



INDEPENDENT CONSUMER & COMPETITION COMMISSION

DETERMINATION

**CLEARANCE APPLICATION FOR THE ACQUISITION OF
SHELL OIL PRODUCTS LIMITED (SOPL)**

BY

**AVIATION OPERATIONS AND AIRCRAFT REFUELLING
LIMITED (AOAR)**

Application Lodged Date: 30th of March 2010

Public Register Number : C2010/12

1. Background

This Determination relates to a clearance application by Aviation Operations and Aircraft Refuelling (PNG) Limited to acquire all of Shell Overseas Holdings Limited's issued shares in Shell Oil Products (PNG) Limited.

Aviation Operations and Aircraft Refuelling Limited ("AOAR") –is a special purpose joint venture vehicle company owned by Pacific Islands Energy Pte Ltd (51%) and NAS Aviation (49%). The primary business activity of AOAR will be the retail sale of aviation fuel products, particularly Jet A-1 for turbo jet and turbo propeller aircraft and Avgas for petrol engine light aircraft.

Pacific Islands Energy Pte Limited ("PIE") - is owned by the members of Pacific Petroleum Company, an active participant in the downstream petroleum sector within the South West Pacific including operations in New Caledonia, Tahiti and Vanuatu.

NAS Aviation Holdings Limited ("NA") - NA is a PNG domicile company of which National Superannuation Fund Limited ("Nasfund") is major shareholder amongst other PNG national entities.

The joint venture partners of Aviation Operations and Aircraft Refuelling Limited (AOAR) are collectively referred to as **AOAR** throughout this determination.

Shell Oil Products (PNG) Limited (SOPL) - is a part of the global energy and petrochemical group, the Royal Dutch Group of companies. Shell's current business interest in Papua New Guinea is confined to the JUHI facility at the Jacksons Airport, operated by SOPL.

JUHI is the aircraft refuelling facility and business located at the Jackson's Airport which consists of fixed storage tanks, a hydrant distribution system and various office and workshop facilities.

2. Acquisition Proposal

The applicant has entered into an agreement with Shell Overseas Holdings Limited (a United Kingdom corporation) to acquire the whole of the issued share capital of SOPL. The Share Purchase Agreement for SOPL acquisition is subject to a condition precedent that AOAR obtains a clearance from the Commission pursuant to section 81 of the **Independent Consumer and Competition Act 2002** (the ICCA Act). Consequently, AOAR has applied to the Commission for clearance of the proposed acquisition.

3. Application for Clearance

On 30th March 2010, AOAR lodged an application for clearance of the proposed acquisition of shareholdings in SOPL. The Commission is therefore required to make a determination on whether or not to grant clearance on or before 20th April 2010. However, due to the Easter holiday period, the Commission and the applicant agree, pursuant to section 81(3) of the Act, to extend the time by 7 days, to 27th April 2010.

4. Elements of a Clearance

AOAR applied for a clearance of the proposed acquisition under Section 81 of the ICCA Act. Section 81(3) of the ICCA Act provides that the Commission shall;

- *if it is satisfied that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, give a clearance; or*
- *if it is not satisfied that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, decline to give a clearance for the acquisition.*

5. Facts & Contentions in support of the application

The applicant's submission is summarised hereunder as follows:

- The level of competition in the market is already very low even before the SOPL acquisition is completed.
- The acquisition of SOPL by AOAR will improve the competition in the market, in that it will allow another partner into the Port Moresby aviation market and therefore the whole of PNG aviation fuel market. This new entry into the market would enhance competition that is dominated by InterOil Products Limited, in terms of price competitiveness and alternative fuel supply.

The applicant therefore submits that its proposed acquisition of SOPL would not have, or would not be likely to have, the effect of substantially lessening competition in a market; and considers that the Commission should give clearance pursuant to Section 81(3)(a) of the Act.

6. Views from Industry Participants and others

The Commission invited submissions from all stakeholders, including relevant government agencies such as Department of Treasury, Investment Promotion Authority, National Fisheries Authority, Civil Aviation Authority, and other interested parties as part of its wider public consultation process. At the time of making this determination, there were no submissions received.

