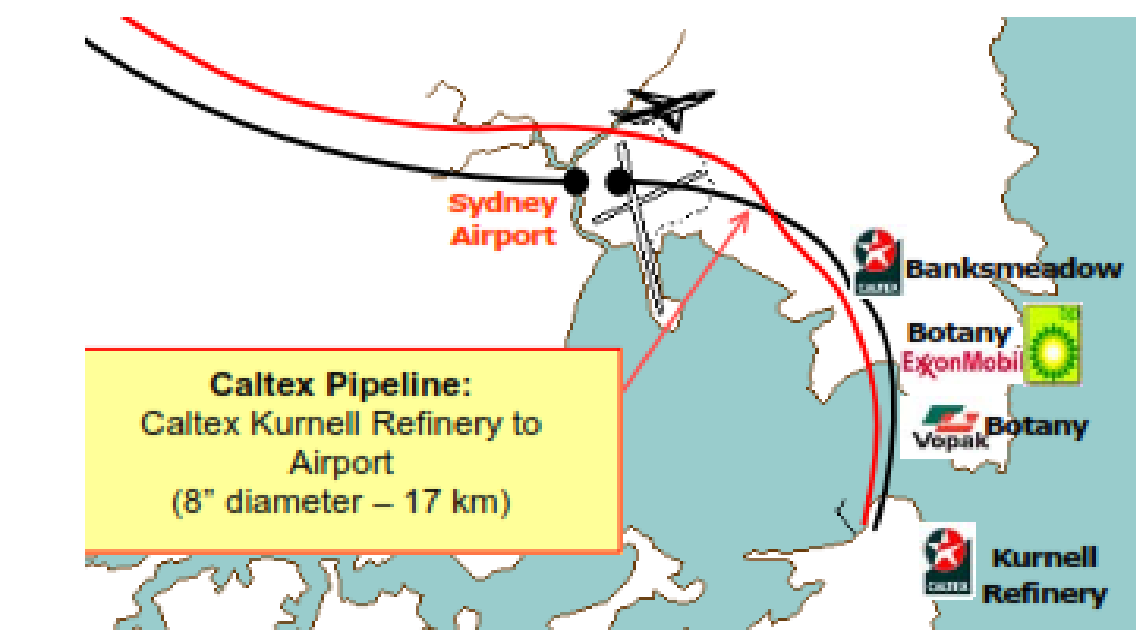


Figure 4 Map of the supply infrastructure for imported jet fuel



Jet fuel suppliers

The supply chain starts with suppliers of jet fuel. They include domestic producers (currently Shell and Caltex) and suppliers of imported fuel. The importers of jet fuel include the existing suppliers (Caltex, Shell and BP) and Q8 Aviation, which has arrangements with Qantas for its self supply. However, other reputable jet fuel suppliers have advised BARA they would welcome the opportunity to tender for fuel supply contracts at Sydney Airport if they could gain access to the Caltex Pipeline and the Sydney JUHI.

Common-user bulk liquids berth

All imported jet fuel is first received by a liquids berth or import terminal. A common-user bulk liquids berth is available at Port Botany on the northern side of Botany Bay, approximately 9 km from Sydney Airport. The berth is owned and managed by Sydney Ports Corporation.

BARA notes that both Caltex and Shell intend to develop their existing refinery assets into fuel import terminals, allowing them to maintain a strong presence in NSW.

Off-site storage facilities

Jet fuel is initially stored off-airport before being transferred to the Sydney JUHI. Vopak owns and operates a petroleum product storage facility at Port Botany on land leased from Sydney Ports Corporation. Currently 91 million litres (ML) of the total 350 ML storage capacity is used for jet fuel. ExxonMobil and BP jointly own a terminal that is also connected to the bulk liquids berth at Port Botany, but from some time subsequent to the exit of ExxonMobil from the market this has not been used for the supply of jet fuel. BARA understands that BP and Shell have secured storage capacity at the Vopak facility.

Pipeline to the Sydney JUHI

Imported jet fuel and Caltex's domestic production is transferred to the Sydney JUHI via a pipeline owned and controlled by Caltex. The Caltex Pipeline, therefore, transfers fuel from two interconnection points: the Caltex refinery and Vopak's storage facilities. Shell also transports jet fuel from its Clyde Refinery to the Sydney JUHI via the Shell Pipeline.

