Submission on:

New Zealand Emissions Trading Scheme Review 2015/16
- Priority Issues

From

Ballance Agri-Nutrients Limited

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SUBMITTER DETAILS

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COMMERCIAL SENSITIVITY

Nothing in this submission is confidential.

Introduction

Ballance Agri-Nutrients Limited (hereafter referred to as 'Ballance') would like to thank the Ministry for the Environment for the opportunity to make this submission on the New Zealand Emissions Trading Scheme Review 2015/16.

Company Overview

Ballance is a farmer-owned co-operative with over 18,000 shareholders and approximately 800 staff throughout New Zealand. We own and operate super-phosphate manufacturing plants located in Tauranga and Invercargill, as well as New Zealand's only ammonia-urea manufacturing plant located at Kapuni, South Taranaki. The Company also owns and operates 'SuperAir', an agricultural aviation company; 'SealesWinslow', a high-performance compound feed manufacturer; and 'AgHub', which provides on-line farm information and management tools. Ballance has a network of fertiliser storage and dispatch facilities across the country.

Ballance places a strong emphasis on delivering value to its shareholders and on the use of the best science to inform sustainable nutrient management.

Ballance's Exposure to the NZ Emissions Trading Scheme

Ballance's operations are directly impacted by the New Zealand Emissions Trading Scheme (NZ ETS):

- The Kapuni Urea manufacturing facility is an Emissions Intense Trade Exposed (EITE) industry (within the SEIP Sector), competing against imported Urea;
- As a manufacturer and importer of Urea, Ballance is a mandatory participant (within the Ag Sector), for synthetic fertiliser containing nitrogen.
- All of Ballance's operations are exposed to NZ ETS costs passed through by energy suppliers and second round impacts including freight costs and inflationary pressure.

Any change in policy that leads to an increase in ETS related costs is therefore a significant concern to Ballance.

Ballance's Engagement in Climate Change Policy Development

Ballance takes an active role in the development of climate change policy, dating from the original industry voluntary agreements of the late 1990's through to the current ETS.

Submission Points

In this submission we provide comments on the **Context and Drivers for the Review** (Questions 1 and 2), as well as, the **Priority Issues** (Questions 3 to 8). All the remaining questions will be addressed in our subsequent submission scheduled for 30 April 2016.

Submission Summary

Question 1

Ballance agrees with the drivers in terms of:

- Improving performance of the NZ ETS against its objectives
- Preparing for a more carbon-constrained future
- Increasing certainty about future policy settings

However, Ballance does not support the 'managing banked emission units' driver as a more detailed assessment and discussion with stakeholders is required.

Question 2

Ballance suggests other factors that should be considered include: more mature emissions trading market; the NZ ETS will not materially affect transport emissions; and encourage consideration of alternative carbon sequestration options.

Question 3

Ballance supports a full surrender obligation by 2020.

Question 4

Full surrender will double our liability net of allocation. Ballance is concerned over adequate NZU supply liquidity in the absence of auctioning leading to potential reliance on the fixed price option.

Question 5

A half year change should be avoided as this just adds additional administrative burden. Ballance recommends that the full surrender obligation be phased in between 2017 and 2020.

Question 6

In a closed domestic market, we believe the risk of significant price fluctuations is high.

Question 7

Ballance suggests that 'price shock' can be best managed through a phased in of the full surrender obligation commencing in 2017, retention of the fixed price surrender option and introduction of NZU auctioning.

Question 8

Temporarily lowering the fixed price option should not be discounted. Once auctioning has been introduced and "matured" and/or international linkage been re-established the fixed price option could be either raised above $25 or even removed.

Context and Drivers for the Review

Question 1 - Do you agree with the drivers for the review?

Ballance agrees with the drivers for the review in terms of:

- Improving performance of the NZ ETS against its objectives
- Preparing for a more carbon-constrained future
- Increasing certainty about future policy settings

The first two drivers are appropriate in the context of New Zealand taking on future international target obligations under the Paris Agreement. The third driver is important in unlocking emission reduction actions / investment that are hindered by the sovereign risk of frequent and unpredictable ETS amendments.

