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**Submission on the Proposed Amendments to the
Emissions Trading Scheme**

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Ministry for the Environment's ("the Ministry") consultation document, *Updating the New Zealand Emissions Trading Scheme*, dated April 2012.
2. No part of this submission is confidential and Vector is happy for it to be made publicly available.

Market efficiency

3. Vector generally supports the operation of markets in the energy sector, such as the New Zealand Emissions Trading Scheme ("ETS"). Market mechanisms provide a low-cost means for parties to find the least-cost sources and opportunities for the abatement of emissions, ie finding the cheapest allocation units. Market mechanisms can help ensure arrangements are efficient, the costs of resources are clearly signalled, and the right incentives for investment are provided.
4. Vector is concerned about the constant changes to the ETS, which recently included qualitative restrictions on the importation of industrial gas international units. Administrative interventions create uncertainty and undermine the efficient functioning of this nascent trading scheme. They distort market signals for those making decisions regarding spending, investment and innovation, and alternative options for abatement.
5. The ETS, itself, is what is intended to limit New Zealand's emissions to their (market-determined) optimal level. The consultation document states that "the Government...intends to introduce a mechanism that would allow the Minister...to

place a restriction on the proportion of international units an ETS participant can surrender to meet its ETS obligations".¹ This proposal would distort price signals that inform business decisions, for example, whether it would be more cost-effective to purchase units (and where to purchase them) instead of implementing abatement measures such as using more efficient technologies or vice versa.

6. Limiting the amount of imported units would simply raise the costs of the ETS. The consultation document states that "[s]uch a restriction would encourage participants to buy NZUs at the auction rather than international units, helping to ensure that there was no excessive overseas purchasing".² Vector does not believe that any restriction is required. If the auction mechanism for New Zealand Units ("NZUs") is transparent, then the NZU price should align with the prevailing international unit price. As a result, ETS participants will not be biased towards purchasing international units, negating the Government's concern about excessive cash flow offshore.
7. Quantitative restrictions are analogous to the previous government's imposition of a moratorium on thermal generation, even though the ETS would provide appropriate signals as to whether thermal or renewable generation should be adopted. The current government subsequently removed the moratorium. Any proposed quantitative restrictions should be rejected on the same grounds.
8. The Ministry should not rely on assertions about "excessive overseas purchasing" without defining what it means by "excessive" and why. The consultation document also refers to "unnecessary offshore cash flows", again, without defining what it means by "unnecessary". Vector observes this is the kind of argument that was used in the past to justify the imposition of trade restrictions and barriers on the importation of goods or services. The Ministry should not rely on anti-trade rhetoric to justify restrictions on the international trading of units.
9. Regular changes to the 'rules of the game' do not provide certainty for ETS participants and is not costless for businesses, households and the Government. Significant changes should only be implemented if they result in a better functioning market, that is, a more transparent and efficient ETS.

The proposed auction

10. Vector anticipates more details on the proposed auction of NZUs. The next consultation document should explore the likely level of interest and participation in such an auction, the revenue the Government expects to generate, and how similar mechanisms played out in overseas jurisdictions.
11. Generally, an auction is a low-cost means of allocating resources by promoting greater price transparency, injecting liquidity into the market, and signalling

¹ Consultation document, page 7

² Ibid.

parties' willingness to pay for that resource. Vector is concerned, however, that the proposed auction is being considered to dissuade parties from purchasing international units.

12. Vector **recommends** that, to achieve an optimal outcome, the proposed auction be designed to promote price transparency for all interested parties, and not to discourage the purchase of international units.
13. In order to provide market certainty, Vector further **recommends** that the rules of the auction apply for a longer and more stable timeframe, say a three-year period, rather than be able to be changed on one year's notice³, as proposed.

Sectoral equity

14. As a matter of principle, Vector supports an "all sectors, all gases" trading scheme. Vector is concerned about the suggestion to further delay the entry of agricultural gases into the ETS. This is inconsistent with the "polluter pays" principle (and therefore inefficient) and effectively taxes the sectors currently bearing emission liabilities. This approach fails the tests of efficiency and sectoral equity.
15. The Government should be mindful that should the agricultural sector not bear the full costs of its emissions and/or its entry to the ETS is delayed, these costs will need to be shared across other businesses and the rest of the economy. This will have an impact on the costs and international competitiveness of those sectors in order to prop up the international competitiveness of emitting/polluting sectors.
16. Vector **recommends** that policy development not only focus on the impact on agriculture but on how New Zealand would fund its emission obligations if agriculture is not required to bear some of the costs.

