

## Office of the Minister for Climate Change Issues

### Chair

### Cabinet Economic Growth and Infrastructure Committee

### Emissions Trading Scheme Review 2011 – Proposed Amendments to the Climate Change Response Act 2002 for the Synthetic Greenhouse Gases Sector

#### Proposal

1. This paper seeks in-principle Cabinet decisions to improve the current treatment of the synthetic greenhouse gas sector in the New Zealand Emissions Trading Scheme (ETS).

#### Executive summary

2. On 12 March 2012, Cabinet agreed to consult on a range of significant policy proposals to amend the ETS [Min (12) (8/7) refers]. At the time, Cabinet also noted that the Minister for Climate Change Issues would propose changes to the Synthetic Greenhouse Gases (SGG) sector in a subsequent Cabinet paper. This paper addresses proposals for changes to the treatment of SGG in the ETS, and in doing so:
  - implements key recommendations of the 2011 Emissions Trading Review Panel;
  - implements key commitments in the National Party's Manifesto; and
  - improves the technical operation of a number of parts of the Act.
3. SGG are most commonly used as refrigerants in fridges and air-conditioning units, as well as in electrical switchgear. The amount of SGGs imported into New Zealand have been increasing relatively quickly since 1990. The increase is due to an increased amount of the SGGs being imported and used to replace ozone-depleting gases, which are being phased out under the Ozone Layer Protection Act 1996.<sup>1</sup>
4. Importers and manufacturers<sup>2</sup> of SGG were required to start mandatory emissions reporting in the ETS from 1 January 2012. These participants are due to have surrender obligations starting 1 January 2013.
5. During the ETS Review 2011, the ETS Review Panel (the Panel) specifically considered the inclusion of SGG within the ETS. The Panel found that on balance the high transaction and compliance costs for importers of SGG in goods and motor vehicles outweighed the benefit of having SGG in goods and motor vehicles in the ETS.

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<sup>1</sup> New Zealand's obligations under the Montreal Protocol are implemented through the Ozone Layer Protection Act 1996 and the Ozone Layer Protection Regulations 1996.

<sup>2</sup> There are no SGG manufacturers in New Zealand. All SGG is imported. The rest of this cabinet paper uses "importers" as shorthand for "importers and manufacturers". The ETS would apply to any new SGG manufacturers and importers.

6. This paper proposes the following policy changes, which largely align with the recommendations of the Panel:
  - The ETS obligation on the importation of SGG in motor vehicles should be removed, and replaced with a levy on motor vehicles fitted with air-conditioning units.
  - The ETS obligation on the importation of SGG in goods, such as fridges and heat pumps, should be removed, and replaced with a levy on goods imported containing HFC/PFC.<sup>3</sup>
  - The SF<sub>6</sub> ETS obligation, for SF<sub>6</sub> in bulk and in goods, should stay within the ETS, but the point of obligation should move from the importer to the user. This will provide for a fairer treatment of this emissions source.
  - The wilful release of SGG from particular sources and activities should be banned. This will address particular market failures and will mirror controls on leakage of Ozone Depleting Substances (i.e. CFCs).
7. In addition to the Panel's recommendations, this paper proposes the following policy changes:
  - The eligibility criteria for receiving emission units when exporting or destroying SGG should be refined. This is in order to reduce fiscal risk from people taking advantage of the current criteria.
  - Deletion of the current removal activities for SF<sub>6</sub> due to the change in point of obligation for SF<sub>6</sub>.
  - The current exemptions from the ETS obligations for importers and manufacturers of HFC-245fa and HFC-365mfc should be removed. This is because from 1 January 2013 New Zealand will have to report emissions of these gases.
8. If the above policy package is adopted, the SGG participants remaining in the ETS would be bulk importers of HFC/PFC, users of SF<sub>6</sub>, and exporters of HFC/PFC (bulk and in goods).
9. The Panel's consultation included a public call for written submissions and a series of stakeholder meetings. It received submissions from 162 organisations and individuals, with just under a third (50) of those addressing SGG. The proposed package of amendments closely aligns with the recommendations of the Panel. Therefore, I am not proposing consultation with industry on any of the recommendations made in this paper.
10. It would be preferable for legislative amendments to be enacted this year, before full ETS obligations are faced by participants in the SGG sector. Accordingly, given the urgency and the previous consultation, I seek Cabinet's agreement that the Parliamentary Counsel Office (PCO) should commence drafting on the amendments set out above.

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<sup>3</sup> The current ETS provisions cover three SGGs: Hydrofluorocarbons (HFCs). Perfluorocarbons (PFCs) and Sulphur hexafluoride (SF<sub>6</sub>)

11. I seek Cabinet approval to delegate to the Minister for Climate Change Issues power to work with PCO to further clarify and develop policy matters relating to these amendments.
12. The proposed SGG amendments are estimated to have a negative impact on the operating balance of \$5.424 million over the forecast period (2011/12 – 2015/16).
13. These in-principle decisions are subject to the broader ETS consultation process currently being undertaken, and will be subject to confirmation depending on the outcomes of this consultation. Any fiscal implications will be recognised when ETS decisions are confirmed, within the broader ETS package.

