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Dear Stuart

Climate Change Regulations for Stationary Energy, Industrial Processes and Liquid Fossil Fuels

Business New Zealand welcomes the opportunity to provide a submission to the Ministry for the Environment on its revised draft climate change regulations for stationary energy, industrial processes and liquid fossil fuels. Our comments are set out below.

In general, Business New Zealand is pleased with the progress made by the Ministry for the Environment since the receipt by it of submissions on the first draft of the regulations. A number of the concerns voiced by businesses in that first consultation round relating to, for example, how unique emission factors will be used and the accommodation of stockpiles comprising of different classes of coal and gas.

However, some concerns remain. These concerns broadly fall into two categories, these being:

1. ensuring that the regulations do not impose unnecessary costs on to the participants. That is, that the costs of compliance are not disproportionate with respect to objectives of the regulations; and

2. technical issues with respect to the workability of the regulations.

The balance of this submission briefly addresses these points and concludes with some comments on the process from here.

Business New Zealand's Interest in this Issue

These regulations concern the measurement, reporting and verification of greenhouse gas emissions for those businesses who will be direct, or opt-in participants under the current Act. While Business New Zealand has an interest at this level in the form of its Major Companies Group, Business New Zealand's specific interest in this case is to ensure that:

1. the final set of regulations is efficient so that the additional compliance costs passed on to downstream, smaller businesses who are not direct trading scheme participants are minimised; and

2. the increased cost of carbon passed on by direct participants to small to medium sized businesses accurately represents their efficient (and proportionate) share.

The Need to Avoid Unnecessary Costs

Business New Zealand remains concerned that the effect of the regulations is to impose unnecessary cost on to participants. While the Bulletin states that:

> "The Government wishes to apply the Act in a way that minimises compliance and administrative costs, and treats all participants fairly."[1]

in reality, the two objectives that appear to dominate the development of the regulations are the desire to minimise any fiscal cost to the Crown and the need to be assured of accurate and verifiable reporting of emissions. The practical application of these two predominate objectives appears to drive the overall 'shape' of the regulations down a path of heavy prescription rather than a more measured balancing of the needs of business against those of the Crown.

The use of the IPCC guidelines is a specific case in point. The policy decision to rigidly adhere to their use has created inflexibility in the application of the regulations and the reporting of actual emissions. In some cases, these guidelines are inconsistent with the reporting standards commonly used by an industry sector or simply do not appropriately reflect local conditions (for example, those that relate to the measurement of fugitive emissions of methane from coal mining). In other cases the reverse is true. Methodologies for measuring emissions have been used that bear no resemblance to the IPCC methodology that the industry currently uses. A further complication is the need to accommodate changes in the IPCC guidelines.

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[1] Emissions Trading Bulletin entitled 'Draft Climate Change Regulations for Stationary Energy, Industrial Processes and Liquid Fossil Fuels', No 10, June 2009, page 1.

In Business New Zealand's view, the regulations need to:

a. be sufficiently flexible to allow businesses to adopt the method of measurement *that best suits their needs* while maintaining accuracy (and therefore meeting the needs of the Crown). To take any other approach simply sheds costs from the Crown to business that business and their customers should not have to face; and

b. better balance a pursuit of measurement perfection (as reflected in a high level of detailed prescription) against the incentives set out in the Climate Change Response Act. Several submitters commented on this particular aspect in response to the first draft of the regulations. While much energy has been expended on the rhetoric of the similarity in approach to the Inland Revenue, self-reporting and audit regime, this is not borne out in reality. Much of the approach to the regulations still appears to have been done in the absence of any recognition whatsoever of the stringent penalty regime that exists in the Act and the strong incentives it places on participants to get it right in the least costs manner. Part 3 of the unique emission factors regulators is a case in point. There appears to be no good reason why this could not have been left to guidelines. [2]

Comments on Some Aspects of Detail

As noted above, many issues of detail raised by submitters in the first consultation round have been addressed. However, two aspects of the regulations as they relate to the monitoring of gas emissions continue to raise issues for Business New Zealand. These are the:

1. reporting of Unaccounted-for-Gas (UfG) or network losses; and

2. use (or in this case, the lack of use) of the emission factor for specification gas.

