

**Submitted via e-mail**

**To: Ministry for the Environment**

**From: Todd Corporation Ltd**

**Date: 28 February 2020**

Todd Corporation welcomes the opportunity to provide this feedback to the consultation document **Reforming the NZ Emissions Trading Scheme: Proposed settings (December 2019)**.

## **1 About Todd Corporation (Todd)**

- a) Todd is one of New Zealand's largest companies. The family owned company has grown over more than a century and now employs a team of about 1,000 people, with investments in energy, minerals, property, healthcare and technology.
- b) Todd Energy produces about one-third of New Zealand's natural gas, from onshore natural gas fields at Kapuni, McKee and Mangahewa, and through its 26% interest in the Pohokura natural gas field. Todd also holds exploration permits in onshore and offshore Taranaki.
- c) Natural gas is a very important energy source for New Zealand. It is used by industry, supplying 38% of the energy used for process heat<sup>1</sup>, and as a feedstock in the production of methanol and urea. It provides energy to 16,000 commercial users and 265,000 New Zealand households.
- d) Through Todd Generation and Nova Energy, Todd generates electricity at its 100 MW fast-start natural gas fired peaker plant at McKee in Taranaki and at three cogeneration plants at Whareroa, Kaponga and Edgecumbe. Another 100 MW fast-start natural gas fired peaker plant is currently being commissioned at Junction Road, New Plymouth, and consents are in place to build 360 MW of capacity in the Waikato. Todd has recently moved into solar power generation, through investments in Sunergise International and Sunergise NZ.
- e) As a producer of natural gas, Todd has been a mandatory participant in the ETS since 2010 (within the "stationary energy" sector).
- f) As a generator and retailer, Todd participates in gas and electricity trading and has extensive experience across the energy industries of New Zealand.

## **2 Submission overview**

- a) Climate change policy has long-term implications economically, socially and environmentally. Todd supports the broad framework for emissions reductions that has been established by the zero carbon amendments to the Climate Change Response Act but notes that it will be the emissions budgets and plans that will define the pathway and the speed of transition to a lower emissions economy. Stable climate policy settings are critical to sustain and encourage business investment in New Zealand.

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<sup>1</sup> <https://www.mbie.govt.nz/assets/8c89799b73/process-heat-current-state-fact-sheet.pdf>

- b) Todd agrees that the Emissions Trading Scheme (ETS) must be the primary mechanism for achieving New Zealand's emissions targets. An ETS is designed to reduce emissions in a cost-effective, market-driven manner, reducing the risk that market distortions (such as arise from subsidies) lock in inefficient technology or infrastructure or create perverse incentives.
- c) A credible and well-functioning trading scheme, which is underpinned by stable and predictable policy should be key objectives. Todd considers that the introduction of unit auctions and the cost containment reserve should support and enable the development of a more efficient secondary trading market for NZUs. This is the key message from both this submission and the earlier submission on the proposals for auction rules<sup>2</sup>. Let's not make the first two years of auctioning the most difficult. Todd considers that the level of abatement required by the provisional budget (for 2021, 2022) will be very challenging to achieve in the short term, given the trend of increasing net emissions which is largely driven by net reductions in carbon sequestration as forestry planted in the 1990s is harvested.
- d) Todd does not support the proposal to remove 27 million units from the volume to be auctioned (2021-2025), in order to reduce the stockpile. Todd considers that this number is too high, given that there is no obligation on the holders (of the 54 million NZUs) to enter the market. Todd recommends that the rate of removal (of surplus units) be delayed until the markets - both primary auctions and secondary - are established and better information is available as to the prices that will encourage surrender or trading of units being held by parties other than those with direct surrender obligations.
- e) The consultation document makes it clear that it will be important for New Zealand to have access to high-integrity international units to meet obligations at least cost. Todd has submitted previously on this matter, as we consider the use of reputable international carbon credits to be a valid and important mechanism for mitigation.
- f) The announcement of a proposed FPO of \$35/NZU, to apply to a period of emissions before the legislation will have come into force, is causing significant economic detriment to participants who have to make pricing decisions prior to knowing the final form of legislation, and are unable to pass it through to customers. The retrospective effect of the legislation undermines certainty and regulatory predictability, contrary to the Government's stated objectives of a well-functioning ETS. Todd therefore supports retaining the FPO in 2021 (for 2020 emissions) at \$25/NZU.
- g) The remainder of this submission provides more detailed feedback on the questions posed in the consultation document.

