Why shut a refinery amidst a boom?

The case for retention of oil refining at Clyde in Sydney

5 September 2011

The announced closure of refinery operations by Shell at its Clyde facility in Sydney will have adverse consequences for the people and businesses of Sydney, and NSW more broadly. These include:

- the immediate loss of around 570 direct manufacturing jobs in western Sydney, and around 1,700 NSW jobs in total;
- the immediate loss of 40% of NSW refining capacity in a city that is growing rapidly;
- loss of skills, capacity and output in associated plastics and petrochemical industries;
- reduced competition in distribution and retail of petroleum products, leading to higher average fuel prices with consequent impact on household incomes and the viability of businesses;
- more volatile and less reliable fuel supplies to the Sydney market and especially Sydney airport, increasing the risk of fuel rationing, shutdowns and major economic loss; and
- increased ship movements in Sydney harbour, leading to both greater shipping hazards adjacent to the Sydney CBD, as well as loss of amenity for residents near Clyde's Gore Bay terminal.

Further, the shutting of refining capacity at Clyde and the sale of part of the site will close down options for the development of biofuels production in the heart of western Sydney, severely limiting the prospects for low-carbon fuels in an increasingly carbon-constrained world.

The solutions are straightforward and commercially viable:

- maintain competition in the refining market in Sydney by requiring Shell to maintain refining operations as an integral part of its highly profitable distribution and indirect retail business, OR
- require Shell to divest its refining business at Clyde to a mid-tier refinery operator that is willing to live with the refinery margins that Shell claims are unsatisfactory, OR
- where refinery production is not attractive to an alternative operator, act to enhance competition in distribution and retail, and preserve options for biofuels production, by requiring retention of the full Clyde site and the opening of the facility to competing importers and distributors.

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The current situation

Sydney has two oil refineries – one at Kurnell operated by Caltex, and one at Clyde operated by Shell. They account for 60% and 40% of Sydney's oil refining capacity respectively.

In April 2011 Shell announced it was considering closing its refining operations and converting Clyde to an "import-only" terminal. On 27 July, after a period of alleged consultation with the workforce (required by law under the site's enterprise agreement), Shell announced that it was proceeding with closure. Shell neither responded to nor rebutted a comprehensive consultants' report commissioned by the CFMEU that made out the case for either continuing refining operations at Clyde or opening the terminal facility to third parties.

The intended closure takes place in a context of Australia having just seven smaller, older refineries that are competing against very large-scale refineries being built across Asia.

The operator of the only other refinery in Sydney, Caltex at Kurnell, has also announced it is reviewing operations there and at its only other refinery, Lytton in Brisbane.

The closure of all or a large part of Sydney's refinery capacity would mean that a large variety of end-use fuels (from diesel through to jet fuel) would need to be shipped from Melbourne (over a thousand kilometres away) or, in most cases, from Singapore and beyond.

Substantial immediate losses from closure

The Clyde site employs around 350 direct employees, and approximately a further 220 through contractors. Remodelled as an import-only terminal, it will have around 50-80 workers.

Economic modelling commissioned by the CFMEU and AMWU indicates that a total of 1,700 jobs will be lost in NSW – predominantly manufacturing jobs based in western Sydney. The total job losses across Australia will be around 2,200.

NSW will lose around $138 million in annual output as a direct cost of closure. Total NSW impacts will be around $187m per year, while the costs across Australia will be around $341m per year.

Many of the jobs lost will be in plastics and petrochemicals, representing a key loss of industry skills and diversity in NSW. It is also understood there will be a contraction in training opportunities for professional/tertiary level students, leading to a permanent reduction in workforce skills in Sydney and NSW.

Growth in the Sydney and NSW markets does not justify capacity loss

Shell is planning to close and permanently remove refining capacity in a city that is growing rapidly.

The Clyde refinery is located in, and services, the western Sydney region. The population of Sydney is 4.5 million, while that of western Sydney is currently 2 million. The latter is forecast to grow to 3 million by 2036.

While automotive gasoline use has been increasing at a relatively modest 0.5% per annum in recent years, automotive diesel consumption has been growing at 5.2% per annum and jet fuel at 8.3% p.a.

Of particular concern is strong growth in air passenger and air freight in Sydney. Aviation passengers are forecast to increase from 31.9 million in 2007 to 78.9m in 2029 - an average annual growth rate of 4.2%. Air freight is forecast to increase from 471,000 tonnes p.a. in 2007 to 1,077,000 tonne in 2029 – a growth rate of 3.8% p.a. Jet fuel consumption is forecast to increase at 7.2% to 2014, and to average growth of 4.2% through to 2029.

Long supply lines – increased risk, volatility and economic loss

The Clyde Refinery is a highly adaptive refinery able to switch production of fuel types rapidly in response to demand. The crude oil it requires are supplied in larger ships of up to 100,000 tonnes – around 90 per year - to the Gore Bay terminal in Sydney Harbour.

