



New Zealand Emissions Trading Scheme Review 2015/2016

Submission made by:

Refining NZ

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Introduction

Refining NZ welcomes the opportunity to make this submission.

Please note that this submission contains supporting information that is commercially sensitive to Refining NZ. While the information is provided for the understanding of the ETS Review team, this information should not be made publicly available, as its public disclosure would be likely to unreasonably prejudice the commercial position of Refining NZ. Commercially sensitive information is clearly marked as such in the submission.

Preliminary issue: definition of Energy Intensive Trade Exposed Industry

As an adjunct to this submission we wish first and foremost, to underline a critical issue for the Refinery namely, that under the Climate Change Response Act 2002 (CCRA) and through what we consider a quirk in the revenue guidelines, the Refinery is not considered an Energy Intensive Trade Exposed (EITE) industry.

This issue was raised with former Climate Change Issues Minister, the Hon. Tim Groser in November 2015. As recommended by Mr Groser, we are raising the issue through the ETS Review process and post the Review, are looking to resume our discussions on the issue with MfE officials. For the purposes of this submission the issue is outlined in more detail in Appendix 1.

Refinery background:

1. Refining NZ is the only oil refinery in New Zealand. It supplies approximately 40% of the total energy needs of New Zealand and 70% of the transport fuel needs. The remainder is imported.
2. Contrary to the CCRA, Refining NZ is an EITE business. The table of New Zealand EITE allocation (see Appendix 1), illustrates that Refining NZ is “Energy Intensive” and given it competes in a global market, it is also “Trade Exposed”.
3. Our objective is to produce the highest quality conventional fuel with the lowest carbon footprint practically possible. We have made substantial investments in our Refinery (~\$735 million) in order to produce low sulphur diesel, remove benzene from petrol, improve energy intensity and hence, our carbon emissions profile.
4. Refining NZ supports the intent of limiting or reducing Green House Gas (GHG) emissions.
5. We are committed to making energy and emissions improvements under the NGA we have had with the Crown since 2003. Key elements of the NGA are:

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- An agreed energy intensity improvement pathway which leads to a reduction in Refining NZ's carbon emissions.
- "Competitive at Risk" (CAR) status. This recognises that if Refining NZ is subject to an emissions charge, there is significant risk of the Refinery reducing or even ceasing production if offshore refineries face less stringent climate change policies.
- An exemption for Refining NZ from a charge on direct CO₂ emissions.
- A transfer of carbon units as compensation for the cost to the Refinery of indirect CO₂ emissions (through the use of bought-in natural gas and electricity).

Since its inception this agreement has provided the necessary level of certainty for Refining NZ to make substantial investment in improving the energy intensity and hence, the carbon emissions profile of our Refinery. We continue to meet our NGA obligations.

6. Refining NZ estimates that in the absence of an NGA the impact of a full surrender obligation will have a significant financial impact on the Company, anywhere between \$6m (carbon at around \$6) and \$57m (carbon at around \$50), depending on the price at that time.
7. Oil refining is a global activity with a clear link between remaining competitive in the international market through reducing energy use; and as a consequence, reducing GHG emissions. Refining NZ is a case in point: energy costs account for around 36% of Refining NZ's corporate costs. Our \$365 million Te Mahi Hou (TMH) expansion will improve our competitiveness mainly through improved energy efficiency and as a consequence, reduce our carbon footprint by around 120,000 tonnes of CO₂ per year.
8. Refining NZ is a major contributor to the Northland regional economy, with 500 employees and contractors. In addition, for every job at the Refinery another six are created in New Zealand (in sectors supplying the Refinery)¹.

Comment and discussion

Our responses to questions in the discussion document 'New Zealand Emissions Trading Scheme Review 2015/2016' can be summarised under two main headings:

Refining NZ believes that New Zealand's ability to meet the carbon reduction targets as set out in the Paris Agreement relies on a working, viable international marketplace for carbon.

Ultimately, a viable market requires the free flow of market forces (supply and demand of carbon units).

New Zealand's policy response to climate change should not be out of step with the commitments made by other parties to the Paris Agreement.

EITE industries, operate in highly competitive global sectors, and require a level playing field if they are to continue to compete internationally and to successfully contribute to New Zealand meeting its carbon reduction obligations.

¹ Bruce, P. Hughes, D. et al (2008); "The New Zealand Refining Company – Our Contribution"; *NorthTec and Institute of Public Policy*; P 6.

We believe that the failure to heed either of these two points would lead to the export of carbon and the loss of jobs without a positive impact on the climate.

Below we address the specific questions posed in the discussion document.

