

TODD CORPORATION LIMITED – NZETS SUBMISSION

1 Introduction

Thank you for the opportunity to provide written submissions on the Government's New Zealand Emissions Trading Scheme Review 2015/16 (the 2016 NZETS Review).

2 Overview

Consistent with the approach set out in the 2016 NZETS Review Discussion Document dated 24 November 2015, Todd has prepared a submission on the Priority Issues (Questions 1 to 8), which is attached and should be read in conjunction with this cover paper.

Our view is that the matters identified as being Priority Issues should not be considered in isolation from the items identified as Other Matters/the overall design, operation and administration of the NZETS. Doing so would run the risk of developing responses focussed only on short term pricing of carbon for existing participants and not addressing a fully inclusive and balanced response to wider concerns about the future design and operation of the NZETS in a post Kyoto environment. Todd considers that the recent Paris Agreement may provide an opportunity to adopt a more holistic approach to the NZETS review focused on first principles.

During a period of global review of responses to climate change, Todd favours an approach where New Zealand does not unilaterally take action or seek to be a market leader in this area, particularly given both continued uncertainty about the future direction of global responses to climate change and at a time of global financial market and economic fragility.

Todd submits that, rather than changing discrete elements of the current NZETS, a better focus would be to develop a unified all-inclusive response to climate change in conjunction with New Zealand's major regional and global partners. As such, Todd does not favour short term legislative change in 2016 to adjust certain provisions of the NZETS in isolation until such time as the future direction and design of the NZETS has been fully developed, communicated and made consistent with the outcomes of the Paris Agreement, which are still highly uncertain. Consistent with that, Todd considers that the NZETS review would be better focussed on the establishment of a holistic road map that sets out clearly how the New Zealand Government intends to transition into a global climate change response network. That road-map should be developed in consultation with key trading partners including Australia.

3 Strategic framework - key concerns

Todd submits that, in designing the NZETS, the Government should apply a consistent strategic framework enabling it to measure scheme design, outcomes, performance and any future review processes against strategic principles. We set out below a summary of a proposed strategic framework, using themes already identified, and provide a high level assessment of the current NZETS's performance against those strategic principles.

To the extent that some change to the current NZETS is seen as necessary without completion of a strategic and holistic design, we have also provided below suggestions on how such changes might be implemented to be consistent with the proposed strategic framework. These are also reflected in the attached Response Document on the specific Priority Issues.

| Strategic principles | | Current NZETS performance | Impact of 2016 NZETS Review |
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| <p>The NZETS should ensure that New Zealand is not placed at a competitive disadvantage relative to its trading partners or competitors</p> | <p>Todd submits it is critical that New Zealand, as a small trading nation, which principally exports commodities for which it is a global price-taker rather than price-maker, retains its international competitiveness and protects the relatively fragile domestic economy</p> | <ul style="list-style-type: none"> • Post the decision to exit the Kyoto Protocol New Zealand has become effectively a domestic-only scheme • In our view this leaves New Zealand exposed to isolation when it comes to carbon and at risk of artificially deriving and ascribing a cost of carbon that is out of step with the global economy • Without direct reference or access to globally traded market pricing inputs there is a risk that the NZETS will be open to manipulation by future scheme administrators and may become a carbon tax in all but name | <ul style="list-style-type: none"> • Proposed review does not address how the NZETS will integrate into any future Paris Agreement actions – noting that these actions will not be defined for at least 12-24 months • Todd considers that the Paris Agreement will promote increasing implementation of regional and/or global emission schemes and fully fungible carbon units • The proposed review does not address how NZ proposes to integrate with regional and/or global emission schemes as they are developed • Global financial markets and a number of NZ's key trading partners are currently experiencing volatile and uncertain economic conditions. NZ's own economy is delicately balanced, with major elements of the domestic economy experiencing financial pressures not seen since the 2008 GFC. At such a time any amendments to the NZETS should focus on ensuring minimal economic and financial impact to NZ's economy and international competitiveness as a priority |
| <p>The NZETS should create certainty to the extent that it is practicable to do so</p> | <p>It is critical that any response to carbon should promote and create long-term certainty that enables businesses to plan ahead and make necessary adjustments with confidence</p> | <ul style="list-style-type: none"> • The current NZETS has been subject to a number of material changes since its inception and in some instances with limited forewarning of changes that materially impact participants • Operation of a domestic-only scheme | <ul style="list-style-type: none"> • Todd applauds the consultation process that is being undertaken in respect of the current review • However, as noted, Todd has concerns that the prioritisation of certain matters does not promote a robust and holistic reassessment |

