



Cabinet

Minute of Decision

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Amendments to the Climate Change Response Act 2002: Tranche One

Portfolio **Climate Change**

On 10 December 2018, following reference from the Cabinet Environment, Energy and Climate Committee, Cabinet:

Background

- 1 **noted** that the paper under ENV-18-SUB-0048 provides a first tranche of proposals to amend the Climate Change Response Act 2002 (CCRA) to support New Zealand's implementation of the Paris Agreement and improve the New Zealand Emissions Trading Scheme (NZ ETS);
- 2 **noted** that the NZ ETS is the government's key policy tool to reduce greenhouse gas emissions and support New Zealand to meet its emission reduction targets;
- 3 **noted** that the 2015/16 NZ ETS review found that, without changes, the NZ ETS will not effectively assist New Zealand to meet emission reduction targets, including the 2030 Nationally Determined Contribution (NDC) for the purposes of the Paris Agreement, and any new target under the proposed Climate Change Bill (CCB);
- 4 **noted** that all decisions about the design and operation of the NZ ETS have the potential to affect the credibility of the scheme and ability to link to other emissions trading schemes;

Aligning the Climate Change Response Act with the Paris Agreement and the Climate Change Bill

- 5 **noted** that the purpose statement of the CCRA needs to be updated to reflect the Paris Agreement and the proposed CCB;
- 6 **agreed** to amend the purpose section of the CCRA to assist New Zealand to comply with its emission reduction and reporting commitments for the purposes of the Paris Agreement;
- 7 **agreed** to include the text of the Paris Agreement as a schedule to the CCRA, alongside the Kyoto Protocol and the United Nations Framework Convention on Climate Change (the Convention);
- 8 **agreed** to make other minor changes to the CCRA to reflect the Paris Agreement and remove now redundant aspects of the CCRA (including certain references to obligations under the Kyoto Protocol which have now been expended);

- 9 **agreed in principle, subject to** final decisions on the CCB, to amend the purpose of the CCRA to assist New Zealand to meet target(s) and emissions budgets set under the CCB;

Establishing a NZ ETS unit supply framework

- 10 **noted** that in December 2017, Cabinet noted four in-principle decisions made by the previous government to:
- 10.1 introduce auctioning of units to align the supply of units in the NZ ETS to New Zealand's emission reduction targets;
 - 10.2 limit participants' use of international units when the NZ ETS reopens to international carbon markets;
 - 10.3 develop a different price ceiling to eventually replace the current \$25 fixed price option;
 - 10.4 coordinate decisions on the supply settings in the NZ ETS over a five-year rolling period;

[CAB-17-MIN-0547.01]

- 11 **noted** that implementing the four in-principle decisions will provide a framework for making unit supply decisions, and that they need to be implemented together to enable a cap on emissions covered by the NZ ETS;
- 12 **noted** that progressing the four in-principle decisions is important for accessing high-integrity international carbon markets to support New Zealand meeting emission reduction targets for the purposes of the Paris Agreement and emissions budgets under the CCB;
- 13 **noted** that the unit supply framework will support the updated objectives of the NZ ETS by allowing unit supply to align with New Zealand's emission reduction targets;
- 14 **noted** that public consultation was recently completed on implementation details for the four in-principle decisions [ENV-18-MIN-0034], and that submitters were broadly supportive of the proposals;
- 15 **noted** that the in-principle decisions need to be implemented in two stages; the first stage will amend the CCRA to put in place a new unit supply framework and enable a cap; the second stage to make regulations on the level of the cap;

Auctioning

- 16 **noted** that the CCRA enables the Minister for Climate Change to sell New Zealand Units (NZUs) by auction, but to date, an auctioning mechanism has not been utilised;
- 17 **agreed** to begin developing an auction platform and regulations to implement auctioning of NZUs to align the supply of NZUs in the NZ ETS with emission reduction targets;
- 18 **agreed** to the development of an auctioning platform:
- 18.1 with a sealed-bid, single-round, uniform priced format because it is less complex and has lower risk of collusion;
 - 18.2 with flexibility for monthly or quarterly auctions;

18.3 that all New Zealand Emissions Trading Register account holders are eligible to participate in, subject to further qualifications provided in regulations;

19 **noted** that the current regulation-making power is sufficient to enable the development of the proposals, referred to in paragraphs 17 and 18 above;

20 **noted** that the current statutory prerequisites for auctioning regulations include an overall limit on the number of NZUs and a five-year rolling unit supply decision-making process;

