

Submission by



to the

## **Environment Committee**

on the

## **Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill**

6 April 2023

**CLIMATE CHANGE RESPONSE (LATE PAYMENT PENALTIES AND INDUSTRIAL ALLOCATION) AMENDMENT BILL**  
**– SUBMISSION BY BUSINESSNZ ENERGY COUNCIL—**

**INTRODUCTION**

1. BusinessNZ Energy Council (BEC)<sup>1</sup> and BusinessNZ welcome the opportunity to provide feedback to the Environment Committee on the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill.
2. This submission comments only on aspects of the Bill that relate to legislative changes impacting industrial allocation policy.
3. BEC acknowledges New Zealand’s net-zero carbon target and sinking budgets to achieve that target. Climate change is a global dilemma. New Zealand contributes to this global problem and has a responsibility to address it.
4. New Zealand’s businesses have a crucial role to play in achieving the reductions sought under the Paris Climate Agreement. The impacts of climate change will not dissipate if only a few global actors transition.
5. BEC believes New Zealand’s ETS is an effective and necessary instrument that ensures external emissions costs are internalised by those who are responsible for the release of carbon emissions. It encourages businesses to adopt cleaner practices in a flexible and least cost way.
6. The ETS needs to support New Zealand’s energy intensive and trade exposed businesses (EITE) to make significant step-changes in their emissions profiles by way of large capital investments and fuel switching, however such moves are undermined by the Bill as drafted. As the Bill stands, several proposed amendments create additional risk for decarbonisation investments, which could lead to resources being invested in other jurisdictions with a lower risk profile.
7. BEC supports the Bill with the inclusion of several amendments required to ensure the ETS remains an effective tool to encourage step-change investments and by doing so help to achieve New Zealand’s climate targets. BEC outlines the importance of these amendments in this submission.

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<sup>1</sup> Read more about BEC in APPENDIX ONE

## International context and the important role of industrial allocations

8. Carbon leakage refers to the situation where an activity in one country, which have climate policies aimed at reducing emissions, shifts to another country with less stringent or no climate policies. This situation increases global emissions, while negatively impacting employment and economic activity within the country where the activity once presided. Industrial allocations play a vital role in alleviating the risk of carbon leakage, while sending recipients a strong incentive to reduce their emissions, thereby to sell their units to the market.
9. Every country that includes energy intensive and trade exposed businesses within its ETS has a form of industrial allocations to protect against carbon leakage.<sup>2</sup> This is understandable, considering the low coverage of emission pricing globally. The reputable International Carbon Action Partnership's (ICAP) report published in March 2023, shows that only 17% of all global greenhouse gas emissions are covered by an ETS.<sup>3</sup>
10. China's emissions trading scheme is the world's largest in nominal terms, covering 4 billion tCO<sub>2</sub> or the equivalent of 44% of its aggregate emissions, slightly behind New Zealand at 49% coverage.<sup>4</sup> However, China's ETS only covers power generation, and does not cover industry. Its carbon price sits close to \$8 a tonne.<sup>5</sup> Notwithstanding countries within the European Union (EU), the only countries that include industry within their ETS is South Korea, the United Kingdom, Mexico, Kazakhstan, Montenegro, and New Zealand.
11. Despite the EU introducing a replacement policy for industrial allocations, such as the EU's Carbon Border Adjustment Mechanism (CBAM), which will take more than a decade to phase in, the mechanism will have limited scope to specific industries, while industrial allocations will remain in place for other participants.