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| | | <p>that is increasingly divorced from regional or international schemes does not promote consistency of outcomes as there is a risk that NZ will have to make continual changes/refinements to ensure alignment with global trends and outcomes</p> <ul style="list-style-type: none"> • Lack of long term certainty has resulted in material price volatility with an inability for the market to send clear pricing signals to participants and end users • This in turn has limited participants' ability to make long term investment decisions in support of the scheme's objectives | <p>of the NZETS and its priorities</p> <ul style="list-style-type: none"> • Any changes to the NZETS should be signalled well in advance of any enactment, to enable participants to adapt to any changes – the current consultation document refers to potential for material amendments to take effect later this year that will impact directly upon participants • The way in which the review process was announced is an example of why certainty and consistency of outcomes is critical to successful operation of the NZETS. The price of NZUs has increased materially in a very short time due to the market having to try and interpret the intent of the NZETS review and the likely outcomes. Comments about the potential need for carbon pricing to increase has created potential market distortions. Price signals should be handled in a more formalised and cohesive manner to prevent short term price volatility |
| <p>The NZETS should be both effective and efficient</p> | <p>An effective response means that the intended results are achieved</p> <p>An efficient response means that delivery and transaction costs associated with compliance under the NZETS are minimised</p> | <ul style="list-style-type: none"> • The current NZETS has failed to some degree to deliver the anticipated results • One of the key reasons for this has been the illiquid market - highly variable liquidity of eligible emission units due to a failure to incentivise the desired behaviours from participants, leading to an instability of carbon pricing • Continuous revisions and the decision not to participate in the 2nd | <ul style="list-style-type: none"> • Short term changes designed to stimulate liquidity via amendment of surrendered provisions or artificially inflating the price of carbon are, in Todd's view, not a sustainable response and will not promote the desired long term changes in emission reductions • The 2016 NZETS review does not address how the NZ Government intends to ensure liquidity and access to eligible emission units • Any review process should address the issue of liquidity as a priority • This cannot be achieved in isolation from |

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| | | <p>commitment period for Kyoto have resulted in material stockpiling of NZUs, which is a commercially rational reaction in the absence of long term stable and liquid access to eligible emission units</p> <ul style="list-style-type: none">• The Crown has talked about the establishment of a NZU auction process for a number of years but seems no closer to establishing a viable or effective process• The responsibility for administration and operation of the NZETS continues to rest with a relatively small number of participants and to represent a significant administrative burden | <p>other global member states, as co-ordination and access to a global emission standard is the only long-term solution to liquidity unless the intent is for the NZETS to remain insulated and isolated from the rest of the globe's response to carbon emissions</p> |
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| <p>The NZETS should result in equitable outcomes</p> | <p>It is critical that all sectors and participants are treated equitably and are all incentivised equally to deliver on the overall objective of reduction in greenhouse gas emissions</p> | <ul style="list-style-type: none"> • The current NZETS continues to promote, in Todd's view, highly inequitable outcomes due to the exclusion of key industry sectors and participants from the scheme • Agriculture currently accounts for almost 50% of NZ's greenhouse gas emissions but continues to be excluded from the NZETS • By not having the broadest base possible for carbon pricing the current NZETS imposes the obligations for climate change response disproportionately onto a narrow set of participants and ultimate end users | <ul style="list-style-type: none"> • Todd understands the arguments made to justify exclusion of some sectors e.g. absence of available technology to mitigate emissions and a desire to ensure that sectors remain competitive in global markets • The proposed review, while it invites views, does not set out a holistic programme on how and when other sectors will be brought into the NZETS. Todd considers that a clear long term road-map is a critical part of any review of the NZETS • Exclusion of those sectors does not promote a balanced and equitable distribution of care and responsibility for climate change responses; instead it artificially creates winners and losers • Creation of a level playing field with common incentives and which drives appropriate behaviours across all industries and sectors is, in Todd's submission, the only way to establish a long term binding and effective commitment to change |
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4 Changes to NZETS (if deemed necessary)

Consistent with its comments above, Todd does not favour any short term changes to the NZETS unless they are predicated on a principled approach that meets the strategic objectives set out in the Proposed Framework above. If it is deemed imperative to make changes prior to completion of a more holistic ETS design, Todd's suggestions on how such changes might be implemented to be consistent with the proposed framework are reflected in the attached Response Document. The key elements are:

- a) longer lead time to any phasing out of the two for one surrender obligation in conjunction with;
 - i inclusion of agriculture / all industries within NZETS;
 - ii sensible & phased lead time for any changes to the price cap; and
 - iii create access to international ETS/credits – for price discovery, liquidity & operational feasibility.