21 **agreed** that this prerequisite, referred to in paragraph 20 above, will no longer be relevant for auctioning regulations, given the new coordinated decision-making process;

Limiting international units

22 **noted** that accessing international units is a last resort rather than a first choice;

23 **noted** that on 28 May 2018 Cabinet agreed to the government's position on international carbon markets [CAB-18-MIN-0248];

24 **agreed** that the minute of Cabinet's decisions on 28 May 2018 be amended by the addition of the text in paragraph 22 above;

25 **noted** that international units could influence the NZ ETS either directly through participant purchase, or government purchase of international units, with a corresponding amount of NZUs auctioned into the NZ ETS;

26 **noted** that it is not possible to make a choice on the mode of purchase at this time as international carbon markets are still developing;

27 **noted** that no decision has been made on when the NZ ETS could reopen to international units;

Price controls - cost containment reserve

28 **noted** that price controls in emissions trading schemes aim to limit unacceptably high or low prices and are normally set well outside of expected market price ranges;

29 **agreed** that the NZ ETS should retain a price ceiling to manage the risk of prices reaching unacceptable levels;

30 **noted** that the current price ceiling, the \$25 fixed price option, is volume-unlimited and creates significant risks to the government;

31 s9(2)(f)(iv)

32 **agreed** that the cost containment reserve will replace the fixed price option;

33 **noted** that the Minister for Climate Change will report back in March 2019 on interim decisions for the fixed price option;

34 **agreed** that the volume of units available via the cost containment reserve, the trigger price(s) these are released at, and operational detail, will be set in regulations as part of the coordinated decision-making process;

- 35 **agreed** to require the Minister for Climate Change to, at least once per emissions budget, secure a corresponding emission reduction equivalent to any NZUs sold from the cost containment reserve (for example, by obtaining international units);

Price controls - price floor

- 36 **noted** that the CCRA does not currently explicitly provide for a price floor in the NZ ETS;
- 37 **noted** that there may be a case to reassess the use of a price floor in the NZ ETS to future-proof the scheme;
- 38 **directed** officials to investigate the potential introduction of a price floor in the NZ ETS, including an option to set a reserve price through auctioning, and report back by March 2019;
- 39 **directed** officials to develop an auctioning platform that retains flexibility to set a reserve price through auctioning;

Coordinated decision making

- 40 **agreed** that there will be a coordinated decision-making process that will require the government to make annual regulation updates setting the supply of units into the NZ ETS on a five-year rolling basis;
- 41 **noted** that the coordinated decision-making process will implement the in-principle decisions, noted in paragraph 10 above, to provide a framework for unit supply decisions;
- 42 **agreed** that the coordinated decision-making process will set an overall limit on the number of NZUs to be auctioned, the access to international units, and price control settings (including the trigger price(s) and the volume of NZUs available via the cost containment reserve), taking into account any expected volumes for free allocation and negotiated greenhouse gas agreements;
- 43 **noted** that the NZ ETS cap is designed to decline over time, consistent with expectations that emissions budgets under the CCB and future NDCs for the Paris Agreement, will be increasingly ambitious over time;
- 44 **noted** that a stringent and declining NZ ETS cap is key for enabling linkages to other established and credible schemes;
- 45 **agreed** that unit supply decisions must generally not be inconsistent with the relevant emissions budget or the relevant NDC;
- 46 **agreed** that when making unit supply decisions, the Minister for Climate Change must also have regard to:
- 46.1 New Zealand's projected emission trends for the relevant five-year period;
 - 46.2 the greenhouse gas emissions to which the NZ ETS applies;
 - 46.3 the proper functioning of the NZ ETS;
 - 46.4 agreements and arrangements for international emission reductions;
 - 46.5 the forecast range of abatement costs that may be needed in order to deliver New Zealand's emission reduction targets;

