



28 February 2020

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## TRUSTPOWER SUBMISSION: REFORMING THE NEW ZEALAND EMISSIONS TRADING SCHEME: PROPOSED SETTINGS

### 1. Context and background

- 1.1.1 Trustpower Limited (**Trustpower**) is pleased to provide a submission to the Ministry for the Environment (**MfE**) on its *Reforming the New Zealand Emissions Trading Scheme: proposed settings* consultation document (**the Consultation Document**).
- 1.1.2 Trustpower welcomes the opportunity to contribute to the discussion and assist the New Zealand Government (**the Government**) in their thinking on the appropriate settings for the New Zealand Emissions Trading Scheme (**the NZ-ETS**).
- 1.1.3 We agree with Minister James Shaw that the NZ-ETS is the primary driver to reduce emissions and help New Zealand meet its targets.<sup>1</sup> A credible and robust NZ-ETS that provides certainty to the market will be vital for ensuring that effective emissions pricing occurs. The NZ-ETS settings must provide efficient signals to encourage businesses to reduce emissions, innovate, and invest in low-emissions solutions.
- 1.1.4 While the NZ-ETS is a key part of the solution to tackle climate change, it is not the only part. Trustpower believes that to successfully address climate change, a problem that Minister Shaw describes as the biggest challenge of our time<sup>2</sup>, it must be tackled with a wide package of reforms. This need for other supporting regulations, policies, and programmes to assist with an accelerated transition to a low-emissions economy<sup>3</sup> has also been highlighted by the New Zealand Productivity Commission and the Interim Climate Change Committee (**ICCC**).
- 1.1.5 We understand the NZ-ETS settings proposed in the Consultation Document are intended to complement the policy options presented in the Ministry of Business, Innovation and Employment's (**MBIE's**) discussion document *Accelerating renewable energy and energy efficiency* (**MBIE Discussion Document**) and work alongside other initiatives in the Government's Renewable Energy Strategy. As Trustpower has outlined in previous submissions to the Government and other agencies, we continue to support and promote cohesive thinking across these issues.

<sup>1</sup> Consultation Document, [2019] Ministry for the Environment, p. 7

<sup>2</sup> Consultation Document, [2019] Ministry for the Environment, p. 7

<sup>3</sup> Low-emissions economy, [2018] New Zealand Productivity Commission, p. 4

- 1.1.6 This submission focuses primarily on the mechanism and the proposed settings of the NZ-ETS. Our response contained herein is designed to be read in conjunction with Trustpower's submission on the MBIE Discussion Document.
- 1.1.7 Trustpower's response to the MBIE Discussion Document addresses the various policy settings and supplementary measures that will complement the NZ-ETS in reducing emissions and enabling New Zealand to meet its targets.
- 1.1.8 Trustpower looks forward to continuing to invest in the energy sector and help New Zealand achieve the targets set under the 2015 Paris Agreement and the Climate Change Response (Zero Carbon) Amendment Act 2019.

## 2. Summary of Trustpower's views

- 2.1.1 The Consultation Document addresses many aspects of the proposed NZ-ETS settings:
  - a) the provisional emissions budget and approach to achieving the 2050 emissions target;
  - b) unit supply settings (emissions cap and auction volumes);
  - c) price controls (auction reserve price, fixed price option, cost containment reserve and price trigger);
  - d) impacts (potential impacts of the proposed changes on households and businesses); and
  - e) process for the release of NZ ETS settings information.
- 2.1.2 Trustpower agrees with the proposed straight-line approach to reach the 2050 emissions target. However, it is important that weight is placed on early, proactive, and cost-efficient emission reductions wherever possible.
- 2.1.3 We consider further discussion and thinking is required around the:
  - a) cost containment reserve trigger;
  - b) auction volume and method to address NZ ETS unit stockpile; and
  - c) auction reserve price.
- 2.1.4 We will elaborate on all the above points further in the remainder of the submission.
- 2.1.5 It is also noted that legislative amendments are required to enact some of the changes the Government has proposed and that the Climate Change Response (Emissions Trading Reform) Amendment Bill is currently going through the parliamentary process.
- 2.1.6 Trustpower agrees that the legislation should not include specific volumes or price settings as this will give the Government greater flexibility and will make it easier to make changes if required.

