

12 January 2023

Environment Committee

By email: en@parliament.govt.nz

Submission on Sustainable Biofuel Obligation Bill

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy advocacy organisation. We enable collaboration across the energy sector and with government, through and beyond New Zealand's transition to net zero carbon emissions by 2050.
2. This document constitutes Energy Resources Aotearoa's submission to the Environment Committee on the Sustainable Biofuel Obligation Bill (the Bill).¹
3. We wish to speak to this submission if the opportunity is available.

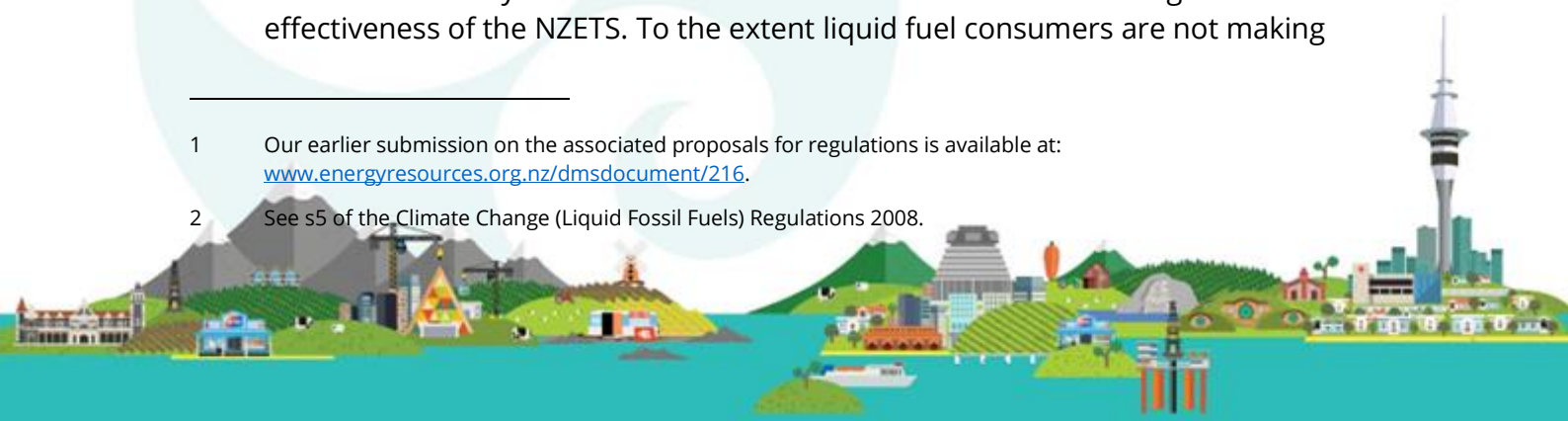
General comments

Fuel-selective policies such as mandates are not the most efficient means to realise net emissions reductions

4. Fuel-selective mandates or bans such as the Sustainable Biofuels Obligation (the Obligation) are generally not the most efficient or effective means to achieve their stated policy outcome (this being the reduction in net emissions).
5. This is particularly the case given the transport fuels sector is already subject to the quantity-capped New Zealand Emissions Trading Scheme (NZETS). As a result, fuel consumers already face a transparent and increasing carbon price that progressively lifts incentives to reduce consumption or switch to cost-effective alternatives over time. The NZETS further incentivises biofuel uptake by 'zero rating' the emissions of the biofuel content of fuels.²
6. The NZETS price will drive demand reduction and fuel-switching decisions at the margin, where consumers are most sensitive to price changes. Critically, a whole-of-economy view should be taken when it comes to assessing the effectiveness of the NZETS. To the extent liquid fuel consumers are not making

1 Our earlier submission on the associated proposals for regulations is available at: www.energyresources.org.nz/dmsdocument/216.

2 See s5 of the Climate Change (Liquid Fossil Fuels) Regulations 2008.



these demand reduction and fuel-switching decisions, this indicates such decisions are being made elsewhere in the economy.

7. The risk is that the Obligation falls victim to the 'waterbed effect', whereby emissions are simply 'rearranged' within the quantity cap of the NZETS, imposing higher than necessary national economic costs with little or no corresponding net emissions benefit arising from the measure.
8. To the extent barriers to biofuels uptake persist, there may be some government role in supporting research and development, addressing information gaps, and/or addressing regulatory barriers to use of biofuels (such as aligning standards).

