

Office of the Minister for Climate Change Issues

Chair

Cabinet

Moderated Emissions Trading Scheme – further proposed amendments to the Climate Change Response Act 2002

Proposal

1. This paper seeks agreement to modifications to the New Zealand Emissions Trading Scheme (NZ ETS), further to those already agreed by Cabinet [Cab Min (09) 33/9 refers].

Executive summary

2. Cabinet agreed to a number of amendments to the Climate Change Response Act 2002 in order to modify the NZ ETS [Cab Min (09) 33/9 of 14 September 2009 refers].
3. This paper proposes the further amendments to the Act which were not included or not explicitly addressed in Cabinet Paper (09) 531, for the most part to further clarify matters addressed in that Cabinet Paper or address issues that have arisen in the course of drafting, including:
 - a. initial allocation of New Zealand units to the agriculture sector for the year 2015 will be 90 per cent;
 - b. decisions as to persons eligible for allocation in the fishing sector will be taken by the Minister for Climate Change Issues under the allocation plan;
 - c. allocation of New Zealand units to owners of pre-1990 forest land who purchased land prior to 1 November 2002 will be 60 units per hectare;
 - d. allocation to owners of fishing quota will be based on tonnage of quota, or equivalent, held (on a one-off basis);
 - e. allocation provisions will be reviewed every five years; and
 - f. a number of more minor amendments.

Background

4. Cabinet agreed to a number of amendments to the Climate Change Response Act 2002 in order to modify the NZ ETS [Cab Min (09) 33/9 of 14 September 2009 refers]:
 - The stationary energy, industrial processes and liquid fossil fuels sectors will enter the NZ ETS on 1 July 2010. Monitoring and reporting requirements for these sectors will still commence on 1 January 2010.
 - A transition phase will operate from July 2010 to December 2012. The transition phase will be implemented through a progressive obligation

requiring participants to surrender only one unit for every two tonnes CO₂-e emitted, combined with a \$25 fixed price option whereby participants can buy units from the Crown through this period for \$25.

- The export of New Zealand units will not be permitted during the transition phase. However the prohibition on exports will not apply to forestry-related units. There will be no restrictions on banking of units during the transition phase.
 - Free allocation to emissions-intensive, trade-exposed industry will be provided on an intensity basis. Eligibility thresholds will be set to reduce trans-Tasman competitiveness risks. The number of units allocated to emissions-intensive, trade-exposed industry will be reduced by 50% during the transition phase when the progressive obligation is in place.
 - The level of free allocation assistance to industry will initially phase-out at a rate of 1.3% per annum beginning in 2013. The phase-out of free allocation will also be considered through a five-yearly review of free allocation. The first review will be conducted in 2011. Any significant changes to the provision of free allocation will require a five year notice period.
 - The progressive obligation will not apply to the forestry sector, but the \$25 fixed price option will apply to all forestry surrender obligations before 1 January 2013.
 - The entry of agriculture into the NZ ETS will be delayed until 1 January 2015. Voluntary reporting for the agriculture sector will still commence on 1 January 2011 followed by the commencement of mandatory reporting on 1 January 2012.
 - Free allocation to the agriculture sector will be provided on an intensity basis on a similar basis to the provision of free allocation to industry and will phase out at 1.3% starting from 2015.
 - An initial processor-level point of obligation will apply for the agriculture sector with flexibility to move to a farm-level point of obligation in the future.
 - Free allocation to the fishing sector will be increased from the current level of 50% of 2005 emissions for three years, to 90% of 2005 emissions for two and a half years (July 2010 to December 2012).
 - Provisions to allow for a domestic '50 by 50' emissions reduction target for New Zealand to be set by regulation.
5. Cabinet also agreed to a number of clarifications and second order amendments, largely technical in nature that would be helpful to assist with the effective functioning of the Act.

Comment

6. This paper proposes the following amendments to the Act which were not included or not explicitly addressed in Cabinet Paper (09) 531. For the most part these are further clarifications of matters addressed in that Cabinet Paper or address issues that have arisen in the course of drafting.
- Initial allocation of New Zealand units to the agriculture sector for the year 2015 will be 90 per cent.

- To ensure that the agriculture sector receive allocation at the full 90 per cent for their first year, the phase out of free allocation will begin in 2016.
 - Allocation of New Zealand units to owners of pre-1990 forest land will be 60 units per hectare for those owners who purchased land prior to 1 November 2002.¹
 - Recommendation 33 in Cabinet Paper (09) 531 proposed that the processing of participants' applications for allocation (excluding forestry) be assigned to the Chief Executive of the Ministry for the Environment rather than the Minister for Climate Change Issues. The decisions as to persons eligible for allocation in the fishing sector should be excluded from the general provision delegating the processing of participants applications for allocation to the Chief Executive for the Ministry for the Environment. These decisions should be taken by the Minister under the fishing allocation plan.
 - Allocation to owners of fishing quota will be based on tonnage of quota held (or equivalent, where the quota is based on a number) (on a one-off basis) on the date of introduction of the Bill to the House.
 - There will be a review of allocation provisions every five years.
7. This paper also proposes a number of more minor amendments which are set out in the Annex.

Consultation

8. The following government agencies were consulted on this paper: the Treasury, the Ministry for Agriculture and Forestry, the Ministry of Economic Development, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, Te Puni Kokiri, Ministry of Social Development, Ministry of Fisheries and the Inland Revenue Department.
9. The Department of the Prime Minister and Cabinet has been informed.

