Gull New Zealand Submission – MBIE Onshore Fuel Stockholding

4 March 2022

NOTE

All sections with a grey background for example: XXXxxxXXX and all graphs are confidential submissions by Gull not to be publicly released.

Introduction

1. This submission is prepared by Gull New Zealand Limited and Terminals New Zealand Limited (**TNZ)** (collectively **Gull**") and addresses the issues and questions in the Ministry of Business Innovation and Employment's (**MBIE**) Consultation Paper "Onshore Fuel Stockholding," dated January 2022 (**Consultation Paper**).

2. This Gull submission provides responses to the questions put in the Consultation Paper but also seeks to highlight the value of maintaining the status quo as well as alternative solutions for meeting New Zealand's onshore fuel stockholding requirements.

3. It is worth noting at the outset that New Zealand's current stockholding arrangements which have worked well to ensure continuity of supply fuel in New Zealand for the last 40 years are not broken and have not resulted in any energy crises affecting the country from any cause whatsoever.

4. Gull has never had to rely on the former refinery at Marsden Point partially owned by the three largest companies for fuel supply and, as New Zealand's smallest integrated fuel wholesaler, has efficiently imported the vast majority all of Gull's petroleum products for over 20 years.

5. Indicatively, Gull sells 10% of New Zealand's total petrol volume and 4% of the country's total diesel volume.

6. Importantly, Gull notes that there is no cost benefit analysis or peer reviewed model to provide any evidential basis for the key assumptions underpinning the Consultation Paper that New Zealand needs increased onshore fuel stockholdings because of the likelihood of "*closed border*" events.

Context and setting the scene

7. Since 1974, all OECD countries including New Zealand have had obligations under the Agreement on an International Energy Programme (**IEA**) to contribute 90 days of net oil imports to the IEA oil stockholding which mitigates price hikes most likely due to supply disruptions such as geopolitical issues. Importantly, OECD member states have been able to meet this obligation using a diverse range of sources of supply including via intra Government tickets guaranteeing strategic reserves.

8. Physical storage of strategic reserves of oil stocks is one of the most expensive options to increase stock holdings because of longer stock holding in tank and tankage capacity requirements. This collective stockholding mitigates the market power of oil-producing countries and releasing stock during an IEA-declared oil supply emergency helps to moderate extreme oil price spikes.

9. New Zealand currently (and for some time) has met its IEA obligations, and it is Gull's view that this is driven by a domestic need rather than by the specific treaty requirements.

10. By contrast, Australia has had a long history of failing to meet IEA obligations and now has moved to on shore storage to move towards these obligations.

11. The wholesale inventories held by energy companies have always contributed to New Zealand's IEA obligation with the rest being composed of the Government's "*tickets*" purchased from global oil traders underwritten by a government-to-government agreement that orders the release of the stock at market price in the event of an IEA emergency. Over the last decade New Zealand has held tickets in a variety of countries including The Netherlands, United Kingdom, Australia, Japan, and Denmark.

12. Oil is the most traded commodity by value in the world, with global oil consumption expected to return to an average of 99.5 million barrels per day in 2022 (being about the same level it was at in 2019). Like other highly tradeable international commodities, the global petroleum industry easily meets this demand through its robust infrastructure, production and exploration facilities, technology and a vast resilient network of both upstream and downstream oil production.

13. The Consultation Paper appears to be largely based on Australia's proposed minimum stockholding levels and associated rules. However, it is important to note that Australia's proposed rules are still at first draft stage and subject to stakeholder submissions. The deadline for stakeholder submissions was as recent as Monday, 28 February and a submission was lodged by Gull's parent, Ampol Limited, on that date. Gull makes this point to emphasise that it is not appropriate for the MBIE to take the Australian proposed minimum stockholding levels and associated rules as a settled model, and a number of key proposed provisions will be contested, both by Ampol and other industry participants.

Storage and stockholding

14. The rationale for increasing onshore fuel stockholding so that New Zealand can meet increased IEA requirements needs to be logical and tested against our national need, the likelihood of disruption to existing supply from current levels and the top up provided by the Government's purchase of tickets providing access to accessible stores in secure international locations such as The Netherlands. New Zealand's access to its international strategic oil reserves from diverse locations is based on the robust security of international sea lines of communication which continue to operate efficiently regardless of regional instabilities or geopolitical risks. Despite the logistical challenges to the global supply chain caused by the COVID-19 Pandemic, the international maritime tanker fleet which transports oil in bulk has shown it to be less susceptible to the issues affecting containerised products because of worldwide shortage of 40ft and 20ft TEUs (40 and 20 foot equivalent vessels). It is also highly competitive with the top thirty oil tanker companies representing only 50% of market capacity, and the largest single tanker operator representing less than 4% of capacity.

