VIVA
EnergyAustralia

The Commissioners
Economic Regulation of Airports

Sent via e-mail: airports@pc.gov.au

25 March 2019

Dear Commissioner,

Viva Energy Australia Pty Ltd ("Viva Energy") welcomes the opportunity to respond and provide additional information to the Productivity Commission's draft report into the Economic Regulation of Airports released on 6 February 2019.

In addition to this submission, as the Joint User Hydrant Installation (JUHI) operator at both Sydney (Kingsford Smith) and Brisbane airports, Viva Energy has also facilitated the preparation of separate submissions on behalf of JUHI joint venture members specifically related to JUHI access arrangements, the application process and assessment for granting access as requested in the draft report.

We were pleased to meet with the Commission last year and look forward to meeting again at upcoming hearings to further discuss our submission and points made.

About Viva Energy

Viva Energy is one of Australia's leading energy companies and supplies approximately a quarter of the country's liquid fuel requirements. It is the exclusive supplier of high quality Shell fuels and lubricants in Australia through an extensive network of more than 1,200 service stations across the country.

The company owns and operates the strategically located Geelong Refinery in Victoria, and operates bulk fuels, aviation, bitumen, marine, chemicals and lubricants businesses supported by more than 20 terminals and 50 airports and airfields across the country.

Our aviation business, which we acquired from Shell in 2017, incorporates the following key business activities;

- Refining of aviation fuels including jet fuel and aviation gasoline (avgas) at Geelong refinery
- Owning and operating multi-product terminals across the country, which store and supply ground fuels as well as aviation fuels to the market
- Owning and operating pipelines which deliver jet fuel from a port or refinery to storage terminals and onto airports (these can be multi-product or dedicated jet fuel pipelines)
- Ownership interest in various Joint User Hydrant Installations (JUHI) facilities at major airports around Australia
- Operating JUHI facilities on behalf of the joint ventures in Sydney and Brisbane
- Management of jet fuel product quality through the supply chain, ensuring the end customer receives on-grade, fit for purpose fuel
- Commercial provision of 'into plane' delivery services to large and small aviation customers across the country

This nationwide supply chain, operation and capability has been established over many years and continues to receive considerable investment by Viva Energy to ensure we continue to meet increases in demand and the long term needs of our customers.

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Viva Energy Response

In respect of the key points and information requests raised by the Commission in the draft report, Viva Energy would like to provide the following responses.

Key Point 3 - "Prima facie, the characteristics of markets to supply jet fuel have enabled incumbent fuel suppliers to restrict competition, which has led to a small number of fuel suppliers at some airports. This has likely led to higher prices to access infrastructure services and higher jet fuel prices."

Key point 9 – "A small number of airports charge fuel throughput levies. These are only justifies if they are part of an efficient pricing structure."

Information request 8.1 – "Fuel companies' return on assets for the terminals, pipelines, Joint User Hydrant Installation (JUHI) infrastructure and into-plane services."

Jet fuel is typically contracted with airline customers under a competitive tender process for terms of 1 to 3 years. The price build-up offered under these tenders consists a variety of cost components which are set out below;

- **Singapore Product Cost:** Given that Australia is a net importer of Jet Fuel, the traded market price for Jet Fuel in Singapore forms the basis of supply into Australia. The price paid is typically based on Mean of Platts Singapore (MOPS) and accounts for more than 90% of jet fuel costs.
- **Shipping Costs:** Given Australia's distance from Asian markets, shipping costs form a significant component of suppling Jet Fuel to airports around the country. Ocean Freight, Insurance, Losses and Wharfage charges are typically charged by third parties and recovered from airline customers in the Jet Fuel price build-up.
- **Terminal Storage and Delivery Costs:** Jet Fuel is initially delivered by ship or from local refineries into fuel storage facilities for delivery when required by pipeline or trucks to the various airports. These costs are either fixed, and apportioned across all fuel managed in the facility (not just Jet Fuel), or variable where the services are provided by a third party.
- **Joint User Hydrant Installation (JUHI) Costs:** This reflects the costs of operating the JUHI facility which are apportioned and charged by the joint venture to the supplier. Operating costs are kept low by sharing facilities and avoiding duplication of assets under these arrangements.
- **Fuel Throughput Levy:** Fuel throughput levies are charged at some airports and are often additional to market rent and unrelated to the provision of services provided by the airports. In these cases the JUHI typically passes these costs onto the various owners/users of the facilities.
- **Into Plane Services:** The costs of delivering the Jet Fuel from the JUHI into the airline customer's aircraft.

