THE EXPLORERS
NEW ZEALAND OIL & GAS

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19 February 2016

NZETS Review Consultation
Ministry for the Environment
PO Box 10 362
Wellington 6143

Submitted via email to: nzetsreview@mfat.govt.nz

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SUBMISSION OF NEW ZEALAND OIL & GAS LTD
NEW ZEALAND EMISSIONS TRADING SCHEME REVIEW 2015/16

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New Zealand Oil & Gas welcomes the opportunity to provide a submission on the priority issues identified in the Discussion Document New Zealand Emissions Trading Scheme Review 2015/16.

About us

New Zealand Oil & Gas is New Zealand's only publicly-listed exploration and production company.

Started in 1981 and headquartered in Wellington with around 13,000 shareholders, the company has interests in hydrocarbon production from three New Zealand offshore Taranaki fields, Kupe, Tui and Maari, as well as international production in Indonesia and the United States.

The company partners with international oil and gas exploration entities to balance its portfolio investment risk and access capabilities and technologies unavailable to it in New Zealand. In New Zealand its significant exploration partners include Woodside Energy and Beach Energy (both ASX listed), and OMV (an Austrian multi-national). Our producing assets in New Zealand are held in joint venture partnerships with Origin Energy and AWE (both ASX listed), and Genesis Energy. The company's interest in the Maari oil field is held

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through a 48.11% controlling interest in Cue Energy, an ASX-listed company.

In the Tui oil fields, New Zealand Oil & Gas has a 27.5% non-operated interest. The Tui field began production on 30 July 2007. The development comprises five horizontally drilled and subsea completed wells, each tied back to a leased Floating Production Storage and Offtake (FPSO) vessel, the Umuroa. The fifth well, Pateke-4H, entered production in 2015 and has increased late-life volumes from the field. Nevertheless the Tui field is now in its decline phase and is likely to be abandoned in the next two to three years.

Nearly all Tui oil is sold on the spot market and exported, usually to refineries in Singapore. Some production is used by the FPSO. New Zealand Oil & Gas surrenders a small number of NZUs each year for this purpose.

The New Zealand Oil & Gas share of production from the Tui field was around 400,000 barrels in the financial year to end of June 2015 and 300,000 barrels in the previous year. The field produced 418,756 barrels of oil in the three months ended 31 December 2015.

New Zealand Oil & Gas has a 15% non-operated interest in the Kupe gas, LPG and gas condensate field off South Taranaki.

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Kupe was opened in 2009. Production is piped through an undersea umbilical to a production station in onshore South Taranaki. Each JV partner arranges their own sales from the field. The New Zealand Oil & Gas share of LPG from Kupe is sold under the OnGas brand to New Zealand consumers. Gas from the field is entirely sold to the New Zealand market, where it is used for domestic energy needs such as cooking, heating, hot water, and for commercial and industrial purposes and for electricity generation. Most of our Kupe gas is sold to Genesis Energy under a long-term contract. Kupe gas condensate is exported through Port of Taranaki.

The company's share of production from the field is as follows:

Financial Year Ended:	Gas (Pj):	Oil (bbls):	LPG (tonnes):
June 15	3.6	242,417	15,391
June 14	3.5	257,700	14,400

An accelerated gas supply contract was announced in 2015, and in the three months to 31 December 2015 the company reported production of 6.73 Petajoules of gas from the field (New Zealand Oil & Gas share 1.01Pj), along with 407,986 barrels of gas condensate, and 27.5 tonnes of LPG (New Zealand Oil & Gas share 61,198 barrels and 4,127 tonnes respectively.)

For the previous January-December 2014 year NZUs surrendered by New Zealand Oil & Gas were as follows:

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[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]

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Question 1 - Drivers for the review

Question 2, What other factors should be considered.