7. Aviation Fuel Sector characteristics

The aviation fuel sector is dominated by InterOil, a vertically integrated firm, which supplies Jet A-1 on a wholesale basis throughout PNG, with SOPL, Airlines of PNG (APNG) and May Refuelling Services participating with InterOil in the retail market. InterOil owns and operates all aviation fuel refuelling

businesses throughout PNG except Londolovit, Daru and Jacksons Airport. APNG operate its refuelling business for its sole needs at the Jacksons Airport. In Daru, APNG operates its aviation refuelling business in partnership with May Fuelling Services. SOPL operates its aviation refuelling business only at the Jacksons Airport, though the JUHI mechanism, but acquires all of its Jet A-1 fuel from InterOil, with Avgas (of little significance in the overall market) coming from Shell Australia.

The market shares of the players as estimated by the applicant are; InterOil Products Limited (**IPL**) (30%), Airlines of PNG (**APNG**) (5%) and Shell Oil Products Limited (65%). AOAR is not a current participant in PNG and thus does not have any market shares in the aviation sector.

Distribution of into-plane aviation fuel is undertaken through two main methods – the JUHI method and the mobile tankering refuelling method. JUHI is the underground aircraft refuelling mechanism in use at Jacksons Airport, but nowhere else in the country. The mobile tankering method involves tanker trucks, which carry fuel onto the tarmac and pump it directly in to aircraft tanks. Mobile tankering is the only method used by all airlines and aircraft owners throughout PNG, except at Jacksons Airport which has JUHI.

The supply of Jet A-1 in the aviation sector is mostly undertaken by InterOil through its NapaNapa refinery. Avgas and lubricants are imported by Shell and InterOil in drums from Australia. While the Commission has a monitoring role over the price of other petroleum products such as kerosene, mogas (diesel), and petrol, this is not so for aviation fuel (Jet A-1 and Avgas) at present.

8. Commission Assessment

The Commission noted that since its last assessment of the InterOil application to acquire the JUHI from Shell in 2009, there has been minimal, if any, changes to the petroleum industry and aviation fuel sector. As such, the Commission considers that its assessment of the InterOil application in 2009 is relevant, and it will draw upon any relevant competition assessment from that application.

8.1 Approaches to define the market

For the purposes of the ICCA Act, the market is defined under Section 45 (2) as;

“...a reference to a market in the whole of Papua New Guinea for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them, including imports”.

8.2 The Market

The hydrant located at Jackson's Airport is the subject of the proposed acquisition. It is used for 'into-plane' refuelling; and the fuel it handles is Jet A-1. Hence, the starting point for market definition is Jet A-1; the functional level is 'into-plane' refuelling; and the demand is from aircraft requiring refuelling with Jet

A-1. From these, it is necessary to consider substitution possibilities in demand and supply in terms of product, geographic area and functional level.

In its submission, the applicant defined its market pursuant to section 45(2) of the ICCA Act. The applicant stated that the market definition is essentially Jet A-1, the functional level is “into-plane” refuelling; and the demand is from aircraft refuelling with Jet A-1. It therefore submits that the relevant market is **the wholesale distribution of aviation fuel throughout Papua New Guinea**. The immediate market is in Port Moresby (Jackson’s Airport) with future possible expansion outside of Port Moresby where the opportunity arises.

The Commission essentially agrees with the applicant’s market definition.

Taking into account the facts and considerations as discussed above, and consistent with section 45(2), the Commission considers that the distribution and into-plane supply of aviation fuel throughout PNG is the relevant market in this case.

9. Effects of Competition in the market

9.1 The Applicant’s Arguments

In arguing that the proposed acquisition would not have, or would not be likely to have the effect of substantially lessen competition in the market, the applicant submitted that two factors need to be taken in consideration.

Firstly, competition in the market is already limited due to major players having chosen to leave the market which was duly authorised; and secondly, SOPL currently acquires Jet A-1 fuel solely from IPL while it acquires Avgas fuel from Shell Australia. It added that whilst IPL may not be involved in distributing aviation fuel at Jackson’s Airport, it is indirectly benefiting from this market through supply of bulk aviation fuel (Jet A-1) to both SOPL and Airlines of PNG.

It therefore argued that the proposed acquisition by AOAR will not alter the current market in terms of into-plane distribution; rather, there is a benefit in terms of having another user of the JUHI through the AOAR joint venture. Furthermore, the applicant stated that both factors demonstrate that the current level of competition in the market is low even before the SOPL Acquisition is completed. It therefore submitted that the proposed acquisition would not lessen the already low level of competition which currently exists. It added that this acquisition in fact will improve the market by allowing another partner into the JUHI Joint Venture.

