

# **Application for Declaration**

## **Part IIIA of the COMPETITION AND CONSUMER ACT 2010**

### **Jet Fuel Supply Infrastructure to Sydney Airport:**

#### **Service No 2: provided by the CALTEX PIPELINE FACILITY**

Board of Airline Representatives of Australia

26 September 2011

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# 1. Executive Summary

## Sydney Airport and jet fuel demand

The number of passengers served by Sydney Airport is expected to more than double by 2029, from about 35 million to 80 million. The direct value of this trade is currently estimated at about \$8 billion per year, or some 6% of NSW's gross state product.<sup>1</sup>

To support this growth, the supply of jet fuel at Sydney Airport will also need to almost double, from a current demand of about 2.9 GL per year 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.

Since about 2009, the total demand for jet fuel at Sydney Airport has begun to consistently exceed local refinery production (provided by Caltex and Shell). This means that imports of jet fuel will be necessary to meet the forecast growth in demand. Shell also recently announced its decision to convert its Clyde Refinery into a fuel import terminal.<sup>2</sup> The majority of Sydney Airport's long-term jet fuel requirements will, therefore, be met through imports.

### Current market conditions

The provision of jet fuel at Sydney Airport is currently characterised by:

- Limited competition between incumbent oil company fuel suppliers;
- Some of the highest 'differential rates' in the world (the difference between the price for jet fuel paid by the airlines over and above the international market price); and
- Poor reliability.

The suppliers of jet fuel at Sydney Airport are currently limited to three of the four main oil companies (namely Caltex, Shell and BP; the Applicant understands that ExxonMobil withdrew from the market in 2010), with Qantas undertaking a limited amount of 'self supply'. The market is highly concentrated, with an estimated Herfindahl-Hirschman Index (HHI) of about 4,000. A score above 2,000 is typically interpreted as indicating high levels of industry concentration.

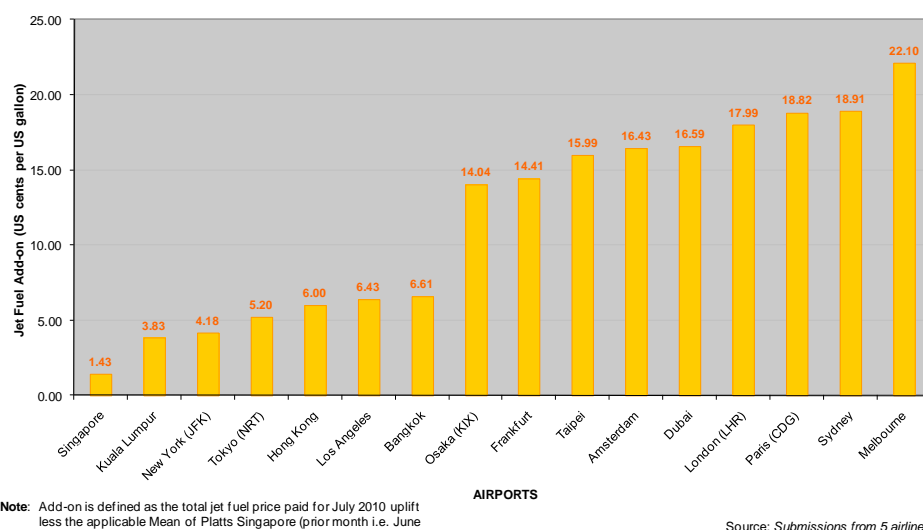
Figure 1 shows some representative fuel differentials for July 2010 as provided by the International Air Transport Association (IATA). Sydney (and Melbourne) Airports are characterised by the highest fuel differentials in the world.

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<sup>1</sup> See *Sydney Airport Master Plan – Annexure 2*

<sup>2</sup> See Shell (12 April 2011) Proposal on future of Clyde Refinery, Press Release – Annexure 4

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



Source: IATA.

The provision of jet fuel at Sydney Airport has been characterised by poor reliability. In response to the disruptions in the supply of jet fuel at Sydney Airport in 2003, a National Operating Committee (NOC) was established by the then four major fuel suppliers to monitor and advise on potential jet fuel supply disruptions and manage supply disruptions. This means that, rather than allowing competition and more diversity in supply to improve reliability and pricing, it is administered by the existing oil companies, with the costs ultimately passed onto airlines and passengers.

### Access to jet fuel supply infrastructure

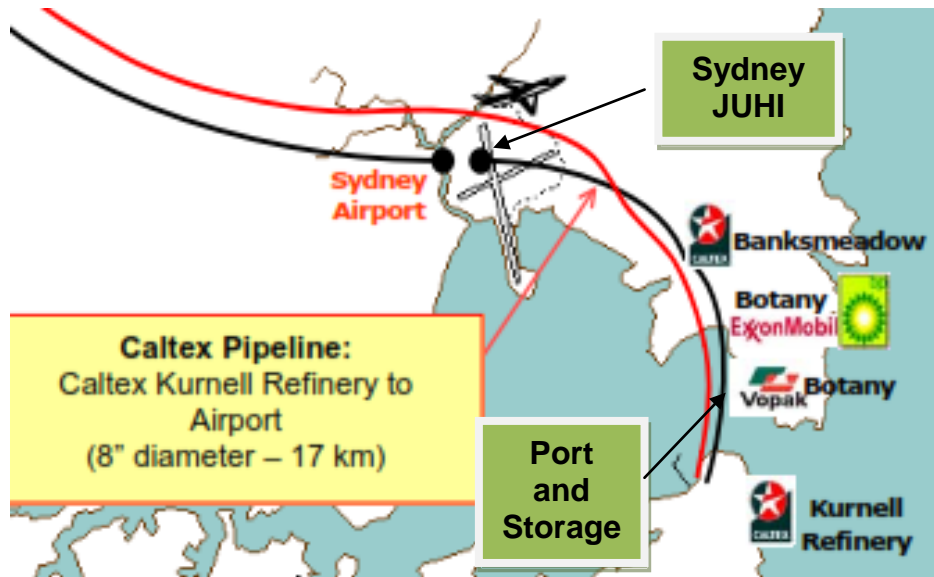
The current excessive pricing and poor reliability problems can be directly addressed through greater competition between the suppliers of jet fuel, by encouraging the entry of new suppliers. There is considerable potential to increase the number of jet fuel suppliers beyond the three incumbent oil companies. Many overseas airports are supplied by six or more providers and such competitive arrangements also could be achieved in Sydney.

To create an environment that promotes effective competition between jet fuel suppliers, it will be necessary for new suppliers (importers) to gain access to the jet fuel supply infrastructure on reasonable terms and conditions. Potential suppliers will need access to:

1. the common-user bulk liquids berth at Botany, currently provided by Sydney Ports Corporation;
2. off-airport storage facilities at Botany, currently provided by Vopak (and possibly other facilities located nearby);
3. the pipeline from the point of interconnection between Vopak's storage facilities and Sydney Airport, currently provided by Caltex (the Caltex Pipeline); and
4. The Sydney Airport Joint User Hydrant Installation (the Sydney JUHI), which stores and distributes jet fuel, currently a joint venture between the major oil companies, with Qantas as an additional Participant.

A map showing the jet fuel supply infrastructure is provided in Figure 2 below.

Figure 2 **Map of the supply infrastructure for imported jet fuel**



Source: Sydney Jet Fuel Infrastructure Working Group Report (2010).

The Applicant considers that open, non-discriminatory access is currently available through Sydney Ports Corporation and the off-site storage facilities provided by Vopak. The Applicant, 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.

### **Vertically integrated supply, the Caltex Pipeline**

The Caltex Pipeline represents 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

The only common-user bulk liquids berth in NSW is available at Port Botany on the northern side of Botany Bay, approximately 9km from Sydney Airport. Once imported jet fuel arrives at Botany, it is transferred to off-site storage facilities owned by Vopak.<sup>3</sup> The Vopak facility in turn has an interconnection point with the Caltex Pipeline, which transports the jet fuel from the interconnection points to the Sydney JUHI at Sydney Airport.

This jet fuel initially enters the JUHI Jet Fuel Storage Facility. From this storage facility, the fuel is transported through the JUHI Jet Fuel Hydrant Pipeline Network Facility or via refuelling trucks to the on-airport aircraft refuelling points. Finally, into-plane services (using qualified personnel) oversee the transfer of the jet fuel from the hydrant network (or refuelling truck) into the aircraft.

<sup>3</sup> The Sydney Jet Fuel Infrastructure Working Group Report (2010) identifies two off-site storage facilities that connect to the Caltex Pipeline at Port Botany. They are the Vopak facility and one jointly owned by ExxonMobil and BP. The Applicant understands that, subsequent to the recent exit of ExxonMobil from the jet fuel market, the storage facilities at Port Botany owned by BP/ExxonMobil are no longer used for jet fuel storage and that BP has secured storage capacity for jet fuel at the Vopak facility. This means that currently the only common user storage facility that connects to the Caltex Pipeline is the facility owned by Vopak.

As in any production process, every stage is critical to ensure the delivery of the final product. However, there are several key features in this market that are essential in terms of this application for Declaration. First, the only common user bulk liquids berth available is at Port Botany. All imported jet fuel for Sydney Airport (other than that imported by Shell, which has its own fuel import terminal) is, therefore, limited to the current supply infrastructure chain available from Port Botany to Sydney Airport.

The Caltex Pipeline represents an essential element of the jet fuel infrastructure supply chain. The least cost way transporting jet fuel from the off-site storage facilities at Port Botany to the Sydney JUHI is via the Caltex Pipeline. This situation will not change until the jet fuel transport requirements reach (or approach) the maximum capacity of the Caltex Pipeline. Once this occurs, and only at such time, would it be socially and privately profitable for an additional pipeline(s) to be constructed from the off-site storage facilities to Sydney Airport. Given the recent decisions by Caltex to increase the capacity of its Pipeline to its maximum possible capacity,<sup>4</sup> the Pipeline can meet forecast demand until about 2020.

Therefore, at the current capacity and forecast levels of demand, it is uneconomic (socially inefficient) to duplicate the Caltex Pipeline between Port Botany and Sydney Airport until about 2020.

Further, a competing pipeline is estimated to cost about \$50 million to \$60million. It would be financially unprofitable to build a competing pipeline while there is still excess capacity available in the Caltex Pipeline. A second pipeline would ensure high levels of excess capacity, resulting in strong competition between two pipeline providers with high sunk costs, but low marginal costs. The excess capacity would likely lead to prices (i.e. prices close to the low marginal cost) that would be too low to recover the sunk costs of building the infrastructure. Anticipating this, a potential pipeline provider could not reasonably expect to earn a sufficient return to cover the cost of capital required to construct a competing pipeline. The second pipeline would also promote competitive market outcomes in the jet fuel market at Sydney Airport. Consequently, a firm constructing a second pipeline could not anticipate high returns in the jet fuel market 'cross subsidising' the cost of constructing the pipeline.

The Shell Pipeline from its import storage facility at Gore Bay through to Sydney Airport, via Clyde, is of limited capacity relative to the requirements of Sydney Airport. This is because it is unable to be upgraded so as to significantly alter its contribution to the volumes required at Sydney Airport. This means that the Shell Pipeline does not present a viable alternative to the Caltex Pipeline for jet fuel suppliers to transport their fuel to Sydney Airport.

Given planning approvals and construction timeframes, it is expected to take about a further five years for an additional pipeline to be available to transport jet fuel even after a decision to construct the pipeline is made in the first place. The available capacity of the Caltex Pipeline, combined with the planning approval and construction timeframes for a competing pipeline, ensure the monopoly status of the Caltex Pipeline for many years into the future.

Through its ownership and control of its Pipeline, Caltex has the incentive and ability to limit competition between the providers of jet fuel at Sydney Airport. This can occur in two ways. First, even when there is excess capacity in the Pipeline, so that there is sufficient capacity for Caltex to provide access to third parties without disrupting the transport of its own jet fuel, Caltex has an incentive to limit the time (capacity) allocated to transfer jet fuel from the Vopak facility, reducing the quantity of jet fuel supplied by its

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<sup>4</sup> Caltex Investment to Benefit Sydney Air Travel, Press Release – Annexure 3.

rivals. This limits the volume of jet fuel rival providers can seek to sell to the airlines and other jet operators conducting business from Sydney Airport.

Second, the Applicant understands that jet fuel suppliers must negotiate with Caltex directly for access to its Pipeline, rather than through Vopak having its own access agreement with Caltex for the transport of jet fuel from its off-site storage facility to the Sydney JUHI. Caltex, therefore, has the ability to refuse or limit access on a supplier-by-supplier basis. This provides Caltex with the ability to limit both the quantity of competing jet fuel and the number of rival suppliers.

As evidence to this, several airlines have highlighted difficulties experienced in successfully tendering for fuel supplies at Sydney Airport. The airlines affected have advised that, for some tenders, all suppliers apart from Caltex declined to bid. The generally advised reasons cited by the declining suppliers for this situation were 'due to supply constraints'. However, in the case of one of the tenders, one supplier reported specifically that it had to withdraw from the tender as the supplier had 'been refused additional pipeline access to the Caltex Pipeline'. This outcome demonstrates that Caltex has the incentive and ability to use its market power through its ownership of the Pipeline to limit the level of competition between jet fuel suppliers at Sydney Airport.

Given the high HHI value, combined with the substantial barriers to entry associated with the Caltex Pipeline (and the Sydney JUHI, subject to a separate but related application for Declaration), the Applicant submits that it must be concluded that the incumbent suppliers of jet fuel at Sydney Airport have considerable market power.

Given the market power afforded to Caltex through its Pipeline, the Applicant considers that Caltex supplies an inflated level of jet fuel at Sydney Airport compared to a competitive market situation. By restricting competition, Caltex provides a larger share of the jet fuel market at Sydney Airport, which in turn provides Caltex with the argument that it has little available capacity to provide to rival suppliers.

### **This application for declaration**

The Applicant represents the interests of international airlines operating to and from Australia. The Applicant's membership currently comprises 30 scheduled airlines, which presently provide over 90% of the international flights to and from Sydney.

The Applicant's members have a keen interest in access, service delivery and pricing issues at Australia's capital city and major regional airports. The Applicant has authorisation from the Australian Competition and Consumer Commission (ACCC) to undertake collective negotiations on a voluntary basis with major international airports, Gold Coast Airport, Airservices Australia and the Bureau of Meteorology.<sup>5</sup> However, the Applicant does not have authorisation to undertake collective negotiations on behalf of its members over the terms and conditions of access to the Caltex Pipeline.

A number of jet fuel providers outside the incumbent oil companies have expressed an interest to the Applicant in having the opportunity to supply jet fuel at Sydney Airport. However, without declaration, it is likely that access to the jet fuel supply infrastructure at Sydney Airport will be limited to the incumbent suppliers, despite the potential opportunities given the forecast growth in demand and reliance on imported jet fuel.

This application seeks declaration of the service provided by the Caltex Pipeline facility. Providing access to alternative suppliers will increase competition in the market for the supply of jet fuel at Sydney Airport. Any increase in competition, with its potential to

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<sup>5</sup> Authorisation number A91200.

decrease prices and improve reliability, could significantly improve overall social wellbeing given the importance to the Australian economy of international and domestic passenger and freight services to and from Sydney Airport.

