NERA
ECONOMIC CONSULTING

Review of Draft Recommendations

A report for Gilbert + Tobin Lawyers

13 February 2012

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NERA Economic Consulting
Darling Park Tower 3
201 Sussex Street
Sydney NSW 2000
Tel: +61 2 8864 6500
Fax: +61 2 8864 6549
www.nera.com

Contents

1. Introduction

My name is Gregory John Houston. I am a Director of the global firm of expert economists, NERA Economic Consulting, and head of its Australian operations, based in Sydney. I have been asked by Gilbert + Tobin to prepare this report on behalf of Caltex Australia Petroleum Pty Limited (Caltex). Its subject is the draft recommendation by the National Competition Council (NCC) not to declare the service provided by a pipeline owned by Caltex that is used for the transport of jet fuel to the Joint User Hydrant Installation (JUHI) fuel facility at Sydney airport (the Caltex pipeline).[1]

This is the second report I have prepared in the context of these proceedings. My first report[2] addressed whether the application meets sections 44(G)(2)(a) ('criterion (a)') and 44(G)(2)(b) ('criterion (b)') of the *Competition and Consumer Act* (CCA). By way of brief recap, I concluded that:

- criterion (a) is not met because access (or increased access) to the Caltex pipeline would not promote a material increase in competition in the market for the supply of jet fuel to Sydney airport, since:[3]
  - the Caltex pipeline is not a natural monopoly and is therefore economic to bypass, ie, access is not necessary to ensure workable competition;
  - there are already a number of competitors supplying jet fuel to Sydney airport using alternative means of delivery;
  - the customers (ie, airlines) have a significant amount of buyer power, which is reinforced by the leverage obtained through international jet fuel tenders;[4] and
  - Caltex already offers capacity to access seekers and intends to make available additional capacity following the expansion of its pipeline; and
- criterion (b) is not met because it is economic to duplicate the Caltex pipeline, since:[5]
  - the Caltex pipeline has been duplicated by means of another pipeline owned by Shell, and by the use of trucks to transport jet fuel; and
  - if Caltex were to refuse access to its pipeline on commercial terms, it is likely to be economic to construct a new pipeline.

I have been asked to consider the implications, if any, of the analysis and conclusions set out in the NCC Draft Recommendations for the findings in my first report. I consider criterion (a)

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1 National Competition Council, *Jet fuel supply infrastructure at Sydney airport*, Draft recommendations, 16 December 2011 (hereafter 'Draft Recommendations').

2 Houston, G, 'Caltex Jet Fuel Pipeline – Assessment of Declaration Criteria' *A report for Gilbert + Tobin Lawyers*, 29 November 2011 (hereafter: 'Houston first report').

3 Houston first report, p.27.

4 Because most international airlines arrange for the provision of jet fuel by means of tender for supply to multiple airports around the world, airlines are likely to have greater bargaining power through the prospect of reprisals in other geographic locations if prices in Sydney exceed the level implied by effective competition.

5 Houston first report, p.16.

and (b) in turn. In preparing this report I have drawn on much of the same material that I relied upon in my first report.[6] I have also been assisted by the same two Sydney-based colleagues, Hayden Green[7] and Luke Wainscoat[8] – Senior Consultant and Consultant, respectively. Notwithstanding this assistance, the opinions in this report are my own and I take full responsibility for them.

I confirm that I have read the Guidelines for Expert Witnesses in Proceedings of the Federal Court of Australia and that I have made all inquiries that I believe are desirable, and that no matters of significance that I regard as relevant have, to the best of my knowledge, been withheld.

Gregory John Houston 13 February 2012

6 See Appendix A of my first report for a complete list of materials upon which I have relied for this report.

7 Hayden holds a Bachelor of Commerce with First Class Honours in economics and a Bachelor of Laws with Honours from the University of Auckland, New Zealand.

8 Luke holds a PhD in Economics and a Master of Commerce in Economics from the University of Melbourne and a Bachelor of Science in Economics from the University of Warwick in the United Kingdom.

