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EU Airline Fuel Departments Prepare For Possible Emissions Trading Scheme

Fuel executives are on the alert, both in terms of raising fuel efficiencies and preparing for possible new fuel department duties.

Aviation has thus far escaped inclusion in the EU's emissions trading scheme that launched at the start of this year, but airline executives are gearing up for what many believe is an inevitable development by 2008. While far from a done deal, it is widely expected that aviation will be included in the carbon dioxide trading scheme. That potential development has put fuel executives on the alert – both in terms of raising fuel efficiencies and preparing for possible new fuel department duties -- as airlines decide how to best implement the new program.

The EU's emissions trading scheme, also known as carbon trading, involves the government setting carbon dioxide emissions limits for individual industries. Companies must either meet the limits or face fines. Those who need to exceed their stated level can "buy" greenhouse gas emissions from more efficient companies, while those operating more efficiently have the opportunity to sell off their excess emissions allowance. For many industries in the EU, trading started at the beginning of 2005, but aviation was exempted due to

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Infrastructure Problems and Other Issues Keep Supplies Tight At Some Airports

Items keep popping up in the news: airports in Wilkes-Barre, PA, and Tobago running out of jet fuel, crises in Orlando or Kona or someplace else on the verge of running the tanks dry. And that doesn't even scratch the surface of the juggling going on behind the scenes to secure supply integrity at some of the nation's largest airports. While some shortages can be attributed to mismanagement or a series of unfortunate events, more often it's a persistent lack of adequate infrastructure that is pushing supply to the breaking point.

Jet fuel demand is rising along with the growth in flights throughout North America, and many pipelines and jet fuel storage facilities are nearing the breaking point. "It's been a persistent problem," notes one airline fuel executive. "The problem initially reared its head in a big way in 2000, and people started to get all uptight and very concerned about it. With the drop in demand due to 9/11 everyone forgot about it so no efforts were made to actually deal with the problems. Now demand has picked up again and all of the sudden we're dealing with critical situations."

In some cases, infrastructure problems are being addressed. At **San Francisco International**, for example, the fuel consortium is taking on an additional storage facility to

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the complicated and competitive nature of the industry.

All countries within the EU signed the 1997 Kyoto agreement, which calls for industrial nations to cut emissions of carbon dioxide to 5.2% below 1990 levels by the end of this decade. The US declined to sign the treaty. While estimates vary, the projected growth of aviation within the EU and globally means aviation may be responsible for up to a quarter of greenhouse gas emissions by 2030. Therefore, it is generally agreed that the industry bears some responsibility for curbing emissions through more efficient fleets and other measures.

The issue of aviation's involvement in the EU emissions trading scheme is likely to be thrust to the forefront later this year when the UK takes control of the EU presidency. British prime minister Tony Blair has set climate change issues as one of the key planks of the UK presidency, and the aviation industry has been put on alert that its inclusion in the scheme is likely in 2008. That gives the industry three years to prepare, and groundwork is being done to ensure airline competitiveness isn't compromised.

Thus far, major airlines have been cautiously supportive of emissions trading. In the January 4 issue of the *Financial Times*, **British Airways** chief executive **Rod Eddington** wrote a column advocating including aviation in the EU-wide emissions trading scheme.

"Aviation is a small but growing source of greenhouse gas emissions," Eddington wrote. "The British government is supporting plans to constrain their growth by including aviation within the EU emissions trading scheme. The reaction of the main players in the UK aviation industry is to give a cautious welcome to these plans. The caution arises from the potential risks to the competitiveness of Europe's aviation industry. But we welcome the British initiative because emissions trading is likely to be the most effective and efficient instrument for dealing with greenhouse gas emissions from aviation."

The Lesser Of Many Evils

While support by airlines may seem counter-intuitive, many in the industry see emissions trading as the lesser of many evils. Taxes or other punitive measures could be far worse.

