

**Application for declaration of the JUHI and
Caltex Pipelines**

Qantas Group Submission

To The National Competition Council

21 November 2011



Qantas Group Response

The Qantas Group (**Qantas**) appreciates the opportunity to provide information to the National Competition Council (**NCC**) in relation to the application for declaration of both the Joint User Hydrant Installation (**JUHI**) at Sydney Airport and the Caltex Pipeline from Kurnell (**Caltex Pipeline**) lodged by the Board of Airline Representatives Australia (**BARA**).

Qantas is in a unique position with regard to the application compared to other airlines and oil companies, because Qantas:

- is a member of BARA;
- is an equity participant in JUHI (along with Shell, BP, ExxonMobil and Caltex);
- has negotiated ongoing commercial access to the Caltex Pipeline from 2007; and
- became a self-supplier at Sydney Airport in 2007.

Qantas believes there are a number of strong reasons why the applications should be declined at this time. The relevant statutory test for declaration has not been met in respect of either the JUHI or the Caltex Pipeline.

The applications should be declined because:

- the problem with reliability of jet fuel supply at Sydney Airport is one of capacity, not access - the most appropriate solution, currently being led by the market, is capacity expansion;
- access to the infrastructure can be, and already has been, granted on competitive, commercial terms;
- declaration will not relieve physical supply constraints;
- declaration is likely to reduce or remove the incentive to invest in capacity expansion;
- declaration will not promote increased competition in any related market;
- BARA has failed to prove that it would be uneconomic to duplicate the relevant facilities. In fact, if current expansion plans do not proceed, it will be economically necessary to duplicate parts of the supply chain and build a new pipeline; and
- declaration is premature and will not be in the public interest. It is Qantas' strong view that declaration would unduly interfere with this progression and stifle the incentive to invest. With declaration, the markets would be less competitive than without declaration.

Overview of Jet Fuel Supply Infrastructure at Sydney Airport

JUHI

The JUHI is an unincorporated joint venture that owns a jet fuel storage, transfer and underground reticulation system. It provides links to aircraft refuelling aprons at Sydney Airport (domestic and international).

The owners of the JUHI are BP, Shell, ExxonMobil, Caltex and Qantas. The JUHI is governed by the *Agreement for Ownership and Operation of Joint User Hydrant Installation at Sydney (Kingsford-Smith) Airport as amended in 2001 (JUHI JV Agreement)*. Participants in the JUHI are entitled to supply and withdraw jet fuel to and from the JUHI facilities for ultimate delivery at Sydney Airport. Participants make their own “into-plane” arrangements.

Among other things, the JUHI JV Agreement sets out the terms on which third parties can access JUHI, by providing an equity contribution and paying usage fees. These access terms are reasonable and objective.