## **Background**

14. In December 2010, the Minister for Climate Change Issues appointed an independent panel (the Panel) to undertake a statutory review of the ETS, as required by the Climate Change Response Act 2002. The Panel delivered its final report to Minister for Climate Change Issues on 30 June 2011, making 61 recommendations for change regarding the ETS.<sup>4</sup>
15. On 18 July 2011, Cabinet invited the Minister for Climate Change Issues to report to Cabinet by February 2012 (through the relevant Cabinet committee) with proposed changes to the ETS based on the Panel's recommendations, developments in and discussions with Australia, and further analysis [Cab min (11) 27/15 refers].
16. In this context, in Cabinet [Cab Min (12) (8/7) refers] the Minister for Climate Change Issues proposed a range of amendments to the Act to implement key recommendations of the Panel and key commitments in the National Party's Manifesto.
17. Key objectives for the proposals of the Minister for Climate Change Issues were:
  - Firstly, to ensure that the ETS more effectively supports the government's economic growth priorities.
  - Secondly, to ensure that the ETS is flexible enough to cater for a range of international outcomes in the period 2013-20.
  - Thirdly, to improve the operation and administration of the ETS in the light of feedback from the panel and stakeholders, and analysis by officials.

### *Synthetic greenhouse gases in the ETS*

18. Synthetic Greenhouse Gases (SGG) in the ETS are listed by the Second Assessment Report of the Intergovernmental Panel on Climate Change (IPCC AR2). SGG are used in many domestic and commercial air conditioning and refrigeration goods as well as in electrical switchgear equipment. The gases are characterised by very high global warming

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<sup>4</sup> Doing New Zealand's Fair Share, ETS Review 2011: Final report, ETS Review Panel, 30 June 2011.

potentials (GWPs)<sup>5</sup> and are released into the atmosphere as the product is used. SGGs covered by the Climate Change Response Act 2002 (the Act) include:

- sulphur hexafluoride (SF<sub>6</sub>), which is used primarily as an insulator for high voltage electrical equipment
  - perfluorocarbons (PFCs), which are mainly found in emissions from aluminium smelters and in some refrigerant gas mixtures
  - hydrofluorocarbons (HFCs), which are used to replace ozone-depleting substances in many applications in the refrigeration and air-conditioning sector and other related industrial processes such as the manufacture of plastic foams and aerosols.
19. The Panel considered whether SGG should remain in the ETS, taking into account alternative policy tools that can reduce emissions of such gases. The following issues were raised by submitters and were key to the Panel's discussions and analysis:
- even if it is appropriate for SGG to be in the ETS, some specific SGG activities could be treated differently;
  - the transaction and compliance costs for importers of SGG installed in goods are too high compared to their level of emissions;
  - ETS prices 'emissions' on import when they don't actually emit for a number of years, meaning there is an unbalanced liability on the importer in comparison to the government.
20. The following SGG changes were recommended by the Panel:
- introducing a levy on imported goods and motor vehicles that contain HFC/PFC;
  - moving the point of obligation for SF<sub>6</sub>; and
  - banning wilful release of SGG.

## Comment

### *Introduction of levies for importing HFC/PFC in goods and motor vehicles*

21. As set out in the accompanying Regulatory Impact Statement (RIS), the compliance costs from participating in the ETS are burdensome for many HFC/PFC importers, particularly those who import only a small amount of HFC/PFC.
22. The Panel concluded that a levy approach would be more effective than the ETS at pricing the HFC/PFC contained in imported goods and registered motor vehicles.
23. The result of applying these levies will mean that importing HFC/PFC in goods and motor vehicles will be removed from the ETS entirely, and importers will no longer need to be participants or submit emission returns.

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<sup>5</sup> GWP is a term used to measure the effect of a gas compared to an equivalent amount of carbon dioxide. The most common SGG mixture used in New Zealand is HFC134a, which has a GWP of 1300. The highest GWP belongs to SF<sub>6</sub>, at 23,900.

24. Exporting HFC/PFC in goods and motor vehicles will remain in the ETS. This is because in relation to the number of companies that import HFC/PFC in goods and motor vehicles, the number of companies that export are low. In addition, to provide an alternative, such as a levy refund system for exporters, would incur a large cost to the Crown for limited benefit to the export businesses.

