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**Submission on the Proposed Regulations Restricting the Use
of HFC-23 and N₂O CERs in the NZ ETS**

1. Vector Limited ("Vector") welcomes the opportunity to make this submission in response to the Ministry for the Environment's ("MfE") *Consultation on Proposed Regulations Restricting the Use of HFC-23 and N₂O CERs in the NZ ETS*, September 2011. No part of this submission is confidential and we are happy for it to be publicly released.
2. As a matter of record, Vector supports the New Zealand Emissions Trading Scheme ("NZ ETS").¹ We generally support market-based mechanisms that efficiently signal the cost (including environmental cost) of using resources to industry participants and consumers, who will make appropriate decisions about spending and investment.
3. With respect though, Vector has serious concerns about the potential impact of the proposal to restrict the use of HFC-23 and N₂O Certified Emission Reduction Units ("CERs") in the NZ ETS. The impact of the NZ ETS on consumers, the economy and the environment, and the impact of changes to the NZ ETS warrant a more in-depth analysis of the ensuing costs and benefits than has been conducted for this consultation.
4. In particular, Vector has the following concerns:
 - a. HFC-23 and N₂O CERs are permitted under the Kyoto Agreement.

¹ <http://www.vector.co.nz/sites/vector.co.nz/files/Submission%20on%20the%20Emissions%20Trading%20Scheme%2019-02-09.pdf> and <http://www.vector.co.nz/sites/vector.co.nz/files/4%20%2020110406Vector%20Submission-ETSIssuesStatement.pdf>

- b. The integrity of the Kyoto Agreement may be undermined if signatories vary their application of the Agreement to reflect that they do not like parts of the Agreement, in ways that could adversely impact on other signatories.
 - c. The proposals would raise the cost of the NZ ETS but there has been no assessment of the extent to which it would raise costs or whether the purported benefits of the changes would be sufficient to offset these higher costs.
 - d. The purpose of the proposal is to “improve prospects of future links between the NZ ETS and other emissions trading schemes that prohibit these units”. This remains to be substantiated. Vector has concerns about the stability of the NZ ETS if changes are made simply to align with other schemes.
5. Vector considers more work needs to be done on these matters before robust recommendations to introduce changes to the NZ ETS can be made.

Need for a regulatory impact analysis

6. The consultation document has not provided any analysis, or compelling argument or evidence, on the impact of the proposed restrictions on various stakeholders and the economy. We do not consider this to be consistent with good regulatory practice.
7. We note that the *Government Statement on Regulation: Better Regulation, Less Regulation* made commitments to:
- Resist the temptation or pressure to take a regulatory decision until we have considered the evidence, advice and consultation feedback, and fully satisfied ourselves that:
 - the problem cannot be adequately addressed through private arrangements and a regulatory solution is required in the public interest;
 - all practical options for addressing the problem have been considered;
 - the benefits of the preferred option not only exceed the costs (taking account of all relevant considerations) but will deliver the highest level of net benefit of the practical regulatory options available;
 - the proposed obligations or entitlements are clear, easily understood and conform as far as possible to established legislative principles and best practice formulations; and
 - implementation issues, costs and risks have been fully assessed and addressed;
 - Require there to be a particularly strong case made for any regulatory proposals that are likely to:
 - impose additional costs on business during the current economic recession;

- impair private property rights, market competition, or the **incentives on businesses to innovate and invest...**² [emphasis added]

8. We strongly believe the consultation document has not met the above requirements.
9. There is a high level of uncertainty surrounding emissions trading due to its nascent nature, its global scale, and various political and economic considerations, i.e. the uncertainty of how other schemes would respond to restricting particular CERs, particularly under the current economic climate.
10. It is 'early days' for the NZ ETS. Any changes that could impose significant costs on parties that are in the process of embedding the initial arrangements into their business planning and operations could undermine the integrity of the scheme and confidence in this market. For example, some trading participants may have agreed to join the ETS on the basis of HFC-23 and N₂O opportunities.
11. As indicated by the ETS Review Panel in its report of 30 June 2011:

Given the current international uncertainty and the challenging state of the economy, this means there should be measures in place which ensure the increase in the costs of the ETS occurs at an appropriate pace.³

12. Vector therefore **recommends** that MfE and Treasury undertake or commission a cost-benefit study on the impact of the proposed regulations on various ETS participants and on the New Zealand economy, to inform this and future regulatory consultations and decisions. The study could explore potential wealth transfers from New Zealand to overseas parties. It could also assess the comparative costs and benefits of linking the NZ ETS with other schemes that prohibit HFC-23 and N₂O CERs and those that do not.
13. Good regulatory practice dictates that these issues and other risks and opportunities should be well understood, if not addressed, before making recommendations to introduce regulations.

Price cap

14. Until such time that the impact of this proposal is better understood in the context of the NZ ETS, Vector further **recommends** the retention of the price cap and surrender ratio at existing levels, to ensure there will be no 'spikes' to NZ ETS compliance costs.

² <http://www.treasury.govt.nz/economy/regulation/statement>

³ <http://www.climatechange.govt.nz//emissions-trading-scheme/ets-review-2011/review-report.pdf>

15. We note that the price differential between industrial gas CERs (Grey CERs) and European Union ("EU") ETS compliant CERs (Green CERs) is forecast to be 10+ Euro in 2013, with Grey CERs priced at 5 Euro and Green CERs in the 15-20+ Euro range. The cost-benefit study could assess the transitional impact of price differentials on ETS participants and consumers.

Other recommendations

16. Without prejudice to our view above that any recommendation should be supported by a robust cost-benefit analysis, we outline some recommendations below should the restrictions be implemented.

Definition of industrial gas CERs

17. We view the scope of industrial gas CERs indicated in the consultation document to be loose.
18. Vector **recommends** that the definition of industrial gas CERs be tightened to reflect EU ETS definitions which are only limited to adipic acid, not nitric acid or caprocatalam Clean Development Mechanism ("CDM") Projects (which account for 44% of forecast N₂O CER issuance).

Timing of restrictions

19. The timing of the proposed restrictions (either January 2012 or January 2013) is ahead of those in the EU ETS (up to end of April 2013). Under the EU ETS, the entire 2012 compliance year can be met with industrial gas CERs.
20. Vector **recommends** that the timing be generally aligned with those of the EU ETS and other major schemes internationally. Non-alignment could affect CER contracts that may have been entered into by New Zealand parties, some of which may have a delivery date of 2012/2013.

Exemptions

21. Should Vector's timing recommendation (as stated above) not be adopted, exemptions will be required. Vector has contractual opt-in arrangements with a number of its customers whereby customers are contracted to supply NZ ETS compliant units to Vector in return for an energy supply free of carbon price (this is a common arrangement between energy suppliers and users). As unit restrictions may conflict with contractual opt-in agreement terms, any exemption should be extended to cover such arrangements.

Future notice periods

22. Vector **recommends** a minimum notice period for restrictions, to provide greater certainty and sufficient time for NZ ETS participants to factor such changes into their business planning.

Closing comment

23. Vector wants to see the NZ ETS succeed. Vector therefore **recommends** that MfE re-consider the proposed restrictions until there is a robust assessment indicating that the benefits of implementing them significantly outweigh the costs, and that the restrictions would not undermine the sustainability of the scheme. We look forward to such an assessment.
24. Should you have any questions, or require further information, please contact Luz Rose, Senior Regulatory Analyst, on 04 803 9051 or Luz.Rose@vector.co.nz.

Kind regards



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