2. Analysis of Criterion (a)

The NCC concludes in its Draft Recommendations that criterion (a) is not met because competition in the market for the supply of jet fuel at Sydney airport is unlikely to be materially promoted by access (or increased access) to the Caltex pipeline. It bases its conclusion on a number of factors, including:

- the applicant had not made out its position that jet fuel supply is characterised by excessive prices or other manifestations of market power;[9]
- a very large portion of the capacity of the Caltex pipeline is likely to remain reserved for existing users even in the event access disputes are taken to the Australian Competition and Consumer Commission (ACCC); [10]
- even if the ACCC was able to require the expansion of the Caltex pipeline, it is highly unlikely that such expansion would occur more quickly or efficiently than otherwise; [11]
- aside from the applicant, no party had raised concerns on the terms and conditions of access to the Caltex pipeline;[12] and
- with the jet fuel infrastructure undergoing a degree of change and investment, the market is likely to experience opportunities for increased, or at least enhanced, competition that are not dependent on access and declaration.[13]

The NCC also concludes that competition in the market for 'into-plane services at Sydney airport' would not be promoted for similar reasons.[14] I agree with all of the points set out above. However, there are a number of other matters discussed below that the NCC either misconstrues or gives insufficient attention to in its Draft Recommendations. A more fulsome consideration of these factors would strengthen its conclusion that criterion (a) is not met.

2.1. Evidence of Workable Competition

I explained in my first report that any reasonable volume of jet fuel can be supplied to an import terminal storage facility for a price reflecting the import parity price (IPP). The existence of and potential for imports determines the price of the domestically refined jet fuel. It can therefore safely be presumed that there is effective competition for the supply of jet fuel to import terminal storage facilities.

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9 Draft Recommendations, para 4.58.

10 *Op. cit.*, para 4.72.

11 *Op. cit.*, para 4.73.

12 *Op. cit.*, para 4.65.

13 *Op. cit.*, para 4.76.

14 *Op. cit.*, para 4.77. In my first report, I did not consider that it was necessary to define a separate dependent market for 'into-plane services'. Rather, I found it convenient to define a single dependent market for the supply of jet fuel to airlines (the dependent market), recognising that this may comprise activities that take place both upstream and downstream of the market for the service (*see:* Houston first report, p.20). However, it ultimately makes no difference to the assessment of criterion (a) since, as the NCC recognises, many of the implications of access for competition in its defined 'into-plane market' parallel the outcomes in its 'market for jet fuel at Sydney airport'.

It follows that the only way in which access (or increased access) to the Caltex pipeline can promote a material increase in competition for the supply of jet fuel to Sydney airport is if such access is integral for the ability to compete downstream. Put another way, it must be shown that the effective competition in the delivery of IPP-priced jet fuel to terminals is being undermined by the subsequent inability to obtain reasonable terms and conditions of access to the Caltex pipeline.

In my opinion, there are several indicators suggesting that competition is workable in both of the downstream dependent markets[15] defined by the NCC that are given insufficient attention in its Draft Recommendations. First, there are a significant number of businesses supplying jet fuel to airlines at Sydney airport using various modes of delivery and/or providing into-plane services. Two of the firms competing with Caltex (and others) do so using their own transportation infrastructure, ie:

- Shell has a pipeline in direct competition with the Caltex pipeline, which will have additional capacity from mid-2013 (the significance of the Shell pipeline is discussed in more detail in section 2.3); and
- BP uses road tankers to make deliveries to Sydney airport (the significance of trucking is discussed in more detail in section 2.2).

Second, there are at least three more firms who resell jet fuel to aircraft at Sydney airport after purchasing supplies from Caltex, Shell and BP.[16] Qantas has also engaged with various infrastructure providers to achieve a certain amount of self supply of jet fuel, including by negotiating access to the Vopak storage facility, the Caltex pipeline and the JUHI.[17]

Third, the significant countervailing power of airlines would further mitigate the extent to which suppliers could impose unfavourable conditions. The large purchases made by Qantas and Virgin in particular are likely to leave these airlines well placed to secure prices that reflect workably competitive levels. Specifically, most airline customers are likely to be in a position credibly to threaten:[18]

- to build a new pipeline, or sponsor an entrant, eg, Qantas alone could guarantee sufficient demand to underwrite such an investment by way of a long-term supply contract; and/or
- to deliver jet fuel by means of the Shell pipeline or arrange for jet fuel to be trucked to the JUHI; and/or

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[15] The NCC defines dependent markets for the supply of jet fuel at Sydney airport and for into-plane services. I noted above that I do not draw any distinction between these two markets in my first report.

