

## Improvements to the Emissions Trading Scheme

NZ Wind Energy Association Submission  
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### Introduction

1. The New Zealand Wind Energy Association (NZWEA) welcomes the opportunity to provide a submission on the Improvements to the Emissions Trading Scheme (ETS) Consultation Document.
2. The Association recently also submitted on the Zero Carbon Bill and considers the Bill a key enabler for New Zealand's transition to a low carbon economy. NZWEA notes the importance of improving the ETS to enable achievement of emission reduction budgets and the 2050 emissions target.
3. The issues with the current ETS have been well canvassed in the 2015/16 ETS Review as:
  - The Government does not have the tools required to effectively manage the supply of units into the NZ ETS.
  - Current settings and management of the NZ ETS create significant regulatory uncertainty for participants.
  - Operational and technical issues are causing administrative inefficiencies.
4. NZWEA does not have exposure to existing administrative inefficiencies and has been most concerned with the absence of a strategy that links ETS policy to an emissions reduction target. In particular the need to effect changes to the ETS to better manage unit supply and prices in a way that generates more predictable price signals to guide domestic decarbonisation.
5. The July 2017 Cabinet in-principle decisions are supported in particular the introduction of auctioning of units to align to our climate change targets, the limiting of participant's use of international units, when the ETS reopens to international carbon markets, and developing a price ceiling to replace the current \$25 fixed price option. The Association considers these changes necessary to make the Scheme an effective cap and trade arrangement.
6. In the Association's submissions on the Productivity Commission's low-emissions Inquiry we noted:
  - The lack of an effective ETS is also a concern for NZWEA as a price on carbon, that better represents the cost of reducing emissions, is required to incentivise investment in low carbon opportunities. The Association notes the in-principle decisions announced by the Government in July and the research note issued by Motu. The objective as outlined by Motu of having a credible long-term emission price signal so to ensure dependable investment signals is supported and, while the Association does not have expertise in trading schemes, the 5 changes proposed by Motu are recommended for further consideration.
7. In response to a specific Productivity Commission question on what policies, including adjustments to the ETS will encourage more sequestering of carbon in forests the Association commented:
  - NZWEA considers that shortcomings in the ETS scheme, particularly having allowed access to questionable overseas units and the resultant price reduction, has had a

negative impact on Land use, land use-change and forestry activities (LULUCF) and renewable energy development.

- The proposed changes following the Ministry for the Environment’s (MfE) review of the ETS will better support LULUCF. NZWEA also supports the changes recommended by MOTU and the need for clear price signals which go further than the MfE review. In particular the need for a near-term supply constraint to guide price and price safeguards in the form of a price ceiling and price floor will provide increased investment confidence.

8. The following section summarises NZWEA’s position on proposed ETS improvements. Further sections provide more detailed comments and the Association’s response to the Consultation Document’s specific questions which are most relevant to the wind industry.

### Summary

9. The refresh of the NZ Energy Efficiency and Conservation Strategy, Productivity Commission’s Low-emissions Inquiry, the proposed Zero Carbon Bill and improvements to the ETS are important developments in ensuring the alignment of climate change strategy and actions which the Association supports.
10. Overall the proposed improvements to the ETS represent a step change in addressing known issues and restoring confidence in the Scheme’s ability to enable emission reduction targets to be met.
11. A key improvement that the Association considers important to include is a price floor as recommended by Motu to build confidence for low-emission investors and innovators.

### Feedback on the Consultation Document

12. In the Association’s view New Zealand has lacked an integrated approach to developing a low carbon strategy and set of implementation actions. The material level of emissions reduction required and potential cost to meet the 2030 Paris target and a longer-term net zero position warrant a specific focus.
13. The refresh of the NZ Energy Efficiency and Conservation Strategy, Productivity Commission’s Low-emissions Inquiry, the proposed Zero Carbon Bill and improvements to the ETS are important developments in ensuring the alignment of climate change strategy and actions which the Association supports.
14. The Association supports the direction of the proposed changes to the ETS and considers they will re-establish the credibility and fulfil the intended purpose of the Scheme when it was established in 2008.
15. The Productivity Commission in their Final Low-emissions Economy Report also commented “Robust and transparent domestic caps on the supply of New Zealand units are needed to drive a higher emissions price to materially influence production and consumption decisions”.
16. NZWEA generally supports the summary of proposals and comments as follows:

