Ministry for the Environment
Manatū Mō Te Taiao

NZ ETS Review 2015/2016

Part 2 – Additional matters

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Submission

Numbering used in this submission are those of the consultation questionnaire.

Context and drivers for the review

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

Yes

The ETS as it is currently structured does not provide adequate incentive for emitters to reduce greenhouse gas emissions and does not provide the certainty that business requires to be able to effectively manage their transition to low carbon activities.

There are a number of low carbon alternatives (e.g. wood fuel, municipal liquid waste and waste for heat,) for emitters to move away from fossil fuels, particularly for heat in the short term. However unless there is a significant increase in the price of carbon the proposed changes to the ETS would only slightly improve the economic incentives for heat users to move from using coal and oil to biomass for the production of heat, and thus contribute to the Greenhouse gas emissions reduction target in the specified time frame. A number of the additional measures could have a greater and more immediate effect than the current ETS will achieve.

Transport biofuel options are a longer term alternative but encouraging research on the high value co-products of liquid biofuel, and upgraded biogas production will improve the overall economics and assist biofuels contribution to achievement of the target within the latter years of the specified timeline.

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

(a) The Bioenergy Association reiterates its previous submission that a carbon tax would be a more effective mechanism than the ETS for shifting the economy to low carbon. It punishes polluters and provides incentives for renewable energy. Furthermore it gives governments a perfect tool to decide on the pace they want to change their economy. Countries which are serious about that are typically using a carbon tax like leading European countries (taxes are

on all fossil fuels incl. petrol and diesel and the money has been used to support renewable energy).

(b) With the ETS not being adequate by itself to achieve the targets in the specified time frame a number of complementary measures should be used to support and assist the transition to a low carbon economy. Many of the complementary measures that could be taken are economic today but there is little additional incentive for emitters to make the change as these often require access to expensive capital.

The possible complementary measures around heat from biomass and organic waste would be low cost and cost effective with regard to reducing greenhouse gas emissions.Certainly they are likley to be cheaper for the Government than purchasing international emission reduction units which will provide no value to the New Zealand economy. Assistance through complementary measures will give long term benefits each year.

Some complementary measures that would assist emitters in the heat sector could be:

- Accelerated depreciation for renewable energy and energy efficiency capital expenditure
- Requiring government owned facilities such as schools and hospitals to consider greenhouse gas emission reductions alongside the financial cost when evaluating capital investment decisions
- Where appropriate using goverentment owned facilities as role models to other emitters
- Encouraging utilisation of municipal solid and liquid waste as a feedstock for the production of energy.
- Encouragement of more domestic added value processing of wood. This produces more wood fuel as a co-product and because this is the best quality, the most reliable source of supply, and generally the most economic fuel , heat plant owners will see it as a low risk fuel source.

A more comprehensive list of complementary measures is provided in section 28.

(c) Reform of the National Environmental Air Quality Standard (NESAQ).

- A significant reason for the unwillingness of industry and commerce to make the long term investment in plant and equipment to use wood and related biofuels is the difficulty, uncertainty, time delay, and cost associated with the requisite air discharge resource consents and their continued maintenance.
- Until the Air Quality Regulations (NESAQ) of the Resource Management Act are reformed to bring them into line with current science and what is generally regarded as reasonable international practice, the substitution of fossil fuels by wood will be limited. At present the New Zealand regulations are well out of line with the rest of the world, most conspicuously with those European countries which are leading in both enlightened clean air regulation and the use of wood as a fuel. (Austria, Germany, and the Scandinavian countries). The Commissioner for the Environment made a very good case for their reform in her recent report “The State of Air Quality in New Zealand”.
- Whilst the Resource Management Act and the NESAQ are national regulations, each regional council interprets them in their own way through regional airplans and other regional regulations and processes. A great number of the regional variations are unnecessary and create further uncertainty, cost, and delay.
- Reforming the NESAQ is a rapid way of demonstrating the Government’s commitment to reducing greenhouse gas emissions. It requires no government

expenditure or subsidies; rather, just for the Government to remove unnecessary roadblocks. With a clear and certain open road ahead, industry and market forces will do much of the rest.

