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Productivity Commission
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Dear Mr Lindwall

ECONOMIC REGULATION OF AIRPORTS INQUIRY: SUBMISSIONS ON DRAFT PC REPORT

AIP welcomes the further opportunity to inform the Productivity Commission's Economic Regulation of Airports Inquiry and makes the following submission on behalf of its four core member companies, namely BP Australia Pty Ltd, Caltex Australia Limited, Mobil Oil Australia Pty Ltd and Viva Energy Australia Pty Ltd.

INTRODUCTION

Thank you to the Commissioners of the Productivity Commission for meeting with AIP on 12 March 2019 to discuss the PC's Draft Report on the Economic Regulation of Airports released on 6 February and to confirm the specific information the PC is seeking in this second round of stakeholder consultation.

In these discussions, AIP emphasised the need to address unsupported claims and conclusions presented in the Draft PC Report in order to provide a robust Final Report to the Government, and sought advice on how AIP member companies can provide further assistance to the PC's assessment of the market, operational and infrastructure arrangements related to jet fuel supply to airports. We appreciate the guidance provided by the PC in this context.

Following these discussions, AIP member companies have made significant contributions to this next consultation phase on the Draft Report, particularly from their own company's perspective and/or as operators of specific 'on-airport' JUHI Joint Venture (JV) facilities at Melbourne, Sydney, Brisbane, Perth and Adelaide airports.

These recent company and JUHI JV submissions and engagements have focused on addressing:

- the PC's Information Request 8.1 related to jet fuel infrastructure owners and jet fuel suppliers
- additional 'priority information requests' identified by the PC in its discussions with AIP
- other claims, conclusions and assessments made in the Draft PC Report.

As the majority of these matters relate to commercial-in-confidence and contractual arrangements, these are the only parties that can assist the PC with this information. Moreover, it is important to understand that certain PC priority information can only be addressed by JUHI JVs ('infrastructure operators') as dedicated unincorporated legal entities involved in joint infrastructure ownership and operation at airports, and other information can only be supplied by individual AIP member companies who supply jet fuel to their customers ('fuel suppliers'). An understanding of this distinction and separation is critical to this Inquiry, and is often misunderstood, as is the genuine legal/contractual and competition law limitations borne by the parties in providing public information.

As requested by the PC, member company and JUHI JV submissions have, to the extent possible, presented additional 'public record' information to assist the PC's assessment, and have offered to provide further information confidentially to validate this information and their submissions if requested.

2.

AIP notes that its member companies have already provided a significant body of evidence to the PC in the first round of consultations to outline the current competitive market for jet fuel supply in Australia. This includes comprehensive public submissions, detailing the jet fuel supply chain, key infrastructure investments and operations, supply arrangements for storage and transport, and the typical commercial arrangements to access services and facilities at different points in the supply chain.

This publicly available advice has been supported and expanded upon by detailed bilateral PC discussions with key personnel in all AIP member companies. In these consultation sessions, commercial in confidence information has also been shared on an appropriate basis to protect commercial sensitivities and in order to provide a complete evidence base for the Commission's information and reference in this Inquiry.

AIP is disappointed that this significant initial contribution was not appropriately acknowledged in the Draft Report, nor was there an acknowledgement and understanding of the significant and genuine legal constraints involved in providing commercial and contractual information on the public record.

AIP MEMBER COMPANIES' INVOLVEMENT IN THE JET FUEL SUPPLY CHAIN

AIP member companies are very significant and long-term suppliers of jet fuel to the Australian market, through their integrated jet fuel supply chains including the production of jet fuel at their local refineries, sourcing of jet fuel from the Australasian region, the transportation and distribution of jet fuel through shipping, pipeline, trucking and storage operations, and the operation of specialised hydrant pipeline systems at major airports including aircraft into-plane refuelling services.

Their participation in the jet fuel supply chain requires very significant investment in specialised infrastructure, both at airports and upstream of airports. This infrastructure includes refineries, ports, wharves/berths, discharge facilities, pipelines to terminals, jet fuel storage tanks, underground hydrant pipeline systems at airports (referred to as a Joint User Hydrant Installation or JUHI Joint Ventures), and into-plane refuelling vehicles. Other key services that support the supply of quality jet fuel to the market include fuel testing laboratories who help to facilitate the release of fuel to the market.

