



NZCC MARKET STUDY INTO THE RETAIL FUEL SECTOR

RESPONSE BY REFINING NZ TO THE NEW ZEALAND COMMERCE COMMISSION'S PRELIMINARY ISSUES PAPER FOR THE RETAIL FUEL MARKET STUDY

21 February 2019

EXECUTIVE SUMMARY

1. The New Zealand Refining Company Limited (**Refining NZ**) welcomes the opportunity to comment on the Commerce Commission's Preliminary Issues Paper for the Retail Fuel Market Study (**Preliminary Issues Paper**).
2. Refining NZ owns and operates New Zealand's only oil refinery, located at Marsden Point. The company is listed on the New Zealand Stock Exchange. The three major oil companies (BP, Mobil and Z Energy, who are also the refinery's customers) collectively hold just under 43% of the shares in the company.
3. The refinery is a stand-alone toll manufacturer, processing crude oil imported by its customers into petroleum products for the domestic market, including petrol, diesel, aviation fuel, fuel oil and bitumen. It is not vertically integrated with downstream wholesale or retail operations.
4. This response is divided into two parts:
 - (a) **Part 1** provides background information about the history of Refinery NZ, and its operations; and
 - (b) **Part 2** sets out Refining NZ's responses to questions 17 to 21 in the Preliminary Issues Paper. These questions relate to the ownership and operation of the refinery including the refinery to Auckland pipeline (**RAP**) which is an integral part of the refinery infrastructure.
5. As we explain in this response:

Utilisation of the refinery

- (a) The Refinery is an integrated, high hazard, highly sophisticated and complex system. It produces volatile, flammable products which require high quality health and safety systems and procedures, and continuing investment to maintain integrity and safety and to meet evolving consumer needs.
- (b) Because of the small size of the New Zealand market, the economics of the refinery depend on it being fully utilised at all times. It has high fixed costs and as MBIE has noted, running the refinery with excess capacity is unlikely to be either efficient or profitable.¹
- (c) Full utilisation of the refinery benefits New Zealand because the refinery's operations reduce reliance on imported energy, provide supply reliability, resilience, flexibility and diversity, and deliver quality products.
- (d) Full utilisation is achieved through the processing agreements with the refinery's oil company customers, which include an obligation to take the full slate of products produced from crude oil, and a minimum processing fee payment obligation designed to support the refinery's ongoing viability when refining margins are weak and refined fuel imports are more attractive.
- (e) The refinery has three delivery points, namely ship and road tanker loading facilities at Marsden Point and the discharge point of the RAP at the Wiri Oil terminal. The efficient and sustainable operation of the refinery requires close co-ordination between the refinery's production planners and its customers, to ensure that refined product can move through the refinery delivery points as it is processed. This coordination is made more complex as operation of the refinery and the RAP is integrated, and the RAP, unlike a traditional gas pipeline, is a multi-product pipeline, not a single-product pipeline requiring very careful sequencing to ensure reliable supply to retail consumers.

¹ MBIE, Report Back on the Findings and Recommendations of the Fuel Market Financial Performance Study, November 2017, para 51.

- (f) If those delivery points are congested, refinery processing has to be delayed or stopped, and consumers will suffer as a result. The refinery's processing, storage, and delivery systems including the RAP are all part of a single, integrated system governed by the Processing Agreement and cannot be efficiently unbundled without jeopardising the reliable, competitive supply of refined fuels to end customers and the viability of the refinery.
- (g) The current processing arrangements have resulted in the refinery being fully utilised for many years. Any material changes to these negotiated agreements could have the unintended consequence of the refinery operating at less than full capacity, putting its ongoing viability at risk.
- (h) In any event where the refinery is not operating at capacity, Refining NZ welcomes new customers to fully load the refinery on the same terms as existing customers – including supplying crude oil, taking the full slate of refined products processed from the crude, and assuming an obligation to contribute to the fee floor.

Refining NZ investment

- (i) Refining NZ has demonstrated a strong willingness to invest in new processing and logistics infrastructure to meet the changing needs of the New Zealand market, thereby delivering significant benefits to retail consumers.
- (j) Since 2005 Refining NZ has invested around \$735 million on lifting capacity and capability, producing cleaner fuels, and reducing its carbon emissions. It has spent tens of millions of dollars increasing the capacity and resilience of supply via the RAP, enabling supply of greater quantities of jet fuel to Auckland, and executing a range of other projects.
- (k) Refining NZ is currently progressing projects that enable the refinery to increase its competitiveness with imported fuels, such as the project to deepen the entrance to the Whangarei Harbour, at an estimated cost of \$35-\$40 million.