The applicant also submitted other matters for consideration by the Commission in its competition effect analysis, which are restated below. The applicant stated that:

- due to the LNG project, future opportunities may arise for AOAR in regional airports, which will improve or enhanced the current level of competition in the distribution of aviation fuel; in terms of price competitiveness and alternative fuel supply.

- Shell is exiting the PNG market entirely, and that AOAR will basically replace Shell in a capacity which complies with the terms of clause 19 of the JUHI operating agreement, mandated by the PNG Government. The acquisition will result in the continuation of the JUHI operations.
- the proposed acquisition meets Commission's condition imposed upon Shell in the previous acquisition of Mobil's interest in that, should Shell divest its share of the JUHI, it would be conditional upon meeting requirement of clause 19 of the JUHI operating agreement.
- the proposed acquisition has little disadvantage for import competition. There is import competition in terms of International airlines uplifting sufficient fuel overseas to make their return flights that maximise passenger and freight pay loads and distance of travel. In the regional ports, there may be direct international flights that tanker enough fuel to top up at Cairns or Port Moresby on exit, with comparatively less volumes. In terms of domestic ports, there is no disadvantage because there is only one supply source for the whole country. The proposed acquisition does not have any influence on aircraft import of fuel. The only potential impact will be when IPL refinery cannot continue supply of bulk Jet A-1 fuel and AOAR will be forced to import fuel on short notice through its joint venture partner Pacific Petroleum Company, which already has existing shipping infrastructure in the South West Pacific or through Mobil Oil New Guinea which may hold minimum reserve stock.
- there will be no adverse effect on the retail pricing of aviation fuel simply because the same pricing template used by SOPL will be adopted by AOAR. The Commission may also intervene to curtail any pricing, or non pricing issues that may arise, through the Prices Regulation Act and through relevant provisions of the ICC Act 2002.

The Commission acknowledges the information supplied by the applicant, and its arguments advanced in its submission as summarised above. Although the competition landscape under which the proposed acquisition is being made is characterised by a limited number of players, the competition dynamics are slightly different, thus would need to be assessed on its own merits.

9.2 The Commission Analysis

Under the current circumstances, the Commission notes that AOAR is a new entrant into the market. Its parent shareholder, Pacific Islands Energy Propriety Limited (**PIE**), which is a member of the Pacific Petroleum Company (**PPC**), is an active industry player in other Pacific Island countries but PNG. Through AOAR's proposed acquisition of SOPL, PIE would be indirectly entering the PNG market. In this regards, the Commission is of the view that the proposed acquisition by AOAR will not reduce the number of players, rather it will maintain the current level of players in the whole of PNG aviation market; and will have the effect of potentially enhancing rather than curtailing, competition.

In addition, the Commission considers that AOAR may also introduce vigorous

and effective competition in the market that is already dominated by InterOil, especially in all other provincial airports. This competition, will in the first instance, be likely to have an effect in the Jacksons Airport. It may also spread to other provincial airports in future, should opportunities present themselves, which could further improve competition levels to the aviation sector and the whole of PNG market overall.

The Commission notes that SOPL acquires most of its aviation fuel, particularly Jet A-1 from InterOil as the wholesaler, and on-sells this to its aviation customers at the Jacksons Airport through the JUHI. By virtue of the Project Agreement, SOPL as with all other players in the industry, have very limited opportunity to source aviation fuel, particularly Jet A-1, from alternative supply sources. The Commission also considers that the acquisition proposal by AOAR would introduce an independent player into the market who is capable of supplying the aviation fuel needs to all aviation customers, in situations of disruptions to supply from the InterOil Refinery and/or where InterOil is unable to arrange alternative sources of supply.

Following Mobil's decision to sell its interest in the JUHI to Shell, the JUHI has since been solely owned and operated by Shell but clause 19 of the JUHI JV Agreement allows for the entry of additional joint venture partner(s). As noted in other past determinations, Shell gave a written undertaking to the Commission in 2006 under section 85 of the Act that this provision would be applied if a third party expresses interest in purchasing part of the JUHI. The applicant notes that "Even after completion of the SOPL Acquisition, the terms of the JUHI Undertaking will continue to bind SOPL. This maintains the current arrangements with respect to the potential for a new entrant into the market through the use of the JUHI facility". While this may well be correct, the Commission notes that the Undertaking in question was given by Shell Papua New Guinea Limited to apply "for so long as that company operates.....[SOPL]....". Accordingly, the Commission considers that any clearance of this acquisition should be conditional upon a new undertaking from AOAR, which would replace the Shell undertaking which currently applies.

