



## The New Zealand Emissions Trading Scheme

# Proposed options for the carry-over of Kyoto units under the ETS

The purpose of this consultation factsheet is to seek your views on the proposed options for the carry-over of Kyoto units under the ETS, and to discuss the impact of the Government's preferred options on ETS individual account holders.

## Summary

The Ministry is seeking feedback on the application of the international carry-over rules within the New Zealand Emissions Trading Scheme (ETS). These rules place a restriction on the number of some types of units which can be carried over from the first Kyoto Protocol commitment period (CP1, 2008–2012) and be valid for surrender in the second Kyoto Protocol commitment period (CP2, 2013–2020).

The international carry-over rules require units which are not carried over to be cancelled. We anticipate this carry-over of units will occur after the 31 May 2015 ETS surrender deadline; however the Government is consulting on this issue now to provide greater certainty to ETS participants and to allow them to plan their compliance purchasing and surrendering appropriately.

The Government must decide to what extent, if any, New Zealand's 2.5 per cent international carry-over entitlement for Certified Emissions Reductions (CERs) and Emission Reduction Units (ERUs) is extended to individual account holders.

The Government's preferred option is to not extend the international carry-over provisions for CERs and ERUs to individual account holders in the New Zealand Emission Unit Register (NZ EUR), as

the potential costs to the taxpayer outweigh the limited benefits to account holders.

We are also taking this opportunity to clarify the process for individual account holders to apply to carry over Assigned Amount Units (AAUs). The Government's preferred option is to automatically carry over any AAUs in the NZ EUR. This is because it is administratively simpler, entails less risk of loss due to oversight, and the benefits to individual account holders outweigh the costs.

## Background

### International carry-over rules

The Kyoto Protocol places a restriction on the number of some types of Kyoto units which can be carried over from CP1 (2008–2012).

Under these international carry-over rules, the following rules apply:

- AAUs can be carried over without limitation
- CERs and ERUs, respectively, may each be carried over up to a quantity equal to 2.5 per cent of a country's initial assigned amount. In New Zealand's case, this amounts to approximately 7.75<sup>1</sup> million each of CERs and ERUs
- any units issued on the basis of a land use, land-use change and forestry (LULUCF) activity may not be carried over. In practice, this means Removal Units (RMUs) and ERUs

<sup>1</sup> More exactly, 7.739m each of CERs and ERUs may be carried over.



converted from RMUs may not be carried over.<sup>2</sup>

### Why do international rules apply to my units?

The Government allows individual account holders to hold Kyoto units for use within the ETS. The international carry-over rules apply to all Kyoto units on a national registry-wide level, regardless of whether the affected units are held in the Government or individual accounts.

Any Kyoto units which are not formally carried over are subject to mandatory cancellation. After this point, those units may no longer be used for surrender purposes or transferred internationally.

Because of this we need to determine how we apply the international carry-over rules domestically, to minimise the risk individual account holders' CP1 Kyoto units are cancelled before they can be used.

### Domestic ETS settings

To give effect to the international carry-over rules domestically, regulations under the Climate Change Response Act 2002 (the Act) need to be developed.

#### *AAUs, CERs, and ERUs*

Section 16 of the Act states that account holders may, subject to regulations, apply to carry over AAUs, CERs and ERUs from one commitment period to a subsequent one. The regulations governing the conditions under which this carry-over may occur have not been made; therefore the Ministry must develop those regulations based on the information from this consultation.

#### *RMUs*

Under section 16 of the Act, RMUs may not be carried over under any circumstances, in accordance with the international carry-over rules. As such, the Government is not seeking submissions regarding the carry-over of RMUs. This also applies to ERUs converted from RMUs.

#### *NZUs*

New Zealand Units (NZUs) are not subject to the international carry-over rules and are not affected

by this consultation. The eligibility of NZUs is not restricted to any specific commitment period.

### Status quo

The international carry-over rules will apply whether or not New Zealand reflects them in the domestic legislation. This means any Kyoto units not formally carried over will be subject to mandatory cancellation.

If the Government's approach to application of the international carry-over rules is not clarified through regulations, the continued lack of certainty would therefore result in significant risk of loss to individual account holders who hold Kyoto units in their accounts.