**Figure 1: Sectors covered by emissions trading schemes globally<sup>6</sup>**



<sup>2</sup> *Emissions Trading Scheme Worldwide, Status Report*, International Carbon Action Partnerships (2023)

<sup>3</sup> Ibid, p28

<sup>4</sup> Ibid, p137

<sup>5</sup> Ibid, p32

<sup>6</sup> Ibid, p31

12. Over the past ten years, the number of schemes worldwide has increased from 13 to 28, increasing coverage from 8% to 17% of all global emissions.<sup>7</sup> BEC remains optimistic that additional countries will introduce their own schemes and integrate their industries. However, during the interim, the justification for retaining industrial allocations remain robust.
13. Reducing emissions by increasing carbon prices and ensuring firms stay competitive and remain in New Zealand is a difficult balancing act. As noted in a Ministry of the Environment (MfE) report published in 2018,<sup>8</sup> there are several industries vulnerable to carbon leakage, especially if the price of carbon is comparatively high in relation to other jurisdictions with lower prices or no carbon price at all. Industrial allocations protect against carbon leakage, while encouraging investment in decarbonisation protects.
14. Moreover, a rapid decline in industrial allocations could mean that for some businesses, the cost of reducing emissions could offset their profit margins. EITE businesses that may not currently, or suddenly, switch to less emission intensive processes due to the infancy of some technology and or the commercial viability of such technology, at this stage, are at risk of moving to jurisdictions with less stringent climate policies or closing completely. These are not desirable outcomes. It would result in higher emissions globally and be detrimental to local employment and economic activity.
15. BEC is pleased to see within the regulatory impact statement, paragraph 14, that the MfE acknowledges an *'ongoing and material risk of emissions leakage in New Zealand.'*<sup>9</sup> The statement reiterates that New Zealand's major trading partners do not have emissions pricing comparable with New Zealand's ETS. BEC is pleased to see MfE underline the need for industrial allocations, and that it further advises the continuation of such allocations.
16. However, BEC believes the MfE has taken a narrow view of the impact of industrial allocations, as noted in paragraph 20-21:

*'IA is meant to minimise emissions leakage risk caused by the ETS. It is not intended to support other economic objectives.'*

*'Feedback suggested IA supports wider economic objectives such as a circular economy, food security, and supply chain resilience. This is an indirect consequence and benefit to New Zealand of minimising the risk of emissions leakage, rather than the purpose of IA.'*
17. BEC understands the MfE's reasoning that the purpose of industrial allocations is to protect against carbon leakage. However, even though the main purpose of allocations is to not 'support' other economic objectives, evidently industrial allocations, or therefore the lack of industrial allocations, does have broad implications for wider economic objectives. Even though food security, supply chain resilience and a circular economy may be the indirect consequence and benefit to New Zealand, rather than the purpose of industrial allocations, industrial allocations inevitably affect these matters of national importance.
18. Acknowledging the broad impacts of the ETS and industrial allocations aligns with MBIE's work on a 'just transition' – ensuring we can achieve the emissions reductions sought, without vast and negative consequences for employment, living standards, security of supply and wider objectives.
19. New Zealand's businesses are vastly interconnected. Outputs from one firm are critical inputs for others. For example, lime is a critical input for steel, water treatment, and pulp and paper; hydrogen peroxide goes into the bleaching of pulp and paper; cement and steel are critical for infrastructure; urea is a key ingredient in resins and nitrogen-rich fertilizers. The absence of one firm can have

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<sup>7</sup> *Emissions Trading Scheme Worldwide, Status Report*, International Carbon Action Partnerships (2023)

<sup>8</sup> *Countervailing forces: climate targets and implications for competitiveness, leakage, and innovation*, Ministry of the Environment, (2018)

<sup>9</sup> *Regulatory Impact Statement*, MfE, November 2022

deep and costly consequences throughout the supply chain, increasing costs and harming consumers.