#### *A levy on HFC and PFC in motor vehicles*

25. The first levy concerns importing motor vehicles that are fitted with air-conditioning units (the motor vehicle levy).
26. The motor vehicle levy will be collected by the New Zealand Transport Agency (NZTA) when a vehicle is first registered for on-road use in New Zealand, which usually occurs directly after importation. However a relatively small number of vehicles will be missed, as some vehicles are imported and not registered.<sup>6</sup> For example, those used in the agricultural or construction sector and non-road vehicles such as the new Matangi trains.
27. The levy will use current regulated categories of vehicles and will initially apply only to the most common HFC (HFC134a). This is because, of the HFC listed by the Second Assessment Report of the IPCC, HFC134a is by far the most common and has the highest global warming potential of any refrigerant used in the air conditioning systems of motor vehicles.
28. Under the ETS, an exemption threshold of 100tCO<sub>2</sub>e/yr (or roughly 110 cars) exists, due to the administration costs of applying this price. Under the levy on motor vehicles this exemption threshold will not be required as administration will be simplified. This will give rise to additional ETS revenues of approximately \$600,000 per year from when the levy is fully in place.
29. Existing constraints on changing systems at the NZTA means the motor vehicle levy will not be able to be implemented until 1 July 2013 at the earliest. The six month delay, assuming ETS obligations are removed from this sector, will reduce ETS revenues (from missed levy payments) by \$1.04 million.
30. In consultation with the Panel, motor vehicle importers strongly supported the replacement of ETS obligations with a levy applied at registration. I expect them to support the relevant policy changes in this paper, and I am therefore not recommending further consultation on the policy.

#### *A levy on HFC/PFC goods*

31. The second levy concerns goods<sup>7</sup> containing HFC/PFCs,<sup>8</sup> such as fridges and air-conditioning units (the goods levy). The goods levy will be collected at the New Zealand border by the New Zealand Customs Service (Customs).

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<sup>6</sup> As no information is known about these vehicles the costs cannot be estimated

<sup>7</sup> When this paper refers to "goods", it does not include SGG contained in the air-conditioning units in motor vehicles. The goods levy will however apply to SGG found in other parts of motor vehicles (for example, refrigerant in refrigerated trucks).

<sup>8</sup> There are currently no goods that contain per fluorocarbons (PFCs) that will be covered by the goods levy, but to future proof the policy these have been included.

32. The categories of goods that the levy will apply to will be set out in regulations and work is underway to identify the optimal number and description of these categories.
33. Customs will collect the goods levy through its established electronic systems on the point of import. Customs will collect the goods levy subject to a de minimis policy. The de minimis policy provides that Customs does not collect tariff duty and other taxes on imports where the tax or duty is less than \$60.00, or if a consignment is valued at approximately \$399 or less. These thresholds will be applied to the levy also.
34. As long as the revenue is raised by a levy rather than a duty, no new trade barriers are created by this policy change. All importers of goods containing HFC/PFC will incur similar emissions costs under the levy scheme as they do currently under the ETS. New Zealand manufacturers of the same goods will also continue to incur emission costs passed through to them from their suppliers of HFC/PFC, which remains subject to the ETS in its bulk form and is not manufactured in New Zealand. It is therefore expected that an amount of HFC/PFC will have the same emissions cost whether it is in a domestically manufactured or an imported good.
35. To allow time for Customs' systems to be updated I propose that the goods levy be implemented on 1 July 2013, and will apply to the specified goods imported on or after that date. This delay in implementation will reduce ETS revenues (from not collecting levy payments during this period) by \$1.389 million.
36. In consultation with the Panel, importers and manufacturers of goods that contain HFC/PFC supported the replacement of ETS obligations with an import levy. I expect them to support the relevant policy changes in this paper, and I am therefore not recommending further consultation on the policy.

*Rates of the goods and motor vehicle levies*

37. The levy formula (used for both levies) will need to be in legislation. The levy revenue will be directed to the Crown's consolidated fund.
38. Regulations will specify categories of motor vehicles or goods, and prescribe the amount of HFC/PFC that is assumed to be in each item.
39. I recommend to Cabinet that the following levy rate formula be applied:

$$\text{Levy Rate} = \text{SGG Rate} \times \text{GWP} \times \text{Averaged Carbon Price}$$

<i>SGG Rate</i>	The amount of SGG that regulations designate is to be treated as contained in a category of items (e.g. either a category of motor vehicles or a category of goods).
<i>GWP</i>	The global warming potential of the SGG that regulations designate is contained in a category of items.
<i>Averaged Carbon Price</i>	The average of a specified emission unit price in the Crown Accounts over the 12 month period preceding 1 July of the year in which the regulations prescribing the Levy Rate.