- New Zealand does not need regulations that are unique. There is nothing about air quality and air science in New Zealand that differentiates it from the rest of the world. If anything our relatively low population densities and windy location make our air quality issues much simpler than most of our contemporaries. New Zealand should bring its regulations and approaches to clean air into line with those countries that are in the vanguard of enlightened wood burning; Austria, Germany, and the Scandinavian countries. Additional benefits to New Zealand from adopting a similar approach to regulation to these countries are:
    - We enable NZ manufacturers of equipment to sell more readily into those markets. This encourages employment.
    - We enable NZ to buy and use equipment from overseas more easily where it is beneficial to do so.
    - It encourages competition right across the board with benefits in both price and quality for all. Our present regulations have created and protected a very small and specialised market for wood burning equipment. Our equipment, (particularly in the domestic arena) when compared to that produced by our contemporaries is primitive, relatively costly, and often of low quality.
    - It saves a great deal in the costs and delays associated with running our own distinctive legislation and all that flows from it. Why waste resources doing things that people with much larger budgets than our own have already done? Why re-invent perfectly good wheels when we can use theirs for free, or at very little cost.

(d) Beneficial use of coal

Where ever possible coal should not be burnt as a fuel, but should be processed, in a similar way to crude oil, to extract all the useful components first, eg for plastics manufacture. Finally the refined coke could be used for fuel if necessary, or as roading or building material. This continues to use one of our natural resources, but extracts useful components while reducing the carbon finally released to the atmosphere. The extraction of valuable chemicals from coal can be a forerunner of technologies for the extraction of biochemicals from biomass and waste.

Other issues: business responses to the NZ ETS

9. **Do you consider the future cost of emissions in your business planning? Please explain your answer.**

Yes

The previous lack of real support from Government for greenhouse gas emission reduction has resulted in business saying “if government doesn’t care why should we?”

Since the Government has appeared to be serious about the latest announced targets our member’s business planning has been transformed. Assisting government achieve its promised targets is now the Association’s highest priority and we have readily available opportunites. The national targets, a stronger ETS, and additional measures should create the demand for solutions our members can respond to. Most significantly, if members think the Government is now

serious about climate change, they will respond. Leadership by Government is the least cost but most effective measure for getting action.

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

Government appearing serious that it wants to achieve its promised targets and having an ETS and complementary measures that provides incentives for emitters to change behaviour. Commitment and responsibility for meeting the targets is critical. This would influence businesses response to accounting for future carbon costs.

Certainty of the cost of carbon is critical when evaluating bioenergy options as renewable energy investments are long term investments with capital plant having long economic lives. The relatively low operating costs of renewable plant fuel compared to fossil fuelled plant make forecasting of possible long term fuel costs critical for decision makers.

Other issues: protecting competitiveness through free allocation

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

Many of the bioenergy solutions are capital intensive and facities generally have a 20-30 year economic life so there needs to be assistance for business to reinvest. Complementary measures such as accelerated depreciation could be one such assistance measure and be fiscally neutral (except for timing). These would be able to be implemented before 2020 in which case the free allocations should be removed entirely by 2020. A four year transition from now is adequate.

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?**

The members of the bioenergy sector, particularly service and wood fuel providers, would have more confidence to expand their business if they saw that there was a serious transition by heat users from coal to wood or other renewable fuel. Any clear pathways that provide business confidence encourage investment in long term solutions. The iImmediate announcement of the removal of the free allocation by 2020 would allow bioenergy sector service providers adequate time for their own capital planning and investment.

Other issues: managing unit supply - forestry

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

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.

It is notable that since 2008, that New Zealand is harvesting forests faster than they are being planted. (http://pureadvantage.org/news/2016/04/22/our-forest-future/)

Uncertainly in the forestry sector has a significant impact on forecasting the availability and cost of wood fuel. An increased forestry sector would result in significantly more biomass being available for the production of wood fuel. If heat plant owners are not confident of the future supply of wood fuel at an approriate price, then they will not move to using wood fuel for heat production. The forestry uncertainty will also affect decisions on the production of transport biofuels from lignocellulosic feedstocks.