Financial implications

10. There are no additional financial implications associated with the proposals in this paper (beyond those already agreed by Cabinet) apart from the proposal to specify that allocation of New Zealand units to owners of pre-1990 forest land will be 60 units per hectare for those owners who purchased land prior to 1 November 2002 and the removal of the cap on free allocation to this sector, which brings increased fiscal risk to the Crown.
11. The fiscal risk in relation to forestry cuts both ways – in some situations the Crown would benefit but in others the Crown would be worse off. The variables that are relevant are the proportion of eligible parties that apply for allocation, the proportion of eligible parties that apply for an exemption to the pre-1990 regime and then deforest, and the exact area of pre-1990 land. It is impossible to be definitive on this point on the scale and direction of the fiscal risk. The Treasury prefers retaining the current capped allocation approach as it maintains the level of compensation that has been previously agreed and does not increase the fiscal risk the Crown. Noting the fiscal risk involved, the

¹ This simplifies the processing of applications under the forestry allocation plan.

Treasury suggests that if a decision is to be made on this point, it is taken at a later date when more information is available (ie at Select Committee stage).

12. Cabinet Paper (09) 531 contained a drafting error suggesting that phase-out of free allocation to agriculture will commence in 2015. In fact, phase-out for agriculture is to commence in 2016. It was intended that the Cabinet Paper reflect this 2016 commencement date and the costs included in that Cabinet Paper were modelled on that basis. As such, the appropriations agreed to by Cabinet in Cab Min (09) 33/19 are consistent with the proposals contained in this paper.

Human rights

13. 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

14. A Bill will be required to implement the proposals covered in this paper in addition to the related proposals agreed by Cabinet [Cab Min (09) 33/9 refers].
15. It is proposed that the Bill be introduced and passed by 10 December 2009, in time for the United Nations climate change conference in Copenhagen, December 7-18, 2009. Cabinet agreed to include a Climate Change Response Amendment Bill on the 2009 Legislative Programme with a category 2 priority (must be passed in 2009).

Regulatory impact analysis

16. The proposals in this paper are of a minor or machinery nature and do not substantially alter existing arrangements, such that a Regulatory Impact Statement is not required.

Publicity

17. The proposals in this paper will be covered in general publicity relating to the Bill. No publicity specific to the proposals in this paper is proposed.

Recommendations

18. The Minister for Climate Change Issues recommends that Cabinet:
 1. **note** that Cabinet previously agreed a range of changes to the NZ ETS [Cab Min (09) 33/9 refers];
 2. **agree** that initial allocation of New Zealand units to the agriculture sector for the year 2015 be 90 per cent;
 3. **agree** that the phase out of free allocation for the agriculture sector will begin in 2016;
 4. **agree** that allocation of New Zealand units to owners of pre-1990 forest land will be 60 units per hectare for those owners who purchased land prior to 1 November 2002;

5. **agree** that decisions as to persons eligible for allocation in the fishing sector should be taken by the Minister for Climate Change Issues under the fishing allocation plan;
6. **agree** that allocation to owners of fishing quota will be based on tonnage, or equivalent, of quota held (on a one-off basis) on the date of introduction of the Bill to the House;
7. **agree** that there will be a review of allocation every five years;
8. **agree** to make amendments in relation to the following more minor matters, as described in the Annex to this paper:
 - 8.1. power of the Minister for Climate Change Issues to require information;
 - 8.2. not allow the fixed price option to be used during true-up;
 - 8.3. ability of the Chief Executive to delay registration of removal activity participants who have failed to pay any applicable fees and charges;
 - 8.4. provision for unincorporated bodies;
9. **note** that I am considering other matters of detail for inclusion in the Bill that will be referred to Cabinet in due course;
10. **agree** to give the Cabinet Legislation Committee power to act to approve the Bill for introduction.

Hon Dr Nick Smith
Minister for the Environment
Minister for Climate Change Issues
____ / ____ / ____

Annex.

More minor policy proposals

1. Extend the power of the Minister to require information from participants for the purposes of recommending eligible activities so that the Minister may require information for other purposes, including to assist with review of the NZ ETS and the establishment of allocative baselines.
2. Cabinet agreed that the fixed price option will be able to be used for the reconciliation mechanism for industrial allocation (the “true-up”). However, this approach could encourage the practice of arbitrage on the price of units. Therefore, the Bill will not allow the fixed price option to be used for making true-up payments. This will have minimal impact on the cost to participants given that the true-up will generally be achieved through changes to the next year’s provisional allocation.
3. Cabinet has agreed to an amendment to clarify the ability of the Chief Executive to delay registration of post-1989 forest land participants who have failed to pay any applicable fees and charges. For consistency of treatment, the Bill introduces this amendment in relation to all removal activity participants rather than only post-1989 forest land participants.
4. Cabinet has agreed to clarify the ability of the Chief Executive to make changes to the composition of joint participants and to provide for authorised representatives in respect of joint activities. In order to effectively implement this, the Bill introduces new provisions referring to “unincorporated bodies”, which allow persons jointly carrying out an activity to participate as an unincorporated body. Changes in the membership of an unincorporated body will thus be able to occur without changing the identity of the entity registered as participant.