20. The closure of Marsden Point refinery is a salient example. The refinery no longer produces raw carbon dioxide (CO<sub>2</sub>) used to produce food and beverage grade CO<sub>2</sub>. This has resulted in a nationwide CO<sub>2</sub> shortage. Among many uses, carbon dioxide is often used in food packaging, to put the 'fizz' in beer and to increase the growth of vegetables, such as tomatoes. The shortage has increased the cost of producing many goods. It would have been difficult to predict, without further examination, that the closure of an oil refinery would increase the price of beer and tomatoes.
21. The examples above (and there are many more) reflect the interconnectivity of businesses and supply chains. Policies impacting one business, or multiple, in this case energy intensive and trade exposed businesses, will reverberate throughout New Zealand's economy.
22. The closure or departure of large integrated firms would negatively impact production costs, delivery times and New Zealand's economic resilience. The latter is emphasised in the Productivity Commission's recently released paper, which outlines the importance of resilient supply chains and their relationship to economic resilience.<sup>10</sup> The consequences are not only for supply chains and the employment these businesses create, but also energy security.
23. Methanex is New Zealand's largest user of natural gas by a large margin. Methanex's presence provides a long-term base demand, reduces commercial risk for producers, provides resilience and flexibility to gas and electricity industries, and gives certainty to initiate upstream investment in the supply of natural gas. Gas plays an important role, supplying the energy needs of many industrial, commercial, and residential consumers. The closure of Methanex would initially increase the supply of available gas, but would likely stop production investment and lead to limited supply. This would likely lead to higher wholesale prices for businesses and consumers. BEC notes that affordability must not be forgotten. It is vital to electrifying commercial processes, and New Zealand's vehicle fleet.

**BEC ACKNOWLEDGES a one-off amendment to allocative baselines.**

24. The Bill updates data from specific years that determine allocative baselines. Current baselines are based on FY2006-FY09 data. The Bill replaces this data with FY2016-FY21 data, with the option of excluding FY2019-FY2021 data, due to the impacts of COVID-19 on industrial activity.
25. BEC acknowledges that this supports the integrity of future allocation policy, ensuring industrial allocation policy remains durable for the following two decades and beyond. As New Zealand's main tool for reducing emissions and meeting our climate targets, the integrity of the ETS is vital.
26. The above provides confidence to the public and ETS participants, minimising the possibility of knee-jerk amendments that may undermine the effectiveness of the ETS in the long term. Therefore, on balance, BEC supports the need for a one-off amendment to the allocative baselines to support the integrity of allocations.
27. However, for some firms that have made investments to decarbonise in preceding years and received a return on such investment, this one-off change may diminish their return, and may unintentionally create regulatory uncertainty and reduce investment confidence. Therefore, firms that believe they have made significant emission reductions in preceding years, should be considered, and reflected in the changes to allocation policy, and thus should have the ability to engage with the Government on the issue.

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<sup>10</sup> [Improving Economic Resilience](#), the New Zealand Productivity Commission. (2022)

**As it stands, BEC OPPOSES the amendment to review activity-specific allocative baselines and periodic reviews every ten years on all allocative baselines.**

