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Ministry of Business, Innovation and Employment

via email: gasfuelpolicy@mbie.govt.nz

Submission on options to improve New Zealand's diesel resilience

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy sector advocacy organisation. We represent participants across the energy system, providing a strategic sector perspective on energy issues and their adjacent portfolios. We enable constructive collaboration to bring coherence across the energy sector through and beyond New Zealand's journey to net zero carbon emissions by 2050.
2. This document constitutes our submission responding to your consultation on options to improve New Zealand's diesel resilience.
3. We make recommendations in Appendix One and address the twenty consultation questions in Appendix Two. We make these with the acknowledgement that there are a range of differing views, including from our members, on matters pertaining to this consultation, such as:
 - a what constitutes resilience and how to quantify it;
 - b the current and future real and perceived risks to New Zealand from external forces such as geopolitics and supply chain disruptions;
 - c how much resilience New Zealand needs from which sources; and
 - d who should pay for the additional 'insurance' cover incurred, and why.
4. Where these views differ from those set out in this submission, they are being made directly, and separately.

Key messages

5. Diesel is a critical engine fuel for the economy and for emergency responses. It is part of a supply chain system that responds quickly and flexibly to most events.

A severe and sustained disruption, such as the 2017 pipeline rupture, is highly unlikely and some in the sector have called it a 'once in 100 years event'. At a principled level, we have previously been opposed to increasing the costs of fuel supply on the basis that it was not required. However, we acknowledge that circumstances change over time and we see the value in assessing New Zealand's diesel resilience in light of worsening geopolitics, especially in the Middle East and East Asia.

6. There are two key parts to this consultation. The first asks whether the level of mandated reserve diesel stocks should increase to bolster resilience. The second asks who should pay if it does get increased:
 - a on the first part, our preference is to preserve the MSO for diesel at 21 days, unless increasing it is justified through findings in the soon to be completed fuel security study; and
 - b on the second, to cover costs for supplying an extra seven days' cover our preference is that costs are shared among all New Zealanders via general taxation, rather than obliging fuel importers which passes the costs through only to diesel users.
7. Diesel is currently supplied at levels that meet demand (i.e., the market). If the fuel security study findings justify an increase to the MSO for diesel, we recommend taking the same principled approach as for other public goods (e.g., fire services, search and rescue, clean air) in terms of determining who pays.
8. Ultimately this is about insurance, and assurance, for a public good/benefit and that must be considered against other public goods and its value for money.

Summary

9. The government had been investigating the option of buying additional diesel of 70 million litres (seven days' equivalence) of reserve diesel stock at a cost of approximately \$84 million (figures from July Cabinet paper) but post-election fiscal constraints on new capital have meant that other options now need to be explored.
10. In July, Associate Energy Minister Hon Shane Jones secured Cabinet agreement to stop work on investigating government procurement, and instead, pursue other policy options to bolster New Zealand's diesel resilience.
11. A report on fuel resilience by Hale and Twomey in 2020 ('the report') followed the 2017 pipeline rupture, an event unlikely to repeat given its unique origins. Since 2020 we have had a global pandemic which disrupted the economy and supply chains, the refinery at Marsden Point has ceased its refining operations, and

tensions between Russia and Ukraine and in the Middle East have impacted global oil prices and supply chains.

12. The status quo defined in the consultation document repeats findings in the report that additional days' cover are needed. This is based heavily on the assertion that New Zealand is vulnerable to international fuel supply disruptions because of geographic isolation.
13. We now operate in a nimble, complex and deeply networked supply chain system that supplies liquid fuels in the Asia Pacific region. We believe the problem has been mis-characterised and presented simply as a days' cover problem (with insufficient analysis to justify this), rather than a risk management problem. Ultimately, this needs to be informed by those in the sector and within government who are best able to understand and quantify the security risks of the geopolitical situation, together with other factors we expect will be covered in the fuel security study.
14. With diesel consumption forecast to decline in the long-term (over the next decade or so as part of the energy transition), we share concerns that unused storage in future could become stranded assets, meaning consumers effectively pay twice (first at the pump, the second time as an opportunity cost) for resources that could have been used for other things, including the transition to a low-emissions future. However, opportunities to repurpose and refit infrastructure at Marsden Point and Auckland Airport illustrate industry's ability to respond and adapt to market changes.