Context and drivers for the review

1. Do you agree with the drivers for the review?

Refining NZ believes an ETS remains the most economical way of reducing CO₂ emissions in the long term and we support measures to improve its effectiveness and central place in a New Zealand CO₂ reduction policy.

2. What other factors should the Government be considering in this NZ ETS Review?

Refining NZ believes there is a need for a fully functioning and liquid international market for carbon.

Any policy decisions out of the ETS Review need to consider the likely impact on the international competitiveness of Energy Intensive Trade Exposed (EITE) industry, such as Refining NZ.

The Government should take account of the slow implementation of ETS in other countries – where regional, rather than national ETS have largely predominated, and critically, where the refining sector is treated the same as other energy intensive industries. In all ETS schemes where refineries are included they receive a free allocation of carbon units and this is likely to continue well beyond 2023 e.g. even in the most stringent EU ETS.

Moving to full surrender obligations

3. Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?

We agree that the NZ ETS move to full surrender obligations is necessary, with the proviso that the carbon price that EITE industries are exposed to doesn't undermine their competitive position.

4. What impact will moving to full surrender obligations have on you or your business? Please include specific examples or evidence of the impacts on your business of:

- a) *increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher*
- b) *any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.*

There is no exposure for Refining NZ while the NGA we have with the Crown remains in place. This Agreement is due to expire in January 2023, beyond which Refining NZ would be similarly exposed to the ETS as other EITE industries.

Refining NZ would not support the phasing of full surrender obligations where it leads to carbon price issues, for example, where NZ ETS carbon pricing is out of 'sync' with international market prices. Full surrender, ahead of our international competitors, would put Refining NZ at a distinct competitive disadvantage and severely impact the Refinery's viability.

5. If full surrender obligations are applied, when should this be implemented?

- a) 2016 b) 2017 c) 2018 d) other**

Refining NZ supports the phasing of full surrender obligations later than 2018 – that is, option d).

Later implementation would give EITE industry the opportunity to manage the transition (including, but not limited to capital investment in CO₂ reduction). This allows the Refinery to maintain its competitive position. It would also allow Government to monitor the progress of similar policies by other parties to the Paris Agreement, providing it time to tweak its policy response, should this be necessary.

Managing the costs of moving to full surrender obligations

6. If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?

We agree that potential price shocks should be managed.

7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?

a) maintain the fixed price option at \$25 b) lower the fixed priced option c) gradually move to full surrender obligation d) other methods

We would favour option c).

8. If the \$25 fixed price surrender option value should change, what should it change to and why?

As above.

Other Issues

Business responses to the NZ ETS

9. Do you consider the future cost of emissions in your business planning – if yes, how do you do this?

The impact of the Refinery's future exposure to carbon pricing is factored into significant Refinery investment. The investment case for the Company's \$365 million investment in Te Mahi Hou is a prime example.

10. What would improve your ability to take into account the future cost of emissions in your business planning?

Significant Refining NZ investments are typically based on a 25-30 year asset life basis. We need certainty on the future shape of the carbon market with few, if any, policy changes in the interim.

Protecting competitiveness through free allocation

With respect to Refining NZ's competitiveness and the issue of free allocation, a more detailed response is outlined in Appendix 1.

11. Under what conditions should free allocation rates start to be reduced after 2020?

Free allocation to EITE industry should only be reduced where such measures are implemented by other nations. To do otherwise would impact the ability of EITE industry to compete on the world stage.

12. What impact would it have on your investment decisions over the next few years if there was clear pathway or criteria for phasing out of free allocation after 2020?

At this stage we're unsure of the exact impact on Refining NZ's investment, going forward. However, the phase out of free allocation would need to be calculated in our investment decision making processes.

Managing unit supply

We have no comment to make on the questions raised in section 4.3. (Questions 13-15).

International Units

16. If international units are eligible for NZ ETS compliance in the 2020s, should any of the following restrictions be placed on their use?

- a) restrictions on where units can be sourced from location of an /or types of projects**
- b) restrictions on how many units can be surrendered**
- c) others**

We believe the answer to a) b) and c) is no. Access to international emissions units remains an important mechanism that can contribute to creating a level international playing field for EITE industry, such as Refining NZ.

NZ ETS participants should be allowed to source units from international markets.

International fungibility would strengthen the NZ ETS and aligns with New Zealand's stated goal, outlined by the former Climate Change Issues Minister in Paris: "New Zealand wants to ensure development of a strong and robust global carbon market that has environmental integrity,"²

17. Should auctioning be introduced to the NZ ETS?

18. What should be the role or purpose of an auctioning function in the NZ ETS, if one were introduced?

- a) to align supply in the NZ ETS more closely with our international target*
- b) to more actively manage NZU prices*
- c) other*

19. How should auctioned NZUs relate to other sources of unit supply in the NZ ETS, especially NZUs generated through forestry removal and or international units?

