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Airport Regulation inquiry
Productivity Commission
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Commissioners,

Re: Productivity Commission Inquiry into the Economic Regulation of Airports – Response to Draft Report

Thank you for the opportunity to provide a submission in response to the Productivity Commission's draft report for the Economic Regulation of Airports inquiry and for meeting with BP on 21 March 2019.

This submission should be read in conjunction with BP's original detailed submission to this inquiry, as well as submissions made by the Australian Institute of Petroleum.

BP has also contributed to submissions made by its joint ventures in the Joint User Hydrant Installations (JUHIs) for airports in Sydney, Melbourne, Brisbane, Perth and Adelaide.

BP also notes that this topic was considered in depth by the National Competition Council (NCC) in 2011-12, based on significant industry submissions and economic analysis.

BP rejects the Productivity Commission's Draft Finding 8.1 (p. 263), particularly its conclusions in relation to market competition and prices and on the claimed conduct of infrastructure owners and jet fuel suppliers.

<u>Third party access to JUHIs</u>

The draft report claims on page 241 that *"The owners of the Joint User Hydrant Installation (JUHI) infrastructure at most airports restrict or do not allow new members. Very little is publicly known about the terms of third party access for each JUHI."*

This claim is incorrect. JUHIs do not restrict or not allow new members.

The qualifying criteria is provided by JUHIs to potential applicants, as BP expects will be reported in JUHI submissions in response to Information Request 8.1.

A copy of the JUHI Sydney qualifying criteria for third party equity participation in the JUHI was published in its submission to the NCC for its assessment of jet fuel supply infrastructure at Sydney Airport.

The NCC stated (page 28, item 4.56) that "…the criteria for joining the JUHI JV (for Sydney) are not such as to create a barrier to entry."

The draft report also claims on page 241 that:

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.

This claim is incorrect. This claim does not take account of the high capital cost, risk and long dated returns required for jet fuel infrastructure investment. The market structure in Australia, under the JUHI model, is open to applications, new membership and investment.

Experience has shown that a disincentive to investment has been the lack of tenure and the lack of a stable operating environment in which to make long term investment decisions.

Where suitable investment conditions have been present, the jet fuel industry has demonstrated over an extended period a record of efficiently and effectively investing in infrastructure to meet market needs with reliable supply.

The draft report claims on page 241 that:

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.

Important context for those infrastructure investment decisions was that the industry was awaiting the signing of a new 20 year lease with Melbourne Airport before having the investment certainty to enable these decisions.

Following the lease tenure being secured at Melbourne Airport, oil companies have proceeded with significant investment both on and off the airport. Recent investments include building a 2.7 km pipeline connecting the Mobil and BP joint venture Yarraville terminal to the Somerton jet pipeline that supplies the Somerton Jet Fuel Depot as well as significant investment in increased jet fuel storage at the Melbourne Airport JUHI with the construction of two new jet fuel tanks.

Jet Fuel Price Differentials

The Productivity Commission's draft report includes Figure 8.3 titled 'Jet fuel price differentials' (p.259), with related commentary (p.257-260).

BP notes that Figure 8.3, sourced from IATA, is comparable to Figure 1 that is addressed in the NCC report from 2012 titled 'Final recommendations - Jet fuel supply infrastructure at Sydney Airport'.

In reference to the equivalent chart of Figure 8.3, the NCC stated:

"The Council agrees with submissions made to it that the fuel differential information it has received has limited, if any, value in establishing (or for that matter rejecting) either excessive pricing or an abuse of market power in relation to supply of jet fuel at Sydney Airport."

While the Productivity Commission's draft report states that *"price differentials by themselves are not sufficient evidence that prices in Australia reflect a lack of effective competition"* (p.258), the publishing of Figure 8.3, and its title, unfortunately provides a platform for an incomplete comparison.

In particular, the NCC identified (p.21-22) the analysis provided by RBB Economics that notes:

- price differentials do not reflect differences in the margins earned by suppliers of jet fuel.

- any price differential between jet fuel in Singapore and a jet fuel product in Australia will largely reflect the significant import costs and any additional costs incurred along the supply chain from Singapore to the final consumer.

- import costs can be considerably higher when transporting smaller volumes: variation in customer sizes across airports can therefore influence the transport cost and final price differentials measured at different airports.

- the price differential is primarily determined by these significant costs sustained across the supply chain and a comparison of price differentials across airports cannot inform in any meaningful way the analysis of price competition for the supply of jet fuel at Sydney Airport.