15. Moreover, New Zealand as a net importer of oil, has a network of multiple suppliers, and can reroute imports as needed. Because New Zealand sources its fuel products from a diversification of petroleum supplies, there is a much-reduced risk associated with losing supply from any one source.

16. The Government has noted this, on page nine of the Consultation Paper " … *industry and independent expert advice is that 100 per cent fuel import model will be more resilient to domestic disruption scenarios than having a domestic refinery, because there will no longer be a 'single point of failure' risk …"* .

17. Thus, need for a detailed cost benefit analysis of the proposals put forward in the Consultation Paper is critical because the ability to stockpile fuel is limited by the high cost of storage infrastructure and the sheer quantity of fuel that would be needed to cover demand over the specified period. This is a whole of industry issue for New Zealand not just a Gull issue.

18. IEA member countries have different national responses to the management of stockholding, and interestingly as China and India are non-OECD countries and therefore outside of the requirements, the IEA's membership's cumulative oil consumption has declined to 46% of the global oil market. Importantly, what this means is that stockholding in IEA members has reduced from around 40% of the 90-day global oil demand in 1974 to only approximately 20% in 2020.

19. Gull's preferred option, as a whole of industry response, is to continue to meet New Zealand's IEA obligation through government-procured tickets, and to fund the tickets via the Passenger or Engine Fuels Monitoring Levy (**PEFML**). The existing appropriation would be increased to reflect the forecast rise in ticket costs, and the additional PEFML revenue would fully fund the appropriation.

20. It is also interesting to recall in an earlier 2012 study by MBIE on the need for onshore stockholding it was concluded, "*No submitters explicitly disagreed with the proposal that government should purchase tickets rather than place a stockholding mandate on industry*."

Since 2012, the cost of bulk fuel storage has increased significantly and any requirement to increase terminal infrastructure would require capital expenditure across the whole of industry in New Zealand which would necessarily translate to increased retail prices at the pumps.

21. Gull is concerned that the practical outcome of any mandated onshore stockholding obligations will directly contrast with the New Zealand Government's declared intentions behind the enactment of the *Fuel Industry Act* and inadvertently undo many of the gains that were made under the *Fuels Industry Act* which were beneficial for the whole of industry in New Zealand. The *Fuels Industry Act* is a very good piece of legislation opening up access to markets and large customers with resulting ultimate benefits to motorists. Key in this was access to either 20% or 100% of major distributors' fuels requirement (and see part 2 of the Regulations items 14 and 15). Gull requests further review of potential impacts on the gains made through the Fuels Industry Act by the Commerce Commission and is available to contribute to this.

22. Gull notes that there is insufficient detail in the Consultation Paper about the treatment of stock on the water (whether inside or outside the New Zealand Exclusive Economic Zone) and at retail service station sites. The Consultation Paper also does not discuss the availability of tankage at the Marsden Point Refinery (now Channel Infrastructure) as an option to provide North Island storage to the whole of industry in New Zealand. Gull and other industry participants are in no position to assess any potential impact of an onshore stockholding mandate without further detail.

23. Gull highlights three key issues with the proposed minimum stockholding levels and associated rules set out in the Consultation Paper:

    Commercial Information & Confidentiality [redacted] **Grace period for whole of industry to comply -** Gull anticipates that any legislation would need to include a generous grace period (as was the case with the *Fuel Industry Act*) to allow time for industry compliance as it is unlikely that the whole of industry, including Gull, would or could be compliant if any legislation of those positions in the Consultation Paper were introduced today or within the time frame set out in the industry meeting of 15 February . The whole of industry, including Gull, will need sufficient time to understand what is needed to ensure compliance and to take appropriate steps, and with sufficient detail of any proposed mandate to do so. Commercial Information & Confidentiality [redacted] Commercial Information & Confidentiality [redacted]

    Commercial Information & Confidentiality [redacted] **Product volumes included in calculations -** Gull submits that product on water destined for New Zealand downstream fuels industry participants should be included in stockholding calculations, regardless of whether title has transferred or whether vessels have entered the New Zealand Exclusive Economic Zone. Commercial Information & Confidentiality [redacted]

Confidentiality [redacted] Indicatively on its current inventory profile, Gull will have a further one month's supply of fuel on water for two-thirds of each month. Gull submits that this must be accounted for in the regulations, even on a discounted factor or on a sinking lid basis over 5 – 10 years as additional storage can be permitted and built. Confidentiality [redacted]

d. **Northern storage availability** – Gull submits that a government solution needs to be explored to free up Northern storage opportunities and provide all industry participants with access to that storage, including Gull.