40. While the levy rate formula will be in the Act, I propose to create the following regulation-making provisions in the Act:
  - Categories of items to be levied;
  - Assumed amount of SGG per category; and
  - Levy rates per category of item.
41. I propose that the regulation-making processes will align with current processes in the Act (such as consultation with industry), except for the levy rates. There will be no requirement to consult affected persons, other than Customs and NZTA, over the annual changes to the rates of levies. This is because of the:
  - high level of transparency in calculation methodologies (levy formula in legislation and carbon price published by Treasury);
  - consultation on the category aspects of the regulations;
  - sufficient lead time before new rates apply (one month).
42. The decision to replace ETS obligations for importers of HFC/PFC in goods and motor vehicles with a levy creates a low fiscal risk, as there is the potential for the levy price to diverge from the SGG obligation (that the sector would have otherwise paid under the status quo). This would result in the Crown receiving either a higher or lower amount of revenue from importers of HFC/PFC through a levy approach compared to these importers being in the ETS.
43. Replacement of ETS obligations with a levy has a financial impact on participants. By leaving the carbon market, importers of HFC/PFC in goods and motor vehicles will bypass the opportunity to buy different units from the market price. Instead, the participants will be subject to the prices the Crown accounts are based on, which is currently the primary Certified Reduction Unit price.
44. The levy will also mean participants will no longer be able to pay for the exact amount of HFC/PFC in their product, as the levy categories will act as a proxy.
45. Despite the limits on price and the proxy for emissions, the SGG sector has stressed through consultation that they support the replacement of ETS obligations with a levy, as they believe a levy provides more price certainty.

*Indicative prices of both SGG levies*

46. Table 2: Indicative<sup>9</sup> price of levy per item (prices used are for comparison only)

Item	Price of Levy using \$10.41 <sup>10</sup> carbon price	Price of Levy using \$12.50 carbon price	Price of Levy using \$8.50 carbon price
Car	\$9.47	\$11.37	\$7.35
Domestic air-conditioning unit	\$18	\$21.62	\$14
Domestic fridge/Freezer	\$1.35	\$1.63	\$1.10

*Recycling revenue*

47. The Panel recommended recycling a portion of the levy revenue into emission reduction activities in the sector. The government will receive approximately \$3.5 million per year from the levy schemes. Recycling revenue would create inequity with other sectors in the ETS, which do not get their surrendered units recycled into emission reduction activities in their sector. The government uses revenue raised from the ETS to meet future international obligations. The recycling of the levy would require a new budget bid and I do not believe that there is a strong business case for doing this.
48. Therefore, I do not recommend that the government adopt the recommendation from the Panel that revenue is recycled into emission reduction activities in the sector.

*Exporting SGG in goods and motor vehicles*

49. Under the ETS the exportation of goods and motor vehicles containing SGG is incentivised by receiving units as a removal activity. I propose that this incentive continue in its current form, but is limited to goods containing HFC/PFC. There is a low risk that there will be a mismatch between the levy costs for an importer of HFC/PFC in goods and the value of emission units claimed from re-exporting the same goods. However, this risk is managed by having the SGG levy prices updated every 12 months to reflect the changes in emission price.

*Point of obligation for sulphur hexafluoride activities*

50. The ETS currently makes all importers of sulphur hexafluoride (SF<sub>6</sub>) mandatory participants for the amount of SF<sub>6</sub> they import in a year. The Panel and submitters considered this inequitable, as the government has international obligations only for the actual emissions, which in the majority of applications occur over 50 years after importation.

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<sup>9</sup> The SGG used in each item will affect the price as some SGG have significantly higher Global Warming Potentials than other SGG, but SGG can be used interchangeably within an item.

<sup>10</sup> Carbon price used in the series of ETS cabinet papers.

51. Table 3: The size of the difference is illustrated in the table below:<sup>11</sup>

	2013	2014	2015
<b>Projected national SF<sub>6</sub> emissions (national inventory, tCO<sub>2</sub>-e)</b>	20,815	20,851	20,880
<b>Net imported SF<sub>6</sub> (ETS obligations, tCO<sub>2</sub>-e)</b>	137,968	138,203	138,401

52. Electrical switchgear use of SF<sub>6</sub> accounts for over 85 per cent of SF<sub>6</sub> emissions in New Zealand. By moving the ETS obligation to large users 77 per cent of emissions from the sector would be covered, and there would be only five potential participants. To identify a large user, I propose using a threshold of one tonne of SF<sub>6</sub> installed in all equipment owned by a specific company. The surrender liability will be based on the assumption that 2% of the total SF<sub>6</sub> in a single piece of electrical switchgear is emitted per year.
53. I propose that users of SF<sub>6</sub> in electrical switchgear, where the total SF<sub>6</sub> installed is more than one tonne, be the ETS participants. Importers and manufacturers would not be required to participate in the ETS.
54. I also propose that exportation or destruction of SF<sub>6</sub> is no longer eligible as a removal activity. By moving the obligation to the user, the actual emissions (leakage from equipment) will be paid for directly, not the entire amount of SF<sub>6</sub> imported (which is the current provisions).
55. These proposals would reduce ETS revenues by \$4.81 million over the forecast period.

