

Minimum Stockholding Obligation (MSO)

Public Consultation – Explanatory Note

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Introduction

The minimum stockholding obligation (MSO) is established by the *Fuel Security Act 2021* (the Act), which commenced on 30 June 2021. This overview has been developed to provide a summary of the key detail contained within the Exposure Draft of the Fuel Security (Minimum Stockholding Obligation) Rules 2022.

Information on the Act and the Australian Government's Fuel Security Package can be found at <https://www.energy.gov.au/government-priorities/energy-security/australias-fuel-security-package>.

The Department is seeking to achieve a fit-for-purpose national framework that supports Australia's fuel security. Implementing an MSO for fuel stocks, along with securing Australia's refining capability through the Fuel Security Service Payment scheme, will protect fuel consumers and the Australian economy through ensuring ongoing fuel availability in the event of supply disruptions. Government, industry and consumers will all benefit from greater certainty of stocks held across Australia at any point in time.

The Department has engaged with the fuel industry on the MSO policy and design in recent months, as part of an ongoing engagement process.

About the MSO

The primary objectives of implementing the MSO in Australia are to:

- a) Provide certainty to fuel consumers and governments of the minimum stocks of key transport fuels (diesel, petrol and jet fuel) ensuring availability to Australians.
- b) Improve our baseline supply chain resilience for these fuels, and significantly increase diesel stocks by 40% from a pre-COVID-19 business-as-usual baseline.
- c) Allow market participants to manage the required stock levels within their own supply chains without the Australian Government becoming a fuel market participant. Industry is best placed to manage fuel stocks, while the Government maintains certain powers to control mandated stocks in times of emergency through legislative mechanisms under the Act and the *Liquid Fuels Emergency Act 1984*.
- d) Contribute to Australia meeting its oil stockholding obligations as a member of the International Energy Agency (IEA).

Overview of the MSO Rules

A national level obligation will be established for corporate importing and refining entities that operate in Australia in relation to gasoline (petrol), kerosene (jet fuel) and diesel transport fuels. If captured by the scheme, these entities will then be required to hold a minimum quantity of these fuels nationally. The Minister will set a national consumption cover day target, and each regulated entity will have a specific obligation determined by reference to the national target and their own historical operations.

Application of the MSO

Minister sets quantity

The Minister will set the consumption cover day (CCD) quantity via notifiable instrument. The indicative target days for each fuel type are:

- 24 CCDs of petrol
- 24 CCDs of jet fuel
- 20 CCDs of diesel

This baseline aligns with the average consumption cover stockholdings in Australia during the 2018 and 2019 calendar years (24 month average), based on data reported through the *Petroleum and Other Fuels Reporting Act 2017*. There will also be a 40% increase in the diesel CCD target from 1 July 2024, as well as an increase to reflect stock being held on water. Other increases to CCDs may also be required subject to this consultation process and final policy settings.

NB: CCDs cannot be compared to IEA days used to measure the 90-day stockholding obligation as set by the International Energy Agency.

The MSO is triggered

Importing and refining entities will be regulated by the scheme if they fulfil certain requirements:

- They import or refine petrol, jet fuel and/or diesel.
- In any calendar year (the 'trigger assessment period') they import or refine volumes above the set thresholds for any (or all) of the three MSO fuel types:
 - o 300 megalitres (ML) of petrol
 - o 400 ML of jet fuel
 - o 350 ML of diesel

Import figures will be based off the total imports for each entity during the 2019 or 2021 calendar years, as declared through the Nature 10 (N10) and Nature 30 (N30) customs declarations to the Australian Border Force. Subsequent years will use data provided through the amendment of the *Petroleum and Other Fuels Reporting Rules*, which have also been released for public consultation.

Production figures will be based off the total production values provided by the refiners to the Department through the *Petroleum and Other Fuels Reporting Rules* through their normal monthly reporting processes.

In the first year of operation, the Secretary of the Department will advise each entity that they have triggered the obligation, and notify them of their expected MSO designated quantity for each fuel type, based on their 2021 data, using the formula below.

Designated quantity formula

To determine an entity's MSO for each fuel type, the following formula will be used:

$$\frac{\text{TOTAL ENTITY ANNUAL IMPORTS OR PRODUCTION}}{\text{PETROL OR JET FUEL OR DIESEL}} \div 365 \text{ (days)} \times \frac{24 \text{ (CCD)}}{\text{PETROL}} \text{ OR } \frac{24 \text{ (CCD)}}{\text{JET FUEL}} \text{ OR } \frac{20^* \text{ (CCD)}}{\text{DIESEL}} = \text{Your MSO FOR THAT FUEL TYPE}$$

Worked example:

Entity A imports 500ML of petrol in 2021.