The Applicant, therefore, seeks declaration of the service provided by the Caltex Pipeline facility for a period of 10 years. The Applicant intends to make a separate but related application with respect to the Sydney JUHI facility. A declaration period of 10 years is considered suitable, given the ability of the Caltex Pipeline to meet forecast demands until about 2020, the time necessary for the planning approvals and construction of an additional pipeline from the off-site storage facilities to the Sydney JUHI and, the initial investments and costs that will be incurred by new suppliers of jet fuel at Sydney Airport.

### **Enhanced competition in three separate markets**

Declaration of the service provided by the Caltex Pipeline will promote competition for the supply of jet fuel, into-plane services and for airline and other jet services at Sydney Airport. If the current arrangements are allowed to continue, it is likely that the projected growth in jet fuel demand will be met from the incumbent suppliers and the potential increases in competition will be lost.

With the growing demand for jet fuel that can only be met through imports, opportunities will become increasingly available for new suppliers to enter and compete for the provision of jet fuel at Sydney Airport. Increasing the level of competition will promote cost competitiveness and greater reliability of supply.

New jet fuel suppliers may also seek to provide 'end-to-end' services to airlines and other jet operators (supply to final delivery into aircraft) and, hence, compete in the market for into-plane services to airlines at Sydney Airport.

Finally, the improvements in competitive conditions in the markets for jet fuel supply and into-plane services will improve the commercial opportunities for domestic and international passenger and freight services from Sydney Airport. As these downstream markets are already competitive, the improvement in commercial conditions will result in a greater service offering and/or lower prices to passengers and freight customers.



## 2. Definitions

### 2.1 The following words have these meanings in this Application:

“**ACCC**” means Australian Competition and Consumer Commission.

“**Caltex Pipeline**” means the pipeline owned and controlled by Caltex, which transports jet fuel from Caltex’s Kurnell Refinery and from interconnection points with off-site storage facilities to the Sydney JUHI, shown on page 22 of **Annexure 1** and Figure 2.

“**Council**” means National Competition Council.

“**GL**” means one gigalitre or one billion litres.

“**IATA**” means International Air Transport Association.

“**Jet Fuel Hydrant Pipeline Network Facility**” or “**Hydrant Network**” means the underground pipelines from the Jet Fuel Storage Facility to apron hydrant outlets located adjacent to aircraft gates at the international and domestic terminals at Sydney Airport, owned by the JUHI JV, shown in page 52 of **Annexure 1**.

“**Jet Fuel Storage Facility**” or “**Storage Facility**” means the jet fuel storage facility, including facilities for dispensing fuel to refuelling trucks, owned by the JUHI JV, at Sydney Airport, shown in page 51 of **Annexure 1**.

“**JUHI JV**” means the joint venture between the JUHI Participants.

“**JUHI Participants**” means:

- Shell
- Caltex
- BP
- ExxonMobil
- Qantas,

as further defined in para 6.6.

“**ML**” means one megalitre, or one million litres.

“**Operator**” means Shell, which operates the Sydney JUHI on behalf of the JUHI Participants.

“**Qantas**” means Qantas Airways.

“**SACL**” means Sydney Airport Corporation Limited.

“**Service**” means the service set out in paragraph 4.1.

“**Shell Pipeline**” means the pipeline owned and controlled by Shell, which transports jet fuel from Shell’s Clyde Refinery to the Sydney JUHI, shown on p.22 of **Annexure 1**.

“**SJFIWG Report**” means the Sydney Jet Fuel Infrastructure Working Group Report dated 30 April 2010, attached at **Annexure 1**.

“**Sydney Airport**” means Sydney Kingsford Smith Airport.

“**Sydney Airport Master Plan**” means the *Sydney Airport Master Plan 2009*, the relevant parts of which are contained in “**Annexure 2**”

“**Sydney JUHI**” means the Sydney Airport Joint User Hydrant Installation, owned by the JUHI JV and operated by the Operator, including the Jet Fuel Storage Facility and the Jet Fuel Hydrant Pipeline Network Facility.

### 3. Applicant Details

#### 3.1 Who is the Applicant?

The Board of Airline Representatives of Australia Inc (BARA), on its own behalf and on behalf of its current members as set out in **Schedule "A"** (the **Applicant**).

BARA is the industry representative organisation representing the interests of international airlines operating to and from Australia. BARA has been established as an incorporated body for 21 years. Prior to that BARA operated for many years as an unincorporated body.

BARA aims to establish a recognised means of communication between member airlines and statutory and other organisations whose interests and actions influence or affect member airlines and the aviation industry. Its purpose is to act on issues affecting the aviation industry in Australia and to provide a single concerted voice on policy and other matters.

BARA represents most of the airline carriers using Sydney Airport. BARA members presently provide over 90% of the international flights to and from Sydney.

BARA has authorisation from the ACCC to collectively negotiate on behalf of its members for the provision and pricing of international aeronautical services and facilities at major international airports, including the provision of refuelling infrastructure (authorisation number A91200). BARA’s activities are voluntary for all parties. Each airline may choose to negotiate different terms and conditions from those negotiated through BARA. Airport operators or aircraft refuelling infrastructure providers are also not required to negotiate with BARA.

BARA does not have authorisation to negotiate on behalf of its members the terms and conditions of access to the Caltex Pipeline.

#### 3.2 Who is the Applicant’s representative?

Mr Richard Davis  
 C/- HWLE Ebsworth Lawyers  
 Level 11-14  
 264-278 George St  
 SYDNEY NSW 2000  
 Telephone: 02 9334 8707  
 Facsimile: 02 1300 369 656  
 Email: richard.davis@hwlebsworth.com .au

#### 3.3 Contact details.

As above.

## **4. Service for which access (or increased access) is sought**

### **4.1 The Service**

The service provided by the Caltex Pipeline facility, which transports jet fuel from the interconnection points with off-site jet fuel storage facilities at Port Botany to the Sydney JUHI.

On page 22 of **Annexure 1** is a map showing the jet fuel infrastructure supply chain, including the Caltex Pipeline.

### **4.2 Describe how, and for what purpose, the Applicant intends to use the Service?**

Provide jet fuel to international passenger and freight aircraft operating to or from Sydney Airport.

The Applicant's members do not negotiate access to the Caltex Pipeline directly. Instead, the airlines enter into contracts with the suppliers of jet fuel. The jet fuel suppliers (except Caltex itself), in turn, negotiate access to the Caltex Pipeline.

This declaration will be available to any airline or jet fuel supplier providing passenger and freight services to or from Sydney Airport.

### **4.3 What are the reasons for seeking access to the Service?**

The Applicant seeks increased access so that its members have an enhanced ability to source jet fuel from existing and new suppliers and to ensure the declared services are provided on fair and reasonable terms.

The demand for jet fuel is expected to almost double from a current demand of about 2.9 GL per year to over 5.6 GL per year by 2029.

Since about 2009, the total demand for jet fuel at Sydney Airport has begun to consistently exceed local refinery production (by Caltex and Shell). This means that imports of jet fuel will be necessary to meet the forecast growth in demand. Shell also recently announced its decision to convert its Clyde Refinery into a fuel import terminal. The majority of Sydney Airport's long-term jet fuel requirements will, therefore, be met through imports.

The suppliers of jet fuel at Sydney Airport are currently limited to three of the four main oil companies (namely Caltex, BP and Shell; the Applicant understands that ExxonMobil withdrew from the market in 2010), with Qantas undertaking a limited amount of 'self supply'. By separating the provision of the Service from the final product itself via declaration, there is considerable potential to increase the number of jet fuel suppliers. Many overseas airports are supplied by 6 or more providers and the Applicant considers that the market for jet fuel at Sydney Airport can sustain more than the incumbent providers.

The Caltex Pipeline represents an essential element of the infrastructure supply chain. The least cost way transporting jet fuel from the off-site storage facilities at Port Botany to the Sydney JUHI is via the Caltex Pipeline. This situation will not change until the jet fuel transport demands reach the maximum capacity of the Caltex Pipeline. Once this occurs and only at such time, would it be socially and privately profitable for an additional pipeline(s) to be constructed from the off-site storage facilities to Sydney Airport. Given the recent decisions by Caltex

to increase the capacity of its Pipeline to its maximum possible capacity,<sup>6</sup> the Pipeline can meet forecast demand out to about 2020.

With access being granted, there will be greater scope for the Applicant's members to source jet fuel at Sydney Airport beyond the incumbent oil companies. Increasing the level of competition between jet fuel suppliers will promote cost competitiveness and greater reliability of supply. Granting access will also enhance the competition for 'into-plane' services (the delivery of fuel from the hydrants into aircraft). The improvements in competitive conditions in the market for jet fuel and into-plane services will improve the commercial opportunities not only for the Applicant's members to provide international passenger and freight services from Sydney Airport, but also for all other operators of domestic and international jet aircraft services at Sydney Airport, whether scheduled or unscheduled, including all general aviation services provided by jet aircraft.

**4.4 What activities would the Applicant undertake if access was provided – what products and/or services would it produce?**

International passenger and freight jet aircraft services to and from Sydney Airport.

**4.5 What would be the consequences for the Applicant and others if access was not obtained?**

If access was not obtained, the Applicant's member airlines would continue to face the current market conditions, namely limited competition for a necessary input, jet fuel. The Applicant's members can currently obtain jet fuel through their contracts with providers (which in turn obtain access to the Caltex Pipeline). To the extent this vertically-integrated supply chain has resulted in higher prices for jet fuel, failure to obtain access will severely impede the Applicant's members from more competitively conducting their business by restricting the opportunity for a competitive market for jet fuel developing.

IATA states that jet fuel costs represent about one third of total airline costs.<sup>7</sup> Any improvement in the pricing and reliability of supply of this major cost item will ultimately improve the commercial opportunities for international and domestic airlines to provide passenger and freight services to customers. The current monopoly position of the Caltex Pipeline is, therefore, reducing the commercial opportunities for international and domestic passenger and freight services to and from Sydney Airport.

**4.6 What alternative ways could the Applicant produce or deliver its products or services? Or would it choose not to produce or deliver those products or services if access were not granted?**

If access were not granted, the status quo would remain. In this case the Applicant's members will continue to source the majority of their jet fuel needs via the Caltex Pipeline, through what is essentially a vertically-integrated monopoly.

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<sup>6</sup> Caltex (5 May 2010), Caltex Investment to Benefit Sydney Air Travel, Press Release – Annexure 3

<sup>7</sup> See <http://www.iata.org/ps/consulting/Pages/fuel-consulting.aspx>

The current arrangements result in higher jet fuel prices and less reliability of supply. Theoretically, airlines might resort to 'alternative' and very costly techniques to shift their purchases of jet fuel from Sydney to other locations. For example, international airlines could rely on a combination of 'tankering' and 'technical stops' to be able to provide a greatly reduced range of international passenger and freight services.

Tankering is the practice of uplifting extra fuel on planes at an alternative airport to remove or reduce the need for uplifting fuel at another airport. Tankering, when used, is generally only for flights that are less than about three hours duration (depending on the type of aircraft used).

Technical stops involve landing at another airport between a flight's origin and destination for the additional uplift of fuel. Technical stops increase flight times, increasing total aircraft operating costs, including:

- Fuel
- Crew
- Aircraft maintenance
- Airport fees
- Air navigation fees.

The Applicant does not consider that either tankering or technical stops represent viable options for the long-term provision of international passenger and freight air transport services to and from Sydney Airport. Rather, they represent expensive, 'stop gap' measures employed during short-term disruptions to available jet fuel supply at particular airports. Indeed, given the cost of jet fuel, airlines seek to minimise the total weight of aircraft to minimise necessary fuel burn.

If jet fuel could not be transported to Sydney Airport via the Caltex Pipeline, then supply would be limited to the Shell Pipeline. The Shell Pipeline cannot transfer enough jet fuel to meet Sydney Airport's daily jet fuel demands. The likely outcome would, therefore, be a substantial reduction in the destinations and frequency of services available through Sydney Airport. It is likely that many international flights to the east coast of Australia would only be offered between Melbourne and Brisbane. It would then be necessary for passengers to board domestic flights, where tankering could be more possible, to travel to Sydney.

Note, all of these options involve considerable cost to airlines and, as a consequence, to the final consumers of air services. On this, it is worth noting two points. First, the alternative methods of sourcing jet fuel are very costly, which gives a monopoly supplier of jet fuel considerable scope to raise its price (considerable market power). Second, these alternative methods of sourcing jet fuel are a significantly higher cost alternative compared to granting access to the Caltex Pipeline.

**4.7 If the Applicant is seeking access to multiple services, describe how these services interrelate?**

No.

**4.8 Why is access to all of these services necessary?**

N/A.

**4.9 What are the consequences of not obtaining access to each of the services?**

N/A.

**5. Facility used to provide the service**

**5.1 Describe the facility(ies) used to provide the service?**

The Caltex Pipeline is approximately 17 km long. It runs from Caltex's Kurnell Refinery to the Sydney JUHI. The Pipeline is predominately 254mm (10 inch) diameter between Kurnell to Botany and 200mm (8 inch) from Botany to the Sydney JUHI.

There are currently two supply points along the Pipeline. The first is from Caltex's Kurnell Refinery. The second is the interconnection point with pipeline from the off-site jet fuel storage facilities owned by Vopak.<sup>8</sup>

**5.2 Where is the facility(ies) located?**

The Caltex Pipeline runs from Kurnell to the Sydney JUHI. See page 22 of Annexure 1.

**5.3 What is the minimum bundle of assets that must be declared to provide the service?**

The entirety of the Caltex Pipeline.

**5.4 Why do all of these assets form the minimum bundle necessary to provide the service?**

See 4.3.

**5.5 How are/would the facility(ies) be used to provide the service?**

To transport jet fuel from the off-site storage facilities to the Sydney JUHI.

**5.6 How would using the facility(ies) to provide the service affect the provision of other services?**

N/A. No other service is provided by the Caltex Pipeline.

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<sup>8</sup> The SJFIWG Report identifies two off-site storage facilities that connect to the Caltex Pipeline at Port Botany. They are the Vopak facility and one jointly owned by ExxonMobil and BP. The Applicant understands that, subsequent to the recent exit of ExxonMobil from the jet fuel market, the storage facilities at Port Botany owned by BP/ExxonMobil are no longer used for storage of jet product and that BP has secured storage capacity for jet fuel at the Vopak facility. This means that currently the only common user storage facility that connects to the Caltex Pipeline is the facility owned by Vopak.

**5.7 Is the owner or operator of the facility(ies) vertically integrated or associated with other entities operating in other parts of the production or distribution chain? If so, describe the nature of its relationship with the associated entities.**

Yes.

Caltex is vertically integrated throughout the supply chain. It produces jet fuel from its Kurnell Refinery, 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.

**6. The service provider**

**6.1 Identify the service provider**

Caltex.

