MAJOR ELECTRICITY USERS' GROUP

29 February 2008

Mr Charles Chauvel
Chairman
Finance and Expenditure Committee
Parliament

By email to carol.brouwer@parliament.govt.nz

Dear Mr Chauvel

Submissions on the Climate Change (Emissions Trading and Renewable Preference) Bill – Parts 1 and 3 to 5 in relation to an Emissions Trading Scheme

This is a submission by the Major Electricity Users' Group (MEUG) on those sections of the Climate Change (Emissions Trading and Renewable Preference) Bill (the "Bill") in relation to a proposed emissions trading scheme (ETS).

MEUG is making a separate submission on that part of the Bill proposing a ban on new thermal generation. We have separated these submissions because:

- While significant work is needed on the ETS provisions, MEUG is supportive of Parliament putting in place mechanisms for greenhouse gas emissions reporting and market mechanisms to abate emissions where economic to do so. The trading mechanisms need to be better defined and risks assessed before the public can comment on the proposals or the Committee report back to the House. One option that needs considering is aligning the design and timing of our ETS with the ETS Australia is working on.
- MEUG is highly critical of the proposed ban on new thermal generation. There are immediate risks to the New Zealand economy that we believe warrant the Select Committee urgently advising the Minister that Part 2 of the Bill should be withdrawn immediately. The separate submission by MEUG discusses this recommendation.

Detailed submissions on the proposed ETS follow.

Yours sincerely

Ralph Matthes
Executive Director

PO Box 8085, Level 8, Wakefield House, 90 The Terrace, Wellington, New Zealand
T +64-4 494 0996, F +64-4 494 0997, info@meug.co.nz , www.meug.co.nz

Submissions on the Climate Change (Emissions Trading and Renewable Preference) Bill – Parts 1 and 3 to 5 in relation to an Emissions Trading Scheme

Introduction

1. The Major Electricity Users' Group (MEUG) comprises 20 individual companies and 2 trade associations. Collectively members of the group consumer approximately 29% of total electricity demand in New Zealand. A list of members and the mission statement of MEUG are set out in appendix 1.

2. The proposed ETS will have near term and long term impacts on the economy if introduced ahead of or not aligned with market mechanisms developed by our major trading and or competitor countries. As an important part of the productive sector, MEUG members will therefore also be affected if policies are not robust. Several MEUG members are making their own submissions. MEUG members have been consulted during the drafting of this submission.

3. MEUG request to be heard before the Finance and Expenditure Committee (the "Committee") to make representations on the Bill. The presenters will be Mr Terrence Currie, Chairman, and Mr Ralph Matthes, Executive Director.

4. The balance of this submission comprises the following sections titled:
   - Support for measuring, monitoring and verification infrastructure;
   - The ETS design has major design uncertainties, lacks a credible cost-benefit analysis to support the proposal and has been inadequately consulted on;
   - An opportunity to align with Australia needs to be considered;
   - An initial comparison of the ETS in the Bill with the alternative of aligning with Australia; and
   - Summary of recommendations by MEUG.

Support for measuring, monitoring and verification infrastructure

5. MEUG supports those parts of the Bill that improve the greenhouse gas measurement, monitoring and verification infrastructure for New Zealand.

The ETS design has major design uncertainties, lacks a credible cost-benefit analysis to support the proposal and has been inadequately consulted

6. MEUG co-signed a Pan Industry[1] letter to the Committee dated 19 February 2008 setting out a number of key design and economic impact issues that are still being worked on by the Climate Change Leadership Forum and Technical Advisory Groups. Those questions were:
   - How large are the economic adjustment costs likely to be?
   - What are the financial flows implications for different sectors?
   - What is the likely extent of and economic cost of leakage?
   - What assets are stranded and who owns them? How is this affected by the treatment of leakage?
   - What are the abatement opportunities and costs in different sectors?
   - What are the implications of slow entry in some sectors?

[1] The Pan Industry letter signatories comprised Federated Farmers, Greenhouse Policy Coalition, Institution of Professional Engineers New Zealand, Minerals Industry Association, New Zealand Business Roundtable, New Zealand Chambers of Commerce, Petroleum Exploration and Production Association of NZ, Road Transport Forum NZ, Wood Processors Association and MEUG.

