



BP AUSTRALIA PTY LTD

**SUBMISSION BY BP AUSTRALIA PTY LTD
REGARDING THE BARA APPLICATION FOR
'SERVICE NO 1: PROVIDED BY THE SYDNEY JUHI
FACILITY'**

21 November 2011

TABLE OF CONTENTS

1.	INTRODUCTION	3
2.	REASONS WHY THE SERVICES PROVIDED BY THE SYDNEY JUHI SHOULD NOT BE DECLARED.....	3
3.	RATIONALE FOR JV MODEL OF JUHI OPERATION.....	5
4.	ARRANGEMENTS AT OVERSEAS AIRPORTS ARE NOT COMPARABLE	6
5.	CONCLUSION	12

1. INTRODUCTION

1.1 BP Australia Pty Ltd, trading as Air BP (*Air BP*)¹, has contributed to:

- (a) the submission by the Sydney Airport JUHI - in its capacity as a participant in the unincorporated joint venture that owns the Joint User Hydrant Installation (**JUHI**) at Sydney (Kingsford-Smith) Airport (**Sydney Airport**); and
- (b) the submission by Airport Fuel Services Pty Limited (**AFS**) - in its capacity as a shareholder in AFS,

which submissions were made in response to the Board of Airline Representatives of Australia (**BARA**) application to the National Competition Council (**NCC**) to declare the Jet fuel infrastructure at Sydney Airport.

1.2 Air BP is making this submission in its own right to provide further Air BP specific information in support of the arguments made in the aforementioned submissions. Air BP fully supports all of the arguments made in the aforementioned submissions, and for the sake of brevity, has not repeated those arguments in this submission but only seeks to identify additional information in support.

2. REASONS WHY THE SERVICES PROVIDED BY THE SYDNEY JUHI SHOULD NOT BE DECLARED

2.1 Air BP believes that the NCC should reject the BARA submission on the following grounds:

- (a) **Pricing:** The proposition that Sydney Airport market is uncompetitive with Jet Fuel differentials that are the highest in the world is misleading and factually incorrect. The basis of the comparison of international airports does not properly consider differences in infrastructure ownership, airport volume effects, sea freight costs, foreign exchange impacts, the appropriate Jet marker pricing basis or duties and taxes, all of which are material in the determination of Jet fuel differentials.
- (b) **JUHI Access:** There is already a clear mechanism for any new fuel supplier to access the JUHI as exercised by the most recently joining member of the JUHI. This method of access has been proven to work.
- (c) **Industry Funded Infrastructure:** Sydney Airport and its associated Jet fuel infrastructure has been funded by the industry, without assistance or support of the state, whom put their capital at risk in order to derive a return. This is a highly efficient and effective model that underpins Australian industry and enables the efficient and timely allocation of capital in order for the nation to grow and prosper.

¹ "Air BP" is the trading name of the legal entity BP Australia Pty Ltd.

- (d) **Product Quality:** There is no recognition that the most important element in supplying Jet Fuel is the safety of the travelling public and the rigorous quality control and operational regime that is required to deliver this. Any review of the Jet fuel market must be cognisant of the quality control standards, the exacting requirements to source, test and ensure the highest standards that underpin the excellent safety record in Australia. The changes proposed by BARA have the potential to lead to developments which undermine this critical aspect of the Jet fuel supply chain.
- (e) **Throughputters Potential Impact on Competition:** Air BP does not support BARA's assertion that enabling throughputter access, without any investment in infrastructure, will enhance competition. Introducing more suppliers through existing infrastructure without any requirement to invest will do little to enhance capacity, efficiency or change market dynamics. On the contrary, Air BP believes the introduction of throughputters will potentially create a disincentive for equity shareholders to continue to allocate and invest capital in the Sydney JUHI infrastructure, which is needed for Sydney Airport to grow.
- (f) **Speculative Margin:** BARA's submission is silent on the motivation a throughputter may have to gain access without any sunk cost or capital at risk. Under this model, a throughputter can speculatively trade paper and physical positions based on Jet demands to derive income. A "Trading" margin can be derived from taking these speculative positions and it can be this margin, rather than servicing long term airline demand at the Airport that may provide a short term incentive for throughputters to access the JUHI. It may not however incentivise investment or encourage the long-term allocation of capital to fund the long term needs of Sydney Airport.
- (g) **Anti-Competitive Conduct:** Air BP refutes, in the strongest possible fashion, the BARA assertion that the JUHI Jet fuel suppliers engage in anti-competitive activity.
- (h) **Vertical Integration:** Vertical integration works to efficiently provide a route to market for Jet fuel travelling from refinery gate (or ship supplied storage facility) to aircraft wingtip. It also enables the cost efficient management of the risk, liabilities and insurance obligations of this process.

