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Board of Airline Representatives of Australia Inc

Board of Airline Representatives of Australia

Submission in response to the National Competition Council draft recommendations on the Caltex Pipeline and Sydney JUHI

Summary

1. The Board of Airline Representatives of Australia (BARA) welcomes the opportunity to provide this submission on the National Competition Council's (the Council) draft recommendations on the Caltex Pipeline and Sydney JUHI.

2. BARA is obviously disappointed that the Council's draft position is to not recommend declaration of the Caltex Pipeline and the Sydney JUHI. In its draft recommendations, the Council agreed with BARA's service and dependent market definitions. It also found that:

   (a) it was uneconomic to develop other facilities,

   (b) the facilities were of national significance, and

   (c) there were no effective access regimes in place.

3. However, the Council also considered that:

   (a) BARA had not made out its position that jet fuel supply is characterised by excessive prices or other manifestations of market power,

   (b) the level of additional competition that might result from access or increased access to the facilities is limited, and

   (c) the costs of access would exceed the benefits, based on the two above findings.

4. BARA accepts that, based on the information made available to the Council in preparing its draft recommendations, a sufficient case was not established to demonstrate the lack of effective competition between suppliers of jet fuel at Sydney Airport, or how declaration could provide a remedy to the lack of effective competition. BARA also understands that a number of BARA member airlines made late submissions to the Council and these submissions were not considered by the Council in reaching its draft recommendations.

5. BARA has addressed the Council's concerns by requesting that its member airlines provide additional evidence on the lack of effective competition between suppliers when they tender for jet fuel at Sydney Airport. BARA considers that the additional evidence and analysis is sufficient to satisfy the Council that:

   1. Effective competition between jet fuel suppliers does not occur for foreign owned international airlines ('International Airlines') providing international passenger and

freight services to and from Sydney Airport. International Airlines are estimated to represent about 40%[1] of jet fuel demands.

2. Declaration can promote a material increase in competition between jet fuel suppliers within a reasonable timeframe. Declaration can assist the new jet fuel suppliers BARA understands are seeking (or may seek) access to the Caltex Pipeline and the Sydney JUHI.

3. It is in the public interest to promote effective competition between jet fuel suppliers at Sydney Airport given the situation described above.

Tendering outcomes vary across airlines

6. Based on the additional submissions by International Airlines and confidential evidence provided to the Council, BARA considers that the following conclusions for different market segments can be drawn:

   1. International Airlines providing international passenger and freight services and, likely, regional airlines do not achieve tendering outcomes consistent with effective competition.

   2. Qantas, by achieving a degree of self supply from Q8 Aviation, is likely to obtain jet fuel on more favourable terms than International Airlines. Qantas is estimated to account for about 38% of jet fuel demand at Sydney Airport.

   3. Virgin Australia, through mechanisms unknown to BARA, is also likely to be obtaining jet fuel on more favourable terms than International Airlines, but perhaps is paying higher prices than Qantas.[2] Virgin Australia is estimated to account for about 18% of jet fuel demand at Sydney Airport.

7. If the Council reaches the conclusion that there is not effective competition between suppliers when International Airlines tender for jet fuel at Sydney Airport, then it is also reasonable for the Council to conclude that:

   (a) there is likely sustained price discrimination over the sale of jet fuel at Sydney Airport, with International Airlines paying jet fuel differentials above the marginal cost of supply,

   (b) the most rational explanation for the lack of effective competition is restricted access to the Caltex Pipeline and the Sydney JUHI, which limits the ability of existing suppliers to compete vigorously and new suppliers to enter the market, and

   (c) the conclusions contained in the RBB Economics Report (ie cost-based prices across all airlines) are not supported by the available market facts.

8. The estimated spend by International Airlines on jet fuel at Sydney Airport is about $1.2 billion per year. BARA considers that this proportion of market share, value of sales and

[1] The estimated market shares are based on a combination of available seat kilometres, flights and fuel intensity information for domestic and international flights.

[2] Virgin Australia may be paying less for jet fuel than International Airlines because of a higher price elasticity of demand (due to more price sensitive passengers) compared to International Airlines.

number of airlines, satisfies the position that there is not effective competition for a sufficiently large market share of jet fuel at Sydney Airport for the purposes of declaration.

Declaration will promote a material increase in competition

9. BARA understands that a number of its member International Airlines are exploring opportunities to source jet fuel from alternative suppliers at Sydney Airport. This outcome is consistent with the position that International Airlines pay jet fuel differentials greater than the marginal cost of supply.

10. These new suppliers, however, will need access to the Caltex Pipeline and Sydney JUHI on reasonable terms and conditions, including appropriate certainty over continual access. Declaration will enhance the ability of International Airlines to bring new suppliers of jet fuel to Sydney Airport, by reducing the barriers to entry and uncertainty over continued levels of access to the Caltex Pipeline and Sydney JUHI.