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

Yes

The strength of the forestry sector has a major bearing on the availability of wood fuel. Complementary measures that would encourage domestic added value processing would produce more wood fuel as a co-product.

The use of wood as a fuel opens the possibility of expanding the forestry sector to grow particular species specifically for fuel. We have large areas of land of little economic value which can readily be used for this. This is already a growing industry in parts of Europe.

15. **What are your reasons for the above answer?**

b) The lack of encouragement from Government for domestic added value processing of wood results in there being little incentive for forest investment to occur. Because forestry companies are often overseas pension fund owned they are risk minimisers and not profit maximisers. Greater encouragement from Government for domestic added value processing would be low cost and influence investor behaviour. At present the message from Government is "we don't care – do what is best for your business and not what is best for the country".

Forestry as a land use is complex issue with there being a complex mix of interrelationships and interdependencies between different parts of the economy. An integrated picture needs to be in place to encourage the best use of land and forestry's role within it. The NZIF Forest Policy is a start for this process but the policy needs to be reinforced by the development of a forest strategy. It is recommended that because there are so many parties in this sector the Government needs to lead this process from a resource management and sustainable development perspective. Just looking at forestry from narrow view points is counterproductive to NZ's economic development.

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. We don't want purchasing to be the easiest solution and we want certainty of bona-fide sellers

b) **restrictions on how many units can be surrendered**

Yes. We don't want purchasing to be the easiest solution

c) **others.**

Purchase of international units should be the avenue of last resort as purchase will do nothing for the New Zealand economy. An alternative to the purchase of international units should be that emitters can invest a similar level of expenditure, as they would otherwise spend on purchasing international units, on domestic mitigation and be credited with that investment. This could include, but is not limited to forestry planting.

Other issues: managing price stability

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

Significant. Businesses have not had good carbon price signals resulting in lack of confidence for the transition by heat users from coal to wood or other renewable fuel.

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

Yes

Business require certainty when considering capital assets.

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?**

(a) The principal barrier to the uptake of bioenergy solutions is in the relative cost of fossil fuel and the high capital cost of the solutions.

(b) The perceived business risk around bioenergy is often because it has not been embraced by government's own heat and waste plant facility operators. The general lack to date of any leadership from central and territorial governments provides poor signals to others. However in recent years the construction of wood fuelled heat plant at some large hospital and swimming pool complexes is starting to demonstrate that such facilities are viable. Expansion of such demonstration facilities would assist to grow the market and also give confidence to possible investors.

(c) The requirement that forest must be replaced by trees and that those trees must be capable of reaching a height of 5m at maturity is a barrier to the planting of internationally recognised energy grass crops such as Miscanthus. There is considerable evidence internationally that Miscanthus is extremely efficient as an energy crop and also a means of sequesting carbon. NZ experience is that Miscanthus dry matter production is two to three times that of radiata pine and hence up to ten times that of planted indigenous forest. Because of this, on an annual basis miscanthus in NZ absorbs from the atmosphere considerably more CO2 per hectare per annum than any tree species. Miscanthus is harvested annually and once planted is essentially a permanent carbon sink. Yet under the existing ETS rules, a land owner is penalised if they convert forest land to Miscanthus. Miscanthus and similar internationally recognised energy crop species should be allowed to replace forest with no penalty providing they have potential to reach height of 2.5 metres at maturity. .

(d) As discussed in Q2 the National Environmental Standard for Air Quality (NESAQ) require reform.

(e) Timing issues. Many businesses will consider their fuel options only as heating equipment comes up for replacement at the end of its current reliable and economic life. This may be as much as 20 years.

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

Central and teritorial government can assist address the barriers to greater uptake of the oppportunities and this can be done by the Government being a proper leader and role model.

Any other comments related to issues set out in the discussion document

28. Matters additional to the ETS.

(a) Employment

In addition to the benefits to be had in the reduction of carbon emissions the significant use of wood fuels can facilitate employment within many regions of New Zealand, with emolu\yment come other societal benefits creating a collective impact that needs also to be factored in to the return on investment:

- Processing wood waste into chip, pellets, and firewood, along with its sale and distribution creates jobs.