By way of example, and to provide more detail into the build-up of Jet Fuel pricing, the chart below sets out the typical costs for Viva Energy to supply Jet Fuel to Sydney airport. In aggregate, these costs represent 99% of the total price charged to airline customers with the small residual margin to contribute to overheads and provide a return on investment.

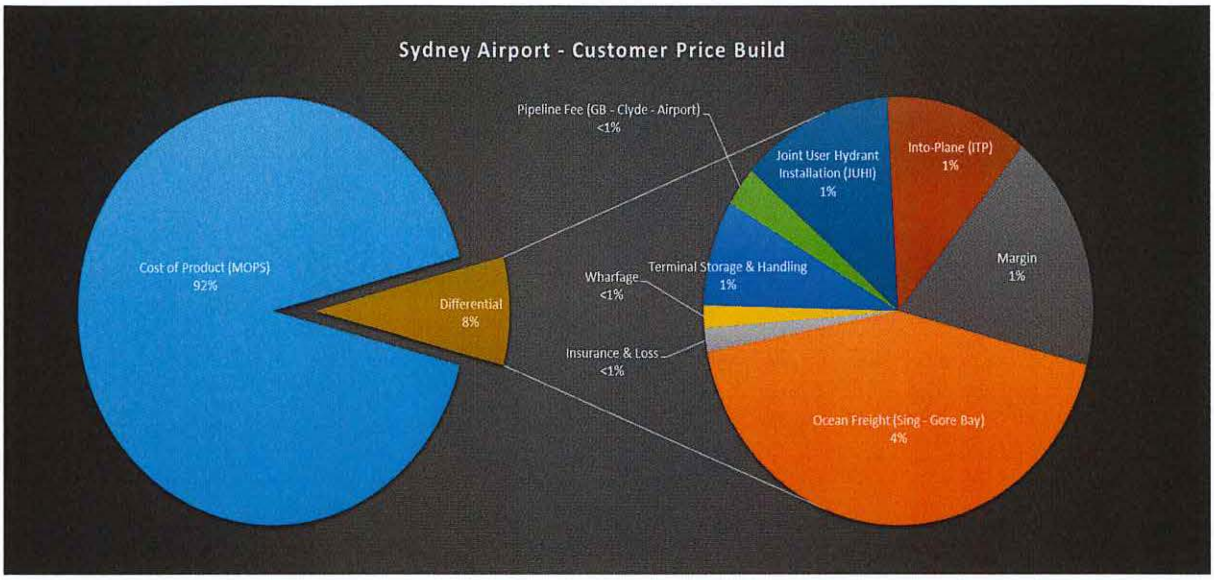

Chart 1 – breakdown of the average jet fuel price for Sydney airport for 2018

Viva Energy has made considerable investment to supply Jet Fuel to Sydney airport including our import facilities at Gore Bay, fuel storage at Clyde terminal, pipeline systems from Gore Bay to Clyde, and onto Sydney airport, together with the share of investment in the Sydney airport JUHI facilities and into-plane delivery equipment.

Some of this infrastructure (such as pipelines) is dedicated to Jet Fuel supply while some (such as import terminal infrastructure) is shared with other fuels such as Petrol and Diesel, and return on investment is captured from the income of all parts of Viva Energy's integrated business.