Sydney JUHI

The Sydney JUHI comprises the Sydney Airport Jet Fuel Storage Facility and Jet Fuel Hydrant Pipeline Network. Once jet fuel arrives at Sydney Airport, it enters the jet fuel infrastructure network on-site, owned and managed by the Sydney JUHI. Jet fuel initially enters the JUHI Jet Fuel Storage Facility and is then transported through the JUHI Jet Fuel Hydrant Pipeline Network Facility, or via refuelling trucks, to the aircraft refuelling points.

The Sydney JUHI is owned and operated by an unincorporated joint venture comprising the Shell Company of Australia Limited, BP Australia Limited, Mobil Oil Australia Pty Ltd, Caltex Australia Petroleum Pty Limited and Qantas Airways Limited (together the JUHI Joint Venture (JV)). Control of the Sydney JUHI is delegated to an operating committee comprised of representatives of each JV participant. Shell operates the Sydney JUHI on behalf of the JUHI JV.

Into-plane services

Into-plane services involve delivering the jet fuel into the wing of the aircraft via the Sydney JUHI's hydrant system or a refuelling truck.

Requirements for jet fuel importers

For there to be vigorous competition between jet fuel suppliers at Sydney Airport, potential suppliers (importers) of jet fuel to the airlines operating at Sydney Airport will currently need access to:

1. the common-user bulk liquids berth at Port Botany provided by Sydney Ports Corporation,
2. off-airport storage facilities at Botany, currently provided by Vopak,
3. the Caltex Pipeline to transport the jet fuel from Vopak's storage facility to the Sydney JUHI (at least until a competing pipeline is available for use), and
4. the Sydney JUHI.

The Caltex Pipeline and Sydney JUHI

BARA considers that open, non-discriminatory access is currently available through Sydney Ports Corporation and the off-site storage facilities provided by Vopak. BARA, however, considers that gaining access to the Caltex Pipeline and the Sydney JUHI on reasonable terms and conditions represent major barriers to new suppliers of jet fuel.

The Caltex Pipeline and Sydney JUHI represent monopoly supply infrastructure to any potential importer of jet fuel. The ownership of the pipeline is also characterised by vertical integration. Caltex is vertically integrated throughout the supply chain. It produces and imports jet fuel, owns and controls the main jet fuel pipeline to Sydney Airport, is a member of the Sydney JUHI and, finally, provides 'into-plane' services. Through its ownership of the jet fuel pipeline, BARA considers that Caltex can exert considerable influence over the level of competition between suppliers.