28. The Bill allows the Minister of Climate Change to review activity-specific allocative baselines (after 5 years). The Minister can update baselines if there is evidence that allocations are equal to, or exceed, their emissions costs. The Bill also includes a requirement to review allocative baselines every ten years from their most recent update. The ten-yearly review can reset allocative baselines if the over-allocation criteria is met.
29. BEC notes that a consideration of investment horizons when MfE drafted this option, in relation both to the ten-year periodic review and the Minister's ability to review baselines if there is evidence of over allocation, is classified as a secondary criterion within the regulatory impact statement (RIS). This is unfortunate. This is a matter of importance belonging in the RIS's primary criteria.
30. BEC believes in the importance of upholding the broad principle that firms have a ten-to-fifteen-year, or longer, investment horizon. Decarbonisation projects, with a large step-change in reducing carbon emissions, have extended periods of return on investment. The projects require significant capital expenditure. The payback period for investments can be ten-to-fifteen years. In many instances, businesses have investment horizons longer than ten-to-fifteen years. For example, overseas firms are making substantial investments in CCUS, without witnessing a pay-back for as long as 20 years or more. These long horizons require regulatory certainty, providing confidence that firms will receive a pay-back for the risk that comes with their significant upfront capital expenditure. Without this regulatory certainty, investments that would deliver large step-change reductions in New Zealand's gross emission will not be made.
31. As noted, the amendment states that before the Minister can undertake activity specific updates to allocative baselines, the Minister must be '*satisfied the effect of the allocative baseline or baselines is that the activity's allocations are equal to or greater than the activity's emissions cost*'. BEC emphasises that this is likely to create considerable regulatory uncertainty, while inadvertently suppressing ambitious investments in reducing emissions commenced by EITE firms.
32. Under this amendment, the Minister could reset a firm's baseline based on a new over-allocation caused by an investment to decarbonise a specific activity, inevitably stripping away the return on such investment. After considering the high capital expenditure of a project and or the higher operating expenditure from substituting a higher cost fuel source, combined with the risk of a baseline reset, firms would likely not go ahead with a large and ambitious investment as the incentive has been removed.
33. For example, if a firm wants to substitute natural gas with electrolysis for making hydrogen, the capex for the equipment is high, and the cost of the energy is also high. The industrial allocation provides the pay-back on both the high capital cost (capex) and high operating costs (opex). If the allocation is reset, after a ten-year review or five years based on the Minister's discretion, there is a material risk the project becomes commercially unviable. In this situation, rather than making a large investment to decarbonise, a firm is instead incentivised to purchase NZUs now to offset future liability, while deferring the decarbonisation project until the reset risk is alleviated by the level of phase down. In other words, firms would have the incentive to keep their emissions above the allocation phase down to avoid the reset and ensure their emission reduction projects are aligned behind the phase down line. This has the potential to unintentionally slow New Zealand's decarbonisation goal.
34. BEC believes the above is not a desirable outcome, either for the climate and industry, or for the Government. It threatens ambitious projects aimed at large step-change emissions reductions at their source, hinders the Government's emissions budgets, and creates risks to New Zealand's

goods remaining competitive in a global market that is increasingly placing more value on less carbon intensive products.

35. New Zealand's EITE firms want to decarbonise. Their customers, shareholders, and wider stakeholders demand action. To remain competitive and retain a social license to operate, these firms are committed to decarbonisation. Many have announced significant investments to make material emission reductions, while setting their sights on more substantial investments out to 2030 and beyond.
36. Methanex is currently installing new technology at its Motunui methanol plant, cutting 50,000 tonnes of carbon emissions each year. The company is pursuing work to produce methanol using renewable natural gas, biomass, and green hydrogen, while setting its sights on methanol as a cleaner-burning marine fuel. The latter is promising. During combustion, green methanol is carbon neutral and conventional methanol can reduce emissions by up to 15% percent compared with conventional fuels.
37. Golden Bay Cement has invested more than \$200m since 2004 in decarbonisation projects. Its Whangarei cement plant now substitutes 50% of the coal used to power its cement kiln with used tyres and construction waste that were once destined for landfills. Emissions from its clinker production are amongst the lowest in the world. The company has a well-developed plan to replace the rest of its coal use with biofuels derived from waste streams. This plan requires investments in the order of \$300m+ to meet its targets.
38. These are only two examples among the various projects New Zealand's EITE businesses have initiated, or plan to initiate in the coming years. For these projects to succeed, adequate incentives must exist and operate in tandem with the intentions of firms' decarbonisation goals.
39. BEC notes that MfE's RIS emphasises that the underlying intent of industrial allocations is merely to safeguard against carbon leakage, and other mechanisms should exist to support investment. The RIS downplays the important role industrial allocations have on promoting lower emissions intensity in industry activity. This view is displayed in the RIS, paragraph 100 and 89:

*"[Regarding IA incentivising improvements in emissions intensity] the government does not consider this to be the purpose of New Zealand's IA policy.... We have not included an objective specifically related to incentivising improvements in emission intensity."*