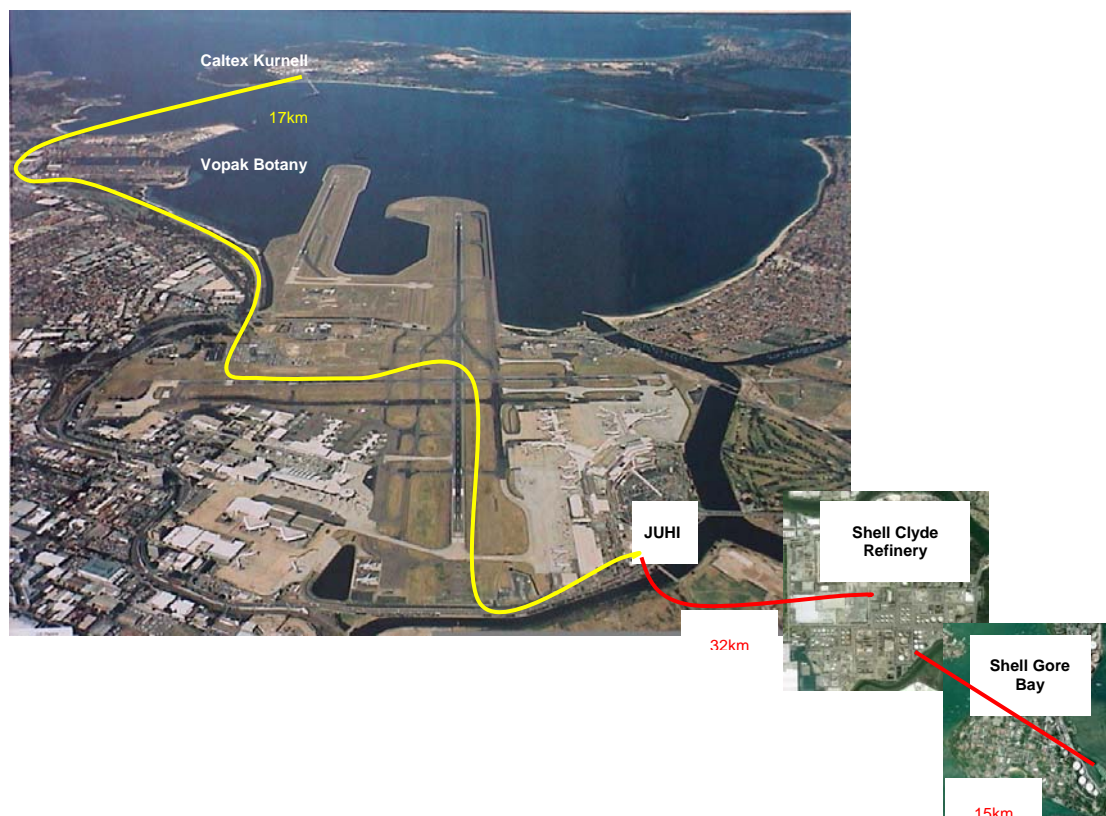
As discussed further below, Qantas was not a foundation member of JUHI. It became an equity participant in “Component A” (tankage and hydrant facilities for the international apron) in 1988 and in “Component C” (domestic hydrant) in 2001. Component B (the pipeline connecting the international and domestic aprons under the runway) was constructed in 1990 and Qantas funded a 20% share of this at the time of construction. These were key steps in enabling Qantas to “self supply” its fuel requirements in Sydney at both the international and domestic aprons.

It is open to other third parties to apply to join the JUHI at any time.

Supply Pipelines

Figure 1 below shows that two pipelines, owned and operated by Caltex and Shell respectively, supply jet fuel to the JUHI facility.

Figure 1: Pipelines Supplying Jet Fuel To Sydney JUHI



The Caltex Pipeline, running from the Kurnell import facility, is a dedicated jet fuel pipeline.

The pipeline running from Gore Bay to Shell's Clyde refinery is currently a crude oil pipeline which also carries finished products. This means that it is not an attractive option for the carriage of jet fuel, due to the high risk of product contamination. The pipeline from Shell's Clyde refinery to Sydney JUHI (**Shell Clyde Pipeline**) is underutilised due to the Clyde refinery's jet fuel production output being less than the pipeline's capacity.

However, as described in more detail below, Shell has announced that it will be converting the Clyde refinery to a fuel terminal for the storage and distribution of refined products, such that it will no longer require crude oil. This will mean that the Shell Clyde Pipeline will be better utilised and offer greater capability for jet fuel supply from approximately July 2013 (in other words, it will stop being under-utilised). This will help to relieve the current bottlenecks.

Jet Fuel Supply Infrastructure - Overview

There are currently four fuel suppliers supplying fuel via two pipelines to Sydney Airport, with three off-airport storage locations being available.

The four fuel suppliers are Shell, BP, Caltex and Qantas (self supply only).

As shown in Figure 1 above, the two pipelines supplying Sydney JUHI are the Caltex Pipeline and the Shell Clyde Pipeline.