## Consultation issue one: CERs and ERUs

The Government must decide to what extent, if any, New Zealand's limited entitlement to carry over CERs and ERUs is devolved to individual account holders. The Government's preferred option is to not allow individual account holders to carry over CERs or ERUs.

The Government has decided to publicly consult on this issue early, to minimise the risk of financial loss to account holders holding Kyoto units beyond the carry-over date that cease to hold currency.

This will mean individual account holders will have the three surrender periods up to 31 May 2015 within which to surrender or otherwise dispose of their Kyoto units.

## Consultation issue two: AAUs

The Government must also decide how to apply the international carry-over rules to the domestic carry-over of AAUs.

AAUs are able to be carried over without a restriction on quantity. The Government's preferred option is to automatically apply for the carry-over of any AAUs held in the NZ EUR, including those in private accounts, on the date which the Government must submit its carry-over notification.

---

<sup>2</sup> For more information on unit types please visit [www.climatechange.govt.nz](http://www.climatechange.govt.nz)

## Objectives of regulations

This consultation will help develop regulations for carry-over of Kyoto units within the ETS. The proposed carry-over regulations have the following objectives:

1. To increase certainty for the eligibility of CP1 Kyoto units in the ETS. This will provide market participants with the necessary information to make long-term business decisions, maximise efficiency, and minimise the risk of financial loss.
2. The carry-over regulations must be written so they can be applied equitably, in a manner which is transparent and which maintains the environmental integrity of the ETS.

## Assessment criteria

In order to meet the objectives, the following criteria must be met:

- efficiency – adopt and maintain only regulations for which the costs on society are justified by the benefits to society
- effectiveness – regulation should be designed to achieve the desired policy objectives
- transparency – the regulation-making process should be clear
- clarity – regulatory processes and requirements should be as understandable and accessible as practicable
- equity – regulation should be fair and treat those affected equally
- environmental Integrity – the environmental integrity of the ETS should be maintained.

Regulations must also be consistent with New Zealand's international obligations and reputation.

## Consultation issue one (CERs and ERUs)

### Proposed options

There are two options when considering how New Zealand's limited entitlement to carry over CERs and ERUs can be devolved to individual account holders. They are:

A) individual account holders are not able to carry over CERs or ERUs at all, or

B) individual account holders are able to carry over CERs and ERUs up to the maximum set in the international rules.

Because the international carry-over rules set such significant restrictions on the carry-over of CERs and ERUs, either option has a significant impact on individual account holders' ability to carry over CERs and ERUs.

### Option A:

Under Option A, individual account holders would be unable to carry over any of their CERs or ERUs. This means they would have to surrender or sell all their CP1-eligible Kyoto units before the Government's carry-over notification date (estimated to occur in mid-2015).

Participants would have three surrender periods when they would be able to surrender CERs and ERUs in preference to NZUs. Any CERs or ERUs remaining in the NZ EUR after the carry-over date would be cancelled.

### Option B:

Under Option B, the Government would extend New Zealand's CER and ERU restricted carry-over entitlement to individual account holders, to the maximum extent allowable by the international carry-over rules (15.5 million units, or approximately 80 per cent of the anticipated total ETS surrender obligation for 2016).

If this option was pursued, then consideration would need to be given to the design of a system to ensure the limited ability to carry over CERs and ERUs was allocated consistently and fairly.

There are a range of alternatives to determine how this is implemented. These include:

- queuing (ie, first-come, first-served basis)
- pro rata (eg, based on the previous year's emissions)
- targeted (ie, the Government will decide which sectors are eligible to apply for carry-over)
- auction entitlements (ie, carry-over entitlements are sold by the Government in a competitive bidding process).

The international carry-over rules mean that a maximum of 7.75 million CERs and a maximum of

7.75 million ERUs may be carried over. This means any such process would need to be run twice – once for CERs, and once for ERUs.

## Assessment of options

The status quo carries with it significant risk of loss to individual account holders due to the potential for mandatory cancellation of CP1 Kyoto units. It is also responsible for continuing uncertainty with regard to the eligibility of CP1 Kyoto units in the ETS beyond 31 May 2015, as the carry-over rules are currently not set in the regulations.

