

Topics for NZ ETS Review 2015/2016 consultation

About the consultation

The Government is reviewing the New Zealand Emissions Trading Scheme (NZ ETS) to assess how it should evolve to support New Zealand in meeting future emissions reduction targets and its ongoing transition to a low emissions economy. This follows the announcement by the Government in July this year that New Zealand's post 2020 target is to reduce greenhouse gas emissions to 30 per cent below 2005 levels by 2030.

The Ministry for the Environment is leading the consultation and welcomes your feedback on how the NZ ETS is working and how it might work better in the future.

The review will focus on:

- some transitional measures introduced to moderate the impacts of the NZ ETS
- what is required for the NZ ETS to evolve with changing circumstances including future targets
- operational and technical improvements.

Discussion document

For more information about the consultation, read our discussion document. It sets out the issues on which the Government is consulting, the objective and drivers for the review. It also contains the terms of reference for the review.

Some transition measures are being given priority and have the first deadline for submissions as they may be candidates for legislative change in 2016 (see closing dates for submissions below). Refer to the discussion document for detail on the priority and other matters under review.

Technical notes on the following specific issues will be available in December or early 2016 to support submissions:

- modelling of the impacts of the priority issues outlined in the discussion document
- forestry sector matters, including accounting methodologies for post-1989 foresters
- operational and other technical matters.

To be notified of when these technical notes are available, please email nzetsreview@mfe.govt.nz.

Closing dates for submissions

- Submissions on priority issues close at 5pm on 19 February 2016
- Submissions on other review matters close at 5pm on 30 April 2016.

You may make submissions on both priority issues and on the other matters. If you provide feedback on both you can do so in a single submission or separate submissions. Please note submissions on priority issues must be received by 19 February 2016.

Publishing and releasing submissions

All or part of any written submission (including names of submitters), may be published on the Ministry for the Environment's website www.mfe.govt.nz. Unless you clearly specify otherwise in your submission, we will consider that you have consented to website posting of both your submission and your name.

Contents of submissions may be released to the public under the Official Information Act 1982 following requests to the Ministry for the Environment (including via email). Please advise if you have any objection to the release of any information contained in a submission and, in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this consultation under the Official Information Act.

The Privacy Act 1993 applies certain principles about the collection, use and disclosure of information about individuals by various agencies, including the Ministry for the Environment. It governs access by individuals to information about themselves held by agencies. Any personal information you supply to the Ministry in the course of making a submission will be used by the Ministry only in relation to the matters covered by this consultation. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry may publish.

Contact for queries

Please direct any queries to:

Phone: +64 4 4397400

Email: nzetsreview@mfe.govt.nz

Postal: NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143

Questions to guide your feedback

The questions below are a guide only, and all comments on topics are welcome.

To ensure your point of view is clearly understood, please explain your rationale.

Contact information

Name	Bryan McKinlay
Organisation (if applicable)	Craigmore Forestry Ltd
Address	PO Box 18, Gisborne 4040
Telephone	██████████
Email	████████████████████

Submission Form

Introduction to Craigmore and the NZ ETS:

This submission from Craigmore Forestry Limited which has established 6,500 ha of new/greenfields forestry in 2010, 2011 and 2012. The ability to generate tradable carbon units (NZUs) has been a driving force in establishing these forests. All 6,500 ha of the new forest plantings were registered into the ETS as Post-1989 forests.

The land planted by Craigmore Forestry was underdeveloped, marginal or erodible farmland. Therefore planting softwood and hardwood trees on these marginal landscapes has created a net benefit to New Zealand in terms of employment, regional development, erosion control, soil and water enhancement and biodiversity values.

Craigmore initially intended to plant a further 1,500 ha in 2013 with further plantings in 2014-15. These programmes have been deferred indefinitely as a result of the poor carbon outlook. This poor outlook is compounded by recent (up until 2015) policy that has allowed emitters to use cheap foreign credits of dubious environmental credibility to meet surrender obligations under NZ's ETS. Whilst doing this, many emitters have also banked large volumes of NZUs and this over supply of units is hindering market price and preventing the full impact of the ETS from coming into force.