Confidentiality [redacted] Gull has for over 20 years successfully grown its business (primarily retail) from a one terminal import base at Mount Maunganui. Gull's growth and impact in the market by the efficient use of one import terminal has brought major benefits to motorists. Confidentiality [redacted]

Commercial Information & Confidentiality [redacted]

Confidentiality [redacted]

Commercial Information & Confidentiality

Commercial Information & Confidentiality

27. Gull notes that floating storage effectively exists (at no additional cost to motorists) if the Regulations simply recognise fuel in transit to New Zealand. Land availability in appropriate locations for additional storage for the industry may well present challenges.

Confidentiality

[redacted]

29. Gull appreciates the opportunity for this initial submission on this proposal and is available to discuss the proposed regulations with authorities.

Yours sincerely

Dave Bodger
General Manager

Cc : Louise Stephenson, Manager Fuel Regulation, Commerce Commission of New Zealand

Consultation Questions

Context and Fuel supply risks

• Do you agree with the description above of fuel supply disruption risks? What other disruption scenarios or types of risk should be considered?

Gull disagrees with the description as it is too simplistic and lacks any evidential basis as well as any cost benefit analysis to support any mandate of increased onshore stockholding.

In Gull's view, the fuel security assessments are skewed and biased and fail to take into account that over the last 40 years New Zealand has never had a major supply issue for an extended period due to a possible scenario such as a complete blockade of major trade and/or shipping routes.

There is little definite detail to the proposals (when applicable, what stocks are counted when, etc) as set out in the Consultation Paper. There are a range of other options to hold a minimum onshore volume of fuel BUT the preferred option as set out in the Consultation Paper is for wholesale suppliers (note this potentially include some distributors) to comply with the 24/28 day requirement.

Further there has been no assessment of "*will the proposal work ?"* Large storage of strategic fuel in Northland will be of no use to the South Island under a State of Emergency.

• Do you agree with the fuel security assessments above (and in the 2020 Hale & Twomey report), including the implications of the Marsden Point Refinery's closure? If not, why not?

Gull agrees with the conclusion in the 2020 Hale Twomey report that the closure of the Marsden Point Refinery and the move to "*a 100% fuel import model will be more resilient to domestic disruption … than having a domestic refinery."*

The Consultation Paper talks about the possibility of an extended period of disruption to New Zealand's oil supply is "*considered unlikely in the next two decades but cannot be discounted*." Gull contends that mandating a significant change to onshore stockholding because of a remote possibility is an inappropriate reaction given the current onshore capacity and Government purchase of ticket agreements for strategic offshore supplies in secure storage facilities. This has worked well for the last 40 years.

• Do you consider that regional ports other than Northport at Marsden Point have sufficient infrastructure to maintain a satisfactory level of fuel supply resilience? If not, which fuels may need better storage and distribution facilities at those regional ports and why?

Gull can only meaningfully comment on the Port of Tauranga as its home base. Gull has happily maintained supply to its expanding network for over 20 years.

Background on IEA membership and 90-day obligation

- **Should New Zealand hold fuel stock equivalent to more than 90 days of net fuel import demand (i.e. more than the minimum level required by IEA membership)? If so, how much more and why?**

Gull sees no need to hold more than 90 days of the net fuel import demand onshore. Gull considers that this would be unnecessarily expensive and result in New Zealand storing large volumes of oil products affecting the country's overall current account deficit and making supplies much more susceptible to market price fluctuations.

In commercial terms, if fuel companies have to increase the onshore stockpiling of oil it would be uneconomic for the industry and lead to unintended consequences such as higher prices for motorists, and added inflationary pressure

More in-country product storage would also mean altering import delivery patterns (particularly size of import ships), as well as investing in new land and terminal storage facilities.