[16] These include World Fuel Services, Universal Fuel Supplies and United Aviation Solutions.

[17] In order to spread risk, Qantas does not self supply all of its fuel requirements at Sydney Airport. It also purchases jet fuel for supply into the JUHI from Caltex and Shell. *See:* Qantas Group, *Application for declaration of the JUHI and Caltex Pipelines: Qantas Group Submission to the National Competition Council*, November 2011, p.7.

[18] Houston first report, p.24.

- reprisals in other geographic locations if prices in Sydney exceed the level implied by workable competition.[19]

The significant number of existing competitors – some of whom are facilities-based competitors – in the dependent markets in combination with the countervailing power of airlines suggests strongly that competition is already workable. In short, there is 'no work' for the declaration criteria to do – competition does not need to be (and cannot be) materially promoted, because it is already effective.

2.2. Role of Trucking

The NCC concludes that 'trucking jet fuel to Sydney airport is best viewed as a complementary mechanism to the use of pipelines rather than as a competitive substitute or alternative.'[20] In arriving at this view it makes the following observations:[21]

- trucks appear to be used in response to difficulties in transporting jet fuel by pipeline or to meet some other occasional or low-volume-bespoke requirement;
- trucking only provides a very small proportion of the total amount of jet fuel supplied into Sydney airport;
- although the cost of expanding the use of trucking appears to be modest, this option was not recommended in the Sydney Jet Fuel Infrastructure Working Group Report (SJIFIWG Report), which the NCC believed indicated, in part, that industry experts expected pipelines to meet increased demand, rather than trucks; and
- transporting large volumes of fuel from Port Botany to Sydney airport by road would create significant additional congestion thereby generating health and safety concerns.

In my opinion, none of the factors listed above imply that trucking is not a close economic substitute for the Caltex pipeline (or for the Shell pipeline). Rather, they suggest that trucking is currently an important source of 'swing supply' – particularly when there are problems with the pipeline and an alternative mode of delivery is required. The modest level of trucking may simply reflect the fact that:

- there are rarely any difficulties associated with transporting jet fuel by means of the Caltex pipeline (or by the Shell pipeline); and
- Caltex has offered prices that are consistent with the competitive level – perhaps due in part to the existence of that source of 'swing supply'.

In other words, the 'peripheral'[22] use of trucks may simply be symptomatic of the fact that they are *not needed* very often. However, that does not mean that trucking is 'not a

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[19] Recall that most international airlines arrange for the supply of jet fuel using tenders for supply to multiple airports around the world.

[20] Draft Recommendations, para 4.43

[21] *Op. cit.*, para 4.38-4.40

[22] *Op. cit.*, para 4.41.

competitive substitute'[23], and has no effect on the prices that Caltex can charge. In order to assess the competitive constraint posed by trucking it is necessary to consider:

- whether there would be a significant increase in the amount of trucking if Caltex attempted to charge prices that materially exceeded the competitive level;[24] and
- whether any resulting reduction in the use of the Caltex pipeline would render any such attempt to increase prices unprofitable.

The NCC does not appear to have undertaken such an analysis, and so its conclusions regarding the competitive constraint posed by trucking have no clear foundation. I did undertake such an assessment in my first report and concluded that:[25]

- the cost associated with increasing the use of tanker trucks is [CIC] [CIC]; and
- trucking could take a significant volume of the jet fuel currently being transported by the Caltex pipeline, the loss of which may be sufficient to render any price increase unprofitable, since:
  - there is already a material volume of jet fuel transported by tanker trucks – BP regularly transports jet fuel in road tankers from the Vopak terminal;[26] and
  - the SJFIWG Report found that an investment of $460,000 would allow approximately 0.5ML of jet fuel per day[27] to be transported by truck.[28]

These findings suggest that any attempt by Caltex to increase the price it charged for pipeline capacity above the competitive level could well see a *significant increase* in the amount of trucking. In other words, trucking may represent a close economic substitute for the Caltex pipeline (and the Shell pipeline). In particular, trucking could be implemented:

- as a *long term alternative* to transporting jet fuel by pipeline – as it has been in other major airports in Australia;[29] or
- on a *short term basis* until new pipeline capacity is built, recognising that it may take time for demand to reach levels that would warrant such an expansion,[30] and for that capacity to be built (see further discussion in section 3.1).