Coordinated decision-making proposals	<ul style="list-style-type: none"> <li>▪ The factors used to set unit supply volumes need to be strongly aligned with achieving the purpose of the ETS which is to ensure emission reduction budgets and targets are achieved.</li> <li>▪ An annual process for ETS supply over a five-year rolling period is supported.</li> </ul>
Auctioning proposals	<ul style="list-style-type: none"> <li>▪ A single round sealed bid uniform price auction format</li> </ul>

	<p>is supported.</p> <ul style="list-style-type: none"> <li>▪ Wider participation involving NZ ETR account holders is supported.</li> <li>▪ Monthly or quarterly auctions are considered most appropriate.</li> <li>▪ The Association notes the preference for not directly allocating auction proceeds. Whether directly or indirectly, sufficient funding does need to be allocated to climate change policies including low carbon R&amp;D and ensuring a fair and inclusive transition.</li> </ul>
Price ceiling proposals	<ul style="list-style-type: none"> <li>▪ Replacing the FPO with a volume-limited CCR is supported as is adjusting the FPO price before 2020.</li> <li>▪ The Association does not have the expertise to comment on the best approach if the CCR price ceiling is struck but notes there needs to be a mechanism to avoid the unintended consequences of price shocks.</li> </ul>
International unit limit proposals	<ul style="list-style-type: none"> <li>▪ NZWEA prefers a domestic mitigation strategy as ultimately a net zero position needs to be achieved and is a lower risk option than relying on carbon markets which have not been developed.</li> <li>▪ Appropriately managing the quality and quantity of international units is acknowledged as paramount so as to no disadvantage NZ's domestic emission reduction pathway.</li> <li>▪ The indirect purchase option via Government would seem to offer stronger quality and volume controls.</li> </ul>
International allocation phase-down approach	<ul style="list-style-type: none"> <li>▪ The purpose of the industrial allocation is to avoid leakage driven by differential emission policies. A decision-making process should be established to monitor the impact of movements in the international price of carbon to ensure competitive neutrality of emission policies and use this to phase-down industrial allocations.</li> </ul>
Market governance proposals	<ul style="list-style-type: none"> <li>▪ NZWEA supports the consideration of initiatives which ensure market participants are adequately informed and protected but does not have the expertise to provide specific feedback.</li> </ul>
Market information proposals	<ul style="list-style-type: none"> <li>▪ NZWEA supports initiatives which improve information flows such as the dedicated NZ ETS website but does not have the expertise to provide specific feedback.</li> </ul>
Compliance and penalties proposals	<ul style="list-style-type: none"> <li>▪ NZWEA does not have a view on compliance and penalty proposals except that they should be sufficient to ensure the integrity of the ETS.</li> </ul>

17. The Association notes Motu's work programme on Shaping New Zealand's Low Emissions Future and in particular their research into an effective NZ ETS and the need for clear price signals to guide low-emission investment.

18. Motu recommend both a price ceiling and price floor. The price floor effectively provides a reserve auction price and is designed to manage downside price risk that discourages investment by withholding NZU's unless a certain sale price is reached.

19. The Consultation Document suggests that no price floor will be needed in the future because of the limit on international purchasing will be sufficient to manage downside price risk. The Government was slow to manage the impact of low-quality international units from 2011 to 2015 and the Association considers there are also other drivers of inefficient downside price risk.
20. Given historic issues and technical, economic and political uncertainty the Association considers a price floor should be included in the improvements made to the ETS to build confidence for low-emission investors and innovators. The inclusion of an auction reserve price is also supported by the Productivity Commission in their Final Report on a Low-emissions Economy.
21. At a framework and design level the proposed improvements, with the inclusion of a price floor, should significantly minimise the risk of the cost of meeting emission reduction targets shifting from participants to the Government.
22. Overall the proposed improvements to the ETS represent a step change in addressing known issues and restoring confidence in the Scheme's ability to enable emission reduction targets to be met.

