Major Electricity Users' Group

17 January 2020

Environment Committee
Parliament Buildings
c/- Committee Secretariat en@parliament.govt.nz

Dear Environment Committee

Submission on Climate Change Response (Emissions Trading Reform) Amendment Bill

This is a submission by MEUG

1. This is a submission by the Major Electricity Users' Group (MEUG). Background information on MEUG is attached in Appendix 1.

2. MEUG members have an interest in the Climate Change Response (Emissions Trading Reform) Amendment Bill to ensure proposed changes will stand the test of time and be beneficial to New Zealanders as part of the suite of climate change related policies.

3. MEUG requests to appear before the committee to speak to our submission.

4. Please contact Mr Ralph Matthes on 027 476 0500, or email ralph.matthes@meug.co.nz or postal address PO Box 8085, Wellington 6143, for any questions in relation to this submission.

Importance of predictability for decision making by major energy users

5. As significant contributors to GDP and employment and as part of continuously improving their performance, members of MEUG consider and make operating and investment decisions that affect their and New Zealand's response to climate change. Making business decisions involves weighing uncertain future opportunities with future uncertain risks and costs. Predictability and confidence in how government sets policy settings are an important risk to be assessed be it for the electricity market, labour market or for climate change policy.

6. Uncertainty on climate change policy settings can undermine businesses confidence on decisions such as:

   a) the optimal timing, scale and sequencing for new investments to electrify existing thermal fuel process heat load

   b) to tender for or to build onsite new renewable generation supply.

7. As discussed in the next section we have become aware a new review of industrial allocation is about to commence. This new review has not been signalled beforehand and has undermined confidence in what industrial allocations eligible businesses can plan on. This in turn risks stalling decisions such as those discussed in the preceding paragraph.

8. There are flow on effects if major energy users defer decisions due to lack of predictability of the process and hence diminished confidence policy decisions yet to be decided will be robust for new climate change policy settings. Generators, Transpower and electricity distribution businesses will have less certainty on when electricity demand by major energy users may change leading to uncertainty on the timing and optimal configuration for new generation, transmission and distribution investment needs or divestment (e.g. thermal fired power stations). The outcome of lack of predictability and confidence that climate change policy settings will be robust will lead to risks of over or under investment in the electricity supply chain.

Changes in industrial allocations

9. In parallel to the proposed default phase-out rates for industrial allocation of 0.01 between 2021 to 2031, 0.02 to 2040 and then 0.03 till 2050 in the Bill, the Ministry for the Environment is consulting on possible changes to the Electricity Allocation Factor (EAF). The EAF affects some industrial allocations. In addition, we became aware just before Christmas that Cabinet has agreed to have a 2-year review of the whole industrial allocation regime.[1]

10. The proposed changes in the Bill (setting aside if we agree with those changes or not) would give business and interested parties a stronger degree of predictability. The concurrent work on the EAF and the about-to-commence wider review has created new uncertainties on where the regime may settle in the next 3-years.

11. Taking this into account and to retain some predictability, MEUG supports the default allocation phase-out of 0.01 from 2021-2030. Beyond that it would be inappropriate for Parliament to decide legislation given the prospect that the about-to-commence review may change the industrial allocation regime.

12. Making changes to industrial allocations is not a trivial exercise. Poor decisions can detrimentally affect the government, the eligible businesses and all New Zealanders. Two aspects for making decisions need to be considered. First what criteria are appropriate for considering industrial allocations and second which party is best to advise the Minister as the decision maker?

13. The Bill sets out a list of criteria in proposed new s.84C (3) (a) to (k). MEUG submits the criteria should focus on the primary reason industrial allocation is needed; that is the risk of emissions leakage. Accordingly, we agree with the factors set out in proposed new s.84C (c) that the Minister must consider:

[1] Relevant to the operating and investment decision making of EITE's and therefore their commercial viability, but not directly related to the quantum of units of industrial allocations, are the concurrent consultations by MBIE on accelerating renewable energy and energy efficiency. The latter focusses on possible complimentary policies to the ETS to facilitate electrification of existing non-renewable energy sources used for process heat.