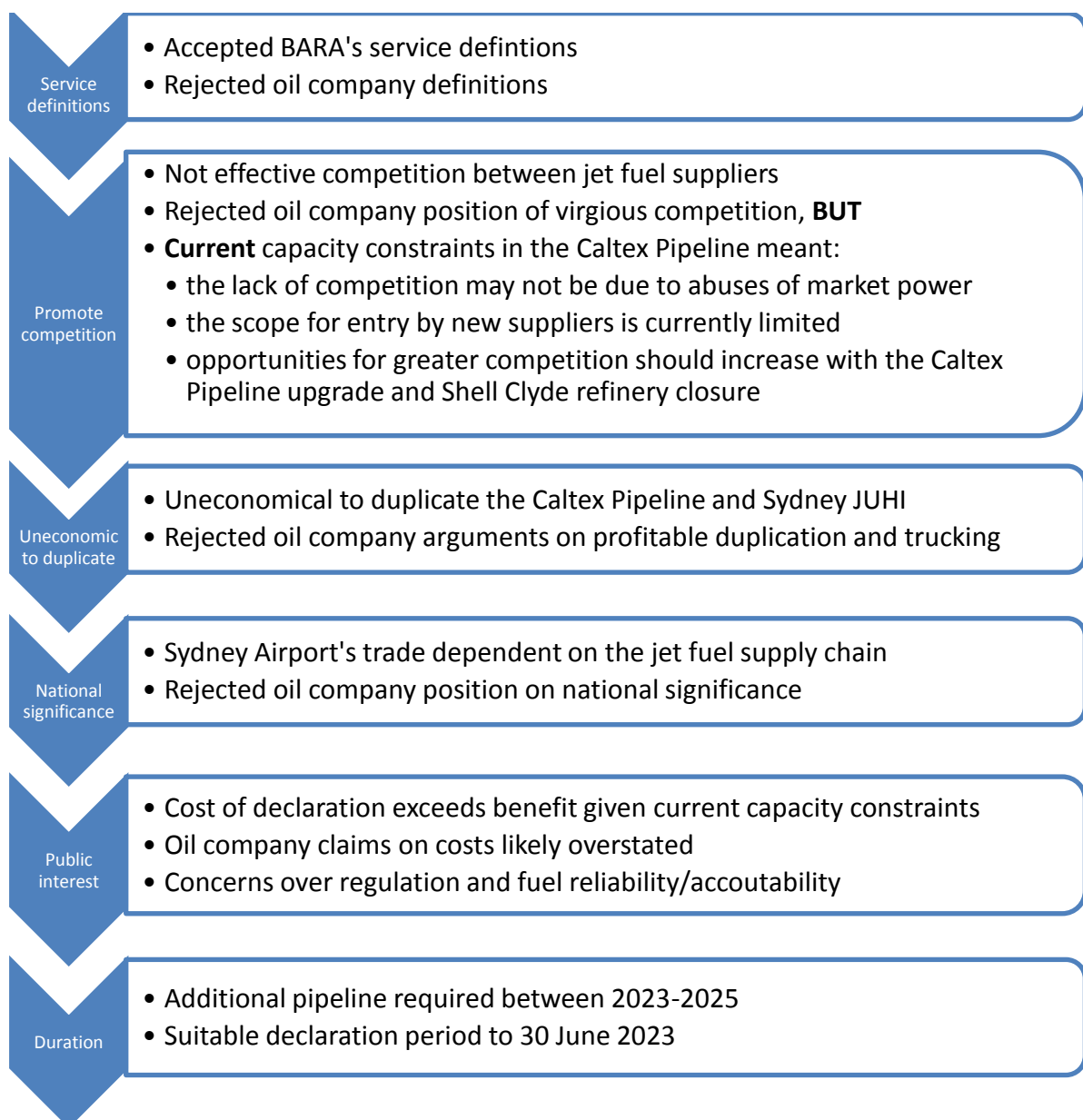
Jet fuel suppliers must also become a member of the JUHI JV, including equity participation in the venture, so that they can sell jet fuel to airlines operating at Sydney Airport. BARA understands that the existing JUHI JV retains the right to refuse participation by a new member. While BARA is not aware of the JUHI exercising this option, BARA is particularly concerned about the length of time it is taking for new suppliers to join the JV after an application is made (see section 6).

5 BARA applications for declaration

In September 2011, in response to the lack of competition and limited access to the infrastructure supply chain, BARA sought declaration under Part IIIA of CC Act of the Caltex Pipeline and the Sydney JUHI. Declaration would provide a mechanism for the ACCC to arbitrate the terms and conditions of access if suitable terms cannot be reached between Caltex and/or the Sydney JUHI over access to its infrastructure with potential jet fuel suppliers.

The National Competition Council (NCC) must consider a number of issues in assessing an application for declaration. A summary of the key findings by the NCC over BARA's applications for declaration is provided in Figure 4 below.

Figure 4 Summary of findings by the National Competition Council



Service definition

BARA sought declaration of the jet fuel transport service provided by the Caltex Pipeline and the jet fuel storage and distribution services provided by the Sydney JUHI.

The oil companies argued that BARA's definition of the jet fuel transport service was artificially narrow and should include any facility that transported jet fuel to the Sydney JUHI (ie include the Shell Pipeline). The JUHI JV argued that many of the services it provides (eg fuel quality testing) could not be subject to declaration.

The NCC concluded that BARA's service descriptions were reasonable. The NCC did not agree that the jet fuel transport service was artificially narrow, or that transporting jet fuel via other pipelines should be included in the service definition.

The NCC did not believe the services for which declaration was sought over the Sydney JUHI were limited in the way as put forward by the JUHI JV.