- How many domestic units will be available at each point in time in New Zealand relative to the demand for them?
- What are the drivers of pre-2012 international emissions prices that will affect us and how well can we predict both availability and price?
- What are the implications of different international rules? E.g. full carbon accounting; harvested wood products?
- What are the non-climate environmental implications e.g. biodiversity, water quality?
- Longer Term: What are the implications of different post 2012 scenarios? What is the cost and likely impact of non-price policies (eg building code changes; vehicle fleet requirements, ban on new thermal generation…etc)

7. Answers to the above questions, as at the date of this submission, have yet to emerge.

8. The lack of detail and as yet no answers to the above questions leads MEUG to suggest:

   a) It is inappropriate for the Committee to call for submissions on a Bill that may result in radical changes to the economy (several speeches by Ministers talk about the Bill leading to a transformation of the economy) when basic details and answers to the questions above are not available.

   b) Because the Bill and the details of the ETS are unclear, parties that might be materially affected may be unaware of that risk. It doesn't seem equitable or reasonable to pass the Bill as is when possibly affected parties have no idea of the possible consequences.

   The public perception of the Bill as relatively innocuous might have been seeded by Ministers when they announced the ETS and New Zealand Energy Strategy and most often referred to a possible carbon cost of about \$15/t CO_2-e. Members of the public may still be relying on those statements and be unaware that the upside risk for future carbon prices could well be above \$50/t CO_2-e or even \$100/t CO_2-e.

9. Over and above the appropriateness of considering a Bill that is more a framework for discussion with design options yet to be firmed up, there are some other concerns about the ETS and the impact on the economy:

   a) The Infometrics report "Carbon Mitigation Scenarios"[2] published on 5 February 2008 for the New Zealand Business Roundtable and Petroleum Exploration and Production Association of New Zealand noted the inconsistency of lifting GDP per head back into the top half of the OECD and the recent carbon neutral visions of the Government. The summary paragraph of the Infometrics report states:

   "*In summary, once the effects on aggregate investment, employment and productivity of investment uncertainty and transitional costs are taken into account, policy action to reduce New Zealand's emissions could lead to a fall in private consumption of 14% relative to BAU. This is about \$7,000 per person in current prices or \$19,000 per household. It also implies a doubling of electricity prices relative to 2007/08 and increases in petrol prices of more than 50% Nevertheless, despite these adverse effects on households, New Zealand's emission levels rise significantly rather than reduce relative to 1990 levels, calling into question the consistency of the government's twin goals of growth and carbon neutrality*."

   b) As the Pan Industry letter noted, the proposed level of delegated authority given to Ministers to promulgate regulations and decide allocations is poor practice and is not recommended by the Legislation Advisory Council[3].

   This is a major design fault of the Bill that needs amending.

[2] Refer http://www.nzbr.org.nz/documents/publications/NZBR%20PEPANZ%20Carbon%20Mitigation%20Scenarios.pdf
[3] http://www.justice.govt.nz/lac/pubs/2001/legislative_guide_2000/chapter_10.html#10.1.6

c) The explanatory note to the Bill explains the policy issues and broad ETS design have been extensively consulted on. MEUG disagrees.

Some debate has taken place during consultation but predominately consultation meetings were "tell and sell" opportunities for the Minister and officials after major design decisions had been made. The current Climate Change Leadership Forum is not "representative" because members are appointed by the Minister and some obvious candidates to gain a broad view of issues have been excluded. MEUG does not believe the Climate Change Leadership Forum has much credibility within the business community.

The Climate Change Leadership Forum has a number of "Cluster" subgroups working on various detail design issues. All of this looks like backfilling to put detail into the ETS that should have been in the Bill before the Committee and available for comment by the public in submissions.

An opportunity to align with Australia needs to be considered

10. The alternatives to the proposed ETS considered by Ministers were[4] direct regulation, information and promotion, emission reduction incentives and a broad price-based carbon tax. Most commentators agree that the best long term global solution is a global greenhouse gas market. In the absence of a global market or as a precursor to such, regional markets and or taxes can be designed as equivalent market mechanisms. Within the latter group of interim market mechanisms pending a comprehensive global market, there are various designs. As noted before, MEUG believes the Bill before the Committee should have included a comprehensive analysis of alternative ETS designs instead of leaving the details to parallel work by the Climate Change Leadership Forum and Technical Advisory Groups.

11. With Australia having now joined the Kyoto Protocol there is an opportunity for both countries to align their climate change response policies and in particular ETS design. MEUG suggest this alternative needs to be considered.