**6.2 Provide contact details for the service provider**

Mr Ken James  
GM Supply & Distribution  
Caltex Australia Petroleum Pty Ltd  
2 Market Street  
Sydney NSW 2000

**6.3 Which entity is the operator of the facility (if different from 6.1 above)?**

As 6.1.

**6.4 Which entity is the owner of the facility (if different from 6.1 above)?**

As 6.1.

**6.5 Are any of the above entities a partnership or joint venture? If so, who are the parties to that partnership or joint venture?**

Not for the Caltex Pipeline. Caltex is a Participant in the JUHI JV.

**6.6 Provide name and contact details, including details of the registered office for all of the entities identified above.**

N/A.

**6.7 Is the provider of the service owned by a state or territory government? If so, which government(s) owns the provider?**

No.

## **7. History of access negotiations**

### **7.1 Outline any history of previous access negotiations with the service provider**

The Applicant does not have authorisation from the ACCC to negotiate on behalf of its members the terms and conditions of access to the Caltex Pipeline. As such, the Applicant has not sought to conduct any negotiations with Caltex over the terms and conditions of access to the Caltex Pipeline.

### **7.2 What were the services under negotiation?**

See 7.1.

### **7.3 When did the negotiations take place and how long did they last?**

See 7.1.

### **7.4 What was the response of the service provider to the Applicant's attempt to negotiate access?**

See 7.1.

### **7.5 What were the outcomes of the negotiations for the Applicant?**

#### **(a) What matters could not be agreed?**

- See 7.1.

#### **(b) Why did the Applicant consider that the service provider's offer (if any) was unreasonable?**

- See 7.1.

## **8. Other interested parties**

### **8.1 Identify and provide contact details for other parties likely to be interested in the application.**

The Applicant has identified the following parties that are likely to be interested in the application:

#### **(a) Sydney Airport Corporation Limited (SACL)**

Contact: Ms Kerrie Mather  
Chief Executive Officer  
Sydney Airport Corporation Limited  
Locked Bag 5000  
Sydney International Airport NSW 2020



**(b) The International Air Transport Association (IATA)**

Contact: Mr Malvyn Tan  
Assistant Director Industry Charges, Fuel and Taxation  
International Air Transport Association  
111 Somerset Road, #14-05  
Singapore 238164

**(c) Regional Airlines Association of Australia (RAAA)**

Contact: Mr Paul Tyrell  
Chief Executive Officer  
Regional Airlines Association of Australia  
Unit 11, 26-28 Winchcombe Court  
Mitchell ACT 2911

**(d) Australian Business Aircraft Association (ABAA)**

Contact: Mr David Bell  
Executive Director  
9 Guthrie Avenue  
Cremorne NSW 2090

**(e) Tiger Airways Australia Pty Limited** (as the only other domestic jet RPT operator not being a member of the Applicant):

Contact: Tony Davis  
Chief Executive Officer  
PO Box 2101  
Gladstone Park  
Victoria 3043

**(f) International Airlines - not being members of the Applicant:**

Adagold Aviation  
Aerolineas Argentinas  
Air Austral  
Air China  
Air France  
Air Niugini  
Asiana Airlines  
British Airways

China Airlines  
China Eastern Airlines  
Hainan Airlines  
Hawaiian Airlines  
Iberia Airlines  
Kenya Airways  
KLM Royal Dutch Airlines  
Lan Airlines  
Norfolk Air  
Scandinavian Airlines

**(g) International and Domestic Freight Operators - not being members of the Applicant:**

Atlas Air  
Federal Express  
Polar Air  
Tasman Cargo Airlines  
Toll Priority  
United Parcel Service Company

**(h) Other jet fuel suppliers (non-exhaustive):**

Contacts:

Mr Julian Amesbury  
Business Development Manager  
**Q8 Aviation**  
PO Locked Bag Q800, QVB Post Office  
Sydney NSW 1230

Mr Ong Sing lim  
Director  
**Vitol Aviation Company Pte. Ltd.**  
260 Orchard Road, The Heeren #13-01  
Singapore 238855

The Business Development Manager

**World Fuel Services**

#17-03 Novena Square Tower A  
238A Thomson Road  
Singapore 307684

The Business Development Manager

**Sinopec (Hong Kong) Limited**

Office Tower, Convention Plaza  
1 Harbour Road  
Wanchai  
Hong Kong

The Business Development Manager

**PetroFina**

52 rue de le-Industrie  
B-1040 Brussels  
Belgium

**(i) Sydney JUHI (and Participants)**

Contact: Julieanne Mamo  
Sydney JUHI Manager  
Gate 2, Link Road  
Mascot NSW 2020

**Shell:** Ms Margaret Kennedy  
Operations and Technical Manager Asia Pacific  
The Shell Company of Australia Limited  
8 Redfern Road  
Hawthorn East VIC 3123

**ExxonMobil:** Mr Stephen Del Monaco  
Regional Aviation Operations Manager – Asia Pacific  
Mobil Oil Australia Pty Ltd  
12 Riverside Quay  
Southbank VIC 3006

**BP:** Mr Geoff Dunne  
Commercial Operations Manager Australia – Air BP  
BP Australia Pty Ltd  
L28, Melbourne Central  
360 Elizabeth Street  
Melbourne VIC 3000

**Qantas:** Ms Jean Elverton  
Head of Procurement Fuel & Aviation Charges  
Qantas Airways Limited  
203 Coward Street  
Mascot NSW 2020

**(j) Other into-plane service providers**

- **Airport Fuel Services Pty Limited**

Peter Klok  
Manager Operations  
GPO Box 3916  
Sydney NSW 2001

- **ZIP Airport Services Pty Limited**

Margaret Kennedy  
Operations and Technical Manager Asia Pacific  
The Shell Company of Australia Limited  
8 Redfern Rd  
Hawthorn East VIC 3123

- **BP Air Refuelling Services**

Geoff Dunne  
Commercial and Operations Manager – Air BP  
BP Australia Limited  
L28, Melbourne Central  
360 Elizabeth St  
Melbourne VIC 3000

## 9. Jurisdiction

### 9.1 Does the service include:

- **the supply of goods;**  
No.
- **the use of intellectual property; or**  
No.
- **the use of a production process?**  
No.

### 9.2 If yes, is this activity an integral but subsidiary part of the infrastructure service?

N/A.

### 9.3 Is the service potentially subject to the access regimes applying to telecommunications or postal services?

No.

## 10. Criterion (b) - uneconomical to develop another facility

### Summary

The Applicant notes that there are various ways of interpreting the criteria of it being 'uneconomical' to develop another facility. Both the Council and Australian Competition Tribunal have consistently interpreted the word 'uneconomical' in a social benefit test, rather than in terms of private commercial interests. The Applicant notes, however, that the Full Federal Court recently construed the question of 'uneconomical' to relate to financial profitability, rather than the costs and benefits of development for society as a whole (see Federal Court of Australia – *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011]). The Council has stated that it respectfully disagrees with the Full Federal Court's interpretation (see National Competition Council, 'Accessible', Issue 13, June 2011).

In this case, it is uneconomical to develop a competing pipeline to the Caltex Pipeline until the jet fuel transport demands reach the maximum capacity of the Caltex Pipeline according to both the social benefit and unprofitability test.

The Caltex Pipeline is an essential facility in the transportation of jet fuel for any importer of jet fuel to Sydney Airport (apart from Shell). As argued elsewhere, the transportation of this jet fuel to Sydney Airport requires the use of the Caltex Pipeline. Moreover, it is categorically less costly to deliver the required jet fuel to Sydney Airport using the Caltex Pipeline than use of any alternative delivery method (namely constructing another pipeline) until the Caltex Pipeline has reached (or nearly reached) its maximum capacity. Consequently, according to a social benefit test, there should only be one pipeline from Vopak's off-site storage facility to the Sydney JUHI until the jet fuel transport requirements reach (or approach) the maximum capacity of the Caltex Pipeline.

It is also the case that developing a new pipeline at the current and foreseeable level of demand given the capacity of the Caltex Pipeline will be unprofitable. A competing pipeline is estimated to cost about \$50 million to \$60 million. A second pipeline would ensure high levels of excess capacity, resulting in strong competition between the two pipelines. The excess capacity would likely lead to prices (i.e. prices close to the low marginal cost) that would be too low to recover the sunk costs of building the infrastructure. Anticipating this outcome, no new provider could reasonably expect to earn its cost of capital on the investment it would make in the competing pipeline.

At this stage, it is not financially profitable for an incumbent oil company to finance the construction of a second pipeline. This is because the strong competition in the jet fuel market (facilitated through two pipelines) could well prevent the prospects of high returns in the jet fuel market covering the losses made from the new pipeline, at current levels of demand for jet fuel. All incumbent oil companies are also likely to benefit from the existing arrangements to some degree, so there is little incentive for any of them to encourage more competitive conditions in the market for jet fuel at Sydney Airport.

It is also not financially profitable for an airline, or group of airlines, to finance the construction of a second pipeline. The competitive nature of the markets for passenger and freight services to and from Sydney Airport means that the benefits of improved competition in the provision of jet fuel will accrue primarily to the final users (passengers and individuals and businesses requiring air freight services). The airlines benefit primarily through increased commercial opportunities given a lower overall cost base, rather than increasing the margins they earn on existing services. Competition between airlines means that individual airlines cannot obtain or sustain excessive returns in the markets they serve. This means that, at current levels of demand, an investment in a competing pipeline on the part of airlines would be unprofitable. The airlines would be unable to capture a sufficient proportion of the reduction in jet fuel costs (in terms of increased airline profits) to fund the cost of a competing pipeline.

#### **10.1 Identify and describe any other facility(ies) that could provide the same service as the service for which access is sought.**

There is no other facility available.

The Sydney JUHI is also served by a pipeline from the Shell Clyde Refinery. The Shell Pipeline, however, is not considered a viable alternative for importers of jet fuel apart from Shell. In the first instance, the Applicant understands that, currently, the Gore Bay terminal is primarily used to import crude oil, which is then processed at its Clyde Refinery.

Shell recently announced its decision to convert its Clyde Refinery into a fuel import terminal.<sup>9</sup> However, the Applicant is unaware of any intention of Shell to make its facilities open to other importers of jet fuel.

More crucially, however, the Shell Pipeline is also of limited capacity, estimated to serve about one quarter of Sydney Airport's jet fuel requirements. The maximum capacity of the Shell Pipeline is stated to be about 3.9 ML per day which Shell currently utilises at an average rate of 56%. This indicates that there is only 1.7 ML per day capacity available for alternative suppliers of jet fuel. This compares to the current 7.9 ML per day transfer capacity available through the Caltex Pipeline from Vopak's storage facility.

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<sup>9</sup> See Shell (12 April 2011) Proposal on future of Clyde Refinery, Press Release – Annexure 4

All of these characteristics mean that the only viable option for importers of jet fuel is through the common-user bulk liquids berth at Port Botany, off-site storage facilities at Port Botany and then transport to the Sydney JUHI via the Caltex Pipeline.

## 10.2 Demand for Service

### (a) What is the current level of demand for the Service:

- **by the service provider**

The stated capacity of the Caltex Pipeline from Caltex's Kurnell Refinery is 5.0 ML per day (see SJFIWG Report). The SJFIWG Report also states that Caltex makes its Pipeline available to other users five days per month. This indicates that Caltex makes use of its Pipeline to transport jet fuel to the Sydney JUHI 305 days per year.

As the Caltex Pipeline can transport jet fuel from only one interconnection point at a time, Caltex effectively uses about 84% (305/365) of available capacity.

- **by any existing access users (including the Applicant); and**

The current existing users are BP, Shell (not all jet fuel supplied by Shell to Sydney Airport is delivered via the Shell Pipeline) and Qantas' self supplier via Vopak's off-site storage facility. The stated transfer capacity from the Vopak storage facility is 7.9 ML per day. The SJFIWG Report states that Caltex makes its pipeline available to other users five days per month. This indicates that transfers from Vopak's off-site storage facilities occur 60 days per year. This indicates that existing users account for about 15% of available capacity.

- **by users of other facilities that provide the same service?**

As explained in 10.1, the Applicant does not consider that the Shell Pipeline represents a viable option for importers of jet fuel other than Shell. Thus, while the pipeline provides a jet fuel transport service from Shell's Clyde Refinery to the Sydney JUHI, it does not provide a viable alternative for importers of jet fuel other than Shell.

The stated capacity of the Shell Pipeline is 3.9 ML per day. The SJFIWG Report states that Shell currently utilises 56% of its Pipeline's stated capacity.

- (b) **Are there existing contractual arrangements that reserve capacity for particular parties? If so, what is the duration of these arrangements? Can third parties enter into commercial arrangements to use any reserved capacity?**

The Applicant does not have information on the contractual arrangements between Caltex and importers of jet fuel. However, the SJFIWG Report states that:

The scheduling of jet fuel transfers within the Caltex pipeline is Caltex's responsibility and is done in accordance with its pipeline access agreements with the parties involved. The agreements currently allow third parties to utilise the pipeline for approximately a total of five days per month. Negotiations to renew arrangements following the increased pumping capacity from Vopak facility are underway. The net effect for the Vopak jet fuel customers will be a function of flow rates and access agreements. (p.25).

Caltex may be prepared to provide the Council with further detail on the contractual arrangements it has in place for granting access to its Pipeline.

- (c) **If access was granted, what would be the expected level of demand over the period for which declaration is sought:**

The demand for the transport of jet fuel through the Caltex Pipeline is a function of the total demand for jet fuel at Sydney Airport, less the supply provided from the Shell Pipeline. Growth in the demand for jet fuel at Sydney Airport will, therefore, increase the daily transfers of jet fuel required.

Table 1 below shows the average daily demand forecast to 2029 for jet fuel at Sydney Airport (2009 actual).

Table 1 **Average daily jet fuel demand at Sydney Airport, ML per day**

	<b>2009</b>	<b>2014</b>	<b>2019</b>	<b>2024</b>	<b>2029</b>
<b>Average</b>	6.7	9.5	10.8	13.3	15.5

Based on a simple linear extrapolation of the stated demand levels at 2009 and forecast for 2014, total current demand for jet fuel at Sydney Airport is estimated to be about 8.2 ML per day.

The Applicant considers that if access was granted, total jet fuel demand at Sydney Airport will be higher, increasing the demands on the Caltex Pipeline. This is because of the improved commercial conditions for the Applicant's members in conducting international passenger and freight services and for other operators of jet aircraft in conducting their services at Sydney Airport. The Applicant cannot quantify the extent of the increases at this stage. However, if prices for jet fuel are lower and supply is more reliable as a result of declaration, the demand for jet fuel will be higher. This would occur through previously abandoned loss-making or marginal routes becoming profitable and, generally, airlines



and other jet aircraft service providers expanding business at Sydney Airport through additional services. Further, airlines or other operators could shift some of their fuel purchases to Sydney Airport, where such a substitution is possible (although likely to be very limited, see comments under 4.6).

- **by the service provider**

With access granted, it can be expected that Caltex would likely lose market share to new entrant suppliers. However, while potentially losing market share as a proportion of total market volumes, Caltex's actual jet fuel volumes may increase, given the forecast increase in overall jet fuel demand.