Preferred options

15. Subject to any material change in context regarding factors such as the level of geopolitical risks from our initial assessment, our preferred option is **option one: no change to the MSO – retaining 21 days' cover for diesel**, to avoid unjustified (as yet) costs to taxpayers and consumers, and to take into account the forecasted decline in diesel over time.
16. We believe there are other options not presented in the consultation document that should be considered by Cabinet. The two alternative options we recommend are:
 - a holding reserve volumes steady so that resilience improves over time as demand for diesel declines (as it is expected to); and
 - b increasing reserves to just 24 days' cover rather than 28, with government funding or achieving it through option (a) above.

17. We provide our full list of recommendations in Appendix One and detailed responses to the consultation questions in Appendix Two. To be helpful we have provided potential mitigations if the Government is committed to increasing coverage to 28 days.

Submission

We previously opposed the Minimum Stockholding Obligation

18. In June 2023, we submitted to the Economic Development, Science and Innovation (EDSI) Committee on the Fuel Industry (Improving Fuel Resilience) Amendment Bill, recommending that the Bill not proceed.¹
19. We made that recommendation because New Zealand does not have a proven fuel security problem beyond what the fuel industry could already respond to effectively; and because the Bill would impose unnecessary costs through its introduction of the MSO. We recommended several ways to improve the Bill if it succeeded. In that same spirit we make some recommendations in this submission if the Government decides to increase diesel reserves.

A sustained and severe disruption is highly unlikely

20. Nobody knows where, when or if a disruption might occur, its scale or impact. We agree a severe and sustained disruption would be catastrophic, but we are unsure of the likelihood of such an event. We continue to believe that the fuel industry (and all its intricate networks) can handle most disruptions.
21. Predictably, the fuel industry is opposed to the possibility of an increased MSO for diesel and the potential impact on fuel prices. We believe the public interest test to increase the MSO for diesel has not been adequately fulfilled.
22. The limited modelling relied upon for this consultation suggests that an additional seven days' cover will provide an additional month's worth of cover (with 25 per cent rationing) on top of the three months' cover that 21 days' cover the MSO already provides. We question whether other resilience measures would not be preferable in such timeframes – a three month lead-in period would usually be ample for ordering more fuel in most supply disruption scenarios. We think all response options should be considered alongside additional storage.

¹ Our submission presented to Select Committee is available here:
<https://www.energyresources.org.nz/dmsdocument/250>

Increasing diesel reserves increases costs

23. MBIE is correct to identify the myriad of compliance costs and to raise questions about 'who should pay' in relation to improving New Zealand's diesel resilience. These issues should not be underestimated.
24. Costs associated with the MSO include monitoring systems and IT, human labour, storage for fuel and for data, legal and contractual fees, engineering and design, and all costs will ultimately be passed on to the consumer – unless the costs are borne by the Government, in which case they become socialised via taxpayers.

Government funding is the fairest way to pay for resilience

25. We think the government is the best source of funding for any additional diesel reserves above the currently mandated 21 days' cover in the MSO, should this be justified.
26. We consider government funding the most rational way of sharing the costs because resilience is not something that individuals benefit from, it is a form of public insurance for the unlikely event of a sustained and severe fuel disruption. The beneficiaries are *all* New Zealanders rather than diesel users. For that reason, costs are best shared among taxpayers through government funding (indeed the cover sought could be characterised as cover for *unknown unknowns*, outside of the ability of the sector to identify, and for which only government on behalf of all citizens is best placed to address).
27. In addition to funding, the government has the advantage of centrally held information and the learnings from the 2023 Request for Proposals (RFP) tender process for reserve diesel stocks, which was stopped to investigate other options currently in this consultation. This gives the Government a head-start when considering options for storage.
28. Other benefits of government's direct involvement in the funding and procurement include the pressure it can put on prices and its role as system monitor to have an oversight and understanding of the systemic costs and money flows, and that includes the levy funding.
29. A second-best option could be a hybrid model whereby public funding pays for diesel storage and fuel companies pay for the fuel, or similar arrangement.