Criterion (a) Promote a material increase in competition

The NCC concluded that this criterion was not satisfied by BARA's application.

This criterion was considered in two parts. The first question was whether there was currently effective competition between the suppliers of jet fuel to Sydney Airport. If there is effective competition, then it is unlikely the NCC would consider that declaration is justified or necessary. Second, if the market is not characterised by effective competition, the NCC then assessed whether declaration could provide for a meaningful increase in competition.

BARA, as supported by individual airline member submissions, argued strongly that the supply of jet fuel at Sydney Airport was not characterised by effective competition, as evidenced by the poor response to airline tenders. The oil companies, including their numerous reports commissioned from economic consultants, argued that there was strong, effective and vigorous competition between jet fuel suppliers.

After assessing the opposing arguments, the NCC stated that:

...the Council does not consider the market associated with the supply of jet fuel is effectively competitive nor that there is a vigorously competitive tender market.⁶

The NCC also did not agree with the claims by Caltex that the NCC had concluded in its draft recommendations that there was effective competition, stating that 'Neither of these representations of the Council's views in the draft determination are accurate.'⁷

To support the second part of the assessment, BARA argued that the potential benefits of declaration should be assessed for the likely future state of sufficient capacity, to allow greater competition between jet fuel suppliers.

⁶Final Recommendations Para 4.41

⁷Final Recommendations Para 4.28

The NCC formed the view that, first, while there were capacity constraints in the Caltex Pipeline, declaration could not generate a material improvement to the existing lack of effective competition:

The key benefit of declaration under Part IIIA is that it gives third party access seekers an enforceable right to seek access to the declared service(s), by notifying an access dispute to the ACCC for arbitration. However declaration cannot create additional capacity where none exists.⁸

Given this capacity constraint, the NCC did not conclude the current lack of effective competition was due to abuses of market power by Caltex and/or the JUHI JV.

Second, the NCC stated that there should be opportunities for greater competition between jet fuel suppliers in the future:

With the critical jet fuel infrastructure undergoing a degree of change and investment, the market is likely to experience opportunities for increased competition that are not dependent on access and declaration under Part IIIA.⁹

The NCC's decision on this criterion is, therefore, based around the capacity constraints at the time of the BARA applications and assumed future outcomes. Namely, effective competition between jet fuel suppliers should emerge when Caltex completes the capacity upgrade of its pipeline and Shell closes its Clyde Refinery. This conclusion is consistent with the NCC's earlier observation that the current lack of effective competition may not be due to abuses of market power, but rather a lack of available capacity.

Criterion (b) Uneconomical to develop another facility

The NCC concluded that BARA's application satisfied this criterion.

Recently, the 'bar' for passing this criterion was raised by requiring the application of the 'private profitability' test in assessing this criterion. Previously, the test was based on the outcomes for society as a whole. The private profitability test was recently upheld by the High Court.¹⁰

BARA's application examined the financial prospects of any new rival provider of a pipeline from Vopak's storage facility to Sydney Airport and competing storage and distribution infrastructure at Sydney Airport. BARA found it would be unprofitable to bring forward the delivery of an additional pipeline until it was necessary, while duplicating the Sydney JUHI was impractical.

The oil companies and JUHI JV, together with supporting reports from economic consultants, argued that it would be profitable to duplicate the infrastructure.

⁸ Final Recommendations Para 4.98

⁹ Final Recommendations Para 4.103

¹⁰ High Court of Australia: The Pilbara Infrastructure Pty Ltd & Anor and Australian Competition Tribunal & Others.

After assessing BARA's application and opposing arguments, the NCC found that it would be uneconomical to duplicate the Caltex Pipeline before an additional pipeline was necessary:

... it will be economical (in the sense of being profitable for anyone) to develop another facility to provide the Caltex Pipeline Service at some point in the future. However, the Council considers that it is unlikely to be economical to develop such a facility until such a time as demand for jet fuel at Sydney Airport approaches capacity for jet fuel to be delivered to (or, potentially, for supply to be replenished at) the Sydney JUHI.¹¹

The NCC also found that it would be uneconomical to duplicate the Sydney JUHI:

There are significant economies of scope (and probably scale) in providing the storage part of the Sydney JUHI Service and in providing these services in conjunction with the distribution service which is also part of the Sydney JUHI service...More generally the Council believes it is uneconomical to develop other facilities to provide the Sydney JUHI Service for which declaration is sought.¹²

The NCC stated that the most likely time of requiring the additional pipeline was around 2023 to 2025. There was no time constraint on the Sydney JUHI satisfying this criterion.