- It encourages local manufacturers to invest in R&D and production of equipment to support fuel manufacture, processing and use.
- It reduces forest waste left behind to rot, or worse, be burned in situ.
- It creates jobs in industry designing and installing wood based heating plant.
- Most of the employment created in the growing and processing of wood and related fuels is in rural areas, areas that are notoriously difficult to create new long term secure jobs in.
- A large proportion of the jobs created are at the lesser-skilled end of the spectrum, that part of the spectrum where we have a major employment problem.
- As the market for wood and other biomass fuels grows, so does the opportunity for farming specifically to produce fuels as part of integrated land use. Wood and related biomass fuels frequently can be grown well on land unsuitable for other purposes. It is complementary to much current agriculture.
- The capture and anaerobic processing of effluent has the potential to create additional revenue streams, reduce CO2 emissions, nitrate and phosphate leaching into aquifers and the resultant bio-fertiliser significantly improves crop growth. Clustered processing plants mitigate most objections and would further support regional economies.

All of the preceding drives a thriving multi-billion dollar industry in Europe.

(b) Governmental Policy

The Government could very easily enact policies for some of its own departments which are currently significant users of fossil fuels where there is a reasonable opportunity to use renewable sources such as wood. Their decision making on fuel source should be based on full life cycle economic analysis and consideration of all Government policies including economic growth, employment and climate change.

The Ministry of Education oversees all of the nation's schools yet has no policy in relation to heating plant beyond temperature standards for classrooms. The MoE awards money to schools in a way that does not encourage them to invest in anything but the lowest capital cost heating solutions; heat pumps.

The MoE still has a large number of schools, mostly the longer established ones, which have boiler plant of one sort or another that can quickly and easily be converted to wood fuel operation. There is no encouragement whatsoever to do so. Indeed the boiler plant in most schools is old and neglected. There is also the possibility that school heat plant is poorly utilised and that the utility of these facilities could be increased significantly for district heating and hot water systems.

The same can be said of many government institutions; hospitals, prisons, government buildings, local government buildings and so on.

If the Government were to enact a procurement policy which required the use of wood fuels (or other renewable energy source, such as solar, wind, biogas / biomass) by its own departments wherever reasonably practicable to do so it would create both an immediate market for fuels, equipment, and skills, and send a powerful message to the rest of the country.

In many cases, long term it would also be the most economical policy that the Government could follow.

(c) Complementary measures

Bioenergy Association is working through its recommendations for additional measures that could be complementary to the ETS. Below is an initial list of recommendations. These are being analysed and refined and will be tested at the "*Yes we can!" achieve the greenhouse gas emission reductions* symposium being held on the 31st May in Wellington. A final report and recommendations will be provided as an addendum to this submission after the symposium.

Recommended complementary measures are:

1. *Collection of statistics on direct heat use*

   Currently no data is collected on biomass use for heating. There is need for a mechanism to ensure that data on the use of wood fuel is collected on a consistent basis, as there is for other fuels, so that the actual growth in the sector can be measured. A database of the location and capacity of heat plant is held by EECA and the Bioenergy association although it has a lot of errors in it because it is not maintained. However there is no data collected on the use of biomass and waste for heating and so any statistics on the switching from fossil fuels to renewable energy is simply informed guesswork.

   Currently the lack of data on the growth in the bioenergy sector makes it difficult to show potential investors that they would be joining a growing sector and that wood energy is a main stream energy source, and the level of waste that is already being converted into valuable energy.

   Data on the use of wood fuel and biogas for the production of heat are the only energy sources that are not systematically collected by MBIE.

   Such data will also be required to quantify Carbon mitigation.

2. *Accelerated depressiation for renewable energy and energy efficiency capital expenditure*

   The access to capital for renewable energy projects is a major barrier affecting uptake. Renewable energy facilities tend to be high capital, low operating costs investments and facities generally have a 20-30 year economic life so there needs to be assistance to business to reinvest. An accelerated depreciation regime for renewable energy projects would be near fiscally neutral (except for timing) and provide significant assistance to many projects

   Internationally accelerated depreciation is a common tool for encouraging polution control.

