Submission of Carbon Market Solutions Ltd
On Improvements to the New Zealand Emissions Trading Scheme

CARBON MARKET SOLUTIONS

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The main point that Carbon Market Solutions Ltd (CMS) wishes to make as part of our submission is that New Zealand will not be able to meet its commitments under the Paris Accord using forestry alone. The One Billion Trees programme, while commendable, should only be a part of the overall policy package and not the main thrust of the Government's package. CMS would like to point out that gross emissions in New Zealand are dominated by the agricultural and energy sectors and that transport also plays an important role. CMS thinks that there is an excessive emphasis on forestry as the main policy tool to meet New Zealand's targets under the Paris Accord and that there are other options that need to be considered.

On the issues related to Improvements to the New Zealand Emissions Trading Scheme, CMS has the following points to make:

- **Government should not be involved in the direct purchase of international credits**: A Government controlled purchase of international credits will result in taxpayers bearing the brunt of the Government paying too much. Market risk should be borne by market participants trading carbon credits in New Zealand. Emitters, third party traders and financial institutions who can better negotiate the purchase of international credits shift the cost burden from the taxpayer. The private sector is well equipped to efficiently make a market and exchange carbon credits, thus providing the lowest cost to those stakeholders with compliance obligations.
  Rather, the Government should develop a policy and framework to ensure the integrity of the NZ ETS and manage the types of international units allowed for compliance as well as set a limit. International credits must be an integral part of a functioning ETS in New Zealand.
- **Auction proceeds should be for actual emissions reductions/climate change adaptation:**
  1. It is recommended that the Zero Carbon Act should have a directive that a minimum percentage if not all of the NZ ETS proceeds from auctions be channelled to a fund that is directly linked to emission reductions.
  2. These proceeds will allow the New Zealand government to fund large scale projects such as the 'One billion Trees' program where commercial incentives fail.
  3. Consequently, activities that generate emission reductions from this fund bolster the integrity and international standing of the NZ ETS and the NZUs that are issued.
- **Fixed Price Offer:**
  The current $25 FPO is inappropriate given the recent rise in the price of NZUs to meet this price ceiling. The $25 FPO limits genuine price-discovery by the market. It creates a perverse incentive for industries with compliance obligations to purchase unlimited units from the government rather than seek forestry units. As a result the $25 FPO needs to be urgently adjusted before 2020. CMS also supports the view to replace the FPO with a CCR price ceiling.
- **Auction Format:**
  CMS agrees with the proposal to implement a single-round, sealed bid auction format with uniform pricing, and believes auctions should be held quarterly or annually to limit transaction costs and allow adequate time for stakeholders to prepare for bidding.
  All NZ ETR account holders should be able to participate at auction.

In addition, CMS wishes to draw attention to two specific options that we think should be considered:

1. New Zealand should launch a new Domestic Projects Mechanism to incentivise GHG emission reduction projects in sectors outside the ETS

It is recommended that New Zealand establish a new Domestic Projects Mechanism to help meet its emissions reductions targets. New Zealand once had 'PRE-Projects' that sought out to reduce emissions. It is surprising that such a mechanism does not feature in the ETS review despite this model having global use in other ETSs. The New Zealand ETS currently works on the assumption that abatement will be met through carbon sequestration in forestry. The New Zealand government should consider the use of other Greenhouse Gas (GHG) reduction projects to meet their 2030 goal of a 30 percent reduction below 2005 levels.

There has been a 54.2 percent increase in net emissions since 1990; clearly depicting a failure to reduce emissions through domestic measures alone and a failure for forestry to really take off as envisaged when the ETS started back in 2008. It is noted that a large part of this emissions increase can be attributed to sectors not currently covered by the ETS. However a singular view of forestry as the only generator of NZUs or abatements in the NZ ETS severely limits the flexibility of the scheme and discourages other forms of emissions reductions practices. Sequestering carbon through forestry does nothing to address non-carbon emissions such as methane and nitrous oxide.

A Domestic Projects Mechanism will help address this imbalance in emissions reductions and provide cost effective emissions reductions, thereby helping New Zealand to meet its Paris Accord target.

The main goal of introducing a Domestic Projects Mechanism is to stimulate new emissions reduction projects in New Zealand, *in sectors that are currently not covered*. It is worth mentioning that Article 24a of the EU ETS Directive provides for a possibility to develop an offset instrument which could substitute project based mechanisms of the Kyoto Protocol. We believe that the Zero Carbon Act should contain a provision for a domestic projects mechanism, which could help tap into emission reductions in sectors not covered by the NZ ETS.