Criterion (c) National significance

The NCC concluded that this criterion was satisfied by BARA's application.

BARA argued that the infrastructure was of national significance given the importance of Sydney Airport to the NSW and Australian economy. BARA also argued that the NCC had previously concluded that Sydney Airport was of national significance (decision regarding Virgin Blue declaration of Sydney Airport) and the infrastructure could be considered the same as the runways and terminals of Sydney Airport.

The oil companies argued that the infrastructure was not of national significance.

In deciding that the infrastructure was of national significance, the NCC stated that:

Neither the Sydney JUHI nor the Caltex Pipeline could be removed from the range of facilities necessary to enable provision of airport services at Sydney Airport without very significantly reducing the contribution made by the airport to both constitutional trade and commerce and the national economy.¹³

The NCC has, therefore, concluded that all the infrastructure necessary to provide final passenger and freight services at Sydney Airport, whether located at- or off-airport, are of national significance.

¹¹ Final Recommendations Para 5.21

¹² Final Recommendations Paras 5.59 & 5.64

¹³ Final Recommendations Para 6.15

Criterion (e) Application of an effective access regime

The NCC concluded that this criterion was satisfied by BARA's application, as the Caltex Pipeline and Sydney JUHI were not subject to any certified access regimes.

Criterion (f) Not contrary to the public interest/discretion not to declare

The NCC concluded that this criterion was not satisfied by BARA's application.

Not contrary to the public interest was determined by assessing the overall benefits and costs of the proposed declarations.

As the NCC found that declaration would not promote a material increase in competition (even though the market is currently not competitive) given the current capacity constraints, the benefits of declaration were small. As such, any costs of declaration would exceed the benefits of declaration.

The NCC is also of the firm view that there are significant costs associated with declaration:

Access to a service inevitably generates some costs to society (the public) including the direct costs of regulatory activity and costs reflective of actual or market perceived regulatory risk.¹⁴

The NCC also expressed concern over the impact the ACCC might have over the reliability of jet fuel supplies:

In addition to the cost issues raised in submissions, the Council is concerned that the involvement of a regulator in determining access to either service for which declaration is sought could weaken the incentives and accountability of the commercial parties involved in jet fuel supply to Sydney Airport to deliver reliable fuel supplies.¹⁵

Finally, the NCC did not consider that BARA's application gave rise to issues that should cause the Minister to exercise the discretion not to declare the services in the event all the criteria for declaration were found to be met.¹⁶

¹⁴ Final Recommendations Para 8.27

¹⁵ Final Recommendations Para 8.35

¹⁶ Final Recommendations Para 8.43

6 Updating the status of access to the Sydney JUHI and Caltex Pipeline

The NCC envisaged that opportunities for greater competition would emerge without the need for intervention. This would occur with the planned upgrade of the Caltex Pipeline and Shell converting its Clyde refinery into a fuel import terminal.

BARA, however, considers that these changes will not result in a meaningful improvement in the level of competition between jet fuel suppliers. This is because the current providers of the infrastructure have no incentive to allow greater levels of competition to emerge. As such, the market is likely to develop in a 'status quo' manner, with international airlines generally only able to obtain their entire jet fuel needs from one supplier.

As it has now been some 14 months since BARA lodged its applications for declaration with the NCC - and Caltex has completed a capacity upgrade - BARA considers it to be an appropriate time to obtain an update on the status of access to the Sydney JUHI and Caltex Pipeline. As BARA's members have not seen any improvement in the level of competition between suppliers, BARA suspects that there has been little change in the level of access provided. The Committee, however, should seek to confirm the level of access currently provided by the Sydney JUHI and by Caltex to its jet fuel pipeline.

