



Submission

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NZ Entity Submissions
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Submission on Consultation Document on Proposed Regulations Restricting the Use of HFC-23 and N₂O CERs in the NZ ETS

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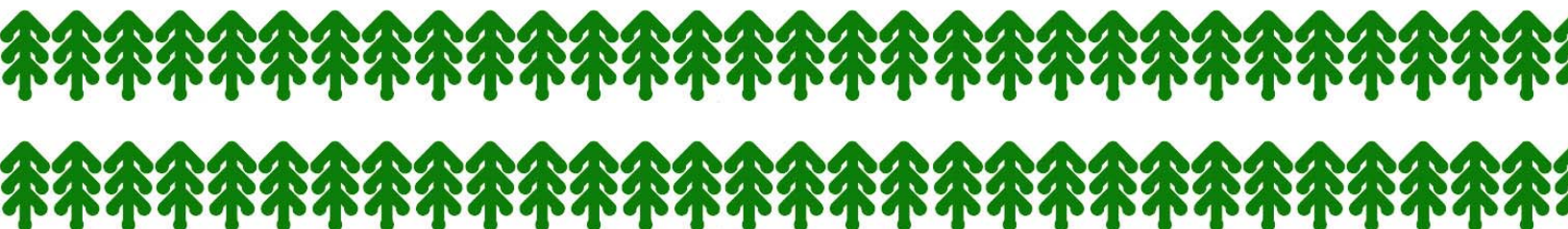


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1. Introduction

The New Zealand Forest Owners Association (FOA) represents the commercial plantation forest growing sector of New Zealand and FOA represents over 200 members with ownership over some 1.2 million ha of plantation forests. These estates comprise around 70% of the total forest growing sector in New Zealand and comprise small owners represented individually or through affiliation with the NZ Farm Forestry Association (NZFFA) through to the major corporate and timberland investment interests.

2. Summary

The FOA supports the proposed restrictions on the use of HFC-23 and N₂O CERs in the NZ ETS on the basis that such restrictions are consistent with the objectives of the NZ ETS and that without such restrictions the ETS will fail to function as intended. As the consultation document notes, this is consistent with the approach being taken by other jurisdictions internationally that operate carbon reduction schemes.

We further contend that other similar restrictions imposed by larger international carbon trading schemes which impact on the NZ ETS should also be replicated.

The FOA favours the restrictions being applied as soon as possible without exemption because of the negative impact the lack of control is currently having on the domestic trading environment.

3. Rationale for Restrictions

The FOA recognises the principle that where possible the market should allow emitters to find the least cost abatement opportunity. We would also note, however, in the case of greenhouse gas emissions reductions there are other factors which must also be weighed up.

The bulk of CERs produced have been from projects related to the destruction of industrial gases – hydrofluorocarbon-23 (HFC-23) and nitrous oxide (N₂O). These gases have made up 75% of the CER units available to date. The associated credits are cheap to produce and their environmental integrity is questionable. The problem is that the potential revenue from credits is many times higher than the cost of the gas itself and there is a suspicion production is being increased in order to then very cheaply destroy it. The methodology used has also been found to be flawed and biased towards production in China and India.

The intent of an Emissions Trading Scheme in New Zealand is not to generate revenue for the government, nor is it to provide a revenue stream for mitigators of emissions either domestically or internationally. The ETS has been introduced in a very measured way to begin the process of transformation away from a carbon-intensive economy to one more reliant on renewable energy. A key part of bringing about

that transformation is establishing a domestic price on carbon emissions that will begin to influence investment behaviour.

New Zealand is also under an obligation to honour the intent of the Kyoto Protocol. Article 12(3) of the Kyoto Protocol clearly states that Annex I Parties to the Kyoto Protocol may only use CERs to meet *part* of their overall emissions target. Article 15/CP.7 provides further direction by clarifying that the use mechanisms such as of CERs “shall be supplemental to domestic action and that domestic action shall thus constitute a significant element of the effort made by each Party”. These directives have clearly influenced the approach of the EU and Australia’

To date the relatively unfettered access to CERs has actually worked against one of the objectives of allowing their use in the first place – that of reducing price volatility. In a situation where HFC-23 and N₂O industrial gases were restricted, emitters in New Zealand would have needed to achieve a balance of CER units and domestic units and the fluctuation in domestic price would have been far less extreme than has been the case.

High price volatility (especially when characterised by marked downward price jumps) is highly likely to deter investment in afforestation projects (i.e. scare off investors).

4. International Alignment

As government has already stated, the path chosen by Australia in implementing its emissions reductions measures will be important in helping to inform the New Zealand response. The Australian government has a clear objective in its aptly named Clean Energy legislation of ensuring that change takes place in the domestic economy. It has followed the lead set by the European Union in banning the use of industrial CER’s (HFC-23 and N₂O).

Furthermore, and very importantly, Australia has stipulated that during the initial fixed price period while there is a cap on price (and thus equivalent to the NZ situation) no international units of any kind will be allowed to be used to meet pricing mechanism liabilities.

Even when Australia moves to an open market and the international price in 2016, emitters will still only be able to meet 50% of their obligations from international units; the rest must come from domestic permits or credits until 2020.