### **3 The provisional emissions budget (Section 2)**

*Q1. Do you agree with the proposal to set a provisional emissions budget of 354 Mt CO<sub>2</sub>-e for the 2021–25 period? If not, why not? Please include your views on: a) using a straight-line approach towards the 2050 target; and b) the considerations that were included in proposing the provisional emissions budget.*

- a) As acknowledged in the document, holding net emissions steady for the first two years (2021 and 2022) requires an increasing level of emissions abatement to be occurring now. This requires immediate changes in behaviour and to physical assets, a

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<sup>2</sup> Response to consultation on Reforming the NZ Emissions Trading Scheme: Rules for auctions (submitted 19 December 2019).

challenge given the time required for business case planning and budgeting, consenting, purchase and installation.

- b) The document states that the provisional budget proposal “requires rapid improvements in energy efficiency, process heat use, on-farm practices and landfill technology” (page 30). However, it is apparent that the initial burden is falling disproportionately on the energy sector, the sector operating within the ETS cap. The projections in Table 4 show non-ETS emissions (primarily agriculture emissions) reducing by 1 Mt CO<sub>2</sub>-e (around 2.5%) compared with an expected reduction in emissions from the ETS of 4.5 Mt CO<sub>2</sub>-e (around 14%).
- c) From Table 1, fuel switching in the space and water heating and food processing process heat sectors, from coal and gas to electricity and biomass is assumed to contribute 1000 kt CO<sub>2</sub>-e. A switch to electricity or biomass may not be feasible straight away, for example, due to concerns around security of supply of biomass and electricity grid capacity. Todd notes that a switch from coal to natural gas would also bring an immediate reduction in emissions given the lower carbon intensity of gas. We also note that MBIE’s current consultation on renewable energy is focused on phasing out coal rather than gas.
- d) The balance of the expected abatement is the result of the displacement of baseload gas-fired electricity, process efficiency improvements in emission intensive businesses (steel, cement, refining and pulp) and reductions in transport emissions resulting from the roll-out of currently proposed policy measures. Todd considers that this level of abatement will be extremely challenging in the short term especially given the current challenges to increase uptake of electric vehicles and introduce a fleet emissions standard. Contributions of the transport sector to New Zealand’s emissions profile are significant and represent one of the key means by which New Zealand can reduce emissions as identified by the Productivity Commission<sup>3</sup>.
- e) Notwithstanding the above, Todd acknowledges that the proposed provisional budget is primarily being set to allow auctioning to commence in 2021 (for 2021 emissions) and will be superseded by budgets set by the Climate Change Commission (for 2022 – 2025).
- f) Todd therefore recommends that the unit supply settings and price controls should be set to encourage the development of a liquid secondary market, as auctioning becomes established. Todd considers that the “flat” budgets for 2021 and 2022 are challenging and for this reason, recommends that no stockpile reduction be forced during the first two years (for reasons described in Section 4).
- g) Further, Todd notes that the actual path of emission reductions (from 2022-2025 and onwards to 2050) will not be linear. Given this, Todd has recommended in the previous submission, and reiterates here, the need to carry over unsold units from auctions from year to year (see paragraph 4(c)).

