MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

AIDE MEMOIRE

Refining New Zealand's strategic review

Date:	30 July 2021	**Priority:**	High
Security classification:	In Confidence	**Tracking number:**	2122-0295

Information for Minister(s)
Hon Dr Megan Woods **Minister of Energy and Resources**

Contact for telephone discussion (if required)

Name	Position	Telephone		1st contact
Andrew Hume	Policy Director	04 901 1474	Privacy of natural persons [redacted]	✓
Gareth Wilson	Principal Advisor		[redacted]	

The following departments/agencies have been consulted

Minister's office to complete:

- ☐ Approved
- ☐ Noted
- ☐ Seen
- ☐ See Minister's Notes
- ☐ Declined
- ☐ Needs change
- ☐ Overtaken by Events
- ☐ Withdrawn

Comments

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Purpose

To update your office on the status of Refining New Zealand's (RNZ's) strategic review and provide reactive communications messages.

Andrew Hume
Policy Director
Building and Resource Markets, MBIE
29 / 7 / 21

Status of Refining NZ's review

Proposal to convert refinery to an import terminal

1. Refining NZ is proposing to convert its Marsden Point oil refinery to a dedicated fuel import terminal. The proposal is the culmination of a strategic review underway since April 2020.

2. The proposal requires the approval of Refining NZ's shareholders before it can proceed. The shareholder vote will occur at a special meeting at 11am on 6 August 2021. The shareholder meeting to vote on the proposal follows Refining NZ reaching agreement in principle with bp and Z Energy earlier this year on key commercial terms, including price. Negotiations with Mobil are ongoing.

3. The proposal remains conditional on lender approvals, entry into final agreements with its three customers (bp, Mobil, and Z Energy) and a final investment decision by the Refining NZ Board. A final investment decision by the Refining NZ board by the end of September 2021 would enable a conversion to occur by mid-2022.

4. At this stage the indications are that shareholders will likely vote to approve the proposal. An independent appraisal report prepared by Grant Samuel concludes that maintaining the current refining operations would be sub-optimal for shareholders.

Impact on staff numbers

5. Under the proposal, Refining NZ would be renamed 'Channel Infrastructure NZ Ltd'. It would distribute fuels primarily to the Auckland and Northland markets, including jet fuel to Auckland Airport, under long term agreements with fuel importers.

6. The current Refining NZ workforce of 300 is expected to reduce over the two-years following commencement of import terminal operations to approximately 60 terminal, fuel testing, and corporate support office employees.

Potential for biofuels production or distribution at Marsden Point

7. Refining NZ continues to seek engagement with the Government on opportunities to explore the production and/or distribution of advanced biofuels, especially sustainable aviation fuel (SAF). Refining NZ believes its Marsden Point site and existing assets (such as deep water port, electricity and gas connections, and multi-fuel pipeline to Auckland) and its skilled workforce could all be leveraged to help kick-start a new biofuels industry. While its strategic location and some physical assets will remain, many of the skilled workforce are expected to relocate when the refinery closes.

8. Refining NZ wrote to ministers on 10 June 2021 seeking a contribution to a SAF feasibility study. Minister Nash responded in July, seeking Refining NZ's assurance that it has taken and will continue to take a social partnership approach to developing its SAF proposal, and more broadly its plans for repurposing its site and managing the associated environmental impacts.

9. Refining NZ recently submitted on proposals for a biofuels mandate. Refining NZ considers that the proposed mandate will not be sufficient to incentivise domestic biofuels production, and suggests that other possible incentives and support structures will be needed, such as:

    a. A SAF production incentive per litre

    b. A levy on individual passenger carbon emissions, for example, through the International Visitor Levy, or another funding mechanism

c. Capital grants to help establish SAF production capacity and supply chain infrastructure

d. Financial incentives for feedstocks sold for mandated SAF production.

Government approach to Refining NZ's proposal

10. The key Government message to date is that the ideas and decisions about any future opportunities relating to Refining NZ's proposal are best developed by Refining NZ and the local community in Northland, with the support of central government.