Discretionary power

17. Vector does not support the amendment of the *Climate Change Response Act 2002* "to include a discretionary power for the Minister for Climate Change Issues to defer the date from which the agricultural sector will incur emissions liabilities,"⁴ or any discretionary power to effect significant changes to the ETS for that matter. The exercise of discretionary power creates uncertainty and is inconsistent with good regulatory practice, which requires that legislative or regulatory proposals be supported by a cost-benefit analysis indicating a net public benefit, and be subject to meaningful consultation.

³ <http://www.climatechange.govt.nz/consultation/ets/cab-min-12-8-7.pdf>, section 20.1

⁴ *Ibid.*, section 34

18. Good public policy involves 1) an understanding of the market failure, 2) identification of options for efficiently addressing the market failure, and 3) assessment of the net consumer benefits of different policy options.⁵
19. A discretionary approach to regulatory decision making is also inconsistent with the Government Statement on Regulation,⁶ which states that the Government will:
- 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...
20. Moreover, the granting of discretionary power is inconsistent with the “wait-and-see” position the Government is adopting in respect of international developments, so it can respond in ways that mitigate short-term adverse impacts on the economy. It is reasonable to assume that discretionary powers are sought to facilitate or ‘fast track’ the passage of particular measures, among other reasons. The high level of uncertainty surrounding the negotiation of an international agreement that would succeed the Kyoto Protocol, exacerbated by the global financial crisis, provides an even more compelling reason to place any proposed measures under careful scrutiny and robust analysis.
21. Vector **recommends** that, in the interest of robust regulatory decision making, the proposed discretionary power, or any other discretionary power, not be considered further.

⁵ *Independent Review of TPAG Discussion Paper*,
<http://www.ea.govt.nz/search/?q=biggar+transmission+pricing>, page 10

⁶ <http://www.treasury.govt.nz/economy/regulation/statement/govt-stmt-reg.pdf>, page 2

Treatment of SF₆

22. The ongoing consultation does not specifically include proposals on the treatment of synthetic greenhouse gases, but signals a future consultation. Vector appreciates the ETS Review Panel's ("the Panel") views on how SF₆ emissions should be charged.
23. Vector's submission of April 2011⁷ proposed that SF₆ emission liabilities be paid as the gas is emitted (actual emission) rather than when it is imported. The gas is not intentionally vented and only minute quantities are leaked during the lifetime of the electricity switchgear that contains it. Lines companies should be seen as 'stewards' rather than 'consumers' of SF₆. Imposing emission charges at the point of importation disproportionately inflates the cost of emissions and does not provide incentives for users to reduce emissions.
24. Vector supports the Panel's recommendations,⁸ which specifically state that:
 - 7.1 The point of obligation under the ETS should be on users of SF₆ in electrical switchgear rather than importers of SF₆.
 - 7.2 The ETS obligation of users of SF₆ in electrical switchgear should be based on estimates of actual emissions.
 - 7.3 The Government should consider the treatment of SF₆ contained within equipment and still remaining upon disposal.
25. Vector **recommends** that the Government adopt the Panel's recommendations in respect of SF₆ emission charges, which more accurately reflect the cost of emissions.
26. Vector also **recommends** that flexibility or a transition period be provided for parties reporting emissions from 2013. Compliance with reporting requirements would not be costless and flawless, particularly for those doing it for the first time.

Closing comments

27. To recap, Vector recommends that:
 - the proposed auction of NZUs be designed to promote price transparency for all interested parties, not to discourage the purchase of international units;

⁷ <http://vector.co.nz/sites/vector.co.nz/files/4%20%2020110406Vector%20Submission-ETSIssuesStatement.pdf>, pages 4-5

⁸ <http://www.climatechange.govt.nz/emissions-trading-scheme/ets-review-2011/review-report.pdf>, page 88

- the auction rules apply for a longer and more stable timeframe, say a three-year period, rather than being able to be changed on one year's notice, as proposed;
- policy development not only focus on the impact on agriculture but on how New Zealand would fund its emission obligations if agriculture is not required to bear some of the cost;
- the proposed discretionary power, or any other discretionary power, not be considered further, in the interest of robust regulatory decision making;
- the Government adopt the ETS Review Panel's recommendations in respect of SF₆ emission charges, which more accurately reflect the cost of emissions; and
- flexibility or a transition period be provided for parties reporting emissions from 2013.

28. Should you have any questions, or require further information, please contact Luz Rose, Senior Regulatory Analyst, on 04 203 9051 or Luz.Rose@vector.co.nz.

Kind regards



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