



Short term impacts on fuel supplies

Watson Farley & Williams LLP

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The escalating conflict in the Middle East and the resulting damage to key regional refineries are sending shockwaves through global jet fuel supply chains. With crude oil movements disrupted, refinery capacity curtailed and tanker routes growing increasingly perilous, airlines worldwide now face an uncertain and volatile operating environment. In a sector already sensitive to fluctuations in fuel availability and pricing, these developments threaten not only short-term operational stability but also the longer-term resilience of the global aviation industry. As disruptions deepen, the effects will extend far beyond the Middle East, reshaping airline economics, passenger travel patterns and broader aviation-related industries.

Short term impacts on fuel supplies

High fuel prices and operational constraints

Prices for refined Jet A-1 fuel ("fuel") have already been driven high by the escalating conflict in the Middle East and remain volatile. Fuel typically accounts for 25-30% of an airline's operating costs.

Airlines that have fuel hedges will benefit for so long as their suppliers are able to supply fuel and for so long as fuel prices are high enough although they will still be vulnerable to fluctuations in the 'spread' between prices for crude oil ("crude") and fuel.

Airlines are still deciding whether - and the extent to which - to impose fuel surcharges for passengers (including those that have bought tickets long before the recent escalation) and for cargo. Others such as Air New Zealand have announced that they are cancelling off-peak and certain other flights.

Some airlines, notably Middle Eastern airlines and those that operate to/from the Middle East, have of course already had to reduce the number of flights that they operate due to safety concerns and airspace restrictions.

Other airlines have had to adapt their flight paths (increasing fuel consumption) to fly around the conflict zone (flagging here the latest restrictions in the Middle East and in Southern Azerbaijan) and to avoid other restricted airspace (noting on-going restrictions preventing many airlines from flying through Russian airspace). Qantas' non-stop flights from Perth to London are currently having to stop in Singapore to refuel.

This will likely last for at least so long as the conflict is fought through the skies in the Middle East.

Reduced crude and fuel supplies

Any refinery's ability to supply fuel depends on its stocks of crude for refinement, its stock of fuel for sale and its access to fresh supplies of crude. If a refinery's crude supply falls below its 'turn-down ratio', it will need to cease refining fuel until reliable crude supplies are restored.

Global supplies of crude and fuel are (not uniformly but) currently greatly reduced by the risks for oil tankers in the Gulf and through the Strait of Hormuz and by the availability of insurance. 20% of global seaborne export volumes of petroleum liquids (including crude and fuel) have already been cut by the conflict. For more information on the Strait of Hormuz see our article here.

Supplies of crude from regions beyond the Middle East (such as the United States, Mexico, Venezuela, Nigeria, Angola and elsewhere) and supplies of fuel from refineries beyond the Middle East will likely be coveted.

Shipments of LNG to Europe are being diverted to Asia mid-journey. We can expect the same to happen to shipments of crude and fuel. China has already announced measures to reduce exports of fuel (without limiting the refuelling of international flights).

Significantly, Saudi Arabia's Ras Tanura refinery has stopped refinement of fuel, Bahrain's Al-Ma'ameer refinery has also been damaged and UAE's Ruwais refinery has also stopped while drone damage is assessed.

This sets the scene not only for higher fuel prices in the longer term but also for longer term disruption.

Longer term disruption to airlines and the aviation industry but a boost for SAF

With refineries in the Middle East damaged and with stocks and supplies to crude to refineries globally insufficient, their ability to continue refining and supplying fuel will be reduced. If airports and airlines' stocks of fuel are depleted for any length of time, airlines will cease to be able to fuel their aircraft and will have to reduce their operations. This may have far-reaching consequences.

Airlines will want to be certain of being able to refuel at their destination (for the return flight) before leaving their home base but passengers/crew of airlines whose supply of fuel may suddenly be constrained (at their home base or at their destination) might find themselves stranded far from home with limited options for flying back.

Further flight cancellations can be expected, even by airlines operating from home bases where there is a reliable supply of fuel, impacting the broader aviation industry (airports, airline caterers, etc.).

The reduced refinement of fuel by Middle Eastern refineries might first affect airlines that operate in and to/from the Middle East but it will only be a matter of time before these supply constraints are felt further afield in other regions that are dependent on their supplies from the Middle East (notably Europe, Asia and Australia). 25-30% of Europe's

fuel is supplied from the Middle East. India, Singapore, China, South Korea and Japan are reliant on imports of crude but may have good capacity to refine fuel. Australia, though, has limited refinery capacity so is heavily dependent on imports of fuel.

Prices for available fuel might be expected to increase greatly.

In today's global economy, this would likely impact poorer countries/airlines more than wealthier ones who may more readily afford premium prices for fuel and pass the cost on to their wealthier passengers and cargo customers by way of fuel surcharge.

We can expect there to be a few disputes arising out of crude and fuel shipping and supply contracts. We have already had enquiries relating to a number of deviation, blockade, *force majeure*, insurance and other claims. Further insight in relation to the potential impact on aircraft insurances can be found in our article here.

Ticket prices for airlines that have reliable fuel supplies can be expected to rise, both because of the higher price of fuel (and fuel surcharges) and because of reduced supply in available seats.

If an airline can fly both outbound and return legs on one tank of fuel, an airline with a reliable source of fuel at its home base may choose to do so. It may, though, need to fly a reduced number of passengers on the outbound leg to respect the aircraft's maximum take-off and landing weights.

This may be beneficial for the on-going development of the market for SAF (sustainable aviation fuel derived from sources other than crude) in narrowing the price difference between SAF and conventional fuel. Indications to date, though, are that prices for SAF have risen by even more than prices for fuel, perhaps due to market pricing mechanisms for SAF being linked to prices for fuel but undoubtedly because demand for SAF has immediately risen due to the constrained supply of conventional fuel. Alongside other renewable energies, expect there to be a renewed drive for the development of production of SAF and its financing, with policymakers keen to ensure fuel supply security.

Where routes and cost-benefit analyses permit, airlines may tend to fly their more fuel-efficient aircraft and to keep their less fuel-efficient aircraft on the ground.

Operations of four-engined and other widebody aircraft may be impacted more than those of narrow-body aircraft although many routes can only be flown by widebody aircraft.

Non-airline businesses that are dependent on international cargo airlines to reach their export markets (those in the supply of perishable goods, for example) may be impacted more than other businesses.

Aircraft that are not being flown will need to be put into short term or longer-term storage. Any necessary positioning flights to storage facilities will of course also need fuel.

These scenarios will likely impact airlines, lessors, banks and investors in any number of ways:

- airlines with reliable access to fuel and with more fuel-efficient fleets/operations may prosper while those without struggle;
- aircraft/engine values may be affected (in turn impacting loan-to-value ratios and financial covenants in a range of different transactions); and
- lessor, bank and investor risk assessments relating to airlines operating in and to/from different regions and relating to different aircraft types may need to be updated.

The impact to the aviation industry over the longer term will depend on how long fuel supplies may be disrupted and how the industry rises to these challenges posed by the heightened conflict in the Middle East.

Ultimately, the scale and duration of the disruption to jet fuel supplies will determine how profoundly the aviation industry must reshape its strategies and operations. While some airlines may weather the turbulence through efficient fleets, reliable fuel access and stronger balance sheets, others could face significant hardship as prices rise and supplies tighten. The crisis may accelerate investment in SAF and other alternative energy sources, but it will also expose structural vulnerabilities across global aviation. What is clear is that the sector is entering a period of heightened uncertainty - one in which adaptability, resilience and forward-looking planning will be essential for airlines, lessors, financiers and governments alike.

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