Jonathan Pardoe, manager, fuels contracts and hedging, **Virgin Atlantic**, says that while Virgin "doesn't want to go into it willingly," emissions trading beats other measures being proposed to curb airline emissions. "It really is a case that this may be a preferred route to any other that has been offered up until now," he says. "It all depends on what the alternatives are. One of the issues that we've had in the past is we don't want to be hit by a unilateral environmental tax that doesn't achieve anything, where the money doesn't go to help the environment, it's purely a punitive action."

Similarly, **Niels Eirik Nertun,** vice president, environmental issues, **SAS Group** says the carrier is in favor of emissions trading "in principle," and says it is far preferable to taxes and charges. "We are absolutely seeing in principle much more to gain in an emissions trading system," he says.

The Association of European Airlines has been working with member airlines to come to a consensus opinion prior to the UK's presidency of the EU in the latter half of 2005. That's no easy feat, says information manager **David Henderson.** At press time, the association did not have a final opinion on the issue, but Henderson says they were "evolving a consensus that looks as though it might be moving towards (support of) emissions trading.

"They come along a continuum of support," he says. "Some are more favorable than others. I would say that none are specifically against it but there are some who are still a bit skeptical." Nor are all airlines convinced that some action, whether emissions trading or taxation, is inevitable, he says. But the real concern is that emissions trading will put EU

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If implemented at all for aviation, emissions trading is likely to at least start with flights operating within the EU.

airlines at a competitive disadvantage.

Competitive Issues

In fact, if implemented at all for aviation, emissions trading is likely to at least start with flights operating within the EU. That would allow airlines to compete on a level playing field globally. But the longer-term goal is to include the rest of the world, which might be a tall order given the US's reluctance to take part in Kyoto.

But the competition issue is what has many airlines holding back full support. Lufthansa, for example, is hesitant to support any scheme that might hurt competitiveness. **Helmut Fredrich**, general manager, corporate fuel management for **Deutsche Lufthansa AG,** says because of competition issues the airline "would prefer to have it embedded in a global rather than just European approach…" But he says emissions trading is preferable to the taxes also under consideration.

"Lufthansa puts a lot of efforts into saving energy and

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British Airway's Emissions Trading Experience

Unlike other airlines, **British Airways** won't be embarking on emissions trading without any experience. The carrier is a member of the voluntary UK emissions trading scheme currently in place. It is the only airline participating in the program, and BA says it "may well be" the only airline in the world to be actively participating in emissions trading.

At British Airways, emissions trading is currently handled within the finance department, with traders working alongside fuel hedging staff, according to BA spokesperson **Laura Goodes**. If a broader participation in the EU-wide scheme comes to fruition, Goodes says a similar structure will likely be in place, although on a larger scale to handle a far higher trading volume.

While still in its infancy, the UK trading scheme has yielded impressive results.

While still in its infancy, the UK trading scheme has yielded impressive results. Although the scheme only covers BA's domestic flights and UK properties, the carrier has achieved a 17% reduction in emissions relative to the scheme's 1998-2000 baseline level.

"Our experience in the UK scheme has benefited BA in several ways," says Goodes. "Firstly it has introduced the concept of emissions trading into the company. Secondly, it has provided us with valuable experience on how to gather and report emissions data, and thirdly, we can use our experience in this scheme to influence the framework for future emissions trading schemes."

In his article in the Financial Times advocating for aviation's inclusion in an EU-wide emissions trading scheme, BA chief executive Rod Eddington said the UK program was a first step in what he views as an eventual global solution. "The longer-term objective is to establish a global approach to emissions trading in aviation, through the **International Civil Aviation Organization**," he wrote. "It will take time to get agreement on this, particularly with the US's rejection of the Kyoto protocol. However, there is an opportunity to demonstrate that such an approach can work in Europe by including aviation in the EU emissions trading scheme from 2008…."