Craigmore believes the integrity and reputation of the NZ ETS requires an immediate move to full surrender obligations, requires greater certainty about future policy settings, and requires a sound approach to managing banked emissions from emitters who have chosen to use environmentally dubious foreign credits, many of which were sourced at prices below NZ\$ 0.20/unit.

Context and drivers for the review

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

Yes

Yes agree. Increasing the performance of the NZ ETS against its objectives (assisting NZ to meet international obligations, and reducing NZ net emissions below business as usual levels) is vital for the validity of the scheme. However, the single greatest driver that the Government should be focused on in the review is ensuring that there is greater certainty around policy settings. The changing nature of ETS policy has seen forest owners lose faith in the ETS and this has seen new forest planting rates drop to virtually nil, deforestation has increased and foresters have exited the ETS scheme in large numbers due to a lack of policy certainty and a lack of confidence in Government's commitment to ensuring that the ETS will apply to all sectors and all gases.

No

Unsure

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

Government needs to acknowledge that the use of cheap overseas credits has put handbrakes on the ETS that will be felt for many years to come. Official figures show that of the 136m credits surrendered to NZ Government by emitters to date, less than 10m of these are from NZ forestry generated credits. Emitters have quite deliberately used cheap offshore credits from as little as \$0.13/credit, mainly from Ukraine, Russia, China. Government must be extremely mindful of this when it considers allowing further access to offshore markets beyond 2020, and to how it

approaches the concept of managing banked emissions. The wider concept of the net benefit to New Zealand must also be considered. Projects within NZ provide wider benefits of appropriate land use, employment, regional development, biodiversity, water quality and enhance New Zealand's international reputation as taking climate change and abatement measures seriously, as oppose to simply allowing further access to offshore markets for buying credits.

The fact that forest planting rates have not increased under current ETS settings indicate the objective of the ETS has been undermined by weak NZU prices as a result of offshore credits and the 2-for-1 policy. NZ could meet climate change targets by enhancing forest planting rates on eroding and marginal lands, and by constructing policy settings that enhance the use of domestic units (NZUs) there would be meaningful supply and demand for these units.

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?

Yes

- Yes NZ needs to remove the 2 for 1 and move to full surrender obligations immediately. The 2 for 1 effectively subsidises emitters who therefore delay behaviour change and the required transition to a low carbon economy. It also reduces demand for NZUs and drives price down, therefore decreasing the incentive for suppliers of NZUs (i.e. forest owners) to remain engaged with the scheme. Removal of the 2 for 1 would create a genuine local carbon market, encourage reduced emissions and behaviour change, stimulate afforestation on marginal lands, and provide an ETS platform that has greater credibility both nationally and internationally.

No

Unsure

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 you or 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.

Craigmore Forestry Ltd would welcome the move to full surrender obligations. Whilst Craigmore has established 6,500ha of new forests since 2010, it has also delayed further planting plans due to policy uncertainty and the low carbon price (driven primarily by factors such as the 2 for 1, the ability for emitters to use cheap foreign credits, and moves to allow future auctioning of units). With a carbon price of above \$15/NZU Craigmore would likely commence further afforestation projects. Many of these projects were abandoned once carbon price fell from \$20 to \$2 and cheap foreign units priced as low as \$0.15 were accepted by Government.

- b) any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

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

- a) 2016

Yes applied immediately.

b) 2017

c) 2018

d) other – please specify

Outline the reasons for your answer, and include any comments on the pros and cons of applying an increased surrender obligation to a partial or a full NZ ETS reporting year.

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?

Yes

No

No the market should be the market and Government should not interfere. When carbon price plummeted from \$20 to \$2 there was no Government intervention or management to slow the price drop. Once NZ has full exposure to the ETS across all gases and all sectors then we will see behaviour change and this is what will help the transformation to a low carbon economy.

NZ needs to enhance the ETS by applying it to all sectors and all gases. It should not have exemptions or 2 for 1 deal for emitters. Agriculture should eventually be brought into the ETS to give the scheme credibility. Further, the incentives to plant trees and sequest more carbon should be enhanced. MfE has a goal of planting 50,000 ha's of marginal land per year. This goal of further planting can only be achieved if policy settings provide confidence to the long term treatment of the ETS. NZ has large areas of marginal farmland that are eroding, are under-developed (especially on maori land) and should be retired or planted. These actions will help NZ achieve its longer term climate change targets through meaningful environmental actions, rather than simply trying to purchase units from offshore markets.