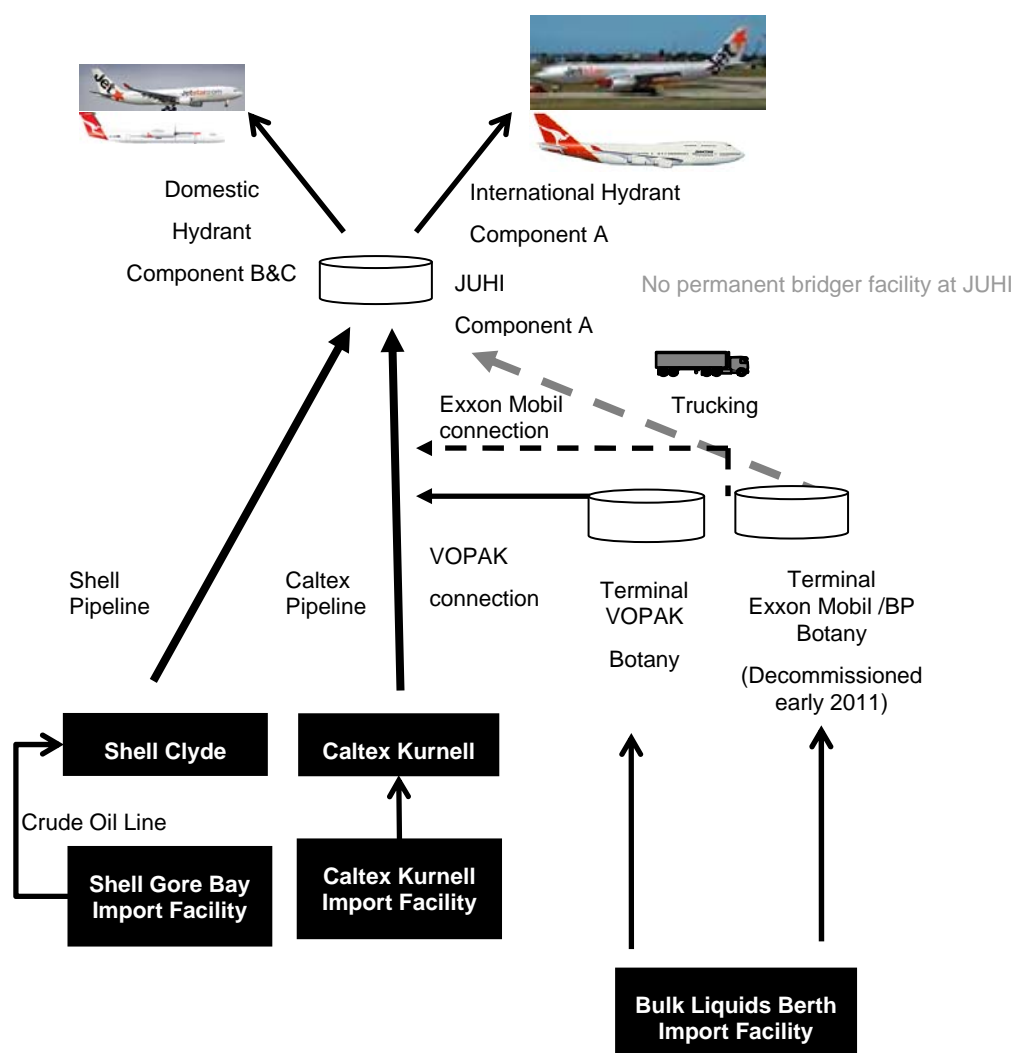
The three off-airport storage locations are Caltex Kurnell Refinery, Shell Clyde Refinery and Vopak Terminal. Shell, BP and Qantas store jet fuel at the Vopak Terminal. Vopak has a connection to the Caltex Pipeline which enables Shell, BP and Qantas to access the Caltex Pipeline. There is no truck loading facility at Vopak for Shell and Qantas (BP has a truck loading facility available at Vopak) nor is there a permanent bridger receipt facility at JUHI.

Fuel is supplied into aircraft by into-plane service providers (such as Airport Fuel Services (**AFS**)). Into-plane services are described further below.

The Bulk Liquids Berth Import Facility (BLB1) is owned and operated by the Sydney Ports Corporation. The product handling facilities at the berth are owned by each of the product terminals that are connected via a pipeline from the berth. The main products handled are refined fuels, gases and chemicals. This is an open access, multi-user facility. Jet fuel delivered at this facility is transferred to the Caltex Pipeline via Vopak. Construction of a second berth import facility (BLB2) is underway due to congestion currently experienced at BLB1.

Figure 2 below shows the jet fuel supply infrastructure at Sydney Airport.

Figure 2: Schematic diagram of jet fuel supply infrastructure at Sydney Airport



Qantas Group's Self Supply Arrangements

As set out below, Qantas' experience clearly demonstrates that it is possible to access the jet fuel supply infrastructure on commercially reasonable terms.

Reliability of supply of the required quality jet fuel (known as on specification fuel) is the prime commercial objective for the Qantas Group when managing access to jet fuel infrastructure. Given the substantial volumes of fuel Qantas requires on an ongoing basis in Sydney, flexible, agile and multi-source supply options are needed to ensure reliability.