#### **4 Unit supply settings (Section 3)**

*Q2. Do you support the decisions made regarding the technical volume adjustment decisions? If not, why not? (this includes non-compliance, voluntary offsetting, accounting differences, uncertainty of projections – of industrial allocations and forestry)*

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<sup>3</sup> “Low Emissions Economy” published in 2018 and supported by the Government in their response to that report in August 2019.

- a) Todd agrees with the decision to make no technical adjustments in the initial budget(s), given the further work that is required.
- b) As noted elsewhere in this submission, Todd would like to reiterate the importance of ensuring that future information about the scale/materiality of adjustments is well communicated in advance in order to avoid introducing regulatory uncertainty and/or price shocks to the ETS market.

*Q3. Are there other adjustments that need to be considered?*

- c) As indicated in the submission on auction rules, Todd recommends that unsold NZUs from auctions should be added to subsequent auctions or held in reserve for future auctions should they be necessary if the cost containment reserve is triggered. The purpose of the ETS should be to achieve New Zealand's emission targets in the most economically efficient way. Emissions reductions are unlikely to occur in a smooth linear fashion and will instead more likely occur with some year on year volatility. As such it would be counterproductive to remove (or cancel) units that do not sell at auction. Those unsold units should be available at times of high demand to smooth price movements and to avoid pricing spikes.
- d) Todd's preference would be to adopt an approach like that used by the EU, which spreads unsold EU ETS units evenly over the next four auctions. A similar approach should be considered for New Zealand and the Government's coordinated decision-making process should be reviewed to enable this.

*Q4. Do you agree with the proposal to address the NZ ETS unit stockpile by reducing the annual volume of NZUs available for auction? If not, why not?*

*Q5. Do you agree with 27 million NZUs being removed from auction volume between 2021–25? If not, why not?*

- e) Todd considers that the volume proposed for removal over the period 2021-2025 is potentially too high, particularly given the challenging emissions budget that has been set.
- f) The units targeted by the proposal are the 54 million units held by individuals or organisations that have no direct surrender obligations. This comprises around 66% of the 81 million units available to auction (given that the 51 million NZUs held by post-1989 forestry participants are "legitimately required to be held within the NZ ETS stockpile" (page 45)). The units targeted by the proposal are the 54 million units held by individuals or organisations that have no direct surrender obligations. This comprises around 66% of the 81 million units available to auction (given that the 51 million NZUs held by post-1989 forestry participants are "legitimately required to be held within the NZ ETS stockpile" (page 45)).
- g) There is no obligation on the holders (of the 54 million NZUs) to enter the market and if companies have expectations that carbon pricing will increase beyond 2025 then they will be incentivised to continue to bank these units.
- h) Todd recommends that the rate of removal (of surplus units) be delayed until the markets, both primary and secondary, are up and running. At that time, steps can be taken to resolve the issue.
- i) Todd acknowledges that the upcoming FPO may create an incentive on parties to hold NZUs in inventory although that does mean that the Government receives cash revenue and still has control over future emissions available for auction. Todd

recommends that the initial focus should be on providing the market with a large enough volume of auction NZUs to allow for market predictability and stability.

*Q6. Do you agree with the steps and calculations taken to reach the proposed annual auction volumes?*

- j) Todd agrees in principle with the steps taken, reiterating the comments made above that the proposal for auction volumes to decline by approximately 10% per year (2023 onwards) is an overly ambitious view to take prior to receiving advice from the Climate Change Commission.

#### **International units**

- k) The NZ ETS is not currently able to access emissions units through international markets. Todd has submitted previously on this matter, as we consider the use of reputable international carbon credits to be a valid mechanism for mitigation. This promotes optimal allocation of capital to emissions reductions initiatives and provides a means of sharing low-emissions technology (and investment capital) across countries.
- l) Todd is pleased to hear the Government is considering how international units could be brought into the ETS and look forward to participating when the Government seeks views. Given the challenges ahead, to meet the 2050 target and the 2030 Nationally Determined Contribution, Todd considers that access to international units will be required to meet commitments at lowest cost.

