LAWYERS FOR CLIMATE ACTION NZ INC.

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11 August 2023

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

SUBMISSION ON TE AROTAKE MAHERE HOKOHOKO TUKUNGA REVIEW OF THE NEW ZEALAND EMISSIONS TRADING SCHEME ('DISCUSSION DOCUMENT')

Introduction

Lawyers for Climate Action NZ Inc (LCANZI) is a non-profit group of 500 members and supporters. 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 *Te Arotake Mahere Hokohoko Tukunga Review of the New Zealand Emissions Trading Scheme* ('discussion document').

The discussion document raises four options for dealing with the problem of unconstrained removals in the NZ ETS, and poses 26 consultation questions. This submission makes a general statement about the difference between gross emissions and forestry removals, and then considers the specific consultation questions which LCANZI considers it is in a position to comment on.

General Statement

Gross emissions and forestry removals are not fungible.

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

The key problem is that removing carbon via forestry is not the same as reducing emissions. 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.[1] When those fuels are burned, the carbon released into the atmosphere lasts for hundreds of thousands of years.

[1] 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.

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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.[2] 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."[3] 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.

The current structure of the ETS is such that it is far cheaper to remove carbon then to stop the pollution from being emitted in the first place. The ETS incentivises removals that will last only decades, while being ineffective in reducing the release of carbon into the atmosphere that is effectively permanent on human timescales.[4] This overreliance on forestry removals significantly reduces the efficacy of the ETS in meeting our long-term climate targets and the necessary reductions in gross emissions.

The implications of the non-fungibility of reductions in gross emissions and increases in forestry removals go well beyond the ETS. Our 2050 target, our NDC and our budgets are all based on the false assumption of equivalence. For example, the demonstration path for the emissions budgets through to 2035 show reductions in net emissions driven by very modest reductions in gross emissions and substantial increases in forestry removals. The false assumption and the reliance on forestry to achieve our climate change goals has been central to our climate change response since the Kyoto agreement. Accordingly, the fix that is now required extends beyond the ETS and is urgent.

Consultation Questions

2.1. Do you agree with the assessment of reductions and removals that the NZ ETS is expected to drive in the short, medium and long term?

The assessment of the discussion document is that the current NZ ETS will drive significant removals via forestry and only play a limited role in reducing gross emissions. We agree with this assessment, and note that the Commission has repeatedly warned of this outcome, including in its first report in 2021:[5]

> 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.

[2] 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.
[3] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 316.
[4] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at p 47.
[5] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at p91.

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Again in 2022:[6]

> 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 most recently in 2023:[7]

> [The ETS' failure to distinguish between reductions in gross emissions and removals,] 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.

Recent developments, such as the rapidly increasing rate of new exotic forests planting, and the collapse in the NZU price, confirm this assessment.

2.3. Do you have any evidence you can share about land owner and forest investment behaviour in response to NZU prices?

The original government baseline projection expected 32,000 hectares of exotic trees per year to be planted between 2022 and 2030. MPI now estimates the current rate of planting to be 60,000 hectares in 2022 alone.[8]

2.4. Do you agree with the summary of the impacts of exotic afforestation?

The discussion document provides a useful summary of the challenges of exotic forestation, including its impact on land-use change and land-use flexibility. There is an additional risk to the permanence category, which is the long-term economic viability of the legal owners of these exotic forests, many of which are single purpose entities. In 2021 BDO wrote a report outlining how a company could simply pay out its carbon earnings as dividends, and close up once the carbon credits ran out. The result would be land on which rates would no longer be paid, and that could not be used for

[6] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2023-2027* (Climate Change Commission, 2022) at p25.
[7] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at p26.
[8] Bruce Manley, 'Afforestation and Deforestation Intentions Survey 2021', 2022 <https://www.mpi.govt.nz/dmsdocument/52405-Afforestation-and-Deforestation-Intentions-Survey-2021>.

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anything else, given the carbon liability of cutting down the trees.[9] Furthermore, if that forest was subsequently destroyed then the carbon liability would not be met be able to be met by the company.

3.1 Do you agree with the case for driving gross emissions reductions through the NZ ETS? Why/why not? In your answer, please provide information on the costs of emissions reductions.

As the Commission reported, the only realistic alternative to the ETS in reducing gross emissions is a series of complementary policies.[10] Such reductions would rely on a myriad of bespoke interventions which are complex, face vested interests, and risk unintended consequences. Further, the Commission warns that such interventions could shift the burden of reducing emissions from the polluter to the taxpayer.[11] The ETS is the most efficient method of driving gross emissions reductions currently available.