- **by the Applicant**

The Applicant's member airlines (with Qantas undertaking a level of self supply) obtain the jet fuel they require through contracts with jet fuel suppliers. These suppliers in turn must negotiate access to the Caltex Pipeline. Given an improvement in the competitive conditions for the supply of jet fuel and into-plane services, the Applicant's member airlines will have enhanced commercial opportunities in providing international passenger and freight services at Sydney Airport. This in turn will generate increased demand for jet fuel compared to the existing arrangements.

- **by any other existing users**

With access granted, it can be expected that the existing incumbent oil companies (currently Caltex, Shell and BP) would likely lose market share to new entrant suppliers. However, while potentially losing market share as a proportion of total volume supplied, the actual jet fuel volumes supplied may increase, given the forecast increase in overall jet fuel demand.

- **by any other new parties taking up access; and**

The Applicant considers that, with access granted, there is considerable potential for new suppliers to enter the Sydney Airport jet fuel market. The Applicant's member airlines have identified the following suppliers whose entry into the market could be facilitated through declaration:

- Kuwait Petroleum Aviation (Australia) Limited
- PetroFina Company Limited
- Sinopec (Hong Kong) Limited
- Vitol Asia Pte. Ltd.
- World Fuel Services

It is not possible at this stage to forecast the level of demand that could be met from these new suppliers with access granted. This is because the strategic response of the existing suppliers is

unknown. For example, it may be that by reducing the barriers to entry into the market for jet fuel at Sydney Airport, the existing suppliers are compelled to improve the cost and reliability of their supply to maintain their respective market shares. However, the Applicant considers that given the interest from alternative suppliers, the more likely outcome is for the existing suppliers to lose proportionate market share as new suppliers enter the market.

- **by users of other facilities that provide the same service?**

There are no other facilities providing the same services (see 10.1).

- (d) **If access was not granted, what would be the expected level of demand over the period for which declaration is sought:**

- **by the service provider**

It is likely that Caltex will increase its market share of the supply of jet fuel at Sydney Airport. Caltex has announced its intention to double the transport capacity of the Caltex Pipeline from about 5 ML per day to 10 ML per day. Given Caltex's control over this essential infrastructure, Caltex is well placed to ensure it obtains an increasing share of the growing jet fuel demands at Sydney Airport.

- **by the Applicant**

The Applicant's member airlines (with Qantas undertaking a level of self supply) obtain the jet fuel they require through contracts with jet fuel suppliers. These suppliers in turn must negotiate access to the Caltex Pipeline.

Without declaration, the status quo arrangements will continue. Demand for jet fuel by the domestic and international airlines (through their contracts with fuel suppliers) could be expected to almost double from a current demand of about 2.9 GL per year to over 5.6 GL per year by 2029, consistent with the status quo assumptions implicitly assumed in the SJFIWG Report.

- **by any other existing users**

Given Caltex's commitment to increase the capacity of the Caltex Pipeline, it is likely that existing users will lose market share in line with Caltex increasing its market share (see above).

- **by any other new parties taking up access, and by users of other facilities that provide the same service?**

If access was not granted, there are unlikely to be any new entrants into the market for the supply of jet fuel at Sydney Airport. The incentive for Caltex to allow for new entrants to compete in the provision of jet fuel at Sydney Airport depends on the expected impact on its profitability, rather than an assessment of the potential net social benefits. Notably, the incentive for Caltex to grant access to its Pipeline depends on the impact on its

profitability over its entire vertically integrated production chain. Crucial in this calculation will be recognition of the fact that allowing access to the Pipeline to new jet fuel importers increases the competition that Caltex will face in the jet fuel market. Given that allowing access will increase the number of jet fuel competitors that Caltex must face in the jet fuel market, it therefore seems likely that there will be little, if any, incentive for Caltex to allow the entry of new rival suppliers. It is not in the financial or strategic interest of Caltex to allow increased competition in the provision of jet fuel at Sydney Airport.

There are no other facilities providing the same services.

- (e) **Explain how current and expected demand — with and without access being granted — have been calculated and the assumptions made in that calculation. Provide evidence to support the estimates and the sources of that evidence.**

Current and forecast levels of demand are sourced from the SJFIWG Report. The Applicant has not sought to quantify the increase in demand with access granted.

### 10.3 Capacity of the facility

- (a) **What is the total current capacity of the facility?**

Table 2 shows the current daily capacity of the Caltex Pipeline from the three possible interconnection points. Note: The Pipeline can only transfer jet fuel from one of the three interconnection points at any point in time. The stated transfer capacities in Table 2 are, therefore, not cumulative.

Table 2 **Transfer capacity at the interconnection points**

Interconnection point	Maximum daily throughput
Kurnell Refinery	5.0 ML
Vopak	7.9 ML
BP/ExxonMobil <sup>(a)</sup>	4.8 ML

*Notes:* (a) The Applicant understands that the BP/ExxonMobil off-site storage facility is no longer used for the storage of jet fuel.

*Source:* Sydney Jet Fuel Infrastructure Working Group Report (2010), p. 24.

The stated capacity of the Shell Pipeline is 3.9 ML per day. Based on these capacities, the theoretical maximum daily throughput is 11.8 ML per day. However, the current 'typical' transfer rate of the existing infrastructure is approximately 7.6 ML per day.

- (b) **Is some of the facility's current capacity required for provision of services other than those for which declaration is sought or for other purposes?**

No.

- (c) **Does available capacity vary between peak and off peak, seasonally, or based on any similar factors. If so, how does available capacity vary?**

Yes. The available capacity depends on the interconnection point from which jet fuel is transferred (see Table 2). According to the SJFIWG Report, Caltex makes its Pipeline available to other users five days per month.

- (d) **Are there any proposals or plans for alterations to the capacity of the facility. What changes in capacity are needed to meet expected demand?**

Yes. Caltex has committed to upgrading the capacity of the Caltex Pipeline to 10 ML per day.<sup>10</sup> Vopak can also increase the transfer capacity from its interconnection point to 10 ML per day.

- (e) **Explain how capacity was calculated and the assumptions made in that calculation. Provide evidence to support the estimates and the sources of that evidence.**

The Applicant relies on the information and data contained in the SJFIWG Report. The SJFIWG Report draws on various sources of information, including SACL's *Sydney Airport Master Plan*.

#### **10.4 Estimate any expected increase in capital or operating costs if access was provided to the existing facility(ies).**

- (a) **Would it be necessary to expand the existing facility(ies) to meet reasonably foreseeable demand?**

Yes. As detailed in the SJFIWG Report, the capability criterion for the replenishment rate of on-airport stocks uses a target level of 1.2 times daily demand. The growth in this target level of transfers or replenishment rates (from both the Caltex and Shell Pipelines), is shown in Table 3 below.

Table 3 **Target replenishment rates, ML per day**

	<b>2009</b>	<b>2014</b>	<b>2019</b>	<b>2024</b>	<b>2029</b>
	8.0	12.1	13.7	16.6	19.2

The theoretical maximum transfer rate from the existing infrastructure is 11.8 ML per day. However, the current 'typical' transfer rate of the existing infrastructure is approximately 7.6 ML per day.

Caltex has announced its decision to increase the capacity of the Caltex Pipeline from 5 ML per day to 10 ML per day.

Based on the maximum transfer rate of the Shell Pipeline (3.9 ML per day) and an upgraded Caltex Pipeline (10 ML), this option (which includes an upgrade of Vopak pumping capacity), would increase total

<sup>10</sup> Caltex (5 May 2010), Caltex Investment to Benefit Sydney Air Travel, Press Release – Annexure 3

transfer capacity to about 13.9 ML per day. This capacity is consistent with meeting target replenishment rates in 2019 and average daily demand in 2024.

The available information, therefore, indicates that, given the commitments by Caltex to increase the capacity of the Caltex Pipeline, no increases in capacity are required until about 2020. When additional capacity is required, this will result in the need for an additional pipeline from the off-site storage facilities to the Sydney JUHI. This is because Caltex has advised that its Pipeline has no technical ability for any further material increases in capacity (SJFIWG Report, p. 38).

- (b) **Could the capacity of the existing facility(ies) be expanded to meet reasonably foreseeable demand? If so, how would it be expanded and at what cost?**

Yes. Caltex has committed to upgrading the capacity of the Caltex Pipeline at a stated cost of between \$20 million to \$25 million (SJFIWG Report, p. 38). Shell can also increase the use of the Shell Pipeline through converting its Clyde Refinery into an import terminal. This means that the effective capacity of the Shell Pipeline can be increased at little or no marginal cost.

- (c) **Would access affect the cost of operating the existing facility(ies). If so, how would it affect operating costs and what would be the size of the cost change?**

No, or at least it would be minimal, as there are already (limited) third party access arrangements and all necessary third party interconnection facilities are in place. However, if access led to increased cost this presumably would be met by throughput charges levied on new access seekers. Also, see (a) above.

- (d) **Explain how the expected increase in capital and operating costs was calculated and the assumptions made in that calculation. Provide evidence to support the estimates and the sources of that evidence.**

The capital costs of increasing the capacity of the Caltex Pipeline are sourced from the SJFIWG Report.

## **10.5 Estimate the capital and operating costs of developing another facility(ies) to provide the service subject to the application**

- (a) **What are the costs of building and operating another facility(ies) to provide the service?**

### *Capital costs*

A competing pipeline would most likely be built between Vopak's off-site storage facility and the Sydney JUHI. This is because Vopak already has sufficient storage capacity to accommodate additional volumes of jet fuel.

The SJFIWG Report states that the cost of the additional pipeline has been estimated (in 2008) at between \$50 million to \$60 million (SJFIWG Report, p. 41).

*Operating costs*

The Applicant does not have information on the operating costs of the competing pipeline. One could reasonably expect the competing pipeline to have similar pumping and maintenance costs to the existing Caltex Pipeline.

*Permanent bridger facility at an on-airport storage facility*

The other option to transport jet fuel from the off-site storage facilities to the Sydney JUHI is to construct a bridger facility at the on-airport storage facility, which would allow jet fuel to be trucked to Sydney Airport. The SJFIWG Report costed this option at about \$460,000. This option, however, does not represent a viable alternative. This is because the amount of fuel that could be trucked is limited to about 0.5 ML per day, which is only a small proportion of Sydney Airport's jet fuel demands. The SJFIWG Report also states that:

The continual use of jet fuel supply trucks would significantly increase traffic congestion around the immediate JUHI storage area at Sydney Airport and cause disruptions to the operations at the JUHI, with fuel trucks competing with airport freight vehicles for road space. Regulatory and safety considerations would need to be considered to ensure there was minimal increase in safety risks and to minimise traffic congestion.

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These considerations mean that trucking jet fuel to Sydney Airport is not a viable option.

(b) **What would be the capacity and route/location of the new facility(ies)?**

Capacity: The Applicant assumes that any competing pipeline would seek an initial capacity of about 10 ML per day. Depending on the design, namely pipe size, this capacity could potentially be increased in the future through increased pumping capacity.

10 ML per day additional capacity, combined with the existing Caltex and Shell Pipelines, would increase total capacity to about 24 ML per day. This capacity would exceed the target replenishment rates out to at least 2029.

Location: The Applicant has not sought to identify the exact route of the competing pipeline. However, it could be reasonably assumed that the pipeline would follow a similar path to the existing Caltex Pipeline from Vopak's storage facility to the Sydney JUHI.

(c) **How would the capital costs of building another facility(ies) compare with the cost of expanding the existing facility(ies)?**

As Caltex has already committed to upgrading the Caltex Pipeline, these upgrade costs (\$20 million to \$25 million) can be considered sunk for comparison purposes. In addition, Caltex has advised that once completed, the capacity of the Pipeline cannot be upgraded further.

This means that there is no relevant comparison between the costs of upgrading the Caltex Pipeline against a competing pipeline. The Caltex Pipeline is at its maximum possible capacity and, therefore, has no further incremental capacity costs. This capacity is sufficient to meet

target replenishment rates out to about 2020 and average daily demand out to 2024.

- (d) **How would the operating costs of the new facility(ies) compare with the operating costs of the existing facility(ies) with access?**

The Applicant does not have information on the operating and maintenance costs of jet fuel pipelines. However, it reasonably could be assumed that the operating maintenance costs of the competing pipeline and the Caltex Pipeline would be similar.

- (e) **Explain how the expected capital and operating costs were calculated and the assumptions made in those calculations. Provide evidence to support the estimates and the sources of that evidence.**

The estimated capital costs are sourced from the SJFIWG Report.

## **10.6 Identify environmental, planning or other regulations that significantly affect construction of another facility(ies)**

- (a) **Describe the regulation**

The SJFIWG Report contains a description of the key State and Australian Government approval processes and legislation which may apply to future investments in jet fuel supply infrastructure to, or at, Sydney Airport (Appendix F of the SJFIWG Report). A list of the relevant legislation and regulations is provided below.

### NSW Government

- *Environmental Planning and Assessment Act 1979*
- *Pipelines Act 1967*
- *State Environmental Planning Policy (Infrastructure) 2007*
- *Occupational Health and Safety Regulation 2001 – Schedule 3*
- *Protection of the Environment Operations Act 1997*
- *Threatened Species Conservation Act 1995*
- *Contaminated Land Management Act 1997*

### Australian Government

- *Airports Act 1996*
- *Environment Protection and Biodiversity Conservation Act 1999*

**(b) How does the regulation affect construction of another facility(ies)?**

The development of another pipeline would be a very long term project involving extensive public consultation and processes for development approval. The SJFIWG Report states that:

*Even if a decision to expedite the development of the pipeline under this option was taken before the end of 2010 it is unlikely the pipeline would be operational before 2015. This is on the basis that the time required to complete an environmental impact assessment process could be of the order of 12 to 18 months with a likely 30 months required for approvals and construction. (SJFIWG Report, pp. 41-42).*

The planning and construction timeframes, therefore, ensure the Caltex Pipeline remains a natural monopoly for a period of about five years from the point at which a decision is made by a provider (presumably not Caltex) to construct an additional pipeline(s).

**10.7 Identify whether the service provider has natural, economic or technical advantages from being the first established facility(ies)****(a) What are these advantages and how significant are they?**

The advantages are very significant and include:

- existing interconnection points with the off-site storage facilities
- existing interconnection to the Sydney JUHI
- current excess capacity
- the planning approval and construction timeframes (likely about 5 years) necessary to deliver an additional pipeline.

**(b) How do these advantages benefit the owner of the existing facility(ies) over new entrants? For example, the incumbent may benefit from access to the only feasible location, strong brand loyalty, benefits from owning and establishing network, or costs to customers of switching between suppliers?**

The existing arrangements strongly benefit the Caltex Pipeline over new entrants.

In the first instance, given approval process and construction timeframes, the Caltex Pipeline will remain a natural monopoly for a period of about five years from the point at which a decision is made by a provider (presumably not Caltex) to construct an additional pipeline.

By committing to the upgrade of the Caltex Pipeline, Caltex has ensured that it is not socially or privately worthwhile to construct a competing pipeline until the jet fuel transport demands reach the maximum capacity of its Pipeline. As described earlier, together with the Shell Pipeline, this capacity is sufficient to meet target replenishment rates out to about 2020, and average daily demand out to 2024.