Eddington said technology and market mechanisms that have driven economic progress should be harnessed to tackle the environmental challenges the world faces. "It is vital that the aviation industry play its part," he says. "Europe's emissions trading scheme offers an ideal opportunity for it to do so." **JFR**

"The AEA is coordinating the airlines actions in Europe and I am sure the major carriers in Europe will work together in order to mitigate the effects toward the competition."

reducing emissions," Fredrich says. "We believe that environmental taxes and fees as proposed by some politicians are not serving the quoted purpose but will lead to distorting competition effects. Emissions trading, if introduced with proper regulations on a global basis, is therefore the only regulatory instrument which can effectively play a role in reducing emissions."

That seems to be the consensus among major airlines. **Robert Bijl,** vice president, general manager, fuel, **KLM**, says "Our objectives are of course not to put the European airlines in a negative competitive position towards their global competitors so we oppose," We believe that if measures for the airlines are unavoidable, that the best way would be through a Co2 quotum so that the cost can be managed through emissions trading."

"The AEA is coordinating the airlines actions in Europe and I am sure the major carriers in Europe will work together in order to mitigate the effects toward the competition," Bijl added.

For some airlines, emissions trading could be a way for them to better capitalize on the relative efficiencies of their fleets. "One reason we might favor this kind of thing is because it will favor those airlines that have been more responsible in their selection of aircraft and fuel efficiency in general," says Pardoe of Virgin Atlantic. "With a younger fleet that is using more modern engines, and if efforts are made to reduce the amount of emissions you're actual producing, those airlines are going to come out with a smaller burden."

It's up to individual airlines to examine how best to incorporate these new functions into their operations, but fuel departments will likely be impacted at most if not all airlines.

And depending on the airline, emissions trading could actually represent cost savings. SAS's regional carrier **Sverige** pays 10-30 million Norwegian kroner ($1.5 - $4.7 million) in Co2 tax each year to the Norwegian government, currently the only nation with a Co2 tax. Assuming emissions trading would supercede the national tax (although Norway is not part of the EU), participation in the emissions trading scheme would cost the carrier about 7-10 million kroner, far less than the tax.

Implementation

Also of concern to airline fuel executives is how any emissions trading scheme would be implemented. "I think one of the big problems is deciding who owns it within the airline," Pardoe says. "Does this come under the environmental and health department or should this come under the actual fuel department or the people who look after risk management and hedging of other products?"

At British Airways, which has participated in a UK emissions trading scheme (see sidebar), emissions trading falls within the finance department, working side by side with the fuel hedging department. Lufthansa and KLM are gearing up for similar structures, with possible increased duties for the fuel departments.

"In my department we are already studying this market so that we may be ready once it will be implemented, probably in 2008," says Bijl. At Lufthansa, no decision has been made on how the scheme would be implemented, but Fredrich says, "Since fuel hedging is within the fuel department the most logical procedure would be to also do the emissions trading in the fuel department." At Lufthansa, the fuel department reports to the executive vice president of finance.

However airlines decide to move forward, the industry in the EU seems to be moving in the direction of emissions trading. The **International Civil Aviation Organization** has concluded that "emissions trading is a far more cost-effective mechanism for limiting international aviation emissions relative to taxes and charges." The Association of European Airlines, along with International Air Transport Association, will likely lead the negotiations relating to technical, legal and competitive issues. It's up to individual airlines to examine how best to incorporate these new functions into their operations, but fuel departments will likely be impacted at most if not all airlines. **JFR**

Infrastructure Problems And Other Issues Keep Supplies Tight At Some Airports
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help ease capacity constraints. The consortium at **Washington Dulles** has agreed to supplemental trucking of fuel into the airport, but not without some fierce infighting among major airlines.

Sources say the crux of the problem lies in how best to divvy up the expense of expansions or alternate fuel deliveries. In the case of Dulles, **Independence Air** launched last year after it lost a contract with **United Airlines** to fly certain routes for the carrier. United, eager to keep its market share, continued to fly to those same destinations served by the new Independence. The result was a spike in demand that taxed the pipelines feeding the airport and the storage there.