11. It can be expected that the majority of the benefits flowing from declaration will accrue to International Airlines, rather than Qantas and, possibly, Virgin Australia. As Qantas likely pays lower prices for jet fuel than International Airlines, declaration could well reduce the competitive position of Qantas in providing international passenger services relative to International Airlines. If so, the incentive for Qantas to support BARA's declarations is greatly reduced. BARA, therefore, considers that the benefits of declaration should be assessed in terms of those that are expected to accrue to International Airlines, Qantas and Virgin Australia, separately.

12. The existing vertically integrated arrangements of the oil companies will not limit the improvement in competitive conditions International Airlines can obtain through declaration below a material increase. The growth in jet fuel demand will be met from imports rather than local production. Greater competition will occur between importers of jet fuel and imports of jet fuel will dominate total jet fuel requirements over the Council's proposed declaration period. BARA does not consider that any supplier should be 'entitled' to some set proportion of the imported jet fuel necessary to meet the growing gap between demand and local refinery production.

13. BARA notes that Caltex has stated that if:

> ...alternative suppliers (including Shell) are winning volume in the downstream market at its expense – then its incentive is to make capacity available to other suppliers in order to improve its asset utilisation, provided it is fairly compensated for the costs incurred in its so doing'[3].

This statement further supports the position that sufficient transport capacity is available to allow a material increase in the level of competition between the suppliers of imported jet fuel. BARA also notes that Caltex Pipeline capacity has not been a constraint in the recent past. International Airlines have always been able to obtain increased supplies of jet fuel to

[3] Caltex submission, p. 71.

meet their growing demand, albeit principally from only one supplier. However, BARA considers that Caltex has the incentive to maintain the status quo over access, as that effectively reserves the amount of imported fuel that must be purchased by International Airlines from Caltex.

It is in the public interest to promote greater competition between jet fuel suppliers

14. BARA considers that if the Council concludes that criterion (a) is satisfied, then it is in the public interest to promote greater competition between jet fuel suppliers at Sydney Airport.

15. As the facilities already provide services to more than one supplier, it is unlikely that there will be any significant increase in operational costs associated with greater competition. The benefits of greater competition far outweigh any such costs, which infrastructure providers are entitled to include in access charges.

16. Declaration also will not stifle investment. It is the potential new suppliers and airlines that lose the most when necessary investments in jet fuel supply infrastructure are deferred or delayed. This means both the potential new suppliers and airlines have an incentive to ensure declaration does not inhibit timely investment in jet fuel supply infrastructure.

17. BARA notes that, in the event the Minister was to declare the services, the Council considers that declaration should expire on 30 June 2023. By choosing this date, any adverse impacts of economic regulation on incentives to invest are further mitigated - declaration essentially operates within the capacity of the existing infrastructure.

Structure of the submission

18. Section 1 covers the issue of effective competition between jet fuel suppliers across airlines. Section 2 provides the case that declaration can provide for a material increase in competition. Section 3 covers the public interest. Section 4 briefly covers the criterion satisfied in the Council's draft recommendations, including the proposed length of the declarations.

1 The level of effective competition

19. BARA has sought declaration of the Caltex Pipeline and Sydney JUHI in response to the concerns expressed by many of its International Airline members over the lack of effective competition between suppliers of jet fuel at Sydney Airport. BARA has been aware of these problems through its members for many years. Given BARA's international members purchase jet fuel at all major international airports in Australia and overseas, they are well placed to provide evidence on this issue.

20. Based on the submissions by airlines to the Council, BARA considers that the competition analysis (including the distribution of benefits), should be considered separately for:

    (a) International Airlines (foreign owned), providing international passenger and freight services, and regional airlines,

    (b) Qantas, and

    (c) Virgin Australia.

21. Based on these market segments, this section covers:

    - estimated market shares (section 1.1),
    - the oil companies' position on the state of competition (section 1.2),
    - BARA's position on the state of competition (sections 1.3), and
    - the logical conclusions from a lack of effective competition (section 1.4).

1.1 Estimated market shares

22. BARA does not have access to the fuel volumes purchased by individual airlines, although some airlines have stated their volumes in submissions to the Council (including the confidential information provided). Estimates of the likely market shares for all airlines were developed using a combination of published information on seats, seat kms, flights and average fuel use by domestic and international flights.[4]

23. Based on the above information, the estimated market shares are:

    (a) International Airlines about 40% ($1.2 billion per year) and regional airlines about 4%,

    (b) Qantas about 38% ($1.1 billion per year)[5], and

    (c) Virgin Australia about 18% ($600 million per year).

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[4] The seat and seat kms data was sourced from: the Bureau of Infrastructure, Transport and Regional Economics website; Qantas (2010) Data Book; and Virgin Australia monthly traffic statistics. Flight information was obtained from the flight forecasts developed by IATA for Airservices Australia's 2011 long-term price notification. The fuel use information was sourced from SKM (2011) Modelling Transport Emissions, Australian Transport Emissions Projections to 2050.

[5] BARA notes that this estimate is close to the 40% market share estimate contained in Caltex's submission, p. 7.