Refining NZ's processing and pipeline fees

- (l) Refining NZ's processing fee is calculated using an import parity formula which takes account of international crude oil prices, Singapore refined product prices, crude oil and refined product shipping costs, and the US\$ to NZ\$ exchange rate. The fee is exposed to movements in all of these elements, and is therefore competitively set.
- (m) The processing fee has historically ranged between 4 and 6 NZ cents per litre, which represents a small proportion of retail petrol and diesel prices. Importantly, this same 'refining cost' is inherent in the purchase price of imported petrol and diesel.
- (n) Refining NZ's processing fees do not impact retail fuel prices in New Zealand. As is the case in Australia and many other countries that are reliant on imported fuel, retail petrol and diesel prices are based on an import parity price from an international refining centre (e.g. Singapore). This price reflects the actual cost of delivering imported fuel into New Zealand.
- (o) Historical assessment of retail margins since 1999 demonstrates that there is no relationship between refining margins and retail margins. This is unsurprising, as the refining charge is based on international prices, and is not influenced by changes in the domestic market.
- (p) The RAP is integral to the refinery's processing operations in the same way as the pipelines connecting to the vessel and road delivery points. The refinery charges a competitively set fee for use of the RAP, recognising the capital investment involved. The fee is calculated by reference to the cost of shipping product from Marsden Point to Auckland, and is in the order of 1 cent per litre.

Merchant refinery/tolling service models

- (q) Refining NZ is a stand-alone toll manufacturer; it is not vertically integrated with downstream wholesale or retail operations. It processes crude oil supplied to it by its customers, who also own the hydrocarbons throughout the supply chain from crude oil through to the refined products (petrol, diesel, aviation fuel, fuel oil, bitumen and sulphur) produced from their crude.
- (r) Unlike a merchant refiner, Refining NZ does not bear the costs of (or risks associated with) feedstock acquisition, ownership and delivery to the refinery, exchange rate fluctuations and sale and delivery of finished product.
- (s) The tolling model is best suited to service the small New Zealand market. It generates immense benefits to New Zealand in providing tankage/storage, reliability, flexibility, resilience, capacity and quality to the supply chain.
- (t) Industry experts Hale & Twomey have concluded that a merchant refiner model in the New Zealand market was unlikely to be sustainable over a business cycle, meaning that the refinery may not survive periods of low margins.² That would not only remove the refinery as a competitive supplier of products to the New Zealand market, relative to the alternative of importing finished product from international markets, but would also deprive New Zealand of a reliable and resilient source of refined products.

² Hale & Twomey, Independent Review of the Refining NZ Processing Agreement, September 2014, p38.

PART 1: BACKGROUND AND CONTEXT

1. History of Refining NZ

- 1.1 Until 1964, all finished fuel products were imported into New Zealand by the oil companies.
- 1.2 In 1956, the Government investigated the viability of a domestic refinery to reduce reliance on imports. Marsden Point was chosen because of its convenient deep-water harbour close to the main North Island markets, low earthquake risk and the availability of land adjacent to the harbour.
- 1.3 The New Zealand Refining Company was listed as a public company, with the oil companies holding close to one third of the issued shares. Construction began in 1962, and the refinery commenced operations on 30 May 1964.
- 1.4 The refinery operated as a toll manufacturer from its inception. It was recognised at the outset that a New Zealand refinery would be too small to process at lower cost than the large international refineries, and that the oil companies would not be prepared to pay more than import parity for fuel products processed in New Zealand. This challenge was addressed by agreement between the oil companies and the refinery – each oil company would purchase and import crude oil for processing, and pay a fee to the refinery for processing services. The processing charge would be based on import parity, and the oil companies would agree to take-or-pay obligations that collectively would cover the refinery's fixed operating costs, while incentivising them to use the refinery in preference to importing refined products.
- 1.5 In the mid-1980s the refinery was substantially expanded and upgraded to allow for increased production. Extra tanks, utility supplies and environmental treatment units were added along with a 170-kilometre RAP at a cost of NZ\$1.84 billion.
- 1.6 In 1988, the energy industry was deregulated with the introduction of the *Petroleum Sector Reform Act*. The refinery's oil company customers signed new processing agreements effective from 1 January 1995, with a revised fee structure which replaced the existing fixed/variable fee model with a model that "moves towards a fully market related fee."³ These agreements remain in force today.