"At Dulles, demand was up and they couldn't get enough supply to the airport," explains one fuel executive with direct knowledge of the situation. "The pipeline went on pro-rationing and then they were going to have to truck barrels. The issue was who was going to pay for the trucking of barrels into the airport. A lot of the airlines said it wasn't their problem, they didn't expand their schedule."

United took the stance that other airlines should share in the trucking costs, and that to deny that would open them up to additional trucking costs in the future, the source said.

"In the end the consortium had to agree to cover the additional cost of trucking up until such time that investments that were taking place within the pipeline were completed to improve the efficiency of supply to the airport," noted one source.

"United is trying to push Independence out, and everybody else is being caught in the crossfire," he adds.

In an inauspicious start to the new year, Kona, Hawaii, also had a near run-out of jet fuel.

Then there are the isolated incidents that executives say are growing in number. Fuel executives were scrambling late last year when **Orlando International** came teeth-clenchingly close to running out of fuel. "In this particular situation it was just a couple of things that conspired to create a major problem," one of the executives said. "The stock situation isn't great, but it was a failure of **ChevronTexaco** to deliver product on time, which was then exacerbated by the fact that one of the storage tanks had a floating suction which malfunctioned and they couldn't use that tank. So a million gallons was untouchable."

At one point, the executive says, the airport was down to less than a day's supply. "Luckily, the floating suction got fixed, but also ChevronTexaco started trucking in product from Tampa to resolve the situation. It is a problem in that there isn't sufficient storage capacity as the airport grows, and particularly during peak times."

Wilkes Barre Scranton International briefly ran out of jet fuel in mid-January after heavy fog in surrounding areas meant several flights were redirected to the airport.

In an inauspicious start to the new year, **Kona, Hawaii**, also had a near runout. According to one industry source, Bradley Aviation was overwhelmed with demand from corporate jets and left too little for commercial carriers. "Over New Year's there was a big influx of corporate jets," the source said. "They sucked up all the fuel, and **(Bradley Aviation)** realized they were running out of fuel to supply the commercial guys." The crisis was averted when suppliers added extra barges out of Honolulu to re-supply Kona.

Another source says the situation didn't reach crisis point, instead it was a "short-term logistics issue. I know it's tight every Christmas. I think they've got some systems in place to avoid it in the future."

Situations like these would suggest that the industry should take a more pro-active approach in beefing up infrastructure or at least having better contingency plans in place. In some cases, addressing core infrastructure problems is nearly impossible. For example, supply is constrained at **Denver International**, but with limited pipeline capacity feeding the airport there is little airlines can do to ease the squeeze.

"Denver is probably within 1,000 barrels a day of being maxed

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"Denver is probably within 1,000 barrels a day of being maxed out."

out," warns one executive. "If airlines start to expand in Denver the airport cannot supply them with fuel. It's because of the gridlock in the pipeline system from the Gulf, with the demand for diesel in that area at certain times of the year, you just can't pump enough jet through the line."

"Something is going to have to happen there," he adds. "Airlines are going to want to expand in Denver and they aren't going to be able to because they can't get jet. We see Denver as a location that may start more international flights, with the runway structure and the infrastructure capability from an airport perspective. We need to somehow increase the supply system capacity – the capacity to get fuel into that airport. There is plenty of storage on the airport."

At other places, like Dulles, the infighting over who pays for what can result in gridlock or an inability to address problems most efficiently. "The animosity was palpable," notes the executive directly involved. "I see issues coming up that airlines are going to start voting via their alliances. There is a ton of mistrust out there. If somebody is putting forward a motion, the other guy -- his competitor -- is thinking if it's good for them, it's got to be bad for us."

"It's no longer a happy club of gentlemen," says another executive. "There is no give and take, saying you'll win this one but I'll win the next. It's more a division of forces through the alliances…."

Such infighting makes some in the industry question the viability of fuel consortiums, and also whether individual airlines should chair them or whether duties should fall to a third-party. More for reasons of manpower than anything else, the day to day operations of Canada's fuel consortium are being handed off to a third party, relieving **Air Canada** of the extensive duties that come with chairing consortiums.