If market protections are put in place, then they should be balanced e.g. a temporary system where there is a both a minimum and a maximum price such as 5 years of \$15 to \$30/NZU

Unsure

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

The \$25 price cap needs to be removed. It shelters NZ from the full reality of the ETS and hinders the ability for the ETS to function properly and be taken seriously by emitters. There is not a price floor to assist those who supply NZUs so why should there be a price cap to shelter emitters. If market prices rise above the \$25 cap then behaviour change will simply be further incentivised. Afforestation would be encouraged and prices would fall.

b) lower the fixed price option

c) gradually move to full surrender obligation

d) other methods.

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

Either removed or a cap and collar of \$15-30 per NZU

Other issues: business responses to the NZ ETS

9. Do you consider the future cost of emissions in your business planning?

Yes

Absolutely – it is the sole reason why the Craigmore afforestation programme stopped so abruptly.

No

If yes, how do you do this?

Yes future planting programmes are currently assessed in light of current carbon price and the future policy settings that are likely to impact carbon price.

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

Simple long term policy stability around ETS such as knowing that there will be no Government interference with the carbon price, and that all sectors and all gases will truly be subject to the NZ ETS.

Other issues: protecting competitiveness through free allocation

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

Under the condition that all sectors and all gases are subject to the ETS.

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

It would provide greater certainty to foresters that emitters are going to be responsible for the full amount of their emissions. If forest owners were certain of this they would have more faith in the NZ ETS as there would be more market certainty around demand for units produced by forest owners as forests grow.

Other issues: managing unit supply - forestry

13. How does the carbon price impact your forestry investment decision-making?

In your answer, we are interested in the:

- a) extent to which the NZU price impacts decisions, compared to other factors
- b) impacts of the current price, and of your expectations for future prices.

NZU price is vital and a price of over \$15/NZU is required in order for forest planting to be initiated. However, of more importance than the market price is the long term policy certainty around the ETS. Forest rotations of 25-30 years mean many Governments will come and go

through the life of a forest. Given the long term nature of the investment, policy certainty and stability is vital.

14. Are there opportunities for the NZ ETS to increase incentives for forestry investments, outside of NZU price?

Yes

Life Cycle

Yes there are actions such as accounting for whole of life cycle analysis for wood products compared to other energy intensive or non renewable materials used in building and construction. Government could further enhance the use of wood in design, architecture and engineering of buildings, and the ETS could acknowledge the concept embedded carbon in wood (as opposed to the assumption of immediate carbon loss upon harvest).

Averaging

Forest owners in the ETS could also have the option of averaging ETS stocks over the rotation. The concept of averaging will allow small and medium forest owners to simply take an “average” amount of carbon from their forest and trade these amounts of credits. The full annual management of carbon stock rises and the carbon stock fall from harvest can be greatly simplified by an averaging approach provided that forests are replanted. This policy change would have a massive impact on afforestation levels, as many owners of marginal land and existing forested land do not sell any NZUs through fear of the NZU price increasing, resulting in a much larger NZU liability at harvest. This is a very significant issue – second only to NZU price.

A carbon neutral criteria could also be allowed for farmers via on farm planting offsets. This means a farmer could simply be classed as carbon neutral and exempt from any ETS liabilities from livestock if he/she planted say 10-20% of their land in trees (i.e. plant enough area to offset livestock emissions over a 30 year period). They would not receive credits for these trees and they would be non ETS forests, but they would likewise be exempt from the ETS liabilities from livestock provided they could show 10-20% of the farm had been planted in new trees (i.e. since 2008 when the ETS was introduced for forestry, or any other such nominated date).

No

Unsure

15. What are your reasons for the above answer? If you answered yes, we would be interested in comments on:

a) any barriers to participating in the NZ ETS that could be reduced

Fear of increasing NZU prices, and therefore increasing harvest liabilities, preventing marginal land owners from selling NZUs. This can be addressed through ‘averaging’.

b) other factors.