Topics for NZ ETS Review 2015/2016 consultation

About the consultation

The Government is reviewing the New Zealand Emissions Trading Scheme (NZ ETS) to assess how it should evolve to support New Zealand in meeting future emissions reduction targets and its ongoing transition to a low emissions economy. This follows the announcement by the Government in July this year that New Zealand's post 2020 target is to reduce greenhouse gas emissions to 30 per cent below 2005 levels by 2030.

The Ministry for the Environment is leading the consultation and welcomes your feedback on how the NZ ETS is working and how it might work better in the future.

The review will focus on:

- some transitional measures introduced to moderate the impacts of the NZ ETS
- what is required for the NZ ETS to evolve with changing circumstances including future targets
- operational and technical improvements.

Discussion document

For more information about the consultation, read our discussion document. It sets out the issues on which the Government is consulting, the objective and drivers for the review. It also contains the terms of reference for the review.

Some transition measures are being given priority and have the first deadline for submissions as they may be candidates for legislative change in 2016 (see closing dates for submissions below). Refer to the discussion document for detail on the priority and other matters under review.

Technical notes on the following specific issues will be available in December or early 2016 to support submissions:

- modelling of the impacts of the priority issues outlined in the discussion document
- forestry sector matters, including accounting methodologies for post-1989 foresters
- operational and other technical matters.

To be notified of when these technical notes are available, please email nzetsreview@mfe.govt.nz.

Closing dates for submissions

- Submissions on priority issues close at 5pm on 19 February 2016
- Submissions on other review matters close at 5pm on 30 April 2016.

You may make submissions on both priority issues and on the other matters. If you provide feedback on both you can do so in a single submission or separate submissions. Please note submissions on priority issues must be received by 19 February 2016.

Publishing and releasing submissions

All or part of any written submission (including names of submitters), may be published on the Ministry for the Environment's website www.mfe.govt.nz. Unless you clearly specify otherwise in your submission, we will consider that you have consented to website posting of both your submission and your name.

Contents of submissions may be released to the public under the Official Information Act 1982 following requests to the Ministry for the Environment (including via email). Please advise if you have any objection to the release of any information contained in a submission and, in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this consultation under the Official Information Act.

The Privacy Act 1993 applies certain principles about the collection, use and disclosure of information about individuals by various agencies, including the Ministry for the Environment. It governs access by individuals to information about themselves held by agencies. Any personal information you supply to the Ministry in the course of making a submission will be used by the Ministry only in relation to the matters covered by this consultation. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry may publish.

Contact for queries

Please direct any queries to:

Phone: +64 4 4397400

Email: nzetsreview@mfe.govt.nz

Postal: NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143

Questions to guide your feedback

The questions below are a guide only, and all comments on topics are welcome.

To ensure your point of view is clearly understood, please explain your rationale.

Contact information

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| Telephone | ██████████ |
| Email | ██ |

Submission Form

Context and drivers for the review

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

In part. As noted in the Cover Paper that forms part of Todd's submission, the review should be holistic and not piecemeal.

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

a. New Zealand maintaining its competitive position in the global market place.

Todd considers that New Zealand should not take a leading position on international climate change. To do so would risk weakening New Zealand's competitive position in the global economy and compromising its ability to invest in emerging technologies as they mature.

b. Need for greater certainty and understanding of the international responses.

There is currently insufficient certainty in a number of areas to warrant New Zealand taking an aggressive approach to climate change, including:

- the intentions of New Zealand's main trading partners and competitors regarding climate change response; and
- global economic conditions, which are currently unstable due to a number of factors including cooling of the Chinese economy, record low commodity prices, increasing volatility and risk in global financial markets and significant unrest in the Middle East.

c. Impact on the New Zealand economy.