However, if Government wants to mandate more onshore stocks as part of the 90 day IEA obligation, then it should be prepared to directly procure and store this itself as a strategic reserve which can be on sold at market price through the downstream domestic retail fuels market in the unlikely event of an extended disruption. This risk and economic burden should not fall on the New Zealand downstream fuels industry participants who are least able to afford the lock up of value in extended storage of oil supplies to meet international, government to government obligations.

Objectives and evaluation criteria

- **Are these the right evaluation criteria? What other criteria should be considered?**

Gull maintains there is a need for a cost benefit analysis to best determine if altering the current combination of stockholding is financially viable (i.e. what is the true cost to Government, business and consumers if it is mandated that there needs to be significant investment in fuel storage and increased holding of reserves?).

This is a solution looking for a problem and the unintended consequences of requiring New Zealand downstream fuels industry participants to increase the levels of onshore stockholding is likely to be many and varied with the most obvious outcomes being increased costs to consumers and more inflationary pressure.

This has not been costed by Government and does not factor that it is not a solution that will necessarily work. Additional storage in North Island will not help South Island issues.

What level of onshore stocks should be held?

- **Do you agree that the minimum onshore fuel stockholding level should be above the current level?**

  No. Gull questions the rationale for New Zealand's stockholding level to be pegged apparently to the same levels as Australia proposes adopting, but which are not finalised, lacking considerable detail, and with key points being heavily contested by Australian industry participants. It goes without saying that New Zealand and Australia are two very different markets with very different economy drivers, New Zealand does not mine minerals and thus does not have major industrial diesel demand.

  Practically speaking storage capacity even at 28 days will not last a blockade of 100 days.

- **Which option for minimum onshore stockholding level do you consider to be the best? Why do you choose that option?**

  Gull favours the current market model where economic drivers for each importer determines what storage each importer requires. This has stood New Zealand in good stead for decades.

Further, Gull notes that the Consultation Paper itself notes that resilience has been improved by moving away from a single point of failure

Should the Government determine that additional onshore stocks should be held then Gull submits that the Government should fund and hold these stocks, potentially as on land storage with Channel Infrastructure or as floating storage. Potentially this is by direct investment or via release of onshore tickets.

Achieving the target level of onshore stocks

- **Do you agree that any biofuel sales should be counted for the purpose of determining a wholesaler's stockholding obligation and any biofuel stocks be counted for the purposes of meeting a wholesaler's obligation?**

  Yes, biofuel imports and domestic production will increase New Zealand's onshore stock holding as they are new grades.

- **Do you agree that the Government should adapt its oil ticket strategy to procure tickets for onshore fuel stocks if the fuel industry participants in New Zealand offer such tickets?**

  Yes, it is Gull's assertion that the Government should be the key party responsible for any increases in the composition of New Zealand's onshore oil stockholding and the manner in which it is stored. This could include procuring tickets for oil supplies stored with, for example, Channel Infrastructure's terminal in the former Marsden Point Refinery.

- **Do you agree that fuel wholesale suppliers should be required to meet minimum onshore stockholding level?**

  No, as outlined in this submission there are significant market disruptions and unintended consequences of legislating the requirement to commercial organisations.

- **Do you consider that there should be minimum stockholding requirements specific to the type of fuel?**

  Noting that Gull does not support a minimum onshore stock holding mandate, if it is introduced, yes. Gull believes there should be different minimum requirements for diesel (including its biofuels 'cousins') and for petrol (likewise including related biofuel substitutes or blend components).

- **Do you consider that there should be minimum stockholding requirements that apply to specific locations?**

  No, the downside of disbursed minimum stock holding mandate is that there will be less concentration in areas of major need. Gull notes that no solution will cover all eventualities and draws attention to the current scenario in Tasmania, Australia where a vessel has sunk in port effectively closing access for a major fuel berth. In mid-February access for fuel tankers was projected to be unavailable until May. https://www.abc.net.au/news/2022-01-28/two-tug-boats-sinking-devonport/100788228

Lack of fuel in Tasmania would be a major issue, and Gull’s parent company Ampol advises that none of the planned builds of onshore stockholding in Australia are scheduled for Tasmania. Simply building onshore storage does not alleviate the problem for an island nation.

- **Do you agree that a stockholding agency should be set up to manage the compliance, enforcement and monitoring activities associated with the minimum stockholding obligations on the fuel wholesale suppliers?**

  Noting that Gull does not a support minimum onshore stock holding mandate, if it is introduced, yes

- **Do you consider that a stockholding agency (if established) should take over the responsibility for managing compliance with New Zealand's IEA obligations, including procurement of oil tickets?**

  Noting that Gull does not support minimum onshore stock holding mandate, if it is introduced, only on the proviso that a stockholding agency would operate with minimal overheads and costs to industry.

