Submission by

to the

Ministry of Business, Innovation and Employment

on

Options for improving our diesel resilience

6 December 2024

– A BUSINESSNZ AND BUSINESSNZ ENERGY COUNCIL (BEC) SUBMISSION –

OPTIONS FOR IMPROVING OUR DIESEL RESILIENCE

Executive Summary

1. The BusinessNZ Energy Council (BEC) appreciates the opportunity to provide feedback on the Ministry of Business, Innovation and Employment's (MBIE) Discussion Paper titled "Options for Improving our Diesel Resilience."

2. A secure and resilient fuel system is critical to sustaining a functional and prosperous economy. Ensuring a high level of confidence in New Zealand's capacity to maintain fuel deliverability and resilience amidst diverse supply-side risks is essential. This ensures the uninterrupted functioning of society and minimises economic disruptions during supply disruptions.

3. In this submission, **we emphasise that evidence indicates New Zealand's fuel supply chain is already robust and resilient,** even under an extreme disruption scenario. Over the past three years, New Zealand's transition to an import-only fuel supply model has bolstered fuel security by diversifying supply from various international sources, expanding the network of where fuel is imported across the country, and increasing flexibility in responding to fluctuating fuel demand.

4. Considering the existing resilience of New Zealand's fuel system, we believe **there is insufficient evidence to justify an increase in the Minimum Stockholding Obligation (MSO) for diesel fuel from 21 to 28 days.**

5. **The problem definition highlighted in the paper lacks clarity and robust evidence**. While the paper provides a thorough analysis of the options presented, it does not present data to establish whether there is a problem worth addressing. We recommend clarifying and substantiating the problem before pursuing potential solutions.

6. The paper also lacks a comprehensive cost-benefit analysis on all proposed options. Without this assessment and given that increasing the MSO would impose costs on taxpayers or consumers without clear evidence of corresponding benefits, **the proposal to increase the MSO for diesel appears to be a solution looking for a problem.**

7. **If the Government remains determined to amend the MSO for diesel, we recommend the Government first steps back from this proposal and monitors the MSO reports when they begin in February 2025** before considering further options to increase onshore storage of diesel fuel. These reports may give the Government additional evidence and confidence that fuel security remains robust and resilient in New Zealand, requiring no further regulatory intervention beyond the implementation of the MSO as planned.

8. In contrast to diesel supply, there seem to be challenges regarding jet fuel resilience. Therefore, we support efforts already underway by industry participants to enhance the resilience of the Auckland jet fuel system by bolstering infrastructure and capacity to ensure 10 days' cover of jet fuel.

9. As part of the collaboration between industry and the Government, we recommend refining the National Fuel Plan to clearly define roles and responsibilities during emergencies. This will ensure that crisis response plans are effective, coordinated, and fit for purpose.

Unclear problem definition

10. We disagree with the conclusions drawn from several statements made to inform the problem definition in the paper. We refer to the statement below:

> *"While the risk of a sustained supply disruption is low, the consequences would be devasting for New Zealand at the current stockholding levels…such a disruption is therefore a low probability but very high consequence event, which justifies government intervention."*

11. The problem definition is not clear as to what type of disruption is referred to and the extent of such disruption which classifies it as a high consequence event. Assuming it refers to a major international event(s) that disrupts the ability to source supply from multiple markets in Asia simultaneously, we agree that this would be a low probable event. It would also be a high consequence event. However, the justification for intervention on this basis is premature.

12. As part of the problem definition, the paper notes that there is "*little incentive for fuel companies to increase stockholding"* as it can reduce efficiency, stating that *"what is efficient for the market does not necessarily build New Zealand's overall fuel and diesel resilience."* It goes on to imply that it is in New Zealand's national interests to bolster additional supply. This also implies the existence of a market failure to address supply risk, justifying the role for Government intervention to address this market failure.

13. Before any Government intervention, it is important to step back and ask whether there is a clear case of market failure. The lack of a clear failure risks the introduction of regulation which could lead to unintended consequences and costs to consumers without clear benefits. Moreover, there is a risk of regulating for the sake of regulating, without a clear problem definition.

14. If there is a significant problem, it is important to ask what potential options are available to improve business outcomes which do not impose significant costs. In the economic literature, market failures most commonly encompass issues with externalities, the provision of public goods, and the presence of information failures. On the issue of fuel stockholding, it is difficult, if not untenable to define the current importation of refined fuels as a market failure.