24. There are currently over 30 International Airlines operating at Sydney Airport, including those providing international freight services. The combined market share for jet fuel of Qantas and Virgin Australia is estimated at about 56%.

1.2 The oil companies' position on the state of competition

25. The oil companies and accompanying consultants' reports all present a consistent picture of effective competition between jet fuel suppliers. The position can be summarised as:

    (a) there is vigorous competition between jet fuel suppliers in providing jet fuel to all airlines at Sydney Airport,

    (b) BARA's International Airlines obtain a high level of bargaining power through international tenders, and

    (c) the price of jet fuel at Sydney Airport is determined by the marginal cost of supply, being the imported cost of jet fuel – the price of jet fuel at Sydney Airport is, therefore, determined by the Import Parity Price (IPP).

26. The market conditions presented are, therefore, ones in which no jet fuel supplier, or group of suppliers, enjoy any degree of market power. Prices charged are cost-based and set based upon the combined cost of producing jet fuel and then transporting this fuel to aircraft at Sydney Airport. As argued by RBB Economics:

    As for petroleum, imports of jet fuel represent the marginal source of supply. This implies that the marginal cost for jet fuel in Australia is determined by the import cost of jet fuel, rather than the marginal cost of local production. As importers determine the marginal cost of jet fuel supply in Australia, pricing will reflect these costs associated with the import of jet fuel.[6]

    And:

    Suppliers therefore have the incentive to compete vigorously, as customers largely distinguish between competitors on price, and seeking to charge prices higher than its competitors for a particular tender will imply that a supplier will lose the contract.[7]

27. A similar case is presented by NERA:

    It is a matter of common ground that domestic production of jet fuel is insufficient to meet total demand, and this will not change in the future. The shortfall will need to be imported from oil refineries located throughout South-East Asia – principally Singapore. In other words, imports represent the 'marginal' source of supply to the dependent market.

    This has a significant bearing upon the price at which jet fuel will be supplied to that market with and without access (or increased access). In particular:

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[6] RBB Economics report, p. 5.
[7] RBB Economics report, p. 4.

(a) the price that parties pay to import jet fuel to domestic storage facilities (before additional costs are incurred to transport it to the Sydney JUHI) reflects the import parity price (IPP) for that internationally traded commodity, and
(b) this in turn determines the price (before transport) of domestically refined jet fuel, ie, prices are set by reference to the costs that are incurred by importers to purchase jet fuel overseas and transport it to a storage facility in Sydney.[8]

Jet fuel differentials

28. In its initial application, BARA presented information on the jet fuel differentials paid across Australian and overseas airports.

29. Using the month of July 2010 for comparison with BARA's stated differential of USD18.91 cents per US gallon, Caltex argues[9] that the cost of:

- shipping and insurance was USD9.51c/US gallon, and
- wharfage was USD0.052c/US gallon (AUD0.16c/litre).

30. At a total cost of USD10.03c/US gallon for the cost components listed above, Caltex argues that this leaves only about 8.9c/US gallon (about AUD2.7/litre) to cover the cost of:[10]

- terminal fees for storage and throughput at either refinery or terminal,
- transportation fees, whether by road tanker wagon or pipeline,
- fees for use of the Sydney JUHI,
- into-plane fees,
- the cost of credit, representing the credit cost based on the time difference between supply and payment by the airlines, and
- a risk premium to cover exchange rate and shipping volatility.

31. BARA notes that Caltex has provided information to the Council on the prices it charges for the use of its Pipeline, while the RBB Economics Report also contains information on the cost of offsite storage. As such, the Council can further limit the estimated margin available to cover the remaining costs, which also includes the profit margin earned by the oil company as retailer.

32. Using information provided by Caltex, Shell and BP, RBB Economics argued that 'we find that the price differential put forward by BARA can be explained by cost elements, rather than differences in competitive conditions'.[11] The Council's view was that the critique of the jet fuel differential data across airports by RBB Economics was compelling.[12]

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[8] NERA submission, pp. 19-29.
[9] Caltex submission pp. 40-41.
[10] Caltex submission, p. 42.
[11] RBB Economics Report, p. 5.
[12] NCC Draft Recommendations, p. 21.

1.3 State of competition – BARA's position

33. BARA considers the proposition of effective competition and cost-based jet fuel prices is not supported by the market facts. This is because the available evidence supports the argument that the outcomes achieved over jet fuel purchases differ greatly across International Airlines, Qantas and Virgin Australia.[13]

International Airlines

34. BARA understands that the following International Airlines have provided submissions to the Council in support of BARA's applications for declaration:

- Cathy Pacific
- Emirates
- Etihad
- Korean Air
- United Parcel Services
- United Airlines

35. There is a common theme across these submissions. When the airlines tender for the provision of jet fuel at Sydney Airport, the response from suppliers is limited. The International Airlines are well placed to judge whether there is effective competition given they purchase jet fuel for all major international airports in Australia and overseas.

36. Another important theme is the inability of most suppliers to fulfil the entire jet fuel requirements of individual airlines, with usually only one supplier being able to do so.