2.2 It is for these reasons that Air BP believes BARA's application is flawed, in both theory and practice, and believes the NCC should decline the request for declaration for services provided by Sydney JUHI.

3. RATIONALE FOR JV MODEL OF JUHI OPERATION

3.1 Equity participation is an appropriate and efficient model at Sydney Airport

- (a) Air BP, on a global basis, has substantial involvement in the aviation fuel industry, and our experience is that equity participation provides the most certain, fair and transparent mechanism for allocating the large and uncertain costs and risks between users in a manner which ensures reliable operation and on-going investment in the infrastructure.
- (b) The main costs and risks involved in the use and operation of the JUHI, and the need for ongoing capital investment, are set out in the Sydney JUHI submission, and are not covered again here. Air BP does highlight though that these risks include risks associated with:
 - (i) the safety of site operations at what is a major hazardous goods storage facility; and
 - (ii) the integrity of fuel product quality delivered to aircraft.
- (c) These are risks that have a major impact on stakeholders such as airlines and other airport users and the public using airline services. They are risks that are well managed in the current JUHI environment of clearly shared obligations, risk and liability within equity participants.
- (d) Air BP believes there would be a much higher degree of uncertainty over the ability of JUHI participants to have effective control and management over these risks in a regulated throughput scenario.
- (e) Air BP believes the NCC should give specific consideration to these potential downsides.

3.2 Difficulty of capturing costs and risks in a throughput fee

- (a) The Sydney JUHI submission explains the significant impediments to capturing all the costs and risks involved in the operation of the Sydney JUHI in a throughput fee.
- (b) Of particular concern to Air BP is the impact that a regulated throughput regime would have on the equity participants and their willingness and commercial ability to continue to be the sole investment source for fuel facility development and expansion. There is a long history of continued investment by joint venture participants at Sydney JUHI and across airport fuel facilities throughout Australia. Future investment is unlikely to be attractive to JUHI equity participants in the scenario that non-investing parties can gain throughput access.
- (c) This is reflected in the experiences at other global airports where throughput does occur. At those locations, facility ownership, operational risk, long-term liabilities and obviously investment needs are held by alternative, and often state owned or controlled parties, and not as in the Sydney JUHI case, by the fuel suppliers.

3.3 Current JUHI access procedure is appropriate and workable

- (a) Air BP believes a critical examination of the entry criteria for new entrants to the Sydney JUHI clearly shows them to be objectively fair and reasonable, clearly necessary and not unduly onerous or arbitrary. They are quite consistent with entry requirements commonly required in equity participant JUHIs around the world.
- (b) Most relevantly, Air BP highlights that most of the entry criteria would have to be applied to any applicant seeking access – regardless of whether such access is by equity ownership or throughputting. This fact reflects the inherent appropriateness of the criteria.

4. ARRANGEMENTS AT OVERSEAS AIRPORTS ARE NOT COMPARABLE

- 4.1 In its submission BARA draws upon a completely inappropriate comparison with other airports. The comparisons do not take into account considerable differences in commercial and ownership arrangements, supply route costs and airport market size.
- 4.2 The JUHI submission provides considerable comment on the errors or incorrect assumptions and Air BP do not include them again in this submission. Air BP highlight though that we view the comparative data provided by BARA to be manifestly inadequate and reflects a failure of the BARA submission to support its assertions regarding competitiveness or reliability of Jet fuel supply at Sydney Airport.
- 4.3 Air BP would like to provide further specific information to assist in any comparison of Sydney JUHI to other global Airports, particularly in regard to assertions from BARA in regarding to pricing comparisons.