Other unintended consequences

30. Costs aside, and how these should be apportioned, there are a range of unintended impacts from increasing diesel resilience that have not been

included in the consultation and provide balance to the arguments in favour of additional days' cover for diesel.

31. Diesel is an important fuel but its consumption is forecast to decline in the longer-term (over the next decade or so, as part of the energy transition). That means investment in diesel assets will eventually become defunct in the longer-term. This makes the business case even problematic, and justifies a balanced approach that recognises the potential for stranded investment.
32. The additional diesel reserves are intended to be held as reserves (and turned over frequently to ensure the fuel remains on spec) but are not needed as part of the natural market response to supply and the forecasted decline in demand. The fuel will most likely remain unsold.
33. We are concerned that the proposal to increase days' cover could be a high-cost solution imposed on New Zealanders for what is arguably still an unproven, vaguely quantified problem). This is significant because the other fuels covered by the MSO (petrol and jet fuel) have levels set at or near to their actual consumption and turnover and these fuels have been subjected to the same policy tests as diesel.

Resilience is a complex system and there are many response options in an emergency

34. Building resilience to respond to unlikely events is quite different to managing the natural peaks and troughs of fuel supply that occurs naturally in the market. The MSO has mandated minimum levels that are just slightly over market consumption levels. Mandating levels above that bring competition and supply reliability issues into the picture.
35. The rationale given for regulating further, being that 'it is essential to increase onshore diesel reserves because impacts on our economy from a severe and sustained fuel disruption would be catastrophic' could be strengthened if it considered diesel as part of a complex system of systems that form an emergency response.
36. In the event of a 'black swan' or even known unknown events, additional storage may help but this, of course, depends on factors such as size, duration and severity. There are many sorts of disruption, from the minor end of the spectrum, such as a shipment that is off-specification, or a major one that is completely unforeseen, such as a pandemic or the outbreak of a Middle Eastern regional war with serious long-duration spill-over effects with respect to fuel supply.
37. Given the potential spectrum of events from mild to extreme, the consultation could also usefully consider alternatives to diesel and alternative modes of

freight and emergency services (such as rail, drones), supply chains beyond just diesel (such as air freight, EVs), new technologies, systemic resilience through our transport system and international allegiances, and demand response beyond the 25% rationing that has been proposed in the consultation.

38. Onshore reserves form only a part of our potential resilience response. Supply diversity, international oil tickets and responsive international supply networks are key components of New Zealand's fuel resilience. Monitoring and market access to refined fuels and offshore refining are examples.

Concluding remarks

39. Thank you for the opportunity to provide feedback on this consultation. We understand the critical nature of emergency response and the role for diesel in that.
40. We have been presented with a weak problem definition and a pre-defined uni-faceted solution, i.e., increasing onshore diesel stock reserves to 28 days' cover under the MSO. There may be geopolitical analysis to which we are not privy that justifies a lift in the cover, and if so we look forward to understanding these risks and their magnitude.
41. Until then, we remain to be convinced that defaulting to an increase in our onshore stocks is justified or that it would materially improve New Zealand's diesel resilience, whether days' cover is the right way to think about future proofing our emergency management system or if justified, that diesel users should pay.
42. Diesel fuels our emergency and freight vehicles but exists within a wider system of fuel supply, transport and technological evolution. Until such evidence of risks emerges, we prefer a focus on the systemic nature of resilience, while avoiding imposing unnecessary costs on New Zealanders at a time when basic living costs are becoming unaffordable for many.

Appendix One: Recommendations

1. We oppose increasing diesel reserves to 28 days' cover based on the evidence we have seen and unless justified by a material change in context regarding factors such as the level of geopolitical risks.