*"We have limited evidence of IA leading to investment in lower emissions....it is difficult to justify maintaining over-allocation, given that the benefits may be marginal."*

40. However, industrial allocations do provide a strong marginal price signal to invest in decarbonisation. Free allocation recipients have an incentive to reduce emissions.<sup>11</sup> This is because they face the opportunity cost of either using their allocations for compliance or selling their surplus units. Businesses have voiced the strong incentive industrial allocations provide. Continual baseline resetting strips away this signal. Removing the signal is counterintuitive to the overarching purpose of the ETS: internalising the external cost of emissions and incentivising polluters to reduce their emissions. BEC reiterates that creating a stable regulatory environment that encourages investment must work in unison with and be of equal merit to the protection against carbon leakage.

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<sup>11</sup> Rontard, Benjamin, and Catherine Leining. *Future Options for Industrial Free Allocation in the NZ ETS*. Wellington, New Zealand: Motu, Economic and Public Policy Research, p4, 2021.

**BEC RECOMMENDS amending s161A(3A)(c) and s161D(3)(e) of the Act to include the Minister's consideration for capital and operating expenditure when testing the over-allocation of units**

41. Regarding the Minister's test for assessing whether a firm receives overallocations, s161A(3A)(c) reads: *'the Minister is satisfied that the effect of the existing baseline is that the activity's allocations are equal to or greater than the activity's emissions costs.'* s161D(3)(e) reads: *'whether the effect of the allocative baseline or baselines is that the activity's allocations are equal to or greater than the activity's emissions costs.'*
42. To reduce uncertainty and the unintended consequence of dampening investment confidence in decarbonisation projects, as discussed previously above, both s161A(3A)(c) and s161D(3)(e) could be amended to include the Minister's consideration of a firm's capital and operating expenditure before recommending changes to existing allocative baselines.

**BEC RECOMMENDS amending s84C (3) of the Act to include the Minister's consideration of capital and operating expenditure when amending the phase-down of the level of assistance**

43. In conjunction with the recommended amendment to the criteria for the baseline reset test, the Act should be amended to include the same consideration under the procedure for setting the level of assistance phase-down rates outlined in 84C (3).
44. 84C (3) notes that the Minister must consider several matters before recommending the making or amendment of regulations concerning the phase-down rate of the level of assistance. These include eleven considerations, from (a) budgets set for reducing emissions to (k) any other matters the Minister considers relevant.
45. If the Minister acknowledges the level of capex and opex when considering a baseline reset and subsequently decides not to reset the baseline on this basis, there still remains a risk that the level of assistance phase-down rate could accelerate in the future without any consideration of capex and opex, as 84C (3) does not list this consideration.
46. This provides a degree of hesitation and uncertainty when EITE firms invest in decarbonisation projects. Uncertainty surrounding the level of assistance, where the phase-down rate can accelerate without first acknowledging capex and opex, once again dampens ambitious decarbonisation projects.
47. However, uncertainty can be alleviated if the Minister must consider the firm's level of capital expenditure and operating expenditure. BEC recognises that this recommendation to amend 84C (3) is outside of the Bill's scope. However, it is relevant to the effectiveness of the ETS to encourage step-change reductions. As already noted, EITE firms wanting to make significant investments in decarbonization projects have high capex from new equipment and high opex from the expensive cost of switching fuel. The latter is important, as per gigajoule, electricity is still far more expensive than natural gas. When switching from a gas boiler to an electric boiler, a firm's operating costs would expand considerably. Therefore, BEC believes it is reasonable to add a specific consideration of opex and capex when the Minister considers changes to phase-down rates, if such changes are ever implemented, especially when firms are investing large quantities of capital with competing uses. The higher the risk, the more likely investments are to be made elsewhere.