## 3. Approach to meet 2050 target

- 3.1.1 Trustpower supports the proposed straight-line approach in principle.
- 3.1.2 While we acknowledge that the provisional emissions budget and, by extension, the emissions reduction pathway is not intended to set the direction for the entire period, we consider that a prudent approach to reducing emissions and the achieving the 2050 net-zero emissions target would be to make significant reductions as early as possible.
- 3.1.3 We expect that there will be diminishing returns at some point on this downwards trajectory. This is because the cost, both in time and resources, required to achieve further reductions will likely

increase significantly the closer the country gets to meeting the 2050 target. The increasing cost of emission reductions is evidenced in the Marginal Abatement Cost curves released by MfE.<sup>4</sup>

- 3.1.4 We agree the provisional budget should include an initial flat-line pathway. This is appropriate as it is reflective of the time taken for projects to be assessed and infrastructure constructed. Nevertheless, New Zealand, as a whole, must hold a mindset whereby we aim and achieve the highest level of reductions as early as possible to allow for a likely slow-down in reductions as we near 2050.
- 3.1.5 We believe that the cost of inaction, or delayed action, early on will have significant implications for achieving the overall target. Policy changes that will facilitate reductions must begin immediately to ensure we make progress towards meeting our emissions reduction targets.<sup>5</sup>
- 3.1.6 Consequently, we support the Government taking early action in areas, such as electrifying process heat, as we consider this to be the most cost-effective way of achieving a significant amount of emissions reductions; the “best bang for buck”.
- 3.1.7 We concur with MfE that:

*“A gradual and deliberate transition will be less disruptive than abrupt changes and will allow us to take advantage of the opportunities along the way. These measures need to be supported by a stable policy environment...”<sup>6</sup>*

- 3.1.8 While the transition to a low-emissions economy should be gradual and deliberate, it must also be efficient and effective.

#### 4. Cost containment reserve

- 4.1.1 Trustpower agrees that replacing the Fixed Price Option (**FPO**) with the cost containment reserve mechanism (**CCR**) will enable the Government to control the volume of NZ-ETS Units (**NZUs**) and reduce the risk that the NZ-ETS prices rise higher than is deemed acceptable
- 4.1.2 We note the proposed provisional budget assumes (for the electricity sector):
- 33% of the electricity efficiency potential identified by the Energy Efficiency and Conservation Authority is implemented by 2025; and
  - additional wind and geothermal renewable stations will be built to displace baseload gas-fired power stations prior to mid-2024.
- 4.1.3 This implies emission abatement from the electricity sector of 1,550 kt CO<sub>2</sub>e in 2025. For this, and other emissions abatement opportunities to be achieved, the CCR must be set at a level to send appropriate signals to the market and incentivise the necessary market behaviour.
- 4.1.4 MfE state, and we agree, that the CCR trigger level should be set outside the expected cost of emissions abatement for meeting our targets and, ideally, should be used very infrequently, if at all.<sup>7</sup>
- 4.1.5 Trustpower believes, however, that the proposed CCR trigger of \$50/t CO<sub>2</sub>e for the 2020-2025 period is too low, and well within the expected cost of emissions abatement. We believe that prices under the NZ-ETS could therefore move upwards towards \$50/t CO<sub>2</sub>e more quickly than currently envisaged.
- 4.1.6 A higher price trigger will reduce the risk that \$50/t CO<sub>2</sub>e is insufficient to ensure coal-fired generation, and baseload gas generation are displaced in the merit order. At a carbon price of

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<sup>4</sup> Refer to Marginal abatement cost curves analysis for New Zealand – potential greenhouse gas mitigation options and their costs, [2020] Ministry for the Environment

<sup>5</sup> Consultation Document, [2019] Ministry for the Environment, p. 25

<sup>6</sup> Consultation Document, [2019] Ministry for the Environment, p. 19

<sup>7</sup> Consultation Document, [2019] Ministry for the Environment, p. 57

around \$75/t CO<sub>2</sub>e, we would expect a change in the generation merit order. This would result in thermal baseload generation moving up the order and, more importantly, baseload gas generation running before baseload coal. We believe that at a price of \$50/t CO<sub>2</sub>e the signal to burn gas before coal will not be strong enough.

