

Pipeline Infrastructure Concerns Underscored By Arizona Situation

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The situation earlier this month with the faulty Kinder Morgan pipeline in Phoenix underscores the unpredictable and occasionally volatile nature of the pipeline industry. While the defect didn't directly impact jet fuel, it disrupted the delivery of gasoline to the Phoenix area and stirred public debate about the reliability of pipeline systems.

Such a situation involving jet fuel could potentially wreak havoc on the airline industry if shipments were disrupted to a major airport. The industry's dependence on pipelines is overwhelming, due primarily to their inexpensive and generally reliable performance. But some in the industry

say more infrastructure is necessary, both to avert any potential problem due to pipeline failures and to prepare for increased demand in the future.

“The situation in Phoenix and Tucson is a good example of how the infrastructure needs to be improved,” notes **Fred Ketzeback**, director of fuel administration for **Alaska Airlines**. He adds that until a supply disaster happens, people “won't believe there is an infrastructure problem because we always seem to make it work.”

Benjamin Cooper, executive director of the **Association of Oil Pipe Lines**, agrees that the Arizona situation

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Airline/Airport Relationships Show Strain Under Pressure to Cut Costs; Perform

Shortly after the terrorist attacks of 9/11, executives at **Minneapolis St. Paul International Airport (MSP)** met with **Northwest Airlines** executives as well as representatives from the cleaning company that had provided service for both entities. Together, they managed to cut about \$1 million a year from the cleaning service contract by paring down and finding economies of scale.

Scenarios such as that played out throughout the United States after 9/11 and continue today. With airlines in deep financial distress, both they and the airports they serve have been forced to re-evaluate nearly every expenditure and in many cases make massive cuts. **Steve Wareham**,

assistant airport director, facilities, at MSP characterized the cleaning contract action and myriad others undertaken as “two financially viable entities working pretty hard to squeeze blood out of a turnip.” The airport more recently offered airlines long-term rent relief to the tune of \$13 million and has taken actions such as capital project deferral, wage freezes and others. Wareham says Northwest has been proactive in dissecting nearly every aspect of the airport budget to look for potential cuts, but he notes that in these financially virulent times, “I've got no problem with someone scrutinizing what I'm spending money on.”

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“We do think that we’re in a position to deliver additional jet fuel where its needed, but we also recognize that demand could be falling off...”

will at least put a spotlight on the current situation. “I think some people are going to conclude from this that it would be nice to have some more infrastructure,” he says.

“I think pipelines are going to have to answer the question of how it happened,” Cooper adds. “One way to improve your reliability is to have alternative infrastructure available.” He adds, however, that economic and political concerns stymie most expansion plans. “It’s still a tough economic proposition to say I’m going to build a pipeline next to the Kinder Morgan pipeline and try to compete with them, fight for some of their shippers.”

Capacity Issues

The problem, of course, is that in normal day-to-day operations, that additional line might not be needed. But Cooper maintains that additional infrastructure is needed to keep up with demand. “There are some expansions going on, but its not like in the gas business where they are expecting to transmit 50% more gas in the next decade,” he says. “We’re only expecting oil consumption to grow when the economy does.”

Expansion has been relatively modest recently. Projects like the Cardinal Pipeline, which runs to Columbus, Explorer Pipeline, which runs from the South up through Tulsa and to the Chicago area, and the Centennial Pipeline, which feeds the Midwest from the Gulf Coast, as well as a few others are underway, but infrastructure development has been less than dynamic.

Tim Felt, president and CEO of **Explorer Pipeline**, says the line’s two-year expansion is nearing completion. Felt says he’s not counting on increasing demand for jet fuel. “I couldn’t say we see a clear picture,” he says. “We’re prepared to handle more and there are indications that we will be handling more, but if those things don’t materialize it won’t surprise us. We do think we’re in a position to deliver additional jet fuel where it’s needed, but we also recognize that demand cold be falling off, that there are alternatives for the shippers....” He

adds: “We don’t really see that as posing a problem to us, because over time we think that lost demand will be made up by other people wanting to move other products.”

While a few pipelines are expanding, industry executives are mixed in their assessment of the need for more infrastructure. The downturn in demand for jet fuel over the past two years has alleviated some of the constraints on the pipeline system, and without a clear idea of future demand, the necessity for pipeline expansion is equally vague.

