

Reforming the NZ Emissions Trading Scheme: Proposed Settings

New Zealand Wind Energy Association Submission

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Ministry for the Environment

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Introduction

1. The New Zealand Wind Energy Association (NZWEA) welcomes the opportunity to provide a submission on Reforming the New Zealand Emissions Trading Scheme: Proposed Settings Consultation Document.
2. The Association has also submitted in support of the Zero Carbon Bill and previous ETS consultations.
3. The Association acknowledges the imperative to reform the ETS to make it fit for purpose and in particular reintroduce key elements that enable a cap and trade system to be effective in reducing emissions.
4. NZWEA also acknowledges the Consultation Document's consistency with recent studies by the Productivity Commission and the Interim Climate Change Committee which noted ¹

The NZ ETS must be reformed so it can play its intended role as a fundamental driver of emissions reductions across the economy and

A comprehensive NZ ETS that caps total allowable emissions is vital.

5. In this submission the Association provides overall summary comments and responds to each of the questions asked in the Consultation Document.

Summary

6. NZWEA considers the Climate Change Response (Zero Carbon) Amendment Act and the Climate Change Response (Emissions Trading Reform) Amendment Bill along with proposed changes to ETS settings represent a step change in approach to achieving a coherent and integrated way forward in achieving a meaningful reduction in emissions and a pathway that commences New Zealand's transition to a low carbon economy.
7. The Association is supportive of the proposed changes and in particular seeking a reduction in emissions prior to the completion of budget recommendations by the Climate Change Commission.
8. Of importance are changes to the ETS which align with the original intent, when the Scheme was first legislated in 2008, such as the introduction of a cap and trade mechanism to reduce emissions.
9. There are several areas where the Association considers ETS could be made more effective:

¹ ICC Accelerated Electrification Report, section 7.

ETS architecture	<p><i>Managing the risk of exceeding the overall emissions budget.</i></p> <p>In determining the NZU auction volume assumptions are made about contribution from other areas so as to achieve the provisional emissions budget. There is a risk that the overall budget target may be exceeded by other activity such as the free allocation limit being exceeded by existing or new EITE business activity. A mechanism which enables auction volumes to be reset based on ensuring the overall budget is achieving should be considered.</p> <hr/> <p><i>Additional measures are required to manage the risk of the stockpile reducing the ETS's effectiveness.</i></p> <p>As noted in the consultation document the oversupply of NZU's within the NZ ETS and the ability of participants to purchase additional units using the \$25 fixed price option rather than surrender existing units has created a significant risk that the ETS's effectiveness will be reduced and that the Crown will incur the cost of meeting the agreed Paris emissions reduction target.</p> <p>Given the emission prices forecast by both the Productivity Commission and Interim Climate Change Commission to decarbonise there is a rationale for units to be purchased rather than surrendered. The Association considers further measures should be considered to reduce the stockpile such as limiting the ability to purchase under the fixed price option.</p>
ETS ambition	<p><i>The fixed price option and the cost containment trigger reserve prices should be set at a higher level.</i></p> <p>The Association considers the FPO and CCR prices should be set at a higher level to:</p> <ul style="list-style-type: none"> ▪ Manage the risk that the proposed price signals are not sufficient to achieve the emissions budget. In particular the risk that the significant carbon abatement opportunities identified with a negative cost are not implemented for other reasons. Higher prices may be required to enable other abatement options further up the MACC to be progressed. ▪ Reflect the view of the Productivity Commission as to the required carbon price to achieve a net zero position by 2050.²
	<p><i>Auction reserve and cost containment trigger prices should be increased annually by at least the rate of inflation.</i></p> <p>To increase the effectiveness of price signals there should be upward price movement over the five-year period. At a minimum this should be the rate of inflation.</p>

10. In supporting the ETS reforms NZWEA considers there is also a need for a wider review to ensure regulatory and policy frameworks are aligned and consistent across all areas that collectively enable a transition to a low carbon economy.

11. For example consultations on freshwater management and indigenous biodiversity reforms have the potential to negatively impact existing renewable electricity generation and new

² Productivity Commission, Low-emissions economy report page 5 - The modelling suggests that New Zealand can move to a low-emissions economy (ie, 25 megatonnes of net CO₂e emissions by 2050) at an emissions price rising to between \$75 and \$150 a tonne of CO₂e by 2050 (Concept Consulting et al., 2018a). New Zealand could reach the more ambitious target of net-zero GHG emissions by 2050, with emissions prices rising to between \$150 and \$250 a tonne of CO₂e by 2050.

developments. The Association has submitted on freshwater management and will also be doing so on indigenous biodiversity.