#### *Banning wilful release of SGG*

56. Releasing SGG is different from it being leaked, as leakage happens over the natural course of a product at a slow rate. Wilfully releasing SGG refers to substantial amounts of SGG being knowingly released, such as all the SGG in a fridge being released through poor servicing practices.
57. There may be instances where the ETS or levy price signals may not be enough to minimise SGG release. The Panel recommended that the government should prohibit wilfully (knowingly) releasing SGG into the atmosphere. I agree with this recommendation, but consider it should be targeted at emissions sources where SGG release can, and should, be avoided.
58. I therefore propose that Cabinet agree that the Act be amended to penalise anyone who knowingly or without lawful justification or excuse releases SGG into the atmosphere while installing, operating, servicing, modifying, or dismantling any electrical switchgear or refrigeration or air-conditioning equipment or other heat-transfer medium.
59. Banning wilful release of SGG in certain circumstances would act as a deterrent to the wilful release of SGG, despite the practical enforcement of an offence being complicated and relatively expensive.
60. This will more closely align the wilful release of SGG with the wilful release of Ozone Depleting Substances. In line with that the Ozone Layer Protection Act, I also propose that the defence in the Ozone Layer

<sup>11</sup> Source: Ministry for the Environment national inventory and net position modelling, and converted using global warming potentials from the IPCC Fourth Assessment Report.

Protection Act be carried over for releasing an SGG into the atmosphere in some circumstances.<sup>12</sup>

61. There was no analysis of fiscal costs or benefits from this policy change as there is no data on the likely emissions.

*Eligibility of exporting HFC/PFC as a removal activity*

62. Under the current ETS provisions, from 1 January 2013 anyone who exports SGG (including HFC, PFC and SF<sub>6</sub>) will receive units as a removal activity. If a person were to import prior to 1 January 2013 and re-export before 31 December 2012 they would get a windfall gain at the expense of the government. This is because there are no ETS surrender obligations for imports of SGG in 2012. This is a fiscal risk to the Crown.
63. I therefore propose that Cabinet agree to restrict eligibility for undertaking a removal activity in respect of exporting bulk HFC/PFC, or HFC/PFC contained in goods. The following criteria are proposed:
  - If the person exporting bulk HFC/PFC or HFC/PFC contained in goods is a manager of a product stewardship scheme accredited under the Waste Minimisation Act 2008, or
  - all the components of the bulk HFC/PFC exported (or if the HFC/PFC was imported in goods, the goods themselves) were imported after 31 December 2012.
64. The first criterion recognises the efforts of the activities of the Trust for the Destruction of Ozone Depleting Substances (The Trust). Without the voluntary efforts of The Trust, New Zealand would have had significantly greater emissions of SGG and Ozone Depleting Substances.
65. As outlined in paragraph 50, I propose to move the ETS obligation for SF<sub>6</sub> emissions from the importer (bulk or in goods) to the heavy/large users. This means that the provisions for receiving units for exporting and destroying SF<sub>6</sub> are no longer necessary.
66. There are no fiscal costs or benefits from this policy change, however fiscal risks (as mentioned above) are being mitigated through this policy.

*Removal of exemptions for importing particular SGG*

67. New Zealand currently reports on the emissions of the greenhouse gases listed by the Second Assessment Report of the IPCC. Cabinet have decided, subject to consultation, [Cab Min (12) (8/7) refers], to report on the emissions of the greenhouse gases listed by the IPCC Fourth Assessment Report. HFC-245fa and HFC-365mfc are not listed in the IPCC Second Assessment Report and are therefore currently exempt from the ETS. However, the IPCC Fourth Assessment Report has added HFC-245fa and HFC-365mfc to the gases that must be reported on. Therefore the justification for the exemption may no longer be valid.
68. Adding HFC-245fa and HFC-365mfc will impact insulation foam manufacturers. As with the rest of the SGG sector, insulation foam

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<sup>12</sup> Where the release occurred during the connection or disconnection of equipment used to transfer controlled substances from one container to another container and the release could not reasonably have been avoided.

manufacturers have been moving away from ozone depleting substances (CFCs) and into HFCs, causing an increase in their use. HFC-245fa and HFC-365mfc are imported in bulk then used to manufacture insulation foam.

69. I therefore propose Cabinet agrees that those exemptions be removed from the Act's regulations. This aligns with the objectives of the ETS, being to transfer the costs of meeting international obligations from the taxpayer to the emitter. This change will increase ETS revenues by \$0.1 million over the forecast period.

### **Next steps**

70. The package of amendments as outlined in this paper closely aligns with the recommendations of the Panel. Therefore I anticipate the SGG sector to be broadly in agreement with the proposed changes, and I am not recommending further consultation on the recommendations in this paper.
71. I propose that I engage with the SGG sector to explain the cabinet decisions. Consultation with the SGG sector will take place as part of the regulation making process and will focus on the detail of the levies.
72. A number of the policy proposals presented above, in particular the goods and motor vehicle levies, will also likely require further, supporting technical and operational policy decisions and clarifications. I propose that Cabinet delegate the Minister for Climate Change Issues responsibility for further decisions on the technical detail of drafting these decisions.
73. Legislative amendments must be enacted in this year, before full ETS obligations are faced by participants in the SGG sector. Accordingly, given the urgency and the previous consultation, I seek Cabinet's agreement that PCO should commence drafting on the amendments set out above.
74. Consultation will continue with Customs on any amendments that will affect the collection of the goods levy or Customs legislation. The Ministry of Transport and the NZTA will also continue to be consulted with on any amendments that will affect the collection of the motor vehicle levy or any land transport legislation and regulations.
75. I propose that Cabinet confirm I am able to share this Cabinet paper, any drafts and final versions of related Cabinet papers, drafting instructions to PCO, subsequent drafts of the amendments (and any sufficiently related documents) with the NZTA for consultation, where necessary.