- (c) **Could these advantages be overcome by a new entrant or are they permanent? What would a new entrant need to do to overcome any incumbency advantages?**

The advantages are permanent. The construction of a competing pipeline would result in two main outcomes, namely:

1. Substantial excess capacity in transfer capacity to about 2020 (and likely beyond) given current jet fuel demand forecasts, and
2. Competitive market conditions in the provision of jet fuel.

The first point means that a non-jet fuel supplier could not reasonably expect to earn its cost of capital on its investment in a competing pipeline. The capacity of two pipelines would far exceed actual requirements to at least 2029. This excess capacity would likely lead to prices that would be too low to recover the sunk costs (i.e. prices close to the low marginal cost) of building the infrastructure. Anticipating this outcome, no non-jet fuel provider could reasonably expect to earn its cost of capital on the investment it would make in the competing pipeline.

The second pipeline would also promote competitive market outcomes in the market for jet fuel at Sydney Airport. Assuming access could also be obtained from the Sydney JUHI (subject to a separate but related application for declaration), then the market for the provision of jet fuel at Sydney Airport would move from its current near monopoly supply to competitive supply (see 11.9). This increase in competition would eliminate the monopoly rents currently obtainable on the sale of jet fuel. This means that any provider of jet fuel could not expect to recover the losses on its investment in the second pipeline through monopoly rents on the sale of jet fuel to airlines at Sydney Airport.

- (d) **How would access overcome these advantages?**

New suppliers of jet fuel could seek access to the existing Caltex Pipeline, which enjoys the advantages of a natural monopoly. This means that new providers of jet fuel at Sydney Airport could become established before it becomes necessary to construct a second pipeline from the off-site storage facilities at Port Botany to Sydney Airport.

## **10.8 Outline any economies of joint production between the Service and other services provided by the facility(ies)**

- (a) **What other services have economies of joint production with the service subject to the application?**

The Caltex Pipeline provides no other services. It currently has two interconnection points, namely Caltex's Kurnell Refinery and the Vopak off-site storage facility, as well as its connection to the Sydney JUHI at Sydney Airport.

- (b) **Why cannot the provision of these services be separated?**

N/A – see (a) above.

- (c) **What would be the cost of separating these services?**

N/A – see (b) above.

**11. Criterion (a) – Access (or increased access) would promote a material increase in competition in at least one market other than the market for the service**

**Market Definition**

**11.1 Describe the demand and supply chain upstream and downstream from, or otherwise linked to, the service for which access is sought**

**What products or services are or could be provided at the various upstream and downstream points in the demand and supply chain?**

**Supply and Demand chain**

The supply and demand chain is summarised in Figures 1 and 2 and may be briefly described as follows:

**Figure 1 Supply and demand chain**

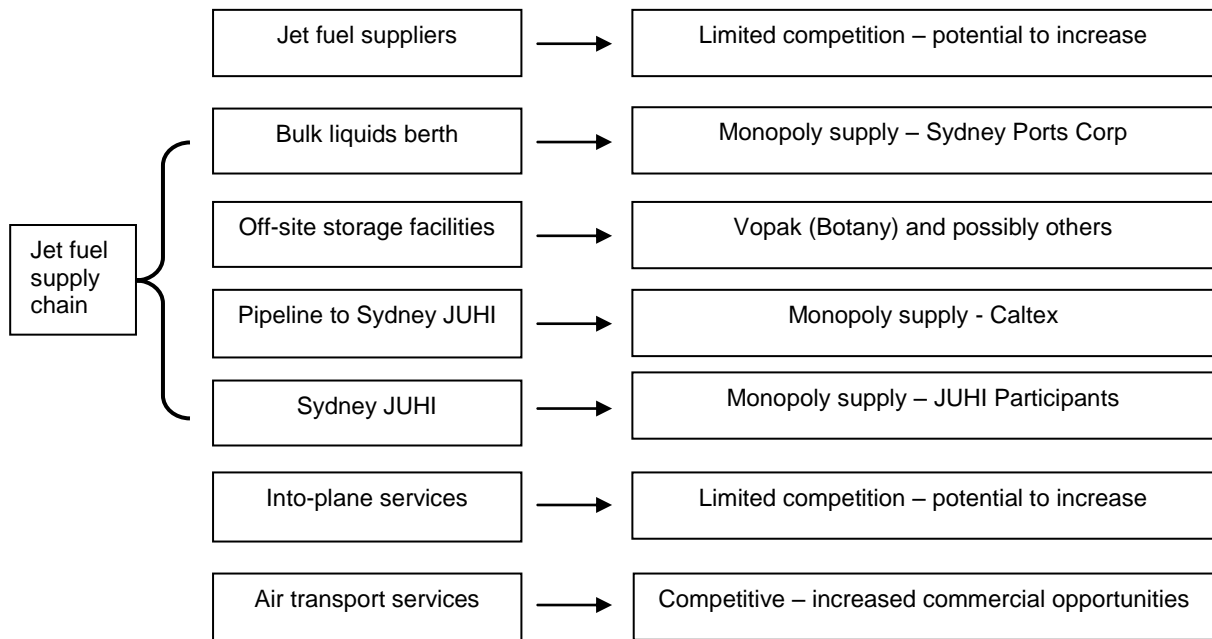
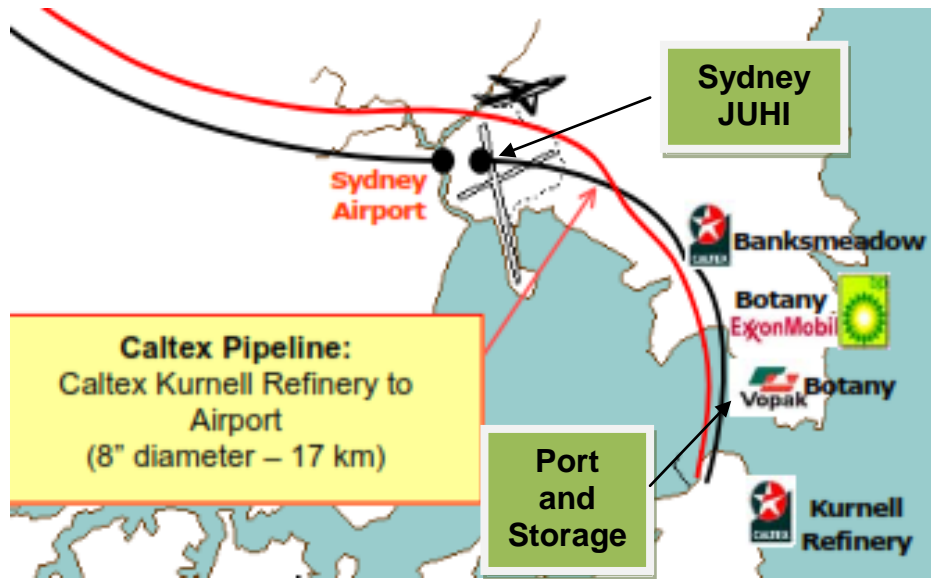


Figure 2 **Map of jet fuel supply infrastructure for imported fuel**



Source: Sydney Jet Fuel Infrastructure Working Group Report 2010

#### Jet fuel suppliers

The demand-supply chain starts with suppliers of jet fuel. They include domestic producers (currently Shell and Caltex) and imported fuel suppliers. The importers of jet fuel include the existing suppliers (Caltex, Shell and BP) and the provider to Qantas for its self supply arrangements.

#### 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.

Shell can also import jet fuel through its Gore Bay Terminal. The Applicant understands that, currently, the terminal is primarily used to import crude oil, which is then processed at its Clyde Refinery. However, Shell recently announced its decision to convert its Clyde Refinery into a fuel import terminal.<sup>11</sup>

#### 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 in Port Botany on land leased from Sydney Ports Corporation. Currently 91 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. The Applicant understands that BP and Shell have secured storage capacity at the Vopak facility.

<sup>11</sup> See Shell (12 April 2011) Proposal on future of Clyde Refinery, Press Release, Annexure 4.

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 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. This jet fuel initially enters the JUHI Jet Fuel Storage Facility. Following the storage facility, the fuel is transported through the JUHI Jet Fuel Hydrant Pipeline Network Facility or via refuelling trucks to the aircraft refuelling points.

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.

Air transport services

The final service provided to users is air passenger and freight services through Sydney Airport. The Applicant's members presently provide over 90% of the international flights to and from Sydney.

**11.2 From the analysis in question 11.1, identify the market(s) in which competition is likely to be promoted as a result of access to the service. These are termed dependent markets.**

**Upstream**

- The market for the supply of jet fuel at Sydney Airport, whether from imports or local production, but mostly imports.

**Downstream**

- 'Into-plane' services at Sydney Airport.
- International and domestic markets for the carriage of passengers and freight into and out of Sydney Airport.

### 11.3 Define the product, geographical and functional dimensions of each of the dependent markets

#### **Upstream: Supply of jet fuel at Sydney Airport**

- (a) **What are the products or services that compete in the dependent market(s)? If there are products or services that are potentially substitutable for those identified in the dependent market, explain why they are not considered to be part of that market?**

The product provided is jet fuel. There are no other products that are potentially substitutable.

- (b) **Are there suppliers of other products or services that could change their production to supply products or services into the dependent market? If so, who are these suppliers, what are they currently producing and how would they need to change their activities? How quickly might they make such changes and at what cost?**

No. Caltex and Shell have refineries in Sydney. All other jet fuel is imported.

- (c) **Is there potential for suppliers or customers to move between products or services purchased in or from different regions? If so, what would suppliers and customers need to do to move between regions, how quickly can this occur and how does it affect competition?**

Domestic production: Caltex and Shell would have ability to maintain, expand, reduce or end domestic supplies of jet fuel at Sydney Airport. Shell has announced its decision to cease its refinery operations at the present Clyde refinery site.

Importers: Importers have the ability to ship jet fuel to Australia and ports in overseas countries. More importers could establish contracts with airlines to provide jet fuel at Sydney Airport. Airlines typically enter into one to three year contracts with fuel suppliers.

Airline and other jet aircraft operator customers: The airlines require jet fuel to undertake air passenger and freight services through Sydney Airport. There are no alternative products available.

- (d) **Are any factors changing demand and supply over time, for example new technology, changing market conditions or market growth? If so, what are these changes? How quickly are they occurring? How are they affecting competition in the dependent market(s)?**

Yes. The supply of jet fuel at Sydney Airport is forecast to almost double, from a current demand of about 2.9 GL per year to over 5.6 GL per year by 2029. Since 2009, the total demand for jet fuel at Sydney Airport has begun to consistently exceed local refinery production, so the majority of the projected growth in the demand for jet fuel will be met from imports.

Currently, the growth in demand for jet fuel at Sydney Airport is having little additional effect on the level of competition between the existing jet

fuel suppliers. One key reason for this outcome is the ability of Caltex to limit competition between suppliers through its ownership and control of the Caltex Pipeline.

- (e) **Describe the assets used to produce the products or services in the dependent market(s).**
- Oil refineries.
  - Bulk liquid transport vessels.
- (f) **Could the assets used in the dependent market also be used to produce products or services at the next layer in the production or distribution chain? Is it possible to separate these assets from assets at other levels in the production or distribution chain? (The answer to this question should focus on the separability of assets in the dependent market and assets used to produce the service to which access is sought).**

No. The assets cannot be used to transport jet fuel from Port Botany to Sydney Airport.

**Downstream: Into-plane services at Sydney Airport**

- (a) **What are the products or services that compete in the dependent market(s)? If there are products or services that are potentially substitutable for those identified in the dependent market, explain why they are not considered to be part of that market?**

The service is the delivery of jet fuel from either a refuelling truck or hydrant into aircraft. There are no other products or services that are potentially substitutable.

- (b) **Are there suppliers of other products or services that could change their production to supply products or services into the dependent market? If so, who are these suppliers, what are they currently producing and how would they need to change their activities? How quickly might they make such changes and at what cost?**

Into-plane services are specialist licensed services usually provided by the jet fuel supplier.

- (c) **Is there potential for suppliers or customers to move between products or services purchased in or from different regions? If so, what would suppliers and customers need to do to move between regions, how quickly can this occur and how does it affect competition?**

N/A.

- (d) **Are any factors changing demand and supply over time, for example new technology, changing market conditions or market growth? If so, what are these changes? How quickly are they occurring? How are they affecting competition in the dependent market(s)?**

Yes. The growth in the demand for jet fuel offers opportunities for new jet fuel suppliers to offer 'end-to-end' services to airlines, which would

include into-plane services. Airlines typically enter into one to three year contracts with fuel suppliers.

- (e) **Describe the assets used to produce the products or services in the dependent market(s).**

Into-plane service providers operate vehicles (generally light trucks) known as hydrant dispensers. This is specialised equipment to ensure the safe and efficient transfer of fuel to aircraft. Into-plane services are provided by highly trained personnel.

- (f) **Could the assets used in the dependent market also be used to produce products or services at the next layer in the production or distribution chain? Is it possible to separate these assets from assets at other levels in the production or distribution chain? (The answer to this question should focus on the separability of assets in the dependent market and assets used to produce the service to which access is sought).**

No. The assets are specialist assets for providing into-plane services.

**Downstream: Air passenger and freight services through Sydney Airport**

The Applicant represents the interests of international airlines. However, the proposed declaration would also be equally available to the jet fuel supply of aircraft operating between domestic airports in Australia.

Passenger and freight markets to and from Sydney Airport have been considered in detail by the Council and the ACCC in the *Application by Virgin Blue for Declaration of Airside Services at Sydney Airport* and *Acquisition by Qantas Airways Limited of Ordinary Shares in Air New Zealand and Cooperative Arrangements Between Qantas, Air New Zealand and Air Pacific Limited*, respectively.

The potential downstream markets, therefore, include:

- International Passenger, further defined by passenger type (leisure and business) and region (e.g. trans Tasman, Asia, Europe, North America and Pacific Islands),
- International Freight, including dedicated freight aircraft, further defined by regions,
- Domestic Passenger and Freight (The Council previously determined that domestic freight services did not represent a separate market to domestic passenger services).

The Applicant considers that, for the purposes of this declaration, it is not necessary to undertake a detailed analysis of the potential improvement in competitive conditions in each of the markets defined above.

This approach is consistent with the ACCC's consideration of the Applicant's application for Authorisation. The ACCC recognised that the benefits provided by collective negotiation by the Applicant would be passed onto final users. The ACCC did not consider it necessary to precisely define the relevant markets for air transport (ACCC Authorisation A91200, p. 17).

Instead, Criterion (a) can be satisfied by simply considering the combined International and Domestic Passenger and Freight Services markets to and from Sydney Airport. The Applicant does not contend that these separate markets

represent one 'bundled' market in any functional sense. Rather, this downstream market represents one of three dependent markets in which competitive conditions will be improved through declaration.

- (a) **What are the products or services that compete in the dependent market(s)? If there are products or services that are potentially substitutable for those identified in the dependent market, explain why they are not considered to be part of that market?**

Air passenger and freight services conducted by competing international and domestic airlines carrying passengers and freight into and out of Sydney Airport.

