

## NZCC MARKET STUDY INTO THE RETAIL FUEL SECTOR

### RESPONSE BY REFINING NZ TO THE NEW ZEALAND COMMERCE COMMISSION'S RETAIL FUEL MARKET STUDY DRAFT REPORT

13 September 2019

#### 1. Introduction

- 1.1 Refining NZ welcomes the Commission's Retail Fuel Market Study Draft Report<sup>1</sup> and appreciates the opportunity to comment on the draft findings.
- 1.2 As Refining NZ is not a participant in the wholesale market, our response is limited in scope to issues that are relevant to the refinery's operations.
- 1.3 We acknowledge that the Commission has accurately reflected Refining NZ's role in the New Zealand fuel supply chain, and in particular the need to utilise the refinery fully for it to remain a viable and cost effective supply route. As noted in our submission on the Commission's Preliminary Issues Paper, "*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*".<sup>2</sup>
- 1.4 Refining NZ's oil refinery at Marsden Point supplies approximately 40% of New Zealand's total energy needs (electricity, gas, coal and transport fuels) and 70% of transport fuel needs (i.e. petrol, diesel and jet fuel). The remaining 30% is imported by the oil companies from refiners (our competitors) in Korea, Singapore and Japan.
- 1.5 The refinery employs 400 staff, with an average of 250 contractors also employed on a long-term basis. In total, an estimated 1,100 Northland jobs are dependent on the refinery, with the refinery contributing around 7 percent of Northland's GDP. Another 2,400 jobs in specialist services across the country are also dependent on work provided at Marsden Point.
- 1.6 Our overall concern is that any actions arising from the Commission's market study do not have the unintended effect of refinery under-utilisation. Refinery under-utilisation would increase the potential prospect of:
- (a) refinery closure; and
  - (b) a shift to 100% imported product, as has been the case with some major Australian locations (e.g. Sydney). Refinery closure would have a damaging impact, both locally and nationally, on economic prosperity and security of transport fuels supply.
- 1.7 We urge the Commission to take a forward-looking approach in its final report. The draft report is silent on the challenges facing the refined fuels industry, such as the current plateauing of gasoline demand and its predicted decline due to:
- (a) improving engine fuel efficiency;

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<sup>1</sup> NZCC, Market Study into the retail fuel sector, Draft Report, 20 August 2019 (**Draft Report**)

<sup>2</sup> Response by Refining NZ to the New Zealand Commerce Commission's preliminary Issues paper for the retail fuel market study, 21 February 2019 [5(c)]

- (b) electrification of transportation;<sup>3</sup>
- (c) transition to non-fossil fuels;<sup>4</sup> and
- (d) climate change related political<sup>5</sup> and public<sup>6</sup> pressure.

1.8 These challenges create considerable uncertainty about the future of the industry, with a consequentially detrimental impact on the viability of the business case for future infrastructure investment. Our concern is that actions arising from this study might have the unintended effect of increasing the level of uncertainty and volatility, and thereby deterring the very infrastructure investments needed for a healthy and competitive retail fuels market.

## 2. Imported Refined Fuel Prices

2.1 We would like to understand the basis for the Commerce Commission's conclusion in the Draft Report that "*domestic refined fuel has been cheaper than imported refined fuel since January 2013, except on one occasion*".<sup>7</sup> While we agree refinery supply must be more competitive (cheaper) on average for the refinery to be utilised, we note that the comprehensive analysis of the refinery's competitiveness by Hale & Twomey<sup>8</sup> shows Refining NZ supply has been uncompetitive for much longer periods (the whole of 2013 and 2014 on average for example).

2.2 The comparative analysis needs to recognise that:

- (a) companies processing through the refinery need to hold more stock in total than is required when direct importing; and
- (b) while the Commerce Commission correctly notes the majors' coordinated coastal distribution model is efficient, these costs remain substantially higher than equivalent freight (cost per distance moved) incurred by direct importers.

2.3 The Draft Report from paragraph 4.51 discusses the significant economies of scale associated with bulk shipping. While paragraph 4.52 notes that the standard size of petrol and diesel cargoes in Asia is approximately 30,000MT, this is now out of date, and therefore understates the economies of scale for bulk shipping. Product tankers coming to New Zealand are now typically between 36,000 and 40,000 tonnes. These larger import cargo volumes reduce the cost per litre of imports, and therefore add to the competitive pressure on the Refining NZ supply route.

## 3. Improving wholesale competition

3.1 While Refining NZ is not a participant in the wholesale market, its Marsden Point facilities support the current shared storage system by providing significant storage capacity and flexibility. Refining NZ has approximately one third of New Zealand's intermediate and final petrol, jet fuel and diesel product storage capacity. This capacity is essential for coastal shipping operations to function effectively and efficiently, and for oil companies to manage port stocks and the timing of their import cargoes.