AIP member companies have the operational and technical expertise required to own, maintain and operate this specialised and often dedicated jet fuel infrastructure, as well as the detailed knowledge on handling and dispensing of jet fuel that meets the high-quality standard required in the aviation sector. This expertise, as well as best practice approaches and technologies, also flows naturally from global affiliates to some of these local market operators.

AIP member companies are therefore very well positioned to provide expert advice to the Commission on the Australian jet fuel supply chain and market, as they have through their extensive engagements and submissions to this inquiry process.

AIP MEMBER COMPANY VIEWS ON THE DRAFT PC REPORT

This AIP submission seeks to summarise some of the key conclusions and evidence presented in member company and JUHI JV submissions to the PC. On the basis of these submissions and engagements, the PC's Draft Finding 8.1 is strongly rejected by AIP member companies, particularly its conclusions in relation to market competition and prices and on the claimed conduct of infrastructure owners and jet fuel suppliers. However, AIP member companies do support the PC's draft Recommendation 8.1 (open access JUHI at Western Sydney Airport) and support in principle the PC's draft Recommendation 8.2 (consultation forum) if there is a clearly defined role and it is directly focused on the discussion of the master planning and coordination of infrastructure investment at the airport and involving airport infrastructure owners and operators. These positions are explained below.

3.

(1) JUHI JVs are operators of common infrastructure, they are not sellers or suppliers of jet fuel

Some parties have claimed that JUHI JVs are fuel suppliers and determine jet fuel prices charged to airlines. This claim is wrong, and reflects an uninformed view of the tightly defined service role played by JUHI JVs in the supply of jet fuel at airports.

All the submissions of JUHI JV operators across all the major airports have detailed the structure, basis and international protocols governing the operation of JUHI JVs and their infrastructure.

Largely without exception, the key features common across all JUHI JV facilities, include:

- the JUHI JVs are unincorporated JVs comprising different companies
- the JUHI JV members (and any new members) all participate on an equal share footing with the same rights and obligations as all participants, and any interested parties can apply for membership
- the JUHI JVs own and operate the jet fuel infrastructure located at major airports (i.e. the storage tanks and the hydrant system which connects the storage tanks to the airport apron)
- the JUHI JVs themselves do not play a role upstream of the JUHI tank farm at the airport
- the JUHI JVs are not commercially involved downstream in provision of into-plane services at airports
- the JUHI JVs are not commercially involved in sales of jet fuel to airlines
- the JUHI JVs do not own the jet fuel that the infrastructure facility is transferring
- the JUHI JV takes deliveries of jet fuel that meets an appropriate specification to be supplied to aircraft, which is commingled with other jet fuel deliveries in the JUHI system; the critical importance of conformance to fuel quality specifications is outlined below
- the primary focus of JUHI JVs is operational efficiency and supply reliability, and timely investment and robust quality controls to support these objectives
- the JUHI JV maintains a strict confidentiality protocol amongst JV members, which is adopted from a global standard, provided by the Joint Inspection Group or JIG (see <http://www.jigonline.com/>).

In simple terms, JUHI JVs are infrastructure operators and owners, who store and transfer jet fuel on-airport on behalf of fuel suppliers. Jet fuel is delivered to JUHIs by multiple fuel suppliers by pipeline and or truck, it is then quality assured, stored and transferred by the JUHI at the airport, and then supplied directly into aircraft by separate 'into-plane' service providers of which there are multiple.

As outlined in the BP submission to the Issues Paper consultation, it is economically and operationally efficient to have one common hydrant and storage system for aircraft refuelling at major airports, and therefore the JUHI JV structure is ideal for the co-ownership of hydrant infrastructure.

"It would be less efficient and much more costly for each fuel supplier to install and manage their own separate storage facilities. For reasons of space and security, airport authorities frequently allow only a single storage services operation. If each jet fuel supplier had to operate their own separate storage facilities they would not be able to exploit the available economies of scale and would also forego the opportunity of pooling their storage requirements, so that more storage capacity would be installed than was actually required. Availability of space for such facilities at large airports is also a significant factor, since many airports are land-constrained and cannot spare acreage for the construction of multiple tank farms."