However, Ballance does not support the 'managing banked emission units' driver. The core design of the NZ ETS is such that:

- NZUs are not date constrained,
- With the inclusion of forestry long term surrender obligations accrue for which NZUs may be withheld; and
- For emission intensive trade exposed firms the accrual of NZUs to offset future costs should allocation be withdrawn is a rational economic choice.

It is our opinion that a significant volume of NZUs are also being retained or "banked" over the medium/long term because of: the current NZU only market, significant future uncertainty as to if/when international unit access is reopened to Participants, and prospects of future higher carbon prices.

The discussion paper describes a fiscal risk to the government through emitters not surrendering enough international units, leading to the government having to purchase international units directly to meet its international target. This argument seems weak when one considers that the NZ ETS places a surrender obligation on all non-biological emissions and not just those above the international target level of 30% below 2005 emissions. At a full surrender obligation, there may instead be a significant risk of over-recovery of international units through the NZ ETS.

More detailed assessment and discussion with stakeholders on the validity of this driver is recommended.

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

Ballance suggests these factors should also be considered:

- The need for a functioning and liquid domestic emission trading market.
- The acceptance that carbon pricing through the NZ ETS will not lead to material emissions reductions in sectors such as transport where price elasticity is very weak. Other policy measures will be required for such sectors.
- Expressly encourage alternative carbon sequestration options by providing a fast track process to approval and issuing of NZUs (e.g., biochar or riparian planting).

Priority Issues

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

Yes in light of the successful conclusion of the Paris Agreement a move to a full surrender obligation by 2020 is supported.

Question 4 - What impact will moving to full surrender obligations have on you or your business?

Obviously, moving to full surrender will double our emissions liability net of allocation. Industrial process emissions are a function of chemistry and cannot be ameliorated. Carbon prices are considered in capital project evaluations. For example, expansion of Urea production into regions where natural gas is not available would be cost prohibitive.

Ballance is concerned over adequate NZU supply liquidity in the absence of auctioning leading to potential reliance on the fixed price option (FPO) and the risk that scheme becomes akin to a domestic carbon tax. Should the FPO become relied upon, transition back to open trading once international linkage is re-established could cause additional difficulties.

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

A mid-year change in surrender obligation creates additional administrative burden. This was experienced in 2010 when for the stationary energy and liquid fossil fuel sectors reporting requirements were doubled with the first half having a zero surrender obligation and the second half having a 50% surrender obligation. Allocation was similarly impacted by half and full year reporting requirements.

Ballance recommends a phasing in the full surrender ratio commencing in 2017. This would:

1) allow time for additional NZU supply mechanism to be established (auctioning) to avoid an NZU supply shortfall
2) allow for ratification of the Paris Agreement to pass before NZ moves to a full surrender obligation.

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

Potential price shocks need to be managed as the risk of significant price fluctuations is high in a closed domestic market.

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

Maintaining the current fixed price option (FPO) of $25 is not ideal, but it would be better than either increasing it or completely removing it. The current FPO of NZ$25 is well above the $15 - $18 NZU price that post-89 foresters have indicated they would need to start re-planting.

Ballance suggests that ‘price shock’ can be best managed through a phased approach where the path to full surrender starts in 2017 and is completed by 2020. The current FPO is more than twice the value of (as of February 2016) traded NZUs, so moving quickly to a full surrender obligation while depend on the FPO would result in a quadrupling of costs.

In the absence of an auction mechanism the FPO may be heavily relied upon.

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

The FPO should be retained until a mature and stable auctioning mechanism is established. Temporarily lowering the FPO should not be discounted. If a phased approach was adopted then both the surrender ratio and FPO could be managed to prevent significant fluctuations.

Once auctioning has “matured” and/or international linkage been established then the FPO could be raised or removed.