SUBMISSION SUMMARY

While we express no view on the appropriateness of the emissions reduction target or the ETS as a broad policy instrument, it would be unfair, distortionary and create perverse incentives that risk increasing emissions if an increased carbon price was imposed only on currently participating sectors. A higher carbon price on sectors currently in the scheme should not be a policy goal unless biological emissions from agriculture are also subject to similar emissions prices.

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New Zealand Oil & Gas does not take a view on the ETS itself as a policy instrument, nor on the specific emissions reductions objectives.

The company's concern is that, if the ETS is to be used as the primary policy instrument to achieve a given reductions target, it should be applied in a way that is consistent across sectors.

If the ambition of the scheme is to transfer costs of reducing emissions to emitters, and to reduce New Zealand's net emissions below BAU, and if the primary instrument to accomplish this objective is an efficient market, then there is no policy or economic justification

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that can support favouring one sector of the economy at the expense of another.

New Zealand's main sources of emissions are energy, transport and agriculture. If an attempt is made to meet all of New Zealand's emissions reduction targets from energy and transport, and biological emissions from the agriculture sector continue to be excluded, then the scheme will create economic distortions and unfairness, and fail to meet its objectives. These flaws will become more pronounced as the economic impact of the scheme increase.

At extreme carbon prices relative to today, the economic effect can only be to incentivise redirection of investment out of sectors such as gas, which functions as a transition fuel, and into more emissions-intensive agricultural activity.

Therefore before policy is designed with the specific intention of increasing carbon prices for those sectors already in the scheme, agricultural emissions should be brought into the scheme first. If agriculture is not brought into the scheme, then increasing the carbon price only for remaining sectors cannot be relied on as a strategy for reducing emissions and will only have the effect of arbitrarily taxing those sectors.

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QUESTIONS 3, 4 & 5 - FULL SURRENDER OBLIGATIONS

The decision to allow non-forestry participants to surrender one unit for every two tonnes of emissions was made at the time because of the financial impact of the global financial crisis at the time. The discussion document makes the comment, at Page 12, that, 'the New Zealand economy has made a solid recovery since the 2008/09 recession.'

This may be true of the New Zealand economy, but the impact of the relevant obligation is experienced at the individual sector level. In the oil and gas sector, there was a substantial decline in the international oil price during the global financial crisis, which then reversed out in 2009. However, since 2014 global hydrocarbon markets have been severely in price decline.

On 19 February Brent oil crude prices were down 43.5 per cent on prices a year ago, and 70.9% compared to prices three years ago.

Therefore, if one factor in moving to a full surrender obligation is the perceived strength of the economic impact, then that underlying assumption is flawed.

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It is submitted that the timing of an immediate move to full surrender obligations would be punitive for the oil and gas industry. At the current carbon price of $10/t, the immediate impact would be to increase costs in the business by between [redacted] of revenue, or around [redacted] of revenue from the Kupe field.

However, scenarios also need to consider that global policy to reduce emissions is also likely to continue to depress oil and gas prices, while one explicit aim of the review is to increase the cost of emissions to emitters, and therefore one can project a lower forward curve for revenue, and a future carbon price higher than $10/t.

At a carbon price of $50/t, and using the emissions levels set out in the table above, the scheme would cost New Zealand Oil & Gas around [redacted] (based on current emissions) or more than [redacted] of projected revenue, assuming a market could be found at those cost levels.

If the decision were made to move to full surrender obligations, it is submitted that it would be unreasonable to move to full surrender before 2018 because there is no time for businesses to immediately change behaviour.

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Most gas supplied in New Zealand is produced under long term supply contracts. Therefore an increase in surrender obligations this year would be unlikely to incentivise any reduction in output, and in practice would function only as a new tax on the producer.

An early indication of a future policy intention maximises policy stability and allows planning for the future.

Concluding comments

New Zealand Oil & Gas is available to assist officials in further discussion of the issues raised in this submission, or in providing a wider perspective on our activities and the industry generally.

Please contact John Pagani as above.

New Zealand Oil & Gas will make a further submission on the April (non-priority) issue.