4.4 Price differential comparison

- (a) The Sydney JUHI submission explains why BARA's attempt to compare fuel differentials at various airports and to draw conclusions from differentials about supplier pricing behaviour at Sydney Airport is inherently flawed.
- (b) Air BP wishes to provide further information to explain the different bases for fuel differentials at different airports.
- (c) In general, airlines contract with fuel suppliers via tendering processes. Fuel suppliers provide pricing quotes to airlines referencing a product benchmark price and a fixed "add-on" price which is commonly termed a "differential". The benchmark price will reflect the closest trading market for that airport. For Australian airports, the prices quoted by fuel suppliers are quoted as Mean of Platts Singapore (**MOPS**) plus a differential. "MOPS" reflects the price of Jet fuel on the Singapore trading market which posts daily prices. MOPS is used in Australia because there is no Jet trading market in Australia. The differential (the fixed component "add-on") reflects the various costs associated with delivering fuel into aircraft, and the supplier's margin.

(d) There are a number of different transport, access and cost considerations for airports around the world and these generate fuel related costs in different ways. For these reasons, comparisons of airports across the world are not readily undertaken because it is difficult to take into account all of the variables so as to provide a meaningful comparison.

(i) *Fees and Charges*

- (A) The fees and charges included in the fuel differential will vary from airport to airport.
- (B) For example, at airports such as Los Angeles and Hong Kong, fees or charges are typically applied directly onto the end user by the owner/operator of the fuel facility, and will not form part of the fuel supplier's price.
- (C) By contrast, the equivalent cost of those same services at Sydney Airport are directly included in the price offered by fuel suppliers.
- (D) Accordingly, in one location the differential will exclude a component for access to fuel facilities and/or completion of into-plane services and in the other instance the differential will include these costs.
- (E) It is not clear from BARA's fuel differential table² if and how this has been addressed. BARA's "add-on" figure may not have a consistent basis for application of airport fees and charges to offset the equivalent services being included in the Sydney and Melbourne differential.

(ii) *Relevant Benchmark (product price)*

- (A) The BARA quoted differentials are referenced as being the "add-on" the customer pays over and above the quoted Singapore Jet price (MOPS).
- (B) It should be noted that fuel suppliers do not quote differentials against MOPS for all of the airports listed. There are numerous benchmarks in the differing Jet trading markets around the world and the relevant trading market for each airport needs to be used in any attempted analysis.
- (C) It appears that BARA has used MOPS in some instances when it is not the appropriate local Jet benchmark.

² Figure 1 in BARA JUHI application.

- (D) For example, the relevant Jet benchmark for European locations is CIF North West Europe or Barges FOB Rotterdam. For Dubai, the relevant Jet benchmark is the Arab Gulf Jet marker. For the US, there are different markers for product sourced out of the US West coast, North East and US Gulf Coast.
- (E) BARA's attempt to compare fuel price differentials, if it is as indicated in BARA's application, based on calculating differentials above a consistent benchmark of MOPS, is irrelevant as it is not based on the appropriate benchmark Jet price.

(iii) *Impact of transportation costs*

- (A) As noted above, as there is no Jet fuel index benchmark actively traded specifically for Australian ports, MOPS is used as a proxy benchmark.
- (B) When MOPS is used for Australian airport pricing, the benchmark does not include freight from Singapore or relevant source port to Australian ports and related sea freight charges (wharfage and demurrage costs, insurance and transit volume losses). Hence it is the differential that includes the notional cost of transport from the benchmark market (Singapore) to the airport location.
- (C) For Australian airports, this sea freight transportation component will be a significant cost and a high proportion of the differential.
- (D) The supply logistics for this transportation cost for Australian airports reflects:
 - (1) Long voyage times and small parcels;
 - (2) Multi product cargos (generating higher costs);
 - (3) A requirement in some instances for two port loading and a common requirement for two (or more) port discharges - also generating higher costs;
 - (4) Minimal return freight cargo, and hence freight costs to Australia include an additional vessel repositioning cost (unlike many other freight destinations, such as Hong Kong, Thailand and Malaysia);

(5) The lack of cross-country pipeline systems (unlike US and Europe locations which often have cross-country pipeline supply options offering a much lower cost transportation option).