2. Refining NZ's operations

- 2.1 Refining NZ operates 24 hours a day, seven days a week, 365 days a year. It processes a wide range of crude oil types to produce premium and regular petrol, diesel, jet fuel, fuel oil, roofing bitumen and sulphur. It employs around 400 staff and has a team of around 250 local contractors.
- 2.2 Crude oil is purchased by Refining NZ's three oil company customers (predominantly from the Middle East and South East Asia), and is shipped by them to the Marsden Point jetty.
- 2.3 The refinery has a crude oil processing capacity of 135,000 barrels a day. It produces around 58% of domestic petrol demand, 85% of jet fuel demand and 67% of diesel demand. The remainder of domestic demand is met by imports, primarily from South Korea and Singapore.
- 2.4 The refinery receives multiple, carefully-sequenced feedstock cargoes of different grades of crude oil from its three oil company customers which it processes to make the refined fuels required by those customers for their end users. These feedstock cargoes are selected to make the required fuels at the right time in a manner that coordinates and optimises the use of the refinery's processing units, storage facilities, utility systems and delivery systems.

³ Deloitte Touche Tomatsu, Letter to the Independent Directors, 14 November 1995.

- 2.5 Coordination and optimisation are required to ensure that:
- (a) The refinery is able to make the quantities and qualities of refined fuels needed to meet market demand across all of New Zealand ensuring availability;
 - (b) The refinery's customers are able to take delivery of the products at a time, and in a manner, that they can effectively and efficiently maintain supply to end customers across the country; and
 - (c) The economic viability and sustainability of the refinery is maintained in an environment of significant international competition, where Refining NZ's customers have compelling import alternatives.
- 2.6 As the refinery has limited storage capacity, finished products must be moved through the refinery delivery points as soon as they are processed. There are three delivery points:
- (a) the terminal end of the RAP, which transports petrol, diesel and jet fuel destined for Auckland and the Waikato to the Wiri oil terminal in South Auckland. The throughput is typically around 400,000L per hour. A service company, Wiri Oil Services Limited (**WOSL**), which is jointly owned by BP, Mobil and Z Energy, operates the Wiri terminal;
 - (b) a truck loading facility adjacent to the refinery that is jointly operated by BP, Mobil and Z Energy which is used for road delivery of petrol and diesel for Northland; and
 - (c) a ship loading jetty at Marsden Point Petrol, where diesel, jet fuel, fuel oil and bitumen for the rest of New Zealand is transferred to product tankers chartered by Coastal Oil Logistics Limited (**COLL**), which is jointly owned by BP, Mobil and Z Energy.
- 2.7 Access to the RAP is not separate from access to the refinery. The refinery's production schedule is dependent on RAP availability. Refining NZ will not commit product to the RAP unless it is certain the product can be receipted at the Wiri terminal. When there is no or limited capacity at Wiri, the refining process must be suspended or slowed down.
- 2.8 Use of the RAP is determined by the refinery's product output, with priority given to jet fuel, as there is no alternative means of supplying jet fuel to Auckland airport.
3. **The processing and RAP fees**
- 3.1 The processing fee is set at 70% of the Gross Refining Margin (**GRM**) which according to Deloitte in 1995, "essentially calculates the difference between landing all the refinery-produced products at New Zealand ports, based on Singapore quoted prices, and the landed crude prices at the refinery, also based on Singapore quoted prices."⁴ Landed crude prices are today calculated by reference to international prices, not only Singapore prices.
- 3.2 The RAP fee (in the order of 1c/litre) is also set by competitive benchmarking by reference to the cost of shipping product from Marsden Point to Auckland.

⁴Above

- 3.3 The rationale for setting the processing fee at 70% of the GRM was explained in an Appraisal Report prepared by Deloitte for the Refining NZ 1995 EGM which approved the new processing arrangements:⁵

"In order to assess the reasonableness of the allocation of the 70% of the GRM to NZRC and 30% to the User Companies, it is important to take into account the relative risks borne by the parties. Furthermore, the allocation should ensure that:

- *NZRC's share provides sufficient funds for new investment requirements when industry economics are favourable; and*
- *the User Companies' share provides sufficient incentive to optimise their use of NZRC's capacity.*

If all the risks were borne by NZRC, then it could be argued that NZRC's share of the GRM should be 100%. Clearly, NZRC does not bear all the risks. They are shared to some degree with the user Companies and accordingly they should be rewarded for bearing those risks.