   Depreciation loading of 20% for qualifying items was available in New Zealand until May 2010. It was introduced as an incentive to encourage New Zealand businesses to invest in new capital equipment.

3. *Requiring government owned facilities such as schools and hospitals to consider greenhouse gas emission reductions and lifecycle costs alongside the financial cost when evaluating capital investment decisions.*

   Currently purchase of central and local government capital works tends to be budget driven rather than including consideration of Government policies. This often results in the choice of low capital cost solutions and little consideration of climate change and on-going operating costs. This is accentuated in the health and education sectors where the capital works may be funded by one entity while the subsequent operating costs are funded by another entity.

   Updating Government procurement procedures so that they take all government policies into account for capital purchases would ensure that decisions would always be in the national interest.

There is need to factor the collective impact of benefits to communities and regions into the financial analysis of government investments. Limited work has been undertaken in this area in NZ but is becoming common practice in many countries such as for US Government funding of State projects at preferential rates.

Government facilities use of wood fuel would be the stimulus to kick start wood fuel supply in some areas.

4. *Government agency KPI*

   In the 1990's contracts for employment of public service senior staff were required to have a KPI requirement, stating what they were doing to improve energy efficiency. This was a great driver from the top down and the same could be done for reducing carbon.

5. *Where appropriate using government owned facilities as role models to other emitters*

   If Governemnt is to show that it is serious about meeting the Paris climate change targets then being a role model is the best place to start. When central and local government agencies are making capital investment decisions and a pro-climate change solution is not chosen they should be required to demonstrate why it was not the best solution..

6. *Availability of suspensory or low interest loans for capital expenditure on renewable energy projects.*

   Many bioenergy projects can be potentially financially attractive but access to capital is a major barrier. Having provision for suspensorty loans which are paid back out of operating profits once the project is operational can assist potential projects get underway.

7. *Establishment of a green fund similar to Crown loans*

   Crown loans are available through EECA for renewabale energy and energy efficiency investment projects. An entity similar to the NZ Super Fund or ACC should be established to make similar loans available to private sector projects.

   The Australian's have such an entity in the Clean Energy Finance Corporation (CEFC) whose role is to overcome market impediments and help accelerate Australia towards the transformation to a low carbon economy, minimise its ultimate cost and create positive adjustment for the economy, including through new forms of clean technology business, new jobs, development of new or expansion of existing businesses and development of new technological know-how

   The CEFC places priority on its investments generating economic, social and environmental benefits, including building capacity and capability within the renewable and low carbon energy sector, demonstrating applications and financing for new technologies, development of new or existing businesses and development of new technologies and know-how.

   CEFC investments to date - even at this initial phase - are demonstrating the potential to expand Australia's manufacturing capability and create new industry and employment opportunities across the country, particularly in regional areas.

   The CEFC's portfolio of contracted investments is expected to earn an average return of approximately 6.1 percent (as reported in their 2014-15 Annual Report). Their participation in the market provides liquidity to ensure efficient pricing. Their lower cost of funds, flexible structuring and capacity to match the term of the financing to the life of

the assets has allowed them to de-risk transactions so that private financiers become involved.

The New Zealand Super Fund could be a suitable entity to fund such on-shore investments to the benefit of NZ as a whole.

8. *Encouraging utilisation of municipal solid and liquid waste as a feedstock for the production of energy.*

   We are very good at producing municipal and industrial waste but then put it into landfill where it contributes to greenhouse gas enissions or is, at best, inefficiently converted into energy via biogas.

   With many territorial councils now separating waste at source it is a simple step to ensure that all organic matter is then collected and used beneficially. Using the organic waste as a feedstock for the production of liquid or gaseous biofuel is commonly done in many countries and this proven technology can be applied in New Zealand.

   Municipal waste water treatment plants can very efficiently convert organic waste into electricty for on-site use thus reducing the plant operating costs.