15. A significant disruption to fuel supply is still a potential risk, however it should be seen from a wider lens of probability and the cost associated with minimising risk. The risk of severe disruption is inherent, as it is across the delivery of all goods and services society relies on. The fundamental uncertainty is determining the optimal amount of risk we are willing to accept, and if this risk is unacceptable, what resources we are willing to forgo to reduce it. Moreover, who is best informed to make a determination that risk is optimal.

16. Finding the right balance between risk and cost can be challenging. The information needed to assess risk will always be imperfect and incomplete. However, the task of assessing risk is most effectively managed by those who possess the relevant information needed to understand and evaluate the risk they face.

17. Businesses have a comparative advantage in assessing their own risks and determining the amount they are willing to pay to minimise them. This is because they have a deeper understanding of their own operations and the industry itself, while holding the relevant information to determine risk. We

question the Government's ability to assess and determine the optimal level of risk without input from industry. As it stands, the problem definition does not have sufficient evidence justifying a problem worth addressing. We emphasise that a decision on the most appropriate option to enhance New Zealand's fuel resilience and reduce risk must be based on the solid evidence of a certain problem.

18. **We <u>recommend</u> the problem definition should be clarified, specifying and scoping the problem the Government believes is worth addressing**. As explained in the section below, once the problem definition is clarified, it becomes clear that the problem and the justification for Government intervention is weak. This is in part driven by the fact that a significant disruption to diesel supply over an extended period is extremely low.

New Zealand's resilient fuel system

19. Nationwide diesel and petrol disruptions in New Zealand are very rare. The delivery of fuel across New Zealand remains resilient and highly reliable. If there are regional or location specific disruptions, they are often addressed quickly as fuel companies have the incentive to protect their competitive advantage and ability to maximise profitability. There have been no major and prolonged disruptions at the pump that has caused concern and questioned the reliability of New Zealand's fuel system.

20. We recognise that in large part, the previous Government's impetus to introduce a Minimum Onshore Stockholding Obligation (MSO), and the current Government's investigation into increasing the MSO for diesel, has largely been driven by the closure of the Marsden Point Refinery ("the refinery") and concerns about fuel supply security. **We emphasise that the closure of the refinery has <u>enhanced</u> security of supply**. The refinery's operation posed a significant vulnerability, as it represented a single point of failure. Any disruption to refining capacity created serious risk to fuel distribution across New Zealand. These risks have been mitigated under the new import-only model.

21. In many respects, New Zealand's import-only model has enhanced fuel resilience. By sourcing refined fuel from a broad range of international suppliers, the country has reduced reliance on a few sources or importers. Instead of predominantly importing crude oil for local refining, refined fuel is now distributed to a diversified network of import terminals. This approach strengthens fuel security by minimising the risk of a single point of failure. Additionally, unlike the previous system, refined fuel shipments can now be arranged on demand. This flexibility has improved New Zealand's ability to adapt to changes in fuel demand and has significantly increased efficiency, halving lead times in the process.

22. Analysis undertaken by Z Energy (Z) has tested four of the most plausible risks to New Zealand's fuel system and whether the system would remain resilient and secure in the face of disruption. The most plausible risks are the following:

    1. **A shortage of refined product from existing sources.**
       (i.e. a South China Sea and North Asia event resulting in fuel stockpile and/or sanctions or the opening of Artic Northern Sea trade route, diverting North Asian supplies to Europe)

    2. **Inadequate assets to support transportation.**
       (i.e. Strait of Hormuz and Suez Canal disruption, e.g. lower vessel availability from Asia due longer shipment times to Europe or the decommissioning of older ships)

    3. **Restriction to major maritime corridor(s)**
       (A South China Sea disruption, e.g., no shipment through, typhoon delaying fuel products from South Korea and Japan)

