27 May 2014

Hon T Groser
Minister for Climate Change Issues
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Parliament Buildings
Wellington

Hon J Goodhew
Associate Minister for Primary Industries
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Dear Ministers

Re-registration arbitrage by post-1989 forest land participants in the ETS

Background

Under the Climate Change Response Act 2002 emitters receiving NZUs were able to discharge their liabilities using Kyoto units and thus benefit from the difference in price.

On 19 May 2014 the government passed amending legislation that retrospectively eliminated that ability for post-1989 forest owners as from 16 May 2014.

Summary

The recent amendment to the Act was introduced because of government concerns over the fiscal and reputational risks of post-1989 forest owners having the unique ability to use the arbitrage opportunity multiple times where other emitters could only use it once.

The forest sector considers that the blanket restriction imposed to address the government's concerns was not fit for purpose and has created a new layer of inequity.

Forest growers recognise the government's concerns related to multiple arbitraging, but consider there is a better approach that meets the government's concerns while also maintaining equity and without having to act retrospectively.

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Achieving an equitable outcome

The government concern, as the Regulatory Impact Statement records, is that "*post-1989 forest land participants have additional opportunities to arbitrage NZU's (that other ETS participants do not have) by their ability to opt-in and out of the ETS multiple times for the same area of forest land*". We agree that this is a legitimate concern and is not the intent of the ETS.

By comparison, government does not have a concern with forest owners using Kyoto units to deregister any more than they have a concern with other emitters using those same units for discharging their liabilities, even where they have already received NZUs.

The objective then should be to remove the ability to carry out multiple arbitraging while still allowing post-1989 forest owners the same single arbitrage opportunity as any other emitter. The current amendment fixes the issue that government has but goes beyond that and penalises owners who are acting legitimately and in good faith.

Many forest owners are exiting the ETS because of concerns about the future price and market rules. Two-thirds of the forest owners de-registering from the ETS have shown no intention, thus far, of re-registering. They have already purchased Kyoto units for the purpose of exiting the ETS. Those purchases were made on the basis of statements made the government, and government departments, as late as December 2013 (and following a round of industry consultation) that this was legitimate and no change to that situation would be made before May 2015.

One unintended consequence has been replaced with another.

The forest growing sector is concerned at the impact of this on investment confidence at a time when we are endeavouring to partner with government on a programme of work to achieve the mutual goal of adding value on-shore.

The sector is also concerned at the prospect that some of its members – those with relevant foreign ownership – are or may be entitled to seek legal redress for this retrospective regulatory change through investor-state dispute settlement. This right extends to most Asian investors through investment chapters of any of the NZ-China FTA, the AANZFTA or the NZ-Malaysia FTA. In contrast, wholly domestic foresters have no legal redress. This disparity of recourse further underlines the inequity in the government's retrospective regulation.

Proposed solution

We believe that the problem identified by the government can be appropriately addressed by a more tailored solution. The most appropriate response to address the unintended multiple arbitrage issue is to permit post-1989 forest owners to use Kyoto units to de-register. Thereafter all transactions would be required to be in NZUs. Thus, if the same forest was re-registered then NZUs would be required for any future de-registration. This eliminates multiple arbitraging.

Furthermore, we suggest that under re-registration the forest in question would only start accruing units from the following year - in this case 2015 - and this rule would apply in the future as well. This latter additional restriction would prevent anyone reclaiming for a year already received. Anyone applying for the first time would not be affected.

These further amendments would address both the unquantified fiscal risk and the reputational risk for forestry units while avoiding the unintended penalisation of forest owners who were not seeking to game the system. It would require an amendment to the recently passed legislation but would have widespread support and not undermine, or reverse, the actions taken by Government.

If the government wished to place restrictions on all emitters purchasing new Kyoto units for arbitraging, forest growers would be supportive of that as we have consistently argued for this. Such a step would, however, be additional to what is suggested above.

We would welcome the opportunity to meet and discuss the matters raised in this letter with both of you. We anticipate approximately 4 attendees at the meeting representing NZ Forest Owners Association and NZ Farm Forestry Association. We appreciate the heavy workload of Ministers and pressure, at short notice, on your daily schedules and would be agreeable to an evening meeting if that was more convenient for you.

Yours sincerely

David Rhodes
Chief Executive