In Sydney, Viva Energy's infrastructure competes with alternative Jet Fuel import terminals at Botany and Kurnell, and the Caltex owned pipeline system through to the Sydney JUHI. Relatively low margins, as demonstrated by the analysis above, reflect a highly competitive market place with multiple suppliers and infrastructure options.

We maintain that the Jet Fuel market is highly competitive with relatively low margins due to efficiencies arising from scale and integrated supply chains.

Key Point 4 – "The ownership of infrastructure to supply jet fuel is both horizontally and vertically integrated throughout the supply chain. This may lead to efficiency benefits but it could also result in higher jet fuel prices if incumbent fuel suppliers limit competition by denying or constraining third party access to infrastructure services."

Key Point 6 and part of draft recommendation 8.1 – "The JUHI infrastructure at Western Sydney Airport should operate on an open access basis to allow for more competition in the market to supply jet fuel."

There are a number of competitors in the Australian market, including Viva Energy, that have integrated supply chains from refinery and/or storage terminals through to participation in on-airport infrastructure joint ventures and into plane. Viva Energy has invested and established this position in a number of markets such as Brisbane, Sydney, and Melbourne, and this has led to efficiencies and supply chain robustness which has benefited airline customers for many years.

Viva Energy continues to invest in this infrastructure, either in its own right or with other suppliers where there are benefits from sharing significant infrastructure costs. Recent examples of such investment include a number of projects to improve supply chain capacity to Melbourne airport (see point 7 below), conversion of our refinery in Sydney to a full scale import terminal, co-investment in pipeline duplication to Brisbane airport, and the construction of new Jet Fuel import storage at Cairns. Competitors have also undertaken a range of projects to improve capacity and access to airports around the country, and there are few impediments to making these sorts of investments.

At some locations, Viva Energy co-invests in infrastructure such as at JUHI's and pipelines, or enters into commercial arrangements to access competitor's infrastructure rather than make investment in its own right. These are typically locations where our business does not have sufficient scale to warrant direct investment, or where there are operating benefits from sharing infrastructure (such as at JUHI's). By their nature, these are commercially difficult negotiations, but there is ample evidence of where satisfactory arrangements have been secured to refute the proposition that 3rd party access is denied and limiting competition.

In some locations, JUHI facilities have open access arrangements for all potential suppliers to utilise the facilities on a throughput basis or to make an application to become a co-investor through an equity position. Despite these provisions, we note that there have been no access requests into the Brisbane JUHI and five requests over the past 10 years into the Sydney JUHI system. The majority of the requests into the Sydney JUHI system cited a lack of lease tenure as not supporting the equity investment required and this was therefore the main barrier to investment and entry.

JUHI models are historical in nature and largely driven by the airports and the lease arrangements that they make available to industry to undertake investment. It makes sense for airports to have just one on-airport fuel facility to avoid duplicate investment and ensure the efficiency of operations. The JUHI model provides this outcome and continues to evolve in conjunction with the airport owners and airline operators. Current participants have demonstrated preparedness to invest in the JUHI infrastructure and all suppliers have the opportunity to participate on equal footings.

We do not agree with the Commission's conclusion that fuel suppliers limit competition by denying or constraining third party access to infrastructure services. Access to airport infrastructure is currently available to other parties and is not a barrier to entry. Details relating to third party access to JUHI infrastructure is covered in both the Sydney and Brisbane JUHI JV submissions as well as some additional comments in this submission.

Key Point 7 – "There has been underinvestment in both on and off-airport infrastructure in Melbourne, which has led to government intervention to coordinate future infrastructure investment to ensure continuity of supply."

