

Joint Consultation response

Forestry in the ETS: Proposed updates to cost recovery tranche two.



Submitters:

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Response overview

This is a joint submission by ETS forestry service providers. Together, we represent 35% of ETS forestry participants.

Overall, we strongly disagree with the cost recovery proposed by this consultation. We believe the proposal is flawed, short sighted and deeply inequitable. We also believe that there has been a concerning lack of engagement with industry players such as us, which has exacerbated the flawed nature of these proposals.

Firstly, we disagree on the grounds on which this proposal was put forward, i.e., a higher proportion of ETS costs should be covered from forestry participants as opposed to taxpayers.

Secondly, some of the proposed fees, particularly the annual per hectare fee, are financially unworkable and unfairly distributed amongst participants.

Thirdly, increasing fees to such a high level for existing registered forest owners is inequitable and an act of bad faith by the Crown.

Fourthly, the consultation is premature. Major changes to the ETS were only implemented this year, and the new Tupu Ake system was released late February. We believe that the consultation would be better timed in 2024, once the new systems and policies have been bedded in, and after Tupu Ake and Te Uru Rākau performances have undergone an independent review.

1) Forests' environmental services are not properly valued.

The consultation undervalues the contribution of forests to New Zealand.

We believe that forests represent a fundamental public good to New Zealand, particularly in meeting the country's climate targets. Therefore, the Crown should cover most of the costs incurred in running Forestry in the ETS. We acknowledge and accept that ETS forestry participants should contribute towards the running of the ETS to promote the efficient use of the system and officials' working time. However, this should be based on user-pays, not annual charges; all ETS participants should pay (especially emitters), and services delivered by Te Uru Rākau must improve significantly.

Forests provide a public good for all New Zealanders, often without recognition for the owners. Primarily, forests play an integral role for New Zealand to meet its international climate commitments. Furthermore, they provide vast non-monetized benefits to the health of our nation including erosion control, cleaner water, and biodiversity gains.

We estimate the carbon stored by privately owned post-1989 forests under average accounting to be valued at \$3.26 billion dollars to the Crown in meeting international climate targets, with little of that value passed on to forest owners.¹ \$3.26 billion would cover the ETS costs associated with forestry set out in the proposal for 109 years. One source of funding could be from ETS auction revenue, which generated \$1.9 billion in 2022. Just 1.4% of the auction revenue would cover the forestry costs.

¹ The Crown uses average accounting for post-1989 forests for its international reporting but did not pass on that benefit to private forest owners. The figure of \$3.26 billion is calculated conservatively as follows; 480,000 hectares of *Pinus radiata*, an average weighted age in 2008 of 11 years old, 115tCO₂ per hectare removed from age 11 to 16 years under averaging accounting, a carbon price of \$59 per tCO₂. \$3.26B= ((480,000ha x 115tCO₂) x \$59 per tCO₂)

We note with concern that no other ETS activity, including both removal and emitting activities, are subject to cost recovery provisions.

We acknowledge that ETS forestry participants should pay for some ETS services provided by the Crown, but this should at most be raised to 15% of *reasonable* operating costs, and other ETS activities (particularly polluting industry) should be subject to the same cost recovery requirements.

2) Fees Financially Unworkable and Unfairly Distributed

The financial modelling within the consultation is based on flawed assumptions and a gross misunderstanding of how the ETS benefits many forestry participants.

The consultation assumes carbon income is hugely profitable for ETS forestry participants, generating \$5 billion annual value in forest backed New Zealand Units (NZUs). This is an incorrect assumption, particularly for small (<100 hectare) and medium (100-499 hectare) timber forests.

Many ETS timber forests have no NZUs that can be sold without incurring a repayment obligation at harvest. We estimate that 70% of ETS participants covering 160,000 hectares have zero NZUs to sell. Larger timber forests (>500 hectares) may have some carbon to sell without repayment at harvest due to scale and stand diversity. However, the 'low risk' NZU level will generally be no more than the 25% of the total NZUs issued and can be as low as zero.

For participants that have NZUs to sell, the income potential decreases considerably as forests age (e.g., permanent forests), or stop completely within a few years (e.g., averaging forests), and the amount of NZUs vary considerably between species groups.

We also believe a user pays model is best suited to cost recovery instead of annual charges. However, if service fees were to increase, this must be done alongside a considerable improvement in the quality of services delivered by Te Uru Rākau.

a) Annual Fee of \$30.25 per hectare

The annual fee is most problematic because:

- it is too high.
- it has no end date.
- it does not differentiate between participants.
- it incorporates services that should be weighted towards user pays.

The current cost of ETS participation in most cases is relatively low, with many participants opting to file emissions returns once every five years. The proposed annual fee completely changes this dynamic, and if implemented, would outweigh the benefit of remaining in the ETS for many participants who have little or no carbon to sell.

The proposed annual charge would also be the single highest cost associated with participation, and far higher than any consultant cost.