First and foremost we believe that international fungibility is preferable to the Government taking a gatekeeper (i.e. price fixing) role in the New Zealand carbon market.

However, an auctioning system for the NZ ETS could play a role in managing price volatility, always an inherent risk in a small and illiquid market which in a domestic only price mode, is highly susceptible to any unit supply/ demand imbalance.

Managing price stability

20. What impact has carbon price volatility in the NZ ETS had on your business?

- a) minor b) moderate c) significant.*

There is currently no impact on Refining NZ because our NGA with the Crown exempts the Company from participation in the NZ ETS. In our view the NGA is a highly effective Agreement. Since the NGA was signed in 2003, Refining NZ has continually met its energy intensity pathway obligations set out in the agreement, and as a result, reduced carbon emissions. This has been achieved in the absence of an NZ ETS carbon price signal.

21. Do you think measures should be in place to manage price stability?

See answers to questions 17-19.

22. What do you consider are important factors for managing price stability?

- a) upper prices limits (e.g. fixed price option, or price ceiling implemented through an auctioning mechanism) b) lower price limits (e.g. price floor) c) other.*

Refining NZ does not favour market regulation by way of Government intervention in pricing

² <http://beehive.govt.nz/release/new-zealand-leads-declaration-carbon-markets-paris-climate-conference>

(i.e. fixed prices). Rather the price should be set through the operation of a viable international market for carbon.

23. What should the Government consider when managing price stability?

Consideration should be given to not exposing the competitive position of EITE industry, such as Refining NZ.

24. Are you aware of ways the administrative efficiency of the NZ ETS could be improved?

No.

25. Can you provide further information to support your answer?

As above.

Addressing the barriers to the uptake of low emissions technologies

26. Are there any barriers or market failures that will prevent the efficient uptake of opportunities and technologies for reducing emissions?

Overly onerous costs associated with meeting emissions could lead to Refining NZ's closure with unintended consequences: - the production of New Zealand's fuel requirements offshore by less energy efficient, more carbon intensive refineries together with increased CO₂ emissions in longer shipping supply chains. Closure of Refining NZ could paradoxically, increase GHG emissions globally (this is carbon leakage).

Refining NZ believes policy makers need to be cautious about overestimating the reduced use of conventional fuels.

The future of transport will require a mix of fuels, with conventional oil continuing to play a significant part for some time as New Zealand makes the transition to alternative fuels.

For example, domestic aviation fuel emissions are likely to grow as a result of increased New Zealand bound tourism. The replacement of international fleets with fuel efficient planes we believe, will only go some of the way to reducing the carbon impact of increased tourism.

The growth of fuel alternatives is a logical step towards reducing New Zealand's dependency on imported fuels, and hence, carbon.

Refining NZ recognises the place of electric and hybrid vehicles as offering a practical transition to lower carbon transport. However, biofuel technology may prove an equally viable future pathway.

Refining NZ sees the opportunity of participating in biofuel technology and maintains a watching brief, believing that a viable future rests with "drop in" second generation. At some point in the future the Refinery could well refine these biofuels, with the proviso that Refining NZ can only assimilate proven technologies for which there is a valid business case.

27. If so, is there a role for Government in addressing these barriers or market failures and how should it do this?

Our preference is for a fully fungible NZ ETS with access to international carbon units. International fungibility is preferable to the Government taking a gatekeeper (i.e. price fixing) role in the New Zealand carbon market.

In Conclusion

As recommended by the former Minister of Climate Change Issues, we are raising the critical issue of our eligibility as an EITE industry through this ETS Review process and post the Review, are looking to resume our discussions on the issue with MfE officials.

As an energy intensive and critical part of New Zealand's energy infrastructure, Refining NZ recognises the part industry has in helping New Zealand to meet its climate change obligations.

We believe that any policy changes resulting from the ETS Review need to be managed so that New Zealand's climate change policy framework is not out of step with our international competitors. Being ahead of the climate change curve would undermine the competitiveness and viability of this country's energy intensive industries, including Refining NZ, and create barriers for an effective response to New Zealand's climate change obligations.

We would welcome the opportunity for more detailed discussion on this submission with Review officials.

For Refining NZ



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Chief Executive Officer

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³ Ministry for the Environment, 2010. *Industrial Allocation Guide to Data Collection*. Wellington: Ministry for the Environment

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