3.2 Do you agree with our assessment of the cost impacts of a higher emissions price? Why/why not?

The consultation document identifies two impacts from higher NZU prices; the risks of leakage and higher costs for energy including to households. As the discussion document itself notes, emissions leakage is currently addressed by industrial allocation, and that an investigation to address any long-term leakage problem is ongoing. We note that there has been little formal analysis of this suggested risk; the one source the consultation document cites makes little mention of leakage. The Commission itself is optimistic for further tools to address emissions leakage, and that leakage itself is "not a reason to shy away from reducing emissions."[12]

A higher NZU price will also lead to increased energy costs, and costs to households generally. The Commission, citing a Treasury study, estimated the cost to households of a $50 NZU price increase to range from $3.30 a week for the lowest income households to $7.30 for the highest. The Commission suggests that these increased costs for the lowest income households could be met through the existing welfare system, and thus the practical impact of a higher NZU price would be mitigated.[13]

3.3 How important do you think it is that we maintain incentives for removals? Why?

Forestry removals are beneficial in the overall response to climate change, and some incentives should remain. However, we need to avoid instruments which over-incentivise forestry removals over gross emission reductions.

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[9] BDO *Report on the Impacts of Permanent Carbon Farming in the Te Tairawhiti Region* (BDO, July 2021) at 17.
[10] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 61-62.
[11] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 62.
[12] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 156.
[13] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 85. See also The Treasury *TAR 318: Household expenditure impacts of ETS carbon prices* 2022.

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Removals via forestry have always been a component to the Commission's overall recommendations and the Government's emissions reduction plans.[14] Removals from exotic trees are needed to reach New Zealand's near-term emissions budgets, and removals from native trees are planned to offset carbon emissions of hard to abate sectors in the long-term.[15] We consider that this is appropriate, although because of the lack of fungibility, limits on the extent of offsetting and/or an exchange rate to convert between forestry removals and gross emissions are required.

Given the ongoing importance of forestry removals, the Government needs to provide some sort of incentive for the necessary planting to occur, though the ETS is not necessarily the only source for such incentives.

4.1 Do you agree with the description of the different interests Māori have in the NZ ETS review? Why/why not?

LCANZI considers it important that any decisions should be made in a manner consistent with Te Tiriti o Waitangi and in partnership with Māori. However, we are not best placed to provide feedback on consultation questions 4.1-4.4.

5.1 Do you agree with the Government's primary objective for the NZ ETS review to consider whether to prioritise gross emissions reductions in the NZ ETS, while maintaining support for removals? Why/why not?

As per our general statement above, it is critical for the review to prioritise gross emissions reductions in the NZ ETS (and across our climate response generally). Reducing gross emissions is New Zealand's most important climate change goal. While there needs to be some limited support for forestry as per question 3.3, incentives for removals do not necessarily have to come from the ETS, or be tied to the price of NZUs.

5.2 Do you agree that the NZ ETS should support more gross emissions reductions by incentivising the uptake of low-emissions technology, energy efficiency measures, and other abatement opportunities as quickly as real-world supply constraints allow? Why/why not?

As above, New Zealand must reduce its gross emissions. A higher NZU price will incentivise polluters to curb their emissions by investing in low-emissions technology, energy efficient measures and other abatement opportunities. It is not clear from the consultation document whether this review envisions support beyond that.

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[14] Climate Change Commission *Ināia tonu nei: a low emissions future for Aotearoa* (Climate Change Commission, 31 May 2021) at 315-316. Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 50.

[15] Climate Change Commission Advice on NZ ETS unit limits and price control settings for 2024-2028 (Climate Change Commission, 2023) at 48-50.

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5.3 Do you agree that the NZ ETS should drive levels of emissions removals that are sufficient to help meet Aotearoa New Zealand's climate change goals in the short to medium term and provide a sink for hard-to-abate emissions in the longer term? Why/why not?

As per question 3.3, there needs to be some limited support for forestry, though the ETS does not necessarily need to be the source of this support.

5.4 Do you agree with the primary assessment criteria and key considerations used to assess options in this consultation? Are there any you consider more important and why? Please provide any evidence you have.

While meeting the NDC should be a key consideration for assessing the proposals, the emissions budgets and path to 2050 net zero also should be considered. Further, as detailed in our responses to questions 7.1 and 7.3, using co-benefits as an assessment criteria should be treated with caution.