(2) Third party access to JUHI JVs is readily available on commercial terms

The draft Report claims that *"the owners of the Joint User Hydrant Installation (JUHI) infrastructure at most airports restrict or do not allow new members.*

This claim is incorrect. JUHI JVs do not restrict, or not allow, new members.

4.

As outlined in the JUHI JV submissions to this consultation, access criteria and conditions are provided by JUHI JVs to potential applicants upon request. Qualifying criteria for third party equity participation in some JUHIs has been published on the public record and, as requested by the PC, some JUHI JV submissions have provided details on the joining criteria and the general application and assessment process.

Importantly, the criteria and assessment processes governing the entry of new participants to a JUHI JV are explicitly provided/allowed for, and covered by, the JUHI Joint Venture Agreements. JUHI JVs have offered to provide, and have already provided in some instances, details of relevant clauses in confidence to the PC. In addition, there are typically strong commercial incentives to reduce capex exposure and related operational expenses in any facility through broader equity participation, so it is not logical to restrict participation of qualified parties.

JUHI JV submissions have also indicated that the access criteria and assessment process is comparable across JUHIs at major Australian airports. This is because the JUHIs all follow recommended industry best practice in the evaluation of participant applications (JIG evaluation process). These submissions also note that it isn't the role of the assessment process or the role of JUHI JV operators to exclude participation.

JUHI JV submissions have also outlined, as requested by the PC, details on the number and outcomes of applications for access to JUHI infrastructure over the last decade. The number of applicants has been small and the most common reason communicated by applicants for not progressing to participation was that there is a lack of Airport lease tenure which did not support the significant investment required (see (3) below).

Therefore, as noted above, new entrants already have the ability to access the JUHI facilities and this is not a barrier to entry. We note that, as indicated in the Draft Report, the PC has not previously received any evidence or submissions from actual 'fuel suppliers' seeking to gain access to the JUHI JVs or to the broader jet fuel market. Therefore, the claims of 'restricted access' or 'no access' can only be from parties or observers with no direct involvement, investment or expertise in the supply of jet fuel nor any commercial interest in the ownership or operation of jet supply infrastructure.

The industry does recognise that the scale of required investments may be a limiting factor to participation in JUHI JVs or the broader jet fuel market but, once again, this is not a barrier to entry.

For this reason, we note that there are parties in favour of implementation of Open Access regimes at airports (i.e. based on a fee-for-use model rather than an equity participation model). Based on industry submissions, it is clear that the jet fuel market and the JUHI models are evolving naturally over time in conjunction with the airport owners and airline operators, and without regulatory or government intervention. However, given the long-term investments and the need to provide investment certainty, there are natural and efficient times to consider changes to operational models at airports for joint infrastructure. For example, during lease renegotiations with airports for existing infrastructure, and when new 'greenfield' airports like the Western Sydney Airport are being established. This enables industry to make assessments and the necessary long-term investment plans with the clear knowledge of the relevant operational model and environment over the life of the lease.

For the reasons above, AIP member companies support the PC's Draft Recommendation 8.1 of an open access JUHI at Western Sydney Airport, as industry can make future assessments and investment plans with a clear knowledge of the future operating environment.

5.

Given the above, AIP members support the PC's conclusions that *"..... there may not be a need for Government action to facilitate access to jet fuel infrastructure"* given developments that have and are occurring in the jet fuel market and at domestic airports (e.g. open access in JUHI lease agreements at Melbourne and Darwin Airports).

AIP agrees with the PC that it would be prudent to consider the outcomes of these changes, and ongoing market developments and evolution, prior to any government action. This is underscored by the Melbourne JUHI JV submission which indicates that "one party has proceeded to apply for and has been granted access to infrastructure services" under the new arrangements. For example, see the following link for the Melbourne JUHI application process - <https://www.tullamarineairportfuelfacility.com.au/>.