Dick Landers, senior director, fuel purchasing for **US Airways**, says the current capacity is adequate for immediate and near-future needs. “Certainly problems will exist from time to time because of the unforeseen shutdowns of various pipelines, but I think on an ongoing basis the capacity is there, especially given the fact that the industry has pared down to a much lower level than previously anticipated,” he said.

“How much of the travel loss that we’ve seen is permanent?” Landers asks. “Growth might be there, but we’re so far back from where we were that we could have four or five years of pretty good growth and still not be back to where we were a couple of years ago.”

Other fueling executives differ however. **Ketzeback** notes that most of the pipelines around the country are prorated, and says expansion is hindered by the “not in my backyard” attitude of communities around the country. “I think we need to improve our infrastructure, but it’s not easy.”

Similarly, **Bob Sturtz**, director of petroleum and purchasing for **United Airlines**, says near future demand warrants infrastructure improvements. “Will we have logistics constraints with our fuel supply at various airports?” he says. “I think the answer is yes, because everybody is playing up the fact that consumption is down, but those volumes are starting to come back to the market. I don’t know anybody who believes that long-term fuel consumption is not going to grow.

“There are a lot of regional airplanes coming into the market and there are certainly a lot of airplanes that

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Pipeline remains the most reliable and inexpensive way to move product across the country.

are parked that could easily be brought back to the market," Sturtz adds. "To me, all this says that, not this year, not next year but soon we'll once again be pushing some of the constraints on the facilities."

Adding to airline concerns is competition for pipeline space among various petroleum products some with substantially higher premiums over jet fuel. "With over 24 different grades of gasoline and higher margin products such as low sulfur and CARB diesels, jet fuel will have to fight for available space," said one trader.

Such situations make shippers look for alternatives, and in many cases there aren't too many. Pipeline remains the most inexpensive and reliable way to move product across the country.

And in some cases it's the only viable option. "Here in the Pacific Northwest you don't have an alternative," notes Katzeback. "You can't move mass volumes in other ways. That's true in certain other locations around the country."

It's clear that, barring any major disaster, the future of pipelines is secure. But how that infrastructure develops in the coming years could have a significant impact on jet fuel availability and cost. **JFR**

Airline/Airport Relationships
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Wareham may be in the minority within the airport community. Many airport executives have been riled by what they view as invasive and overbearing efforts by airlines to intrude on the finances of airports. Moreover, some airport managers have charged airlines have initiated a pattern of "hide and seek" or stall tactics in connection with decisions on much needed airport improvements. "The theory goes that if they [airlines] can avoid making a decision they could stop the project altogether or at the very least avoid capital outlays." Most airports have made substantial cuts since 9/11, but airlines continue to ask for more," offered one manager.

A letter sent earlier this year from **American Airlines** to at least one major airport illustrates the often-divisive nature of airport-airline relationships today. In part, the letters said: "I ask that you and your staff scour your budget and save every dollar you can. As you prepare new budgets, postpone capital projects that are not absolutely essential for the safe operation of the airport. Keep staffs to a minimum. Reevaluate the necessity for all positions. Look at items as mundane as carpet cleaning and as far-reaching as generating new services for concession revenue. Rebid service contracts. Realize that the old thinking that airport costs are not important because they make up only a small percentage of airline costs is no longer true...."

Some airport executives

consider such letters -- which are not unique to American Airlines nor to just one or two airports -- to be crossing the boundaries, inflaming the already divisive nature of airport-airline relationships. **Kent George**, executive director of the **Allegheny County Airport Authority**, notes that airlines have been broadsided with the overall economic difficulties, the war in Iraq and the SARS crisis. "The airlines have responded in a completely draconian manner and are trying to cram down -- in any way, shape or form through ridiculous requests -- a reduction in overall costs, but they still want the services," George contends.

He points to the consolidated operations at PIT, where **US Airways** is by far the dominant carrier, as well as to a 10% reduction in the airport authority workforce and about \$8 million slashed from the operating budget. "When you put that all together, that's pretty damn responsive," he says. "We didn't have to have US Airways breathing down our necks telling us what to do. We were doing it before US Airways, **United**, Northwest or any of the other carriers asked us to."