9. *Expansion of the National Policy Statement for Renewable Electricity Generation*

   The National Policy Statement for Renewable Electricity Generation 2011 is consistently referred to as covering renewable energy when it actually only covers electricity. It would be of some assistance to the renewable energy sector if this policy was broadened to include all renewable energy projects and not just those of electricity

10. *Encouragement of more domestic added value processing of wood*

    Encouragement of the processing of forest wood within New Zealand can produce a large number of economic growth, emploment and new business benefits. More domestic added value processing of wood produces more wood fuel as a co-product, and because this is the best quality fuel, heat plant owners will see it as a low risk fuel source.

11. *Change in biodiesel blend limit*

    Expanding the blend limitation for biodiesel from 5% to 7% would provide more flexibility for biofuel retailers and allow an increase in the quantities of biodiesel able to be sold in the motor vehicle retail market.

12. *Moror vehicle owner education*

    The education of motor vehicle owners by an independent party as to the safety for their vehicles from the use of biofuels would assist an increase in the amount of biofuels used. If vehicle owners understand that biofuels can be safely used in their vehicles there will be no necessity to have separation of biofuel sales at the pump. This would reduce the infrastructure required and eliminate unnecessary costs.

13. *Reducing sulphur limits in marine fuel*

    The International Maritime Organization has introduced new regulations to reduce the maximum sulphur emissions limit for all vessels traveling in Emission Control Areas(ECAs) by 2015. Global refining, bunkering and commercial shipping industries will be affected, and any vessels traveling through ECAs will be forced to shift to low sulphur fuels such as Marine Gas Oil, or alternatively stimulate exhaust gas scrubbing. Compliance can also be by way of a number of emission abatement methods including compliant low suplphur marine fuels fuels such as biofuel. Application of such a standard to New Zealand would be good for New Zealand airsheds.

14. *An alternative to the purchase of international units should be that emitters can invest a similar level of expenditure, as they would otherwise spend on purchasing international units, on domestic mitigation and be credited with that investment..*

    It appears as if the Paris climate change targets will only be reached if there is puchase of international emission reduction units. Such expenditure would provide no value to the New Zealand economy. If the same amount of money was spent on assisting domestic mitigation projects then there would be a economic, employment and social benefits over many years.

Harvested Wood Products

F12. Do you think deferred liability for emissions from Harvested Wood Products (HWPs) should be recognised domestically? If so, how?

Yes

We consider that the deferred liability for emissions from HWPs should be recognised domestically as if done appropriately, it should encourage both forest planting as well as domestic wood processing – both of which will enhance New Zealand's position with respect to Greenhouse gas emission targets.

This will result in increased availability of suitable economic material to provide heat for both domestic and commercial/industrial applications from processing residues.

To avoid any distortion to the value chain and in particular to ensure that the use of wood for heating purposes is not disadvantaged in any way, we suggest that the deferred liability should be devolved on an overall product mix averaging basis to the owners of post-1989 forests that are registered in the ETS .

F13. How might the options for deferred liability for emissions from HWPs impact on your business decisions?

Any devolvement option which favours product mix will undoubtedly result in distortion to the value chain. The wood supply chain in New Zealand is complex, highly integrated and yields a wide range of products. The long run economic viability of the supply chain depends upon the interdependence of products and residues. Options which upset the balance risk undermining the sustainability of the overall supply chain. Such options will also deter biotechnological innovation at the end of the supply chain which will likely produce both long and short "half life" products which may otherwise displace high carbon intensive products and fuels such as coal and liquid transport fuels.

Any direct devolvement via the ETS of HWP to the domestic arena appears to have significant issues particularly for wood processors and users of wood to produce heat in that

- All of the scenarios for direct devolvement have a negative impact on domestic processing (ie carbon leakage)
- The impact is particularly severe on energy production (for heat production or liquid fuels)
- At present, no other suitable model for direct domestic devolvement is apparent
- The relative importance of attempting to distinguish between wood products is minor in comparison with distinguishing between wood versus non-wood products. The averaging approach proposed retains a wood versus non-wood market signal.

This assessment leads us to the view that the only practical method of devolving HWP domestically is as described in question F12.