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Reforming the NZ ETS: Rules for auctioning
Ministry for the Environment
PO Box 10362,
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Via email: etsconsultation@mfe.govt.nz

SUBMISSION ON Reforming the NZ ETS: Rules for auctioning

Background

Horticulture New Zealand, along with Tomatoes New Zealand Incorporated and Vegetables NZ Incorporated, welcome the opportunity to provide feedback on 'Reforming the NZ ETS: Rules for auctioning'.

Horticulture New Zealand (HortNZ) represents the interests of New Zealand's 5,000 commercial fruit and vegetable growers who grow around 100 different crop types and employ over 60,000 workers. The horticulture industry is valued at over $6 billion annually to the New Zealand economy and continuing to grow. Land under horticultural crop cultivation in New Zealand is calculated to be approximately 126,000 hectares.

Tomatoes New Zealand Incorporated (TomatoesNZ) is the national organisation representing New Zealand's 125 fresh tomato growers, almost all of whom grow in greenhouses. The fresh tomato industry has an annual farm gate value of $124m (March 2019), including export sales of about $10m per year.

Vegetables New Zealand Incorporated (VNZI) is the national organisation representing 550 fresh vegetable growers with a total gate sale value of over $420m, including approximately $40m in export sales. This includes approximately 120 greenhouse growers of crops including capsicums, eggplants, cucumbers, lettuces, chilies and herbs.

A 2018 report by NZIER evaluating the contribution of the covered (greenhouse) vegetable crop industries to New Zealand[1] found:

- Gross output (or turnover) of $295 million
- Contribution to GDP of $120 million
- 2,400 jobs
- Exports of $35-$40 million per year
- Spending of $34.3 million on heating (including electricity, coal, gas)
- This is an important industry for New Zealand, attracting stable jobs and skills in a growing market for covered crop products. It makes important

[1] Valuing covered crops. A national perspective. NZIER report to TomatoesNZ and Vegetables New Zealand, March 2018

contributions to GDP and general wellbeing through the employment it provides, exports it makes, and an increased use of technology.

- Is a stable and growing industry which provides a significant contribution towards diversifying the New Zealand economy
- Helps to diversify the revenue sources for companies involved in agriculture and horticultural industries.

Impact of ETS – covered crops

Covered crop growers of tomatoes, capsicums, eggplant and cucumbers are currently captured in the New Zealand Emissions Trading Scheme (NZ ETS) via NZ units charged by energy providers (coal and gas) for greenhouse heating fuel. These growers have access to free allocations via the Emissions Intensive Trade Exposed (EITE) scheme. These free allocations offset the ETS costs to varying degrees depending on location. South Island greenhouses are subject to a cooler climate so require more heating; and because most rely on coal are impacted by high ETS costs, as there is no access to natural gas in the South Island.

Indoor tomato, capsicum and cucumber growers who have applied for units under the allocation scheme are all ETS account holders.

In the South Island, where coal is the primary source of heating for glasshouses, growers incur a higher ETS cost and these costs are not fully recovered by the free allocations they receive. For example, at an NZU price of $25, we calculate the average net cost of the ETS (after allocation) on heating costs for a South Island tomato grower is $26,693 per hectare. At an NZU price of $50, this rises to a net cost of $53,386 per hectare.

Growers have refined their growing techniques over the past 5-10 years in an attempt to produce enough volume in winter to supply the market and keep prices stable. However, it would not be possible to continue producing at the current level without ready access to heat, plus Carbon Dioxide (CO^2) augmentation to enrich growing.

Whilst growers have made significant gains in yield and energy efficiency over the past 10 years, the current infrastructure is reaching its limits and there are not many opportunities for future improvements without significant re-investment in new greenhouses and/or energy technologies. This will not happen without certainty of ETS settings; cost-effective technological solutions involving alternative energy sources and/or energy saving; a reasonable transition period and support to make transition a feasible business prospect for growers.

NZ consumers are unlikely to be willing to pay higher costs for produce. Thus managing the ETS Auction Cost Containment Reserve effectively will be important to prevent production costs rising so high that growers are put out of business, particularly in the South Island, because they cannot pass on the costs to consumers.

The alternative is that in the future these vegetables will not be grown in New Zealand for substantial periods of the year and instead be imported, which we believe would have negative social and economic consequences. For example, people would no longer have access to locally grown produce that is fresher than imports; biosecurity risks will increase from the imported products; jobs and export income will be lost; and New Zealand's own food security (ability to provide its own fresh vegetables) reduced. Additionally, those countries that the produce is imported from may not face the same carbon charges that our growers face, or they may pay a

different price, or they may produce with much higher emissions than NZ growers – i.e. the potential for Carbon Leakage.

There has been an increase in the types and volumes of crops grown indoors for domestic supply, including lettuces, herbs and berries. These crops do not currently have access to free NZU allocations despite also paying ETS costs on their heating. Indoor growing is becoming more popular worldwide including in New Zealand because it mitigates the risks associated with unpredictable climatic events, requires less water per unit of output, and produces more consistent, high quality products.