Other airport executives expressed similar frustrations. One says the pressure from airlines has always been present, and "their normal behavior has just become a lot more intense." Similarly, another airport executive notes that while relationships

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One airline source acknowledges that airlines have been aggressive in calling for cutbacks, sometimes on the very projects the airlines requested and lobbied for when economics were better.

with airlines have always been strained at best, "now they are trying to be intensely involved in our businesses when they should be taking care of their own."

The airline involvement impacts all airport operations. One concessions executive laments that airlines continually want to get involved in how concessions are run, and they want the old formula of high rents, fat MAGs [minimum annual guarantee] and little or no concessionaire support from the airport. "It's a control issue," notes the source. "If an airport has a progressive, dynamic concessions program the airlines are much better off letting the airport do it, but they don't."

In fact, one recent letter from Northwest Airlines to at least one airport advised: "Do not waive minimum annual guarantees of any concessionaire." And a different American Airlines letter dated January 8, 2002, advised, among other things, that the airport terminate all consultant agreements and require each department head to reduce overall budgets by at least 25%.

"They are constantly pressuring us to spend our budget monies to benefit them, as opposed to the customer or the building or the infrastructure," the concessions executive laments. "The piece that I find difficult with the airlines is that far, far too many short-term decisions are being made that will cost long-term dollars. Our job is to continue to build a fabulous experience for passengers to be able to get to their flights. That's a building block thing, not something that can be changed on a Monday and adjusted on Tuesday and screwed with on Wednesday...."

Cost Cutting Comes at a Price

In their effort to cut costs, airlines are swinging a wide axe. Just as the cleaning company at MSP had to endure a reduction in fees, ramp operators are under siege from airlines eager to cut costs associated with aircraft cleaning, pushbacks, baggage and fueling. "Every aspect of our service has come up for review which is a nice way of saying lower your costs or lose the business," complained one airport ramp operator. "Our choices are lose money or walk away from the business, not much of a choice."

Concerns are starting to be raised in some quarters that under the current cost cutting regime safety may

be compromised on the ramp. "Some of the companies may not survive and for the others it will be sometime before fees rise which will lead to increased employee turnover rates and a reduction in trained professionals. Two of the primary ingredients for an increase in ramp accidents," offered another operator. If correct, airline savings derived from reduced fees for ramp services may be insignificant compared to higher costs from delays or damage to aircraft.

Airlines Under Pressure

For their part, the airlines argue that desperate times call for desperate measures. One airline source acknowledges that airlines have been aggressive in calling for cutbacks, sometimes on the very same projects the airlines requested and lobbied for when economics were better.

"The airports will continually say 'we're spending money because you asked us to spend money', to expand the airport or fix the terminal or whatever," the airline source says. "And that very well may be true. While they respond favorably to those kinds of requests, our view is they ought to respond favorably when we say 'we know we asked you for it, but now we can't afford it anymore.'"

"The realization that the industry is suffering much more than anyone could have imagined hasn't sunk in with a lot of people," the executive continued. "I don't want to leave the impression that no airport is doing what they need to do. Many airports have done a tremendous amount of work to cut their budgets, both their operating budgets and their capital budgets. Some of them have done better on one side or the other, and some have been aggressive across the board. We greatly appreciate that, but just like the airlines have had to cut and then cut again, what the carriers individually are asking is for that to happen at the airport."

The source adds that airlines are continuously making massive cuts themselves. "The airlines are in a zero growth mode, they're just trying to survive," he says. "The airlines have done what they are able to do to cut costs and now they're going to what is, quite frankly, one of their biggest suppliers and saying please help us."

An airline consultant adds that many airlines feel that airports aren't

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run like lean businesses, an argument that many airport executives would shoot right back at the airlines. But the consultant says, "(Airports) tend to have plenty of staff. There seems to be a lot of consultants, which the airlines would say are probably not needed." The consultant adds that airlines are also concerned with capital projects that they view as extraneous. "Airlines think that airports tend to undertake public works-type projects more in the interest of creating jobs and doing something than in actually building something that is going to have economic benefit. Airlines would rather have them focused on pure economic returns to the airlines...."

Varying Degrees of Involvement

The level of airline involvement in the finances and day-to-day operations at an airport depends to a certain extent on its presence there. Airports largely dependent on one major hub carrier are most vulnerable. In those cases, airlines wield considerable power because the specter of airline scalebacks would mean a huge blow to airport operations. Conversely, airports with many good-sized competing airlines face less hardship if one airline cuts back or walks away.