The Sydney JUHI

BARA is concerned that the Sydney JUHI is drawing out the length of time taken to complete the commercial arrangements for new suppliers to join the JUHI. BARA understands that applications to join the JUHI by two potential new suppliers were made over 22 months ago and 15 months ago, respectively, and that the suppliers still have not obtained the necessary access. Such time is considered excessively long to complete the commercial arrangements, with BARA being advised that similar commercial arrangements sought at overseas ports typically take no longer than three months to finalise.

BARA, therefore, considers that the Committee should obtain from the Sydney JUHI the status of applications from new suppliers to join the JUHI. It would be useful for the Sydney JUHI to provide details of both the length of time that has been passed since the applications by new suppliers were first made and the expected timeframe for completion. Assuming such transactions are typically completed within three months, the Sydney JUHI should also provide information on what it considers a suitable length of time for it to process applications for new suppliers to join the JUHI. BARA understands that large and reputable suppliers are seeking to join the Sydney JUHI. As such, the financial or operating capacity of the new suppliers would not appear to be a reason for the Sydney JUHI to take such a long time in assessing the applications.

The Caltex Pipeline

BARA understands that in about August 2012 Caltex completed a capacity upgrade of its Pipeline. BARA does not know the transfer capacity of the upgraded Pipeline. However, according to Caltex in its submission on BARA's applications for declaration, the upgrade would increase the transfer capacity from Caltex's Kurnell refinery from 4.7 ML per day to

9.3 ML per day (see Table 2). The actual increase, however, may be lower than this amount, as 9.3 ML per day was the maximum possible daily throughput possible.

Table 2 Capacity of the Caltex Pipeline^(a)

	Pre-Stage 1 Upgrade	Post-Stage 1 Upgrade (and minor upgrades to the Vopak Terminal)	Post-Stage 2 Upgrade
Pumping capacity from Kurnell Refinery	4.7 ML per day	5.0 ML per day	9.6 ML per day
Pumping capacity from Vopak Terminal	5.2 ML per day	7.9 ML per day	7.9 ML per day
Pumping capacity from Mobil/BP Terminal	4.8 ML per day	4.8 ML per day	4.8 ML per day
Total average pipeline capacity*	4.8 ML per day	5.5 ML per day	9.3 ML per day

* Assuming jet fuel is pumped from the Kurnell Refinery for 24.5 days per month and from the Vopak Terminal for 5.5 days per month.

Notes: (a) Assuming jet fuel is pumped from the Kurnell Refinery for 24.5 days per month and from the Vopak Terminal for 5.5 days per month.

Source: Caltex submission on BARA's applications for declaration, p. 21

The main implication of the upgrade is that it should have significantly reduced the proportion of days necessary to transfer Caltex's local refinery production from its Kurnell refinery. This means that the upgrade should provide for a substantial increase in the number of days available each month for competing suppliers to transfer jet fuel from Vopak's offsite storage facilities to the Sydney JUHI. Prior to the upgrade, Caltex has stated that it allocates 5.5 days per month to transfer jet fuel from Vopak's storage facilities.¹⁷

In providing access to its upgraded Pipeline, Caltex has stated that:

The Stage 2 Upgrade is expected to be completed and commissioned around mid 2012. Once the upgrade is complete and Caltex has had the opportunity to test the technical capacity of the expansion, Caltex intends to offer further third party access to the Caltex Jet Fuel Pipeline. The details are still being considered, having regard to commercial and technical factors, but it is anticipated that additional capacity will be made available via a tender process. Any tender would be assessed on the basis of commercial terms such as price, quantity and duration and on a non-discriminatory basis as to the identity of the access seeker or seekers.¹⁸

BARA is particularly concerned about outcomes that may emerge through Caltex's tender process for the capacity it decides to make available to competitors. It is possible that the 'market' that develops could be one of reserved capacity for the dominant supplier, with most

¹⁷ Caltex submission on BARA's applications for declaration, p. 18.

¹⁸ Caltex submission on BARA's applications for declaration, p. 21

other suppliers (ie all suppliers apart from Shell) competing for the right to compete with the dominant supplier.