(E) Air BP notes that other airports included in the BARA submission, and other airports in general in Europe and the US, generally do not incur such significant transport costs. Airports such as Singapore, for example, which are located at a fuel trading hub, will have only a very minimal transport cost component in the fuel differential quoted by fuel suppliers.

(e) *Data integrity and analysis concerns*

Air BP also has a number of general concerns with the integrity of the fuel differential data cited by BARA in its application:

- (i) BARA have not replicated their data over a significant time period or over multiple months, and hence their analysis may be overly influenced by particular supply conditions at that point in time;
- (ii) BARA has not identified the customer mix, and differentials vary according to customer size, credit terms, and contract length. For example, it is common in the US for differentials to reflect customer prepayment while in Asia longer credit terms are common;
- (iii) BARA has not identified the details of the methodology used for determining the differentials it quotes, and it is not clear what methodology could have been used to make this a meaningful comparison;
- (iv) BARA's data appears to include a selection of larger airports with lower supply costs for the marginal short volume. This presents a significant bias in the data presented. Reflecting import parity pricing principles, the differentials for Sydney and Melbourne Airports will include the notional transport cost from Singapore to Sydney. Similarly, a transport cost will be included in the differentials for other airports. However, the significant variation is in the scale of those costs. Transportation costs from Singapore to Australia are several times higher than the equivalent costs for European, US or Asia locations.

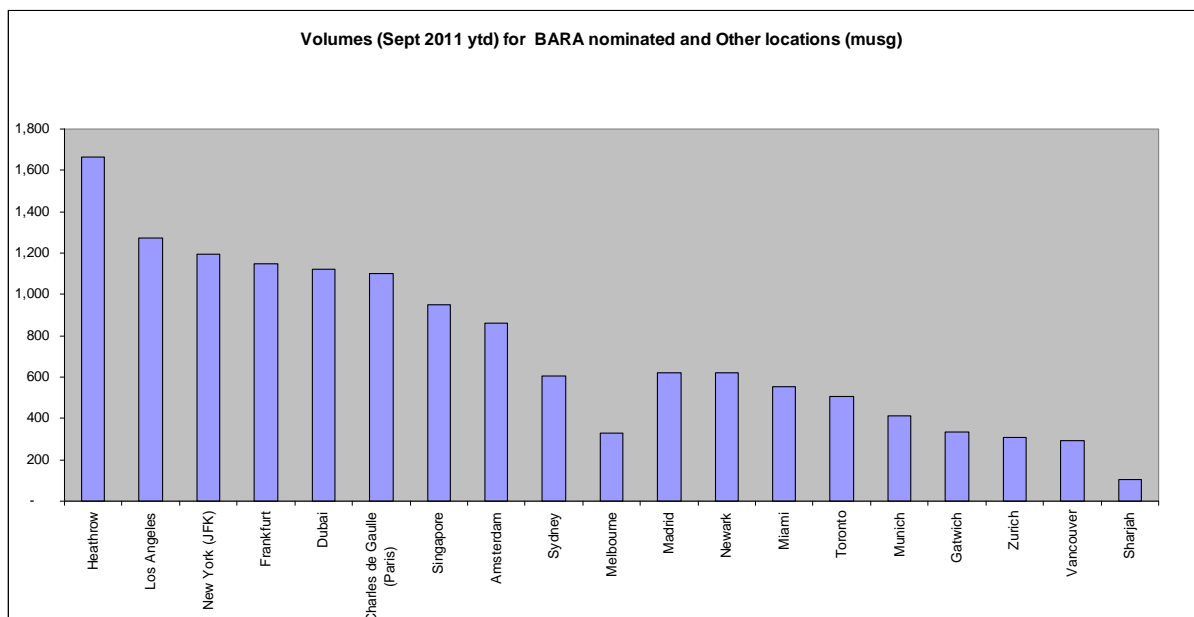
(f) *Exchange Rate impacts*

In Australia, Air BP's costs (such as storage, pipeline fees and into-plane fees) are primarily incurred in Australian dollars, but international airlines require quotes (and pay) in US dollars. This introduces exchange rate volatility to Jet fuel differentials and as evidenced by the strengthening Australian dollar in recent years, and can have the impact of significantly eroding Australian dollar based margins.