The risks specifically borne by the User Companies include:

- *the risks and associated costs of maintaining crude purchasing and product sales teams;*
- *the finance and currency costs and risks associated with maintaining crude and product inventories;*
- *shipping and demurrage risks; and*
- *the guarantee of the minimum processing fee.*
- *Based on the above, we are of the opinion that the allocation of 70% of GRM and 30% to the User Companies is not unreasonable as it provides sufficient rewards to both parties relative to the risks they bear."*

- 3.4 Not only is the refining margin a very small component of retail prices (fluctuating between 4c and 6c per litre in accordance with movements in the components of the import parity formula, the evidence is clear that it has had no influence on retail margins over the past two decades.
- 3.5 The figures below clearly show that since the current pricing model has been in place (1995), retail margins experienced a long period of decline (to around 2008), followed by a period of rising margins. The processing fee (based on the GRM) has demonstrated quite different movements.
- 3.6 Figure 1 shows the MBIE petrol and diesel importer margin for the period from 1986 to 2016.
- 3.7 Figure 2 illustrates the annual processing fee charged by Refining NZ to its customers for refining services between 1999 and 2017. For consistency with Figure 1, the processing fee is expressed in NZ cents per litre of product produced at the refinery, with the same vertical scale as Figure 1.

⁵ Deloitte Touche Tomatsu, Independent appraisal report of the processing arrangements of NZRC, 14 November 1995, [10.5] to [10.8].

Figure 1: MBIE - Long terms retail margin trend (NZ cents per litre) (1989 -2016)

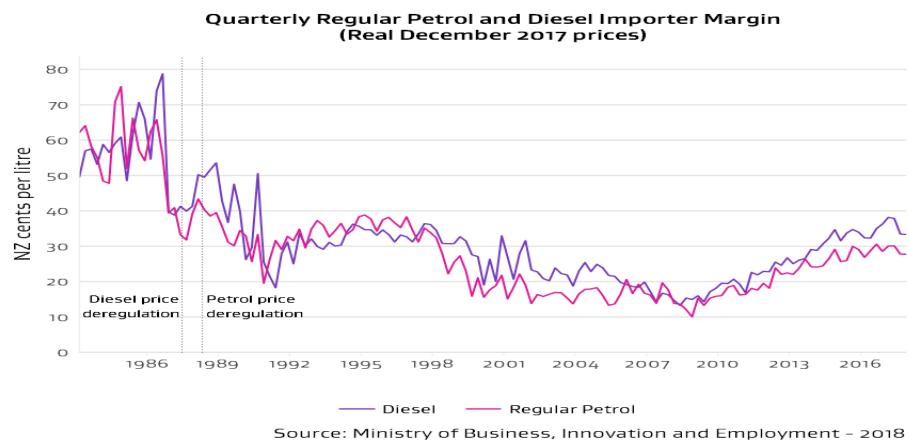
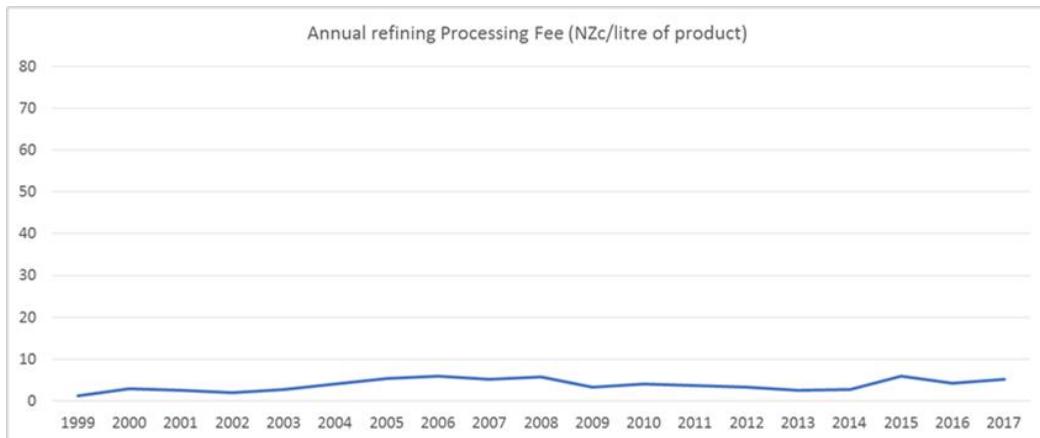


Figure 2: Chart showing movement in the refinery processing fee (NZ cents per litre) (1999 – 2017)