In relation to demonstrating access to JUHI JVs is on 'commercial terms', AIP notes advice in the previous Mobil Submission that, in relation to the Melbourne airport, *"all JUHI users (equity holders and non-equity holders) are charged reference tariffs for JUHI services. These tariffs are the same for both equity and non-equity JUHI users. Reference tariffs cover the operating costs of airport storage and distribution, a return on capital for investments into airport infrastructure, and off-airport to airport delivery fees if applicable (via pipeline or road trucker). Reference tariffs are set by joint venture members on an annual basis. They change with changes to operating costs and JUHI infrastructure. JUHI users are also charged an application fee when applying for access. If granted access, the fee will be offset against reference tariffs in the first 12 months of use."*

(3) Airport Lease Tenure impacts on access by third parties and infrastructure investments on-airport

There must be clear investment signals and a stable investment and policy environment for industry to make the very significant capital investments in fuel supply infrastructure, including ongoing investment in maintaining/expanding existing infrastructure and in new infrastructure itself. Crucial aspects includes secure lease tenure, a long term view of the market and stable government policies. These requirements are the same for both incumbent market participants and also new market entrants.

As noted above, a number of parties have not participated in JUHI JVs as a result of Airport lease tenure not supporting the significant investment required as assessed by these applicants.

Security of lease tenure is also critical to ongoing investment in infrastructure capacity to meet growth in jet fuel demand. For example, very significant investment in Melbourne airport has occurred, and more is underway, following the successful renegotiation of the new 20 year lease. Certainty of lease tenure led to the immediate progression of a range of very significant capital investments at that airport by the JUHI JV participants. These investments are aimed at significantly increasing storage capacity and improving operational flexibility and reliability through the expansion of truck unloading facilities.

For these reasons, AIP member companies support in-principle the PC's draft Recommendation 8.2 to establish a jet fuel infrastructure coordination forum, if directly focused on the discussion of the master planning and coordination of infrastructure investment at the airport and involving airport infrastructure owners and operators. AIP notes that the intended purpose of this recommendation can alternatively be achieved (and is achieved as recent experience demonstrates) when lease arrangements between airports and JUHI JVs are negotiated with clear and effective planning arrangements and triggers for investment in infrastructure upgrades or expanded capacity. The role and focus of such forums need to be tightly and clearly defined to ensure there is no impingement of commercial and contractual rights and sensitivities.

6.

(4) Jet Fuel Prices in Australia are competitive and reflect market prices and circumstances

Jet fuel pricing in Australia is market based and competitive.

AIP member companies agree with the PC's draft Report conclusion that *"price differentials by themselves are not sufficient evidence that prices in Australia reflect a lack of effective competition"* (p.258). However, the PC's subsequent claim (in the absence of information according to the PC) that *"the structure of the markets to supply jet fuel has likely contributed to relatively high prices for jet fuel in Australia"* is incorrect.

As noted in a number of submissions, there are competitive tender processes for fuel suppliers to supply jet fuel at airline wingtips and rounds of bids and negotiations. This highly competitive and regular tendering process underpins competitive pricing outcomes for airlines, both domestically and internationally. There are no barriers to, and it is not uncommon for, airlines to switch their fuel supplier through this tendering process. This is a demonstration of a competitive, dynamic environment.

AIP member company submissions – both to the Issues Paper and Draft Report consultation processes – have provided detailed information on price differentials, the relevance of comparisons to other airports, and on the standard components making up the delivered price of jet fuel to airlines in Australia.

In particular, the components of the jet fuel price offered to airlines under competitive tenders has been detailed.

A simple summary of the key components includes:

- **Product Cost of jet fuel**
 - This is a market determined and transparent price. The Mean of Platts Singapore (MOPS) price is the key jet fuel pricing benchmark for Asia-Pacific including Australia and is published daily.
- **'Landed' Costs**, including:
 - ocean freight – shipping cost to Australia (determined by market shipping rates)
 - forex exposure – all products (including jet fuel) are priced internationally in US dollars
 - product insurance and loss
 - wharfage costs, demurrage and surveyors' costs
 - infrastructure costs used for jet fuel discharge (e.g. terminals, pipelines, storage tanks).
 - quality control testing of jet fuel imports and refinery production
- **Transport costs to the Airport (whether by pipeline or truck)**
 - Costs of transporting jet fuel from import terminals/refineries to airports
- **On-Airport costs**, including
 - Storage costs at the airport
 - Cost of moving jet fuel into and through the airport (e.g. by pipeline or tanker) including JUHI costs, lease costs and any Airport throughput fees
 - Into-plane service costs
 - insurance costs and quality control testing of jet fuel.

