

## **TODD CORPORATION LIMITED – NZETS SUBMISSION – OTHER ISSUES**

### **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 and the subsequent Ministry workshops, Todd has prepared a submission on the Other Issues (Questions 9 to 28), which is attached and should be read in conjunction with this cover paper and our earlier submission on the 'Priority Issues'.

As we noted in the cover paper to the Priority Issues submission, Todd's view is that the matters identified as being Priority Issues should not be considered in isolation from the 'Other Issues' or from 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 in which New Zealand does not unilaterally take action or seek to be a market leader, particularly given both continued uncertainty about the future direction of global responses to climate change and at a time of global economic fragility.

Todd submits that, rather than changing discrete elements of the current NZETS, a better approach would be to develop a unified 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 Government proposes that New Zealand should 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. In our Priority Issues Submission we set out a summary of a strategic framework, using themes previously identified, and provided a high level assessment of the current NZETS 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 suggestions on how such changes might be implemented to be consistent with the proposed strategic framework. These are reflected in the attached Response Document on the Other Issues.

## **Todd Corporation Limited - Other issues: business responses to the NZ ETS**

Todd sets out below its response to the specific questions relating to “Other Issues” in this second phase of the NZ ETS submission process. This response document should be read in conjunction with Todd’s **attached** cover paper and the previous response on the Phase One “priority issues”. Consistent with the comments in the cover paper, Todd does not favour any short term changes to the NZETS unless they are predicated on a holistic and principled approach that is consistent with the international environment and agreed strategic objectives.

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

Yes. Financial business plans include assumptions about carbon costs as Todd has direct obligations under the ETS legislation. Most (but not all) costs are expected to be passed through to consumers. Some ETS costs are treated as a cost of production (flaring and own use) and may not be recoverable.

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

A key input to the business planning process is the future price of carbon credits. There are currently no sufficiently active forward markets with respect to carbon prices to provide clarity about the likely future price of carbon units. This makes forecasting future carbon obligations or managing price risk difficult. This is exacerbated by the absence of international carbon markets that have the depth and scale to support futures/forwards markets. Without a credible basis for forecasting carbon prices and the ability to manage risk through futures/forward markets, investment decisions driven by mitigation of carbon liabilities are difficult to make. Accordingly the discount rate attached to future cash flows is higher than it would be if markets existed to manage this risk.

## **Other issues: protecting competitiveness through free allocation**

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

- New Zealand should seek consistency with international developments rather than establishing isolated timelines that do not take account of regional / global activities or emissions. Any consideration of a reduction would also benefit from the:
  - o Establishment of an auctioning system for surplus units that are not made available through the free allocation mechanism.
  - o Existence of sufficiently liquid secondary markets for spot sales/purchases of valid units as well as access to forwards/futures markets.

Todd believes that consideration should also be given to the treatment of the agricultural sector under the ETS, applying free allocation rules (or a specific subset of them) to agriculture to start to quantify the impact of emissions. In that way, incentives can be placed on that sector to adopt practices and make investment decisions that take into account environmental carbon costs. Given New Zealand’s competitive advantages in this area, it provides a way for those advantages to be monetised relative to the current framework that simply ignores emissions from that sector. That is not to say that there will not be challenges associated with how the administration of such agricultural emissions will be

efficiently and effectively undertaken but they seem no less complex than those the forestry industry must deal with.

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?

Todd's view continues to be that a more measured and holistic approach is necessary if New Zealand is to avoid becoming uncompetitive with its international trading partners. On that basis Todd continues to caution against making changes prior to working with the international community and understanding the responses of other nations. However, improved certainty of the regulatory framework would assist all participants in long run investment decisions. A regulatory framework that is continually subject to political change undermines the value of any market-based system.

### **Other issues: managing unit supply - forestry**

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

No comment

In your answer, we are interested in the:

- 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.

14. Are there opportunities for the NZ ETS to increase incentives for forestry investments, outside of NZU price? Yes/No/Unsure

No comment

15. What are your reasons for the above answer? If you answered yes, we would be interested in comments on:

- a) any barriers to participating in the NZ ETS that could be reduced
- b) other factors.

