



Tunakino Forestry Ltd

29/04/2016

NZ ETS Review Consultation,
Ministry for the Environment,
P.O. Box 10362,
Wellington 6143

To Whom it May Concern:

Re: NZ ETS Review 2015/2016 Consultation

Please find below a response to the above-referenced consultation – for the second part, “Other Issues”.

We would like to emphasise that there is a single issue within these consultations that we believe is the most important one to address, and that it should be reprioritised to as to be the top issue that the Ministry and MPI focuses on and resolves. That is the issue of deferred liability for emissions from HWPs. We strongly recommend that Option 1 set out in the Forestry Technical Note of the consultation paper should be adopted (to defer the liability for the emissions from HWP from post-1989 foresters’ existing harvest liability within the NZ ETS). We think this approach is fair, efficient, and corrects a major failing of the existing ETS settings. It should be urgently implemented.

That aside, please note that Tunakino Forestry Ltd responded to consultation questions 9 through 28 inclusive (relating to “Other Issues”) in our Part 1 response in February. Our first submission still stands; we do not repeat all those responses here except to emphasise the particularly critical points from our perspective.

We also respond to select points here on the subjects of the Forestry Technical Note and the Operational Matters Technical Note.

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

A more accurate representation of the actual emissions caused by harvest. Rather than paying back 100% of credits at harvest, unless timbers is actually burned (and released into the atmosphere), I should be required to pay back a schedule matching actual (i.e. typically real) emissions profiles for harvested timber. Timber used for construction, for example, will not decompose for decades.

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?

It would make investment in new forestry more attractive.

I would be significantly more likely to plant trees than is the case now.

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

Yes

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.

Consistent and fair and common-sense application of the ETS rules by MPI. This is not the case now.

Consistent policy-making that wasn't so obviously tilted towards emitters at the expense of forestry. For example, the 1:2, and the assumption that forests are effectively burned and released into the atmosphere on harvest.

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)

b) restrictions on how many units can be surrendered

c) others (please explain).

Answer: a) and c).

It is unfair to New Zealand carbon producers if New Zealand can only import units but not export. That decreases the price of NZ units (or at best leaves them unchanged) and is another example of the market being tilted away from New Zealand carbon producers. If the New Zealand Government is incapable of negotiating reciprocal agreements where we can sell as well as buy, then the market should remain domestic-only.

17. Should auctioning be introduced in the NZ ETS?

No.

While labelled as "auctioning" the proposal is effectively one of the Government standing in the market as an additional source of supply – competing with foresters – so as to manipulate ("influence") price and quantity outcomes to meet Government objectives. This is incredibly chilling on investment incentives as far as a carbon producer is concerned at least. Government manipulation of the market is the antithesis to a free market economy. It destroys investor confidence and market efficiency.

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

Yes

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 NZ ETS to improve efficiency.

Tunakino Forestry would appreciate the opportunity to discuss these directly with the Ministry for the Environment and MPI and not in a public forum.

Regarding the Forestry Technical Note:

F1. What do you consider are the strengths and weaknesses of the NZ ETS forestry settings?

The overall ETS represents good policy, and it is pleasing to see New Zealand take the lead on such an important issue. But there are many aspects New Zealand should improve, particularly in the area of forestry.

A major weakness is the assumption that forests release CO₂ immediately upon harvest. We return to this point in Question F3 and Question F6 and in our response to the Forestry Technical Note.

F2. Do the NZ ETS forestry settings discourage deforestation? If not, what settings do you think would?

No. Settings which increase the carbon price will tend to discourage deforestation, including:

- Immediate removal of the 1:2;
- No Government manipulation of the carbon price – i.e. no so-called “auctioning”, which is effectively competing with foresters by artificially increasing carbon supply
- No sudden and overnight policy U-turns, which have a chilling effect on investment decisions. Regardless of the merits of the policy itself, the 2014 Budget announcement that gave foresters until midnight that same night to submit for repayment of carbon liabilities with ERUs left a subset of foresters facing massive financial cost. If a policy is to be changed, at least do it in a way that does not hurt a subset of family businesses so significantly in the way that this did.

F3. Do the NZ ETS settings incentivise afforestation and replanting? If not, what settings do you think would?

No. Carbon liabilities at harvest should be based on an estimate of typical actual emissions from harvested lumber, appropriately deferred over time (and with an adjustment for waste and non-lumber products), rather than literally assuming that trees are burned with the CO₂ released into the atmosphere upon harvest (which is effectively what is assumed under the current arrangements). Refer to our response to Q6 and to the Forestry Technical Note for more on this point. If this setting was corrected there would be a significant incentive to plant new forests (and to replant them when they are harvested, which most forests eventually will).

Additionally, a higher carbon price will incentivise new planting. As above, this should be achieved by the immediate removal of a key distortion, i.e. the 1:2, and a commitment not to add a future significant distortion, i.e. no Government “auctions”.

Finally, a considerable incentive would be created if some emitters were potentially required to enter into longer-term contracts for a portion of their expected emissions – rather than just a single year. The contract could be required to be with *new* forests. This approach has parallels in the international electricity industry. Longer-term contracts would help support new plantations by making them bankable – i.e. with financial certainty for a number of years, rather than being exposed to spot NZU prices it is easier to justify investment and debt financing. They would provide greater certainty upon which to make long-term forestry investment decisions.

F5. Does the NZ ETS work well alongside other forestry programmes? If not, how do you think these programmes could be better aligned?