### **Consultation**

76. The following agencies were consulted in the preparation of this paper: the Ministry of Agriculture and Forestry, the Treasury, the Ministry of Foreign Affairs and Trade, the Ministry of Economic Development, the Department of Conservation, Customs, the Ministry of Transport, the NZTA, the EPA and Te Puni Kōkiri. The Department of Prime Minister and Cabinet was informed. The Officials' Committee for Economic Growth and Infrastructure Committee have also been consulted.

## Financial implications

### Summary fiscal implications

77. Cabinet agreed that the ETS package would be fiscally neutral. Therefore, these in-principle decisions and resulting fiscal implications are dependent on the broader ETS consultation that is currently underway. The fiscal impacts of any decisions will be recorded, when they are confirmed, within the fiscal implications of the final ETS package. Final Cabinet decisions are scheduled to be made by July [CAB Min (11) 37/16 refers].
78. These in-principle SGG amendments are estimated to have a negative impact on the operating balance of \$5.424 million over the forecast period, in comparison to the current ETS settings for the SGG sector. Any final impacts will depend on the price of carbon when final policy decisions are made. A prevailing price of \$10.41 has been used for these estimates.

Table 4: Net estimated fiscal impact of proposed policy changes (\$ million)

	<b>\$m - Increase/(decrease) in operating balance</b>					
	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>Total</b>
Application of SGG levy in goods	0.000	(1.389)	0.000	0.000	0.000	(1.389)
Application of a SGG levy to motor vehicles	0.000	(0.787)	0.521	0.521	0.521	0.775
Change point of ETS obligation for SF <sub>6</sub> activities	0.000	(0.686)	(1.373)	(1.375)	(1.377)	(4.810)
<b>Net impact on operating balance (\$ million)</b>	<b>0.000</b>	<b>(2.862)</b>	<b>(0.852)</b>	<b>(0.854)</b>	<b>(0.856)</b>	<b>(5.424)</b>

Note: the additional cost of transitional phase measures for the SGG sector is \$2.134 million. The costs of transition phase measures post-2012, were agreed in-principle by Cabinet [Cab Min (12) (8/7) refers] and are therefore not included in these fiscal estimates. Both the status quo and the preferred options were estimated using IPCC AR2 global warming potentials, which aligns with the other ETS cabinet papers fiscal estimates [Cab Min (12) (8/7) refers]. The removal of exemptions for HFC-245fa and HFC-365mfc has a fiscal cost of zero because these SGG do not have IPCC AR2 global warming potentials. Using IPCC 4AR global warming potentials, the annual fiscal benefit from the policy change is less than \$0.1m per year.

79. The proposal to replace ETS obligations for HFC/PFC importers with a levy would have a marginally positive impact on the Government's net debt position. This is because the levy provides the Government with a financial cash asset rather than emission units which are an intangible asset.
80. I am not seeking changes to appropriations at this stage. Any financial implications are subject to final decisions and later agreement by Cabinet. I will seek Cabinet approval for appropriation changes along with final policy decisions on the ETS package and drafting instructions by July 2012.

### Implementation and administration costs

81. The Environmental Protection Authority (EPA) will continue to be responsible for the monitoring and compliance of the SGG sector under penalties and offences sections aligned (where possible) with the current penalties and offences in the Act.

82. The Ministry for the Environment have advised that this package of ETS amendments will give rise to new operating costs for Customs, the NZTA and the EPA. The indicative total of these costs is \$0.9 million across the forecast period. The costs to the NZTA and Customs arise from set up and ongoing costs of updating their electronic systems and both agencies have signalled that these costs cannot be met through existing baselines. The costs to the EPA arise from new responsibilities, such as the reversal of current participants and the banning of wilful release of SGG. Most of the cost associated with the compliance function of the EPA will come out of existing ETS compliance function baselines.
83. Cabinet agreed [Cab Min (12) (8/7) refers] to establish a contingency fund so that Ministers can further consider new operating costs, and that this contingency be funded through Budget 2012. The new operational costs will be funded out of reprioritisation or out of that contingency fund in accordance with the criteria set down in Cab Min (12) (8/7). As part of this process, and subject to final decisions, each agency will present a business case to Treasury. The Ministry for the Environment will complete the business case for the SGG costs on behalf of the NZTA, the EPA and Customs.