Policy objectives for an effective biofuels obligation

9. Having noted our general position on fuel mandates, our priorities for the Obligation are to ensure that it is, as much as possible:
 - technology- and fuel-neutral;
 - market-based (and over the long term sustainable in a competitive market);
 - based on robust analysis of actual carbon intensity and net emissions outcomes; and
 - aligned with global best practice and standards.
10. These priorities directly inform our submission on this Bill. Aligning the Obligation with them will minimise the cost and complexity for fuel suppliers and consumers, at a time when the fuel industry already faces significant uncertainty and rising costs as we chart the low-emissions transition.
11. This means maximising flexibility in the regime and ensuring the emissions intensity reduction targets reflect a balance between ambition and pace. Meeting the Obligation will require significant infrastructure investment from fuel suppliers – MBIE's latest estimates are in the order of \$80 million – and much or all of these will need to be passed to consumers. It is critical that the regime is workable and limits costs where possible.

We welcome the inclusion of measures that will smooth the implementation of the Obligation

12. We welcome the Bill's inclusion of several elements that reflect our preference for as much flexibility as possible to reduce cost and complexity for suppliers and consumers. These include:
 - the Government's decision to defer implementation of the Obligation to April 2024, in recognition of its likely fuel price implications and the need for more time to plan for implementation; and

- an ongoing deferral mechanism of 10% (up to 20% with Minister's approval) of a supplier's biofuel obligation volume in any given year; and
- the ability for obligated fuel suppliers to trade emissions reductions with each other.

We suggest more could be done to maximise flexibility in delivering the intended policy outcome

13. Our previous submission made further suggestions about how the Obligation could incorporate more flexibility in achieving the intended policy outcome. These could varyingly be implemented through the Bill and/or the Regulations. We repeat these here for the Committee's reference:
- given the intended policy outcome is net emissions reductions, the Obligation ought to allow for fuel suppliers to meet their emissions intensity reduction obligation using any range of lower-emissions fuels (rather than specifying it must be met using biofuels);
 - rather than a uniform assumed emissions intensity for fossil fuels, fuel suppliers ought to be able to certify the life cycle emission of particular products so as to recognise supply chain and process efficiencies that achieve emissions reductions; and
 - rather than excluding specific fuel types, residues, or co-products, utilising calculations to certify their acceptability on a more case-by-case basis.

Relegating penalties to regulations

14. We suggest that the penalty for non-compliance – currently proposed at \$800 per tonne of CO₂ – be set in regulations, with regular review to ensure it remains appropriate in the circumstances. This is important because growing global demand (competition) for biofuel feedstocks may place significant upward pressure on prices.
15. Significant spikes in biofuel costs could result in a situation wherein triggering the non-compliance penalty would impose lower costs to consumers than supplying biofuels (with corresponding emissions abatement required elsewhere in the economy).
16. We also suggest the penalty could be replaced with a buy-out scheme, as implemented in other jurisdictions overseas. This would set a price in regulations at which an obligated supplier could “buy out” of their obligation, on a dollars per litre or dollars per tonne (of emissions) basis. This would create a cap on the maximum costs which can be incurred by consumers because of the policy. Being set in regulations, it could be reviewed frequently to reflect prevailing economic conditions, biofuel costs, and the cost of carbon.

17. This could complement the deferral mechanism in instances where the 10% volume deferral (up to 20% with the agreement of the Minister), is insufficient to mitigate significantly elevated costs arising from global prices and/or supply constraints. We see this as a possible scenario given growing global competition for biofuel feedstocks.

We suggest a review of related regulatory regimes to ensure the regulatory burden is minimised

18. The refined fuels sector has undergone significant regulatory change in the past few years, so we suggest it is worthwhile reviewing related regimes considering the Obligation. Examples of the interdependencies that should be reviewed or monitored include:
 - a timely review of the Engine Fuel Specifications Regulations 2011 ahead of the implementation date of the Obligation, to ensure the market has clarity about how biofuel blends will be treated;
 - the interaction between the Obligation and the Fuel Industry Act 2020, including whether the terminal gate pricing exclusion for biofuels should be retained and addressing situations in which an obligation for a wholesaler to supply conflicts with their meeting the Sustainable Biofuels Obligation. We note MBIE officials intend to monitor this situation closely (though do not propose any changes at this stage); and
 - assessing consistency of treatment across all type of biofuels under the Customs and Excise Act 2018.