Qantas has engaged with the infrastructure providers to achieve "self supply" on the following basis:

- **Negotiating Access To The JUHI:** Qantas now has a 16.67% equity interest in Component A and a 20% equity interest in Components B and C of the JUHI. The negotiation process is described further below;
- **Investment in Airport Fuel Services (AFS):** AFS is an incorporated joint venture. It provides into-plane services primarily to Qantas and other

international carriers at Sydney Airport. Qantas became a shareholder in AFS in 1992. The other shareholders are BP, Caltex and ExxonMobil. AFS has hydrant refuelling vehicles which connect from the in-ground hydrant reticulation system to the aircraft to enable the refuelling of the aircraft. AFS also have tanker refuelling vehicles which are filled at the truck loading facilities at JUHI and refuel off-hydrant aircraft, as well as providing defuel services;

- **Negotiating Access to the Caltex Pipeline:** Qantas successfully negotiated access to the Caltex Pipeline from 2007;
- **Negotiating Access to the Vopak Storage Facility:** Qantas has access to the Vopak storage facility through arrangements with Q8.

In order to spread risk, Qantas does not self supply all of its fuel requirements at Sydney Airport – Qantas also purchases fuel for supply into JUHI by Caltex and Shell.

Figure 3: Qantas Group Self Supply Arrangements

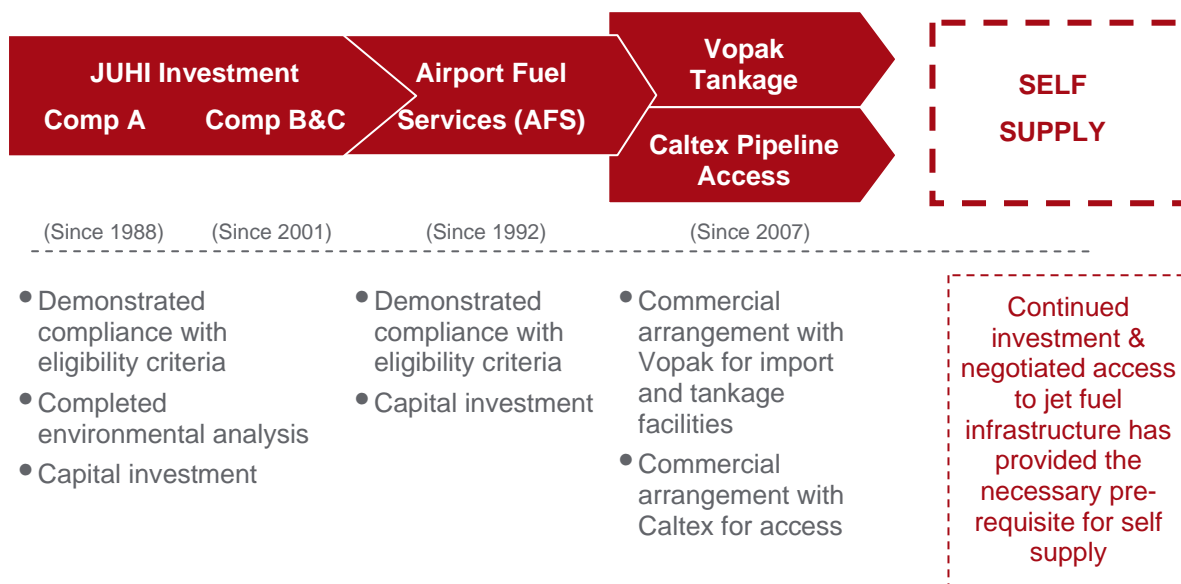
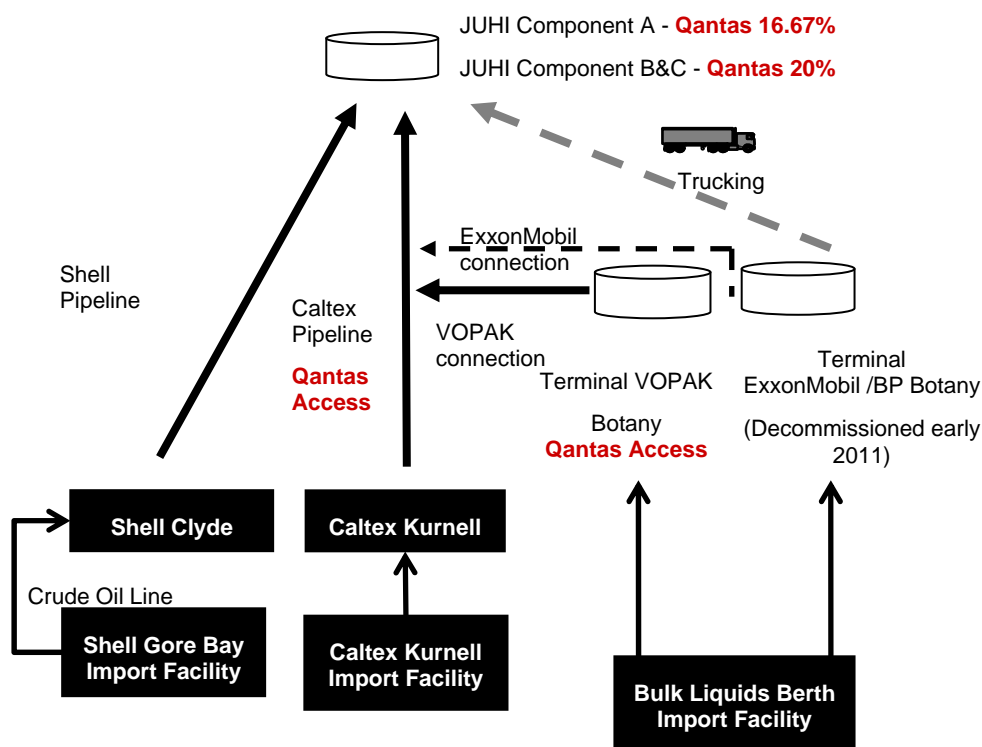