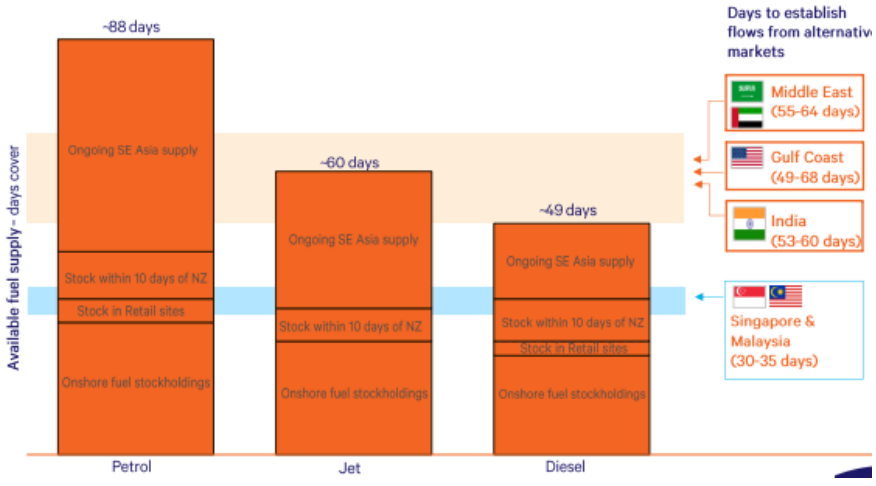
4. **Inability to meet demand due to infrastructure or distribution constraints**
   (i.e. Damage in Marsden Point to Auckland pipeline (RAP) or the Wiri to Auckland pipeline (WAP) with no alternative method to transport fuel to the Airport.)

23. Across these possible scenarios, New Zealand's five major fuel importers can reliably source supply from their parent organisations and international partners in a timely manner, ensuring the continued deliverability of fuel at the pump. At any given time, New Zealand's fuel importers have cargo on route to New Zealand. It is very unlikely that all of New Zealand's importers, such as BP, Z, Mobil, Gull and Tasman Fuels will not be able to source supply simultaneously. Such a scenario would represent a global event on a significant scale, like a COVID like event.

24. Even in the most extreme scenario, where 40–60% of all imported refined product from North Asia (Korea, China, and Japan) a major source of New Zealand's refined fuel is disrupted, shipping vessels from other markets would remain available. As shown in Figure 1 below, in such a situation, New Zealand would still maintain 88 days of petrol, 60 days of jet fuel, and 49 days of diesel supply. These figures account for ongoing imports from alternative Southeast Asia supply, stock held within New Zealand (i.e., at retail stations and in tanks) and onshore fuel reserves.

25. New Zealand would have sufficient fuel until alternative supplies could be sourced from Southeast Asia (Singapore and Malaysia). This would take 30 to 35 days to establish. In an even more extremely unlikely scenario, where fuel could not be sourced from Korea, China, Japan, as well as Singapore and Malaysia, establishing supply from alternative markets such as India, US and the Middle East would take 60 to 68 days. Under this scenario, New Zealand would still have sufficient jet, petrol and diesel fuel, as shown Figure 1.

Figure 1: Projected available fuel supply if North Asia supply is disrupted[1]



26. Increasing the onshore stockholding obligation of diesel to 28 days from 21 days, as currently prescribed in legislation, would provide additional cover in the event of a significant disruption. However, the likelihood of an event of such magnitude is very low. If such event did occur, New Zealand would not be the only country affected. It would also be highly likely that an event of such size would also involve the disruption of other goods in addition to fuel.

[1] Z Energy's Assessment on Aotearoa New Zealand's fuel security and resilience (2024)

27. This could be an event similar to the Covid-19 pandemic. Under this scenario, there is a limit to how much New Zealand can prepare, considering our reliance on overseas markets to source fuel supply. Additional diesel storage would provide some additional cover; however, we question the cost of building storage and whether the additional cost to consumers or taxpayers is worth the additional benefit in a scenario that is very unlikely to occur.

28. Probability plays a key role in determining which options to prioritise when evaluating different scenarios. While there is inherent uncertainty in assessing what is likely, it is challenging to justify significant expenses to mitigate the impact of highly improbable events. The rationale for increasing diesel stockholding levels appears, in part, to stem from the precautionary principle—preparing "just in case" for an unlikely but high-impact scenario.

29. Determining and reducing risk based on the precautionary principle is fraught and largely subjective. It often leads to an inconsistent approach to assessing risks across an economy. For instance, if more diesel storage is justified for a "just in case" scenario, the same logic can be applied to building an additional HDVC cable across the Cook Strait to protect against a failure, or the construction of additional generation units for periods of insufficient supply, or the expansion of the Huntly coal pile to reduce the impact of dry year risks. This same logic can be used to justify a plethora of interventions to reduce risk. But of course, it is not possible to apply the precautionary principle to reducing all risks in a world of scarcity.

