Our Ref: RAD:199327
Your Ref: 1530.3A

HWL EBSWORTH
LAWYERS

4 November 2011

The Executive Director
National Competition Council
GPO Box 250
MELBOURNE VIC 3001

Dear John

Application for declaration of jet fuel supply infrastructure services provided by the Caltex Pipeline Facility, Sydney Airport

I refer to your letter dated 27 October 2011, and respond as follows:

1. **The Service**:

   The Applicant adds the following sentence to paragraph 4.1 of the Application:

   "The Application is restricted to the service provided by that part of the Caltex Pipeline from its interconnection with the Vopak storage facility, to and including its interconnection with the JUHI, including the filtering, straining and other equipment owned by Caltex at the interconnection with the JUHI, together with any other ancillary equipment necessary for the operation of the specified part of the Caltex Pipeline."

2. **Commercial developments in the market place**:

   Attached is a further Supplementary Submission from BARA dated 4 November 2011.

3. **Duration of Declaration**

   The Applicant amends paragraph 17.1 of the Application to "13 years". The Applicant relies on its Supplementary Submission dated 4 November 2011 in relation to the extended declaration period.

Yours sincerely
HWL Ebsworth

Richard Davis

Richard Davis
Partner

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Supplementary submission in relation to Commercial developments in the marketplace

The Council has asked the Applicant to update or supplement its submission given Shell's decision to stop refining operations at its Clyde Refinery and convert its Gore Bay Terminal into a fuel import facility before mid 2013. The Applicant had noted this likely development in its Application for declaration of the Caltex Pipeline (p. 20).

To supplement the initial Application, the Applicant considers that there are two main issues to be considered given Shell's decision, being the implications for:

1. jet fuel transfer capacity to Sydney JUHI and, in particular, the timing of an additional pipeline (most likely from Vopak's offsite storage facilities to Sydney JUHI), and
2. market outcomes, in terms of both the level of effective competition between existing suppliers and the potential for new entrants.

These two issues are addressed below. The Applicant does not consider that the market developments have any material impact on the Sydney JUHI. Regardless of the pipeline through which jet fuel is transferred, Sydney JUHI remains the monopoly provider of the Storage Facility and Hydrant Network at Sydney Airport.

Jet fuel transfer capacity

Shell's decision provides Shell with the option of increasing its jet fuel transfers to Sydney JUHI. The stated maximum transfer capacity of Shell's pipeline is 3.9 ML per day. Currently, Shell transfers, on average, 2.2 ML per day. This means that Shell has the option of increasing transfers by about 1.7 ML per day. The current average day demand is estimated at about 7.8 ML per day. The Applicant understands that Shell also currently imports jet fuel through Port Botany and transfers this fuel to Sydney JUHI via Vopak's storage facility and the Caltex Pipeline.

In assessing the potential increase in transfer capacity, the Applicant does not claim to have a detailed understanding of Shell's operational requirements in transporting jet fuel to Sydney JUHI. However, the Applicant would understand that the pipeline from Shell's Gore Bay Terminal to Clyde Refinery will primarily transport fuel for road transport. It is also understood that Shell will need to clean the pipeline each time it decides to transport jet fuel rather than fuel for road transport.

This means that depending on the relative profitability of sales of fuel for road transport and jet fuel, it may not prove worthwhile for Shell to transfer jet fuel to Sydney JUHI at the maximum capacity possible through its pipeline. Instead, it may be in Shell's financial interest to essentially maintain the status quo arrangements, increase marginally or perhaps even decrease its transfers to Sydney JUHI through its pipeline. Shell's commercial incentive in relation to jet fuel transfers also may change through time. This means that it cannot be assumed that the effective transfer capacity to Sydney JUHI will increase by the full 1.7 ML per day.

If Shell was to increase transfers by 1.7 ML per day (to 3.9 ML in total), then given the upgrade to the Caltex Pipeline to 10 ML per day, the total transfer capacity to Sydney JUHI would be about 13.9 M per day.

With a target replenishment rate of 1.2 times daily demand, the required transfer capacities contained in the SJFIWG Report is 13.68 ML per day in 2019 and 16.64 ML per day in 2024. This means that an additional pipeline will still be required at some point during 2020. If Shell makes full use of its pipeline, then this would likely delay the need for an additional pipeline by around two to three years, given projected growth in jet fuel demands.

Likely market outcomes

The most likely outcome of Shell's ability to increase its supply of jet fuel to Sydney Airport is a modest redistribution of sales between existing suppliers. It cannot be expected to increase the level of effective competition between existing jet fuel suppliers or encourage new suppliers to enter the market. In summary, marginal increases in the transfer capacity of the existing oil companies will not alter the underlying market conditions. In fact, the Applicant would still be seeking declaration of the Caltex Pipeline and the Sydney JUHI even if Shell was presently utilising its Pipeline to its full capacity.

The current market for jet fuel is one of high industry concentration, with the two largest suppliers (Caltex and Shell) enjoying considerable market power. It is not in the interest of either Caltex or Shell to dissipate the profits currently earned on the sale of jet fuel through aggressive price competition due to marginal increases in Shell's jet fuel transfer capacity.

Instead, it is more profitable for Caltex (as the dominant supplier) to accommodate any increases in sales by Shell through either less sales by itself and/or reducing the sales of other suppliers by restricting access to its Pipeline. For Caltex, any loss in immediate sales can be recouped in a relatively short timeframe given the projected increases in jet fuel demands at Sydney Airport.

It is also in Shell's interest not to start or encourage aggressive price competition between suppliers. If Shell did compete aggressively on price to expand sales, then total profits would likely fall given the market power it has on existing sales. One therefore cannot expect Shell's increase in jet fuel transfer capacity to translate into increased competition between jet fuel suppliers at Sydney Airport.

If Shell did increase transfers through its own pipeline, and possibly cease making use of the Caltex Pipeline, then this would free up some capacity in the Caltex Pipeline. Caltex, however, given its current market power, has little incentive to make any such capacity available to new suppliers of jet fuel.

Rather, Caltex actually has the incentive to reduce the available capacity of its Pipeline to competitors below what is currently provided (five days per month). By doing so, it would mean that any increase in sales by Shell is borne by both Caltex and the other providers. Reducing available transfer capacity also would reduce the incentive for jet fuel suppliers reliant on the Caltex Pipeline to compete aggressively, as their total available market is already largely controlled by Caltex.

In summary, if Shell does increase the use of its pipeline to the full extent possible, then this is likely to delay the need for an additional pipeline by around two to three years. It is also likely to increase the combined market dominance of Shell and Caltex in the market for jet fuel to airlines operating to and from Sydney Airport. Neither Shell nor Caltex has any incentive to increase the level of competition between jet fuel suppliers. Caltex also has no incentive to allow more jet fuel suppliers to enter the market through increased access to its Pipeline.

The Applicant, therefore, does not consider the decision by Shell reduces the case for the declaration of both the Sydney JUHI and Caltex Pipeline. Indeed, the likely outcome without declaration is an increase in the combined dominance of Shell and Caltex, which further supports declaration.

However, as the need for an additional pipeline could be delayed by two to three years, the Applicant considers it appropriate to extend the declaration period of the Caltex Pipeline by 3 years, to 13 years in total, to best match the likely timing of the additional pipeline. The Applicant, therefore, requests that the Council give due consideration to extending the declaration period of the Caltex Pipeline by three years.

4 November 2001