When assessing the options, we are therefore assessing Option A against Option B, as both are preferable to the status quo.

### Impact assessment

Option A would clearly result in some extra costs for individual account holders. When assessing the impact of not allowing the carry-over of CERs and ERUs, two factors need to be considered:

- 1) *Amount of units:* The number of CERs or ERUs they would have otherwise been able to carry over (ie, under Option B)
- 2) *Price differential:* The difference between the cost of the unit they would have been able to carry over, and the cost of a unit eligible for surrender post-31 May, 2015.

#### *Amount of units*

The exact number of CERs or ERUs an individual account holder would otherwise have been able to carry over (under Option B) would depend on which method was used to determine the allocation of New Zealand's limited carry-over entitlement.

However, across the whole of the ETS, the projected surrender obligation for the period 2013 to 2020 is approximately 170 million units. Under Option A, participants could still use 60 million CP1 Kyoto units (or 35%) to meet their collective obligations. Under Option B, they would be able to use 75.5 million (or 44%). This means that under Option B, participants would be able to use approximately 9 per cent more CP1 Kyoto units to meet their collective obligations out to 2020.

#### *Price differential*

The price differential would depend on the cost of the next cheapest unit that would be eligible for surrender post-31 May, 2015. The global carbon market is volatile, and prices are difficult to predict with any certainty.

Eligible units will be available through a range of different supply mechanisms, which could include auctioning of NZUs and continued access to CERs through primary investment in the CDM. The price differential is therefore difficult to determine at this stage, but will likely reflect the international prices prevailing at the time.

The exact impact on individual account holders is therefore difficult to determine. This consultation document is therefore seeking any information from affected stakeholders which would allow us to better evaluate this impact.

### Evaluation criteria

#### *Efficiency*

Option A places the least burden on the taxpayer. The resources required to write regulations based on Option A would require minimal time and effort compared to Option B.

The cost to the taxpayer of implementing Option B would depend on the actual system implemented. There would be a cost in progressing work on which system to pursue. The information available to us is, at present, insufficient to allow us to quantify what the benefits to individual account holders of pursuing this option in preference to Option A would be. There is likely to be at least some opportunity cost to individual account holders as a result of the Government pursuing Option A. This consultation document is seeking any information that would allow us to better assess these costs.

#### *Effectiveness*

Option A would meet both objectives to the fullest extent. While Option B would also meet both objectives to an extent, the extra time needed to fully develop a preferred distribution system under this method would delay the ability to provide certainty to the market. It would also be difficult to apply the distribution fairly and equitably, in a manner which took into account all affected account holders.

### *Transparency*

Both options would allow the regulation-making process to be clear and transparent.

### *Clarity*

Regulatory processes and requirements would be clearest under Option A, as it is the simplest option. Although it would depend on the specific distribution system, clarity would, to some extent, be compromised by any of the systems outlined above under Option B.

### *Equity*

Option A provides the greatest guarantee of equity across all individual account holders, as it would apply equally to all.

There are issues of equity under all of the proposed distribution systems under Option B. It would be difficult to ensure all account holders – including new entrants, those with surrender obligations varying from year to year, foresters who may only have deforestation obligations years from now, and those account holders who are not direct ETS participants – are accounted for fairly and equitably.

### *Environmental integrity*

Both options would rate equally for environmental integrity.

### **Conclusion**

Based on the above analysis, the Government's preferred approach is to adopt Option A: to not extend the international carry-over entitlements to individual account holders.

Fully developing a system under Option B that would meet the evaluation criteria set out above would likely involve a significant cost to the taxpayer. Also, further consultation would likely be necessary before a preferred method was selected. On balance, the Government considers these costs would likely outweigh the benefits accruing to individual account holders.

However, we are seeking information from affected stakeholders that would allow us to better gauge the impact that pursuing Option A over Option B would have.

The Government is signalling this early, so there is sufficient time for participants to plan their compliance purchasing and surrendering appropriately.

## **Consultation issue two (AAUs)**

### **Proposed options**

Unlike the international rules governing the carry-over of CERs and ERUs, there is no restriction on the ability to carry over AAUs. Therefore, there is no need for the Government to manage the allocation of carry-over entitlements. This means there are two options regarding the ability of individual account holders to carry over AAUs.