4. Refining NZ investment

- 4.1 Refining NZ has demonstrated a strong willingness to invest in the necessary processing and logistics infrastructure to meet the changing needs of the New Zealand market, thereby delivering significant benefits to retail consumers.
- 4.2 Since 2005 Refining NZ has invested around \$735 million on lifting capacity and capability, producing cleaner fuels, and reducing its carbon emissions. Refining NZ has built facilities to produce cleaner fuels (\$180 million in 2005), increased the refinery's crude oil distillation capacity (\$190 million in 2009) and increased petrol production by around 2 million barrels per year (\$365 million in 2015).
- 4.3 In making these investments, Refining NZ has reduced carbon intensity by 20%, removed 24,000 tonnes/year of sulphur from its products, reduced sulphur dioxide emissions by 17% and removed benzene from petrol.
- 4.4 In addition, Refining NZ has spent tens of millions of dollars increasing the capacity and resilience of supply via the RAP, enabling supply of greater quantities of jet fuel to Auckland, and executing a range of other beneficial projects. Refining NZ is currently progressing projects that enable the refinery to stay in business (\$20 million sulphur solidification facility) and grow the refining margin. It has received consent to deepen the entrance to the Whangarei Harbour at an estimated cost of \$35-\$40 million in order to improve the refinery's competitiveness with imported fuels.
- 4.5 Refining NZ is a significant contributor to the New Zealand economy and is strongly committed to the Northland community.

5. Comparison of toll refiner and merchant refiner models

- 5.1 As described above, Refining NZ has operated as a toll refiner since its inception. As we explain below, toll refiner and merchant refiner models have different risks and rewards for each party to the arrangement.

Toll refiner

- 5.2 A toll refiner processes crude oil owned and supplied to it by its customers, who also own the refined products (petrol, diesel, aviation fuel, fuel oil and bitumen) produced from their crude.
- 5.3 All responsibilities for feedstock acquisition and ownership, delivery to the refinery, and sale of finished product lie with the refinery's customers. The refiner does not at any stage own the feedstock, or assume any related risk position.
- 5.4 While the overall supply chain risk of a toll refiner is low, it is effectively a "price taker" and therefore has limited access to the wider value streams that are available from the supply chain.⁶

Merchant refiner

- 5.5 In contrast, a merchant refiner purchases and refines its own crude oil, and sells the resulting refined products on the market at refined product prices (which would need to be competitive with imported alternatives). All responsibilities for feedstock acquisition, ownership, and finished product sale and delivery, lie with the merchant refinery.
- 5.6 The refinery therefore bears all the costs, and takes all the commercial risk, of buying crude oil, transporting it to the refinery, processing the crude, selling finished product, and delivering it to the buyer.⁷

⁶ Refining NZ, Board Review Risk Appetite for Supply Chain Control Merchant Refiner, October 2012, p2.

⁷ Hale and Twomey, Independent Review of the Refining NZ Processing Agreement, September 2014, p35.

- 5.7 As customers are not typically obliged to purchase product from the refinery, there is a significant risk that, in periods where the price differential internationally between crude oil and refined products is low, the refinery would not be fully utilised.

PART 2: RESPONSES TO QUESTIONS 17 – 21

6. Tolling/merchant refinery models

Q17	Does the operation of the refinery as a tolling service (as opposed to a merchant refinery) adversely impact competition in the retail fuel markets?
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- 6.1 We have explained the difference between the toll manufacturing and merchant refinery models in section 5 of this response. Refining NZ has always operated as a toll refiner. We believe this model is best suited to service the small New Zealand market. It provides resilience and reliability of supply, minimises the likelihood of product shortages, and therefore, compared with the merchant refinery model, has a positive impact on competition in downstream retail fuel markets.
- 6.2 Refining NZ has considered whether the risk profile and value generated by a merchant refiner model would be more appropriate for New Zealand than a tolling service, and concluded that the risks outweigh the benefits.⁸
- 6.3 The key factors necessary for a successful merchant refinery model are:

Size	<ul style="list-style-type: none"> ▪ Capture economies of scale via lower unitary operating costs ▪ Scale of purchasing power ▪ Leverage of financial scale for the benefit of less advantaged customer base
Complexity	<ul style="list-style-type: none"> ▪ Maximise benefits via lower cost feedstock or ability to upgrade low value products
Location	<ul style="list-style-type: none"> ▪ Access to low cost feedstock or proximity to markets which offer price premia to absorb production
Integration	<ul style="list-style-type: none"> ▪ Captive power supply or added value specialty products ▪ Minimise uncontrolled costs / potential sub optimal elements in the supply chain through ownership or controlling interest (pipelines, shipping, selected terminals)
Customer	<ul style="list-style-type: none"> ▪ Ability to add value in areas where customers have specific unmet needs or structural inefficiencies they are unable to solve on their own
Trading	<ul style="list-style-type: none"> ▪ Access to strong trading teams or resources to maximise margins, implement risk/hedging programs and provide attractive financing sources ▪ Access to required feedstock for delivering optimised refinery operations

- 6.4 Refining NZ's analysis shows that these factors are not present in the New Zealand market, and that the merchant refiner model is therefore not sustainable. In addition, the inherent risks of a merchant refiner model means it is unlikely that investors would be willing to provide the level of equity injection required to fund the move to that model.