In view of these competition dynamics and assessments made above, the Commission notes that the potential entry into Jackson's Airport by AOAR through its acquisition of SOPL, provides the impetus needed for competitive pressure to other aviation fuel suppliers, potentially throughout the whole of PNG. It will also introduce yet an alternative supplier in the event of aviation fuel supply disruption by other suppliers in the market; and also increase the choices available for aviation customers for their fuel refuelling tender needs in the whole of Papua New Guinea.

10. Statutory Factors taken into account in Assessing Competition

In addition to the assessment of the application, the Commission is required under Section 69(5) of the ICCA Act to take into account the following statutory matters. These are provided in the box below.

- [a] Actual and potential level of import competition in the market.
- [b] Nature and effect of barriers to entry in the market.
- [c] Number of buyers and sellers in the market.
- [d] Degree of countervailing power in the market.
- [e] Likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins.
- [f] Extent to which substitutes are available, or are likely to become available, in the market
- [g] Dynamic characteristics of the market, including growth, innovation and product differentiation.
- [h] Likelihood that the acquisition would result in the removal from the market of a sustainable, vigorous and effective competitor.
- [i] Nature and extent of vertical, integration in the market.

[a] The actual and potential level of import competition in the market

Certain aircraft operators at Jackson's Airport have the capacity to "tanker" fuel which does not require access to the JUHI facilities. Aviation operators may uplift minimum fuel quantities at Jackson's Airport and maximize uplift at other airports, including airports throughout South East Asia, Australia and the Pacific which may be able to supply fuel at lower cost.

While "tankering" does provide some form of import competition, this would be very small and would be insignificant to constrain the applicant from significantly and sustainably increase prices or profit margins. However, there is no change in this criterion as a result of the acquisition.

[b] The Nature and Effect of Barriers to Entry to the Market

The applicant claims that the proposed acquisition would not affect the barriers of entry into the market. It further claims that even after completion of the SOPL acquisition, the terms of the JUHI Undertaking will continue to bind SOPL. The applicant asserted that this maintains the current arrangements with respect to the potential for a new entrant into the market through the use of the JUHI.

The applicant further submitted that there is considerable potential for new entrants to enter the market given the relatively low cost of delivering aviation fuels via tanker trucks at Jackson's Airport and other provincial airports. It submitted that tanker truck arrangements are an effective alternative to delivery via the JUHI.

The Commission notes the applicant's claims and maintains the view that it would be commercially unviable to build a new JUHI at Jacksons Airport and, thus the costs of entry into the market are high. Similarly, the entry cost of a new entrant into the existing JUHI is high due to technical and financial requirements, although this may be readily overcome by a new entrant. This barrier can be overcome if a suitable undertaking is given to the Commission.

[c] The number of sellers and buyers in the Market

The acquisition would not change the number of sellers and buyers in the market.

[d] Degree of Countervailing power in the market

The applicant submitted that there are relatively few but large customers of aviation fuel in the market and these will exert competitive influence on suppliers. It claimed that such customers have the ability to secure aviation fuels from suppliers such as Airlines of PNG and potential entrants in the relevant market.

The Commission agrees that there is countervailing power in the market; Air Nuigini, as the (effectively) sole customer of the JUHI, can exercise significant countervailing power.

[e] Likelihood of acquirer being able to significantly and sustainably increase prices and profit margins

The applicant submitted that its ability to increase prices is mitigated by the potential for new entrants to conduct non-JUHI fuelling operations at Jackson's Airport in addition to Airlines of PNG; potential for new entrants to purchase an interest in the JUHI in accordance with the JUHI Undertaking (ICCC's condition precedent to SOPL when it purchased Mobil's 50% share in the JUHI); and potential for international aviation operators to refuel overseas and "tanker" fuel thereby providing import competition.

The Commission acknowledges the above claims of the applicant.

The Commission also considers that there are other competitive forces, as well as price control mechanism, that could constrain AOAR from significantly increasing its prices and profit margins. These are through InterOil's competitive position in the market and potential for new entry into the market; including the Commission's ability to review and place price control on Jet A-1, where it may deem it necessary to do so. Price control mechanism, while is an available option, would come at significant costs to the Commission, thus, other options such as undertakings for access to the JUHI mechanism, may be appropriate.

