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Ministry for the Environment
By email: etsconsultation@mfe.govt.nz

SUBMISSION ON ANNUAL UPDATES TO THE NEW ZEALAND EMISSIONS TRADING SCHEME LIMITS AND PRICE CONTROL SETTINGS FOR UNITS 2023 (CONSULTATION PAPER)

Introduction

Lawyers for Climate Change Action Inc (LCANZI) is a non-profit group of 300 lawyers. We advocate for legislation and policies to ensure Aotearoa New Zealand meets or exceeds its commitments under the Paris Agreement and achieves net zero carbon emissions as soon as possible and no later than 2050. More information about us can be found on our website: https://www.lawyersforclimateaction.nz/.

LCANZI welcomes the opportunity to make submissions on the *Annual updates to the New Zealand Emissions Trading Scheme limits and price control settings for units 2023*.

The Consultation Paper recommends unit and price settings for the ETS (ETS Settings) for the years 2024-2028. This submission describes the background to the Consultation Paper, and then considers two aspects in detail:

(a) the requirement for the ETS Settings to be in accordance with New Zealand's NDC; and
(b) the treatment of removals via forestry.

Background to the Consultation Paper

Each company covered by the Emissions Trading Scheme (ETS) must surrender a quantity of New Zealand Units (NZUs) each year, corresponding to the quantity of their covered greenhouse gas emissions. An NZU represents one metric tonne of carbon dioxide, or the equivalent of other greenhouse gases. The ETS employs two complementary forces to drive lower emissions; a higher NZU price, which channels investment and behavioural changes away from polluting activities, and a lower unit volume, which gradually reduces the number of units companies can surrender in order to pollute. The Government has a critical role in limiting NZUs, by setting the amount available for sale at regular auctions, as well as the amount and price of additional NZUs should auction prices exceed a level pre-determined by the government (namely the Cost Containment Reserve, or CCR).

In 2022, the Commission undertook an extensive analysis of the quantity of available and planned NZUs, and the price at which the Government would release additional units, in its *Advice on NZ ETS unit limits and price control settings for 2023-2027* ('2022 ETS Advice'). This advice recommended reducing units auctioned each year, and increasing the price at which more units would be made available from the CCR. In each instance the Commission considered the status quo as an option, and determined that the status quo was insufficient to meet New Zealand's emission requirements.

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Last December the Government rejected the Commission's advice, choosing to maintain the status quo in the *Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2022* ('2022 Amendment Regulations'). The effect of this decision was to make available at low prices an additional 35 million units over the next five years.

LCANZI has judicially reviewed the 2022 Amendment Regulations on the grounds that, in overriding the recommendations from the Commission and the Minister, Cabinet failed to address whether the settings were in accordance with the emissions budgets and the NDC. Instead, the decision was driven by concerns that rising ETS unit prices would flow through to households.

The Climate Change Response Act 2002 requires that when the Minister recommends ETS Settings different to the Commission's advice, the Minister must report the reasons for those differences, and he did so on 14 December 2022.[1] This report was brief, and did not address core problems in areas such as whether the 2022 Amendment Regulations accorded with the NDC and the issues surrounding forestry removals.

The Commission has repeatedly asked the Government to make decisions and give policy guidance in relation to key aspects of our climate response including how the Government intends to meet the NDC and how forestry removals will be reformed. In the face of continued Government delay, we consider that the Commission must include the costs of delay in its work on the ETS settings.

ETS Settings in accordance with New Zealand's NDC

In 2021, the Commission estimated the gap between the NDC and the recommended emissions budgets at 52 MtCO2e over the next 9 years.[2] The Commission warned that bridging that gap with domestic reductions would "likely lead to severe social and economic impacts on communities, people and businesses."[3] The Commission advised that "offshore mitigation will be critical to meeting the current NDC."[4]

In 2022, the Commission increased the estimated gap between the NDC and emission budgets to 99 MtCO2e in response to the 2021 NDC.[5] The Commission warned that there was a:[6]

> "pressing … need for the Government to clarify what role the NZ ETS will have, if any, in delivering the offshore mitigation that is needed to meet the NDC. It is essential that the

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[1] Section 30GC(7).
[2] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 368.
[3] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 363.
[4] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 364.
[5] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2023-2027* (Climate Change Commission, July 2022) at 26.
[6] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2023-2027* (Climate Change Commission, July 2022) at 5.

> Government secure access to sources of offshore mitigation as soon as possible, and decide how this will affect the NZ ETS. This matter cannot be left until later this decade."

In its advice on ETS Settings for 2024-2028, the Commission continues to highlight the Government's indecision:[7]

> "In its emissions reduction plan, the Government also stated that significant offshore mitigation is likely required to meet the NDC (Nationally Determined Contribution). However, it has not yet approved any overseas units (units from another country's ETS or other foreign mechanism) and has provided no clarity as to when or how it will access offshore mitigation. The absence of this information has created significant uncertainty for market participants and for the Commission as we have prepared this advice. Once this information is available, our future advice could materially change."

In our October 2022 submission on the 2023-2027 ETS Settings, we summarised our opinion that ETS Settings are legally required to be in accordance with our NDC. Specifically, that the Minister must be satisfied that the NDC can be met through domestic reductions — that is, by aligning ETS quantities to NDC quantities to the greatest extent possible — unless New Zealand has current agreements with other countries to purchase and rely on their reductions ('international agreements').

In both 2022 and 2023 the Commission considered two options to address the lack of international agreements; to either incorporate the reductions demanded by the NDC into the ETS Settings, or to ignore the NDC in anticipation of future international agreements. In both instances, the Commission has rendered its advice only for the second option. That is, it has only given advice under the assumption that offshore mitigation would be obtained to meet the international component of the NDC.