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[23] Draft Recommendations, para 4.43.

[24] In my opinion, there is no apparent danger of such an analysis being affected by the 'cellophane fallacy' since, as the NCC has recognised, there is no indication that jet fuel supply is characterised by excessive prices or other manifestations of market power (*see:* Draft Recommendations, para 4.58).

[25] Houston first report, pp.13-14.

[26] See: Qantas Group, *Application for declaration of the JUHI and Caltex Pipelines: Qantas Group Submission to the National Competition Council*, November 2011, p.5 and Caltex Submission, p.93.

[27] The current average capacity of the Caltex pipeline is 4.8ML per day, and so the loss of 0.5ML per day would constitute a material reduction in throughput.

[28] Sydney Jet Fuel Infrastructure Working Group, Final Report – Infrastructure for the provision of jet fuel at Sydney airport for the period to 2029, 30 April 2010 (hereafter: 'SJFIWG Report'), p.40.

[29] For example, Caltex uses trucks to transport jet fuel to other major airports in Australia where it does not have pipeline infrastructure, including over distances far greater than the 10km between the Vopak terminal and the Sydney JUHI. *See:* Caltex Submission, para.82.

Finally, it is not clear how the potential for increased congestion and health and safety concerns cited by the NCC is relevant for the assessment of competition under criterion (a). It may be that such consequences give rise to additional compliance costs for trucking service providers, but these have not been identified or assessed in the Draft Recommendations. In my opinion, it is more likely that these factors are externalities that are best considered under criterion (f). In any event, large quantities of jet fuel are delivered to other airports in Australia (including Melbourne airport) by truck, which suggests that such concerns have not proved to be insuperable.[31]

For these reasons, the factors cited by the NCC are not a sufficient basis to conclude that trucking does not provide a close substitute for the Caltex pipeline. In my opinion, had the NCC undertaken a more fulsome consideration of the matters set out above, it may have concluded that the prospect of increased trucking *does* provide a competitive constraint on the prices that Caltex can charge for access to its pipeline.

2.3. Shell Pipeline

The NCC acknowledges that the Shell pipeline also services the JUHI and that by mid 2013 Shell is likely to be increasingly using its own import and supply infrastructure.[32] However, the NCC downplays its significance on the basis that the pipeline does not run proximate to any common user facility and will therefore be used only to transport Shell products.[33] The implication seems to be that unless Shell offers third party access, the effect of the pipeline on competition is somehow less immediate. In my opinion, this inference is misplaced.

First, even if Shell does not offer access to its pipeline (which is by no means certain), it still has an incentive to compete vigorously with Caltex in the dependent markets. Indeed, an airline that was dissatisfied with the terms and conditions being offered by Shell could switch its custom to Caltex, and vice versa (not to mention utilising trucking or sponsoring a new entrant). The NCC effectively acknowledges that the Caltex and Shell pipelines are close substitutes when it observes that:[34]

> '[T]he increase in capacity [in the Shell pipeline post-2013] may result in Shell increasingly using its own import and supply infrastructure, so reducing its use of storage at the Vopak terminal and, more importantly, freeing up capacity on the Caltex Pipeline.'

Second, it may be that Shell *will* ultimately choose to offer access to its Gore Bay terminal facilities and its pipeline to third parties post-2013. The NCC appears to dismiss this possibility altogether, although the basis for it doing so is unclear. Moreover, the Shell

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30 To be clear, demand does not need to be equal or greater to the available pipeline capacity for new investment to occur. It may be that in the first few years the new asset operates at a loss, as demand grows. Nonetheless, as I explain in section 3.1, investment can be expected to occur if the total cost of an expansion (or a new pipeline), plus a commercial return, can be recovered over its useful life – a period of 40 or 50 years.

31 For example, trucks would cause less congestion (and hence health and safety concerns) if they made deliveries at night.

32 Draft Recommendations, para 4.59.

33 *Op. cit.*, para 4.66.

34 *Op. cit.*, para 4.59.

pipeline has similar physical attributes to the Caltex pipeline, which is currently being expanded, and so it seems possible that the Shell pipeline could also be expanded by upgrading the pumps and infrastructure so as to create additional spare capacity that may be offered to third parties.