There are no substitutable services for international passenger and freight services. Transport by sea is not considered a substitutable service for consumers of international air passenger and freight services.

As described in the Council's consideration of *Application by Virgin Blue for Declaration of Airside Services at Sydney Airport*, taking all domestic routes and all passenger types and classes as a whole, the Council considers there to be insufficient inter-modal substitution for the market to be characterised as anything other than an air transport services market.

- (b) **Are there suppliers of other products or services that could change their production to supply products or services into the dependent market? If so, who are these suppliers, what are they currently producing and how would they need to change their activities? How quickly might they make such changes and at what cost?**

No. As described earlier, the relevant markets are air transport passenger and freight markets. There are no other products or services that substitute for the services provided in the dependent market.

- (c) **Is there potential for suppliers or customers to move between products or services purchased in or from different regions? If so, what would suppliers and customers need to do to move between regions, how quickly can this occur and how does it affect competition?**

Suppliers: International, interstate and regional providers of air transport passenger and freight services are driven by the demands of customers. Airlines will, therefore, enter, expand, reduce or exit markets based on the financial viability of the services offered.

Customers: Customers will change their demand patterns based on their individual preferences and business needs.

- (d) **Are any factors changing demand and supply over time, for example new technology, changing market conditions or market growth? If so, what are these changes? How quickly are they occurring? How are they affecting competition in the dependent market(s)?**

Demand and supply vary over time in the markets, but over the long term demand has increased and, correspondingly, so has capacity made available by airlines. The number of passengers served by Sydney



Airport is expected to more than double by 2029, from about 35 million to 80 million.

New services into the dependent market may emerge as a result of worldwide economic developments. For example, new destinations may emerge as a result of differential regional economic circumstances.

Over the long term, new aircraft technology has greatly reduced the real costs of delivery of international and domestic passenger or freight air services. It is expected this trend will continue.

Occasionally events such as the following can have short term or long term effects on the market:

- terrorist attacks
- wars
- fuel price surges
- financial crises
- flu pandemics (e.g. SARS) and global health problems.

(e) **Describe the assets used to produce the products or services in the dependent market(s).**

- Airports.
- Jet aircraft.

(f) **Could the assets used in the dependent market also be used to produce products or services at the next layer in the production or distribution chain? Is it possible to separate these assets from assets at other levels in the production or distribution chain? (The answer to this question should focus on the separability of assets in the dependent market and assets used to produce the service to which access is sought).**

No. The assets are unique in terms of providing air passenger and freight services.

#### **FOR EACH DEPENDENT MARKET:**

##### **Market competition**

#### **11.4 Describe the businesses that supply or could supply products or services in the dependent market?**

(a) **How many businesses are there?**

##### **Upstream: Supply of jet fuel at Sydney Airport**

*Existing:* currently there are four suppliers: Caltex, Shell, BP and the supplier which is currently servicing the Qantas self supply arrangements. (ExxonMobil exited the market as stated above).

*Potential:* Potential new jet fuel providers are listed under 8.1(e) above. ExxonMobil could re-enter the market.

**Downstream: Into-plane services at Sydney Airport**

*Existing:* currently there are three suppliers as set out above.

*Potential:* Potential new jet fuel providers are listed under 8.1(e) above.

**Downstream: International and Domestic Passenger and Freight Services**

*Existing:* There are currently many domestic and international airlines that provide passenger and freight services to and from Sydney Airport. The current listing (as available from SACL's website) is:

Domestic: Aeropelican, Brindabella Airlines, Qantas, Jetstar and QantasLink, Regional Express, Virgin Australia and Tiger Airways.

International passenger: Adagold Aviation, Aerolineas Argentinas, Air Austral, Air Calin, Air Canada, Air China, Air France, Air Mauritius, Air New Zealand, Air Niugini, Air Pacific, Air Tahiti Nui, Air Vanuatu, Asiana Airlines, British Airways, Cathay Pacific, China Airlines, China Eastern Airlines, China Southern Airlines, Delta Airlines, Emirates, Etihad Airways, Garuda Indonesia, Hainan Airlines, Hawaiian Airlines, Iberia Airlines, Japan Airlines, Jetstar International, Kenya Airways, KLM Royal Dutch Airlines, Korean Air, Lan Airlines, Malaysia Airlines, Norfolk Air, Pacific Blue, Philippine Airlines, Polynesian Blue, Qantas Airways, Scandinavian Airlines, Singapore Airlines, South African Airways, Strategic Airlines, Thai Airways, United Airlines, V Australia, Vietnam Airlines, Virgin Atlantic.

International freight: Atlas Air, Cathay Pacific Cargo, Federal Express, Korean Air Cargo, Malaysian Airlines Cargo, Polar Air, Qantas Freight, Singapore Airlines Cargo, Tasman Cargo Airlines, Toll Priority, United Parcel Service Company.

*Potential:* Other airlines may enter the Sydney passenger and freight markets given the improved commercial conditions through declaration. Airlines that already operate to Sydney Airport may also find it profitable to expand capacity on existing routes or commence operations on new routes.

**(b) Are the businesses large or small?****Upstream: Supply of jet fuel at Sydney Airport**

Each supplier is one part of a large multi-national enterprise.

**Downstream: Into-plane services at Sydney Airport**

Each supplier is owned and controlled by one or more of the incumbent jet fuel suppliers (and ExxonMobil).

**Downstream: International and Domestic Passenger and Freight Services**

International: From large international airlines conducting multiple daily services to various destinations in Australia to other international (overseas based) airlines (whether large or small) which may conduct limited services, whether passenger and/or freight services.

Domestic: From large network-based airlines to smaller regional airlines.

- (c) **If there are only a few actual or potential suppliers, name them.**

**Upstream: Supply of jet fuel at Sydney Airport**

See 11.4(a) and 8.1(e) as to other jet fuel suppliers.

**Downstream: Into-plane services at Sydney Airport**

See 11.4(a). The Applicant understands that the existing service providers cannot prevent other willing operators from delivering the service. The Applicant further understands that a new service provider merely requires a licence granted by SACL.

**Downstream: International and Domestic Passenger and Freight Services**

See 11.4(a).

**11.5 Describe the customers that purchase or could purchase products or services in the dependent market?**

- (a) **How many customers are there?**

**Upstream: Supply of jet fuel at Sydney Airport**

International and domestic airlines and other jet aircraft operators; see 11.4(a).

**Downstream: Into-plane services at Sydney Airport**

International and domestic airlines and other jet aircraft operators; see 11.4(a).

**Downstream: International and Domestic Passenger and Freight Services**

- (i) Persons desiring international or domestic air travel services.
  - (ii) Persons desiring international or domestic freight services.
- (b) **Are they industrial or domestic (consumers or other end users)?**

**Upstream: Supply of jet fuel at Sydney Airport**

Industrial (airlines).

**Downstream: Into-plane services at Sydney Airport**

Industrial (airlines).

**Downstream: International and Domestic Passenger and Freight Services**

Both.

- (c) If there are only a few actual or potential customers, name them?

**Upstream: Supply of jet fuel at Sydney Airport**

See 11.4(a).

**Downstream: Into-plane services at Sydney Airport**

See 11.4(a).

**Downstream: International and Domestic Passenger and Freight Services**

N/A.

**11.6 What is the size of the dependent market in volume and dollar terms?****Upstream: Supply of jet fuel at Sydney Airport**

Volume: Currently about 2.9 GL per year. The price of jet fuel varies due to world supply and demand conditions and exchange rates. At a price of \$1.00 per litre, the estimated cost is currently about \$3 billion per year.

**Downstream: Into-plane services at Sydney Airport**

Volume: Currently about 2.9 GL per year. The Applicant does not have information on the prices charged by the existing oil companies to provide into-plane services.

**Downstream: International and Domestic Passenger and Freight Services**

In 2009-10, the reported numbers of international and domestic passengers were over 11 million and 23 million, respectively. The reported weight of freight carried to and from Sydney Airport in 2010 was over 232,000 tonnes.

Sydney Airport has estimated that the direct value of this trade is about \$8 billion per year, or some 6% of NSW's gross state product.

**11.7 What are the current barriers to competition or entry in the dependent market?****Upstream: Supply of jet fuel at Sydney Airport**

The current barriers to entry in the jet fuel market are access to the Caltex Pipeline and access to the Sydney JUHI at the Airport (subject to a separate Application). Apart from access to the jet fuel supply infrastructure chain, there are currently few barriers to entry into the market for supply of jet fuel at Sydney Airport.

There are multiple, large multinational providers of jet fuel that currently operate at many leading airports throughout the world. These suppliers have the experience and technical and financial capacity to become long-term providers of jet fuel at Sydney Airport. While entering the market would involve a degree of start up costs, these costs do not represent long-term barriers to entry.

**Downstream: Into-plane services at Sydney Airport**

The main barriers to entry are obtaining the specialised hydrant dispensers and appropriately trained personnel to refuel aircraft.

The Applicant understands that the existing service providers cannot prevent other willing and certified operators from delivering the service. The Applicant also understands that a new service provider would require a licence granted by SACL.

**Downstream: International and Domestic Passenger and Freight Services**

*International:* The main barrier to entry is regulatory. Before an airline can operate international services to another country, the government must first negotiate a treaty level agreement with the destination country's government. These treaties are known as bilateral air services agreements (ASA's).

Australia currently has ASA's with 68 countries. Airlines operating international air services do so within capacity entitlements contained in ASA's. The Australian Government is engaged in a program of bilateral air services negotiations to continue to expand access and to allow foreign carriers to increase their access to Australia.

The normal operational requirements for international airlines (e.g. aircraft, approvals, etc) to increase capacity into Australia are not considered meaningful barriers to entry given the existing operations of international airlines to Australia.

*Domestic:* The barriers to entry into Australia's domestic markets are also low. Australia permits foreign persons (including airlines) to own up to 100% of the equity in an Australian domestic airline (subject to Foreign Investment Review Board approval, if required). As a result, any foreign airline interested in competing in the Australian domestic market is able to do so via an Australian-based subsidiary operating under the safety oversight of the Civil Aviation Safety Authority.

The normal operational requirements for domestic airlines (e.g. aircraft, approvals, etc) to increase capacity into Australia are not considered meaningful barriers to entry given the existing operations of domestic and international airlines to Australia.

## 11.8 Describe the current level of competition in the dependent market

### (a) Is the dependent market competitive?

#### **Upstream: Supply of jet fuel at Sydney Airport**

The Applicant considers that the current level of competition between the incumbent suppliers is low. Based on the stated utilisation of the Shell and Caltex Pipelines in the SJFIWG Report (p. 24), the implied market shares between the existing oil companies are estimated at:

- Shell: 28%<sup>12</sup>
- Caltex: 55%<sup>13</sup>
- Others, including Qantas self supply: 17%<sup>14</sup>

Assuming an equal market share between BP and Qantas self supply (about 9% each), the calculated Herfindahl-Hirschman Index (HHI) is 0.40 (or 4,000). A value of 0.40 or 4,000 is well above the generally accepted level for a 'concentrated' industry. For example, the ACCC has stated that an industry would be considered concentrated for the purposes of mergers assessment if the HHI was greater than 2,000.<sup>15</sup> The Applicant is unaware of there being any other suppliers of jet fuel apart from the incumbent suppliers at Sydney Airport for many years. This means that the HHI for past years is also likely to have been well in excess of 2,000.

Given the high HHI value combined with the substantial barriers to entry associated with the Caltex Pipeline (and the Sydney JUHI, subject to a separate but related application for Declaration), the Applicant submits that it must be concluded that the incumbent suppliers of jet fuel at Sydney Airport have considerable market power.

#### **Downstream: Into-plane services at Sydney Airport**

The Applicant considers that the current level of competition between the incumbent suppliers is low, consistent with the upstream supply of jet fuel. Given the control the incumbent suppliers have over key elements of the jet fuel supply infrastructure chain, the potential level of competition is suppressed and limited to those suppliers.

#### **Downstream: International and Domestic Passenger and Freight Services**

International and domestic passenger and freight markets are highly competitive. The level of competition in each market depends on a combination of factors, including the commercial viability of routes or networks for individual airlines and the capacity entitlements described earlier.

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<sup>12</sup> Based on a transfer capacity of 3.9 ML per day, being utilised at 56%

<sup>13</sup> Based on a transfer capacity of 5 ML per day, used 305 days per year.

<sup>14</sup> Based on a transfer capacity of 7.9 ML per day, used 60 days per year.

<sup>15</sup> See ACCC (July 2008) Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, p. 49.

- (b) **Are there other sellers and buyers competing in the dependent market that are not reliant on the service subject to the application.**

No.

- (c) **Is there the potential for other suppliers or buyers to enter the dependent market that are not reliant on the service subject to the application?**

No.

### **Increasing competition**

#### **11.9 How will access (or increased access) increase competition in the dependent market?**

- (a) **Explain how access (or increased access) to the service for which declaration is sought would affect competition in the dependent markets.**

##### **Upstream: Supply of jet fuel at Sydney Airport**

Increased access to the Caltex Pipeline would enhance the ability for new suppliers of jet fuel to enter the market. In the first instance, declaration would override the ability of Caltex to simply refuse without negotiation, access to jet fuel suppliers to its Pipeline for the purposes of reducing competition between suppliers of jet fuel at Sydney Airport.

Increased access to the Caltex Pipeline would significantly alter the current competitive dynamics between the existing and potential suppliers. Additional competition, or the increased threat of it, would increase the cost competitiveness and reliability of jet fuel supplies.

##### **Downstream: Into-plane services at Sydney Airport**

Increased access to the Service would enhance the ability for new, large suppliers of jet fuel to provide 'end-to-end' services to airlines, which would include into-plane services. This would significantly alter the current competitive dynamics between the existing and potential suppliers.

##### **Downstream: International and Domestic Passenger and Freight Services**

International and domestic passenger and freight markets are likely to be characterised by differing degrees of commercial viability. Some routes may be reasonably profitable, while others are far more marginal. Outcomes depend on demand and supply conditions, including the price elasticity of demand for air transport services and the level of competition between airlines for particular customers.

Since 2000, the exiting of a number of European carriers, such as Lufthansa, KLM, Alitalia, Olympic Airways and Austrian Airlines, from routes between Sydney and European destinations demonstrates the difficulty of maintaining airline schedules in the market for international air services to and from Sydney. Other airlines, such as British Airways and Japan Airlines, have reduced schedule frequencies while not yet exiting the market.

A more cost effective and reliable supply of jet fuel at Sydney Airport will translate into lower overall costs and improved commercial opportunities for airlines. This would improve the commercial viability of marginal routes and, potentially, make currently unviable routes commercially viable.

- (b) **Explain how the effect(s) explained in 11.9(a) amount to a material increase in competition in the dependent markets?**

**Upstream: Supply of jet fuel at Sydney Airport**

The enhanced ability for new suppliers to enter the market for the supply of jet fuel at Sydney Airport represents a material and, likely, substantial increase in the competition for the provision of jet fuel. Potential new suppliers have advised the Applicant of their interest in providing jet fuel at Sydney Airport (see 10.2(c)). New entrants will increase both the number of suppliers and also reduce the dominant market shares of Caltex and Shell. This in turn will substantially reduce the level of industry concentration, promoting far greater levels of competition between jet fuel suppliers.