If New Zealand adopted a more aggressive climate change framework than its global competitors then that would likely result in:

- wealth transfers to those other nations, without any impact on global carbon emissions (and in fact emissions might increase because other nations might produce products using more carbon intensive technologies than those currently available to NZ);
- a reduced standard of living for New Zealanders; and
- a reduced ability to sustain the changes necessary to mitigate or adapt to climate change in the long term. Maintaining a strong and stable NZ economy will enable New Zealand to fully participate in the global effort to address climate change over the long term.

The NZIER economic impact report concludes that the impact on New Zealand's economy is adverse but relatively minor even at \$50/t. However, the nature of macroeconomic computable general equilibrium modelling implicitly assumes that New Zealand maintains its international competitiveness once the transitional measures introduced in 2009 are removed and that assumption may not be correct. While the Paris accords have been finalised, they are a record of high level intentions only and it is not yet known what changes will be implemented by New Zealand's main trading partners and international competitors or over what timeframe. There is no certainty that a global emissions trading framework will be available for New Zealand to mitigate its exposure post 2020 and Todd recommends a more holistic review of the way that New Zealand meets its climate change commitments. At this stage, it is not clear that an emissions trading scheme will be the most appropriate mechanism for doing so.

In addition, since:

- i. agriculture (~50% of New Zealand's carbon emissions) is excluded; and
- ii. transport (~22% of current emissions), is likely to be insensitive to the price of carbon;

any emissions trading scheme is, in effect, aimed at only 28% of total emissions – primarily energy production and process heat. As a very high percentage of New Zealand’s electricity production comes from renewables already, there are limited opportunities for further reductions and there are no alternative technologies available for firms that rely on process heat.

- d. Equity and consistency of incentives: in particular this means bringing all industries, including agriculture, into the NZETS. See further comments below.

Moving to full surrender obligations

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

Not at this time and not until at least the following conditions can be met:

- a. stability of the NZ and global economy;
- b. more certainty that equivalent efforts are made by nations that New Zealand trades and competes with internationally;
- c. implementation carried out through a phased transitional program, to prevent price shock and to provide time for consumers and investors to adjust; and
- d. comprehensiveness of the ETS and, in particular, bringing in agriculture (even if there are transitional arrangements) to create an even playing field for investment opportunities.

By continuing to exclude agriculture from the ETS, more investment capital will continue to flow to that sector than it would if agriculture faced the costs associated with its activities and impacts on the environment. Without ETS incentives, the drive for innovation and change in the agricultural industry will not occur, which are required given that almost 50% of emissions are from this sector. While internationally agriculture has been excluded from carbon emission reduction targets, and that may make it acceptable from that international perspective, by excluding agriculture New Zealand prevents a potentially valuable contributor to its climate change objectives from playing its part. It also fails to provide an incentive to further develop farming technology, particularly around grass varieties that may reduce agricultural emissions.

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

Please include specific examples or evidence of the impacts on you or your business of:

- a) **increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher.**

Todd Corporation expects to be able to pass through much of the carbon emissions cost to its customers, with a potential consequential impact on disposable incomes. To the extent that is not possible, there will be reduced profitability for the business.

Todd notes that businesses that are deemed to be trade exposed in international markets will be eligible for allocation of free units but will still be exposed to indirect costs associated with electricity and gas supply for process heat requirements, which may not be fully covered.

Carbon costs that Todd Corporation cannot pass on include:

- i. the cost of flared and own use gas at production facilities, the major site affected being the Maari oil and gas field, which is 80 km offshore, making alternatives to flaring impracticable; and
- ii. the non-recoverable element of CO₂ emissions from the Kapuni gas field, which has a CO₂ content of 84TCO_{2e}/TJ compared to 53TCO_{2e}/TJ at other gas fields.