- 4.1.7 We believe that should the CCR trigger be struck early on the signal for emission reduction projects will be muted, and that the effectiveness of the ETS will be weakened.
- 4.1.8 A higher CCR price will also provide certainty that the Government will not need to change it in the short term. This is important as there is a large quantity (~132 million) of NZUs held by participants with non-surrender obligations. The CCR price trigger must be set at a point that incentivises the placement of these banked units into the market.
- 4.1.9 As stated earlier, we believe it is important to “front-load” emissions reductions wherever possible to give New Zealand the best chance of meeting the 2050 target. If the CCR trigger is set too low from the outset, New Zealand may not achieve the straight-line trajectory, let-alone the accelerated emissions reductions that we believe will be necessary.
- 4.1.10 In congruence with the Productivity Commission, Trustpower believes that the emissions price will need to rise to levels of approximately \$75/t CO<sub>2</sub>e in order to sufficiently influence the market towards achieving both the domestic and international targets.<sup>8</sup>
- 4.1.11 Trustpower believes that setting the CCR trigger at \$75/t CO<sub>2</sub>e also effectively balances the need to contain the impact of costs to the public, whilst driving the necessary behavioural changes and investment decisions to meet New Zealand’s climate change targets.

## 5. Fixed price option

- 5.1.1 Trustpower supports the proposal to increase the FPO from \$25/t CO<sub>2</sub>e to \$35/t CO<sub>2</sub>e for surrender obligations arising from activities in the 2020 calendar. This is a pragmatic step sending the signal that the cost to meet our reduction targets has risen.
- 5.1.2 We consider transitional measures, such as this, are important as they provide both predictability about the direction of change and the time to adjust and take the opportunities that the transition offers.<sup>9</sup>

## 6. Addressing the NZ ETS unit stockpile

- 6.1.1 Trustpower agrees with the Government’s proposal to reduce the NZ-ETS unit stockpile in order to reach a level that is effective for the long-term functioning of the NZ-ETS.
- 6.1.2 We also agree that the proposed annual removal of NZUs available by auction (resulting in 27 million units removed between 2021-2025) will go some way to help stimulate NZ-ETS participants to use stockpiled units to meet their surrender obligations.
- 6.1.3 Ultimately, however, the sale of banked NZUs will come down to market price expectations. If the market does not believe that the emissions reduction target will be met, then participants with no surrender obligation are likely to retain their NZUs due to the expectation that emission prices will rise further and, therefore, provide higher returns.
- 6.1.4 Setting an appropriate CCR trigger (\$75/ t CO<sub>2</sub>e rather than the proposed \$50/ t CO<sub>2</sub>e) will help to provide holders with the appropriate incentives to participate in the manner sought by Government.

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<sup>8</sup> Low-emissions economy, [2018] New Zealand Productivity Commission, p. 5

<sup>9</sup> Low-emissions economy, [2018] New Zealand Productivity Commission, p. 12

## 7. Auction reserve price

- 7.1.1 Trustpower can see merit in the Government setting an auction price reserve. We do question, however, whether this needs to be publicly notified.
- 7.1.2 It is our belief, and expectation, that all parties participating in the NZ-ETS auctions should be bidding prices that correspond to their willingness to buy. The auction reserve price should not be a factor in their behaviour. By publicly notifying this auction reserve price, perverse behaviour, such as gaming, may develop as a result. The auction price reserve should also be able to adjust and follow the international carbon price as and when required. By notifying the reserve price to the market, the price will be less able to freely move to match the international market.
- 7.1.3 We note the Government has advised that the NZ-ETS will remain closed to international carbon markets, although the Consultation Document states that this could be an option for the future.<sup>10</sup> We support this as a future development, but believe that all units eligible for surrender in the NZ-ETS must meet the same high standard of locally sourced emission units.
- 7.1.4 We agree with MfE's conclusion that if the Government were to sell NZUs at auction during 2020–25 for less than their expected future value, then this could result in the Government locking-in expected losses if it then needed to purchase higher-priced international units in the future.<sup>11</sup>
- 7.1.5 Setting the auction reserve price but not disclosing it publicly may reduce the risk of losses incurred by the Government. The NZ ETS mechanism needs to perform in such a way as to minimise impacts on the public wherever possible.

For any questions relating to the material in this submission, please contact me on [REDACTED]

Regards,



**CRAIG SCHUBAUER**

**WHOLESALE MARKET MANAGER**

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<sup>10</sup> Consultation Document, [2019] Ministry for the Environment, p. 47

<sup>11</sup> Consultation Document, [2019] Ministry for the Environment, p. 56