30. The sobering and undeniable fact is that resources are limited, and risk cannot be completely eliminated, not even at great cost. To find the economic level of effort appropriate for risk reduction, it is necessary to consider the benefit, so the benefit can be compared with the cost. This ensures resources used to reduce risk are used efficiently.

31. While risk reduction may be possible, beyond a certain point the marginal cost of acting becomes progressively greater, while the potential returns decrease. As mentioned, it is therefore in companies' own interests to invest in risk minimisation strategies up to the point at which the marginal cost equals the marginal benefit. For example, a large electricity user will hedge up to an optimal point for their operation, driven by their own risk appetite.

32. The same is true for fuel importers. New Zealand's petrol and diesel importers currently have the incentive to invest up to a level of risk which is optimal. If it was not currently optimal, there would likely be a heightened risk of shortages and disruptions occurring more frequently. As evidenced above, even if there is a disruptive event, supplies can be sourced reliably in a timely manner from alternative markets.

Options to enhance diesel supply

The paper outlines four main options to improve diesel supply resilience:

1. Do nothing (status quo)
2. Increase diesel stockholding obligation for diesel from 21 to 28 days of cover
3. Government procurement of 70 million litres of diesel stock and access to storage, paid through the Petroleum or Engine Fuels Monitoring Levy or general taxation
4. Increase the stockholding obligation for diesel from 21 days to 28 days of cover, with the Government supporting industry with the cost of additional storage.

33. **We <u>oppose</u> the need to amend the MSO for diesel any further**, **and therefore we <u>support</u> option 1**. Increasing the days of coverage from 21 to 28 days must be seen through balancing the three limbs of the Energy Trilemma: Affordability, Sustainability and Security. Options 2 to 4 would provide additional security in a highly unlikely international risk scenario. However, options 2 through 4 would mean importers would have to hold more inventory. This would result in a less efficient supply chain and higher operating costs. It would also require the construction or lease of more tankage resulting in higher capital and operating costs. These costs will need to be recovered, either through consumers or by taxpayers.

34. Given additional capital will need to be spent on storing fuels, there is a risks tankage built to meet the obligation could become stranded capital as forecasted demand for petrol and diesel decline into future. This could divert capital away from more efficient or low-carbon investments to the benefit of consumers. As mentioned, the primary justification for intervention seems to hinge on a precautionary approach, preparing for an extremely unlikely "black swan" event where supply from Asian markets is simultaneously disrupted. This overlooks additional supply chain inefficiencies, the diversion of capital towards more risky investments, and finally, additional costs to consumers.

35. When evaluating the value of each potential option, it is also crucial to consider alternative priorities where decision-makers could allocate time and resources. While the paper emphasises the importance of enhancing diesel resilience to improve fuel supply security, we believe that if the Government chooses to act on supply security, efforts would be more effectively directed toward strengthening New Zealand's gas sector. This approach would also enhance overall supply security.

36. The allocation of taxpayer resources, as suggested in options 3 and 4, is challenging to justify when more pressing issues, such as the decline in gas supply, demand attention. Declining gas availability increases risks to industrial users reliant on gas and to electricity generators, highlighting the urgency of addressing vulnerabilities in the gas sector.

37. While the Government does not have a comparative advantage in assessing risk compared to industry, this should not necessarily exempt them from assisting importers in managing risk effectively. The Government can play a role in reducing regulatory barriers and providing relevant information that may hinder businesses from making well-informed risk management decisions.

38. For example, barriers to obtaining relevant consents may impact business decisions related to managing risk. In this case, obtaining consents for additional storage might provide a barrier or slow the delivery of storage. The Government's efforts to reform New Zealand's resource management regime, premised on the enjoyment of property rights, is welcomed and will likely reduce this barrier.

39. Another possible role for the Government is their accessibility to relevant information through multiple channels which could be valuable to industry participants in their assessment of risk. For example, the New Zealand Government will hold and regularly collect information on geopolitical developments that could impact possible risks facing fuel importers. We are not aware of any information of this nature that is provided to importers. A regular update to importers could therefore provide additional value.