The table below shows Todd's calculations of the direct impact on consumers over a range of carbon costs and are comparable to the calculated costs included in the ETS scheme review document. These price escalations only include direct ETS costs and do not include increases in commodity prices due to reduced incentives for future oil and gas exploration activity.

| Unit Price (\$/TCO2e and 1:1 surrender ratio) | 5 | 10 | 15 | 20 | 25 | 50 |
|---|----------|----------|----------|----------|-----------|-----------|
| Increase in wholesale electricity price (\$/MWh) | \$ 1.93 | \$ 3.86 | \$ 5.79 | \$ 7.72 | \$ 9.66 | \$ 19.31 |
| Increase in Wholesale natural gas price (\$/GJ) | \$ 0.27 | \$ 0.54 | \$ 0.80 | \$ 1.07 | \$ 1.34 | \$ 2.68 |
| Increase in petrol price (\$/l) | \$ 0.01 | \$ 0.03 | \$ 0.04 | \$ 0.06 | \$ 0.07 | \$ 0.15 |
| Increase in residential electricity costs per annum | \$ 15.45 | \$ 30.90 | \$ 46.34 | \$ 61.79 | \$ 77.24 | \$ 154.48 |
| Increase in residential natural gas costs per annum | \$ 6.71 | \$ 13.41 | \$ 20.12 | \$ 26.82 | \$ 33.53 | \$ 67.05 |
| Increase in petrol costs per annum | \$ 20.23 | \$ 40.45 | \$ 60.68 | \$ 80.91 | \$ 101.14 | \$ 202.27 |

As indicated by the economic analysis performed by NZIER, those costs will likely disproportionately impact lower socio economic groups and some rural provinces due to the economic incentives/disincentives on local businesses.

Consumers will also be indirectly affected as higher gas, transport and electricity prices are passed on by businesses through the prices of goods and services.

The above costs will likely be understated if New Zealand's trading partners and international competitors do not adopt climate change measures at the same pace as New Zealand.

b) any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

It is difficult to comment on the administrative and operational issues without a greater level of specificity, however any system for carbon accounting will involve administrative costs. Todd would be grateful to receive any further data on this issue.

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

d) other – please specify

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.

A graduated increase in the surrender obligation over 5 years (once the conditions noted in section 3 have been met). This would:

- i. provide an opportunity for the New Zealand Government to show intent subject to international competitors and trading partners demonstrating their commitment to action on climate change;
- ii. enable consumers and investors to adjust their consumption and investment behaviours in an orderly fashion without the disruptive and negative impacts of price shock; and
- iii. allow the development of the global carbon trading arrangements which are integral to New Zealand's ability to meet its long term climate change objectives.

A near term change to a full surrender ratio and an increase or removal of the fixed price option without access to international markets for acceptable carbon units would unnecessarily expose New Zealand to rising carbon costs. That may, in turn, result in premature and irreversible investment/divestment decisions, especially if global carbon trading arrangements do not emerge.

Managing the costs of moving to full surrender obligations

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

Yes - as per Q3, Q4 and Q5 answers regarding managing the balance between:

- a. providing regulatory certainty;
- b. providing and maintaining consistent signals to investors and consumers but allowing them the time to invest and change behaviours; and
- c. demonstrating that New Zealand will move only as fast as its international counterparts do.

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

a) maintain the fixed price option at \$25

The fixed price option, currently at \$25/t, effectively caps the market price of carbon and is an effective tool to manage price shock risk through time. By changing the fixed price option, Government can manage a transitional program. Todd strongly suggests that if any changes to the price cap are made, they should be phased over a longer period so that consequent changes in investment (e.g. around technology) can occur.

b) lower the fixed price option

c) gradually move to full surrender obligation

If a decision is made to remove the current 2:1 surrender obligation, Todd strongly recommends a gradual phased approach given this would in effect be doubling the cost of the obligation.

d) other methods.

Consider further allocations of units (in a phased manner) to affected industries.

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

Factors used in determining the fixed price option should be:

- a. the expected long run costs of deployable carbon reduction technologies; and
- b. an assessment of the impact of carbon costs on consumers, which is expected to be harmful, especially to those on lower incomes.

Based on the technical paper prepared by the University of Canterbury with respect to afforestation, Todd recommends retention of the \$25 price cap until acceptable international carbon trading arrangements are implemented. This would mitigate the risk of a shortage driving prices unreasonably high. \$25/t is sufficient to incentivise appropriate land use investment and, in particular, choices between land use for forestry versus agriculture (which currently does not face direct exposure to carbon emission costs).

When your submission is complete

Email your completed submission to nzetsreview@mfe.govt.nz or post to NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143.

Submissions on Priority issues close at 5.00pm on 19 February 2016.

Submissions on Other matters close at 5.00pm on 30 April 2016.