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<sup>3</sup> According to the Productivity Commission, by 2030 80% of NZ vehicle imports need to be electric, and by 2050 nearly every vehicle will need to be electric; *Climate Change: What New Zealanders have to change and when*, Newshub, <https://www.newshub.co.nz/home/shows/2019/06/climate-change-what-new-zealanders-have-to-change-and-when.html>

<sup>4</sup> New Zealand has set three greenhouse emissions reductions targets – to reduce emissions to 5% below 1990 levels by 2020, 30% below 2005 levels by 2030, and 50% below 1990 levels by 2050, Ministry for the Environment, *About New Zealand's emissions reduction targets*, <https://www.mfe.govt.nz/climate-change>

<sup>5</sup> The Climate Change Response (Zero Carbon) Amendment Bill 2019 is currently under consideration by the Environment Select Committee. Among other things, the Bill will establish a Climate Change Commission as an independent Crown entity with advisory and monitoring functions to monitor and review the Government's progress towards its emission-reduction and climate-resilience goals

<sup>6</sup> Refining NZ advised the market on 5 September 2019 that it was one of seven defendants in climate change civil proceedings issued in the High Court at Auckland

<sup>7</sup> Draft Report [2.118]

<sup>8</sup> Hale & Twomey, "*Independent Review of the Refining NZ Process Agreement*" April 2017 This report is referred to by the Commerce Commission in Attachment B (B35 pg. 255) of the Draft Report

- 3.2 Refining NZ is exposed to import competition, with its customers only using its refining service to the extent that this provides competitive supply across the range of supply locations (i.e., Marsden Point Truck Loading Facility, Wiri Terminal and Refining NZ's jetty for distribution to coastal ports).
- 3.3 Refining NZ operates in an internationally competitive environment. We are under constant pressure to compete with direct imports from much larger international refineries, and expect this competition to continue. Given the refinery's very high fixed costs, structural under-utilisation of the refinery would be economically unsustainable for the company.
- 3.4 Refining NZ is keen to understand how any proposed changes to open up the shared storage system might work in relation to the refinery's role in supporting the system. The existing limitations in port storage capacity identified by the Commerce Commission are arguably only manageable because of the supply security provided by Refining NZ's facilities, which gives its customers flexibility to respond to market conditions.
- 3.5 The New Zealand supply chain needs to be able to withstand disruptions from natural disasters and other unforeseen extreme events. New Zealand has an obligation as a member of the International Energy Agency (IEA) to contribute to global oil security by holding 90 days of net imports of oil stock. This obligation is met by a combination of oil stock held in New Zealand terminals, tankers bound for New Zealand, and option contracts with oil companies/traders in other IEA countries to purchase specified quantities of stock at market prices in the event of an IEA-declared oil supply emergency. Refinery stock holdings account for 60% of domestic stock-holdings of crude oil and refined fuels stocks (excluding crude and condensate stored at domestic production facilities).
- 3.6 Any proposed changes to the shared storage system should ensure the existing competition between supply from Refining NZ and imported product remains robust. The distribution efficiency from the refinery to the ports must be maintained to achieve the strategic national imperative that all ports are supplied.
- 3.7 Refining NZ agrees that any change to the shared storage system must incentivise investment in tankage. As noted at paragraphs 1.6 to 1.8, changes that increase the level of market uncertainty and volatility will deter, rather than incentivise, infrastructure investment.
- 3.8 Refining NZ believes that the introduction of more transparent wholesale pricing across New Zealand could create opportunities to optimise the fuel supply chain, and we are committed to evaluating how we might be able to contribute to this outcome. We are ideally placed to act as an independent stand-alone structurally-separated infrastructure service provider if the market were to evolve in that direction.

#### 4. Processing Agreement issues

- 4.1 The Commission considers that *"the potential to facilitate coordination could be reduced by restricting each refinery customer representation to reviewing its own data"*.<sup>9</sup>
- 4.2 Refining NZ agrees that some of its and the Technical Committee's processes could be modified to reduce the current level of information sharing so that each refinery user would only be able to review its own and aggregated data, which is necessary as part of the planning process. This would be similar to the Commission's proposed options for restricting information sharing within the shared storage system, taken from the Hale & Twomey 2017 Report on the shared storage system.
- 4.3 The Commission also considers that a shorter timeframe for the allocation of refinery capacity *"would potentially improve the ability and incentive for the majors to compete"*.<sup>10</sup> Refining NZ supports using a shorter timeframe for the allocation of refinery capacity, and agrees this is unlikely to have any material costs.
- 4.4 Refining NZ has already initiated bilateral discussions with each of its refinery users (i.e. the "majors") on changing the agreements with them to accommodate this. Our view is that the refinery users are likely to be supportive of such a change.

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<sup>9</sup> Draft Report [8.54.1]

<sup>10</sup> Draft Report [8.54.3]

5. **Options for improving the quality of available information**

- 5.1 Refining NZ is happy to work with the Commission on an acceptable disclosure regime to improve the level and quality of data available.
- 5.2 As the focus of the Draft Report is the wholesale market, the information that Refining NZ can contribute may be limited; we are not a wholesale market participant nor, as a toll service provider, do we have any ownership in the refined fuels.

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