### **Preferred approach: Automatic carry-over of AAUs**

Under this approach, the Government would automatically apply to carry over all AAUs held in the NZ EUR (including those held in private, non-government accounts). This option would have the least amount of administrative burden on individual account holders.

This option would meet all the criteria set out above.

### **Alternative approaches**

The Government could require account holders to specifically apply to carry over AAUs. This option would result in a higher level of administrative burden for both the Government and individual account holders. It also would increase the risk AAUs might not be carried over due to an administrative oversight by individual account holders. Due to this risk, this option might be neither effective nor efficient. As such it is not preferred by the Government.

The Government has not considered prohibiting individual account holders from carrying over AAUs.

## General consultation questions

### Status quo

How would you describe the status quo?

Do you feel there are any other impacts of leaving the status quo that have not been described?

### Objectives/ evaluation criteria

What objectives do you feel the options should meet?

How would you weigh the evaluation criteria we have selected?

Which evaluation criteria do you feel should be used to assess the options?

### Problem definition / options

How would you characterise the issues surrounding carry-over?

What options could address these issues that have not been considered here?

## Consultation issue one (CERs and ERUs)

What impact would the Government's preferred approach of not allowing carry-over of CERs and ERUs have on you? Have you purchased or contracted for more Kyoto units than you need for the next three surrender periods? If possible, include any information you feel would help us better quantify the impact – but bear in mind that your submission may be subject to the OIA, as described in "About submissions" overleaf.

If the Government was to allow individual account holders to carry over Kyoto units,

which method of implementation (ie, queuing, pro-rate, targeted or auctioning entitlement) do you believe would best meet the evaluation criteria, and why?

Are there any additional implications or benefits of these options that are not outlined in this factsheet?

Are there any other options you feel should be considered?

## Consultation issue two (AAUs)

The Government's preferred option is that the NZEUR automatically applies to carry over AAUs held in accounts, unless the account holder specifically opts out.

Do you agree with this approach? If not, why not?

Are there any additional options or implications you feel should be taken into consideration?

## Next steps

The Ministry will review all submissions received under this consultation and brief the Minister for Climate Change Issues regarding this topic. If the Minister decides to implement Option A, regulations will be drafted and enacted before the end of 2013. If the Minister decides to implement Option B, then further work and consultation will be required to determine the most appropriate method of implementation.

We intend to communicate the Minister's decision before the 31 May 2013 surrender deadline to allow individual account holders to plan their compliance purchasing and surrendering appropriately.

## About the submission process

The closing date for submissions is:

5pm Friday 29 March 2013.

### Find out more

[www.climatechange.govt.nz/ets](http://www.climatechange.govt.nz/ets)  
Phone: 0800 CLIMATE (254 628)

### Have your say

Please send your submission by email to:

[etsconsultation@climatechange.govt.nz](mailto:etsconsultation@climatechange.govt.nz)

If you are unable to email your submission then please post it to

**ETS Carry-over**  
**Ministry for the Environment**  
**PO Box 10362**  
**Wellington 6143.**

## About submissions

The Ministry for the Environment may publish all or part of any written submission on the Government's climate change website. We will consider you to have consented to such publishing by making a submission, unless you clearly specify otherwise in your submission.

The content of submissions is subject to the Official Information Act 1982. Copies of submissions sent to us will normally be released in response to an Official Information Act request from a member of the public. If you object to the release of any information contained in your submission, please clearly state this in your submission, including which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this document.

If you do not wish your name and any identifying details in your submission to be released in response to a request, please clearly state this in your submission. At your request, we will make your submission anonymous before it is published on the climate change website. However, please note that the Ministry for the Environment will not be able to withhold any information if doing so would contravene the requirements of the Official Information Act.

**Published in February 2013**  
**by the Ministry for the Environment**  
**PO Box 10362, Wellington 6143**

**Publication No: INFO 678**



Ministry for the  
**Environment**  
*Manatū Mō Te Taiao*

Ministry for the Environment  
Manatū Mō Te Taiao

Po Box 10362  
Wellington 6143

[www.climatechange.govt.nz/ets](http://www.climatechange.govt.nz/ets)  
0800 CLIMATE (0800 254 628)