The Commission is required to forecast availability and cost of ways to reduce greenhouse gases that may be needed for New Zealand to reach its emissions targets, including under the NDC.[8] It is clear that after two years of no apparent progress on international agreements, the Commission must recognise the real possibility that the Government will not negotiate the necessary international agreements. As such, the Commission should forecast the cost of being in a situation where no international agreements are entered into and the NDC reductions must all be domestic and within a very short time frame. The Commission should also consider taking greater action now domestically to guard against this risk.

Removals via Forestry

The ETS allows NZUs to be produced by forestry on a one-for-one basis; forest owners are issued an NZU for each ton of carbon their forests remove from the atmosphere. NZUs produced by forestry are identical to those auctioned by the government, and they can be surrendered by polluting

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[7] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, March 2023) at 8.

[8] Section 30GC(5)(d).

companies to cover their emissions. New Zealand is the only country that allows such extensive use of removals in its ETS.

NZUs produced from forestry are relatively cheap. The Commission has found that a pinus radiata forest delivers NZUs at a cost of $25-$50.[9] The increase in NZU price in excess of $50 has driven rapid afforestation, as land owners have planted 60,000 hectares of forest to harvest carbon at that price.[10] This effectively places a cap on the emissions price; should the price rise materially above $50, more forests will be planted to meet the demand for NZUs by emitters.[11] The Ministry for the Environment has found there is enough suitable land to continue such planting for decades.[12]

The Commission has also found that most of the opportunities to reduce the emission of greenhouse gases, ie to stop or reduce the production of the gases by emitters, cost in excess of $100 per tonne of CO2e.[13] Effectively, as long as the ETS continues its current forestry removal policy, emitters will have no incentive to change their behaviour or to invest in plant and processes to emit less greenhouse gas.

This situation would not be problematic if reducing emissions and increasing removals were truly equivalent. But they clearly are not.

While the ETS treats emissions and removals equally, there are substantial differences in their place in the carbon cycle. Fossil fuels are part of the slow carbon cycle, where compressed biomass has been stored underground for millions of years.[14] When those fuels are burned, the carbon released into the atmosphere lasts for hundreds of thousands of years. In contrast, carbon captured by trees is part of the fast carbon cycle, which is measured in a lifespan and consequently the risk of reversal is high.[15] Trees are vulnerable to forest fires, disease and pests, and further, as the Commission has noted, "changes in climate may affect tree growth rates, increase wind throw and wildfire, and enable more pathogens to spread."[16] The costs of maintaining or replanting these forest carbon sinks fall on future generations, while the 'savings' of not curtailing current emissions is enjoyed by the current generation.

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[9] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 53.
[10] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 55.
[11] The CCC has found that New Zealand has enough land suitable for forestry that it could plant enough trees to hold the price at $50 through 2035 and beyond. Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 56-57.
[12] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 57.
[13] [Need to add a Ref.]
[14] NASA. *The Carbon Cycle*. www.nasa.gov. See also Hoglund et al. 2022*. Nature restoration and carbon removal are not the same*. www.climatechangenews.com.
[15] NASA. *The Carbon Cycle*. www.nasa.gov. See also Hoglund et al. 2022. *Nature restoration and carbon removal are not the same*. www.climatechangenews.com.
[16] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 316.

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The Commission, in its first report in 2021, was clear that unconstrained removals through forestry would limit New Zealand's ability to reach its climate change goals:[17]

> An approach that does not constrain carbon removals by forests would not drive meaningful decarbonisation before 2050 and would instead use up land resources for the purpose of offsetting emissions in areas where there are proven options to reduce gross emissions.

The Commission repeated its warning in 2022:[18]

> Maintaining a common emissions price for carbon removals by forests and gross emissions reductions risks a downwards correction back to an NZU price that would be insufficient to drive meaningful decarbonisation. This would undermine investments in reducing gross emissions, erode market participants' confidence, and severely damage the scheme's effectiveness…. Without changes, future emissions budgets would likely deliver a far smaller reduction in gross emissions than currently planned by the Government in the emissions reduction plan.

And yet again in March 2023:[19]

> This, combined with the relatively low cost of carbon dioxide removals by forests compared to the cost of reducing gross emissions, means that the NZ ETS is likely to continue to drive extensive afforestation rather than gross emissions reductions… Under the current structure of the NZ ETS, forestry can displace the gross emissions reduction efforts in other sectors, thus disincentivising the very behaviour the scheme seeks to promote.

Most recently, in April 2023, the Commission continued to note this lack of policy direction in its *Draft advice to inform the strategic direction of the Government's second emissions reduction plan*, the key document to inform the Government on the second ERP.[20] This included two separate, explicit, recommendations urging the government towards a clear policy on forestry removals.[21]

Given the Government's inaction to date, it is critical that the Commission analyse, estimate and publish the costs associated with the continued lack of policies around forestry removal from the Government. The Commission alludes to some of these costs in its 2023 advice, but offers no

[17] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 91.
[18] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2023-2027* (Climate Change Commission, July 2022) at 25.
[19] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, March 2023) at 26.
[20] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 126.
[21] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 54 and 132.

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figures.[22] Policy delays and confusion around forestry will render the ETS increasingly ineffective and irrelevant as a tool to reduce gross emissions.

These costs of inaction are very real, and they need to be calculated and publicised by the Commission in order to inform the Government (and the public) in consultation over the ETS Settings.

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[22] Climate Change Commission *2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan* (Climate Change Commission, April 2023) at 62.