Tunakino Forestry Ltd was an early and enthusiastic participant in PFSI. However we soon learned after the establishment of PFSI that the Government was not going to support it in any meaningful way or differentiate the product to reflect its premium characteristics – essentially the Govt. set up the scheme so that a PFSI AAU and an NZU were entirely fungible from a carbon consumer's point of view, but expensively different products from a carbon producer's point of view – and so we were quickly disillusioned. It was a pointless exercise. We have no intention of being involved with PFSI again. If we wish to ensure forests are permanent for charitable reasons, it is more straightforward to arrange a private covenant over the land than to get involved in PFSI. Our view is that participation in PFSI is essentially a mechanism of charity, but not a particular efficient one to use.

F6. What changes could be made to NZ ETS forestry sector provisions to improve the scheme?

Carbon liabilities at harvest should be based on an estimate of typical actual emissions from harvested lumber, i.e. deferred over time (with an adjustment for waste and non-lumber products), rather than literally assuming that trees are burned with the CO₂ released into the atmosphere upon harvest (which is effectively what is assumed under the current arrangements). Much of the wood harvested from a forest does not decompose and/or is not burned for decades. The current arrangements which assumes instantaneous release of CO₂ back into the atmosphere is a huge distortion of the overall science behind the ETS. It tilts the playing field significantly away from foresters. It is unfair, inefficient, and simply wrong. It penalises foresters, and New Zealand in total, for no good reason.

F7. What are important factors when considering changes to forestry accounting settings in the NZ ETS?

1. Regulatory certainty
2. Economic efficiency
3. Fairness (at least, not creating winners and losers overnight)
4. Transparency and simplicity
5. Correcting existing deficiencies
6. Professional, timely, efficient and unbiased management of the scheme by MPI
7. Achieving the overall objective of having the scheme – reducing emissions

F8. Do you think a different forestry accounting approach in the NZ ETS would change the scheme's incentives for afforestation?

Of course.

F9. Do you think averaging should be introduced for post - 1989 forests? If so, why, and do you think it should be optional or mandatory?

We don't think enough information has been put forth yet upon which to make an informed decision.

There are aspects of it which certainly sound appealing to a small forester such as ourselves: if we commit to a permanent replanting regime after each harvest we can sell a set number of NZUs for the land concerned with some degree of certainty.

However it also appears to have a potentially major drawback that could impact many of the criteria listed in our response to Question F7 and in particular in economic efficiency and fairness. One of the main attractions of the existing scheme under which companies such as Tunakino Forestry have committed investment is that it allows a degree of optionality. We can make harvest vs. sale of carbon credit decisions and time those decisions based on prevailing market prices for logs vs. carbon. For example, if carbon prices fall to zero (as they nearly did just recently) we have the option to harvest (and perhaps re-plant). If carbon prices go very high, we have the option to sell a full inventory of accumulated credits for a mature forest and not harvest – perhaps simply maintain a permanent forest until such time (if ever) that carbon prices fall again.

Not only are these the rules under which we committed to investment decisions, it also seems inherently efficient that market signals should work in this way: to properly signal the value of emission reductions and to allow economic trade-off decisions to be made with other products – in this case harvested wood.

Under the averaging proposal it seems that this optionality could potentially be taken away – however it was exactly this optionality that was a key reason for us investing in the first place.

It is too early to analyse without all the details being developed and made available, but at a minimum it would seem only reasonable and fair that any averaging be at least optional for those forests which had already entered the ETS at the time averaging was introduced.

It would also be necessary to develop a fair approach for treatment of carbon accumulation between 1/1/1990 and the first year of the ETS in 2008.

F10. Should there be limits on the types of forests that can use an averaging accounting method? For example, new forests only or forests under a size threshold.

We believe we do not have enough information upon which to make an informed response to this point at this time.

F11. How might averaging impact on your business decisions?

It could impact them very significantly. Potentially in a negative way if this is not an option for our existing forests. Potentially it could be a positive, as it was intended, in terms of giving us the certainty to invest in additional new plantations. However, again, there is not enough detail yet for us to form an opinion.

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

Yes, for the reasons set out in our responses to earlier questions above.

Further, we urge that this be implemented as soon as possible. A goal should be made to implement it within the current carbon accounting year.

We strongly recommend Option 1, set out in the consultation paper (defer the liability for the emissions from HWP from post-1989 foresters' existing harvest liability within the NZ ETS).

We think this approach is fair, efficient, and should be urgently implemented.

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

This would make an *enormous* difference. It would change our entire investment calculus, and make us much more likely to invest in planting new post-1989 forests.

It is the single most important decision the Ministry should make, from our perspective, and it has the benefit of being the right thing to do, from an economic efficiency, environmental and fairness perspective.

F14. Do you have any other comments or things you think are important?

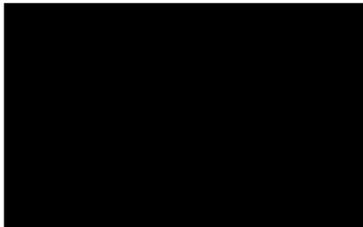
We understand the issue of deferred liability for emissions from HWP's is an important one and has some complexities, but we urge the Ministry and MPI to make this their absolute number one priority and to have a goal of implementing it this year.

OM1. Do you encounter challenges when completing NZ ETS requirements, such as meeting your emissions reporting or surrender requirements?

Yes, very much so. Tunakino Forestry would welcome the opportunity to discuss these directly with the Ministry for the Environment, and with MPI.

Thank you again for the opportunity to make this submission.

Yours sincerely,



Hamish Fraser, Director