Example: a 50-hectare participant, can expect to pay a consultant around \$1,000 to file the final emissions return every five years. The proposed annual ETS charge is 750% higher at \$7,5625.50 for the same period.

Example: for a 3,000-hectare participant, consultant fees could be as high as \$100,000 every five years covering field measurement, provisional and final emissions returns and

other specialist consulting. The proposed annual ETS charge adds another \$453,750 for the period, an increase of 454%.

This outcome is even bleaker for species other than radiata pine, where a flat annual charge per hectare would disproportionately prejudice native forests and other slower growing species.

Example: radiata pine earns double the NZUs as Douglas-fir by age 30, and 3.5 times that of indigenous forest (according to the the default look-up carbon tables).

Therefore, a blunt fee will lead to an even greater incentive to plant radiata pine to the detriment of alternative species, particularly indigenous species.

Furthermore, the fee does not differentiate between the different earning NZU potential for difference types of forests. We outline some examples below:

Example: a timber forest planted in 1995 has no low risk saleable NZUs. They joined the ETS to keep the carbon option available under stock change.²

Example: a timber forest planted in 2008 under stock change, may have up to 20% low risk saleable NZUs. All have been earned and sold by 2017 at an average carbon price of \$20. They have no more saleable NZUs.

Example: a timber radiata forest under averaging has 16 years of saleable NZUs. Once they reach 16 years, no more NZUs are earned.

Example: a permanent native forest under stock change, is earning only one NZU per hectare per year by age 50.

Example: a permanent forest affected by an adverse event will stop earning NZUs for up to 14 years.

We believe the possibility of paying an annual charge forever, when the registered forest only earns income for a small number of years, or worse, earns no carbon income, will lead to unintended consequences. The main impact will be a large of number of landowners leaving the ETS and ultimately being put off the ETS altogether (and not planting more trees). In addition to this, many timber foresters will be tempted to switch to permanent carbon forests. We have already been noticing a shift for small forest owners, who have decided to opt into the permanent scheme to benefit from the stock change accounting. Their primary purposes have shifted from timber to carbon.

This will lead to multiple flow-on effects including:

- unemployment in the timber industry.
- a decrease in the domestic wood supply.
- a decrease in foreign export earnings, and.
- an increase in forestry NZUs available to emitters.

We believe over 50% of the services the annual charge covers should not be socialised across all participants and should be based on a user pays model (Services 23 and 26).

² Importantly, these forests were pressured to register in 2022 due to the introduction of averaging accounting. These forests are contributing to New Zealand's Greenhouse gas inventory and they deserve to be rewarded for it. If they had not joined the ETS, they would have the option to deforest without ETS liabilities.

Example: an ETS participant has not used a professional service provider which results in bogging down Te Uru Rākau with enquiries and compliance issues: why should other compliant and efficient participants who use professional services subsidise this?

Finally, if an annual charge were to go ahead, it should be for a limited time only. It should target those who can afford it and the key challenge is on Te Uru Rākau to lower their operating costs over time.

b) Core and Non-core Fees

We reiterate that fees should be based on user pays and not socialised. Some fees appear extremely high and unwarranted.

It is impossible to see how the proposed costs were determined given some services have not yet been implemented, and therefore there is no track record to justify how the numbers were determined.

We are particularly concerned about how some of the higher fees will impact smaller participants.

Example: service 8, reconfiguring a forest area is expensive at \$6,600 (40 hours). This flat cost is unfair for parties wishing to reconfigure one or two carbon accounting areas versus a large participant wishing to amend multiple carbon accounting areas.

Example: service 20, apply to suspend accounting on forest cleared due to a temporary adverse event at \$4,207.5 (25.5 hours) will disproportionately impact smaller participants.

We believe Te Uru Rākau should revisit how these fees are calculated, and switch to a scale and user pays model. This could include revisiting the cost of emissions returns, for instance by charging more for larger participants than the current flat fee of \$165 +GST.

3) It is unethical to retrospectively impact registered participants.

We furthermore believe there is an ethical issue around introducing a new annual charge fee for existing registered participants. This is unjustifiable when ETS participants could not have foreseen those costs. Many landowners have spent considerable effort and expense in participating in the ETS over the years, even with little prospect of carbon income, with the expectation that ongoing fees would be relatively minor. Some may now consider cutting their losses and exiting the ETS as opposed to paying annual charges forever, with little to no income potential. However, leaving is not an option for many participants who have sold some NZUs.

This major issue highlights another unique aspect of forestry in the ETS and why this proposal is particularly unequitable for existing participants. Participants who have sold NZUs must re-purchase NZUs if they wish to leave the ETS.

Example: a participant who sold NZUs at \$15 would now have to buy out of the ETS at \$60 per unit. An unaffordable cost.

The precedent set by this proposal will have a chilling effect on people's confidence in the ETS, other similar policies, and considerably challenge trust in Government. If fees can be changed at the whim of Government, then it likely will happen again to unsustainable levels. The distrust that this proposal will create will mean less farmers, Iwi, and investors are likely to commit their land to forestry, precisely at a time when the country needs more trees to combat climate change. This is particularly relevant as New Zealand committed to purchase \$12.8 billion in carbon credits offshore to meet its climate change target.