The conversion to an import-only facility will require that multiple fuel types be imported in smaller ships, leading to a doubling or tripling of ship movements in Sydney Harbour – with consequent increased maritime safety risks as well as additional noise and disturbance to the communities near Gore Bay.

During previous periods when Clyde has operated as import-only – twice in the last decade – there were “stock-outs” of various fuels in the retail market – specific products were simply unavailable at times. Even more ominously, Sydney Airport was subject to “red alerts” when shortages of fuel signalled the possible start of fuel rationing at the airport – a highly disruptive situation.

Long supply lines for multiple fuel products from elsewhere in Australia but primarily from Asia will expose Sydney and NSW to far greater economic risk and potential for loss. This may occur in the ordinary course of business (eg when there is high demand for shipping) but will become particularly acute during times of political and economic upheaval eg in response to terrorism, piracy or geopolitical tensions.

Greater vulnerability and volatility in fuel supplies may not harm Shell – indeed it will probably lead to higher average fuel prices and fatter profit margins – but it will adversely affect fuel users. That is, all of us.

Reduced competition in the Sydney market

The petroleum products market is already problematic in terms of competitive pressures as it is dominated by the major oil companies including Shell. Removing 40% of Sydney’s refinery capacity during a period of demand growth will considerably exacerbate the problem.

Shell has made it abundantly clear that it is NOT seeking to leave the distribution business, nor to exit its indirect retail role via the Coles Express arrangement. It clearly makes good money from these operations. Its market share has grown from 20% in 2002-03 to 24% in 2009-10.

The concern is that the loss of refinery capacity will reduce competition and lead to higher average fuel prices in Sydney – to the detriment of households and businesses other than those in petroleum distribution.

That Shell has not sought to sell the refinery as a going concern - and indeed is seeking to permanently prevent oil refining occurring at Clyde through the sale of a large part of the site – indicates that this is a very real concern.

It is also very disturbing that Shell's action will reduce options for biofuels production in Sydney. Biofuels represent a significant market opportunity in a carbon-constrained world, and the aviation industry is very keen on its development. The Clyde site is well-placed to serve both the airport and the western Sydney region – but Shell's intended course of action will permanently remove the site as an option.

Maintain refining in Sydney – or at least maintain competition!

The best way to maintain competition in oil products in the Sydney and NSW markets is to maintain refinery capacity. This will also act to reduce the risk of long supply lines for multiple fuel products and reduce market risk and volatility.

If Shell is either too lazy or too greedy to live with the existing profit margins in the refining business, it should sell to someone who is more inclined to do so. Alternatively, the NSW Government could require Shell to manage its business as an integrated one (something that Shell has generally done in the past) using its strong profit margins in distribution and indirect retail to support the refining business.

Finally, if options to require continued refining do not bear fruit, the NSW Government and/or competition authorities should act to maintain and enhance competition in the Sydney and NSW market through requiring Shell to operate the import-only facility as an open-access basis allowing alternative importers and distributors to use the facilities.

What's good for Shell may not be good for the economy and communities of Sydney and NSW

Shell has made a global decision to exit a significant part of its global refining capacity – in the order of 30% since 2002. While this may or may not make sense for Shell (it appears to mirror a current management fad in the industry) it does not follow that this represents an optimal market outcome for the people and businesses of Sydney and NSW.

In reducing competition in the Sydney region but maintaining its market share in distribution and retail, Shell is pursuing a strategy that will clearly benefit Shell shareholders in the UK and The Netherlands. But as with Shell's attempted takeover of Woodside Petroleum Ltd in 2001, it may not be in the public interest, and it was rejected by then-Treasurer Peter Costello on that basis. The concern in the Woodside case was that Shell would seek to delay development of Woodside assets in order to maximise its asset profitability worldwide, while the Australian public interest was in further development of oil and gas assets in Australia.

In the Clyde case the loss of competition, the increased threat to supply security, likely higher average prices and the loss of petrochemical manufacturing capacity and competency all pose a threat to the public interest of Sydney and NSW.

20 September 2011

Mr Rod Sims
Chairman
Australian Competition and Consumer Commission
GPO Box 311
Canberra ACT 2601

Mr David Crawford
President
National Competition Council
GPO Box 250
Melbourne VIC 3001

Dear Mr Sims and Mr Crawford,

Shell's Clyde Refinery closure:
Alternatives that prevent decline in competition in petrol markets

I write directing the attention of the ACCC and the NCC to the decline in petrol market competition that is likely to occur as a result of the closure of the Clyde Refinery in Sydney announced by Shell Australia Limited on 27 July 2011. I specifically draw your attention to alternatives - that Shell's plans will prevent – that would enhance competition in refining, importing and wholesaling. As the ACCC has repeatedly expressed concern about shortcomings in competition and barriers to entry in these areas, action is warranted to require Shell to pursue a more pro-competitive strategy.

