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NZ ETS Review Consultation
Ministry for the Environment
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By email: mfeetsreview@mfe.govt.nz

Dear ██████████

New Zealand Emissions Trading Scheme Review 2015/16 Discussion Document and Call for Written Submissions

Genesis Energy Limited welcomes the opportunity to provide a submission to the Ministry for the Environment (“MfE”) on the “New Zealand Emissions Trading Scheme Review 2015/16 Discussion Document and Call for Written Submissions” dated 24 November 2015 (“the Consultation”).

We understand that, following the Paris Agreement in December 2015, the New Zealand economy needs to prepare for a carbon-constrained future and the New Zealand Emissions Trading Scheme (“NZ ETS”) is the central mechanism for New Zealand’s long-term emissions reductions.

We have attached our responses to the “Priority Issues” first stage of the Consultation. We are generally supportive of the changes, provided there is as much transition time as possible for the market to adjust. Announcing policy changes to the NZ ETS as soon as practicable will provide certainty for the market, and ensuring the changes come into force with as much notice as possible will allow for a well-managed transition period.

We agree with the “The New Zealand Emissions Trading Scheme Evaluation 2016” that there needs “to be long-term signals of stability and surety in the policy settings around the NZ ETS for it to influence business decisions”. But this is also the case if the NZ ETS is going to be a strong and appealing market

for participants. Without sufficient liquidity, the NZ ETS will not be an effective mechanism for managing New Zealand emissions levels. An effective NZ ETS also needs trading standardisation, agreed market documentation and market making schemes. We understand that these details are part of the second stage of the Consultation, and we look forward to providing input and a more detailed response regarding these issues.

If you would like to discuss any of these matters further, please contact me on

[REDACTED]

Yours sincerely

[REDACTED]

Rebekah Cain
Regulatory Advisor

Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
Moving to full surrender obligations	
<p>Q3: Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?</p>	<p>Yes, provided there is a transparent and achievable transition to full obligations.</p>
<p>Q4: What impact will moving to full surrender obligations have on you or your business?</p> <p>Please include specific examples or evidence of the impacts on you or your business of:</p> <p>(a) increased carbon prices, including actions to reduce emissions and future investment decisions.</p> <p>Please comment of the effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher.</p> <p>(b) any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.</p>	<p>(a) Genesis Energy has a number of thermal plants that incur emissions obligations under the NZ ETS. The thermal plants generate energy into the New Zealand electricity Market (“NZEM”). The NZEM has a mixture of different energy sources to manage security of supply, including: hydro, geothermal, wind, gas and coal fired power stations. The effect of a rise in the New Zealand carbon unit (NZU) price will be to increase the offer price of thermal generation into the spot electricity market. This is because thermal producers should be able to recover the cost of carbon emissions from the wholesale electricity price they receive for their generation. Thermal power plants make up approximately 18% of the NZEM. For example, a rise in the price of NZU from \$5 to \$25 will change that wholesale price by a further \$4.50/MWh. A move of the NZU price from \$25 to \$50 will change that wholesale price by a further \$4.50/MWh. If the effect of these potential increases is fully passed through to the spot market that increase in cost will ultimately fall on consumers.</p> <p>Whether a higher NZU carbon price will change behaviour is a difficult question to answer. If the NZEM has surplus generating capacity, then there may be some substitution of thermal for alternative sources. This means the additional carbon cost will be borne by generators. However,</p>

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	<p>if there is no market ability to substitute the thermal generation, then the increased cost can be expected to be reflected in the wholesale spot price. This increase in spot price is likely to be passed through to end consumers over time.</p> <p>(b) No</p>
<p>Q5: If full surrender obligations are applied, when should this be implemented?</p> <p>(a) 2016</p> <p>(b) 2017</p> <p>(c) 2018</p> <p>(d) Other – please specify.</p> <p>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.</p>	<p>Full obligations should resume at the end of 2018. This will give time for companies such as Genesis Energy to structure their business activities accordingly. Any earlier imposition will impose sudden, material costs on companies such as Genesis Energy.</p> <p>Genesis Energy uses a balance of spot and forward contracts to manage its future emissions obligations. Under 1:1 surrender obligations, our obligations will double, leading to a potential unit shortfall and financial cost for the Company.</p> <p>For example, if 1:1 is implemented at the end of 2016, the NZEM will have a very large additional NZU obligation for 2017. To mitigate this increase in obligations, Genesis Energy and other NZEM participants will need to purchase more NZUs. This will put pressure on the current supply of NZUs. Any resultant rise in NZU prices will need to be sufficient enough to incentivise reluctant sellers to release their unencumbered NZUs into the spot market. This may require a significant price increase over a short period of time. This price increase will either be borne by the companies directly through margin compression, or by raising consumer prices.</p> <p>A more gradual change in price by delaying implementation of the 1:1 until 2018 will give both buyers and sellers more opportunity to plan their sales and purchases, respectively. A more gradual change will also give market participants the ability to execute forward transactions that more closely match their obligations to allocated</p>

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	<p>carbon units.</p> <p>Genesis Energy has also announced plans to close the two remaining coal-fired Huntly Rankine units by the end of 2018, unless market conditions change. The closure of these units will have a significant impact on New Zealand's emission obligations. We consider that allowing a transition to 1:1 by the end of 2018 will be far less costly to the NZEM and New Zealand.</p> <p>But even implementing 1:1 obligations by the end of 2018 is an incredibly short timeframe with potentially significant cost implications. Therefore, Genesis Energy urges Ministers' to announce the decision as early as possible.</p>
Managing the costs of moving to full surrender obligations	
<p>Q6: If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?</p>	<p>There are arguments both for and against managing price shocks in the market.</p> <p>Managing price shocks has the advantage of providing price certainty to all participants. With a price ceiling, participants will know there is a limit to their potential liabilities, thus increasing the transparency of the whole system. This allows for more accurate long term planning for all participants.</p> <p>However, like any intervention, managing price shocks will prevent the market from allocating resources with optimal efficiency. Unencumbered market prices are an important signal to participants. A severe increase in price will reflect either a shortage of NZUs (not enough forestry planting) or an excess of emissions. The market's adjustment to the price will be either to encourage more planting of forests and/or reducing emission generating activities. If a price ceiling is put in place, this dynamic will not work properly and market behaviour will not change to the same extent.</p>

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<p>Q7: If potential price shocks associated with moving to full surrender obligations should be managed how should this be done?</p> <p>(a) Maintain the fixed option at \$25</p> <p>(b) Lower the fixed price option</p> <p>(c) Gradually move to full surrender obligation</p> <p>(d) Other methods</p>	<p>If the decision is to intervene and price shocks are managed, then Genesis Energy considers a price cap will be the best way to do this. A price cap can work as a medium term measure to assist in adjustment to full surrender obligations.</p>
<p>Q8: If the \$25 fixed price surrender option value should change, what should it change to and why?</p>	<p>Changing the Fixed price surrender option to a level different from the \$25 level should not be considered lightly. Any change would introduce a sense of volatility into the ETS. This would increase uncertainty for the emissions market. Transparency and certainty are key elements for a correctly functioning market.</p> <p>Genesis Energy can see the benefits of a lower fixed price surrender option in the short run as a lower price would reduce our potential obligation costs. However, that needs to be balanced with the comments above in providing long and medium term certainty to the ETS market.</p>