$500 \text{ ML} \div 365 \times 24 \text{ CCD} = \mathbf{33\text{ML for petrol}}$ (rounded to the nearest ML).

Therefore Entity A has an MSO of 33ML for petrol. This is the minimum volume of stock that Entity A is required to hold on each 'obligation day' – the day they are required to confirm their stockholdings (see below).

The Secretary is required to provide each regulated entity with at least 3 months' notice before the obligation period begins, allowing time to amend business processes as required to meet the MSO.

Stockholding

Once an entity has become regulated under the scheme, and their MSO for each relevant fuel type has been set, each entity will need to report their stockholding levels for each obligation day, ensuring they are above their MSO for each fuel type.

To achieve a balance between the MSO policy intent and the impacts on industry, the preliminary position is to establish a fortnightly obligation day for the first two years, before moving to a weekly obligation from 1 July 2024.

The Department has allowed a range of circumstances where petrol, jet fuel and diesel products can be counted toward an entity's MSO including:

- Pipeline stocks
- Stocks on a vessel within Australia's exclusive economic zone
- Intermediary market stocks: stocks where a legally enforceable arrangement is in place to allow the entity to count it towards their MSO (eg. reserved/quarantined stock, or in a situation where the entity is entitled to take ownership of the stock but it is not yet in their possession).
- Refiners can also include crude and unfinished product if it is located at the refinery, as it can be converted into refined product at location.

Intermediary Market

To support the implementation of the MSO, the Act establishes a mechanism for stocks which are outside of an entity's direct control to be able to be counted toward their MSO.

The concept recognises an entities stockholding may (from time-to-time) be below their required MSO, and the need for a flexible industry-led option to resolve non-compliance in these instances. This would also allow entities who hold stocks above their required amounts to assist other entities to meet their MSO and support the national requirement through commercial arrangements.

Flexibility in meeting the MSO through third party arrangements will provide opportunity for companies to minimise compliance costs, capture economies of scale and or adjust the size and location of their fuel stocks.

Through the Rules, the Government will enable the intermediary market, but it is not the intended for the Government to become a market player or for the market to be heavily regulated. It is the Department's preliminary position that industry is best placed to establish processes to enable arrangements. However, the intermediary market framework will be closely monitored and subject to change if deemed necessary.

Auditable and accurate systems that ensure stocks are not counted twice will be required.

Through a light-handed regulatory approach of the intermediary market, innovation within the market to deliver stockholding accounting solutions that work best for the industry can be developed.

The below table outlines the main anticipated responsibilities of buyers and sellers in the intermediary market.

Intermediary Market - Seller	Intermediary Market - Buyer
Have the stock available and stored in Australia.	Establish a reasonable assurance that the stock exists.
Ensure stocks made available through intermediary market are counted only once.	Ensure arrangements for reliance on intermediary market are detailed with MSO Compliance Plan.
Report seller data to the Regulator.	Report buyer data to the Regulator.
Establish legally enforceable arrangements with buyers.	Establish legally enforceable arrangements with sellers.

Reporting

Reporting requirements have been developed through consequential amendments to the *Petroleum and Other Fuels Reporting Rules 2017*. The draft rules and explanatory statement are also published for consultation.

Extenuating Circumstances

The Act establishes a framework to support circumstances when a suspension or temporary reduction may be required due to extenuating circumstances outside of the control of the entity. For example:

Scenario	Resolution
There is a likely national disruption to supply of a product, or current disruption of supply	The Minister can suspend the MSO (s26 of the MSO Rules and s27 of the Act)
There is a localised disruption of supply	The entity may apply to the Secretary for a suspension of their MSO (s27 and s28 of the MSO Rules)
Tank inspections are required	The entity may apply for a temporary reduction in quantity of stocks (s24 of the MSO Rules)
Significant shipping disruption due to unforeseen circumstances	The entity may apply for a temporary reduction in quantity of stocks (s24 of the MSO Rules)
Repairs are required for damaged infrastructure	The entity may apply for a temporary reduction in quantity of stocks (s24 of the MSO Rules)
Supplied fuel stock does not meet the necessary fuel quality standards	The entity may apply for a temporary reduction in quantity of stocks (s24 of the MSO Rules)
A major contract changes hands	If an entity loses a contract, they can apply to have their MSO divided with the new contract owners, or apply to have their MSO varied to reflect the change (s39 of the MSO Rules).