Figure 4: Qantas Group Self Supply Arrangements in the context of overall infrastructure



The problem with jet fuel supply at Sydney Airport is one of capacity, not access

The Caltex Pipeline is currently operating at maximum capacity. The Sydney Jet Fuel Infrastructure Working Group (**JFIWG**) recognised this risk to supply reliability in its report titled *Infrastructure for the Provision of Jet Fuel at Sydney Airport for the period to 2029* in April 2010 (**JFIWG Report**). The JFIWG Report reviewed the existing infrastructure at Sydney Airport against projected demand and identified deficiencies in the existing supply infrastructure, including the supply pipelines and the JUHI.

The JFIWG Report identified six potential infrastructure options to better meet projected jet fuel demand in Sydney. These were:

- upgrading the Caltex Pipeline;
- increasing utilisation of the Shell Clyde Pipeline;
- constructing a permanent bridger facility at Sydney JUHI;
- building an additional pipeline to Sydney Airport;
- building additional storage at Sydney JUHI; and
- opening additional import facilities in the Sydney basin.

Four important proposals have since been announced. These are:

- upgrading the Caltex Pipeline (known as the “Phase 2 upgrade”);
- increased utilisation of the Shell Clyde Pipeline;
- building additional storage at Sydney JUHI; and,
- construction of a second Bulk Liquids Berth at Port Botany (BLB2).

A summary of these recent announcements and their implications is provided below.

In short, the implementation of these proposals - most importantly, the upgrade of the Caltex Pipeline - will remove the previous supply chain bottlenecks and postpone the urgency of any further expansion or construction until at least 2023.

Upgrading the Caltex Pipeline

In May 2010, in conjunction with the JFIWG Report, Caltex announced its intention to upgrade its pipeline from 5 million litres per day to 10 million litres per day by late 2011.¹

Qantas understands that the upgrade has recently completed the Major Projects approval phase with the New South Wales Department of Planning and Infrastructure and that some preliminary work has commenced.

Upon completion of the upgrade, Qantas anticipates that an additional 5 million litres per day pipeline capacity will be available into the Sydney Airport jet fuel supply infrastructure.

Increased utilisation of the Shell Clyde Pipeline

In April 2011, Shell announced plans to convert its Clyde refinery into a fuel import terminal by mid 2013.² Like the Caltex Pipeline upgrade, this announcement has positive implications for the jet fuel supply chain into Sydney Airport. As published in the JFIWG Report, the Shell Clyde Pipeline has a theoretical capacity of 3.9 million litres per day, but is only currently utilised at 56% due to bottlenecks within the Clyde refinery.

As a result of the conversion of the Clyde refinery, Qantas anticipates that the bottlenecks identified by the JFIWG which limit the utilisation of the Shell Clyde Pipeline due to refinery operations and the use for crude oil of the Shell Gore Bay Pipeline will be removed. This presents the opportunity to utilise the Shell Clyde Pipeline at up to 100% by adding 1.7 to 2.0 million litres per day of pipeline capacity into the Sydney Airport jet fuel supply infrastructure from mid 2013.