12. Rapid progress is being made on an Australian ETS. Some reports indicate an Australian ETS may commence by late 2010. For example Professor Ross Garnaut has been working for the eight Australian State and Territorial governments since April 2007[5]. Under new Prime Minister Kevin Rudd the federal government is now participating in the Garnaut review. Professor Garnaut published an interim report on 21 February and plans to publish a draft report by 30 June and a final report by 30 September 2008.

13. This is no soft option to defer the ETS in the Bill. Professor Garnaut has made a step change in Australian policy from where the Howard government stood. Prime Minister Rudd has clearly indicated a preference to get on with a scheme.

An initial comparison of the ETS in the Bill with the alternative of aligning with Australia

14. Assuming the factual is the ETS set out in the Bill and the counterfactual is the alternative of amending the ETS to align design details and timing with the work by Australia on their ETS then the benefits will be:

a) Overall step changes in energy costs throughout each economy will be harmonised. The cost differences to New Zealanders should our ETS start just one year ahead of Australia are not trivial:

- MEUG estimate that in calendar year 2009 consumers will pay approximately $587 million in additional costs as the liquid fuels sector enters the ETS and assuming a carbon cost of $30/t CO_2-e. In calendar year 2010 the cost to consumers becomes $1,317 million as the stationary engine sector enters the ETS. At earliest Australia might have an ETS commencing in late 2010. By that time the total carbon costs

[4] Refer Climate Change (Emissions Trading and Renewable Preference) Bill, Explanatory Note, p 25, list of alternative options as set out in the Regulatory Impact Statement for the ETS.
[5] http://www.garnautreview.org.au/domino/Web_Notes/Garnaut/garnautweb.nsf

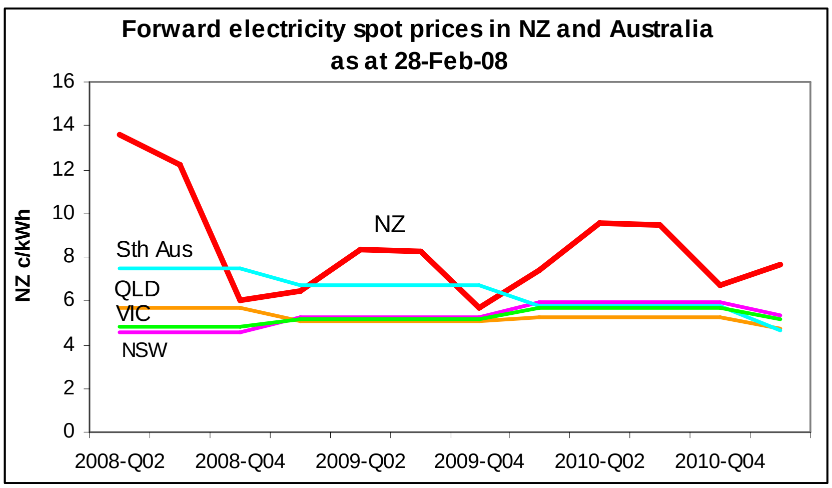
incurred by households and businesses in New Zealand compared to their Australian counterparts will, at \$30/t CO_2-e, be almost \$2 billion.

MEUG is concerned at whether the economy can withstand this carbon price shock ahead of our largest trading partner.

- A relatively small survey of just over 40 enterprises from a range of different sectors of the economy by the Greenhouse Policy Coalition and MEUG late last reported significant risk to existing and new jobs and investment if there were a price of carbon of \$30/t CO_2-e. A summary of the survey results are set out in appendix 2 of this submission. As noted beforehand, the actual price may well be in excess of \$50/t CO_2-e or even \$100/t CO_2-e.

- In the electricity sector New Zealand businesses are already facing a significant disadvantage in market expectations of spot prices compared to Australian businesses. The graph below compares the wholesale electricity forward price curves for New Zealand[6] and Australia[7] using a common New Zealand dollar exchange rate[8]. The New Zealand forward price for the next 2 quarters is influenced by the very low inflows and low lake storage. For calendar year 2010 the New Zealand forward price is 8.30 c/kWh, 2.38 c/kWh higher than the forward price in NSW and 3.09 c/kWh higher than the forward price for Queensland. Every 1 c/kWh of spot price difference equals just under \$400 million additional cost paid by New Zealand consumers.