AIP notes that the ACCC uses an 'import parity price' (IPP) indicator for petrol and diesel that represents the notional cost of importing fuel to Australia (including 'product' and 'landed costs'). As stated in member company submissions, the components of a notional import parity price for jet fuel are very similar to this.

7.

As outlined in member company submissions and engagements with the PC, and similar to the price of other transport fuels in Australia, the largest single cost component (typically > 90%) of the price to bulk fuel customers is the 'product cost', which is determined by international markets (Singapore MOPS price). The Singapore price plus the 'landed costs' noted above represent almost the entire price – typically around 95%. The remaining share is accounted for by transport costs to the airport and on-airport costs and fees, and a margin where competitively possible.

To support this assessment, for example, the Viva Energy submission provides a breakdown of the average jet fuel price for Sydney Airport for 2018 (see Chart 1, page 3) and also the Mobil submission provides a derived jet fuel cost analysis for Melbourne airport (see Figure 4, page 9). In addition, AIP member companies are willing to share additional information to support these pricing analyses if requested.

Jet fuel price differentials between international airports can largely be explained by variances in freight/landed costs, transport costs to airports, and on-airport costs. Variances in these costs will largely be explained by relevant freight distances, and the specific characteristics of the local fuels supply chain servicing each airport (for example, how jet fuel is transferred, the distances and infrastructure involved, and jet fuel demand at the airport which will determine the scope for economies of scale).

For these reasons, simple comparisons of price differentials across airports, including internationally, cannot inform a robust assessment of price competition for jet fuel supply at a specific airport. In this regard, we support the PC's conclusion that *"care should be taken when comparing price differentials across different airports and countries. For example, comparisons do not take into account different planning and environmental regulations, distance from port to plane or different quantities supplied at each airport."*

(5) Biojet Supply - Claims by Bioenergy Australia are False and Uninformed

The Submission on behalf of the Brisbane JUHI JV provides significant detail in relation to the delivery and supply of biojet to Brisbane airport, including biojet trials conducted in 2018. It also provides details on international standards for jet fuel specifications, standard quality controls at JUHI JVs, and on the critical importance of meeting fuel quality specifications to ensure jet fuel is fit for use in aircraft to avoid potentially severe consequences.

The Brisbane JUHI JV submission also addresses the range of false and uninformed assertions made to the PC by Bioenergy Australia in relation to biojet supply and trials in Brisbane. We note that Bioenergy Australia has no direct interest or involvement in any aspect of the airport supply chain and infrastructure and, moreover, has played no role in any commercial interactions in relation to the biojet trials in Brisbane.

8.

CONCLUSION

Based on the above summary of submissions to the PC, AIP member companies fundamentally assess that jet fuel prices in Australia are competitive and reflect market prices and circumstances, and third-party access to JUHI JVS is readily available on commercial terms and is evolving. Also, third parties can and do invest in off-airport infrastructure and, while significant capital is needed, this is not a barrier to entry.

As a consequence, AIP member companies strongly reject the PC's Draft Finding 8.1 and see no clear and strong case to justify consideration of the heavy-handed regulatory options canvassed in the draft PC Report. AIP agrees with the PC's overarching conclusion that *"the benefits from measures to improve the conditions for competition should be carefully weighed against the potential costs, such as changes to incentives for infrastructure investment. Even if the benefits of industry specific regulation are greater than the costs, there may not be a need for Government action to facilitate access to jet fuel infrastructure"*, given clear market developments and evidence that access arrangements and models are evolving naturally and on commercial terms without Government intervention.

Instead, AIP member companies do see a basis for the PC's draft Recommendation 8.1 which is supported for the reasons outlined in this and member company submissions. AIP member companies also support in-principle draft Recommendation 8.2 if the role of such forums is clearly defined (so as to not impinge commercial and contractual rights and sensitivities) as is directly focused on the master planning of infrastructure investment at the airport and involving airport infrastructure owners and operators.

Thank you again for the opportunity to inform this Commission Inquiry and we look forward to ongoing engagement and to the release of the Final Report in June 2019. Please do not hesitate to contact me if AIP and its member companies can be of any further assistance.

Yours faithfully

{Signed}

Nathan Dickens
Deputy CEO

28 March 2019