No comment

### **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)

Todd considers that any future NZ ETS regime should include access to carbon mitigation measures through suitable international market arrangements. Access to international markets should:

- be two way – i.e. units in either New Zealand or other international markets should be able to be traded cross border to avoid distortions and transaction costs associated with constraints;

- be governed on the principle that units reflect genuine carbon reduction efforts or allocations of the right to emit;
- include New Zealand's main trading partners and competitors so that New Zealand is not placed at a competitive disadvantage relative to those countries.

b) Restrictions on how many units can be surrendered

Todd does not favour restrictions or constraints on the surrender of international units but anticipates the development of international trading protocols and standards that will ensure and promote the integrity and global acceptance of such units.

**Other issues: managing unit supply – auctioning**

17. Should auctioning be introduced in the NZ ETS?

Todd considers it is important to be clear around the purpose of auctioning and that it needs to be part of a cohesive framework of measures (see Q 18 below).

Auctioning should be introduced as soon as reasonably practicable to ensure sufficient liquidity of units is maintained in the NZETS. In practice we believe that this, at a minimum, represents the difference between New Zealand's carbon budget (as per international agreements such as those committed to in Paris last year) and the units that are issued as a free allocation to trade exposed industries and potentially agriculture.

18. What should the role or purpose of an auctioning function in the NZ ETS be, if one were introduced?

Todd considers that the purpose of auctioning should be focussed upon allocating supply of units rather than specially managing prices (which should be a function of the wider market). The role for auctioning is also closely connected to the availability of domestic and international units and whether these are accessed directly by market participants or by the government and having an upper price limit in place (see Q 22 below). Assuming that there is a secondary market for carbon units then an auctioning system will aid in adding depth and liquidity to that market and may assist with price discovery / transparency.

19. How should auctioned NZUs relate to other sources of unit supply in the NZ ETS, especially NZUs generated through forestry removals and/or international units?

Todd believes that, in the interests of reducing complexity and transaction costs and reducing the potential for distorted market outcomes, all ETS units - whether procured by auction, free allocation, international markets or forestry - should be treated equally. Fungibility of carbon units regardless of their source is desirable because that assists with:

- a) units being treated as commodities; and
- b) development of market trading mechanisms, including futures and forwards markets.

Without fungibility, units of different classes would need to be managed and transaction costs would be higher due to the additional complexity.

## **Other issues: managing price stability**

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

Moderate.

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

Yes, until mature and liquid international markets have developed and are accessible.

International markets and the scale they should bring would assist with a number of attributes if managed well:

- improvement of market depth and liquidity;
- development of secondary futures and forwards markets to assist in long term decision making; and
- maintenance of international competitiveness in relation to carbon pricing.

After a substantial and liquid international market has been established, and has matured, there may be less need for domestic measures such as carbon price caps and floors or for other measures designed to reduce price volatility, except in the most extreme scenarios such as market failure.

22. What do you consider are important factors for managing price stability?

- a) upper price limits (e.g., fixed price option or a price ceiling implemented through an auctioning mechanism)
- b) lower price limits (e.g., price floor)
- c) other (please explain).

Upper price limits only. As discussed at the Ministry workshops, lower price limits have a natural floor of \$0 whereas markets with no upper price limits are uncapped and in such instances, risks are asymmetric. Without an upper limit, surety of liquidity, or access to international units, net purchasers of units have an absence of certainty around future carbon prices and risk being the subject of market price manipulation and must discount that risk in their economic evaluation of projects. As such an upper limit will assist certainty around future investments and enable the market to make more coherent and balanced decisions.

23. What should the Government consider when managing price stability?

Relevant factors include the:

- workability or otherwise of current market arrangements
- depth and liquidity of the NZETS market in the absence of access to international markets
- unit prices that will incentivise (not unjust enrich) investors in carbon reducing technologies/activities.

**Other issues: operational and technical matters**

24. Are you aware of ways the administrative efficiency of the NZ ETS could be improved?

Consideration of a greater level of investment in back office systems and technology would assist e.g. the NZEUR website can be very slow, particularly on the final filing and surrender dates.

25. Can you provide further information to support your answer? We would be interested in comments on:

- a) complexities involved in NZ ETS participation
- b) penalties for breaching NZ ETS obligations
- c) any technical or operational changes that could be made to the NZETS to improve efficiency.

No comment

**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? No comment

27. If so, is there a role for the Government in addressing these barriers or market failures and how should it do this? No comment