12. The Association notes that the Government's renewable energy strategy has been identified as a key input to achieving the emissions budget and that submissions on an options paper are sought. NZWEA considers aspects of the strategy such as revising the National Policy Statement for Renewable Electricity Generation (NPS-REG), to support new development, are long outstanding and need to be progressed with urgency.
13. The Association also notes that a separate review of the industrial allocation is underway and considers it important to assess the combined impact of all reviews relating to ETS reform on consumers and carbon emitters. Doing so will ensure a managed transition and avoid the risk of carbon leakage.
14. 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 meaningful emissions reductions to be achieved.

Response to Specific Questions

- Q1. Do you agree with the proposal to set a provisional emissions budget of 354 Mt CO₂-e for the 2021–25 period?

Yes. It is important to make progress reducing emissions in advance of the Climate Change Commission's recommendations. The approach taken is supported and the Association endorses the areas identified where emissions reductions can be made but NZWEA does have concerns that abatement opportunities with a negative cost may not be progressed for other reasons. To manage this risk higher price settings are recommended.

In addition to the key programmes identified on page 29 of the consultation document the Association considers an integrated wider regulatory and policy framework is required to enable meaningful emission reductions to be achieved. For example the Association has submitted on the draft National Policy Statement for Freshwater Management (NPS-FM) and the importance of preserving hydro generation capability to cost effectively support the variability of wind and solar generation.

The Association will also be submitting on the draft National Policy Statement for Indigenous Biodiversity (NPS-IB). As currently drafted the NPS represents a significant risk to new renewable electricity generation and transmission. The draft NPS-IB is expected to result in areas where development would occur under current planning rules becoming "must avoid" for development without any ability to consider mitigation and offsets which are currently available.

- Q2. Do you support the decisions made regarding the technical volume adjustment decisions? If not, why not?

Yes.

- Q3. Are there other adjustments that need to be considered?

Yes, the risk of exceeding the overall emissions budget needs to be managed. In determining the NZU auction volume assumptions are made about contribution from other areas so as to achieve the provisional emissions budget. There is a risk that the overall budget target may be breached by other activity such as the free allocation limit being exceeded

by existing or new EITE business activity. A mechanism which enables auction volumes to be reset based on ensuring the overall budget is achieving should be considered.

- Q4 Do you agree with the proposal to address the NZ ETS unit stockpile by reducing the annual volume of NZUs available for auction? If not, why not?

Yes, the stockpile represents a risk to achieving actual future emission reductions and needs to be managed.

The Association considers additional measures are required to manage the risk of the stockpile reducing the ETS's effectiveness.

As noted in the consultation document the oversupply of NZU's within the NZ ETS and the ability of participants to either surrender existing units or purchase additional units using the \$25 fixed price option has created a significant risk that the ETS effectiveness will be reduced and that the Crown will be required to meet the cost of achieving the agreed Paris emissions reduction target.

Given the forecast emission prices identified by both the Productivity Commission and Interim Climate Change Commission there is a rationale for units to be purchased rather than surrendered. The Association considers further measures should be considered to reduce the stockpile such as limiting the ability to purchase under the fixed price option.

- Q5. Do you agree with 27 million NZUs being removed from auction volume between 2021–25? If not, why not?

Yes, the reduction seems reasonable over a 5-year period.

- Q6. Do you agree with the steps and calculations taken to reach the proposed annual auction volumes?

Yes. The Association notes the problems identified from the previous use of international units and that currently no market exists. As in previous submissions the Association supports a focus on domestic mitigation, limiting overseas units and ensuring a strong framework is in place before opening the ETS to international supply.

- Q7. Do you support the proposal to auction 80 million NZUs over the 2021–25 period plus 2 million NZUs for auctioning trial in 2020? If not, why not? Please include your views on the process for adjusting auction volumes.

Yes. As noted in the Association's response to question 3, consideration should be given to a mechanism to amend the auction volume should the overall emissions budget be expected to be exceeded.

- Q8. Do you agree with the proposal to set an auction reserve price floor at \$20 for the period 2020–25? If not, why not?