*Q7. Do you support the proposal to auction 80 million NZUs over the 2021–25 period plus 2 million NZUs for auctioning trial in 2020? If not, why not? Please include your views on the process for adjusting auction volumes.*

- m) Todd supports the running of a trial auction as an administrative trial, to test the auction platform(s) and communications.

#### **5 Price controls (Section 4)**

*Q8. Do you agree with the proposal to set an auction reserve price floor at \$20 for 2020–25? If not, why not?*

- a) In principle, Todd opposes the imposition of a price floor but acknowledges that low NZU prices have been an issue in the past. Todd agrees with the Government view that the root cause has been addressed but acknowledges concerns that there may still be some residual issues that undermine confidence.
- b) As an interim measure for 2021 and 2022, Todd considers the price floor of \$20 appropriate, noting that “participants will be able to trade NZUs on the secondary market for lower than this price if they choose to do so”.
- c) Todd notes that the Government is also considering the introduction of a technical auction reserve price and suggests that there is no need for both mechanisms. In any case given the low level of maturity of the secondary market there will likely be practical issues associated with trying to apply a technical auction reserve based on the secondary market which only currently exists in an “over the counter” form.

*Q9. Do you agree with the proposal to increase the fixed price option to \$35 for obligations arising from activities over 2020?*

- d) Todd's primary concern is that the proposed increase of the FPO from \$25 to \$35 is already having a significant economic impact on ETS participants, with a spike in the secondary market immediately following the announcement. Yet ETS participants are being prevented from surrendering at the \$25 FPO price which applied at the time that the emitting activity took place, and are unlikely to be able to pass through the higher price to customers as contracts won't provide for retrospective application, putting participants at a real economic disadvantage.
- e) The retrospective effect of this legislation violates the rule of law and constitutional norms including a fundamental constitutional principle that the law should be clear, and clearly enforceable<sup>4</sup>.
- f) Retrospective laws should only be used in exceptional and very limited circumstances which do not apply here. It undermines the desired outcomes of certainty and regulatory predictability, contrary to the consultation document which refers to the importance of ensuring predictability, certainty and stability to provide "businesses with confidence on the direction of travel of NZ ETS settings and prices".
- g) Consistent with these arguments Todd recommends that the FPO for 2021 be retained at \$25.

*Q10. Do you agree with the proposal to set the price ceiling trigger of the cost containment reserve at \$50 for the 2020–25 period? If not, why not?*

*Q11. Do you agree with the proposed annual cost containment reserve volumes to be released if the price ceiling trigger is hit? If not, why not?*

- h) On balance, Todd agrees with the proposed price ceiling trigger of \$50 (that will apply at auctions in 2021, and possibly 2022 depending on Climate Change Commission advice).
- i) Todd considers the volume of the cost containment reserve (CCR) (at 90% of the difference between forecast net emissions and the proposed supply) to be appropriate.
- j) Given the availability of the FPO in 2020, there is theoretically no need for a CCR volume in 2020. In addition, the availability of stockpiled units, will act as a form of reserve.

## **6 Process for release of ETS settings information (Section 6)**

*Q12. Do you agree with the proposed approach for release of NZ ETS settings information? If not, why not? (5 year rolling settings, released annually in September)*

- a) The impact that this consultation document had on the market demonstrates the need for care with the release of settings in the future.
- b) Todd agrees with the proposals in the document for five-year rolling settings to be released annually in September each year; and for a calendar of dates to be published at the beginning of each calendar year.

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<sup>4</sup> Codified in section 7 of the Interpretation Act, section 10A of the Crimes Act 1961 and 26(1) of the New Zealand Bill of Rights Act 1990, Parliament's Standing Order 319(2)(g) and section 7.82 of the Cabinet Manual.

- c) Todd agrees with circumstances under which the Y+1 and Y+2 auction volumes and settings can be adjusted, noting that the carry-over over unsold units (from one year to the next) should not be considered an adjustment.