(g) A more accurate and meaningful comparison

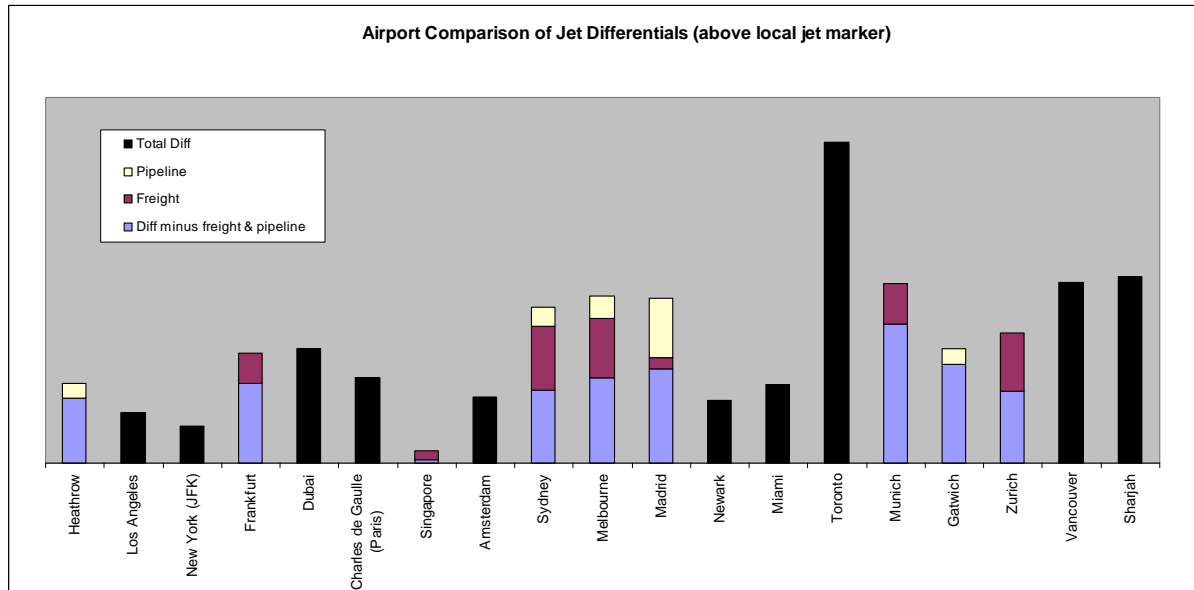
(i) **Figure 1** below gives some perspective on the relative Jet volumes at various comparator airport markets including many of the locations cited by BARA in its differentials comparison table. This illustrates that Sydney and Melbourne Airports are the smallest in terms of volume relative to the BARA quoted locations, and in the case of Los Angeles, Frankfurt, Dubai, New York, Paris, these airports are double the volume. London is 270% larger and Singapore & Amsterdam are circa 50% larger.

Figure 1: Volume (Musg) estimates for airports to show relativity to Sydney Airport



(ii) Figure 2 below provides comparative data for the BARA referenced locations and additional similar sized airports based on what Air BP considers to be a more accurate reflection of the differentials for these airports. This Air BP estimation is based on based on weighted average differentials, and includes fees and taxes and relates to the same time period as used in the BARA graph (July 2010). This comparison is made against the applicable local Jet fuel benchmark applying at each airport. Where data was readily available the differential was separated to show the varying impact of Fees and Charges and of Transportation (sea freight and pipeline). Figure 2 demonstrates that Sydney and Melbourne Airports are certainly not outliers in terms of Jet fuel differentials. It also highlights that sea freight is a significant component of the overall differential, reflecting the points made above that there are higher transportation costs for Australian airports.

Figure 2: Market differential comparison using local benchmark (incl fees & charges)



Note: For reasons of commercial sensitivity, the above shows the relative differences between airports rather than absolute figures. The above is based on Air BP data.