37. In considering the submissions by International Airlines in preparing its draft recommendations, the Council stated that:

> Several airline submissions raise concerns about a lack of response and availability of jet fuel supply to the airline's tenders (refer Emirates, Korean Air, UPS). It seems to the Council that these concerns are more likely to reflect overall supply constraints than a lack of competition that could be rectified by access or increased access. However, without further information on the parameters and requirements of the tenders concerned it is difficult to reach a firm conclusion as to whether or not access could improve the tender response and reliability in this regard.[14]

However, BARA notes that neither Caltex Pipeline capacity nor Sydney JUHI capacity have 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.

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[13] BARA also notes that the Regional Aviation Association of Australia (RAAA) also supported BARA's declaration, noting that new jet fuel suppliers have the potential to offer fuel under more favourable arrangements than currently exist. (p.3 of the RAAA submission).

[14] Draft Recommendations, p. 29

38. To assist the Council in considering the level of effective competition, BARA has requested that its members provide additional information on a strictly confidential basis to its legal representative (HWL Ebsworth) about the extent of competition between suppliers when they tender for jet fuel at Sydney Airport. BARA has not sought to access the data and no data has been shared between airlines. HWL Ebsworth has submitted the information provided by the airlines to the Council as a separate confidential submission.

39. HWL Ebsworth has advised BARA that the confidential material supports the argument that International Airlines, on average, do not achieve effective competition when tendering for jet fuel at Sydney Airport. A number of instances are documented where there was little or no competition between suppliers when International Airlines tender for jet fuel at Sydney Airport.

Qantas and Virgin Australia

40. BARA understands that, in its draft recommendations, the Council has drawn the conclusion that Qantas and Virgin Australia are obtaining jet fuel at prices consistent with effective competition:

> If the market for the supply of jet fuel at Sydney airport is uncompetitive the Council considers that these airlines [Qantas and Virgin Australia] would be the two most likely to gain from declaration of the services, particularly given Caltex's claim that they source jet fuel nationally. Were that to be the case the Council anticipates that one or both Qantas and Virgin may have made a submission to the Council supporting BARA's applications. This did not occur. Qantas made a submission opposing declaration and Virgin did not make a submission so the Council is unaware of its views. That Qantas opposes declaration is informative, however, regard does need to be had to the unique position Qantas holds as an existing user of the Caltex Pipeline and a member of the JUHI JV. The absence of any submission from Virgin seems inconsistent with a suggestion that access would materially promote competition.[15]

41. BARA considers that, given Qantas' objection to declaration and the lack of a supporting submission from Virgin Australia, it is reasonable to conclude that both airlines pay, on average, lower prices for jet fuel at Sydney Airport than International Airlines.

42. Qantas is likely to pay lower prices for jet fuel than International Airlines given its ability to source part of its demands from Q8 Aviation. Caltex has estimated that Qantas sources around 200 ML per year from Q8 Aviation.[16] Based on Qantas' estimated market share, this indicates that Qantas is able to source about 20% of its jet fuel requirements from Q8 Aviation. Caltex also contends that Qantas' ability to source jet fuel from a supplier other than the three oil companies demonstrates that other fuel suppliers are exerting a competitive constraint.[17]

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[15] Draft recommendations, p. 30.
[16] Caltex submission, p. 35.
[17] Caltex submission, p. 35.

43. BARA agrees with Caltex that Qantas' ability to source around one fifth of its jet fuel requirements independently from the incumbent oil companies means that Qantas, on average, pays the lowest price for jet fuel at Sydney Airport. BARA would also expect that this provides Qantas with a meaningful competitive advantage over International Airlines on this important cost input.

44. As Qantas is likely to be paying the lowest price for jet fuel at Sydney Airport, then it has a commercial incentive to seek to maintain this cost advantage. Qantas' CEO recently stated that Qantas International's cost base was some 20% higher than its key competitors.[18] Jet fuel is, therefore, likely to be a critical cost advantage for Qantas, which overall has a higher cost base than its competitors.

45. The lack of a supporting submission from Virgin Australia would also suggest that it also pays a lower price for jet fuel than International Airlines, but perhaps a higher price than Qantas, given the lack of an additional source of supply. BARA is unaware of the commercial strategy Virgin Australia has employed to obtain its jet fuel purchases.

1.4 Lack of effective competition for International Airlines– some logical conclusions

46. Should the Council conclude that the International Airlines do not achieve effective competition between suppliers in purchasing jet fuel at Sydney Airport, then BARA also considers it reasonable for the Council to conclude the following outcomes:

1 *There is likely sustained price discrimination over the sale of jet fuel at Sydney Airport*

47. As noted in Caltex's submission, the pricing for jet fuel generally comprises a floating benchmark plus a differential. The differential is a function of costs above MOPS.