Shell announced on 27 July 2011 that it would stop refining operations at its Clyde site in Sydney and convert it to an import-only terminal by mid 2013 (see attached). It did this following a period of alleged consultation with its workforce (required under its enterprise agreement with this union) but without responding to the detailed consultants' report commissioned by this union and the Australian Manufacturing Workers' Union (AMWU). That consultants' report is attached.

Also attached is a summary four page document outlining numerous concerns raised in the consultants' report and putting them in an immediate public policy context. I draw your attention to aspects of Shell's decision that fall within the purview of the ACCC:

- the immediate loss of 40% of NSW refining capacity in a city that is growing rapidly;
- reduced competition in distribution and retail of petrol products, leading to higher average fuel prices with consequent impact on household incomes and the viability of businesses; and
- more volatile and less reliable fuel supplies to the Sydney market and especially Sydney airport, increasing the risk of fuel rationing, shutdowns and major economic loss.

The CFMEU has made recommendations that would prevent or at least mitigate the adverse impacts being implemented by Shell. These are:

- maintain competition in the refining market in Sydney by requiring Shell to maintain refining operations as an integral part of its highly profitable distribution and indirect retail business, OR
- require Shell to divest its refining business at Clyde to a mid-tier refinery operator that is willing to live with the refinery margins that Shell claims are unsatisfactory, OR
- where refinery production is not attractive to an alternative operator, act to enhance competition in distribution and retail, and preserve options for biofuels production, by requiring retention of the full Clyde site and the opening of the facility to competing importers and distributors.

Shell persists in indentifying refining operations as a separate business from distribution, even though it has operated as a vertically-integrated oil company for many decades. It clearly considers the distribution business to be highly profitable given its plans to convert the Clyde site to an import-only terminal.

If the company were to continue refinery operations at Clyde it would continue to be a profitable vertically-integrated business.

What should most concern the ACCC and NCC is the refusal of Shell to consider alternatives to its current plans that would maintain refinery operations OR maintain and increase competition in the Sydney/NSW petrol markets.

Shell has not considered seeking to sell the refinery operation to another operator as a "going concern". There are specialist mid-tier oil refining companies that appear happy to be in the allegedly low-margin refining business; Shell's "problem" is the higher margins available in the upstream oil business as a result of deteriorating global oil reserves.

A further option that Shell has not considered, but which is very much in the public interest, is for an import-only terminal to be operated on a competitive third-party access basis. That is, operating the terminal on the basis that other importers and distributors would be able to access the facility subject to the payment of reasonable fees.

In support of this proposition I note the statement by the ACCC at page 20 of its 2007 report "Petrol Prices and Australian Consumers" that the lack of fully effective competition in wholesale petrol markets was determined in part by the lack of access to import terminal facilities of sufficient scale. I also note the recommendation by the ACCC on page 23 of the same report that "there be on-going monitoring of the use, leasing and sharing of terminals suitable for importing refined petrol into Australia."

Shell's stated strategy is to continue to restrict the facility as an exclusive Shell service. This is despite no longer undertaking refinery operations that could be argued to be an integrated service that could not be reliably operated on an open-access basis.

Shell intends to dismantle the refinery equipment, preventing any possibility of refinery operations being undertaken in the future. It will convert existing tanks and build more to sustain its import-only business. However, it intends to close and dispose of a large proportion of the site. This will probably have the effect of precluding operations of sufficient scale to facilitate third party access.

The CFMEU understands that provisions exist under Part III A of the Competition and Consumer Act 2010 for the regulation of third party access to declared services with the objective of promoting "the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets." (Sec 44AA)

The CFMEU is *not* a party that would conceivably seek access to the facility for the import and distribution of petrol products. So it would not seek to make formal application for the declaration of a service with respect to the Clyde facility.

However, the CFMEU contends that there is a significant public interest concern with respect to the conversion of one of only two refineries servicing the largest city in Australia and also the largest international airport in the country. An opportunity exists to improve competitive processes in the petrol market. As of this moment, Shell is undertaking a course of action that will lessen competition in the largest subsection of the Australian petrol market, and appears to be converting its Clyde facility in a manner that will prevent its operation on a competitive third-party access basis.

The CFMEU therefore requests that the ACCC and/or the NCC investigate the Clyde refinery closure and conversion to determine if competition in the petrol market would be best served by adopting any of the three options previously identified in this letter:

- the continued operation of the refinery by Shell; or
- its sale as a going concern to an alternative refinery operator; or
- the declaration of the import and distribution services provided by the Clyde site so that third parties may utilize the service on a competitive basis.

Yours sincerely,

Tony Maher
General President
Attachments:
1. Shell media release of 27 July 2011
2. CFMEU summary of case against Shell strategy (5 September 2011)
3. CFMEU commissioned report "The Future of the Clyde Refinery" (July 2011)