40. **If the Government remains determined to amend the MSO for diesel, we <u>recommend</u> the Government should first step back from this proposal and monitor the MSO reports when they begin in February 2025** before considering further options to increase onshore storage of diesel fuel. These reports may give the Government additional evidence and confidence that fuel security remains robust and resilient in New Zealand, requiring no further regulatory intervention beyond the implementation of the MSO as planned.

Amending the MSO

41. The discussion document seeks input on the timeline required for industry participants to meet the obligation if legislation is amended to increase diesel stockholding to 28 days. Meeting this requirement would necessitate the combination of holding more inventory, building or leasing more tankage, or selling less product as importers would become more selective about where they participate. This process would likely take at least 18 months and more realistically around 24 months. However, this timeline depends on obtaining resource consents and completing necessary geotechnical work.

42. Under the most optimistic scenario, industry participants would likely require approximately three years to fully comply with the new obligation. It is crucial that participants are provided with clear regulations and sufficient time to adapt if the MSO for diesel is increased to 28 days.

Jet fuel resilience

43. In contrast to the lack of a clear problem with the supply of diesel in New Zealand, the Auckland jet fuel system would benefit from greater resilience to reduce the impact associated with a potential outage or large-scale disruption. The jet fuel supply event of 2022 provided concern about the extent of supply chain resilience.

44. Yet the industry and the Government worked effectively to ensure the impact was minimal, resulting in no cancelations of scheduled flights. Additional storage and capacity would be beneficial, such as a new WIRI jet fuel tank and WAP booster pump. Industry participants have collectively agreed on the need to increase jet fuel storage. This work is currently underway. Further Government intervention is therefore not necessary. Even more storage will be dependent on Auckland International Airport's confirmation on their re-development plans.

Refine the National Fuel Plan

45. **Despite opposing options to increase the MSO of diesel to 28 days, we <u>support</u> and see value in refining the National Fuel Plan** – a plan which delegates roles and responsibilities across industry and government agencies during a crisis. The plan's guidelines should be clarified to support actions by industry participants during a crisis. Refining the National Fuel Plan could occur as part of the Government's Fuel Security Study. We emphasis that the study, and any resulting strategy, should be co-designed in partnership with industry. We recommend clarifying the National Fuel Plan in the following areas:

    1. Clarify MSO guidelines:
        - Establishing clarity on who has the authority to make decisions on when MSO stocks can be drawn down; what is the prioritisation of its use; what are the replenishment conditions

    2. Clarify on fuel specification relaxations during a crisis:
        - Establish fuel specifications by product (petrol and diesel) and timeframes that fuel importers need to adhere to during a crisis to support identification and establishment of relationships with potential alternative markets.

    3. Clarify plans to stand up trucking labour during a domestic crisis:

- Establish guidelines and protocols on the prioritisation for repurposing trucking resources (assets and labour) to support during a crisis; how industries with trucks will work together during a crisis; transport rules during a crisis

4. Clarify risk practices and compliance for assets:
    - Establish clear guidelines and protocols on industry obligations to operate assets in line with best-in-class operations, where redundancy options are not feasible (Marsden Point Wharf)
    - Risk practices and compliance requirements to minimise likelihood of an outage, e.g. ensuring shipping practices around minimum water depth are adhered to and pipeline inspections done at correct frequencies.

Appendix One - Background information on BusinessNZ Energy Council

About the BusinessNZ Energy Council

The BusinessNZ Energy Council (BEC) is a group of New Zealand energy organisations taking on a leading role in creating an affordable, reliable, and sustainable energy system for New Zealand. The BEC is a division of BusinessNZ, New Zealand's largest business advocacy group and the New Zealand Member Committee of the World Energy Council (WEC). The BEC offers a unique opportunity to shape the New Zealand's energy-system with business leaders, government, and research as well as access to global thinking on energy issues via our involvement with WEC.

About the World Energy Council

The World Energy Council is an independent global organisation that promotes an affordable, reliable and sustainable energy system for all. It is comprised of over 100 member countries. The Council provides impartial information on critical issues that affect society's well-being such as climate change mitigation strategies; energy efficiency; renewable energies; nuclear power; clean coal technologies; rural electrification; energy access; regional integration; urbanisation; geopolitics; innovation; finance; human capital; governance; resilience; hydrogen; storage; digitalisation; mobility; cooling; heating; behaviour change; scenarios; and transition leadership.

About the BusinessNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods
- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy. In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

www.businessnz.org.nz