48. If the market for jet fuel is characterised by effective competition, then it should be expected that the jet fuel differentials charged by oil companies would be both cost-based and very uniform across airlines for closely timed contracts. A uniform, cost-based differential can be expected in the presence of effective competition because:

(a) the jet fuel is being sold at a common location (Sydney Airport),
(b) many of the prices charged for the marginal cost of supply (imports), such as shipping, insurance, wharfage and storage, appear to be volume or value based – this indicates that the prices faced by importers for these cost items are generally 'avoidable' rather than fixed costs,
(c) contract lengths (usually one to three years) would average out any short term cost fluctuations, and
(d) all airlines are purchasing substantial volumes of jet fuel through either their national or international tenders.

49. Under effective competition, no supplier would be able to charge a differential higher than the marginal cost of supply (see earlier statements by RBB Economics). This is because, in a well informed market, individual airlines would not accept any bids from suppliers that

[18] Alan Joyce, (16 August 2011), 'Building a Stronger Qantas', media release.

sought to obtain differentials higher than prevailing costs, as lower differentials could readily be obtained from other suppliers. Equally, no supplier has a commercial incentive to charge a differential below prevailing costs. This means, for equally timed contracts, in the presence of effective competition, there should be no meaningful differences in jet fuel price differentials.[19]

50. BARA believes that the available evidence indicates that Qantas and Virgin Australia pay the lowest prices for jet fuel at Sydney Airport, with International Airlines, on average, paying higher prices. As no price charged is likely to be below the marginal cost of supply, it is reasonable to conclude International Airlines pay jet fuel prices greater than the marginal cost of supply.

51. The available evidence, therefore, does not support the market description put forward by the incumbent oil companies. Rather, the market is characterised by sellers having a substantial degree of market power, with varying degrees of offsetting bargaining strength of individual airlines. As such, jet fuel prices are a function of relative bargaining strength rather than a cost-based price in the presence of effective competition between suppliers.

52. A market characterised by oil company market power and differing airline bargaining strengths suggests a number of possible market outcomes, including:

(a) individual oil companies charge different jet fuel differentials to individual airlines based around the relative bargaining strength of each airline, or

(b) individual oil companies tend to consolidate their jet fuel sales to particular airlines or groups of airlines – therefore, the prices charged by individual oil companies to airlines may be relatively uniform, but there are still substantial differences in the differentials paid across airlines (ie, differences in jet fuel differentials across incumbent oil companies).

53. BARA and, likely, any individual market participant does not have access to all the data necessary to fully identify the manner in which price discrimination is occurring over sales of jet fuel at Sydney Airport. That said, the market outcomes contained in the submissions by airlines and further confidential evidence provided to the Council clearly supports a market description of incumbent oil company market power and price discrimination, rather than one of vigorous competition between sellers and cost-based prices.

54. It is also important to note that if the latter possible situation is occurring, then it is likely individual oil companies could claim that they do not engage in price discrimination in selling

[19] BARA notes that airlines engage in price discrimination and this does not imply the airlines have significant market power. This is because the market conditions and cost structure of airlines are fundamentally different to jet fuel. First, air transport is characterised by highly differentiated products. They include the class of travel (eg economy, business, first class etc), the time of travel (day, peak vs off peak), route (major capital city and regional locations) and prior time booking (months or weeks before the flight down to close to flight time). Second, many of the costs incurred by airlines can be considered fixed rather than marginal. They include many aircraft costs (lease or purchase prices, aircrew) together with support functions (eg ticketing, flight operations, etc). Given these market conditions, price differentiation is both possible and necessary to recover total industry costs. See for example de Roos N, Mills G and Whelan S, 2010 *Pricing Dynamics in the Australian Airline Market*, The Economic Record, **86**, pp. 545-562.

jet fuel at Sydney Airport. For example, an oil company could claim that they apply a standard formula in developing bid prices across all airlines. However, to the extent an oil company sells most of its available jet fuel to airlines with lower (higher) bargaining power, the average price obtained will tend to be higher (lower) than other oil companies. At the same time, the bargaining strength of oil companies may also vary. In this instance, airlines may pay multiple prices for jet fuel for equally timed contracts, with the differences in prices occurring due to the differences in bargaining strengths and the inability of some supplier(s) to met 100% of the airline's jet fuel needs.

2 The lack of effective competition is sustained through restricted access

55. BARA considers it reasonable to conclude that the lack of effective competition between jet fuel suppliers is sustained through restricted access to the Caltex Pipeline and Sydney JUHI. If access to the Caltex Pipeline and the Sydney JUHI could be obtained on reasonable terms and conditions, then new suppliers would likely enter the market and compete with existing suppliers (given prices to International Airlines exceed the marginal cost of supply). At the same time, existing suppliers would be able to offer far more bids on the tenders by International Airlines.

56. BARA understands that a number of its member International Airlines are exploring opportunities to source jet fuel from alternative suppliers at Sydney Airport. This outcome is consistent with the position that International Airlines pay jet fuel differentials greater than the marginal cost of supply. International Airlines have the greatest incentive to bring new suppliers to the market given the ability to reduce jet fuel costs closer to the marginal cost of supply.