Building additional storage at JUHI

The JFIWG Report identified that JUHI's current jet fuel storage capacity is suitable until 2014. JUHI is aware of this issue and has commenced discussions with Sydney Airport Corporation Limited (**SACL**) regarding lease tenure to facilitate ongoing investment in airport storage post 2014.

¹ Caltex Australia, 'Caltex investment to benefit Sydney air travel' (Press Release, 5 May 2010). Available online at: <http://www.caltex.com.au/latestnews/pages/newsitem.aspx?id=13185>

² Shell Australia, 'Proposal on future of Clyde Refinery' (Press Release, 12 April 2011). Available online at: http://www.shell.com.au/home/content/aus/aboutshell/media_centre/news_and_media_releases/2011/proposal_on_future_of_clyde_12042011.html

Implications of capacity expansion – no need for declaration

The implementation of these proposals – most importantly, the Caltex Pipeline upgrade – will remove the previous supply chain bottlenecks and remove the urgency of any further expansion or construction until at least 2023. This is demonstrated in Figure 5 below.

The developments indicate that, absent declaration, the market is moving towards expansion and increased competitive access to jet fuel in Sydney. It is Qantas’ strong view that declaration would unduly interfere with this progression and stifle the incentive to invest.

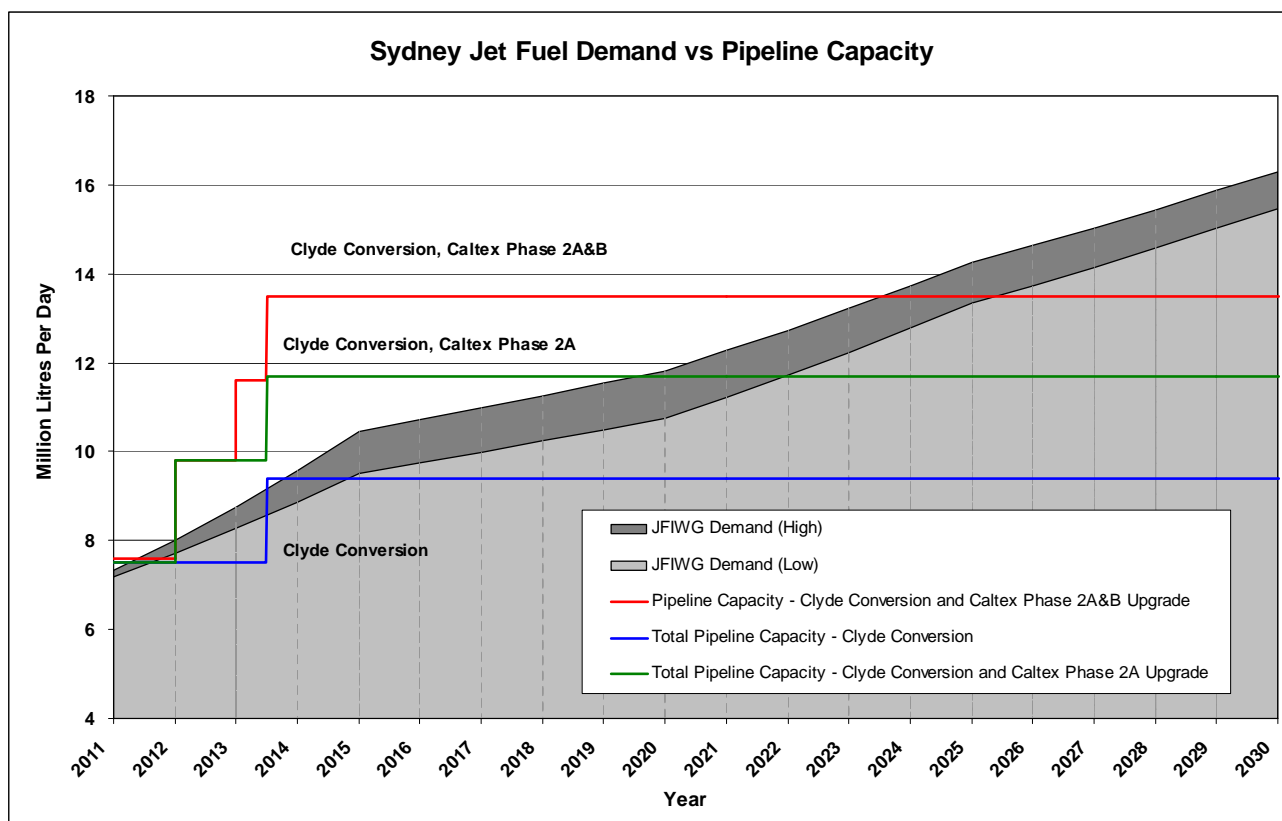
Figure 5: Removal of bottlenecks from announced improvements based on Qantas estimates