PIT and Denver International Airport (DIA) are two obvious examples of where airline-airport relationships have been tested to the limit. Both deal with bankrupt airlines - - US Airways at PIT and United Airlines at DIA -- and in both cases the key issue involves leases. U.S. Airways rejected its airport leases before emerging from bankruptcy in March, renegotiation efforts are currently underway. At DIA, United Airlines has cut back its service at the airport but has refused to give up its leases on eight gates on Concourse A. United also wants the airport to build additional capacity, but the airline has until December 15 to decide whether to reject its 30-year airport lease.

Neither George nor airport executives at DIA would discuss their respective ongoing negotiations. However, both situations are being closely watched by others in the airport community. "I'm very much (on top of) what US Airways is trying to do in Pittsburgh, and I'm very concerned about it," notes **Leonard Griggs Jr.**, airport director at **Lambert-St. Louis International Airport**. "I think not just the aviation community should be

concerned about it, but the entire bond market. If a given airline...can come in and make those kinds of demands... and achieve those kinds of draconian results, what is the future of municipally backed bonds? There has to be some protection to the issues of these bonds."

As for the situation at DIA, Griggs notes that "United sits in the catbird seat. They have the ultimate power in Denver." Another airport executive says United's demands in Denver are "indicative of how the airlines are operating right now.

"(United is) going to certain airports saying 'I'm your savior'," and making promises of future loyalty in exchange for the airport catering to United's desires, the source says. "Anybody that feels that an airline can make a promise today that you can take to the bank or be comfortable with five years from now should be very careful."

The airline source concurs. "I'm not saying there shouldn't be that level of distrust, but at the same time I think it will put more discipline on the airports to be more careful with what they are attempting to do in terms of long-term capital development," he says.

The situation leaves airports in the difficult position of trying to appease their key tenants while at the same time attempting to wiggle out from the influence those carriers have. Politics clearly plays a role, in some cities more blatantly than others. One airport source maintains that "Of course the airlines have never been shy about pulling any political punches. We always joke that there is a path down to city hall. Any place that has a hub or hometown airlines sees that."

But the accusations fire both ways. "The political influence manifests itself in the staffing levels at airports, and with the number of consultants, who are often there as political favors," one airline consultant says.

How much influence airlines will have on airport finances and operations remains to be seen. Many airport executives say this period of financial distress for the industry will likely prompt airports to tighten up leases and do what they can to become less beholden to airlines. That might mean shorter lease times, compensatory rather than residual financial structures or different styles

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of bond financing.

The airline source says he believes airports will eschew compensatory models in favor of residual agreements because the latter requires airlines to make up the difference after all other revenues are taken into account. Such a model, he maintains, puts more risk on the airlines' shoulders.

Certain airports may view that as the best path going forward, but many express desire to move away from residual arrangements. Compensatory agreements allow airports more freedom in how they spend money because airlines pay based on lease agreements

and passenger numbers. Money from concessions, parking and other revenue streams is used for whatever purpose the airport chooses. Generally speaking, at residual airports the airlines have longer-term leases. "We want to get away from the long-term lease, because as we can see in Pittsburgh and Denver, that model isn't working," notes one source. He adds that airports need to have more control over their finances, rather than putting up with airline scrutiny and demands. "We have to make sure that our money remains our money." JFR

News Briefs ~~~~~

Boeing, FAA Stress New Safer Fuel Tanks Still in Early Stages

Chicago... Despite the recent successful test by **Boeing** of a new fuel inerting system that may prevent fuel tank explosions, both the aircraft manufacturer and the **Federal Aviation Administration (FAA)** stress it is still in the very early stages.

"It holds great promise and

we're very encouraged by what we've been thus far, but there's been no cost benefit analysis done yet, so we don't know how much it will cost," said FAA spokesperson **Alison Duquette**. "But it's very exciting for us because this is something that only a few years ago everyone said it was impractical in

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Mark Your Calendars...

6th International Jet Fuel Conference & Exhibition Returns to Miami's Inter-Continental Hotel

Armbrust Aviation Group is pleased to announce that the **6th Annual International Jet Fuel Conference & Exhibition** is scheduled for March 7 -10, 2004 at Miami's Inter-Continental Hotel.