4) Poorly timed consultation

Finally, the timing of the consultation is premature. Many of the service fees covered by the proposal have only been introduced since 1st of January 2023 and are not yet operational, for example, Service 8, reconfiguring forest areas. Therefore, it is impossible for Te Uru Rākau to estimate these costs. More importantly, the new Tupu Ake system has been operational for only three months and is suffering major teething issues. We would expect this system to return administrative and operational efficiencies after some time. Until such time, it is unfair to charge participants for the implementation of a flawed system.

The group strongly believes that if Te Uru Rākau introduces increased fees then the timeliness and accuracy of services must first improve dramatically. We believe there are systemic issues within Te Uru Rākau's delivery of the ETS that must be addressed to bring down operating costs and considerably improve services. This includes urgently moving away from a micro administrative model, towards a more pragmatic and proportionate approach, particularly in dealing with compliance issues. For example, for errors in historic emissions returns, Te Uru Rākau currently unwinds all returns dating back to the historic issue. Often a simple fast pragmatic solution is overlooked in favour of complex paths to corrective action that can take years to complete.

Consultation questions

1. Do you agree with the proposal to introduce new fees relating to 22 services? What are the reasons for your answer?

Agree with some, not others. As per above but specifically,

- Weight service fees towards user-pays (at least scaled based). For example, service 8 should be based on number of CAAs affected.
- New services seem too high without operational track record to justify costs evidence. For example, service 20, apply to suspend accounting on land cleared by a temporary adverse event.
- Pre-1990 forest related services should have no charge given it is a mandatory emitting activity. For example, services 17, 18, 21, and 22. Charges should only apply if all ETS emitters face similar charges.

2. Do you agree with the proposal to introduce a new annual charge relating to six services?

What are the reasons for your answer?

No- as per above but specifically,

- Weight service fees towards user-pays. For example, service 26 and 27 should be charged to users when service is used.
- Fees should not apply to existing registered participants, especially those who cannot afford to exit the scheme.

3. Do you have any comments around MPI's assessment around the four cost recovery principles?

As per above but specifically,

- **Transparency:** many of the costs cannot be allocated transparently given the lack of time passed since the implementation of the new rules and Tupu Ake system.
- **Justifiability:** the costs are not reasonable, particularly given the lack of quality of the services provided.
- **Efficiency:** We believe annual costs of \$29.8M indicate a grossly inefficient service provider and they should be much lower. We also believe the taxpayer should carry a far greater proportion of costs given the benefits forests provide to New Zealand.
- **Equity:** we believe the Taxpayer is a major beneficiary and therefore should pay. We also have proven that many ETS participants do not benefit. Finally, unreasonable fees are inequitable for those who cannot afford to exit the ETS.

4. Please describe any impact the proposed fees and the annual charge might have on you and/or your business/organisation. Quantify this if possible.

As per above but specifically,

- Promote forests leaving the ETS.
- Motivate switching from timber to permanent forests.
- Increase the sale of NZUs from forests.
- Promote radiata pine over other species such as indigenous forests or slower growing species.
- Disproportionately impact smaller participants
- Disproportionately impact Māori landowners by imposing another barrier to entry for landowners who are already underrepresented in the ETS, and who Government are committed to increasing ETS participation levels.
- Erode rural landowner trust in the ETS and the Government

5. Are there any other issues with the proposed fees and the annual charge that you think Te Uru Rākau – New Zealand Forest Service should be aware of?

See above.

6. Are the proposed methods for apportioning costs between participants reasonable? Could they have a disproportionate impact on certain participant types or groups? Please provide examples of impacted groups if disproportionate impacts and are foreseen, and the drivers for this.

See above.

7. To what extent do you perceive potential unique implications for Māori because of the proposed cost recovery settings? What are the reasons for your opinion?

The proposed changes will discourage Māori from entering the ETS. This seems counterproductive as Māori land is underrepresented in the ETS and Government wish to increase Māori participation.

Governance structures and decision-making process for Māori are complex and can be time consuming. As such, the increased fee proposals will create a further barrier to entry. Māori land cannot be borrowed against given the ownership structures, and without a funding partner in place (which is not always viable on remote, isolated, small, and degraded lands), a natural regeneration option is often the only viable way to enter the ETS.

These natural regeneration options are further prejudiced against in the above proposals given their slower growth rates and carbon volumes. This will ultimately lead to a perverse outcome of less Māori participation in the ETS, on the erosion prone Class 6, 7, and 8 land that often characterises Māori land.

8. Do you feel the annual charge is reasonable, do you consider there will be differing impacts from the annual charge on various forest sizes/type or accounting approaches?

See above.

9. When considering the services provided, how do you think any ongoing annual charge should interact with forests that are under averaging accounting once the long-term average carbon stock has been reached.

See above.