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A Singular Approach

But no matter how consortiums are structured, the fact remains that infrastructure problems are increasingly pervasive. Another approach, favored by **Southwest Airlines** in particular, is to take individual responsibility for fuel infrastructure needs and key airports.

Southwest is currently in lease negotiations with **Baltimore-Washington International** with the intent to build new fuel facilities to support the airline's new hydrant system at the airport. Rather than view it as a consortium issue, Southwest is taking on the project alone.

"I think we're going to take it as an airport issue, similar to what we've done in Sacramento," says **Robert Myrben,** director, fuel purchasing and inventory, Southwest Airlines. "We're building a hydrant system at the airport and to feed a hydrant system the current storage is not adequate in design and size. We're looking at how to increase that.

"Baltimore is a little different because there is some additional storage on the airport that probably could handle the majority of the other business if you take ours out of it," Myrben continues. "We need to build a new facility that's more conducive to supplying a hydrant system. There really wasn't any need for other airlines to be involved."

Myrben points to airports like **San Jose International, Oakland International** and **Albuquerque International** where Southwest will be involved in upgrading or expanding fuel facilities. "We're trying to take a very proactive approach and either de-bottleneck or add new facilities where we need it," he says. "But it becomes more difficult as capital gets a little tighter."

Of course capital is tight at Southwest given the weak revenue environment, but at most other airlines in the US the capital situation is several times worse. Simply put, airlines can't afford fuel facility upgrades and expansions. Because every penny matters, reluctance to commit to capital projects and bickering over who pays for what will likely be status quo for the foreseeable future. **JFR**

News Briefs

In its annual report on the regional outlook for aviation and tourism, the Centre for Asia Pacific Aviation predicts a more subdued, but still robust performance for airlines and airports in the year ahead.

Swissport Sells Stations Gains Contract At Gatwick

France… **Swissport** has agreed to sell its Toulouse and Nice stations to **MAP-Handling** for an undisclosed sum. The company said that Swissport France intends to focus on its ground handling activities at **Paris Charles de Gaulle**, where it offers various passenger and operational services in Terminals 1 and 2 and is a partner for a comprehensive range of airport services in Terminal 3.

Swissport France is also moving its head office from Nice to Paris. All Swissport's passenger ground handling business in Toulouse and Nice, including all the personnel and equipment involved, will be acquired by MAP-Handling with effect from March 15, 2005. The sale does not include the private executive aviation business in Nice, which will remain in Swissport's hands. Swissport will also continue to operate its cargo handling businesses in Lille, Lyon, Mulhouse, Nantes, Nice, Rouen, Paris and Strasbourg.

Separately, Swissport announced that it will assume responsibility for **First Choice Airway's** ground handling services at the key London Gatwick hub on April 10th, 2005 under a multi-year agreement. The contract involves approximately 5 000 flights a year. First Choice Airways, whose home base is Manchester Airport, serves over 60 destinations with its 33-aircraft fleet.

GlobeGround Parent Joins With France's CFF Recycling

France… France's **CFF Recycling** has joined with GlobeGround parent company **Penauille PolyServices** in a venture that will see the creation of a business with revenues of more than 3 billion Euros, the companies said. While details were scarce, **Jean de Courcel,** CEO of **Servisair/GlobeGround,** said, "The arrival of CFF as the principal shareholder will bring about a major recapitalization of our business and the restructuring of its debt. It will allow for the creation of a parent company with a financial base that is in line with industrial goals, enabling us to consolidate our financial position and to have the necessary resources for the development of our business as specialist suppliers of service to the aviation industry."

"The arrival of CFF as the principal shareholder will bring about a major recapitalization of our business and the restructuring of its debt."

Skytanking Wins Contract At Chicago Midway

Ft. Lauderdale… **Skytanking USA** has been awarded the fuel system operating contract by the Midway Airline Terminal Consortium. The contract starts February 1 and will run for a term of five years. Skytanking president **John Gassett** said the transition is expected to be "seamless," and noted that six companies bid on the contract.