Specific comments on the Bill

Section 11: Emissions intensity reduction percentages

Reviews of the emissions intensity reduction percentages should specifically consider the cumulative fuel price impacts of multiple policy instruments

19. In reviewing the emissions intensity reduction percentages that will apply to each year, Section 11(3)(b)(v) of the Bill requires the Minister to have regard to, among other things, “the extent to which any likely increase in fuel prices as a result of the percentages can be absorbed by the New Zealand economy without undue detriment to economic activity”.
20. This implies the Minister could – and in our view, should – take a broader view of the impact of likely fuel price increases, including other factors driving those prices (such as global commodity prices and the prevailing carbon price) and the economy’s ability to absorb them (such as general macroeconomic conditions).
21. For avoidance of doubt, we suggest this clause could specifically reference the fuel cost imposition of the carbon price under the NZETS. This would specify that the

Minister must have regard to “the extent to which any likely increase in fuel prices as a result of the percentages, taken together with the NZETS carbon price, can be absorbed by the New Zealand economy without undue detriment to economic activity”.

22. Specifying this would recognise that both policy tools (the Obligation and the NZETS) are geared toward the same policy outcome, and that their cumulative impact on fuel consumers should therefore be considered in its totality. This is doubly important given the waterbed effect – the mechanism by which complementary measures such as a biofuels mandate may serve to simply rearrange emissions reductions within the quantity cap of the NZETS, thereby imposing additional costs to the economy with little or no corresponding net emissions benefit.³

Section 14: Regulations made under section 13(1): additional matters

Regulations should preserve flexibility within acceptable policy parameters

23. Section 14(b) enables regulations to place limits on the extent and/or use of particular types of biofuel in meeting the Obligation. Notwithstanding the Bill only allows that regulations “may” place such limits, we emphasise that application of blanket limits on types or categories of biofuels reduces flexibility and likely increases the cost to consumers of the Obligation. We also note that initial consultation on the accompanying regulations proposed using limits of this kind.
24. The ability to place these limits introduces a risk if a supplier(s) invests in a particular solution, with subsequent regulations then ruling this solution out (thereby stranding assets). This risk dampens investment incentives.
25. Our preferred approach is to retain flexibility within the parameters set out in Section 13 of the Bill (relating to biodiversity, food security, land use change, etc). This would mean that outright limits on the use of particular biofuels would not be applied, with the onus instead on fuel suppliers to validate via certification that their proposed biofuels would remain within the acceptable parameters.
26. By the same token, our submission on the Government’s proposals for regulations expressed our preference that all biofuels be required to have certification showing they are at “low risk” of causing indirect land use change, rather than setting a cap on the maximum amount of food and feed-based biofuels and banning feedstocks that have historically resulted in significant land use change emissions.

3 The waterbed effect could arguably also be considered under Section 3(b)(i), which relates to the consistency of the emissions intensity reductions with New Zealand’s net emissions targets and budgets.

Schedule 2: Emissions intensity reduction percentages

A deferral of year one rather than skipping it entirely could mitigate the 2024 cost impacts on consumers

27. The Bill currently includes an emissions intensity reduction target of 2.4% in 2024. With the decision to defer implementation from 2023, the initial 2023 target of 1.2% was effectively 'skipped'.
28. We understand fuel suppliers are generally confident they can operationalise the 2.4% target in 2024. Regardless of what target is eventually legislated, the key is providing certainty to support the necessary investment in the right timeframe.
29. We suggest that in response to concern about the potential cost impacts of this policy, the Committee could consider reverting to the original first-year target of 1.2% for 2024, rising to 2.4% in 2025 and 3.5% in 2026.

Conclusion

30. We appreciate the opportunity to provide input on this Bill. We are keen to continue engaging constructively to ensure the Obligation balances its intended outcome (net emissions reductions) with the need to minimise cost and complexity for fuel suppliers and consumers.