(c)	the level of risk of emissions leakage (increased emissions overseas as a result of emissions reductions in New Zealand, for example an activity being relocated outside of New Zealand to reduce the emissions-related costs for the activity), based on—	
	(i)	the emissions-related costs and policies in competing jurisdictions; and
	(ii)	the markets for international trade in the products produced by the activity; and
	(iii)	the ability of affected eligible persons to pass on increased costs to customers; and

14. Some of other factors listed in proposed new s.84C (3) potentially undermine the desired outcome to effectively and even-handedly mitigate the risk of emissions leakage. For example:

   a) Inappropriate assessment of over allocation that results from a firm having invested in emission abatement (s84C(3)(d):

      i) Currently EITE firms are incentivised to reduce their emissions through the price of carbon, regardless of whether they receive a free allocation or not.

      ii) This incentive is undermined if having made an investment to reduce emissions which is reliant on (partial or full) abated emissions costs, the savings are then withdrawn through a determination that as emissions have now reduced, allocation phase-out should be increased.

   b) The potential for allocation to be "squeezed" to address emissions targets or budgets being under pressure through under delivery in non-EITE sectors e.g. slow electric vehicle uptake (s84C(3)(a)).

   c) The focus being on the cost to the taxpayer of providing allocations for the activity, with no reference to the benefits e.g. financial, employment, strategic importance, security of supply, absorptive capacity foundation for a just transition, etc. (s84C(3)(i)).

   d) Other parameters that are outside the influence of the EITE activity and/or which are not readily tracked or predictable (s84C(3)(b),(e),(g),(h),(j),(k)), further undermining the predictability of future allocation and the business case for investment.

15. In terms of which party is best to advise the Minister as the decision maker on future industrial allocations MEUG submits:

   a) The proposal in the Bill for a phase-down or 0.01 per annum between 2021 to 2031 be retained.

   b) From 2031 the Climate Change Commission be tasked to advise the Minister on the best methodology for the industrial allocation regime using only the criteria set out in proposed new s.84C(3)(c). A snapshot of that subsection is in paragraph 9 above.

      We do not accept that the Regulatory Impact Statement (RIS) prepared for the Minister's paper to Cabinet in July 2019 proposing the legislated default phase-out rates to 2050 sufficiently addressed the factors in proposed new s.84C(3)(c) in comparing alternative longer-term methodologies for industrial allocations.

Estimating risks of a substantial unavoidable loss of income or wealth

16. Ministerial announcements on climate change related policies frequently refer to major transitions expected within the economy to implement such policies. It was surprising therefore that the Departmental Disclosure Statement did not include an analysis of "the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?"[2]

17. As noted beforehand in paragraph 12 "making changes to industrial allocations is not a trivial exercise. Poor decisions can detrimentally affect the government, the eligible businesses and all New Zealanders." Many of the businesses eligible for industrial allocation are based in regional communities. The risk of substantial unavoidable loss of income or wealth if the proposed industrial allocation regime in the Bill is implemented may fall disproportionally on those regions. Hence our surprise the Departmental Disclosure Statement did not consider that possible risk.

18. We expect that if the Climate Change Commission were tasked with providing advice to the Minister on industrial allocations that they would analyse and report on the risks of a substantial unavoidable loss of income or wealth and distributional effects on different income classes.

Yours sincerely

John Harbord
Chair
Major Electricity Users' Group

[222] Departmental disclosure statement, p11, http://disclosure.legislation.govt.nz/bill/government/2019/186

Appendix 1

The 18-members of MEUG are listed alphabetically in the table below:

Ordinary members	
Cold Storage Nelson	Oji Fibre Solutions
Daiken NZ Ltd	Pan Pac Forest Products
Fonterra	Progressive Enterprises Ltd
Lion	Ravensdown
Norske Skog Tasman	Refining NZ
NZ Steel	RioTinto NZ
OceanaGold	Whakatane Mill
O-I	Winstone Pulp International
Industry group members	
BusinessNZ	
Wood Processors' and Manufacturers' Association of NZ	

The mission statement of MEUG is "to add value to MEUG members' management of electricity costs and risks achieving outcomes consistent with competitive markets for the long-term benefit of electricity consumers."

MEUG members use approximately 26% of total electricity consumption ($900 million per annum electricity costs), have annual sales revenue of around $30 billion, employ in excess of 25,000 people and contribute $11 billion per annum to GDP.[3]

[3] MEUG flyer published 9th March 2018, refer http://www.meug.co.nz/node/917