⁸ Refining NZ, Board Review: Risk Appetite for Supply Chain Control Merchant Refiner, October 2012.

- 6.5 In addition, a negative customer reaction could lead to increased imports, reduction in demand for domestic processing, and the ultimate closure of the refinery.
- 6.6 Industry experts Hale & Twomey concluded that a merchant refiner model in the New Zealand market was unlikely to be sustainable over a business cycle, meaning that the refinery may not survive periods of low margins.⁹ That would remove the refinery as a competitive supplier of products to the New Zealand market, relative to the alternative of importing finished product from international markets.¹⁰
- 6.7 In contrast, the tolling model, which has been in place since the refinery commenced operation in 1964, has resulted in consistent and reliable domestic supply for more than 50 years.
- 6.8 Whether a refinery is operated as a tolling or merchant refinery:
 - (a) does not impact the price a wholesale market participant is charged for processing services; and
 - (b) does not have any impact on market entry (that is a terminal investment decision).
- 6.9 As imports are an alternative to domestic processing, the pricing structure would be similar whether the refinery was a tolling refinery or a merchant refinery; both would need to be competitive against an IPP price benchmark. Consequently, the refinery operational model has no impact on the price the refinery could charge a wholesale market participant for processing services.

⁹ Hale & Twomey, Independent Review of the Refining NZ Processing Agreement, September 2014, p35.

¹⁰ Ibid.

7. Refinery ownership, management and supply/access arrangements

Q18	Are there any features of the ownership, management, or supply/access arrangements relating to the refinery which may impact competition in the retail fuel markets?
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- 7.1 We comment on each of the aspects raised in this question (i.e. ownership, management and supply/access arrangements) separately.

Ownership

- 7.2 There are no features of the refinery ownership that have any meaningful impact on competition in the retail fuel markets.
- 7.3 Refining NZ is a publicly listed company. At the end of the last financial year, the three oil company customers had a combined shareholding of 42.7%; various institutions and individuals hold the balance of the shares.
- 7.4 The Board is responsible for setting Refining NZ's strategic direction and for providing oversight of the management of the company. The Board comprises eight members, five of whom are independent directors, and three of whom are appointed by the oil company shareholders.
- 7.5 An Independent Directors' sub-committee that does not include any oil company directors deals with matters that are customer commercially and strategically sensitive. These include issues concerning individual oil company customers (including processing arrangement and fee issues), strategic developments and projects to improve the company's performance (including return to shareholders), and investment/divestment opportunities.
- 7.6 We also note that in 2017, MBIE acknowledged there was no evidence to suggest that ownership arrangements of the refinery could affect how the oil companies price in downstream markets.¹¹

Management

- 7.7 Refining NZ's board appoints the CEO, and approves appointment of the senior management team, which is responsible for the operation of the refinery in the interests of all the company's shareholders, and in accordance with the refinery's contractual obligations. These include an obligation to operate the refinery efficiently in accordance with good international refinery practice.
- 7.8 Refining NZ has an independent management team and while, as would be expected in a highly specialised industry, some have previous work experience with international energy companies, they are all Refining NZ employees with no link to their previous companies.
- 7.9 The management team discusses operational aspects of the refinery and compliance with the processing agreements on a bi-lateral basis with its customers. Similarly, management negotiates commercial/pricing issues bi-laterally with each customer, with the overall objective of maintaining an efficient and sustainable refining operation.
- 7.10 This independent management of the operational and commercial aspects of the refinery means that refinery management has no ability to influence competition in downstream retail markets.

Supply arrangements

- 7.11 Refining NZ has a processing agreement with each of its oil company customers. These agreements took effect from 1 January 1995. The refinery currently has three customers, as a consequence of the acquisition by Z of Shell in 2010 and Caltex in 2016.

¹¹ MBIE, Report Back on the findings and recommendations of the Fuel Market Financial Performance Study, November 2017, para 55.