Covered cropping is vital to ensuring New Zealander's ability to access freshly grown vegetables from a local supplier throughout the year. To protect this in the future, support for indoor growers to access energy saving technology and assistance with capital for conversions and energy saving measures from government is vital.

Impact of ETS – wider horticulture sector

Horticulture has an important role to play in a low emissions future, however in order for horticulture to expand substantially, ETS costs need to be considered and barriers removed. Currently for covered crop growers energy is the second highest single input cost (~30%), following closely behind wages. ETS costs are also present for transport, refrigeration and fertiliser, for all horticulture enterprises.

Horticultural producers are mostly small to medium sized businesses with a few larger corporates in some sectors. Changes in costs can have a dramatic effect on the ability of these businesses to remain profitable and continue to offer job opportunities to New Zealanders. Horticulture is a significant employer and a key factor in the maintenance of provincial New Zealand's cultural and social wellbeing. New Zealand's unsubsidised horticulture sector is highly efficient but is also highly exposed to competition from moderately to highly subsidised overseas producers[2].

Successive New Zealand governments have worked hard to remove barriers to trade. It would be counterproductive for New Zealand governments to impose costs to New Zealand producers that would counter these free trade gains and policies that would reduce New Zealand's emissions-efficient food production. Any loss of New Zealand's food production ability would likely be taken up by much less emissions-efficient producers overseas who are not facing the same costs[3]. That would be to the detriment of the climate change initiative.

The 2015 Paris Agreement (and its predecessor the Kyoto Protocol), is strong on ensuring global food security and not reducing food production. New Zealand's unsubsidised, but highly efficient, primary sector is highly exposed to competition from moderately to highly subsidised producers[4], for example New Zealand's pipfruit is the highest per hectare producer, with relatively low inputs. If our costs rise and make us uneconomic there will be an increase in emissions as higher emitting producers stay in place.

Rising ETS costs will impact on the wider horticultural sector by increasing costs of transport and costs of running on-farm machinery. Horticultural production makes use of higher numbers of on farm vehicles per hectare compared with pastoral agricultural land use.

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[2] Statistics New Zealand: "Red, ripe, and really versatile: tracking tomato prices in the CPI" http://archive.stats.govt.nz/browse_for_stats/economic_indicators/CPI_inflation/tracking-tomato-prices-in-cpi.aspx

[3] OECD Producer Support Equivalents show 1% for New Zealand compared to 18% average across the OECD,21% in the EU and in some countries as high as 60%.

[4] Refer above.

As in other countries, the transition away from fossil-fuel vehicles is feasible and occurring in public transport and light private transport. There currently are no feasible options for growers to convert heavy on-farm machinery to non-fossil fuel vehicles. Regulation on emissions intensity of vehicles in other countries has seen the forced obsolescence of older vehicles, which improves emissions intensity, but negatively impacts the life cycle assessment of vehicles and total emissions.

Some of the costs of reducing emissions that will be borne by the horticulture sector via the ETS or otherwise, will either be passed on to consumers, or result in significantly reduced domestic supply. For example, most of the vegetables grown in New Zealand are for domestic consumption, and increasing costs of vegetable production may threaten the ability of growers to continue to provide fresh affordable vegetables for New Zealanders.

The expansion of horticulture, in place of animal-based agriculture, has been identified as a method of reducing NZ's overall emissions. While HortNZ agrees that horticulture is an efficient land use, this should not be negated by ETS settings that discourage or prevent that expansion.

Another point to note is an international move towards more covered cropping. This move will be essential to adapt the food production system to the changing, more volatile world climate while still producing enough food, in a way that also uses less water and nutrients. Climatic variability, along with increased global demand for fresh produce, is already resulting in a move to more indoor crop production, meaning that those factors impacting the current covered vegetable crop sector will begin to extend into other crops.

Responses to consultation questions

Our responses to relevant questions in the consultation document are included on the enclosed submission form.

Yours sincerely,

Mike Chapman
Chief Executive
Horticulture New Zealand

Helen Barnes
General Manager
Tomatoes New Zealand Inc.

Antony Heywood
General Manager
Vegetables New Zealand Inc.

Questions

1 Do you agree that auction volumes should be evenly distributed over the calendar year?

- **Yes;** auction volumes should be evenly distributed over the calendar year, for maximum price transparency and to avoid price shocks.
- No
- Unsure

2 If no, do you have a suggestion for how volumes should be weighted?

N/a

3 Do you think that unsold units should be:

- **All added to the next auction;** for certainty, to minimise potential market manipulation and to stay close to market-driven principles.
- Added to subsequent auctions within a limit (preferred)
- Other, please specify

4 If unsold units are only added to subsequent auctions within a limit, what should it be?

5 Other than public holidays, and days when important economic or emissions data is released, are there any dates when auctions should not be held?

6 The surrender date in the NZ ETS is 31 May. How far in advance of this date should the closest auction be scheduled? Please consider both monthly and quarterly auction scenarios.