**BEC SUPPORTS the amendments to s161C of the Act, replacing the thresholds for an activity to be classified as moderately emission-intensive or highly emissions-intensive.**

48. The current eligibility threshold, calculated on the tonnes of CO<sub>2</sub> per million dollars of revenue, is 800t CO<sub>2</sub>-eq and 1,600t CO<sub>2</sub>-eq for moderately and highly emissions intensive businesses respectively. The current thresholds were set in 2010 and were based on emissions cost of \$25.

For moderately emission intensive firms, this is the equivalent of 2% of a firm's revenue, and 4% for a highly emissions intensive firm.

49. However, carbon prices have changed significantly since 2010, and the \$25 carbon price used to calculate the emissions costs equivalent to 2% and 4% of firm's revenue is outdated, considering the current spot price, as of March 2023, is \$65 a tonne. This would not be a problem if the risk of carbon leakage had subsided since 2010. But evidently it has not. New Zealand's EITE firms face global competition from rival firms that do not face a price on emissions. The global carbon price average is \$6 a tonne.<sup>12</sup> As noted earlier, jurisdictions with emissions pricing, the risk of carbon leakage is acknowledged. The European Union, with its large and varied industrial base, acknowledges the risks of carbon leakage. For its highly exposed firms, industrial allocations are given up to 100%, depending on the firm's risk.<sup>13</sup>
50. BEC agrees with the RIS, paragraph 244, that this is a problem that should be addressed. The new thresholds, adjusted to the carbon price for 2023 of \$67.63, as specified in the Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013, are 296 CO<sub>2</sub>-eq for moderately intensive firms and 591t for highly emissions intensive firms.
51. BEC agrees with the RIS paragraph 196 – "*existing thresholds are no longer reflective of the level of carbon leakage*" – and believe threshold changes are sensible. Adjusted thresholds would reflect the material risk of carbon leakage, considering the higher carbon price since 2010. This protects the original intent and materiality of the eligibility thresholds based on the equivalent of 2% of revenue for moderately emissions intensive firms and 4% for highly emissions intensive firms. Again, the thresholds were based on the risk of carbon leakage. These risks remain relevant and appropriate today.
52. BEC believes recent developments to the price of carbon should not undermine the justification for amending eligibility thresholds. Recent price reductions are based on low volumes, with demand becoming light due to firms hedging against the proposed adjustments to price settings by over purchasing credits. The long-term trajectory remains that prices will be higher in the future, as auctioned units decline. Therefore, higher carbon prices must be factored in when the eligibility thresholds are reassessed.

**BEC RECOMMENDS either amending s161E (2) of the Act to include new emission sources or including new sources through secondary legislation. BEC PREFERS the latter.**

53. In calculating allocative baselines and eligibility thresholds, certain emissions sources are eligible in the formula. In the Act, s161E(2)(a)(i) outlines these sources. They include gas, coal, liquid fuel, waste oil, geothermal fluid, and direct use to generate steam, including industrial processing emissions and indirect electricity cost passed through the MWh x PEAf (the number of megawatt hours of electricity used when the activity is carried out multiplied by a prescribed electricity allocation factor.)
54. BEC was expecting the Bill would introduce additional eligible emission sources under s161E(2)(a)(i). BEC believes one important emission source that could be included is externally sourced CO<sub>2</sub> feedstock. This is necessary for firms that are taking out steam methane reformers and replacing them with hydrogen electrolysis. These firms still require an external source of CO<sub>2</sub>.
55. Broadly however, BEC prefers a permissive approach outlining new specific eligible emission sources through secondary legislation, rather than requiring an amendment to primary legislation. This ensures we do not 'lock in' sources in primary legislation, while providing for new technology adoption in the future, such as sustainable fuels. This supports the future proofing of eligible sources by providing flexibility, as we cannot fully contemplate the appropriate fuels sources for New Zealand in the future.