Preferred option

2. We recommend:
 - a Option one: keeping 21 days' cover as laid out in legislation for the MSO.

Second best options

3. If that option is not preferred, we recommend two new options that are not in the consultation document, these being:
 - a maintaining current volumes of cover without increasing storage, which will increase resilience over the coming years as diesel demand declines;

OR

 - b increasing days' cover to just 24 days, with Government paying for all the increased storage.

Preferred options for apportionment of additional costs

4. If the Government is committed to increasing diesel storage to attain 28 days' cover, we recommend the following mitigation measures to reduce unintended consequences:
 - a apportion additional costs to the Government, which fairly distributes the costs across all New Zealanders who will benefit from having increased diesel reserves onshore if an emergency should eventuate;

AND

 - b leverage prior government work on tendering for storage of onshore reserve diesel stocks to find the most cost-effective options;

OR

 - c engage fuel importers to co-fund and manage the ongoing operating costs, which will in turn share costs between all New Zealanders (who benefit from increased resilience) and consumers.

5. We do not recommend increasing the fuel levy to fund the additional storage as this will only be paid for by diesel consumers who would not be the sole beneficiaries of increased resilience – all New Zealanders would be.

Preferred option for timing

6. We recommend a long lead time of at least two years, giving consideration to the feasibility of building any new storage which will be entirely impossible to provide by 2026.

Appendix Two: Responses to consultation questions

Submitter information

MBIE would appreciate if you would provide some information about yourself. If you choose to provide information in the section below, it will be used to help MBIE understand how different sectors view the options for domestic diesel reserves. Any information you provide will be stored securely.

Your name, email address, phone number and organisation

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- The Privacy Act 1993 applies to submissions. Please tick the box if you do **not** wish your name or other personal information to be included in any information about submissions that MBIE may publish.
- MBIE may upload submissions and potentially a summary of submissions to its website, www.mbie.govt.nz. If you do **not** want your submission or a summary of your submission to be placed on either of these websites, please tick the box and type an explanation below:

I do not want my submission placed on MBIE's website because... [insert reasoning here]

Please check if your submission contains confidential information

- I would like my submission (or identifiable parts of my submission) to be kept confidential, and **have stated** my reasons and ground under section 9 of the Official Information Act that I believe apply, for consideration by MBIE.

Options for improving our diesel resilience

1. Do you agree with this characterisation of the status quo? If not, please provide evidence to support your views.

Yes Yes, with changes No Not sure/No preference

Please explain your views.

The status quo characterised in the consultation document resembles a largely functioning system of diesel supply within New Zealand, now and into the future. It implies that there isn't a policy problem, but there could be a decision point for government to intervene if it wishes (with cost implications and no clear benefits).

Please see our submission above, in particular paragraphs 11-12.

2. Do you agree with our problem definition? If you don't, what would you suggest changing?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

We do not agree with the problem definition. It presumes that not having 28 days' cover is 'the problem', and the inverse of increasing our diesel reserves to 28 days is the solution. Incorrect problem identification is the downfall of good policy. It is not the fault of officials in this case, but the overhang from a previous government's ambitions to increase days' cover of a range of fuels based on over simplified comparisons to Australia's fuel storage, and calculations that bear insufficient resemblance to the actual supply chain matching demand. As a result, 28 days appears to be a number that has been plucked from the air.

Please see our overarching thoughts on the problem definition in paragraphs 12-13 above.

3. Have we identified the correct objectives?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

Please see paragraphs 20-22 of our submission, above.

4. Is 28 days' cover the right level? Should we have more or less? Why?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

We do not outright support 28 days' cover.

Please see our recommendations section in our submission, above.

5. Are there any other options that we have not considered?

Yes No Not sure

Please explain your views.

We offer two further options.

Please see our recommendations section in our submission, above.

6. There is a trade-off between cost impact and timing. Options that have a higher cost impact are quicker. Do you prefer an option that is fast but more costly or slow and cheaper? Can you explain your answer?