7 Do you agree that the bidding window should be three hours, from 9am to 12 noon on the scheduled auction date?

- **Yes** (as long as the prescribed window works for bidders if they if they have a head office based off shore, so as to maximise the opportunity to receive bids. This may require further investigation but agree to a three-hour window).
- No
- Unsure

8 When a price trigger is reached in the cost containment reserve, how should the volume of units from the reserve be sold?

- **In a separate reserve auction open to all registered participants (preferred)**
- In a separate reserve auction with participants limited to those with surrender obligations
- In the same auction that triggered the reserve

9 If you support option 2, should the units sold in the reserve auction be limited for use to meet surrender obligations?

- Yes
- No
- Unsure

10 Do you agree that the cost containment reserve should have a single price trigger for all the reserve volume?

- **Yes**

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- No
- Unsure

11 How far in advance should the auction notice be published?

- 60 calendar days (only an option if auctions held quarterly)
- **30 calendar days**
- Other, please specify

12 Do you have any comments on the pre-registration process?

13 Do you agree that an intention to bid form must be submitted a minimum of 28 calendar days in advance of an auction?

- Yes
- **No.** The time period should be shorter e.g. 10 -15 days, to maximise the opportunity to be able to bid.
- Unsure

14 Do you agree that bidders should have to provide collateral to participate in an auction?

- **Yes**
- No
- Unsure

15 If collateral is required, how much should it be?

- **Between 10 and 25 per cent of the maximum bid value (preferred)**
- 100 per cent of the maximum bid value
- A flat rate payment, please specify amount
- Other, please specify

16 What forms of collateral should be accepted?

- **Cash**
- **Bank guarantee**
- **Irrevocable letter of credit**
- Credit rating (not preferred)
- Other, please specify

17 How many days before an auction do you think is sufficient lead time for provision of collateral (Government suggests 5 business days)?

Five business days.

18 Do you agree that collateral (depending on its form) should be used against payments for successful bids, if the bidder requests?

- **Yes**
- No
- Unsure

19 Do you agree that bidders should be able to choose to have their collateral automatically returned, released at their request, or retained for future auctions?

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- **Yes** (if the bidder requests).
- No
- Unsure

20 What should be the minimum number of NZUs that can be sold at auctions?

- **100 NZUs** to allow small participants to participate.
- 500 NZUs (preferred)
- 1000 NZUs
- Other, please specify

21 Bids are only accepted in multiples of minimum lot size. What should the minimum lot size be for auctions?

- **100 NZUs**
- 500 NZUs (preferred)
- 1000 NZUs
- Other, please specify

22 What should the minimum price increment be?

- $0.01–$0.02
- **$0.05 (preferred)**
- $0.10
- Other, please specify

23 Do you think a maximum bid limit should be set?

- **Yes**
- No
- Unsure

24 If set, should the maximum bid limit apply to:

- **All bids made by a single participant**
- All bids made by related participants

25 If there is a maximum bid limit, what should it be?

26 How do you think tied bids should be resolved?

- Random assignment to the entire bid
- Random assignment by lot (preferred)
- On a pro-rata basis, with rounding
- Other, please specify

27 Do you agree that a technical reserve price should be set for auctions?

- Yes
- **No**, we do not feel this will be necessary.
- Unsure

28 If a technical reserve price is set, do you agree that the methodology for calculating the

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price be kept confidential?

- Yes
- No
- Unsure

29 What results should the auction operator publish as soon as practicable following an auction? Please select all that apply. (All those listed below)

- **Clearing price**
- **Total volume of units auctioned**
- **Total volume of bids**
- **Average bid size**
- **Number of bids**
- **Cover ratio (total volumes bid divided by total volumes for sale)**
- **Total number of bidders and the number of successful bidders**
- **Number of unsold units, if any**
- Other, please specify

30 What is the best approach for settlement of successful bids?

- **Payment before delivery (preferred)**
- Delivery versus payment
- Other, please specify

31 Do you have a view on the time for settlement (suggested it may take 4 business days)?

Four business days

32 What information should the auction monitor report include? Please select all that apply.

(All of those listed below)

- **Detailed volume statistics, (eg, average volume bid per bidder)**
- **Detailed statistics on number of bids, (eg, average number of bids per bidder, number of bids submitted, number of successful bids)**
- **Relevant aggregate information (eg, largest bids as percentage of total volumes sold, percent of volumes awarded to entities with mandatory obligations)**
- **Relevant distributional information (eg, number of units awarded to which winner, with bidder names withheld)**
- **Distribution of successful bids among market participants with and without mandatory compliance obligations**
- **Relevant information to resolve tied bids**
- Other, please specify

33 Do you think that releasing information on the number of NZUs won by each successful bidder, who will not be named, would raise any issues of data confidentiality?

No

34 Does auction monitor reporting raise any concerns for you with respect to commercially sensitive information.

Questions

35 How often do you think the auction monitor should review the auctioning system?

- **After one year initially, then every two years thereafter (preferred)**
- Annually
- Other, please specify

36 Do you have any other comments?