- 7.12 The processing agreements set out the entitlements of each customer to deliver their crude oil to Refining NZ, and Refining NZ's obligations to process the crude oil into an agreed set of refined products.
- 7.13 The processing fee is calculated using an import parity formula which is a function of international crude oil prices, Singapore refined product prices, crude oil and refined product shipping costs, and the US\$ to NZ\$ exchange rate. The fee is therefore exposed to movements in all of these elements. The pipeline fee is benchmarked against the cost of alternative distribution. As a consequence, both charges are competitively set.
- 7.14 The processing arrangements have been subject to regular independent reviews in the past 20 years including reviews by Deloitte (1995, 1998), Purvin & Gertz (2009, 2012), and Hale & Twomey (2015, 2017). Hale & Twomey in 2014 concluded that, "the current processing fee structure and split of gross refining margin provides an appropriate balance between Refining NZ's return and customer competitiveness."¹²
- 7.15 Under the current supply arrangements, Refining NZ operates efficiently and delivers a set of products agreed with its customers at competitive prices. Its supply arrangements do not have an adverse impact on competition in the retail fuel markets.

Access arrangements

- 7.16 As the Commission has noted in its Preliminary Issues Paper, the refinery produces around 58% of petrol and 67% of diesel consumed in New Zealand. The shortfall is made up of imports of refined fuels. As a consequence, the refinery (including the RAP) typically operates at capacity.
- 7.17 Under the processing agreements, refinery capacity is allocated between the customers based on their retail market share by product over the previous three years. If the capacity allocated to any particular customer is not fully taken up, the unused capacity must first be offered to the remaining customers, and after that to third parties on the same terms.
- 7.18 The refinery has three product delivery points being vessel and tanker facilities at Marsden Point and the exit point of the RAP at the Wiri Oil terminal in South Auckland.
- 7.19 The RAP is the most efficient and safest means of delivering fuels from the refinery into Auckland to meet the transport fuel needs of Auckland and the immediate region south of Auckland. The co-ordinated use of the RAP optimises its use and ensures that Auckland's fuel needs are always met.
- 7.20 As explained at paragraphs 2.4 – 2.7, access to the RAP is not separate from access to the refinery. The refinery's production schedule is dependent on RAP availability. The refinery's product output determines use of the RAP, with priority given to jet fuel, given the criticality of supplying jet fuel to Auckland airport.
- 7.21 The fee for using the RAP is in the order of 1c/litre, and is benchmarked on the cost of shipping refined product from Marsden Point to Auckland.
- 7.22 Refining NZ has over the last three years invested in projects to increase pipeline capacity by around 10%, and has further upgrade projects under consideration.
- 7.23 Refining NZ's customers began importing jet fuel into Marsden Point in 2017 as the refinery did not have the capacity to manufacture sufficient jet fuel to meet the increased demand from its core processing facilities. Refining NZ agreed to accept imported jet fuel for transfer over the RAP to the Wiri terminal, conditional on:
 - (a) the refinery processing capacity being fully utilised;
 - (b) the RAP having unutilised capacity;

¹² Hale and Twomey, Independent Review of the Refining NZ Processing Agreement, September 2014, pi.

- (c) customers meeting refining NZ's planning, logistics and specification requirements, and
- (d) payment of the required terminal and RAP fees.

7.24 Management's primary objective however is to ensure that the refinery (including the RAP) operates on a "fully loaded" basis i.e., as close to capacity as can prudently be achieved. As MBIE has noted, running the refinery with excess capacity is unlikely to be either efficient or profitable, making it an unsuitable counterfactual.¹³

¹³ MBIE Report Back on the findings and recommendations of the Fuel Market Financial Performance Study, November 2017, para 51.

8. Ability and incentive for third parties to use the refinery

Q19	Are these features restricting the ability and incentive for firms other than the major fuel firms to use the refinery?
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- 8.1 If the refinery had unutilised capacity, Refining NZ would welcome additional customers to use its toll manufacturing operations, on the same terms as its existing customers. This would involve supplying crude oil to be refined into a full product slate, and contributing to the Fee Floor obligation. The floor is an element of the processing fee structure that sets a lower limit for the processing fee payable to Refining NZ even if the processing fee calculation results in a lesser amount than the floor.
- 8.2 The three major features that impact the ability of a new customer to use the refinery are:
 - (a) a lack of unutilised refining capacity;
 - (b) the requirement that, because Refining NZ is a toll manufacturer, the customer must take all the products that are derived from refining its crude oil, (including fuel oil and sulphur) and not only those products most valuable to the customer; and
 - (c) the cost of shipping and holding crude oil for a small customer processing over an extended period of time would be uneconomic.
- 8.3 In 1997, Refining NZ worked constructively with then Fletcher Energy Limited after they had established the Challenge! business in New Zealand to assess the viability of becoming an additional refinery customer. Fletchers decided not to pursue the opportunity on the basis that it was not attractive to take the full slate of products from the refining operation.

9. COLL, the RAP and the Wiri terminal

Q20	Are there any features of the ownership, management, or supply/access arrangements relating to COLL, the RAP, and/or the Wiri terminal which may impact competition in the retail fuel markets?
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The RAP

- 9.1 The RAP is an integral part of the refinery operations and not a separate piece of infrastructure. This is discussed in our response to Questions 18 and 19.