6.1 Which option do you believe aligns the best with the primary objectives to prioritise gross emissions reductions while maintaining support for removals outlined in chapter 5?

Option 4 decouples the market for emission reductions from the market for removals. This will allow the NZU price to rise and force polluters to reduce emissions. With a separate removal market, decisions around removals would be made as needed to address the specific outcomes required by removals, such as excessively hard- to-abate sectors of the economy.

6.2 Do you agree with how the options have been assessed with respect to the key considerations outlined in chapter 5? Why/why not? Please provide any evidence you have.

In Option 2, the discussion document suggests that increasing the opportunity to sell NZUs from removal activities, for example selling units overseas, will increase demand and consequently the price of NZUs (leading to gross emissions reductions). This ignores the economics of removals and gross reductions. The Commission has reported that establishing a forest for removals costs between $25 and $50 per tonne of carbon removed, and that with over 4 million hectares of available land in New Zealand, the amount of removal from forests far surpasses any expected level of demand.[16] This availability means the price will never rise above $50, as more forests will just be planted. As the Commission has estimated reducing gross emissions will require an NZU price of at least $100, Option 2 will never lead to gross emission reductions.[17]

6.3 Of the four options proposed, which one do you prefer? Why?

As discussed above, it is critical for New Zealand to reduce its gross emissions. Option 4 has the cleanest structure to decouple the NZU price from removals, and allow the NZU price to rise to a level that will deter polluters.

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[16] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 53 and 56.
[17] Climate Change Commission *Advice on NZ ETS unit limits and price control settings for 2024-2028* (Climate Change Commission, 2023) at 53.

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Option 3 could also usefully reduce gross emissions, though its proposed restriction on the number or conditions of the units could hamper that impact depending on the specific design. Options 1 and 2 would do little to deter polluters and lower emissions, and are not suitable.

6.5 Based on your preferred option(s), what other policies do you believe are required to manage any impacts of the proposal?

The most significant drawback of Option 4 in the discussion document is the fear this option would take the longest to design and implement, given the scale of change to the design of the NZ ETS. This conflates two distinct processes. The first process, eliminating removals from the NZU market, could happen relatively quickly, which would allow the ETS to start to deter polluters. The second process, creating a separate incentive structure for removals, would be more complicated and could take longer. However, the primary goal of removals is to offset hard to abate sectors through 2050 and beyond. A slightly longer design process now would yield benefits for decades.

7.1 Should the incentives in the NZ ETS be changed to prioritise removals with environmental co-benefits such as indigenous afforestation? Why/Why not?

Incentivising co-benefits in the NZ ETS should be treated with caution. Prioritizing removals with co-benefits could align the NZ ETS more closely with broader sustainability and climate resilience goals. By integrating incentives for practices that have multiple environmental benefits, the scheme could foster a more comprehensive and resilient approach to climate action.

However, while prioritising removals with co-benefits is appealing, it may also introduce complexities and trade-offs. Determining the value and effectiveness of various co-benefits, balancing them with emission reduction goals including cost, and ensuring that incentives do not inadvertently promote unintended consequences would be essential considerations.

7.2 If the NZ ETS is used to support wider co-benefits, which of the options outlined in chapter 6 do you think would provide the greatest opportunity to achieve this?

Option 4 is the most capable of allowing co-benefits while reducing gross emissions. By separating the emissions market from the removal market, gross emissions will reduce regardless of incentives in the removal market. This will allow the government of the day to design incentives for co-benefits and removals without impacting gross emission reductions.

7.3 Should a wider range of removals be included in the NZ ETS? Why/Why not?

A wider range of removals should also be treated with caution. There are benefits to diversifying removals, encouraging innovation and the exploration of various methods to reduce emissions. Some removals, such as afforestation with indigenous species or soil carbon sequestration, may align with broader environmental and sustainability goals, offering additional co-benefits. A diverse range of removal options might make the removal market more accessible to different sectors and industries, allowing for more tailored approaches to emission reduction.

However, expanding the range of removals requires robust measurement, reporting, and verification systems to ensure that each type of removal is accounted for accurately and transparently. Further, not all removals are equally effective or sustainable. Careful assessment and regulation are needed to avoid incentivising removals that might be temporary, reversible, or associated with negative environmental or social impacts.

Climate models also include the impact of some biosphere removals. Care must be taken to avoid double counting where a removal that has already been accounted for is double counted as an offset.

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