11. The Government is supporting Refining NZ and its regional stakeholders though participation in Northland's Refinery Transition Working Group. The Ministry of Social Development is the lead government agency, and collaborates with Northland Inc. (the economic development agency), NorthChamber (which provides the business voice) and relevant district mayors to support Refining NZ and its staff to identify opportunities to remain successful participants in the regional economy and manage business confidence in the region.

12. Patuharakeke, the trust board for a composite hapu with interests in Marsden Point, wrote to you recently about the future of the refinery, plans for environmental remediation and potential alternative uses of the site such as biofuels production. We have prepared a response for you.

13. MBIE officials hosted a teleconference this week with representatives from Patuharakeke and officials from Ministry of Transport and Te Uru Rākau. The prospect of SAF production at Marsden Point was the principal topic of discussion. We learned that Refining NZ and Patuharakeke signed a relationship agreement earlier this week, which is positive step for their future engagement and exchange of information.

Implications of refinery closure for fuel supply security

14. We commissioned advice on the implications of the proposal to close the Marsden Point refinery, and we briefed you on the key findings in June 2021 (*Briefing 2021-4061*). These implications are summarised below.

15. Closure of the refinery would result in a significant reduction in stocks held in New Zealand, primarily crude and intermediate product currently held as part of refinery operation. In total stocks could reduce to less than 70% of the previous level. Other things being equal, New Zealand will need to procure more reserve oil stocks to remain compliant with obligations under the International Energy Agreement. The current policy is to procure reserve oil stock at least cost, which is by way of options on oil held offshore.

16. Under most disruption scenarios closure of the refinery will not have a major impact on fuel security as:

    a. Much of the stock that will no longer be held is currently required to operate the refinery and the related distribution system (coastal shipping) so is not immediately available to respond to disruption events.

    b. New Zealand's stock held on water (i.e. in transit to New Zealand) will still be a similar volume and being 100 per cent finished products will provide a very flexible response measure to disruptions; and

    c. In most domestic disruption events, the resupply constraint is set by availability of tank trucks and drivers and the different supply method has little impact.

17. However, the loss of refining capacity could have more adverse outcomes in an unlikely, but nonetheless plausible, event in which New Zealand becomes completely cut off from global oil and fuel markets for an extended period. An extended “closed border” event would have a severe impact whether or not New Zealand has a domestic refinery, but the impact could be worse without a refinery.

18. Having a domestic refinery, in a closed border event, would potentially enable the refining of at least some fuels from crude oil produced within New Zealand. Domestic crude production is currently about 20 per cent of New Zealand’s total fuel demand. While the refinery is configured to refine overseas crude oil rather than domestic crude oil, in an emergency the refinery could refine domestic crude oil, albeit at a sub-optimal level. Assuming that the refinery can continue to operate in some capacity in a closed border event[1], at least some critical functions will be maintained (e.g. food distribution) even though most fuel use would be severely constrained.

19. In a closed border event, without a domestic refinery and sufficient domestic crude production, New Zealand would need to carefully ration its diesel stocks to maintain critical services for a limited period. While the national demand for critical services is not known precisely, it is likely that typical in-country diesel stocks equivalent to 20 days of total demand could perhaps last a few months if used only to fuel critical services.[2]

20. In June 2021 you agreed that MBIE should develop a discussion paper on options to ensure minimum levels of stockholding of diesel and other fuels are maintained or increased.

The case for a subsidy to keep the refinery open

21. Simon Terry, from the Sustainability Council, has suggested the Government subsidise Refining NZ to keep the refinery open for a period of time – at least until New Zealand is no longer so dependent on it. This proposal has received recent media coverage.

22. Simon Terry considers an annual subsidy, equivalent to about 1 cent per litre on fuel sold ($70 to $100 million), would be sufficient for Refining NZ to achieve its desired financial return, and would represent a reasonable cost to insure against the closed border risk described above. The subsidy would need to be maintained as long as New Zealand remained dependent on imported fuels and as long as the refinery is otherwise uneconomic.