COLL

- 9.2 New Zealand is geographically sizable but has a very low population density. This makes it costly to service small demand centres with fuel, as the demand at each coastal port is insufficient to warrant the investment in adequate tankage to allow a product import tanker to discharge a full cargo into a single coastal port. Product tankers are therefore required to make multiple port calls, which increases distribution costs.
- 9.3 This distribution cost is minimised in New Zealand by virtue of a joint venture (COLL) between the three major oil companies. COLL charters two coastal vessels with the primary objective of distributing fuels manufactured at the refinery to coastal ports around New Zealand. The investment, costs and risks of coastal distribution are therefore shared by the JV partners.
- 9.4 COLL provides oversight and co-ordination of transport fuels inventories at each of the New Zealand transport fuels terminals. From the refinery's perspective, the single co-ordinated planning and scheduling of two dedicated coastal vessels servicing the New Zealand coastal terminals allows for optimal, and least cost, distribution.
- 9.5 COLL consults closely with refinery planners (daily scheduled meetings) to ensure optimal co-ordination between fuels manufacturing and ship liftings. This provides flexibility in cargo optimisation, allowing the oil companies to respond to the latest market demands. For example, if Timaru's petrol demand is lower and diesel demand higher than anticipated, the cargo that is loaded at Marsden Point may be changed at short notice to accommodate this latest market demand information.
- 9.6 The reverse is also true - the close consultation between COLL and Refining NZ allows COLL to respond to Refining NZ's product stocks situation. If, for example, inventories of petrol at the refinery are forecast to rise, the coastal shipping schedule may be altered to deliver more petrol to the ports where there is storage capacity, even when it is not immediately required there. This avoids unnecessary slowdown of refinery production and disruption in the supply of other refined products.

- 9.7 The sharing of vessels and coastal shipping infrastructure (and the oil companies' sharing of their terminal facilities in regional ports) reduces the overall distribution cost to the end consumer. Distribution costs would be significantly greater if a single entity did not operate vessels and port infrastructure.

Wiri terminal

- 9.8 The RAP terminates at the Wiri terminal, which is operated by a service company, WOSL. Fuels transmitted through the RAP are separated into tanks at Wiri and re-tested, and then distributed to facilities such as jet loading tanks at Auckland Airport and service stations. The Wiri terminal provides buffer storage capacity for refined products to service the Auckland region in the event of a slowdown or breakdown in upstream processing and/or distribution systems, e.g. the 2017 RAP rupture.
- 9.9 WOSL is owned by BP (27.78%), Mobil (27.78%) and Z Energy (44.45%) (**JV Partners**). They own the land upon which the Wiri terminal is sited. Refining NZ owns the terminal facilities, having constructed most of the original facilities. The JV Partners lease the land to Refining NZ, which sub-leases the land, and leases the terminal facilities to WOSL.

- 9.10 The original head lease of the land between the JV Partners and Refining NZ, and the sub-lease of the land and lease of the terminal facilities between Refining NZ and WOSL, were entered into in 1983. These arrangements were reviewed in the 1995-1998 period, resulting in a new head lease and sub-lease dated November 1998, both of which were renewed in 2012. The head lease and sublease expire in February 2022.
- 9.11 Rent payment for the facilities will end upon the expiry of the leases, and ownership of the terminal facilities will pass to the oil companies. The leases provide that neither Refining NZ nor WOSL are entitled to remove the terminal, and neither is obliged to reinstate the land upon the expiry of the leases.
- 9.12 A Wiri Terminal Agreement (**Agreement**) dated 30 August 1990 between Refining NZ, WOSL and the JV Partners provides for the transmission of product through the RAP to the terminal, product quality and specification, and reception of refined product into tanks at the terminal. The Agreement also defines the respective responsibilities of Refining NZ and WOSL for the testing and quality of the product transmitted to Wiri.
- 9.13 The Agreement provides that it will remain in effect until the expiry of the head lease, unless terminated earlier and, upon such expiry or termination, "*a new agreement concerning the operation of the Terminal between [Refining NZ], the Oil Companies and WOSL will be entered into.*"

10. **Advantages and disadvantages of RAP and COLL arrangements**

Q21	What are the advantages and disadvantages of the current arrangements that govern COLL and the RAP for competition in the retail market?
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RAP

10.1 The RAP is an integral part of the refinery. See our response to question 19 above.

COLL

10.2 Refer to paragraphs 7.2 -7.7 above.

END