ASIG Europe Appoints Fuels Executive

Orlando… **ASIG** has appointed **David Freeman** as general manger fuels for ASIG Europe. Freeman has 28 years experience in providing aircraft fueling services. He previously served as technical services manager for aviation fuel services at **London Heathrow Airport.** Freeman will be based at ASIG Europe's headquarters in Egham, UK.

"With continued growth of ASIG's fuel services division in both Europe and Asia, plus our recent expansion into a new line of business, it is imperative that we preserve our position as a leading provider of high quality aviation fuel services," said **Mark Edwards**, senior vice president and managing director, **ASIG Europe.** "As general manager, fuels, David will be the official custodian of fuel technology and quality standards for all our international operations thus ensuring the highest quality and level of service possible."

Continued Growth For Asia Pacific Airlines Predicted

Singapore… The aviation sector in the Asia Pacific and Middle East region will continue to defy global industry trends in 2005, maintaining high growth and profitability after a record 2004, a leading consultancy firm says. In its annual report on the regional outlook for aviation and tourism, the **Centre for Asia Pacific Aviation** predicts a more subdued, but still robust performance for airlines and airports in the year ahead.

The Centre estimates that airlines in Asia and the Middle East

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World Jet Fuel Prices

Spot Cargoes

Trend 

Rotterdam			Mediterranean			Middle East			New York			US Gulf Coast		
1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14
457.9	438.2	429.5	449.6	432.1	424.5	54.11	52.05	51.17	148.9	142.7	138.2	138.8	136.9	132.7

Chicago			Los Angeles			Pacific NW			CIF Japan			Singapore		
1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14
139.8	139.6	135.6	140.7	135.1	127.8	141.2	135.5	128.1	56.11	53.05	51.70	54.09	51.70	50.55

Futures/Differentials

Trend 

IPE Gasoil*			NY Heating Oil			WTI Crude			Brent Crude			Rott Jet/IPE Gasoil		
1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14
438.2	411.9	404.6	134.2	139.3	135.1	47.18	48.53	48.38	45.03	46.11	46.02	19.70	26.30	24.90

NY Jet/Heating Oil			Gulf Jet/NY 2 Oil			Gulf/Los Angeles Jet		
1/28	1/21	1/14	1/28	1/21	1/14	1/28	1/21	1/14
10.60	9.38	7.60	0.80	2.50	2.07	-1.86	1.80	4.81

Key: U.S. weekly averages cents per gallon, WTI Crude, Asian jet in $/barrel, Europe, Medd $/Ton *Sources: Opis Jetfax, JFR*

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achieved a record US$3 billion profit in 2004 – US$750 million from Chinese airlines - on traffic growth of more than 20%. That compares with aggregate losses of US$6-8 billion in the US, and US$500 million in Europe. "For Asia Pacific airlines, 2004 was an oasis in a desert of global bad news," according to the Outlook 2005 report, presented by the Centre's managing director **Peter Harbison.** "While operators in Europe and North America licked their wounds, the region's carriers moved rapidly from recovery to robust growth and profitability. That growth should consolidate in 2005, barring further upsets, and establish the Asia Pacific as a key target for major investment in service expansion and new operations."

The report notes that "this snowballing development and intensifying competition should deliver substantial benefits to airports, regional economies and tourism and consumers". "However, for the airlines, the prospect of high growth is overshadowed by likely manpower shortages and a further depletion of yields, raising the potential for a profitless (or less profitable) volume scenario for some."

The report predicts that the outstanding profit levels of 2004 are unlikely to be repeated in 2005, although results should be positive again this year. "As liberalization sweeps through the region, traffic growth should be impressive, with double figure increases again commonplace," it says. "The entry of new airlines in regional markets and expansion of access rights on long haul routes will stimulate the growth, but at the same time dilute profitability." **JFR**