Viva Energy has made a number of significant investments to improve supply chain capacity and robustness at many major airports (including Melbourne) to meet anticipated growth in airline customer demand. Recent examples include;

- A new $4M jet fuel gantry at Geelong refinery to replicate the existing capability from our terminal at Newport, improve diversity of supply and streamline supply of jet Fuel to Avalon airport.
- Construction of a $23M pumping station to increase the pipeline capacity from Geelong Refinery to our fuel storage facility at Newport, and onward to the JUHI at Melbourne Airport.
- Construction of a new 8ML jet fuel tank at Newport terminal to provide additional jet fuel storage in the Victorian basin (cost $10M).
- Co-investment into new truck bridging facilities at Melbourne JUHI to supplement pipeline delivery to the airport

- Co-investment with other JUHI participants to build two new Jet Fuel storage tanks at Melbourne airport to increase supply cover
- Conversion of Clyde refinery to a full scale import terminal with expanded Jet storage capacity to meet growing demand at Sydney airport, and ultimately support the new Western Sydney International (Nancy Bird-Walton) airport.
- Co-investment in pipeline duplication at Brisbane airport
- Construction of a new $10M 8ML jet fuel tank at Cairns

These recent Viva Energy projects represent around **$50M** invested in improvements in Jet Fuel supply capacity, clearly demonstrating Viva Energy's commitment to support anticipated demand growth and meet our customer's requirements for reliable and secure Jet Fuel supply. Beyond these investments, Viva Energy is also developing plans to construct additional jet fuel pipeline capacity in Melbourne in light of the expected future demands from Tullamarine airport. This project would duplicate part of the existing pipeline system and provide long term increases in fuel supply capacity as well as provide additional supply chain redundancy, thereby improving supply security. This project, like many others, will require significant investment and could ultimately be constructed and operated jointly with other parties.

In terms of Melbourne airport, Viva Energy acknowledges that some joint venture on-airfield investment has been hindered by lack of long term tenure and delays in formalising a new lease agreement for facilities on Melbourne Airport land. We also acknowledge the support of the Victorian Government in finalising these agreements and the successful renegotiation of a new 20-year lease with Melbourne airport, and note that the necessary investment commenced immediately after these agreements were concluded.

In order to secure investment by industry, it is important that airport operators provide sufficient tenure and lease terms to ensure that this investment can be made with certainty and in time to meet anticipated increases in demand and capacity.

We do not agree with the Commission finding that there has been underinvestment in jet fuel related infrastructure - Viva Energy has made significant investments in infrastructure and supply chain capability both on and off-airport with more planned in Melbourne and around the country.

We do not agree with the Commission's conclusion that government intervention has unlocked investment in Melbourne airport – rather it has been the finalisation of the lease and securing adequate tenure which has unlocked the investment needed.

Conclusion

Viva Energy has invested over many decades to establish a safe, integrated and efficient supply chain to service the needs of its customers. We continue to invest in supply chain infrastructure to meet the future needs of our customers both in terms of location (where they need supply) and product (what they need supplied).

Access to on-airport JUHI infrastructure in Australia is already available on appropriate commercial terms to recognise the significant investment that has already been made and to ensure aspects such as product quality are assured which is critical for fuel supply. Other third parties (for example, Vopak) can and do invest in off-airport infrastructure and, while investments can be significant, they are not a barrier to entry.

Jet fuel pricing in Australia is competitive and product costs and shipping represent the vast majority of the end jet fuel price paid by airline customers. In Sydney on average for 2018 these two costs alone accounted for >95% of the jet fuel price. As acknowledged by the Commission it is difficult to compare Australian airport pricing to other, much larger international airports due to a range of factors including scale, supply chain set-up and ownership.

As a participant in the supply of jet fuel and a supply partner to a variety of Australian and international airlines, we would be very concerned by any recommendations to introduce regulations which might limit our ability to operate efficiently and effectively or that might provide other suppliers not currently invested in this infrastructure with an unfair competitive advantage. This would have the effect of stifling further investments in jet fuel infrastructure and have the potential to damage the competitiveness of Geelong refinery.

We look forward to continuing to engage with the Commission on this important matter. Please contact Edwina Pribyl in the first instance

Yours sincerely,

Edwina Pribyl
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