ESSAR
OIL UK

The Road Fuel Market Study Team
The Competitions and Market Authority

Via email Roadfuels@cma.gov.uk

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Dear Sirs,

Essar Oil UK response to the CMA Road Fuel Market Study – Invitation to Comment

Many thanks for the opportunity to respond to the 'Road Fuel Market Study – Invitation to Comment' and the accompanying Market Study Notice published on 8 July 2022.

Essar is a leading UK-focused downstream energy company whose main asset is the Stanlow Manufacturing Complex, one of the most advanced refineries in Europe situated close to the major cities of Liverpool and Manchester.

The company has ~ 800 payroll employees, and is a key strategic national asset, annually producing over 16% of the UK's road transport fuels, while playing a key role in Britain's broader petrochemical industry.

The company is a major supplier in the North West and beyond with customers including most of the major retail brands operated by international oil companies and supermarkets, Manchester Airport, leading commercial airlines and the region's trains and buses.

In the Invitation to Comment, you set out a number of questions. Given the nature of business and our position within the market, we are providing our comments in relation to industry dynamics and some input into the overall approach the CMA should take.

In line with our recent call, you have indicated that the company will be required to submit a detailed questionnaire as part of the Road Fuel Market Study. We await this formal request and will respond as required.

The refining industry operates in a global market due to perfect fungibility of crude and fuel product. Domestic demand for products is linked to national economic well-being so individual refiners have no control over demand. This means that from both an input side and sales side, refiners are price takers responding to market conditions.

Given this, Essar Oil UK suggests that the following three aspects be considered by the CMA for finalising the terms of reference for this study.

<u>**Global nature of the sector**</u>

- **Oil and gas are globally traded commodities**. Oil can be moved globally for \$3-4/bbl from anywhere in the world. Given the strategic nature of energy security, the transport and logistics infrastructure for both crude and refined products is highly evolved. This means that the market operates efficiently. The "landed cost" at any point A from point B is readily quantifiable and is factored into all trade economics, for example supply by refiners to the wholesalers or resellers.

- **Perfect fungibility of crude and oil products.** Refinery products are standardised, storable and transportable and there are hundreds of refineries with access to all markets. This makes it impossible for refiners to dominate or influence market behaviour and price in any particular market.

- **The UK is a global market participant.** The UK both imports and exports products (with jet and diesel imports and gasoline exports). If UK prices were more profitable relative to other markets, global supplies would automatically increase at the margin and bring the returns down. As a result, UK refiners compete amongst themselves and also with other importers who have a significant share in the UK domestic market.

- **Impact of overall economic performance.** The prospects of the industry are linked with the global, national and local economic development and industrial growth. All impact demand and refiners have limited control over this.

- **Global geo-political market impacts**. Global geo-political events have led to tightness in supply, and this has temporarily increased margins. Markets have significantly corrected since July 2022 having seen a peak in June due to recession concerns. These items are not within the control of refiners. These currently include items as varied as a reduction in refining capacities, under-utilised refining capacities due to geo-political situation, lower export allocations by China, tax imposition on exports by India and lack of new investments in refining due to policy announcements. This list is not exhaustive! This industry is truly global and developments in one region will directly influence the benchmark indices in another.

- **Central role of crude pricing**. Crude pricing is a big driver of forecourt price along with the risk management costs for the whole value chain. It is essential that the CMA includes the price of crude within its study. It is suggested that this is not included because its price fluctuates on global markets. This is true of all refining products, including diesel, petrol and jet. Given how vital crude pricing is to overall cost, it should be included.

<u>**Features specific to standalone refiners**</u>

- **Prices set independently.** Essar Oil UK sells its products at prices which are set by independently assessed product markers. The prices are set by organisations including Platt and Argus and prices are transparent to all market participants.
  - Wholesale supplies are made under term contracts and these are generally set on an annual basis. This means there is no ability to change the pricing mechanism during the contract period.
  - Selling prices are linked to daily-published price markers. This means that prices changes are passed immediately onto wholesalers and to other buyers.

- **Specific cost structure of refining.** The cost of running refineries in the UK and in Europe has increased significantly because of increases in compliance requirements, ongoing investment requirements, risk management costs and investing to decarbonise. These costs must be recovered across the trading cycle. Measures like gross refining spread do not consider such increased costs. Refining as a standalone industrial sector is subject to several specific costs:
  - Carbon compliance costs – including the UK Emissions Trading Scheme (UK ETS)
  - National-level compliance with blending obligations (RTFO)
  - National-level compliance with critical stock obligations (CSO)
  - Continuous process industry, requiring risk management on inventory volumes and prices, in turn causing P&L absorption of hedging and backwardation costs
  - Capital intensive industry with periodic turnaround events
  - Progressively investing in decarbonisation

- **Appropriately measuring refinery profitability**. Refining spread is not an appropriate measure for refining profitability. This is set out in some detail in the UKPIA response to this CMA Invitation to Comment. In recent markets, where refining spread on gross level has increased, risk management costs (backwardation and hedging) and crude differentials have also significantly increased. This means that the net refining spreads are lower than the gross refining spreads used by the CMA for this study and a significant proportion of the gross refinery margin (spread) is not earned by the refiners.

- **Understanding value for all market participants.** The CMA should consider the risk incurred by different value chain players in relation to the reward that can be earned. Refiners provide energy supply security and have recently been subject to some of highest levels of risk with lowest levels of return within the value chain when compared to other significant players.

Risk management: intrinsic to refining business

- **Cyclical and highly volatile business**. We would be concerned if any conclusions were reached by the CMA basing these on the short period referenced in the Road Fuel Review. This short time period does not appropriately capture this volatility. During the pandemic, for example, refiners made losses and operated in a very low, and at times negative, margin environment. This demonstrates that refiners do not control pricing – they did not during the pandemic and do not now. We urge the CMA to consider a longer "across-the cycle" view and to consider the published return on net worth for these businesses over that longer period.

- **Role of risk management.** Due to very volatile nature of this market, the value chain is complex and involves participants which are in addition to those identified in the CMA's Rapid Fuel Review. One additional and important consideration is the role that risk management plays in this unpredictable market. Investment by refiners in hedging and backwardation to manage risk can significantly reduce refinery margins. The cost of managing risk and the role of intermediaries and aggregators who are also risk management counterparties is also an important consideration. This should be an area of focus for the CMA as risk counterparties play a significant role in this sector to support responsible refiners to manage such risk.

We hope you find this response helpful. We look forward to receiving the detailed questionnaire from you and welcome your offer of further discussions during your review process,

Yours sincerely,

Deepak Maheshwari
Chief Executive Officer