The Association supports having an auction reserve floor price. While it is unlikely the price floor will be reached given the intention to implement a cap and proposed controls on the supply of international units, should markets develop, a floor is supported as a backstop to provide assurance

and confidence in the market for investors.

NZWEA considers the price floor should be set at a higher level to manage the risk that the price signal is not sufficient to achieve the proposed emissions budget. In particular the risk that the abatement opportunities identified with a negative cost are not implemented for other reasons and that higher prices are required to achieve the emissions reduction required with abatement opportunities further up the MACC.

A higher price is also more consistent with the view of the Productivity Commission as to the required carbon price to achieve a net zero position by 2050.

- Q9. Do you agree with the proposal to increase the fixed price option to \$35 for obligations arising from activities over 2020?

Yes. The fixed price option needs to increase to signal the need to reduce emissions and encourage investment in carbon abatement opportunities.

As noted in response to Q8 the Association considers ETS prices should be set at a higher level.

- Q10. Do you agree with the proposal to set the price ceiling trigger of the cost containment reserve at \$50 for the 2020–25 period? If not, why not?

Yes, there needs to be a mechanism to avoid the unintended consequence of price shocks.

As noted in response to Q8 the Association considers ETS prices should be higher.

- Q11. Do you agree with the proposed annual cost containment reserve volumes to be released if the price ceiling trigger is hit? If not, why not?

If the cost containment reserve is to achieve its purpose, of preventing price shocks above the reserve price, it must be backed by an appropriate volume of units. The Association notes the considerations including effectiveness, fiscal risk and contribution to the stockpile have been identified. If NZ is seeking a measured pathway to the financial impacts of decarbonisation then effectiveness in managing price shocks and necessary industry disruption should be the key measure rather than also considering fiscal risk and stockpile effects.

- Q12. Do you agree with the proposed approach for release of NZ ETS settings information? If not, why not?

Yes. Having a longer-term communication approach provides transparency and supports least cost abatement strategies being deployed.

- Q13. Do you have any further comments?

The Association supports the direction of the proposed changes and in particular the introduction of a volume cap as the only meaningful way to reduce emissions. The introduction of a price floor and the cost containment reserve (if an appropriate supply of units is available) provides appropriate

boundaries that offer increased certainty for those exposed to a carbon cost and investors.

As noted in the Association's response to question 1 for the emissions budget to be achieved an integrated approach is required. Section 2 (page 27) of the consultation document notes as abatement opportunities:

- improving vehicle fuel efficiency and adopting electric vehicles.
- building wind farms or geothermal power stations to displace gas and coal fired electricity generation.
- switching from coal and diesel to biomass or electricity for low and medium temperature heat process.

These opportunities require both new renewable electricity generation to be developed and for the variability of new renewables to be supported by the flexibility of existing hydro generation. New Zealand is uniquely advantaged in having an excellent wind resource and a high level of flexible hydro generation to lower the cost of supporting wind and solar variability.

Both the draft NPS-FM and NPS-IB create significant risks and issues for existing hydro generation and the development of new renewables particularly wind energy. The Association supports the intent of both NPS's and considers, with appropriate review, a balanced approach can be achieved.

The Association notes that a review of the ETS industrial allocation factor is underway with submissions having been sought. NZWEA did not submit on this consultation but considers it important to ensure that the combined impact of all reviews is assessed on consumers and carbon emitters. Doing so will ensure a managed transition and avoid the risk of carbon leakage. In particular the Association considers it necessary to monitor movements in the internal price of carbon to ensure competitive neutrality.

The Association notes that the Government's renewable energy strategy, which has been identified as a key input to achieving the emissions budget, is at an options development stage. Aspects of the strategy need to be progressed with urgency. In particular the reform of the RMA, to support the consenting of new renewables at both an industrial and community scale, has been identified in MfE's Outcome Evaluation Report on the NPS-REG (completed in 2016), the Productivity Commissions low-emission economy Report (2018) and the Interim Climate Change Committees Accelerated Electrification Report (2019) as necessary to support renewables development yet remains outstanding.

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 the 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.

The Association's strategy focuses on three key areas:

- Leveraging NZ's emission reduction imperative to enable the energy transition to renewables, particularly wind energy.
- Optimising wind energy's position and ensure the regulatory environment supports wind farm development.
- Expanding the opportunity for wind energy development to enable community and industrial projects including wind's integration with other technologies.

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