3 The conclusions contained in the RBB Economics Report are not supported by the market facts

57. BARA also considers it reasonable for the Council to reject the findings of the RBB Economics report. First, there is not vigorous competition between jet fuel suppliers when International Airlines tender for jet fuel at Sydney Airport. Rather, the International Airlines have documented a number of instances where there was little or no competition between jet fuel suppliers. Second, jet fuel differentials paid by individual airlines at Sydney Airport are a function of relative bargaining strengths, rather than cost-based prices.

2 Declaration and increased competition

58. BARA considers that declaration will promote a material increase in competition between suppliers of jet fuel at Sydney Airport. This because the current lack of effective competition is sustained through the ability of Caltex and the Sydney JUHI to limit access to the infrastructure supply chain.

59. BARA understands from its member International Airlines that a number of alternative jet fuel suppliers are seeking, or will be seeking, access to the Caltex Pipeline and the Sydney JUHI. In considering the impact these potential new suppliers can have on competition, it is necessary to estimate the potential volume available to new suppliers and the likely beneficiaries of greater competition.

2.1 Volumes open for competition

60. In its draft recommendations, the Council has concluded that 'very large portions of the capacity of both the Caltex Pipeline and the Sydney JUHI are likely to remain reserved for existing users even in the event access disputes are taken to the ACCC.[20] This was seen by the Council as one important factor limiting the impact of access, or increased access, on competition between jet fuel suppliers.

61. BARA considers that the available volumes accessible by new suppliers are more than adequate to promote a material increase in competition. This is because:

    (a) the upgrade of the Caltex Pipeline is scheduled to be completed by mid this year,[21] and

    (b) the growth in jet fuel demand will be met from imports rather than increased local production.

62. BARA has replicated the capacity table from the Caltex submission on the following page. The table shows the past and predicted capacity of the Caltex Pipeline and Vopak's transfer capacity. A number of important conclusions can be drawn from the table relevant to the Council's consideration.

63. First, the proportion of days necessary to transfer Caltex's local refinery production should be significantly reduced once the upgrades to its Pipeline are complete by mid this year.

64. An estimate of Caltex's local refinery production was developed based on the transfer capacity prior to the upgrades and number of days allocated to third parties. Assuming 4.7 ML/day at 294[22] days per year, then local refinery production is estimated at about 1,380 ML per year. BARA acknowledges that this is an estimate only (and probably over estimates as it assumes no outages or imports of jet fuel by Caltex[23]). Caltex may be prepared to provide the Council with its average annual production from its Kurnell refinery.

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[20] Draft recommendations, p. 31.
[21] Caltex submission, p. 21.
[22] Based on 24.5 days per month.
[23] BARA understands that Caltex also imports jet fuel in addition to its local refinery production.

Table 2: Capacity of the Caltex Jet Fuel Pipeline[39]

	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.

Source: Caltex submission, p. 21

65. With an increase in the daily transfer capacity to 9.6 ML per day, there should be a large fall in the total number of days necessary to transfer Caltex's local refinery production to the Sydney JUHI. Based on the proportional increase in capacity, the days needed to transfer Caltex's local production falls by about 50% to 144 days per year. BARA recognises that Caltex is likely to object to these calculations, citing operational and other factors that mean the reduction in the number of days necessary to transfer its local refinery production is not equal to the proportional increase in transfer capacity. That said, BARA considers it reasonable to assume a significant reduction in the number of necessary days. Caltex may be willing to provide the Council with more accurate estimates of the number of days necessary to transfer its local production after the capacity upgrades are complete.

66. Second, over the term of the Council's proposed declaration period, imports of jet fuel will increasingly dominate total supply. Based on estimated local refinery production of 1,380 ML per year, the proportion of total demand met by imports are estimated to be about 60% in 2014, rising to about 70% by 2023.

Table 1 **Estimated jet fuel proportions, local production and imports**

	2014	2017	2020	2023
Forecast total demand (ML)	3,471	3,771	4,105	4,367
Domestic production (ML)	1,380	1,380	1,380	1,380
Imports (ML)	2,092	2,391	2,725	2,987
% Imported	**60%**	**63%**	**66%**	**68%**

Sources: Estimates based on the Caltex submission (table 2) and SJFIWG Report.

67. BARA does not consider that either Caltex or the Sydney JUHI participants should be in a position to determine their share of this imported volume of jet fuel through their ownership and control over the Caltex Pipeline and Sydney JUHI. Caltex's requirements are reasonably defined by the capacity necessary to transfer its local refinery production. The demand to be met through imports of jet fuel, which are expected to increasingly dominate total supply,

should be determined through merits based competition rather than infrastructure supply ownership arrangements.

68. BARA also notes that Caltex has stated that if:

> ...alternative suppliers (including Shell) are winning volume in the downstream market at its expense – then its incentive is to make capacity available to other suppliers in order to improve its asset utilisation, provided it is fairly compensated for the costs incurred in its so doing.'[24]

This statement by Caltex further supports the position that sufficient transport capacity can be made available to allow a material increase in the level of competition between the suppliers of jet fuel at Sydney Airport.