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<sup>12</sup> *More countries are pricing carbon, but emissions are still too cheap*, International Monetary Fund Blog, July 2022

<sup>13</sup> The European Commission, [Carbon Leakage 2022](#)

**BEC SUPPORTS the new activity provisions outlined in 161F of the Bill and RECOMMEND the inclusion of economic considerations before the Minister recommends a new activity to be eligible.**

56. The Act currently does not allow for new activities to receive allocations, as the allocative baselines are set on data originating from FY2006-2009. New entrants do not hold the appropriate data. The new activity provisions allow new entrants to use design, historical and forecast data. Over a period, applicants who provided this data are required to submit actual operational data. A wash-up is calculated, with ex-post adjustments.
57. BEC supports this new provision and note that New Zealand has not had a new activity participate in the ETS since 2010. Whether this situation will continue is unknown. It is likely new eligible activities might operate in New Zealand in the future. This provision is sensible, as it future-proofs industrial allocations for new activities operating in New Zealand.
58. BEC notes that the changing approach to assessing the eligibility of a new activity indicates that the Climate Change Minister must consider criteria set out in s84C (3) of the Act, before a new activity can be added. This seems warranted, considering a new activity arriving in New Zealand might provide a significant barrier to achieving the country's emissions budgets and international obligations by increasing emissions in New Zealand. However, this should be weighed against wider economic objectives, as a new activity might provide employment, generate economic activity, and improve living standards.
59. BEC recommends that the Minister be required to consider the wider economic benefits before recommending a new activity as eligible.

**BEC RECOMMENDS the Bill's new activities provisions should be extended to existing activities with changing operations.**

60. Under the Act, and the Climate Change (Eligible Industrial Activities) Regulations 2010, each eligible activity is tightly defined. The definitions involve products, inputs, emissions, and fuels. For example, the eligibility definition of producing market pulp, in clause 14 of the regulations, it outlines the market pulp products that must be used as the basis of allocations, including the strict definition of market pulp, how it is made and its outputs.
61. However, as eligible activities decarbonise, through fuel switching, using different inputs, producing different products, and adopting alternative production methods, they would no longer be eligible to receive allocations, as the new inputs, new methods and fuels are not specified under the eligible activity definition. In this situation, a firm is disincentivised to undertake investment in decarbonisation. This provides an obstruction for allocation recipients in implementing significant step-changes in their emissions profiles.
62. Extending the same flexible approach proposed under s161F for firms changing their activity would counteract and solve this problem of inflexible and prescriptive definitions blockading investment in changing activities. Amending each eligible activity would be slow. But most importantly, amending the activity definition would be difficult and restrictive as we do not know what future solutions will arise and the extent to which they will be adopted. To provide flexibility and encourage decarbonisation investment, eligible firms with changing activities should be able to use historical, forecast and design data. Once their activity has changed, and operating data has been collected, a wash-up of the differences between the projected and actual data can occur and ex-post adjustments can be made. This ensures firms can make step-change investments without losing their allocation.

## **BEC SUPPORTS the insertion of 161FA to the Bill relating to the Electricity Allocation Factor (EAF)**

63. BEC agrees that the EAF value and its methodology is no longer fit for purpose. The EAF has not changed since 2013. BEC notes that the market has evolved significantly in the past decade, and the current methodology does not accurately reflect the cost of the ETS obligation firms face. The proposed change to the methodology is to calculate the EAF based on a three-year rolling average determined by the spot-market and the EA's market model, whilst taking into account a dry or wet year.

64. BEC supports these changes. As in the past, the EAF has been determined based on look ahead modeling where core assumptions on generation mix and demand were required. This process is time and resource intensive, both for the Government and industry. The proposed method ensures that the EAF has a higher degree of accuracy, and best reflects the pass-through cost of NZ ETS obligations compared with the counterfactual.