Because Australia will also have a floor price (unlike NZ) then if the CER price fell below this a top-up would be required to be paid on any CERs used for compliance. This provides a further safeguard that is also unavailable in New Zealand.

These measures are all intended to ensure that the Australian economy undergoes change in order to remain competitive in the future. It is also consistent with the Kyoto Protocol directive to undertake significant domestic action, described above, which the Australian government has clearly interpreted as being at least 50%. We endorse this approach and consider that the New Zealand government should

similarly set a maximum allowance of CER units that can be used to meet obligations.

The EU has declared that CERs from industrial gas projects will no longer be acceptable for use in the EU ETS after April 2013. Again, like Australia, the EU will have additional constraints. Firstly, in phase 3, the EU will apply "supplementarity" limits on the use of all CERs. These vary from country to country but are generally not more than 10 per cent.

Secondly, from 2013 it will also only accept CERs from new projects hosted in least-developed countries (LDCs). So far non-LDC countries (notably China and India) have provided 98% of the CERs. Like Australia, the 50% restriction on international CERs will also apply. These will be fundamental changes and New Zealand must follow suit (i.e. not just restricting the use of industrial CERs) if we are to achieve the same objectives.

5. Timing

The consultation document seeks feedback on the timing of any ban on HFC-23 and N₂O CERs. We consider that entry of CER units into the NZ EUR should be banned from 1 October 2011 onwards.

This is a crucial decision. Many emitters will have acted cautiously to date given the uncertainties surrounding the acceptability of industrial CER units. Any creation of a "free reign" period, however limited, can be expected to lead to swift and significant purchasing of these units for both current and future use. This will exacerbate, and prolong, the current issue of virtually zero participation by forest owners and other potential suppliers of carbon units. As government has frequently acknowledged, New Zealand's ability to meet its international commitment is going to be heavily influenced by forestry. Carbon can provide a sufficient signal to generate new planting and there is evidence of this has happened already but the presence of cheap industrial gases in the market will act against it.

The FOA accepts that CERs already in the NZEUR up to, but not including, 1 October 2011 should remain eligible for use. From this date onwards it was clear that both the EU and Australia would be severely restricting these units, the review panel had called for restrictions to be imposed, and the government had publicly signalled on more than one occasion that there would be no certainty of CERs being used beyond 2012. We consider this, collectively, has provided sufficient notification that these units have environmental credibility problems associated with them and that the ability to continue to use them was unlikely.

Future legislation which locks in a 30 September 2011 cut-off point based on policy advice which gives a very strong indication of future regulation is not without precedent in climate change policy. This is exactly how the pre-1990 deforestation liabilities came to have differential compensation weightings.

6. Treatment of Forward Contracts

A related and key question is how forward contracts of CERs should be dealt with. We are aware that some emitters may have entered into such arrangements while others have chosen to wait for clarity on the acceptability of the units. The challenge for government and the market is that such transactions do not appear on the ETS registry. Potentially, forward transactions have the ability to significantly extend the influence of industrial gas CERs in New Zealand and, if unconstrained, provide a means of avoiding any timing restriction. This is another important reason why the ban on industrial CERs must be effective immediately (ie post 30 September 2011). If not then any number of forward contracts could be entered into between now and the close off date of even 1 January 2012. The FOA does not support a blanket exemption for such units.

The FOA considers that there are two possible responses that could be followed to deal with futures contracts; they are as follows:

a) No exemption:

Preventing any industrial CER units being used after the cut-off date of 30 September, 2011 notwithstanding that this will include some forward contracts not being able to be exercised. As noted, the government has previously signalled that such units might not be able to be used in the future and thus any purchaser had this knowledge when they entered into the contract. Furthermore, any emitter has the ability to divest themselves of such units by selling back in to in the market.

b) Partial exemption:

Allowing forward contracts purchased on or before 30 September 2011 to be used until May 2013 (the surrender date for 2012 obligations). If this option was used it would be important to be able to establish proof of purchase date. We also consider that if this option is used it must be in conjunction with a restriction on the total amount of CERs that could be used to satisfy an emitter's obligations (we consider the maximum of 50% as intended by Australia is appropriate). This could provide a transitional arrangement that allowed the CER units to be used, but also ensured that the domestic market and the objectives of the ETS were protected. We believe it would also adequately satisfy New Zealand's complementarity obligations.

On balance it is considered that Option B is more aligned with government objectives and the additional flexibility provided will increase stability and investment confidence for both buyers and sellers of units in the NZ ETS.

7. Implementation

Questions have also been posed in the consultation document about how any ban on industrial gases should be implemented.

The FOA does not have a strong view on either of these options. It is possible that the compliance costs associated with government monitoring of every transaction would make this the least desirable option. The alternative of self-assessment by participants could avoid this but if this approach was adopted it is essential that the criminal liability under the Act for non-compliance provided a sufficiently large deterrent, and also that government audited a sufficient number of surrender transactions.

8. Engagement

The treatment of CER units, and HFC-23 and N₂O CERs in particular, is critical.

The FOA welcomes the government's response to the ETS review panel recommendations via the prompt release of the consultation document and the opportunity to submit on it. The Association would be happy to be involved in further discussion or elaboration should that be deemed desirable.

Yours faithfully

A handwritten signature in black ink, appearing to read 'David Rhodes', with a stylized, cursive script.

David Rhodes
Chief Executive