(h) *Summary:*

- (i) In summary, the fuel differential comparison relied upon by BARA is not a consistent and meaningful comparison.
- (ii) Differentials presented by BARA are said to be the “add-on” above MOPS (the Singapore Jet trading market price) for all the airports cited by BARA. This is a wholly inappropriate comparison as many of those airports are not supplied from Singapore and the Singapore trading market is not the relevant benchmark used by fuels suppliers in their offers and contracts with airlines.
- (iii) The significant transportation costs associated with Australian locations are not considered and neither is the relative size of the airport markets.
- (iv) Most importantly, BARA makes the inappropriate and incorrect assumption that differentials directly reflect margins. In fact, a Jet fuel supplier's margin is only one of the many factors taken into account in a fuel differential, and margins cannot be identified without analysing the various cost components which go into each differential. The fuel differential comparisons presented by BARA say nothing about the behaviour of Jet fuel suppliers at Sydney Airport, and are inaccurate and misleading.

5. CONCLUSION

- 5.1 Air BP believes that the BARA application fails to consider the long-term needs of Sydney Airport. Its analysis appears superficial, its arguments are misleading and predicated by sweeping assumptions that compare international airports without cognisance of ownership models or pricing bases. Air BP remains deeply concerned by this proposal and feels obliged to illustrate to the NCC the unintended consequences of such a declaration. In Air BP's view, BARA's proposal would dis-incentivise investment in Sydney Airport, constrain the growth and prosperity of the Airport and community it serves and, significantly reduce safety and product quality standards.
- 5.2 BARA's case heavily draws upon the comparison of differentials between international airports. However, as illustrated in our submission, it does not take into account the material impact of sea freight rates or the fundamentally different pricing bases, which when taken into account prove that Sydney airport is a highly competitive and efficient marketplace. Furthermore, the notion that absolute levels of differentials reflect profit margins is factually incorrect as in the number of competitors present in a given market as a determinant of competitive intensity.
- 5.3 BARA's proposition that its members have access to infrastructure without any need to invest its capital or place its resources at risk, overlooks the investment model in Australia. Generally speaking, where throughputters access infrastructure, it has been funded by the state (e.g. Hong Kong Airport), or enjoys access to a fully depreciated, government owned legacy systems (e.g. UK's GPSS pipeline) that enables a throughputter to enjoy these assets without capital investment. In a geographically dispersed country such as Australia, the government encourages, and in deed requires, private capital to be invested in order to fund vital energy infrastructure to support the long-term growth of the nation. One cannot make a meaningful comparison of international airports without recognition of this fundamental difference in investment models.
- 5.4 Similarly, Air BP believes that one must consider the motivation of a throughputter to free-ride assets. In our view, this is underpinned by the speculative trading activity of throughputters whom may trade Jet based products (paper, futures and physical product) to earn income from global market structures. In order to derive this income, a throughputter typically needs a physical outlet for these trades, such as Sydney Airport. However, as these market structures change, it may be a significant determinant in the appetite of a throughputter to continue to market when opportunity becomes more attractive elsewhere. This should be brought to the NCC's attention, as it will in Air BP's view, have a significant impact on the ability of private capital to be attracted into material long-term investments required at Sydney Airport when the prime benefactor is throughputters, whom could use the ability to free ride infrastructure to capitalise upon trading opportunities.
- 5.5 Furthermore, one only has to look at Airports that have embraced the free riding model BARA proposes to see how this has resulted in infrastructure plagued by under investment and the erosion of safety and product quality standards that can occur. In Air BP's view, Australian airports operate to a very high standard of operations and product quality controls in comparison to such Airports.

- 5.6 The inference made by BARA, that Sydney Jet fuel suppliers (assuming inclusive of Air BP) is engaged in anti-competitive practices is strongly refuted by Air BP. If BARA has any evidence whatsoever to support this allegation it should be brought immediately to the attention of the ACCC and Air BP.
- 5.7 Finally, Air BP believes that the existing model works and is the most equitable, transparent and sustainable model that enables and encourages any new entrant to access the JUHI. This model has been proved to work by the most recent investor into the JUHI and in Air BP's opinion, there is no logical justification for change, other than to serve the self-interest of BARA and its members.
- 5.8 For such reasons Air BP respectfully requests that the NCC exercise its discretion against declaration.