Barriers to the ETS entry for forestry include the ability to do away with the FMA and allowing participants to use regional look up tables. This would save a large amount of time, cost and confusion for forest owners who have more than 100 ha’s in the ETS, but don’t want to go through a full measurement process every 5 years.

Other issues: managing unit supply – 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 and/or types of projects)

Yes there should be restrictions on where credits can be sourced from and only projects which have suitable environmental integrity should be eligible for use in the NZ ETS.

- b) restrictions on how many units can be surrendered

Yes there should be restrictions on the amount of credits allowed to be used by emitters. The greater the restriction on foreign credits the greater the demand for NZUs which is what will enhance NZ behaviour change and NZ's transitions to a low carbon economy, as well as providing further local benefits such as employment, regional development etc. The greater NZU demand will also encourage more forest owners to partake in the scheme and benefit from the carbon sequestered by forests, in turn further enhancing the planting rates for NZ forests on marginal and erosion prone land.

- c) others (please explain).

Other issues: managing unit supply – auctioning

17. Should auctioning be introduced in the NZ ETS?

Yes

No

It is difficult to understand the place for auctioning and the benefits and costs without understanding the full context. For example, auctioning "free allocations" may be better than no auctioning at all. However, a simple market-driven process is preferable, with auctioning potentially used only where there are extreme market circumstances (demand or supply) in order to bring about a more normalised price. Unsure

If yes, when?

- a) in the next two to three years

- b) within five years (before 2020)

- c) after five years (post 2020).

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 (please explain).

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

If auctioned units are made available in NZ they should only be allowed for use once forestry generated credits have had the option of selling at that price. Government should also give ample warning as to what price is going to be the trigger for auctioning so that forest woners who hold NZUs can be fully aware and informed. Forest owners who have NZUs should not be forced to sell units at a price dictated by auctioning. i.e. forestry generated credits do not want to be “capped” and limited by auctioning prices.

Other issues: managing price stability

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

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

ETS volatility has had a major impact on the viability of Craigmore Forestry Ltd – as noted above planting plans for 1500 ha’s of land were abandoned in 2013 once carbon price had crashed from a previous high of \$20 to below \$2. The carbon price crash impacted on the viability of forest planting for ETS purposes and made new planting uneconomic.

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

Yes

No

Unsure

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

- a) upper price limits (eg, fixed price option, or a price ceiling implemented through an auctioning mechanism)
- b) lower price limits (eg, price floor)
- c) other (please explain).

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

Certainty and stability are the greatest issues for ETS price.

Other issues: operational and technical matters

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

Yes

No

Unsure

25. Can you provide further information to support your answer? We would be interested in comments on:

a) complexities involved in NZ ETS participation

The NZ ETS for Post 1989 forest participants is complex through having a myriad of new terminology and concepts. However, the greatest complexity and cost is around managing the FMA approach for participants over 100 ha's (especially the fact that FMA becomes compulsory, and it must be replicated again in every 5 year period).

b) penalties for breaching NZ ETS obligations

c) any technical or operational changes that could be made to the NZ ETS to improve efficiency.

Other issues: addressing 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?

Yes, the previous unlimited access to offshore markets for cheap credits meant that the uptake of new technology for emissions reductions in NZ was never given enough emphasis.

Lack of "averaging" for plantation forestry creates complex harvest liability issues which make afforestation decisions more difficult and can be the ultimate impediment. For example, the only "safe" carbon (NZUs that can be sold and not repaid if the block is replanted post harvest) in a new plantation is from the root carbon (cica 20-25% of the full NZU allocation up until harvest), however averaging can increase the risk-free/sellable carbon to the first 50% of NZUs. This change has a massive impact on the economics for smaller landowners to plant marginal land in trees.

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

Yes, the role of Government should be to further promote the NZ ETS by incentivising emissions reduction activities in NZ, reducing/limiting the amount of access NZ has to offshore units and setting out a policy for "averaging".

Any other comments

28.

When your submission is complete

Email your completed submission to nzetsreview@mfe.govt.nz or post to NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143.

Submissions on Priority issues close at 5.00pm on 19 February 2016.
Submissions on Other matters close at 5.00pm on 30 April 2016.