For these reasons, in my opinion the incentive for Caltex to charge a supra-competitive price to its customers is reduced if not eliminated by the existence of the Shell pipeline (and other transport alternatives such as trucking). Moreover, the existence of the second pipeline also reduces the incentive for Caltex to refuse access to its pipeline, or to set unreasonable terms and conditions of access. In short, the constraint posed by the Shell pipeline is sufficient in and of itself for criterion (a) not to be met.

3. Analysis of Criterion (b)

The NCC concludes that criterion (b) is not met because it is uneconomical to develop another facility to provide the service offered by the Caltex pipeline for at least the period for which declaration is sought.[35] Although the NCC acknowledges that it will be economical to develop another facility at *some point* in the future, it considers that:[36]

- it would not be profitable for anyone to do so until such time as demand for jet fuel at Sydney airport approaches the capacity for jet fuel to be delivered to the JUHI; and
- until that point, any party developing a duplicate pipeline would face competition from existing capacity such that its business would be unprofitable.

In undertaking this assessment it adopts a narrow service description comprising the transport of jet fuel via a pipeline from the Vopak facility to the JUHI. In other words, the definition precludes alternative routes to the JUHI, such as via the Shell pipeline or trucking. In my opinion the NCC's assessment of criterion (b) is deficient in number of respects.

3.1. Profitability of a New Pipeline

In its first supplementary submission, the Board of Airlines of Airlines Representatives (BARA) explored whether it would be profitable to bring forward the construction of a new pipeline from 2020 – the date at which it claims more capacity will be needed. It concluded that a new pipeline would not be profitable prior to 2020 because, while there is excess capacity, prices can be expected to be set at short run marginal cost (SRMC). In my first report, I highlighted two problems with this analysis, both of which recur in the Draft Recommendations.

First, it does not automatically follow that the construction of a new pipeline that gave rise to spare capacity would imply SRMC pricing, for any or all of the pipelines. Rather, several factors are likely to constrain the extent to which prices will depart materially from the long run average cost (LRAC) of building and operating a new pipeline. Most notably, if Caltex and Shell were setting charges for existing capacity that exceeded this level, then an alternative supplier could enter into a contract (of, say, 3-6 years in duration) with one or more[37] airlines (or jet fuel resellers) to transport all their jet fuel through a new pipeline at a price between the prevailing price and the LRAC.

Both parties would benefit from such a commitment, since the airline customers (and/or jet fuel resellers) would have access to a cheaper means of transporting jet fuel to the airport and the entrant would make a commercial return. There are also a variety of ways in which the

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35 Draft Recommendations, para 5.28.

36 *Op. cit.*, para 5.17.

37 A commitment from Qantas alone could guarantee sufficient demand to make such an investment worthwhile. Qantas currently consumes 40 per cent of all the jet fuel at Sydney airport (*See:* Caltex Submission, para.37). If this was still the case in 2014, Qantas would require approximately 3.8ML of jet fuel per day (based on total annual demand for jet fuel at Sydney airport of 3,472ML, Caltex Submission, para.116). This is approximately equivalent to the capacity of the Shell pipeline. Alternatively, a pipeline might 'aggregate' the custom of a number of the smaller airlines in order to secure the volumes needed to justify the investment.

respective parties could mitigate the risks associated with such a contractual arrangement, including:

- a 'most favoured nation' clause could be included in contracts with foundation customers to prevent the pipeline owner from offering any spare capacity at a low price after it has been constructed;[38]
- an airline (or airlines) might commit to using the pipeline for a certain proportion of its total demand, rather than committing to take a fixed volume of jet fuel (a 'take-or-pay' contract);[39] and
- as I noted in section 2,2, trucking could be used as an alternative mode of delivery until that new pipeline is built, since it may take time for demand to reach levels that warrant the expansion[40] and for the capacity to be built.

The potential for new entry in combination with economic arrangements for managing the risks associated with investment in and use of a new pipeline is likely to constrain the extent to which prices will depart materially from the LRAC of constructing and operating a new pipeline.[41] In my opinion, there is no basis for BARA to conclude in its first supplementary submission that the existence of spare pipeline capacity between 2017 and 2020 would imply SRMC pricing during this period.[42] Similarly, there is no clear foundation for the NCC's conclusion that, so long as there is excess capacity:[43]

> '[A]ny party developing a duplicate pipeline will face competition from existing capacity such that its business would be unprofitable.'