Reporting Unaccounted-for-Gas

With respect to UfG, while the draft regulations now confine the application of UfG to the activity of mining gas, its treatment still seems unnecessary (or at best overly technocratic). In the unlikely event that there is a difference between metered

[2] The degree of methodological over-prescription is no better demonstrated than in the addition of Schedule 1 which outlines in some detail the stockpile adjustment calculations for activities of importing and purchasing coal. In reality, these regulations are only relevant to one participant. While providing them with certainty of calculation, it also eliminates flexibility and their future ability to develop more innovative (and therefore cost-effective) ways of measurement.

quantity of gas at the point of sale and the metered quantities delivered this should be dealt with in the same way as gas vented and flared. That is:

a. responsibility for the emissions should remain with the miner; and

b. the cost of any residual emission obligation (that is, differences between production and delivered sales) should be allocated via commercial negotiations.

While the regulations *do* allocate the responsibility for UfG to the miner, accounting for the volume of gas at the point of sale should be sufficient to capture any downstream losses and therefore that volume would reflect the miner's obligation to surrender permits on those losses. This raises questions as to the need for the losses component in regulation 16(4). Business New Zealand understands that this issue was raised at the gas sector workshop and the Ministry for the Environment have indicated its intention to remove both the factor for losses and the oxidation factor removed from the equation.[3] Business New Zealand would support this.

Use of the Specification Gas Emission Factor

With respect to the use of an emission factor for specification gas, this seems to be missing-in-action. The only references to the use of the emission factor for specification gas are in the bulletin (Appendix 1, Table 5 – Mining or Purchasing Natural Gas) and regulation 43(3) – the calculation of the storage adjustment for opt-in natural gas.

The apparent effect of this change is to have a field-specific emission factor apply to each gas field for gas purchases. While this is absolutely appropriate for determination of the gas miner's obligation up to the point of sale, beyond that point, gas (with the exception where gas is not distributed via the transmission system, such as Kapuni direct supply) is specification gas and should be treated accordingly under the regulations.

This point is, in an indirect way at least, recognised in the use of the specification gas emission factor for the gas storage adjustment. The use of the factor in this regard appears to be in recognition of the difficulty of reconciling between the type of gas that goes into storage and the type of gas that comes out of storage. The same analogy can be drawn between what comes out of a field and what goes into the transmission system.

In Business New Zealand's view, as a matter of principle, all gas purchases (irrespective of opt-in or not) should be at a specification gas emission factor unless otherwise determined. This will ensure that the appropriate price signal flows

[3] Note to attendees at the gas sector workshop on NZETS Reporting Requirements from Katherine Wilson, dated 2 July 2009.

through the economy. Any other treatment risks contravention of the principle being applied by the Ministry for the Environment to:

> "send a clear price signal, with no perverse incentives"[4]

Given the sunk cost nature of the investment in existing fields, gas field specific emission factors for gas purchasers - from existing fields - could inefficiently distort the decision making around gas purchases, or create 'carbon arbitrage' opportunities. This is particularly relevant given that due to the process by which gas is transported over the high pressure transmission lines, purchasers are almost certain to burn specification gas and not what they may have specifically contracted to purchase.

Business New Zealand appreciates that differences will exist between field-specific emission factors and the specification gas emission factor and that this will, in all likelihood, either slightly advantage or slightly disadvantage gas purchasers, depending on the whether the differential favours the producer or purchaser. However, Business New Zealand can see no alternative way around this outcome except for the use of a single specification gas emission factor for gas purchases.

Business New Zealand considers this to be a pragmatic, relatively simple solution and that commercial negotiations will resolve any outstanding issues (similar to what is expected to occur regarding any costs associated with venting, flaring or own use).