23. Simon Terry’s proposal is broadly comparable to one element of the Australian government’s recent fuel security package, which includes a subsidy to keep open the two remaining oil refineries in Australia. We have spoken to Australian officials and we understand that the subsidy is, at least in part, a form of insurance, until 2025, against the ‘closed border’ risk.

24. We have not provided advice on the merits of a subsidy to maintain domestic refining capacity as a means of insurance against the risk of New Zealand becoming cut off from global fuel supply chains for a sustained period. While the cost of such an event would undoubtedly be significant, National security or defence

National security or defence

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[1] A closed border event could potentially also affect the imports of other inputs for the refining process and therefore limit the production of finished fuel products from domestic crude oil.
[2] Diesel demand dropped below 40 per cent of normal levels during several weeks at Covid Alert Level 4 in April 2020. An estimate of diesel demand for critical services could be less than 20 per cent of normal total demand.

25. On an 'expected values' basis, there is not a clear case for subsidising the refinery to keep it open. However, providing a subsidy to maintain refinery capacity is a reasonable insurance option to consider, as illustrated by recent Australian government policy decisions. Whether to subsidise the refinery is a matter of judgement and aversion to risk, taking into account the severe consequence of the worst case disruption scenario (no fuel to support essential services, including food distribution). Similar judgement is required when considering the insurance value of domestic reserve fuel stockholding.

26. If you wish to consider the option of subsidising the refinery to keep it open, we recommend early discussions with Treasury and the Minister of Finance. The first step would be to consider options for engaging with Refining NZ to explore the minimum subsidy required to maintain the desired level of refining capacity.

27. Refining NZ has not, to date, sought or proposed a subsidy to keep the refinery open, but recent discussions indicate it may be open to any such discussions before committing to the conversion proposal. We understand the window for any discussions on options to keep the refinery open will close rapidly after Refining NZ's board makes a final decision on the proposal.

Next steps on stockholding policy

28. As proposed in our June 2021 briefing, we are preparing a paper for you to take to Cabinet in September 2021, before or very soon after Refining NZ makes its decision on the proposal to close the refinery. The paper will:

    a. advise on the implications of Refining NZ's decision, drawing on the expert advice commissioned by MBIE

    b. provide an update on actions in response to the Auckland Fuel Supply Disruption Inquiry, and

    c. seek approval to consult on options to ensure minimum levels of domestic fuel stocks are maintained or increased, to promote fuel security.

29. In December MBIE will prepare its annual tender for domestic reserve stocks to help meet New Zealand's 90 day IEA stockholding obligation. While we have not previously received compliant proposals for domestic stockholding, Refining NZ has indicated that it expects to make a proposal in the next tender. The proposed conversion to an import terminal would free up significant volume of otherwise unused crude tank capacity that could be converted (at some cost) to support stockholding of diesel or other refined products. This will provide an opportunity to gauge the potential cost of domestic fuel stockholding.

Suggested reactive communications messages

30. We will provide a communications plan to your office in coming days, In the meantime we have set out below some reactive communications messages relating to Refining NZ's proposal.

    a. The Government has been closely monitoring developments in relation to Refining NZ's future business model and is awaiting the outcome of the shareholder vote on 6 August.

    b. The Government will work with Refining NZ where necessary to ensure that economic opportunities in Northland can be maximised and utilised.

c. The ideas and decisions about any future opportunities are best developed by Refining NZ and locals in Northland, with the support of central government.

d. A Refinery Transition Working Group has been established to prepare plans to support the possible transition of the refinery to an import terminal and support the Northland region should this transition be confirmed. This will include identifying opportunities for future alternative uses of the site.

e. Refining NZ could potentially play a role in New Zealand's transition to a net zero carbon economy. It has some strategic assets that could potentially be repurposed for the production of green fuels, such as sustainable aviation fuel.

f. In addition, the Government is currently undertaking a review of the fuel security policy settings, as the overall level of oil and fuel stock held in New Zealand could be lower, once the refinery no longer holds commercial inventories of crude oil and intermediate products if it were to convert to a fuel import terminal.

Annexes

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