  If the New Zealand ETS starts ahead of the Australian ETS as proposed in the Bill, this gap will widen even further.



b) Consistent policies to protect competitiveness-at-risk enterprises.

This has been a key issue for many and needs to be resolved, eg Professor Garnaut has long recognised this as an important issue, Castalia noted this as a key problem in the ETS design in their report to the Greenhouse Policy Coalition[9]. Belatedly the Minister seems to have recognised this issue isn't easily solved and we understand it's now an issue before the Climate Change Leadership Forum.

c) Consistent timing for coverage of all sectors. The ETS is described as "all gases all sectors" but with the qualifier "over time." The latter is not "the same time." MEUG believe this is a mistake as perverse incentives in favour of different sectors over others will arise.

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[6] NZ quarterly forward prices from www.energyhedge.co.nz as at 28 February 2008
[7] Australian annual forward prices from http://d-cyphatrade.com.au/ as at 27 February 2008
[8] Exchange rate as at 28 February 2008 from http://www.rbnz.govt.nz/statistics/exandint/b1/data.html
[9] Competitiveness issues were also identified as a key issue by Castalia in their report to GPC dated 30 January 2008.

d) An opportunity to reconsider how to allow incentives for growth in emitting industries. Castalia have suggested New Zealand should consider the EU policy of providing free allocation for new entrants between 2013 and 2020.

Australia has also been considering an emission intensity regime for some industries prior to 2013 rather than an absolute cap and trade regime.

e) Consistent application of a safety valve to cap emission unit prices. Again the Bill is light on how this might be achieved if at all[10].

f) MEUG remains very concerned at the exposure of the New Zealand economy to how the EU decides the carbon market should be run. Harmonising ETS designs with Australia will give us greater leverage to offset any change in EU policy that might disadvantage us (although no guarantee that leverage might be sufficient). Similarly a combined approach with Australia would help any debate on border-tax-adjustment regimes being proposed by the EU or other countries.

g) Consistent compliance regimes. Many companies operate in both New Zealand and Australia. There may be opportunities for harmonizing measurement, monitoring and verification processes (if they haven't been harmonized already). Similarly consistent ETS designs would lower compliance costs to businesses and the government agency costs.

h) One important risk of an ETS is fraud. A scheme consistent with Australia would assist enforcement agencies monitor and expose attempted fraud cases.

i) An opportunity to reconsider policy options for meeting the immediate Kyoto Protocol obligations. For example a joint New Zealand and Australian government option of a 'pooled purchase' arrangement whereby the government purchases AAUs and issues as emissions units onto the domestic ETS market[11].

15. There does not appear to be any downside to considering an alignment with the ETS Australia might develop. In terms of a broader objective of reducing global greenhouse gas emissions, a one or two year delay to implementing an ETS in New Zealand to allow alignment with Australia would have nil effect.

16. MEUG has not undertaken a comprehensive cost-benefit analysis; however on the basis of the above initial analysis there seems to be merit in considering the alternative of aligning the New Zealand ETS and Australian ETS.

Summary of recommendations

17. MEUG recommend the Finance and Expenditure Committee:

a) Agree to the provisions in Parts 1 and 3 of the Bill establishing processes for measuring, monitoring, reporting and verifying greenhouse gas emissions;

b) Note that Parts 4 and 5 implementing the ETS announced October 2007 have been and are still subject to detailed analysis by government and therefore should be referred back to the Minister until such time as that analysis is complete;

c) Note that with Australia having now joined the Kyoto Protocol and the new government working on an ETS that might start late 2010, there is an opportunity to align the design and timing of both ETS with mutual benefits and little if any downside. This option should be considered; and

d) Note that MEUG has made a separate submission on those parts of the Bill proposing a ban on new thermal generation.

[10] Castalia in their report to GPC of 30 January 2008 go further and say the safety valve in the Bill will not work.

[11] This option has been canvassed for some time. A useful recent case for this to be considered has been Holcim, *A consideration of the proposed design of the NZ ETS*, January 2008

Appendix 1: List of MEUG members and Mission Statement

There are 20 member companies in MEUG plus two industry group members as listed below along with estimated annual load, onsite generation and peak demand.