Please explain your views.

Building or converting new storage is currently understood to take 3-5 years. However, we think the government has the ability to leverage the work done during the RFP tender process to gain insights into how and where storage could be built in the most efficient way. By doing so, it could potentially save time, and therefore money.

7. There are risks to New Zealand if we experience a severe and sustained supply disruption. Do you agree that doing nothing isn't acceptable? If you prefer this option, please tell us why.
- Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

Resilience is multi-faceted and systemic. The fuel industry is best placed to respond in an emergency and has the networks and expertise to do so without unnecessary additional storage.

Please see paragraphs 34-38 above.

8. If we increased the minimum stockholding obligation (**MSO**) for diesel to 28 days, how can we maintain competition in the fuel industry?

Please explain your views.

Government funding would help keep downward pressure on prices and encourage fuel companies to continue operating competitively.

9. Do you have any information on how much an increased MSO for diesel could cost consumers? Please provide details and explain how any estimates have been arrived at (if applicable).

Yes No

Please provide details and explain if possible.

We do not have any concrete information but assume that a few cents per litre could be added at the pump to cover the additional costs, once fully implemented, and potentially more than that if industry are asked to cover upfront capital and establishment costs of the additional storage and fuel supply.

10. How quickly could fuel importers meet an increased MSO? What could be done to get diesel in tanks earlier than 2026?

Please explain your views.

We have been advised that at least two years but more likely, 3-5 years, would be required from the point of the preferred option becoming law.

11. We have assumed that fuel importers will begin planning for an increased MSO as soon as it is announced, rather than wait until regulations are made. Is this a fair assumption?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

Until the requirements become law, there is too much uncertainty with policy changes occurring without much warning so we expect that our response to question 10 would apply to the planning for as well as meeting the obligation.

There could be an unintended chilling effect on investment if changes are pursued above the current 21 days' cover in the MSO legislation because of frequent changes to legislation.

12. Do you have a preference about whether the government uses Levy funding or general taxation if this option was adopted?

Levy funding General taxation Not sure/no preference

Please explain your views.

We think general taxation spreads the costs most fairly. Levy funding would impact consumers of diesel but the objective of improving diesel resilience is to enhance New Zealand's ability to respond to an emergency, which benefits all New Zealanders.

- 13.** Given the government has already done work on procuring storage, is this timeframe realistic? What could we do to speed it up?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

We are unsure what timeline this question refers to.

We agree that the government should use work already done on procuring storage. We disagree that an ambitious timeline should be pursued for meeting the obligation.

- 14.** Do you think the government should provide fuel importers with financial support to help alleviate flow on costs to consumers? Why or why not?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

We think the simplest way to support industry would be to fully fund the additional storage. See our response to question 15 below and paragraphs 25-29 of our submission above.

- 15.** In your opinion, what kind of financial support would be appropriate?

Please explain your views.

Our preference is for government funding of the additional days' storage, if agreed to.

- 16.** What proportion of government funding would noticeably reduce an increase to fuel prices?

Please explain your views.

We think a compromise option could be a 50/50 share between government and industry. Please see our response to question 17, below.

- 17.** Should the government recover the cost of financial support through raising levy from fuel consumers?

Yes, I agree I agree in part No, I don't agree Not sure/no preference

Please explain your views.

Diesel consumers are not the sole beneficiaries so should not bear all the costs.

- 18.** Do you have a preferred option? Why?

Yes No Not sure/no preference

Please explain your views.

We prefer Option 1 – status quo, with caveats explained in our submission.

- 19.** Do you have a preference for how quickly we implement increasing our diesel reserves?

Yes No, I don't agree Not sure/no preference

Please explain your views.

As quickly as possible, but at least two years after the obligation becomes law.

- 20.** If we increase the MSO for diesel, would you prefer a staggered approach? If you are a fuel importer, would this make a difference to how you invest in additional storage?

Yes No Not sure/no preference

Please explain your views.