Incentive for oil companies to limit competition

69. Caltex has indicated in its submission that, after the upgrades of its Pipeline are completed, it intends to offer further third party access.[25] However, the critical factor here is that Caltex will effectively determine the level of access (through the number of days offered) and, hence, the proportion of jet fuel that can be met by other importers of jet fuel (other than Shell) and the amount of imported jet fuel volumes it reserves for itself. As noted earlier, in the confidential information provided to the Council, a number of instances are documented where there was little or no competition between suppliers when International Airlines tender for jet fuel at Sydney Airport.

70. BARA considers that Caltex has the incentive and ability to maintain the status quo arrangements by limiting the total imported volumes competitors can supply to Sydney Airport. It can do this by limiting the number of days it makes available to transfer imported jet fuel from Vopak's offsite storage facility. As the growth in jet fuel demand will be met from imports, unreasonably limiting the available capacity effectively reserves the amount of imported jet fuel that must be purchased by airlines from Caltex.

71. The Sydney JUHI also has the ability and incentive to deny or delay access, or only make it available on unreasonable terms and conditions. As found by the Council, neither Caltex nor the Sydney JUHI have in place effective access arrangements.

2.2 Beneficiaries of increased competition

72. BARA considers that the benefits of increased competition between jet fuel suppliers will (at least initially) be obtained primarily by International Airlines and, probably to a lesser extent, Virgin Australia and regional airlines.

73. BARA understands from its member International Airlines that a number of new suppliers are seeking opportunities to provide them with jet fuel at Sydney Airport. This outcome is to be

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[24] Caltex submission, p. 71.
[25] Caltex submission, p. 5.

expected: new suppliers have the incentive to target the most profitable customers (ie, those paying above the marginal cost of supply), which are the International Airlines.

74. BARA, therefore, does not agree with the Council's conclusion that the main beneficiaries of declaration would be Qantas and Virgin Australia.[26] Rather, the main beneficiaries are likely to be International Airlines.

75. BARA considers that in reaching its final recommendations, the Council should consider the benefits of declaration based around BARA's identified market segments, rather than the outcomes for Qantas and Virgin Australia only. Further, BARA considers that a finding that declaration will benefit International Airlines (and likely regional airlines) is sufficiently large in terms of costs, market share and the number of airlines to satisfy criterion (a).

[26] NCC Draft Recommendations, p. 30.

3 The public interest

76. If the Council considers that declaration can promote a material increase in competition, then BARA also considers that the declarations are in the public interest.

3.1 Operating costs and incentives to invest

77. BARA considers that the possible operational cost increases and investment disincentives presented in submissions opposing declaration are highly overstated.

78. Declaration is not expected to interfere with the 'reliability and efficient operation of the Caltex Jet Fuel Pipeline' as claimed by Caltex.[27] Caltex is already providing some access to its Pipeline. As such, Caltex already has experience in operating the Pipeline in a reliable and efficient manner. Should arbitration by the ACCC be required, an overarching objective of providing regulated access is to promote efficient operation of the infrastructure used.

79. BARA accepts that there may be a modest increase in Caltex's operating costs (which are likely to be a very small component of the total jet fuel costs) should it start transferring more jet fuel from Vopak's offsite storage facility to the Sydney JUHI than currently occurs. However, these costs are likely to be very minor compared to the benefits derived from increased competition between jet fuel suppliers at Sydney Airport. The goal is to promote effective competition between jet fuel suppliers (recognising Caltex's reasonable requirements), rather than minimise the operating costs of the Caltex Pipeline. If Caltex is willing to provide operational cost data to the Council, then this data would put such costs in perspective. It is also noted that any increase in costs can be legitimately included in the access price.

80. In the case of the Sydney JUHI, the impact of increased access on operating costs should be minimal.

81. BARA also contends that declaration will not reduce investment incentives. First, once Caltex has completed its upgrades, BARA understands that further capacity upgrades are not possible. That is, the next investment will be a second pipeline (something BARA will strongly lobby should be provided by a party not supplying jet fuel, eg Vopak, rather than an incumbent oil company). Therefore, the investments undertaken by Caltex over the proposed declaration period are likely to be minimal given the investment commitments already undertaken.

82. Equally important, it is the airlines that lose the most when necessary investments in the jet fuel supply infrastructure are deferred or delayed. The ability of new suppliers to obtain the necessary transfer capacity (given Caltex's reasonable requirements) is dependent on timely investments. Without the necessary capacity, their ability to compete is restricted, with the airlines losing the most from such a situation.

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[27] Caltex submission, p. 31

83. The cost of the Caltex Pipeline (and likely the Sydney JUHI) represents a modest proportion of total jet fuel prices. But access to the services provided by the infrastructure is critical for effective competition between jet fuel suppliers. This indicates that declaration will play an important role in ensuring access can be obtained on reasonable terms and conditions, while the likelihood that there will be disputes requiring arbitration is low.