One particular issue is the length of time access is offered in the tender. For example, it may be worthwhile for a potential supplier to offer a higher price for access to the Caltex Pipeline on the basis that access is provided for an extended period of time, which will reduce the scope for entry by other suppliers. This could be a profitable strategy because the higher prices paid to Caltex for the transfer capacity will be offset by the higher final prices for jet fuel charged to airlines given the suppressed competitive tensions between suppliers. As such, Caltex's competitive tendering arrangements could well further reduce the level of competition between jet fuel suppliers, even below the current poor levels.

BARA, therefore, urges the Committee to obtain from Caltex detailed information on the basis which it plans to provide access to its upgraded Pipeline. Relevant information would include:

- those suppliers invited by Caltex to tender for capacity. BARA would be particularly concerned if the tender was only available to those parties that are currently a member of the Sydney JUHI. As described earlier, BARA is concerned that new suppliers have not been able to join the Sydney JUHI after at least 14 months since they made their applications,
- the amount of transfer capacity made available in the tender,
- if suppliers can obtain access for a longer period of time if they are prepared to pay a higher price for the transfer capacity,
- how Caltex will assess the tenders. For example, will it be a 'winner takes all' arrangement, and if not, how will the available access be shared between those suppliers that chose to bid on Caltex's tender?

After obtaining the relevant information, BARA considers that the Committee should seek expert independent economic advice on the jet fuel market that is likely to emerge from Caltex's tendering process.

7 BARA's recommended actions

The lack of effective competition between suppliers of jet fuel at Sydney Airport is of national significance. Airlines pay more for jet fuel than necessary and this reduces the commercial opportunities for international airlines to provide passenger and freight services to customers in Australia.

Australia's generic competition law (ie Part IIIA of the CC Act) is not capable of remedying the lack of effective competition between jet fuel suppliers at Sydney Airport. BARA's applications for declaration were unsuccessful even though the current situation delivers poor outcomes for airlines and the community.

Creating an environment for greater competition between jet fuel suppliers at Sydney Airport is in the national interest. It also provides for an important 'test case' over the ability for Australia to secure its fuel needs at lower cost by ensuring all importers of fuel have the ability to compete effectively. Such an outcome is far preferable compared to relying on cost data provided by the existing oil companies.

BARA, therefore, considers that the Australian Government should play an active role in developing an environment that encourages effective competition between jet fuel suppliers at Sydney Airport.

The Sydney JUHI

One key outcome necessary to promote greater competition is open access to the Sydney JUHI. The underlying problem with the JUHI is not the capacity of infrastructure, but rather its ownership arrangements. BARA considers that a change of ownership is necessary to enable open access to the Sydney JUHI.

BARA considers that open access can best be achieved by Sydney Airport Corporation Limited (SACL):

1. ending the lease over the JUHI with the current JUHI JV participants, then
2. re-leasing the facilities to a party(s) that does not supply jet fuel to the airlines (eg Vopak or airlines) or, alternatively, operate and maintain the facilities themselves (with the assets included as 'aeronautical assets' for prices monitoring purposes).

To promote this outcome, the Australian Government should require SACL to include plans for the competitive supply of jet fuel as part of its current review of its Master Plan. If airlines cannot obtain a reliable and competitive supply of jet fuel, then this could ultimately constrain the long term growth prospects of the airport. As such, this requirement is consistent with promoting the most productive use of Sydney Airport.

A competing jet fuel transfer pipeline

The preferred solution for suppliers other than Caltex to transfer jet fuel to the Sydney JUHI is a competing pipeline from Vopak's storage facilities to the Sydney JUHI, rather than obtaining additional access to the Caltex Pipeline. However, it is currently not 'privately profitable' for another party to build a competing pipeline to the Caltex Pipeline before about 2023.

BARA, therefore, considers that government intervention is needed to facilitate the delivery of a competing pipeline. As a start, the Australian Government can facilitate the planning approvals for the competing pipeline. This would reduce the time and cost for another party to deliver the project.

Another potential option is for the Australian Government to encourage SACL to build a competing pipeline. To the extent that part of this investment is unprofitable, that amount, possibly, could be included in the asset base used in setting aeronautical prices charged to airlines. That is, the airlines could be inclined to support the profitability of the pipeline by accepting higher aeronautical prices to cover an agreed amount of pipeline costs. BARA would be prepared to consider facilitating the necessary commercial negotiations with SACL.