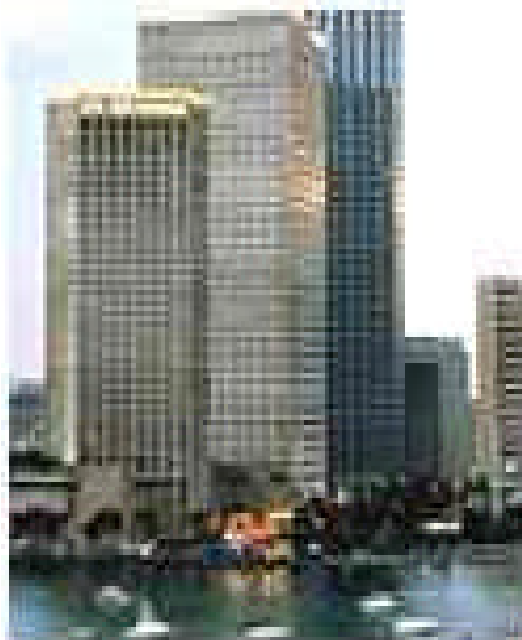
This will be the second time that the hotel, which overlooks Biscayne Bay, will host the conference.

AAG is currently working with key industry participants to identify topics and speakers to create an informative agenda. Early indications call for significant focus on the accuracy of current pricing models with plans to explore additional pricing options.

AAG plans to facilitate industry challenges regarding existing pricing models in open discussions and working groups. Check back regularly for information on topics and speakers.

We welcome suggestions regarding agenda topics and speakers.

Contact **Barb Moreno**, Conference Manager at 561.659.6818 ext. 104 or email: bmoreno@armbrustaviation.com



World Jet Fuel Prices

Spot Cargoes

Trend ?

Rotterdam			Mediterranean			Middle East			New York			US Gulf Coast		
6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30
274.5	267.6	264.2	268.9	262.5	258.3	33.87	33.22	33.05	84.19	83.35	82.80	81.74	80.87	80.15
Chicago			Los Angeles			Pacific NW			CIF Japan			Singapore		
6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30
85.71	84.60	84.52	89.70	88.75	94.20	90.20	89.50	94.00	35.95	35.11	34.05	34.10	33.60	32.84

Futures/Differentials

Trend ?

IPE Gasoil*			NY Heating Oil			WTI Crude			Brent Crude			Rott Jet/IPE Gasoil		
6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30
			81.60	83.50	79.60	31.50	31.84	30.89						
NY Jet/Heating Oil			Gulf Jet/NY 2 Oil			Gulf/Los Angeles Jet								
6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30	6/13	6/6	5/30			
			2.59	2.78	2.08	-1.15	-0.07	-0.46	-7.96	-7.88	-13.33			

Key: U.S. weekly averages cents per gallon, WTI Crude, Asian jet in \$/barrel, Europe, Medd \$/Ton

Sources: Opus Jetfax, JFR

terms of how it worked on the airplane itself.”

Fuel tank explosions may have been responsible for the 1996 mid-air destruction of **TWA Flight 800** that killed 230 people as well as a 2001 incident involving a parked **Thai Airways 737** in which one person was killed and a 1990 **Philippine Airlines** accident that killed eight.

During the test at Dulles International Airport in late July, Boeing engineers were able to reduce the amount of oxygen in a plane’s center fuel tank from 21% to 12% by

pumping in nitrogen rich gas. With less oxygen in the tank, the chances of a fire are greatly reduced.

Airbus confirmed it is also developing a similar system for its planes but has not yet begun the certification process. Duquette noted both manufacturers were working off a FAA prototype system that had been shared with the industry.

“There are some differences in the Boeing system but its all proprietary,” she said. “The flight testing were doing now is part of the actual certification process.”

A Boeing spokesperson would only say the successful test was a major step forward but that it was still in the early stages.

Duquette confirmed that if additional testing goes well, the FAA and Boeing are targeting early 2005 target to begin putting the fuel inerting system in new 747s, with the retrofitting of older planes occurring after that. As to whether the FAA would require the system in all planes, she said, “The testing is not completed, so it’s a little premature to talk about if we would make it mandatory.” **JFR**