The second, more fundamental problem with BARA's and the NCC's analyses is that they focus on the period for which there is expected to be spare capacity. No attention is given to the fact that a new pipeline would have a useful life well beyond these timeframes – 40 years or more. Even if it was correct to conclude that a new pipeline would make little if any profits in the first few years of its life (a conclusion that has no sound basis, for the reasons set out above), the observation is of limited relevance. What matters is whether such an investment is likely to be profitable over its entire useful life.

The fact that a new pipeline may not be profitable during the declaration period alone does not make the asset 'uneconomical' within the meaning of criterion (b).[44] Rather, the relevant consideration is whether the total cost of the asset, plus a commercial return, can be recovered over its 40 to 50 year life. Put simply, by focusing on the period during which the

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[38] These would guarantee that the pipeline will not supply other firms at a lower price than that offered to the initial customers.

[39] This would allow an airline to mitigate the uncertainties inherent in the routes and frequency of flights that it will operate in the future.

[40] *Supra*, note 30.

[41] Houston first report, pp.14-16.

[42] Houston first report, p.26.

[43] Draft Recommendations, para 5.17.

[44] A new pipeline may not be profitable during the declaration period if it is under-utilised for an initial period of time or if fixed costs cannot be recovered in the near-term.

demand for jet fuel is less than the existing capacity,[45] the NCC has, like BARA, directed its attention to the wrong question.

The analysis I set out in my first report illustrated that, even under very conservative assumptions,[46] a commercial return *could* be obtained upon such an investment over a 40 to 50 year period, suggesting that criterion (b) was not met in this instance.[47] The NCC does not address this aspect of my first report in its Draft Recommendations. However, when discussing very similar points made by Caltex in its submission the NCC simply states that it 'does not accept all of these [points] to be valid or relevant'.[48] Since no reasons are given for the NCC's proffered view, I have no basis for reviewing or amending my original conclusion that criterion (b) is not met.

3.2. Existing Duplication of the Caltex Pipeline

The narrow description of the service that is employed by the NCC consciously overlooks the fact that the Caltex pipeline has already been duplicated by the Shell pipeline and by trucking. The NCC appears to rationalise its decision to adopt such a narrow focus for criterion (b) on the grounds that:

- it is 'generally for an applicant to identify the service' since:[49]
  - if an applicant 'unduly or artificially narrows a service description', although criterion (b) may be easier to meet, criterion (a) will be commensurately harder; and
  - if '[t]oo broad' a description is adopted, although criterion (a) may be easier to meet, there is an increased risk that criterion (b) will not be satisfied;
- expanding the service description to include other modes of transporting jet fuel, such as the Shell pipeline and trucking, would 'complicate considerably the consideration of the declaration criteria';[50] and
- the applicant (BARA) 'wishes to see jet fuel transported from the Vopak storage facility (at Port Botany) to the Sydney JUHI',[51] not from another point of origin.

In my opinion, none of these factors provide a sound economic basis for adopting what is clearly an 'artificially narrow'[52] definition of the service. First, the NCC seems to imply that if a particular service description means that the threshold for criterion (b) is reduced

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45 Draft Recommendations, para 5.26.

46 For example, I adopted BARA's (unrealistic) assumption that a new pipeline would not earn any revenue (or profits) between 2017 and 2020. *See:* Houston first report, p.15.

47 Houston first report, pp.14-16. I note also that the potential success of such an investment could be further enhanced if it is underwritten by an airline customer – a quite plausible scenario given the potential for mutual benefit.

48 Draft Recommendations, para 5.16.

49 *Op. cit.*, para 2.13.

50 *Op. cit.*, para 2.16.

51 *Op. cit.*, para 2.17.

52 *Op. cit.*, para 2.13.

(increased), then it will be commensurately harder (easier) to meet criterion (a), and vice versa.