## **BEC SUPPORTS the insertion of s149(3)(4)(5) to the Bill relating to information sharing.**

65. The amendment to s149 through inserting subsection (3), (4) and (5) allows the EPA to share data, including emission returns and allocation returns, with the MfE and the Climate Change Commission (CCC). BEC supports this amendment. This improves decision making based on accurate information, especially if allocations are to be reset. However, this will not collect all the information required for such assessments, as many firms are downstream of the point of obligation. For instance, if a firm is consuming natural gas, the gas miner completes the emissions return, rather than the end-user. Therefore, this may create misunderstanding and confusion.

66. It is therefore important that the MfE and the Climate Change Commission recognise that additional information will be required prior to making any judgements on over allocation.

## **CONCLUSION**

- i. BEC acknowledges the importance of meeting New Zealand's emissions targets and support New Zealand's transition to a net-zero economy.
- ii. The ETS is the most important tool to reduce emissions by placing a cost on carbon and internalising the public externalities of emissions.
- iii. BEC reiterates the vital role industrial allocations play, not only in reducing the likelihood of carbon leakage, but also in providing a strong signal to invest in step-change decarbonisation projects.
- iv. BEC supports a **one-off** reset to allocative baselines to support the future integrity of the ETS.
- v. However, BEC **opposes** continued baseline resetting every ten years, and the power given to the Minister to possibly reset activity specific baselines after five years. This provision strips away the signal to invest in step-change decarbonisation projects. Large projects resulting in significant step changes would not proceed, as the economic returns would not outweigh the large opex and capex associated with a project. This is undesirable for the environment and the Government's targets.
- vi. BEC **recommends** adding a requirement that the Minister must consider a firm's opex and capex before resetting allocative baselines and amending phase-down rates.
- vii. BEC **supports** changes to the eligibility threshold, protecting against the increased risk of carbon leakage from a higher carbon price.
- viii. BEC **recommends** including new eligible emission sources, preferably in secondary legislation. This will provide an additional opportunity for firms wanting to adopt new methods with the aim of reducing their overall emissions.

- ix. BEC **supports** the new activity provisions outlined in the Bill. These will ensure new activities arriving in New Zealand will be eligible for allocations. BEC **recommends** the inclusion of economic considerations before the Minister adds (or excludes) a new activity from eligibility.
- x. BEC **recommends** new activity provisions are extended to existing activities with changing methods, inputs, products, fuels, and emissions. This flexibility ensures eligible activities continue to receive allocations when they change their activity, encouraging the changes that arise from decarbonisation.
- xi. BEC **supports** changes to the EAF's methodology. These will provide for a more accurate calculation and best reflect the pass-through cost of ETS obligations.
- xii. BEC **supports** the changes relating to information sharing with the MFE and the CCC. These ensure better decision making, if allocative baselines are reset.

## APPENDIX ONE – BACKGROUND INFORMATION ON THE BUSINESSNZ ENERGY COUNCIL

The [BusinessNZ Energy Council \(BEC\)](#) is a group of leading energy-sector business, government and research organisations taking a leading role in creating a sustainable, equitable and secure energy future.

BEC is a brand of BusinessNZ and represents the [World Energy Council](#) in New Zealand. Together with its members, BEC is shaping the energy agenda for New Zealand and globally.



BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups: [EMA](#), [Business Central](#), [Canterbury Employers' Chamber of Commerce](#), and [Employers Otago Southland](#)
- [Major Companies Group](#) of New Zealand's largest businesses
- [Gold Group](#) of medium sized businesses
- [Affiliated Industries Group](#) of national industry associations
- [ExportNZ](#) representing New Zealand exporting enterprises
- [ManufacturingNZ](#) representing New Zealand manufacturing enterprises
- [Sustainable Business Council](#) of enterprises leading sustainable business practice
- [BusinessNZ Energy Council](#) of enterprises leading sustainable energy production & use
- [Buy NZ Made](#) representing producers, retailers, consumers of NZ-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy. In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation ([ILO](#)), the International Organisation of Employers ([IOE](#)) and the Business and Industry Advisory Council ([BIAC](#)) to the Organisation for Economic Cooperation and Development ([OECD](#)).