		Year	2011/2012	2012/2013	2013/2014	2023/2024
DEMAND		Airport Consumption	7.0 to 7.6 ML/Day	7.7 to 8.8 ML/Day	8.0 to 9.6 ML/Day	11.5 to 13.6 ML/Day
SUPPLY	Case 1	Pipeline Capacity (Shell Pipeline Expansion Only)	7.5 ML/Day	7.5 ML/Day	9.4 ML/Day	9.4 ML/Day
	Case 2	Pipeline Capacity (Caltex Upgrade Phase A and Shell Pipeline Expansion)	7.5 ML/Day	9.8* ML/Day	11.7* ML/Day	11.7* ML/Day
	Case 3	Pipeline Capacity (Caltex Pipeline Upgrade Phase A and B and Shell Pipeline Expansion)	7.5 ML/Day	9.8 * ML/Day	13.5* ML/Day	13.5* ML/Day

*Capacity of “Phase 2 Upgrade” of the Caltex Pipeline is not yet confirmed.

Figure 6 below demonstrates that the upgrade of the Caltex Pipeline and increased utilisation of the Shell Clyde Pipeline will increase capacity of the supply infrastructure to meet projected demand until at least 2023.

Figure 6: Improved capacity to meet demand based on Qantas estimates



Assessing declaration in this context

The above improvements to the infrastructure supply chain at Sydney Airport mean that declaration is neither necessary nor appropriate at this time.

The problem with reliability of jet fuel supply at Sydney Airport is one of capacity, not access - the most appropriate solution, currently being led by the market, is capacity expansion.

Moreover, Qantas submits that the criteria for declaration have not been met in respect of either the Caltex Pipeline or the JUHI. The case for declining the application is made even stronger with reference to the objectives of Part IIIA of the *Competition and Consumer Act 2010 (CCA)*. The objectives are to promote the economically efficient operation, use and investment in the relevant infrastructure thereby promoting effective competition in upstream and downstream markets. In Qantas' view, in the current market circumstances, these goals will be better achieved without declaration.

Specific comments are set out below.

Criteria For Declaration – Caltex Pipeline

(a) Access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service

In Qantas' view, the only two relevant markets to examine would be the markets for the supply of:

- jet fuel to Sydney Airport (**Jet Fuel Market**); and
- into-plane services at Sydney Airport (**Into-Plane Market**).

Qantas submits that any increased access to the services provided by the Caltex Pipeline or JUHI would not have any material impact on competition in downstream aviation markets.

Qantas fully supports the principle of increased access to the Caltex Pipeline. Qantas would welcome other oil companies or suppliers being able to supply fuel to Qantas and to other airlines. However, any increased access to the supply chain can only occur through capacity expansion. Declaration is not the most effective or efficient way to achieve capacity expansion at this time and, by stifling investment incentives, may in fact decrease the potential for greater competition in the relevant markets.

Accordingly Qantas submits that BARA has not satisfied this criterion in respect of either the Jet Fuel Market or the Into-Plane Market.

Jet Fuel Market

Declaration would not increase competition in this market.

The Caltex Pipeline is already operating at full utilisation. There is no "increased access" to grant through the declaration process. Increased access can only be achieved by capacity expansion that would allow suppliers to negotiate access and bid for new growth. The market is currently driving this capacity expansion, as demonstrated by the announcements from Caltex and Shell outlined above.

Prior to the current application for declaration being lodged by BARA, Qantas was confident that Caltex would proceed with the announced capacity expansion. Although Qantas cannot make any claims on Caltex's behalf, Qantas is concerned that Caltex's incentive to invest in capacity expansion would be eroded if declaration was granted. The threat and uncertainty of mandated access terms may cast doubts on whether the plans remain profit-maximising for Caltex. Any additional uncertainty created by having the infrastructure declared is likely to lead to less incentive to invest and expand, and therefore less competitive market conditions overall compared to the status quo.

Qantas submits that any mandated expansion and access plans would not be as effective or efficient as the current market-driven plans given the likelihood of long delays and uncertainty about how this would be funded and operated.