[f] Extent to which substitutes are available in the market

The applicant stated that current supply regime between InterOil and the PNG Government provides limited substitutes for the current Jet A-1 market. It added that all bulk Jet A-1 fuel is supplied by InterOil from their refinery at NapaNapa and there is no alternative if supply is disrupted. The applicant also claimed that InterOil itself does not have back-up storage at the refinery site and instances of disruption of supply through force majeure incidents are known.

The applicant further stated that with the acquisition, Pacific Islands Energy (PIE) a Joint venture partner is able to arrange alternative supply to Jackson's

Airport in the event that InterOil refinery at Napa Napa is unable to continue Jet A-1 supply. PIE (through Pacific Petroleum Company) has the necessary infrastructure in place to quickly mobilize supply continuity to Jackson's Airport at any time when the situation permits.

The Commission considers that in terms of types of products, this is true for Jet A-1, Avgas and aviation lubricants, although competing brands and suppliers exist outside of the Papua New Guinea market. In terms of into-plane refuelling facilities, the provision of airside refuelling of aircraft from tankers (non-JUHI) is an alternative to the use of the hydrant system offered through the JUHI. This system has been used in the past and could potentially be used again in the future.

The Commission considers that AOAR would provide an alternative source to supply, should InterOil be unable to supply the PNG market due to disruptions. In the absence of contrary information from InterOil, the applicant's comments on the InterOil lack of backup storage at the refinery site is also supportive of the Commission's view.

[g] Dynamic characteristics of the market

In its submission, the applicant stated that the market for wholesale distribution of aviation fuel has matured over time with reasonably large volumes and product types. However, there are major new resource projects currently being planned for Papua New Guinea which will lead to an upturn in general economic activity and an overall growth in the market. It added that the growth will create opportunity for increased competition with more customers and suppliers.

The Commission acknowledges the applicant's position and accepts that under the current circumstance the market is matured, with little growth, innovation or product differentiation is unlikely. In the medium - long term the Commission considers there is a real likelihood of growth and expansion of the aviation sector and consequently the market. This outcome could potentially see likely expansion of the JUHI and non-JUHI facilities at the Jacksons Airport, including at a number of regional airports.

Consequently, the Commission considers that the impact of new entry would spur growth and innovation in the market that is currently experiencing an upturn in economic activities.

[h] Likelihood of the removal from the market of a sustainable, vigorous and effective competitor

The applicant submitted that the acquisition will not have any effect, neither change the current market position either at Jackson's Airport or in provincial airports. AOAR will basically replace SOPL.

The Commission agrees that the acquisition would not result in the removal of a sustainable, vigorous and effective competitor, however, it will have the opposite effect.

[i] Nature and Extent of Vertical Integration in the market

The Commission considers that the proposed acquisition will not cause any vertical integration concerns in the market, simply because the applicant does not have any upstream and/or midstream business in PNG such as InterOil. Consequently, the Commission would agree that there is no issue of vertical integration that would be of concern to the Commission.

10.1 Summary and Conclusion

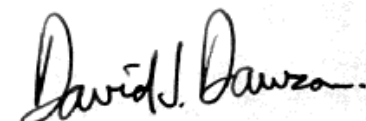
To grant a clearance under Section 81(3) of the ICCC Act, the ICCC must be satisfied that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market.

In light of the discussions set out above, the Commission is of the view that the proposed acquisition would not lead or be likely to lead to a substantial lessening of competition taking into account the analysis of the statutory factors as required under Section 69(5) of the ICCC Act, provided an undertaking is given under section 85 of the Act in the terms discussed above.

11. Decision

In view of the above factors, analysis and considerations, and subject to the condition that the applicant gives an undertaking to the Commission under section 85(1) the Commission is satisfied that the acquisition of the JUHI by AOAR, will not have, and will not be likely to have, the effect of substantially lessening competition in the market for the into-plane supply of aviation fuel throughout PNG and hereby grants clearance for the proposed acquisition to proceed pursuant to Section 81(3) of the *Independent Consumer and Competition Act 2002*.

The clearance is conditional on AOAR giving an undertaking under section 85 to the Commission, in similar terms to that given by Shell Papua New Guinea Limited in 2006, that in the event that in future, other persons wish to supply fuel through JUHI, AOAR will offer to divest the requisite share of the JUHI to that person or persons on the terms to those applying under clause 19 of the JUHI Joint Venture Agreement. The wording of the undertaking is to be settled between AOAR and the Commission, and the written undertaking given, within 45 days of the date of this determination.



David Dawson
(Associate Commissioner)



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19th April 2010

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