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POWERING A BETTER NEW ZEALAND TOGETHER

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Economic Development, Science and Innovation (EDSI) Committee
By email: edsi@parliament.govt.nz

Submission on the Fuel Industry (Improving Fuel Resilience) Amendment Bill

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy advocacy organisation. Our purpose is to enable collaboration across the energy sector through and beyond New Zealand's transition to net zero carbon emissions in 2050.

2. This document constitutes our submission on the Fuel Industry (Improving Fuel Resilience) Amendment Bill, which establishes a minimum stockholding obligation (MSO) on obligated fuel importers.

3. We wish to speak to this submission if the opportunity is available.

Recommendations

4. We recommend that the Bill does not proceed as it will impose unnecessary costs on fuel users that can be avoided by achieving the Bill's objectives by other, more effective means.

5. Should the Bill proceed, we provide some suggestions to strengthen the Bill and strike a better balance between fuel supply resilience and costs to fuel consumers. We suggest the Committee recommends:

   - the MSO be set to current stockholding levels (i.e., approximately 20 days' cover on average across petrol, diesel, and jet) to reflect the expected long term declining demand in these fuels;

   - the Bill specifies a minimum time period before it takes effect, to ensure fuel importers have sufficient time to make the necessary investments. The 1 April 2024 date (as currently intended) is too aggressive;

   - including transitional provisions that recognise the investment and time required to buildout the infrastructure by obligated parties to meet MSO requirements;

- the flexibility to establish location-specific MSOs through regulations in the future is removed on the basis that this is unnecessary and creates additional regulatory uncertainty;
- adopt a 12-month rolling average for obligated parties to reflect seasonable demand and shipment sourcing; and
- include more reasonable and pragmatic exemptions such as removal of infrastructure for inspection and maintenance and changes in customer base.

Submission

We do not believe an MSO is required

6. If fuel importers are required to hold greater fuel stock volumes than they otherwise would on a commercial basis, this will impose additional costs that inevitably flow to the consumer.

7. These include costs associated with administrative and compliance costs and, more significantly, any costs of building fuel storage and transport infrastructure beyond what would otherwise be built on a commercial basis. Additional costs to consumers might be justified if the benefits – i.e., increased resilience to low-likelihood supply disruptions – exceed those costs.

8. We believe the case for these additional costs has not been made. In our view the status quo approach adequately addresses the expected risks to New Zealand's fuel supply resilience. The status quo includes stockholding and supply risks being actively managed by:

   - supply diversity, which is managed by fuel importers on a real-time and commercial basis within a competitive market; and
   - New Zealand's continued compliance with the IEA's 90-day oil stocks obligation through a combination of domestic stocks and ticketing.

9. The explanatory note of the Bill asserts there is a risk that fuel supply resilience could deteriorate because of (among other things) the closure of the Marsden Point oil refinery. We disagree with this characterisation. This assertion is inconsistent with the advice of officials, independent expert advice, and the fuel industry.

10. MBIE briefings and independent reports conclude that the shift to a 100% import-only model (adopted since the Refinery's closure) has not had a major impact on fuel security. Indeed, this shift has:

    - *increased* New Zealand's resilience to domestic disruption scenarios, because there is no longer a 'single point of failure risk' associated with refining, and import shipments of refined fuels provide more flexibility to respond to local disruptions because they can be redirected to ports for distribution by road; and

- *not materially changed* New Zealand's resilience to a severe 'closed border' import disruption, because the design of the Refinery meant it had only limited capability to refine domestically produced crude oil.[1]

11. Independent experts investigated a hypothetical disruption to North Asian supply. Under a 100% import-only model, this could disrupt up to 50% of New Zealand's normal supply (compared to only 10-15% under previous settings). Investigations concluded the market would respond quickly (prices would rise) and in the majority of cases expected domestic fuel inventories would provide sufficient volumes to buffer any impacts.

12. Based on the information above, and in the absence of a detailed cost-benefit analysis to justify it, we believe the additional cost to consumers of an MSO outweighs its potential benefits. This is because:

    - the risk to New Zealand's fuel supply resilience has not materially changed;
    - worst-case scenarios such as a severe 'closed border' disruption are very low likelihood; and
    - BAU domestic fuel inventories are sufficient to cover the more likely scenarios.