#### *Fiscal risks and other impacts*

84. The decision to replace ETS obligations for SGG importers with a levy creates a low level of fiscal risk, as there is the potential for a levy price to diverge from the ETS emission unit price (as outlined in paragraph 39). This would result in the Crown receiving either a higher or lower amount of revenue from importers of SGG through a levy approach compared to these importers being in the ETS.
85. I propose that this risk is managed through having the goods and motor vehicle levy prices updated every 12 months, based on the average price of certain units (to be confirmed) in the Crown accounts for the preceding 12 months. The Crown accounts currently use the primary CER price. Any price caps or limits for ETS participants will also be factored into the levy.

#### **Human rights**

86. There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

#### **Legislative implications**

87. To ensure that levy participants and ETS participants are treated equally a number of amendments will need to be made to the Act to ensure that equivalent functions, powers and regulation-making processes regarding the ETS can also be applied to the levies.
88. A bill will be required to implement a range of modifications to the ETS. The bill may also include consequential modifications to land transport and customs legislation.
89. The Act binds the Crown. The bill for the proposed amendments will also bind the Crown. New regulations will be required to specify details of proposed amendments and rates of levies. Consequential amendments to a

number of regulations under the Act will also be required within 12 months of enactment of the bill to give effect to certain provisions in the bill. Depending on further consultation with NZTA and Customs, amendments may be needed to some land transport or customs regulations.

### **Quality of the Impact Analysis**

90. The Regulatory Impact Analysis (RIA) requirements apply to the proposal in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached.
91. The Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by Ministry for the Environment and associated supporting material, and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.

### **Consistency with Government Statement on Regulation**

92. I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:
  - are required in the public interest;
  - will deliver the highest net benefits of the practical options available; and
  - are consistent with our commitments in the Government statement “Better Regulation, Less Regulation.”

### **Publicity**

93. It will be necessary to manage public announcements on policy decisions for amendments to the ETS through a coordinated strategy. I am seeking authorisation to manage public announcements/ engagement on the proposed package of amendments prior to the finalisation of Cabinet’s deliberations on amendments to the ETS. I propose to proactively release this Cabinet paper and associated RIS once cabinet decisions are made.

## Recommendations

The Minister for Climate Change Issues recommends that the Committee:

### **Background**

1. **Note** that a statutory review of the New Zealand Emissions Trading Scheme (ETS) was completed in 2011 where the ETS Review Panel (the Panel) gave specific attention to the inclusion of Synthetic Greenhouse Gases (SGG) within the ETS.
2. **Note** the Panel made 8 recommendations in relation to the SGG sector with the most significant being to remove some activities from the ETS and instead use a simpler levy system;
3. **Note** that because of the complexity and number of issues covered, advice on ETS amendment is being provided over a series of papers, that this paper is the second and it seeks Cabinet's in principle agreement to the policy changes focussed on the SGG sector [Cab Min (12) (8/7) refers];
4. **Note** that all the policy decisions in this paper are in principle and subject to the broader outcomes of the current ETS consultation;

### **HFC/PFC in goods and motor vehicles**

5. **Note** importers of HFC/PFC in goods and motor vehicles incur relatively substantial ETS compliance costs compared to other sectors, and the Panel recommended that their ETS obligations be removed and replaced with an administratively simpler levy system;
6. **Agree in principle** to remove all ETS obligations for importers of HFC/PFC contained in goods and motor vehicles;
7. **Agree in principle** that a levy on the importation of goods (excluding motor vehicles) containing HFC/PFC, from all countries, will apply from 1 July 2013;
8. **Agree in principle** that a levy on motor vehicles containing specified HFC/PFC will apply at the first point of on-road use registration from 1 July 2013;

### **Rate of the levies**

9. **Note** that given the levies are not charges for services or cost recovery and will be directed to the consolidated fund, the levy formula (used for both levies) should be in legislation;
10. **Agree in principle** that the Climate Change Response Act 2002 specify that the levy will be calculated on the following basis (subject to Parliamentary Counsel Office (PCO) drafting):

$$\text{Levy Rate} = \text{SGG Rate} \times \text{GWP} \times \text{Averaged Carbon Price}$$

**SGG Rate** The amount of SGG that regulations designate is to be treated as contained in a category of items (e.g. either a category of motor vehicles or a category of goods).

<i>GWP</i>	The global warming potential of the SGG that regulations designate is contained in a category of items.
<i>Averaged Carbon Price</i>	This average of a specified emission unit price in the Crown Accounts over the 12 month period preceding 1 July of the year in which the regulations prescribing the Levy Rate being calculated are created.