It is estimated at Sydney airport that the hydrocarbon costs (MOPS) plus the "landed cost" which is commonly included in the Jet fuel differential pricing for major domestic and international commercial airlines in Australia, typically represents 95% of the final price paid.

The 'Landed' Costs, include:

- ocean freight – shipping cost to Australia (determined by international 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 (eg. terminals, pipelines, storage tanks);
- quality control testing of jet fuel imports and refinery production.

The balance of the differential covers a range of supply infrastructure cost and activities including but not limited to the below components which will vary amongst different supply chains:

- transportation of jet fuel to the Airport storage such as pipeline costs or road transport fees;
- costs associated with JUHI airport storage and hydrant systems at Sydney airport;
- labour costs to deliver into plane refueling services and maintaining refueling assets at Sydney airport plus;
- overheads, working capital and ongoing cost and investment to maintain the supply chain safety and integrity.

In addition, based on Air BP's knowledge of jet fuel differentials and pricing at other international airports, there could be important differences and factors that needs to be considered when comparing the jet fuel differentials and final jet fuel pricing across different international airports.

In Australia, for instance it is common practice to include all cost incurred by the fuel supplier into the jet fuel differential such as procurement, importation, storage, transportation, testing and safe delivery of product into the wing of the customers aircraft.

On the other hand, Air BP understands that at Heathrow, Vancouver and John F. Kennedy and other international airports, commercial airlines would typically also pay extra charges in addition to the jet fuel differential. These charges to the Airline may range from into-plane fees, fuel consortium fees and compulsory stock obligation charges levied by Airport authority, governments or other third-party service providers in addition to the jet fuel differential invoiced by a fuel supplier.

Furthermore, it is prudent to consider the material differences in jet fuel demand, throughput and scale of varying international airports and the impost this places upon servicing fixed costs of long term infrastructure.

It is Air BP's experience that Airports with larger throughputs can provide significant operational efficiencies and enjoy synergies on a per gallon basis verses smaller consumption airports. Hence scale and throughput materially impact a fuel supplier supply chain costs and economics when setting jet fuel differential to their customers.

For instance, based on Air BP internal estimates, Dubai, Frankfurt, Amsterdam, Heathrow and other similar size international airports are estimated to have jet fuel demand more than double that of Sydney's. In some cases, demand could exceed the entire total jet fuel demand across all capital city airports in Australia. This difference is reflected in the substantially different passenger numbers that traverse these airports on an annual basis relative to Sydney airport and ultimately, the resultant demand for jet fuel.

Jet fuel differentials and the shortcomings in the IATA table are also covered in extensive detail in the Sapere Research Group submission to the NCC inquiry of 2011 (p. 11 to 17).

Tenders

The draft report notes on page 256 that:

"However, the Commission understands that, in some cases, international airlines only receive one or two bids on their tenders for fuel supply. Submissions to the NCC during the 2011 BARA application for declaration noted there was a small number of bids for tenders at Sydney Airport. Since that time, there have been no new entrants to the Sydney market and it is unlikely that there has been a material change in the extent to which suppliers compete for tenders. In a market with vigorous competition, it would be expected that the players would bid on all contracts for supply if they have the capacity."

The NCC report referred to above considered this matter in some depth and stated (p.25):

"The Council considers that the limited bids are reflective of supply and capacity constraints, more so than a lack of access or abuse of market power by any service provider."

Draft Recommendations

Air BP notes the recommendation re. an open access operating model for Western Sydney Airport and in principle would support an open access business model that provides clarity around the future long-term operating environment. With this clarity the industry can make future investment decisions throughout the supply chain.

In regard to the draft recommendation for introducing jet fuel supply coordination forums, in Air BP's experience the purpose of this recommendation can be achieved (and therefore avoid duplication) when lease arrangements between Airports and JUHI JVs have clear and effective planning arrangements and triggers for investment in infrastructure upgrades.

BP is also of the view that the powers of jet fuel forums, other than between Airports and JUHI JVs, must be clearly articulated to avoid impinging on commercial rights or sensitivities. For example, commercial requirements can prevent fuel suppliers revealing future upstream investment decisions until an appropriate time.

Thank you for the opportunity to make this submission. If the Commission would like to discuss this submission further, please contact BP's Director – Government Affairs, Darren Disney

Yours faithfully

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Air BP