13. <u>On that basis we recommend the Bill not proceed.</u>

14. However, on the basis the Bill does proceed, the remainder of this submission is offered in the spirit of improving the Bill and reducing its cost impost on consumers (while still acknowledging and supporting its policy intent).

If the Bill proceeds, we suggest the MSO is reduced to current stockholding levels

15. If the Bill proceeds, its cost impact for consumers could be minimised by setting the MSO at current stockholding levels (around 20 days' cover on average).[2]

16. Demand for petrol and diesel is expected to progressively decline over the next few decades. Setting the MSO based on current average stockholding thus helps to manage the risk of fuel resilience declining as demand falls. The quantity requirement (in terms of volume) would reduce with time, but this would hold the 'days' cover' level consistent with where it is today, with forecasts suggesting the

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1 This briefing can be accessed at the following: https://www.mbie.govt.nz/dmsdocument/25927-aide-memoire-2122-2872-implications-of-refinerys-closure-for-fuel-security

2 This was canvassed as Option 1 in MBIE's February 2022 consultation on the onshore fuel stockholding consultation.

mid-2020s represent ‘peak’ petrol and diesel supply/demand. The advantage of this approach is that it requires less major new infrastructure investment in an industry that is facing long-term demand decline and transition away from fossil fuels, while also providing assurance that as demand declines consumers will continue to enjoy the security of a consistent stock buffer against disruptions.

17. Jet fuel demand is expected to continue growing. This means that average stockholding of jet fuel, in volume terms, will likely increase to continue meeting this demand. The Bill’s proposal to set an MSO greater than current stockholdings could compound the cost implications of this from an infrastructure investment perspective. Instead, setting the MSO (in terms of ‘days’ cover’) at current levels as we suggest would ensure that the volume increase in stockholding remains proportionate with demand growth, enabling continued optimal infrastructure investment.

We support the MSO being specified in terms of average stock in a single month, based on an estimate on a 12-month rolling average basis

18. We note the calculation method has changed from that consulted on in 2022 (which specified volumes on a three-month rolling basis). Our preferred approach of a rolling 12-month average provides more certainty about the level fuel importers are required to meet and will reduce fluctuations throughout the year.

19. The new shift to a monthly target introduces significant supply chain stressors. It is unclear how notice periods for monthly targets will be managed and will likely create origination issues for shipments. Our members advise us supply chain logistics require sourcing shipments 3-4 months in advance, with buying on shorter timeframes commanding premium pricing.

20. We recommend a rolling annual target. This approach has better cost and logistics profiles, allowing obligated parties to plan outages for infrastructure (tanks etc.) and source shipments in a more cost-effective manner.

We support the inclusion of fuels on-board vessels in the exclusive economic zone

21. We support the Bill’s inclusion of fuels on-board vessels within New Zealand’s EEZ. This approach is consistent with the approach taken in Australia’s MSO, where many of New Zealand’s fuel importers or parent companies operate.

22. Given New Zealand’s remote location there is high certainty that the fuel on-board vessels within the EEZ will be delivered to New Zealand. These vessels can spend an average of 3 days, and up to 6 days, within the EEZ. This includes initial sailing time, discharge operations, and sailing time between New Zealand ports. This is effectively floating storage, and recognising this in the MSO will reduce its cost to consumers.

The proposed implementation timeframe is too aggressive

23. We understand the Government intends to see the Bill passed by the end of August 2023. It will come into force by Order in Council once the necessary regulations have been made. We understand an exposure draft of these regulations will be released for consultation later this year, meaning the obligation could come into effect as early as 1 April 2024.

24. In our view this implementation timeframe is too aggressive. The new MSO requirement outlined in the Bill will require one-off investments by obligated fuel importers in IT and other infrastructure to support compliance, and more materially, will require investment in significant new infrastructure (or procurement of existing infrastructure from other parties).