### **Response to Specific Questions**

- Q1. What issues should the decision maker consider when making unit supply decisions?

The ETS is the key mechanism to ensure emission reductions targets and budgets are achieved with NZU supply being the key determinant of price and therefore the level of emissions reduction achieved. Unit supply decisions should be made on the basis of considering emissions budgets and other factors which enable the proper functioning of the ETS as a cap and trade scheme.

- Q2. What, if any, restrictions should be placed on the NZ ETS decision maker when making unit supply decisions?

Appropriate notice to enable participants to adjust strategies. A one-year timeframe seems reasonable.

- Q3. Do you agree with the proposal to implement a single-round, sealed bid auction format with uniform pricing?

Yes

- Q4. Auctioning frequency.

Quarterly or monthly (if preferred by participants)

- Q5. Do you agree with the proposal that all NZ ETR account holders should be able to participate at auction?

Yes

- Q6. Do you think that the Government should use the proceeds gained from the auctioning of NZUs for specific purposes?

The Association notes the preference for not directly allocating auction proceeds. Whether directly or indirectly sufficient funding does need to be allocated to low carbon policies including R&D and ensuring a fair and inclusive transition.

- Q7. Do you agree with the proposal to replace the \$25 fixed priced option with a cost containment reserve price ceiling implemented through the auctioning mechanism?  
Yes
- Q8. How do you think the price level and number of units in the cost containment reserve should be managed over time?  
Decision maker to have discretion to determine the settings based on the level of emissions reduction sought but also considering any unintended consequences from emissions prices exceeding acceptable levels.
- Q9. What actions should occur if the price ceiling is struck?  
The Association does not have the expertise to comment on the best approach if the CCR price ceiling is struck but notes there needs to be a mechanism to avoid the unintended consequence of price shocks.
- Q10. Do you agree with the proposal to review the price ceiling if another significant event occurs?  
Yes
- Q11. Do you agree that the \$25 FPO may not be appropriate for the short term, and may need to be adjusted before 2020?  
Yes. A higher price may be required to reduce emission levels in order to make positive progress to achieving the Paris Agreement target.
- Q12. Which mode of purchase for international units (direct or indirect) would be the best approach for the NZ ETS, acknowledging that there are other significant factors that will influence this decision?  
An indirect purchase via the Government provides greater confidence in ensuring the integrity and quantity of units purchased and managing the risks for participants arbitraging the cost international units and NZU's.
- Q13. If NZ ETS participants are able to purchase and surrender international units directly, do you think that there is justification for varying the percentage of allowable international units by participant type? If not, why not?  
There would need to be a clear rationale for why this is needed to ensure the integrity of the ETS is not adversely impacted.
- Q14. How do you think decisions on a phase-down of industrial allocation should be made?  
The purpose of the industrial allocation is to avoid leakage driven by differential emission policies. A decision-making process should be established to monitor the impact of movements in the international emissions prices to ensure competitive neutrality of emission policies and use this to phase-down industrial allocations.
- Q15. If a decision-making process for industrial allocation is implemented, which of the following factors should the decision maker take into account?  
The risk of emission leakage, with the aim of avoiding leakage driven by differential emission pricing policies, and based on economic analysis of the markets for emissions intensive and trade exposed activities and their products.

Q16. If a phase-down is initiated in future, which of the following rates for phasing-down industrial allocation should be considered?

Other category - Having a prescribed % annual reduction does not necessarily support the intent of the industrial allocation arrangement.

Q17. What impact would changes to the levels of industrial allocation from 2021 have on your investment or business decisions?

Changes to the industrial allocation would only effect Association members to the extent electricity demand changed and the impact this would have on their investment plans.

#### **About the NZ Wind Energy Association (NZWEA)**

- The NZWEA is an industry association that promotes the development of wind as a reliable, sustainable, clean and commercially viable energy source.
- We aim to fairly represent wind energy to the public, Government and energy sector.
- Our members are involved in the wind energy sector and include electricity generators, wind farm developers, lines companies, turbine manufacturers, consulting organisations and other providers of services to the wind sector
- By being a member of NZWEA you are assisting the development of wind energy in New Zealand and helping to reduce our greenhouse gas emissions to meet climate change targets.

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