Table 2 below shows the number of jet fuel suppliers at a number of international airports (including Sydney), together with the jet fuel volumes in 2010. Many international airports have five or more jet fuel suppliers and the volume of fuel supplied does not appear to exert any 'cap' on the number of suppliers at individual airports. For example, both Taipei and Osaka airports currently have less annual volumes than Sydney Airport with six competing jet fuel suppliers. The number of jet fuel suppliers at airports with greater annual volumes than Sydney Airport range from 5 to 10.

The overseas airports provide additional supporting evidence of the potential to increase the number of jet fuel suppliers at Sydney Airport. Combined with the interested expressed to the Applicant by potential new jet fuel suppliers, strong evidence exists to support the Applicant's stated objective that substantially increased levels of competition can be achieved if all potential jet fuel suppliers can obtain access to the essential elements of the supply chain on reasonable terms and conditions.

**Table 2 Jet fuel suppliers and jet fuel volumes**

<b>Airport</b>	<b>Number of suppliers</b>	<b>2010 Fuel volume (millions of US gallons)</b>
London	9	1,839
Hong Kong	9	1,708
Los Angeles	10	1466
Frankfurt	5	1,453
Dubai	5	1,423
Paris	5	1,374
New York	6	1,305



Tokyo	9	1,269
Singapore	6	1,251
Seoul	7	1,158
Bangkok	6	1,139
Amsterdam	6	1,004
Sydney*	4	720
Taipei	6	622
Kuala Lumpur	3	608
Osaka	6	309

\*Qantas also undertakes a limited amount of self supply. Also see previous comments on ExxonMobil.

Source: IATA.

### **Downstream: Into-plane services at Sydney Airport**

The enhanced ability for new suppliers to enter the market for supply of jet fuel at Sydney Airport will also promote a material increase in competition in the market for the provision of into-plane services. Potential new suppliers of jet fuel could seek to provide 'end-to-end' services to airlines, which would include into-plane services.

### **Downstream: International and Domestic Passenger and Freight Services**

With more cost-competitive and reliable supplies of jet fuel, the overall commercial viability of air passenger and freight services will be increased.

The Council previously found in its Draft Decision on the *Application by Virgin Blue for Declaration of Airside Services at Sydney Airport* that SACL had the incentive and ability to exercise its market power and this would lead to a lessening of competition in the market for domestic air services. This outcome is analogous to the situation with the Caltex Pipeline.

- (c) **How would the size of the dependent market be affected by access (or increased access)? Estimate the size of the dependent market if access (or increased access) was available.**

The Applicant is unable to assess how the size of the dependent markets would be increased. Forecast passenger and jet fuel demands are implicitly based on status quo arrangements (see 10.2(c)).

However, it could be expected that the size of the dependent markets will be larger under declaration. More price competitive and reliable supply of jet fuel will increase the commercial opportunities for domestic and international airlines. This in turn will increase the demand for jet fuel and into-plane services (as derived demands).

- (d) **Would access (or increased access) affect some types of customers or suppliers more than others?**

**Upstream: Supply of jet fuel at Sydney Airport**

Increased access could be expected to have a large and likely equal effect on all the existing suppliers of jet fuel, given the increased potential for entry by new suppliers.

See para 11.9(b) above.

**Downstream: Into-plane services at Sydney Airport**

Increased access could be expected to have a large and likely equal effect on the suppliers of into-plane services, given the increased potential for entry by new suppliers.

See para 11.9(b) above.

**Downstream: International and Domestic Passenger and Freight Services**

The impact on the capacity decisions of individual airlines will depend on the existing supply and demand conditions of particular markets or routes. It would be expected that the greatest impact will be on those markets which are commercially marginal.

- (e) **What affect would access (or increased access) have on barriers to competition or entry in the dependent market?**

**Upstream: Supply of jet fuel at Sydney Airport**

Access would significantly lower the barriers to entry. Caltex has the incentive to use its monopoly and vertically integrated position to suppress competition in the market for the supply of jet fuel at Sydney Airport.

**Downstream: Into-plane services at Sydney Airport**

Access would significantly lower the barriers to entry. Caltex has the incentive to use its vertically integrated monopoly position to suppress competition not only for the supply of jet fuel but also into-plane services at Sydney Airport, through its control over the number of providers of jet fuel.

**Downstream: International and Domestic Passenger and Freight Services**

By obtaining a more cost-effective and reliable supply of jet fuel, the commercial opportunities available to domestic and international airlines will be increased. Access is not expected to impact on any barriers to entry to this dependent market.

- (f) **How would access (or increased access) affect innovation and the operation of niche suppliers in the dependent market(s)?**

**Upstream: Supply of jet fuel at Sydney Airport**

The Applicant expects that new suppliers of jet fuel will increase innovation. There are multiple, large suppliers of jet fuel to many leading overseas airports. The new suppliers may be able to provide contract and supply innovations not currently offered by the existing oil companies.

**Downstream: Into-plane services at Sydney Airport**

The Applicant expects that new suppliers of jet fuel will increase innovation in providing 'end-to-end' jet fuel supply solutions.

**Downstream: International and Domestic Passenger and Freight Services**

Improvements in commercial conditions for the provision and pricing of jet fuel will encourage smaller airlines and the commercial viability of marginal routes.

**11.10 Is there any evidence that the access provider is exercising its market power?**

- (a) **Has access been denied?**

The Applicant's members do not seek access for themselves, as it is the fuel supply companies that obtain access from Caltex. The Applicant also does not have authorisation from the ACCC to negotiate the terms and conditions of access to the Caltex Pipeline on behalf of its members.

However, several of the Applicant's member airlines have highlighted to the Applicant difficulties experienced in successfully tendering for fuel supplies at Sydney Airport. The airlines affected have advised that, for some tenders, all suppliers apart from Caltex declined to bid. The generally advised reasons cited by the declining suppliers for this situation were 'due to supply constraints'. However, in the case of one of the tenders, one supplier reported specifically that it had to withdraw from the tender as the supplier had 'been refused additional pipeline access to the Caltex Pipeline'.

The Applicant also notes that Caltex's discretion to deny access may well be sufficient to dissuade potential competitors from seeking to enter the market for jet fuel at Sydney Airport or entering into negotiations with Caltex for access to the Caltex Pipeline. That is, the barrier to entry is sufficient such that it is not necessary for Caltex to formally deny access to potential new jet fuel suppliers. As the outcome is already known to potential entrants, they do not waste their time and resources in seeking to negotiate access.

- (b) **Is the service provider charging prices that exceed the competitive level for the service?**

The Applicant does not have specific information on the charges levied by Caltex or the rates of return it earns on its pipeline assets. The charges imposed by Caltex in providing the Service are unknown to the

Applicant. However, economic theory can provide insight into the incentives of Caltex in setting prices.

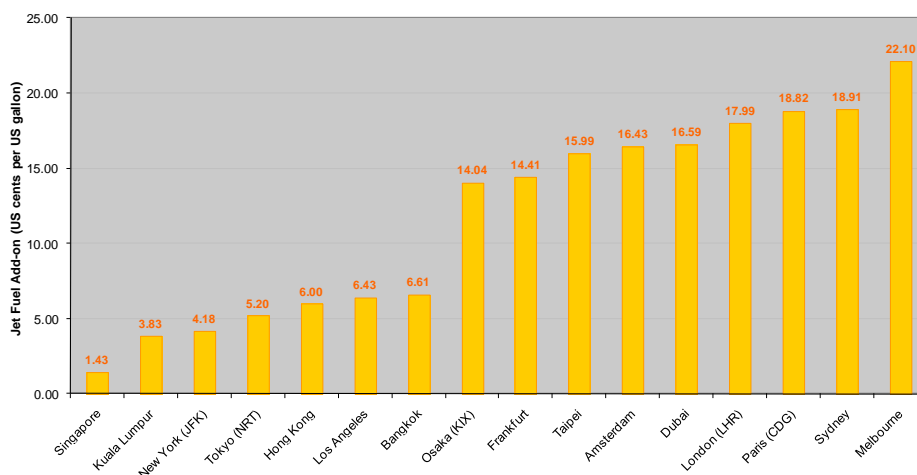
Taking into account the nature of competition when jet fuel is sold to the final users, Caltex can set charges for its jet fuel transport service that, once the final mark-up has been accounted for, maximises (or nearly maximises) profits. This opportunity arises because the Caltex Pipeline, an essential link in the delivery chain for jet fuel, conveys substantial market power; and the owner of this essential element of the supply chain is also the same company selling jet fuel. As a consequence, it is in the interests of Caltex to limit access to the Caltex Pipeline in order to soften price competition in the jet fuel market. Access can be limited through denying access to a new supplier and/or limiting the time allocated to transport jet fuel from the off-site storage facilities to the Sydney JUHI. The latter limits the volume of jet fuel providers can seek to sell to the airlines operating from Sydney Airport.

While the specific details regarding the prices charged by Caltex for the use of the Caltex Pipeline are unknown, the Applicant notes that IATA has previously raised concerns about the pricing of jet fuel in Australia. In its submission to National Aviation Policy Green Paper: *Flight Path to the Future* (2008), IATA argued that:

In Australia, aviation fuel supply has been plagued by concerns over supply reliability and price efficiency... Fuel differential (the component of the fuel price paid by airlines over and above the international market price) has risen steadily over the last six years. In comparison, the fuel differential that airlines pay at Australian airports is significantly higher than at the main airports around the Asia Pacific region such as Singapore, Kuala Lumpur, Jakarta, Bangkok and Hong Kong. (pp. 4-5).

Figure 3 shows the fuel differential for July 2010 at Sydney Airport, Melbourne Airport and a number of overseas airports. Sydney and Melbourne airports are characterised by the highest fuel differentials in the world. This differential relates to the entire jet fuel supply infrastructure chain.

**Figure 3 Jet fuel differentials, US cents per US gallon, July 2010**



Note: Add-on is defined as the total jet fuel price paid for July 2010 uplift less the applicable Mean of Platts Singapore (prior month i.e. June)

AIRPORTS

Source: Submissions from 5 airlines

Source: IATA

The Applicant does not have sufficient information on which to benchmark these fuel differentials based on variables such as the amount of infrastructure used (length of pipes, storage capacity, etc), ownership arrangements and fuel volumes. However, given the limited access arrangements that apply, it is not unreasonable to expect that Caltex takes advantage of its monopoly supply in setting charges in providing the Service.

Even if this was not the case, Caltex can earn monopoly rents through higher prices for the provision of jet fuel to airlines given the lack of effective competition. That is, the impact of the market power may manifest itself in the returns earned by Caltex on the Caltex Pipeline and/or the returns on the supply of jet fuel.

As Caltex is estimated to supply the majority of jet fuel at Sydney Airport, it will be the main beneficiary of restricting competition between jet fuel suppliers. By increasing the capacity of the Caltex Pipeline, Caltex is likely to be able to increase its market share through increasing supply (either through increased refinery production and/or imports of jet fuel) combined with denying and/or limiting access to other suppliers of jet fuel to the Caltex Pipeline. This would mean that Caltex would obtain an ever growing proportion of the monopoly rents earned on the sale of jet fuel in line with its growth in market share.

- (c) **For a vertically integrated service provider, is it engaging in behaviour to leverage its monopoly power into the dependent market? How is the access provider using its vertical integration in ways that disadvantage potential competitors? How is the access provider benefiting from these actions and how is it affecting competitors?**

Caltex is vertically integrated in the dependent markets for the provision of jet fuel and into-plane services. As noted in 11.10(b), the Applicant understands that Caltex has full discretion to deny access and this discretion is likely to be sufficient to dissuade potential competing providers of jet fuel.

As described in 11.10(a), the Applicant's members have advised of a lack of effective competition between jet fuel suppliers at Sydney Airport and, in the case of one of the tenders, one supplier reported specifically that it had to withdraw from the tender as the supplier had 'been refused additional pipeline access to the Caltex Pipeline'.

The Applicant, therefore, considers that Caltex has the incentive and ability to refuse or limit access to the Caltex Pipeline with the intent of excluding or limiting scope for other suppliers to compete in providing jet fuel to airlines at Sydney Airport. The Applicant has been advised that Caltex has undertaken such conduct in the past.

The lack of effective competition means that the existing suppliers benefit from being able to supply the entirety of Sydney Airport's growing jet fuel requirements without the need to consider the strategic response of potential suppliers. The benefits, therefore, include assured volumes of supply and an ability to charge prices for jet fuel, including oil company overheads, above what they would charge under more competitive conditions.

The lack of effective competition also comes at the expense of reliability in supply. As noted by IATA, aviation fuel supply in Australia has been plagued by concerns over supply reliability. As described in the SJFIWG Report, in response to the disruptions in the supply of jet fuel at Sydney Airport in 2003, a National Operating Committee was established by the then four major fuel suppliers to monitor and advise on potential jet fuel supply issues and manage supply disruptions.

This means that rather than allowing a more competitive market, with a greater number of participants and more diversity of supply, addressing reliability issues, it has become an administrative arrangement between the existing oil company suppliers. This further entrenches their incumbent position, while the additional costs of the arrangements are ultimately passed onto airlines and passengers.

- (d) **Explain the evidence to support any claims that the access provider is exploiting its market power and the source of that evidence.**

IATA supplied the above information, as requested by the Applicant from IATA.

**11.11 Do the access provider's customers or suppliers have countervailing market power?**

- (a) **How reliant are the customers on the service provided by the access provider? Do the customers have access to alternatives to the access provider's service?**

The airlines are heavily reliant on the Caltex Pipeline for the provision of jet fuel at Sydney Airport. Only the Shell Pipeline offers some other limited degree of supply.

- (b) **Does countervailing power vary between customers or customer groups? If so, how does it vary and what groups are affected.**

The critical issue for countervailing power to exist, is to separate the provision of jet fuel from the Service. It is possible that the airlines could have some countervailing power when negotiating contracts for jet fuel, provided that access to the Caltex Pipeline was available on a competitive basis. Currently, the countervailing power is limited because there are, for all practical matters, no alternative suppliers an airline can opt to go to (the majority of their jet fuel needs must be transported to the Sydney JUHI via the Caltex Pipeline) and the access charges levied by Caltex could be used as a credible device to sustain higher prices for jet fuel. The relative bargaining strength of airlines could be further enhanced by the entry into the jet fuel market by additional new providers.

Consequently, given the current limited access for alternative jet fuel suppliers, the consumers of jet fuel do not have countervailing power.

**11.12 Are there any other facilities that provide similar or competing services to the service for which access is sought?**

- (a) **Describe any facility(ies) not described in question 10.1.**

N/A.

- (b) **Describe the service the other facility(ies) provides and the extent to which it differs from the service to which access is sought.**

N/A.

- (c) **Does this facility(ies) (or could it) provide services in the dependent market?**

N/A.

- (d) **Has the access seeker sought to use this facility(ies) instead of the one to which access is sought? If so, what was the outcome of those discussions? If not, why not?**

N/A.