An example of how this worked in the past was landfill gas methane capture projects that flared the methane and reduced GHG emissions. CMS advised two landfill gas projects (Palmerston North landfill gas project and Christchurch City Council landfill gas project) with reducing GHG emissions, creating carbon credits, and selling them internationally in Europe. At the time, CMS was in discussions with other landfills in New Zealand that were interested to develop and implement similar methane flaring projects. When the Government cancelled the PRE mechanism these projects never took place.

To ensure the integrity of these Domestic offsets, quantitative and qualitative restrictions can be imposed on projects. California currently allows 8% from offset projects to be used for compliance. New Zealand could also implement such a measure in order to limit offset credits.

Concerns over potential double counting of emissions reductions can be mitigated through adequate tracking of NZUs through the emissions register. Issues around double counting will be avoided as New Zealand puts in place its MRV (Monitoring, Reporting and Verification) system.

In conclusion New Zealand:

1. Should establish a Domestic Projects Mechanism to increase the flexibility of the ETS

2. Limit the exposure to a collapse of forestry or limited uptake of forestry practices

3. Encourage sectors currently outside the scheme to invest in emissions reductions

4. Reduce the cost of compliance under the Paris Accord

2. Links to International Carbon Trading should be prioritized

New Zealand will only meet its 2030 emissions reduction target due to international trading and due to the fact that international carbon trading reduced the cost to the New Zealand economy of being in compliance; the importance of links to International Carbon Trading will be crucial for meeting commitments under the Paris Accord. New Zealand should commission a review of other ETSs to link to and subsequently execute a scheme to establish bilateral agreements with countries where there is an existing free-trade framework.

New Zealand needs to be laying down the groundwork now for potential bilateral agreements with countries to link ETSs. By aligning ETS regulation with other schemes, New Zealand would be well positioned to capitalise on the new Sustainable Development Mechanism (SDM) that emerges from the Paris Accord. It is important to note that the linking process can be lengthy given it took Switzerland 9 years to be able to link with the EU ETS. New Zealand should start bi-lateral negotiations now with selected countries and schemes, and the New Zealand Government should not be involved in the business of buying international units as this will end up costing the New Zealand tax payer more.

Evidence that the New Zealand government is not a good buyer of carbon credits can be found in the projects to reduce emissions mechanism when the New Zealand Government paid more than anybody else for units from several emissions reductions projects in New Zealand. This is an experience that should not be repeated.

The South Korean ETS provides a model of international credits for compliance use in a domestic ETS. New Zealand could follow this practice and allow units generated from UNFCCC mechanisms, either a new CDM or the new Paris SDM. South Korea, currently allows for 5% of the share of compliance obligations by companies to be made up of CERs that meet qualitative restrictions. These international CDM projects have to be developed by domestic companies in Korea. From 2021 to 2025 these offset credits can make up 10% of compliance requirements, of which a half can come from international offsets. New Zealand should also incorporate project elements from the Australian Carbon Farming Initiative to address sectors not covered:

- Agricultural emissions avoidance projects that limit methane and nitrous oxide through livestock, soil and crop management;
- Landfill emissions avoidance projects for capture, flaring and power generation from GHG;
- Animal emissions avoidance projects specifically targeting the avoidance of emissions from animal waste decomposition.

The Government should build on the experience of the New Zealand Projects to Reduce Emissions by emulating design elements of the Korean ETS or the Australian Carbon Farming Initiative. It is recommended that New Zealand Offset Credits (NZOCs) be established for use in domestically certified emissions reductions. Similar to Korea, New Zealand could make NZUs the allowance unit and NZOCs the offsets. NZOCs can then be exchanged for NZUs (for compliance) or allow them to be traded internationally. *This framework allows a controlled introduction of domestic offset credits and international units that will maintain the integrity of NZUs.*

In conclusion:

1. A key component of being able to link schemes and international carbon trading will be through the active participation in the Sustainable Development Mechanism (SDM) and in getting this mechanism up and running in the shortest possible time frame. This means adopting the CDM methodologies (with restrictions) to avoid re-inventing the wheel.

2. New Zealand should prioritise a bilateral agreement with South Korea to link schemes because the South Korean Scheme is the first to allow CERs and CER successor units from the Paris Accord.

3. New Zealand should prioritise a bilateral agreement with Australia to link schemes as New Zealand and Australia are natural trading partners.

4. Providing New Zealand businesses access to the international carbon market will allow NZU prices to align with the international prices for carbon, avoiding the possibility that New Zealand is paying a much higher price than the rest of the world for emissions reductions.

Thank you for taking the time to consider our submission

Sincerely,

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