25. The justification for such an aggressive timeframe appears to rest on recent, short-lived supply chain disruptions to aviation fuel supplies. We think these events, while focusing attention on supply chains for an important but specific sector, do not provide sufficient justification for rapid implementation of a broad based (multi-fuel) obligation. The Committee should consider these obligations coming into effect a minimum of two years after Royal Assent.

26. Given the scale of investment required, and the timeframe to deliver on those investments, we recommend the proposed legislation include transitional arrangements to enable obligated parties to develop the infrastructure to meet these new MSO requirements.

The flexibility to introduce region-specific MSOs introduces further investment uncertainty and is unnecessary

27. We do not support the inclusion in the Bill of flexibility that enables future MSOs to be applied to specific locations (i.e., enables regional or port-specific MSOs).[3] This introduces yet further regulatory uncertainty and could mean even more complexity for fuel importers (i.e., if a national and location-specific MSO are in force at the same time).

28. Existing arrangements (and likely arrangements under the proposed nationwide MSO) will be sufficient to manage regional issues (i.e., domestic disruption scenarios). Fuel importers already have significant ability to flexibly respond and move stock between terminals, and the existing emergency response process via MBIE and the National Emergency Management Agency can facilitate this. In any case, we expect a significant portion of fuel stockholding will already coincide with the locations considered most strategically important (specifically, Auckland).

29. On New Zealand's ability to deal with domestic (location-specific) disruption, MBIE concluded the following:

3 See section 58(2)(a) of new Part 4 in the Bill.

> *"Also, import shipments of refined fuels can provide more flexibility to respond to local disruptions, as shipments can be redirected to ports where they will be most useful for fuel distribution by road. Under the existing cabotage regime, international fuel tankers have historically been allowed to operate on the coast if there are no New Zealand vessels available. International fuel tankers, which arrive in New Zealand with full load of refined fuel and do not pick up any domestic fuel for distribution, are allowed to deliver fuels to the New Zealand ports they are scheduled to visit.*
>
> *Generally speaking, internationally flagged vessels are not allowed to primarily pick up domestic cargo for distribution between regional ports in New Zealand. However, an exemption to this rule can be granted if there are no New Zealand flagged ships that can undertake this task. During a local fuel emergency, the Secretary of Transport can grant an exemption to international tankers quickly to allow international fuel tankers to pick up fuel stocks stored at one regional port and deliver them to another.*
>
> *Fuel companies can also redirect international tankers on different international shipping routes to deliver fuels to New Zealand during a fuel emergency."*[4]

Exemption grounds

30. The Bill enables the Minister to grant an exemption for all or any of a fuel importer's MSO. However, in our view the Bill establishes too high a threshold for applying such an exemption. The current drafting suggests exemptions should only be granted in the event of a "significant" disruption, with the specified example being a natural disaster.[5]

31. We suggest this should be amended to enable a broader range of credible scenarios that could reasonably and justifiably warrant an exemption (though in most cases of a much shorter duration than a natural disaster). More 'routine', but still material, events might include scheduled maintenance and certification of fuel storage tanks and other infrastructure, and significant changes in major customer contracts and commercial arrangements.

32. Ensuring the exemption provisions in the Bill are sufficiently broad will enable the regulations that follow to specifically provide for these types of foreseeable circumstances. This in turn will improve regulatory certainty and minimise costs being passed on to consumers.

Conclusion

33. Thank you for the opportunity to provide feedback on this Bill. We are concerned the condensed timeframe for consultation on these important matters does not

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4 Paragraphs 7-9 of "Implications of Refinery's closure for fuel security" https://www.mbie.govt.nz/dmsdocument/25927-aide-memoire-2122-2872-implications-of-refinerys-closure-for-fuel-security

5 For reference, see new section 59 of the Bill.

allow sufficient time for thorough consideration, ensuring all relevant matters and implications of the MSO are surfaced.

34. In our view New Zealand does not have a fuel security problem. While our overarching recommendation is the Bill does not proceed, we understand the Government is committed to introducing an MSO on obligated parties. In this light we offer a range of improvements to the Bill.

35. We welcome the opportunity to present our submission to the Committee, if available.