- (e) **How would the cost of using the other facility compare with the cost of using the facility under the application?**

N/A.

- (f) **Does the other facility(ies) constrain the access provider's ability to exploit its market power?**

N/A.

**11.13 Are there any government policies or commercial imperatives that limit the service provider's ability to use market power?**

- (a) **Identify any such policies or incentives.**

(i) Nil.

- (b) **How do they affect the service provider's ability to use its market power and what scope, if any, remains for it to continue to use its market power?**

(i) N/A.

**11.14 Are there any other factors that might limit the access provider's ability and incentives to exercise market power?**

- (a) **If so, what are these factors and what are their affects?**

The Applicant is unaware of any constraints on the market power of Caltex in providing access to the Caltex Pipeline. In particular, the Shell Pipeline is not a viable alternative for imports of jet fuel at Sydney Airport.

**11.15 Establish that there are no other barriers to competition in the dependent markets that would prevent access from having a material impact on competition**

- (a) **Are there significant barriers to competition that would remain even if access was introduced?**

**Upstream: Supply of jet fuel at Sydney Airport**

No. See para 11.7 above.

**Downstream: Sydney JUHI**

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

**Downstream: Into-plane services at Sydney Airport**

No. See para 11.7 above.

**Downstream: International and Domestic Passenger and Freight Services**

No. See para 11.7 above.

- (b) **Are existing customers locked into long term contracts?**

The Applicant understands that airlines generally enter into contracts with existing fuel suppliers for periods of one to three years; these contracts would not constitute a significant barrier to entry by potential new providers.

**11.16 Show that the effects of access (or increased access) would be large enough to have a material impact on the dependent market.**

- (a) **How important is the service to which access is sought in meeting customer demands in the dependent market?**

**Upstream: Supply of jet fuel at Sydney Airport**

The Caltex Pipeline is an essential element of the jet fuel infrastructure supply chain to Sydney Airport. Jet fuel suppliers (other than Shell) must have access to the Caltex Pipeline, in order to supply the Applicant's member airlines.

**Downstream: Into-plane services at Sydney Airport**

The Caltex Pipeline is an essential element of the jet fuel infrastructure supply chain to Sydney Airport. Jet fuel suppliers (other than Shell) must



have access to the Caltex Pipeline, in order to supply the Applicant's member airlines.

**Downstream: International and Domestic Passenger and Freight Services**

It is critical. Jet aircraft cannot operate without jet fuel. Also see 4.6.

- (b) **How large a part of the total cost of supplying the dependent market is the cost of the service to which access is sought?**

As noted, the cost of service is unclear. Access is, however, a crucial element in any attempt to produce competitive prices for jet fuel – see 11.10(b). IATA states that jet fuel costs represent about one third of total airline costs.<sup>16</sup> The total cost of providing jet fuel at Sydney Airport (jet fuel and the infrastructure supply chain) is likely to exceed \$3 billion per year. This value will grow through time with the forecast increases in the demand for jet fuel.

- (c) **How large an affect is access likely to have on the costs of the declared service, taking into account the constraints discussed previously?**

Declaration should lead to more balanced terms and conditions of access, including the prices charged by Caltex. Even if Caltex was charging competitive prices in providing the Service, the existing oil companies (of which Caltex has the largest estimated market share) can earn monopoly rents through higher prices for the provision of jet fuel to airlines given the lack of effective competition. That is, the impact of declaration could lead to lower prices charged by Caltex for the Service and/or the final price of jet fuel at Sydney Airport.

- (d) **How large an effect is access likely to have on the quality of the declared services? Are the quality characteristics important in the dependent market? If so, why are they important?**

The Applicant does not believe declaration would lead to any diminution in quality. In particular, the infrastructure must meet certain minimum technical standards. The infrastructure must be maintained to those standards regardless of level of usage.

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<sup>16</sup> See <http://www.iata.org/ps/consulting/Pages/fuel-consulting.aspx>

## 12. Criterion (c) — National significance

**12.1 Describe how the facility(ies) is important to the nation, answering any of the following questions that are relevant to its national significance?**

**12.2 What is the size of the facility(ies)? What did it cost? What area or distance does it cover or serve?**

- (a) Size: The Caltex Pipeline is approximately 17kms, connecting Caltex's Kurnell Refinery and the Port Botany storage facilities to the Sydney JUHI.
- (b) Cost: The Applicant does not have information on the cost of building and maintaining the Caltex Pipeline.
- (c) Area served: Domestic and international jet aircraft operating to Sydney Airport provide passenger and freight services to all major airports in Australia and many overseas airports.

**12.3 What is the volume or value of goods or services going through the facility(ies)?**

The Caltex Pipeline is estimated to transport about 72% of Sydney Airport's jet fuel needs, or some 2 GL of jet fuel per year. At a price of about \$1.00 per litre, the value of the jet fuel is estimated to be over \$2 billion per year.

**12.4 How does the facility(ies) contribute to trade between the States and Territories? What is the volume or value of that trade?**

Sydney Airport is the largest airport in Australia in terms of domestic passengers (see Table 5 below).

**Table 5 Domestic passengers (including domestic on carriage), Sydney, Melbourne, Brisbane and Perth Airports, millions, 2009-10**

	Sydney	Melbourne	Brisbane	Perth
<b>Passengers</b>	23.5	20.6	14.9	7.5

Source: ACCC Airport Prices Monitoring Report, 2009-10.

Sydney Airport, therefore, contributes greatly to the commerce between States and Territories. The direct value of all trade (domestic and international) is currently estimated at about \$8 billion per year, or some 6% of NSW's gross State product (see *Sydney Airport Master Plan*).

The Applicant notes that the Council was satisfied that Sydney Airport satisfied criterion (c) in assessing the *Application by Virgin Blue for Declaration of Airside Services at Sydney Airport*.

The Caltex Pipeline represents essential infrastructure in enabling the passenger and freight movements through Sydney Airport to occur. In this respect, the national significance of the Caltex Pipeline is no different to the runways and terminals operated by SACL.

## 12.5 How does the facility(ies) contribute to trade between Australia and places outside Australia. What is the volume or value of that trade?

Sydney Airport is the largest airport in Australia in terms of international passengers (see Table 6 below).

**Table 6 International passengers, passengers, Sydney, Melbourne, Brisbane and Perth Airports, millions, 2009-10**

	<b>Sydney</b>	<b>Melbourne</b>	<b>Brisbane</b>	<b>Perth</b>
<b>Passengers</b>	11.4	5.7	4.3	3.0

Source: ACCC Airport Prices Monitoring Report, 2009-10.

Sydney Airport, therefore, also contributes greatly to the trade between Australia and places outside of Australia.

## 12.6 How important is the facility(ies) in providing services in other significant markets?

The Caltex Pipeline is an essential component in providing international and domestic passenger and freight services to and from Sydney Airport.

Sydney Airport is vital in providing an efficient air transport service for Australia's various significant international trade and tourism markets. Given Australia's remote international location as an island continent, international air passenger and freight services are critical to all markets requiring air transport of people and goods.

## 12.7 Are there any other characteristics of the facility(ies) that make it nationally significant?

None identified, other than that listed above.

## 13. Criterion (d) — Human health or safety

[N/A]

## 14. Criterion (e) — Application of an effective access regime

### 14.1 Is the service already covered by an access regime? If so:

No.

- (a) **Is the regime established by state, territory or Commonwealth regulation?**

N/A.

- (b) **Are there any other documents that establish the regime? If so, what are they, what matters do they regulate and what is their legal status?**

N/A.

- (c) **When was the regime established?**

N/A.

- (d) **Have there been any attempts to negotiate access under the regime? If so, when did they occur and what type of service was under negotiation?**

N/A.

- (e) **Have the attempts to negotiate access under the regime been unsuccessful? If so, when did access under the regime apply and what was the service covered? What were the condition of access?**

N/A.

- (f) **Have the attempts to negotiate access under the regime been unsuccessful? If so, why did they fail?**

N/A.

#### **14.2 What is the scope of the existing access regime?**

- (a) **What services and facilities are covered by the regime?**

N/A.

- (b) **What is the process for negotiating access under the regime?**

N/A.

- (c) **Does the regime provide a right to negotiate? If so, what is the nature of that right?**

N/A.

- (d) **Does the regime have a regulator? If so, what organisation is the regulator and what are its role, scope and powers?**

N/A.

- (e) **Does the regime provide for independent arbitration if agreement is not reached? If so, who is the arbitrator (or how is an arbitrator chosen), what the role, scope and powers of the arbitrator?**

N/A.

- (f) **What guidance, if any, does the regime give the arbitrator in resolving access disputes?**

N/A.

- (g) **Do the regulator and/or the arbitrator have information gathering powers?**

N/A.

- (h) **Is the regime legally enforceable by third party access seekers?**

N/A.

- (i) **Does the regime result in economic outcomes?**

N/A.

## **15. Criteria (f) — Public interest**

### **15.1 Outline issues that should be considered in determining whether access is contrary to the public interest. Where relevant discuss the impact of access on:**

- (a) **the development of alternative access regimes and arrangements**

The Applicant believes that declaration is timely and appropriate in terms of the long term competitive provision of jet fuel at Sydney Airport. Declaration will not undermine the development of alternative access regimes or arrangements.

It is open for Caltex to submit an access undertaking with the ACCC for access to the Caltex Pipeline. Such an undertaking, if accepted, would revoke declaration.

- (b) **consistency across access regimes or arrangements**

The Applicant is unaware of any access regimes in Australia covering the provision of transporting jet fuel from off-site storage facilities to on-airport storage facilities.

- (c) **incentives to invest**

Declaration will not reduce the incentive for timely investment in the Caltex Pipeline. Caltex has already committed to upgrading the Caltex Pipeline to its maximum capacity. Once this occurs, Caltex has advised that it cannot further meaningfully increase the capacity of the Caltex Pipeline.

- (d) **any other costs associated with access**

Nil.

- (e) **the achievement of other government policy objectives**

Declaration would only provide a mechanism of last resort for dispute resolution in the event of failure of commercial negotiation. Declaration is an important mechanism to enhance competitive conditions in dependent markets, especially when the monopoly supplier is vertically integrated, as is Caltex.

- (f) **ecologically sustainable development**

N/A.

- (g) **social welfare and equity considerations, including community service obligations**

N/A.

- (h) **government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity**

None identified.

- (i) **economic and regional development, including employment and investment growth**

Increased access will result in enhanced competitive conditions in a number of dependent markets, resulting in increased employment and investment opportunities at Sydney Airport and in Sydney, NSW and Australia generally, for the reasons stated above.

- (j) **the interests of consumers generally or of a class of consumers**

The improvements in commercial opportunities for domestic and international airlines will benefit the travelling public and businesses. Australians will have enhanced opportunities to travel overseas as the benefits of greater competition between fuel suppliers will translate into a greater range of services and/or lower prices for air travel. For businesses where air travel to and from Sydney is a significant component of their costs, the lowering of costs will improve their competitive position.

- (k) **the competitiveness of Australian businesses**

As an input cost in terms of export and import, any reduction in costs of these services should result in a saving to Australian businesses which in any way, directly or indirectly, acquire or sell goods or services requiring jet aircraft services.

- (l) **the efficient allocation of resources**

Declaration should improve allocative efficiency by enhancing competitive conditions in a number of dependent markets.

Through declaration, the additional increase in jet fuel demand above that currently forecasted will bring forward the need for an additional pipeline(s) from the off-site storage facilities to Sydney Airport. Once the additional pipeline(s) is available, this should remove the need for access regulation over the Jet Fuel transport service. Declaration now, therefore, can improve on the timing of more competitive outcomes over the jet fuel infrastructure supply chain.

## 16. Residual discretion

### 16.1 Identify any considerations the Council should take account of as part of its residual discretion

None identified.

- (a) **Why are these considerations relevant to the Council's recommendation?**

N/A.

- (b) **What are the implications of these considerations for the Council's recommendation?**

N/A.

## **17. Duration of declaration**

### **17.1 Specify the preferred period of declaration**

10 years.

- (a) **Why is this period preferred?**

The capacity of the upgraded Caltex Pipeline, together with the Shell Pipeline, is sufficient to meet target replenishment rates out to about 2020, at average daily demand out to 2024. Planning approvals and construction timeframes mean that it will take about five years for an additional pipeline(s) to be providing Jet Fuel transport services.

New suppliers of jet fuel will incur a number of start up costs in providing jet fuel at Sydney Airport. Certainty over the terms and conditions of access to the Caltex Pipeline for an extended period of time will ensure that these costs can be amortised over a reasonable timeframe.

10 years is, therefore, also considered suitable given the existing capacity and the likely five year timeframe before the service of a new pipeline would be available from when a decision is made to invest in the second pipeline.

- (b) **What would be the consequences of a longer or shorter period?**

Greater than 10 years: It might be that a competing pipeline(s) is available before the expiry of the declaration. However, declaration provides only for a dispute resolution mechanism. If a second pipeline(s) did become available within the 10 years, then the declaration would effectively become redundant. Given the enhanced ability for jet fuel suppliers to obtain access to either pipeline under far more competitive conditions, it would not be necessary to rely on declaration to obtain a Jet Fuel transport service on reasonable terms and conditions.

Less than 10 years: Caltex could remain the sole supplier of Jet Fuel transport services from the off-site storage facilities for a period of time until a competing pipeline(s) was available. Caltex could use this period (especially given the potential lack of available capacity with growing jet fuel demands) to refuse or limit access to other jet fuel suppliers (i.e. force out new entrants that achieved entry through declaration). This could prove to be detrimental in ensuring effective competition between jet fuel suppliers at Sydney Airport over the long term.

## **18. Objects and purpose of Part IIIA and the CCA**

### **18.1 Is there anything further you consider the Council should take into account in respect of the application and the objects and purpose of the CCA, particularly Part III A?**

No.

**Schedule A: List of BARA Members**

1. Air Calin (**SB**)
2. Air Canada (**AC**)
3. Air Mauritius (**MK**)
4. Air New Zealand Limited (**NZ**)
5. Air Pacific Limited (**FJ**)
6. Air Tahiti Nui (**TN**)
7. Air Vanuatu (**NF**)
8. Cathay Pacific Airways Ltd (**CX**)
9. China Southern Airlines (**CZ**)
10. Delta Airlines (**DL**)
11. Emirates (**EK**)
12. Etihad Airways (**EY**)
13. Eva Airways Corporation (**BR**)
14. Garuda Indonesian Airways (**GA**)
15. Japan Airlines (**JL**)
16. Korean Air (**KE**)
17. Malaysia Airlines (**MH**)
18. Philippine Airlines (**PR**)
19. Qantas Airways Limited (**QF**)
20. Qatar Airways (**QR**)
21. Royal Brunei (**BI**)
22. Singapore Airlines (**SQ**)
23. South African Airways (**SA**)
24. Strategic Airlines (**VC**)
25. Thai Airways International (**TG**)
26. Turkish Airlines (**TK**)
27. United Airlines (**UA**)
28. Vietnam Airlines (**VN**)



29. Virgin Atlantic Airways (**VS**)
30. Virgin Australia (**DJ**)