84. It will be in the interests of jet fuel suppliers, Caltex and the Sydney JUHI, to reach agreement over the terms and conditions of access without recourse to arbitration. This is because both Caltex and the Sydney JUHI will know there is little value in seeking to unreasonably limit the access available to the infrastructure by rival jet fuel suppliers given their ability to obtain arbitrated terms and conditions. With this key issue removed, there is a high likelihood agreement can be reached between the parties over suitable terms and conditions.

85. Should a dispute arise that requires arbitration, the ACCC is also able to take the underlying characteristics of the market into account in setting terms and conditions. That is, the ACCC can best serve the industry by setting prices and other terms that encourage infrastructure providers to undertake the investments necessary to underpin effective competition between jet fuel suppliers.

3.2 Accountability and reliability of supply

86. The Council has also raised concerns about the impact declaration may have on the accountability of the existing oil companies:

> ...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.[28]

87. BARA notes that a key reason for establishing the SJFIWG was to address the lack of co-ordinated response by the oil companies to ensuring timely investments in the jet fuel infrastructure supply chain. BARA considers that because infrastructure ownership is fragmented between oil companies, airlines and third parties, the commercial interests of the different parties are often in conflict and not aligned with promoting the long-term efficient provision of jet fuel at Sydney Airport. BARA also understands that Qantas, in its submission to the SJFIWG, argued that upgrades to increase the capacity of essential infrastructure have been deferred and delayed.

88. BARA considers that the lack of timely investments in jet fuel supply infrastructure to date can actually be attributed to the lack of accountability and incentives of the existing owners. Creating bottlenecks in the infrastructure supply chain provides the argument that little capacity is available for competitors.

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[28] Draft recommendations, p. 56

89. It is inevitable that, as the Caltex Pipeline approaches capacity, some form of intervention by the Australian Government will be necessary. This will probably require more than just an inquiry. It will be necessary to resolve the two key issues of:

(a) who will construct the second pipeline and how best to facilitate the necessary planning requirements, and

(b) the future location and ownership of the Sydney JUHI.

90. Given the delays in necessary investments to date, BARA has little confidence that these important issues can be resolved by the existing owners in a manner consistent with promoting effective competition between jet fuel suppliers. It is inevitable that a high level of government involvement will be necessary for a jet fuel infrastructure supply chain to emerge that is responsive to jet fuel demands at Sydney Airport, with the incentive to promote competition between jet fuel suppliers.

91. Over the declaration period proposed by the Council, declaration may encourage Caltex and the Sydney JUHI to provide greater transparency over the transfer arrangements, available capacity and investment priorities over a sustained period of time. This could assist in the development of more open and transparent arrangements than currently occur. Declaration may, therefore, support more transparent arrangements, which in turn will support future investment decisions about a second pipeline and a possible off-airport Sydney JUHI.

4 Remaining criteria

92. In this submission, BARA has primarily sought to provide the evidence and analysis sufficient to satisfy the Council of the lack of effective competition at Sydney Airport for International Airlines and the role of declaration in promoting increased competition. BARA does not have any additional information to provide in respect of the other criteria, which were satisfied in the Council's draft recommendations.

93. Obviously, BARA considers that the service definition for the Caltex Pipeline should be limited to the Pipeline rather than extended to other facilities. Equally, trucking jet fuel is best characterised as a complementary transport option and in no way represents a viable alternative for any meaningful volumes of jet fuel to Sydney Airport. It is also clear that no other provider has an incentive to construct a second pipeline until the Caltex Pipeline approaches capacity. The Sydney JUHI is effectively rendered a monopoly at Sydney Airport given Sydney Airport Corporation Limited has no incentive at allow a second JUHI at the airport.

4.1 Declaration period

94. BARA notes the Council's reasoning for a declaration period to 30 June 2023, in line with the period the Council was satisfied that it is unlikely to be economic to develop another facility to the Caltex Pipeline.[29]

95. BARA considers the Council's proposed declaration period to be reasonable. In choosing this period, BARA notes two key issues. First, should the Minister choose to declare the facilities, it is considered inevitable that Caltex and the Sydney JUHI will make an application for review by the Australian Competition Tribunal (ACT). With such a review also likely to take six months, declaration cannot be expected to apply until well after Caltex has completed the upgrades to its Pipeline. As such, BARA considers that the Council should consider the application for declaration in the context of there being more than sufficient capacity in the Caltex Pipeline to accommodate new entrants, rather than a position of constrained capacity.

96. Second, there will be more than adequate time for new jet fuel suppliers to become established over the remaining declaration time available. These new suppliers will likely play a critical role in any future decisions about the capacity and ownership arrangements of a second pipeline and, possibly, an off-airport Sydney JUHI. That is, once the benefits of increased competition between suppliers become entrenched through declaration, it is considered unlikely that the Australian Government will allow the incumbent oil companies to own and control the new infrastructure. As such, the declaration period proposed by the Council is adequate to ensure both greater competition over the period and establish the market conditions for continued effective competition post 30 June 2023.

[29] NCC Draft Recommendations, p. 58.