MEUG member[12]	Load GWh/y	Onsite generation GWh/y	Net Load GWh/y	Peak demand
Comalco New Zealand Limited	5,000	-	5,000	580 MW
Norske Skog	1,300	230	1,070	170 MW
Carter Holt Harvey Limited	1,105	260	845	130 MW
New Zealand Steel Limited	1,045	600	445	106 MW
Pan Pac Forest Products Limited	550	66	550	78 MW
Fletcher Building Limited	454	-	454	
Winstone Pulp International Limited	330	-	330	48 MW
The New Zealand Refining Co. Limited	235	-	235	
Telecom New Zealand Limited	190	-	190	
Oceana Gold Limited	152	-	152	16.5 MW
Holcim (New Zealand) Limited	70	-	70	
Dongwha Patinna NZ Limited	58	-	58	9 MW
Heinz Wattie's Limited	56	-	56	
Tegel Foods Limited	56	-	56	
Canterbury Meat Packers Limited	41	-	41	
Solid Energy New Zealand Limited	29	-	29	
Ravensdown Fertiliser Co-op	28	22	6	
Auckland International Airport Limited	23	-	23	13 MVA
Lion Breweries	23	-	23	6.5 MW
Methanex New Zealand Limited	18	-	18	
Business NZ	…			
Wood Processors Association of NZ	…			
	10,763	1,178	9,585	
NZ total demand[13]	36,898			
MEUG as percentage of total[14]	29%			

The Mission Statement for MEUG is:

"*The members of the Major Electricity Users' Group are committed to ensuring the continuing availability of electricity services, at the lowest cost to the economy as a whole, consistent with sustainable development. Within this framework, the Group seeks to ensure competitive electricity prices and security of supply to the members of MEUG*."

The 2007/08 external strategic objectives for MEUG are:

1) Improve competition;
2) Environmental policies that support the primary goal of economic growth;
3) Security of supply arrangements do not distort the market;
4) Most cost efficient transmission; and
5) Most cost efficient distribution.

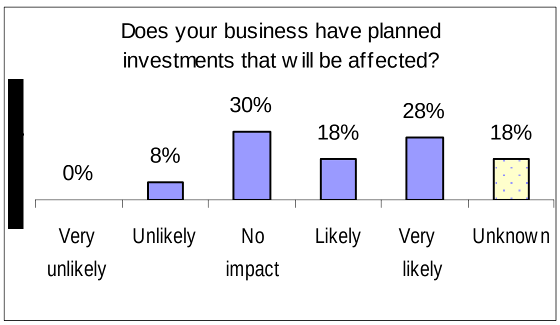
[12] Load, generation and peak load data may not be up to date because of changes in operations by individual companies since last surveyed by MEUG.
[13] Refer Ministry of Economic Development, Energy Data File, January 2006, p139, demand for year ended 30 March 2005
[14] Excluding demand by non-MEUG members of Business NZ and Wood Processors Association

Appendix 2: Results of Greenhouse Policy Coalition and MEUG survey 28 November 2007

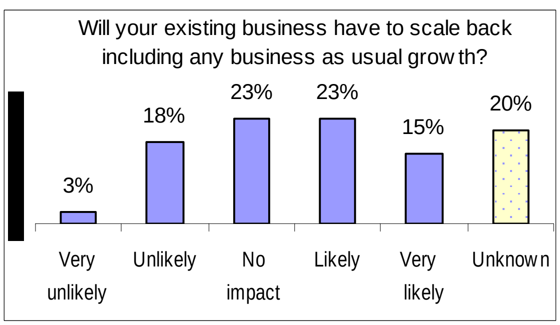
Forty one companies participated in the survey from a range of sectors. At the time of the survey it was estimated 14 companies might be eligible for some initial free credits, though details were and are still so unsure that difficult to assess which companies might be eligible:

Industrial:	(using Australian NZ Standard Industry Classification)
A01-A02	Agriculture, agriculture services and hunting
A04	Commercial fishing
B11, B12, B13-B15	Coal Mining, Oil & gas extraction, Other mining & quarrying, & services to mining
C211	Meat and meat products
C212	Dairy products
C231-C232	Log sawmilling and timber dressing, and other wood products
C233	Paper and paper products
C253-C254	Chemicals and chemical products
C271	Iron and Steel
C272	Basic non-ferrous metals
C284-C286	Electronic, electrical and industrial equipment and appliances
Commercial:	
F-G	Wholesale and retail trade
I63	Water (transport)

The survey asked respondents to assess the impact assuming $30/t CO_2-e



Survey respondents reported 681 potential new jobs and $1.665 billion of new capital were at risk



Survey respondents reported 2,995 existing jobs were at risk