Process from Here

Business New Zealand has a number of comments with respect to 'where to from here'. These relate to the:

1. need to accommodate the implications, if any, of the on-going review of the Act;

2. desirability of sector participants having a further chance to review the draft regulations before they are gazetted; and

3. need to settle on the calculation methodologies *before* moving to finalise the reporting requirements templates.

Business New Zealand comments on each of these briefly below.

It is Business New Zealand's expectation that these regulations will need to be amended as a result of the review of the emissions trading scheme currently underway. Issues such as a move to an intensity-based obligation, the accommodation of an opt-in option by gas purchasers for the gas they procure from

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[4] Ibid, Emissions Trading Bulletin, page 1.

gas wholesalers who themselves have opted-in, and the incorporation of a threshold for the combustion of waste could all implications for the design of these regulations.

This likelihood, combined with the highly technical nature of these regulations, and the possibility of large implications from small 'technical' changes means that It is important that this current draft is not the last time our members get to see the regulations before they are gazetted. It would be highly desirable to let business see the regulations just prior to gazetting – not to engender further debate on the merits or otherwise of particular approaches - but to enable a final review of the workability of the changes made by officials.

This expectation is heightened by the nature of the changes that have been made between the first and second draft set of regulations, and that need to ensure that they not only achieve the Crown's objectives but are workable, and make good sense from a business perspective.

But it is also important that the feedback-loop between the review of the Act and the development of these regulations not be all one-way (that is, from changes emerging from the review impacting on the regulations being drafted by the Ministry for the Environment). The Ministry for the Environment plays an important role in the review process and can still (despite its Departmental Report having already been submitted to the Select Committee) play a role in ensuring that the Act is consistent across sectors.

The risk exists that the work on these specific monitoring and reporting regulations is done in isolation of developments on the broader scheme design. In particular, that the monitoring and reporting requirement is implemented but the surrender obligation is delayed. Should a delay in the surrender obligation be a possibility (which Business New Zealand believes is the case), Business New Zealand would urge the Ministry for the Environment to advise the Select Committee in favour of uncoupling the compliance regime from the reporting requirement. The obligation to monitor and report should becoming voluntary (that is, without compliance penalties) until such time as the surrender obligation commences. The precedent for voluntary monitoring and reporting of emissions already exists in the current Act for the liquid fossil fuels, some industrial processes, agriculture and waste sectors.

Finally, a small, but practically important point of process. Given the on-going review of the trading scheme, the work being undertaken in parallel on the Government's policy position on the design of the trading scheme and the need for the regulations to neatly 'dovetail' into this work, Business New Zealand requests that the calculation methodologies be settled on *before* moving to finalise the reporting requirements templates. Otherwise the risk exists of numerous rounds of rework on the templates as the policy positions shift.

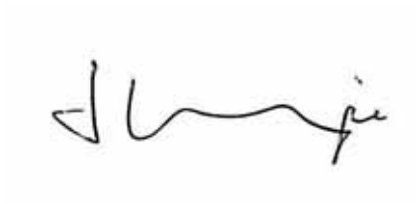
Summary

Business New Zealand is pleased with the progress that the Ministry for the Environment has made, but does not believe that it has yet got it completely right.

These regulations are in effect, where the trading scheme 'rubber' hits the road for sector participants. Therefore, getting these regulations right is vitally important as they not only embody the cost that will flow from the trading scheme for the participants, but also the cost that will flow through to the small to medium sized non-direct participants and the rest of the economy.

There is considerable imprecision in the measurement of emissions and Business New Zealand does not believe the regulations need to be excessively prescriptive in order to attempt to measure emissions to the n^{th} degree. The regulations can always be improved over time as more information comes to hand, but at this point in time, Business New Zealand sees no reason why the '80/20 rule' cannot be applied. The dogged pursuit of precision is neither necessary, nor required to deliver an outcome that meets the needs of both business and the Crown. And Business New Zealand looks forward to working with the Ministry for the Environment to ensure that an appropriate balance between the respective needs of these two parties is reached.

Yours sincerely



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