- **Do you consider that a stockholding agency (if established) should take on a role in managing responses to fuel disruptions and coordinating the relevant contingency planning and emergency exercises?**

  The National Emergency Management Plan covers this; any stockholding agency would have a part to play in overall plans but should work with other parties to address the emergency.

- **Do you consider that a stockholding agency (if established) should develop or manage other fuel resilience mitigation measures, such as investments in fuel storage and distribution facilities?**

  No comment until there is determination to require a minimum stock holding.

- **If a stockholding agency is established, should it be government-funded, industry-funded or co-funded by government and industry? If it is co-funded, what should be the share of government funding?**

  No comment until there is determination to require a minimum stock holding.

- **Do you agree that the Petroleum or Engine Monitoring Fuel (PEFM) levy should be used to provide government funding for a fuel stockholding agency if it is set up?**

  Yes.

- **Do you agree that a stockholding agency, if established, would improve coordination between the Government and the fuel industry in managing fuel supply resilience? If so, in what ways?**

Gull does not accept that there is an issue with fuel supply stock resilience and we refer again to the Consultation Paper "*a 100% fuel import model will be more resilient to domestic disruption … than having a domestic refinery."*

Gull submits resilience was already good, has now improved and we do not see that oversight from a government agency will improve it further.

- **In your view, how much resources would be needed for the operation of a stockholding agency if established?**

  No comment until there is determination to require a minimum stock holding.

- **Are there any other options for meeting the target level of onshore stockholding?**

  Allowing for Government leased oil tankers to store strategic supplies at sea within NZ's EEZ

  Government to provide infrastructure funds for the building and development of new terminal facilities as in Australia.

<u>Assessment of levy options</u>

- **Do you agree that the PEFM levy formula should be amended to distinguish the component of managing IEA-related costs (including procurement of tickets for onshore fuel stocks and possibly funding for a stockholding agency in the future)?**

  Yes .

- **Do you agree that the PEFM levy rate for covering the IEA-related costs should be variable, subject to three-yearly review and the Minister of Energy and Resources' approval? If not, why not?**

  Undecided. Three years is a long time to require commitments to requirements that may need amendment quickly to work and also to reduce a fuel company from receiving multiple fines if they don't comply at both a corporate and personal level (for false statements). In the end the quantum of the levy compared with other taxes and charges is low. The Government should balance / hypothecate this tax in the most efficient way.

<u>Implementing minimum stockholding obligations (if required)</u>

- **Do you agree that fuel wholesale suppliers be required to meet minimum onshore fuel stockholding obligations? If not, who should ensure that we have sufficient onshore fuel stocks to keep fuel supply resilient?**

  No, the need has not been established and the cost of alternate options has not been determined.

<u>Monthly reporting</u>

- **Do you agree that fuel wholesale suppliers should file monthly returns on onshore fuel stockholding? If not, why not?**

This data is available and Gull believes provided to Government now. Gull is happy to comply.

- **Do you have any view on the information disclosure requirements for monthly returns on onshore fuel stockholding, particularly the type of information to be provided and relevant record-keeping requirements?**

  This must be confidential as it is competitive information that if publicly available has implications for how New Zealand downstream fuels industry participant will offer supply to end-users.

<u>Trading of Obligations</u>

- **Do you agree that fuel wholesale suppliers should be allowed to trade with each other to meet the minimum fuel stockholding obligations through entitlement agreements between them? If not, why not?**

  Gull does not see that the trading system will actually deliver increases in stocks.

  Gull also sees a further unintended consequence of buying "*compliance*" from other fuel companies who, if they have spare capacity, will extract a heavy value which will ultimately impact motorists.

  Gull has reviewed its own inventory profile and sees that matching its own over stock holding limit (which happens in the days/weeks following receipt of a new import cargo to our terminal) with a counterparty's under stock holding limit (and vice versa) to be difficult and not something (due the variability of ship discharges) that could be planned in advance.

<u>Penalties for Non-compliance</u>

- **Do you think the proposed penalties for non-compliance with minimum stockholding obligations are appropriate? If not, why?**

  No, the penalties are significant and may be automatically imposed on fuel companies who have no means to comply within the suggested timeframe (2023) through no fault of their own other than their relative lack of scale compared to the three largest competitors in the market.