Further transitional arrangements have been developed to help entities transition into the scheme over the first two years of the scheme's operation, which are discussed in the following section.

Transitional Arrangements

The Department acknowledges the implementation of the MSO is likely to have a range of impacts for different industry participants depending on business models, storage infrastructure, and contractual arrangements with clients, amongst other matters.

It is anticipated the MSO CCDs will initially be set at levels that are largely able to be met by industry, minimising the need for transitional arrangements for most entities. The intermediary market is also envisioned to be a key aspect of the framework to assist entities through this phase.

There are two automatic industry-wide transitional arrangements allowed by the rules:

1. As touched on above, the obligation day will initially be fortnightly, before moving to a weekly obligation day from 1 July 2024.
2. The initial CCDs will not include the increase in stock to adjust for the allowance of stock within the EEZ to be counted towards an entity's MSO.

There are also two sections of the rules that could be utilised before 1 July 2024 under certain circumstances:

1. **Designated quantity – circumstances impacting MSO entity at commencement (s21 of the MSO Rules)**
This section can only be used if an entity can prove they have attempted to prepare for the MSO and have done their due diligence by testing the market to meet their obligation in the

first instance. If these elements are satisfied, the entity can apply to have their MSO reduced by either 20% of the MSO, or 15ML (whichever is smaller). There is a limit on the available reduction to quantity to ensure the MSO still maintains an adequate fuel security benefit for Australia in the first two years of operation. The entity will also need to provide the Secretary with a credible path to compliance within the next 2 years, with details provided in their MSO compliance plan.

2. Additional transitional reduction in quantity of stocks (s25 of the MSO Rules)

This section acknowledges the data the Department receives from the Australian Border Force may not be completely reflective of what is occurring in practice. Therefore this section allows entity's to amend their import data if they are able to prove that the figure should be different.

Changes in 2024

From 1 July 2024 a range of changes to the MSO framework will occur at the same time:

EEZ CCD increase

The national baseline CCD calculation does not include any stock held within the EEZ. The Department has allowed refined stock within the EEZ to be counted towards an entity's MSO, which should help entity's transition into the scheme. However, from 1 July 2024, the CCD figure will be adjusted to reflect stock being held on water to ensure national stock levels on land do not decrease.

40% diesel CCD increase

Further to the EEZ increase, the Government announced there would be a significant increase in diesel stocks by 40% from the pre-COVID-19 business-as-usual baseline. This is reflected in the draft notifiable instrument released for public consultation.

No further transitional arrangements

Transitional arrangements allowed through section 21 and 25 of the MSO Rules (listed above) will no longer be applicable.

Compliance and Enforcement Framework

The Act establishes the audit and compliance framework for the MSO scheme. It ensures the Department has a number of scalable response options to address instances of non-compliance.

At the highest level, civil penalty provisions for not meeting an MSO have been set to directly relate to an entity's obligation. This ensures the costs of non-compliance incentivise an entity to meet its MSO, while also ensuring it does not disproportionately impact smaller market players.

The MSO Rules also provide an anti-avoidance provision, where a company can be captured by the scheme if the Secretary determines they are operating with a purpose of avoiding the trigger thresholds (see section 16 of the MSO Rules).

Compliance Plan

The MSO compliance plan is an important aspect of a regulated entity's MSO compliance governance framework. A regulated entity must provide a copy of their compliance plan to the Secretary by 31 July 2022. An outline of compliance plan requirements is below:

Outline

- Outline of organisational structure of entity
- List of key people, their role and contact details
- Process for review to keep the plan up to date
- Signed statement acknowledging organisational commitment to the plan

Overview of current practices

- Importing frequency
- Volume of capacity to store each MSO product
- Location of facilities that store MSO products
- Details of fluctuations in storage of MSO products
- Details of significant ongoing contracts

Compliance pathway

- Steps and strategies taken to comply with MSO, including in the event of non-compliance
- Contingency planning information
- If currently non-compliant, the steps and strategies that are being undertaken to return to compliance and avoid future non-compliance
- Intermediary market approach and processes

Data collection, reporting and record keeping

- Methodology and practise for counting stock
- How to ensure accurate reporting for all stock intended to be counted (including within the EEZ, pipelines and co-located stock)
- Description of the quality assurance process and the reporting approvals required
- The process for advising the Secretary on expected MSO quantities and how reporting of intermediary market stock is managed
- Arrangements for keeping records in an auditable form and how they can be accessed

Planned/Scheduled Major Outages

- Schedules for any known tank, pipeline or refinery outages. eg. for maintenance

Flowchart – operation of the MSO (from 2023 – the first year will operate slightly differently)