Declaration would not promote any material increase in competition in the Jet Fuel Market compared to the status quo. Declaration may, in fact, put Caltex's current expansion plans in jeopardy and therefore remove the short-medium term likelihood of greater access and increased competition.

Into-Plane Market

Declaration would not increase competition in this market. Existing market characteristics will not be changed by declaration.

Qantas believes that barriers to entry to this market are already low. The cost to start-up an into-plane company is minimal in comparison to other infrastructure, taking into account the cost of a hydrant truck (approximately \$500,000), insurance, licensing and labour costs. In addition, Qantas believes it would be unlikely that SACL would apply restrictions on new operations.

As far as Qantas is aware, AFS has not received any queries seeking access to its facilities or services. There are already options for alternative into-plane suppliers, including Zip Airport Services Pty Limited (a subsidiary of Shell) and Air Refuel Pty Limited (a subsidiary of BP that only has tankers to refuel small aircraft). An airline's choice of into-plane supplier will often depend on commercial efficiencies. For example, Qantas uses both AFS and Shell depending on flight schedules (time of the day), domestic or international apron refuelling and volume requirements.

The main reason why the Into-Plane Market may not be able to sustain more suppliers is due to gaps in demand (ie the "peak and trough" nature of Sydney traffic) and the subsequent labour costs and lost productivity.

Declaration will not change this market characteristic and would have little if any impact on competition in this market.

(b) That it would be uneconomical for anyone to develop another facility to provide the service

BARA has not satisfied this criterion.

Qantas acknowledges that the significant costs and lead time (of at least 6 years) required to construct a new pipeline mean that the better option is to upgrade existing pipelines. However, this does not mean that it would be uneconomical for anyone to develop a third pipeline.

Qantas submits that if the planned upgrade announced by Caltex does not proceed then there will be a real case for developing a third, alternative pipeline now.

(f) That access (or increased access) to the service would not be contrary to the public interest.

Qantas fully supports increased access to the services provided by the Caltex Pipeline, but submits that declaration will not achieve this outcome and may in fact be contrary to the public interest because it will stifle investment incentives or delay any intended expansion.

Qantas would benefit (as would other airlines) from having as many jet fuel suppliers supply Sydney Airport as is feasible. However, Qantas submits that additional jet fuel suppliers (such as Q8 and World Fuel Services) are not being “denied” entry to the market for the supply of jet fuel at Sydney Airport – the problem is one of capacity, not access.

As noted above, increased capacity to the Caltex Pipeline has already been announced. Any mandated access terms are likely to either reduce the incentive for that investment or render the expansion less efficient or expedient. Qantas submits that in the current circumstances utilising and expanding existing facilities on reasonable commercial terms is better than building new facilities or mandating access or expansion. For these reasons, Qantas submits that the current application for declaration of the Caltex Pipeline is premature.

Criteria for Declaration - JUHI

In Qantas’ view, BARA has not satisfied the criterion for declaration of the JUHI.

Qantas fully supports further access to the JUHI. Qantas would benefit (as would other equity participants in the JUHI) from sharing costs and risks associated with operating the infrastructure. However, declaration is neither necessary nor desirable to achieve this outcome.

Access to the JUHI is already possible through equity participation. The qualifying criteria to be met in order for a third party to become an equity participant are clearly set out in the JUHI JV Agreement and are applied on a non-discriminatory basis.

The criteria are reasonable, having regard to the long term investment required to operate JUHI. The criteria objectively require that users have appropriate technical qualifications and capabilities for supplying jet fuel, as well as the need for the JUHI owners to share the associated costs and risks of operation.

As set out above, Qantas successfully negotiated access to the JUHI in Sydney. The negotiation process to become an equity participant in Component C in 2001 took approximately 14 months, which is not considered an unreasonable length of time given the nature of the tests to be conducted. This included time taken to conduct environmental assessments (these would need to be repeated each time a new application for equity participation was received). Qantas submits that in the normal operating environment the required equity contribution and usage fees are fair and reasonable.

Qantas submits that, based on its experience, the JUHI participants are willing to negotiate in good faith with applicants for equity participation. In fact, the JUHI has never refused a genuine application for equity participation and is currently in the process of negotiating access with Q8.

For these reasons, Qantas submits that the application for declaration of the JUHI is premature.

Conclusion

In respect of both the Caltex Pipeline and the JUHI, Qantas submits that declaration in the current circumstances would not result in any improved access and therefore no increase in competition or other public benefits compared to the future world without declaration.