In my opinion, this misconstrues the symbiotic relationship between the criteria. In particular, if criterion (b) is not met because a facility is economic to duplicate, it is *more likely* that criterion (a) will also not be met – not less likely. I explained in my first report that if a facility can be economically duplicated it does not represent a bottleneck to competition in dependent markets. It follows that access to the service provided by that facility is not needed to promote competition in those dependent markets.[53]

In effect, the NCC is suggesting (wrongly, in my opinion) that it can adopt a narrow service description and ignore economically duplicated facilities, because they will be given greater attention in the consideration of criterion (a). However, the Draft Recommendations illustrate that this is not necessarily the case, since:

- the applicant has 'unduly or artificially narrowed' the service description, since only one of the three ways of transporting jet fuel to the JUHI is considered in the NCC's assessment of criterion (b); and
- the alternative facilities that would have resulted in criterion (b) not being met if a broader service description was adopted did not play a decisive role in the NCC deciding that criterion (a) is not met, ie:
  - it concludes (wrongly, in my opinion) that trucking is not a close substitute for the Caltex pipeline; and
  - the constraining influence of the Shell pipeline is said to be limited (again wrongly, in my opinion) because it does not adjoin a common user facility.

In other words, the economically duplicated facilities that were not considered by the NCC in its assessment of criterion (b) were *not* given greater attention in its evaluation of criterion (a). Indeed, had it not been for the other matters described in section 2, the NCC might well have reached the wrong conclusion and made a draft recommendation to declare the service provided by the Caltex pipeline. This highlights the potential risks associated with accepting service descriptions that are known to be too narrow.

Second, I do not agree with the NCC's contention that expanding the service description to include other modes of transporting jet fuel would complicate the assessment of the declaration criteria. Rather, it would seem to simplify things considerably since, as I noted above, it is clear that multiple facilities exist and have therefore been 'economically duplicated'. Even if that were not so, the fact that an approach may be more complicated is not an adequate justification for implementing an incorrect, albeit simpler alternative.

Third, the fact that BARA has sought declaration of the service provided by the part of the Caltex pipeline running from the Vopak storage facility to the JUHI should not be

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[53] It was for this same reason that I found it convenient in my first report to consider criterion (b) before turning to criterion (a), since whether or not it is economical to provide the service by means of one or more alternative facilities was a logical precursor to the analysis of the effect on competition of access to the Caltex pipeline. Put another way, if an applicant does not meet criterion (b), Part IIIA of the CCA is constructed so that it is also more likely to fail to meet criterion (a). *See:* Houston first report, pp.8-9.

determinative for the service description. In my opinion, allowing the supposed wishes of the applicant to colour the service definition conflates the inquiry as to whether or not it may be economic for one or more other facilities to be developed with the separate question as to the identity of the owner and/or users of any such alternative facility. There is no economic reason for the second question to have any bearing on the first.

As a matter of principle, the question as to whether or not the facility is economic to duplicate involves an inquiry into the nature of the service that is being provided by the facility, and its cost characteristics given market demand. The question of whether or not alternative facilities have been or could be developed by *anyone else* to provide that service is likely to be relevant to that inquiry. However, I explained in my first report that such a process does not contemplate any qualification as to the identity of that other party, or the preferences of the applicant.[54]

In this instance, a potential importer of jet fuel can be expected to be indifferent to the various ways that its product can be delivered to the JUHI, save for questions of relative capacity, cost and reliability.[55] Importantly, the demand for the service of transporting jet fuel from a relevant point of origin to Sydney airport does not have to be satisfied by using the Caltex pipeline. It follows that the service should properly be defined as the transport of jet fuel from *any* suitable import storage terminal facility or refinery to the JUHI.

I note also that broadening the service description is in no way inconsistent with the stated purpose of BARA's application. That purpose is to enhance its members 'ability to source jet fuel [at Sydney airport] from existing and new suppliers…on fair and reasonable terms.'[56] The willingness and ability of jet fuel suppliers to offer their product at Sydney airport on 'fair and reasonable terms' is *not contingent* upon them securing access to the Caltex pipeline. Economically viable alternatives exist, and there is no reason for them to be ignored when defining the service.

If the broader definition of the service described above is adopted, it is immediately apparent that criterion (b) is not met, since multiple facilities already offer that service and have therefore been economically duplicated. Furthermore, in my opinion, even if the artificially narrow service description is adopted, I still conclude that criterion (b) is not met, since it would be profitable to build a new pipeline between the Vopak storage facility and the JUHI (see section 3.1).

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[54] Houston first report, p.9.

[55] Indeed, an incumbent importer seeking to expand or a potential new entrant simply requires there to be a suitable bulk liquids berth, accessible terminal storage facilities and a means of transporting the jet fuel from the storage facility to the JUHI. Moreover, a reseller need not concern itself with these factors at all.

[56] BARA Original Submission, p.9.

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