11. **Agree in principle** that the initial period for the calculation of the Averaged Carbon Price will need to cover a different 12 month period as the levies apply from 1 July 2013 rather than the start of the year;
12. **Agree in principle** that any price cap or limits implemented in the ETS be factored into the calculation of the levies;
13. **Agree in principle** that the HFC/PFC levies will be imposed by amendment of the Climate Change Response Act 2002, with empowering provisions inserted to allow the New Zealand Transport Agency (NZTA) and the New Zealand Customs Service (Customs) to collect the HFC/PFC levies revenue through their electronic collection systems. Customs would do this subject to applying a de minimis policy to the levy;

#### ***Monitoring and compliance of the levies***

14. **Agree in principle** that Customs will be able to use the relevant powers in the Customs and Excise Act 1996 in collecting the HFC/PFC levy on goods;
15. **Agree in principle** that the NZTA will be able to use the relevant powers in relevant transport legislation to collect the specified HFC/PFC levy on motor vehicles;
16. **Agree in principle** that the Environmental Protection Authority (EPA) will continue to be responsible for the monitoring and compliance of the entire SGG sector (ETS and levy provisions) under consequential amendments to extend existing penalties and offences sections in the Climate Change Response Act 2002 to the levies where applicable;
17. **Agree in principle** that aggregated reporting on activity under the levies will be provided quarterly by Customs and the NZTA to the Inventory Agency and the EPA;

#### ***Regulatory and consequential powers needed for the levies***

18. **Agree in principle** to create a regulatory ability to restrict eligibility as a participant for exporting or destroying SGG (including SGG contained in goods);
19. **Agree in principle** to create regulation-making abilities for:
  - a. Categories of items to be levied;
  - b. Assumed amounts of SGG per category; and
  - c. Levy rates per category.
20. **Note** that there will be other consequential amendments to the Climate Change Response Act 2002 to ensure that relevant parts of the Climate Change Response Act 2002 also apply to the levies where applicable. Any

consequential amendments to relevant transport and customs legislation will be completed in consultation with the relevant Ministers and agencies;

21. **Agree in principle** that there will be no requirement to consult affected persons other than Customs and NZTA over changes to the rates of levies because of the transparency on calculation methodologies, triggers for rate recalculation, and sufficient lead time before new rates apply;

#### ***Wilful release of SGG***

22. **Note** that the wilful release of SGG is not currently prohibited, although Ozone Depleting Substances are not allowed to be knowingly released to atmosphere;
23. **Agree in principle** to create an offence in the Climate Change Response Act 2002, prohibiting the release of SGG into the atmosphere knowingly or without lawful justification or excuse while installing, operating, servicing, modifying, or dismantling any electrical switchgear or refrigeration or air-conditioning equipment or other heat-transfer medium;
24. **Agree in principle** to create a defence in the Climate Change Response Act 2002 where the release occurred during the connection or disconnection of equipment used to transfer controlled substances from one container to another container and the release could not reasonably have been avoided;

#### ***Sulphur hexafluoride (SF<sub>6</sub>) activities***

25. **Note** that the ETS currently treats importers of SF<sub>6</sub> inequitably, as ETS obligations are currently greater than the obligations of the government due to differences in when emissions are reported;
26. **Agree in principle** that the mandatory point of obligation for SF<sub>6</sub> emissions should be shifted from importers of SF<sub>6</sub> to users of SF<sub>6</sub> in electrical switchgear who have more than 1 tonne of SF<sub>6</sub> installed;
27. **Agree in principle** that, in light of the change in surrender obligations, the removal activities of exporting or destroying SF<sub>6</sub> should be deleted from the Climate Change Response Act 2002;

#### ***Financial implications of SGG policy package***

28. **Note** the in principle decisions would have an indicative net negative impact on the operating balance of \$5.424 million across the forecast period, at the current carbon price;
29. **Note** that these decisions are subject to the outcomes of the broader ETS consultation, and therefore changes to appropriations will be made when Cabinet makes decisions on the final package of ETS changes by July 2012;
30. **Note** that officials advise that these amendments will give rise to new operating costs for Customs, the NZTA and the EPA totalling \$0.9 million across the forecast period, which Customs and the NZTA have advised cannot be met through existing agency baselines;

31. **Agree in principle** that the operating costs for the levies be considered against the "Emissions Trading Scheme Review implementation contingency" process that was established by Cabinet to fund implementation costs that cannot be met through existing agency baselines [CAB Min (12) 8/7 refers];
32. **Agree in principle** that levy revenues collected by Customs and the NZTA will be paid into the Crown bank account;

**Process**

33. **Note** that the Minister for Climate Change Issues will engage with the SGG sector to explain cabinet decisions, but consultation with the SGG sector will only take place as part of the regulation making process.
34. **Agree** that the Minister for Climate Change Issues will:
  - a. Further clarify and develop policy matters relating to the amendments set out in this paper, in a way that is not inconsistent with Cabinet decisions;
  - b. Consult on parallel regulatory provisions; and
  - c. Be responsible for the communication and engagement regarding the proposed amendments and response to Panel recommendations.
35. **Agree** that this Cabinet paper and associated Regulatory Impact Statement be released once Cabinet has made decisions (subject to withholding information consistent with the Official Information Act 1982);
36. **Agree** that the Minister for Climate Change Issues may share this Cabinet paper, drafts of further Cabinet papers on related issues, related cabinet minutes, drafting instructions to the PCO, subsequent drafts of amendments to the Climate Change Response Act 2002 or regulations, and related documents, with the NZTA, as a key agency in the proposed amendments.

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Hon Tim Groser  
**Minister for Climate Change Issues**  
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