- 46.6 any international emission reductions obtained by the government for the purposes of enabling NZUs to be auctioned into the NZ ETS;
- 46.7 recommendations of the Climate Change Commission, including a desirable carbon price path;
- 46.8 any other matters that the Minister for Climate Change considers relevant;
- 47 **agreed** that when deciding the number of NZUs to be auctioned that as well as the considerations listed in paragraphs 45 and 46 above, the Minister for Climate Change will also have regard to:
- 47.1 the limit on the number of international units that a participant may surrender;
- 47.2 the number of NZUs expected to be allocated through free allocation or provided under negotiated greenhouse gas agreements;
- 48 **agreed** that in making decisions on price control settings, including the trigger prices, and the number of NZUs that could be provided via the cost containment reserve, as well as the considerations listed in paragraphs 45, 46 and 47 above, the Minister for Climate Change must also have regard to:
- 48.1 the impact of emissions prices on households and the economy;
- 48.2 the level and trajectory of international emissions prices (including price controls in linked markets);
- 48.3 inflation;
- 49 **agreed** that, to provide predictability to participants, once unit supply decisions are made, years one and two of this period can only be changed in accordance with paragraph 50 below;
- 50 **agreed** that, unit supply decisions in relation to price control settings are able to be adjusted in years one and two:
- 50.1 if they are utilised;
- 50.2 in special circumstances, including in relation to linking with other international carbon markets, a change in emissions budgets or a force majeure event;
- 51 **noted** that other relevant procedural requirements of the current unit supply regulation-making power will continue to apply;
- 52 s9(2)(f)(iv)

Compliance regime

- 53 **noted** that low-level offending in the NZ ETS is common, but has often gone unsanctioned;
- 54 **agreed** to amend the CCRA to enable regulations that establish a set of infringement offences targeted at low-level compliance issues, including defining which offences in the Act are infringement offences and requiring consultation;

- 55 **noted** that prosecution would still be available for more serious non-compliance;
- 56 **noted** that changes to forestry in the NZ ETS may mean new penalties are needed, which will be part of the advice in March 2019;
- 57 **noted** that further improvements to the penalty regime including potential changes to penalties for errors in reporting, claiming allocations, and failing to surrender or repay units, will be part of the advice in March 2019;

Market governance

- 58 **agreed in principle, subject to** final decisions on the broader, coherent market governance framework, to prohibit insider trading and market manipulation in the NZ ETS market;
- 59 **agreed in principle, subject to** final decisions on the broader, coherent market governance framework to, as much as is practical and appropriate, approach insider trading and market manipulation in the same manner as they are treated in the Financial Markets Conduct Act 2013 (FMCA);
- 60 **agreed in principle, subject to** final decisions on the broader, coherent market governance framework to, as much as is practical and appropriate, have penalties and offences for insider trading and market manipulation in the NZ ETS that mirror the equivalent relevant penalties and offences in the FMCA;
- 61 **noted** that Ministry for the Environment officials will do further work determining the most appropriate regulator to enforce this conduct, including careful consideration of which regulator is most appropriate and ensuring that the regulator is adequately resourced to deal with this conduct;
- 62 **directed** officials from the Ministry for the Environment and the Ministry of Business Innovation and Employment to develop a broad and coherent market governance framework for the next tranche of NZ ETS decisions, by March 2019;
- 63 **invited** the Minister for Climate Change, in consultation with the Minister of Forestry and the Minister of Commerce and Consumer Affairs, as appropriate, to recommend final decisions on the broader, coherent market governance framework in the next tranche of NZ ETS decisions;

Operational and technical improvements

- 64 **agreed** that the CCRA be amended so that:
- 64.1 when an entitlement to units is approved, these units are used first to repay any overdue unit obligation, before any remaining balance is transferred to the person;
 - 64.2 the reporting of all coal sold or used from a person's stockpile in the year is required, regardless of whether the person meets the threshold for coal importing, purchasing or mining;
 - 64.3 regulators are able to amend unique emissions factors from previous years if an error is found;
 - 64.4 a participant is able to use any eligible emission units to repay the Crown;
 - 64.5 industrial allocations can be transferred to a consolidated group account;

64.6 an account holder's representative cannot operate a New Zealand Emissions Trading Register account after the account holder has been removed from the New Zealand Companies Register, and any units in that account are vested in the Crown, in accordance with section 324 of the Companies Act 1993;

Next steps

- 65 **noted** that any new funding required to implement the final policy decisions noted above will be sought through a separate Cabinet paper or through Budget 2019;
- 66 **noted** that the Minister for Climate Change will proactively release the paper under ENV-18-SUB-0048 on the Ministry for the Environment's website, subject to redactions equivalent to withholdings under the Official Information Act 1982;
- 67 **noted** that the Minister for Climate Change intends to bring the second tranche of proposals to amend the CCRA to Cabinet for consideration in March 2019;
- 68 **noted** that these two tranches and the forestry proposals are intended to culminate in a single amendment bill to the CCRA expected to be introduced in mid-2019;
- 69 **noted** that the timeframes for progressing this bill are tighter than usual timeframes for legislative drafting;
- 70 **noted** that the Minister for Climate Change intends to return to Cabinet by July 2019 to begin developing regulations needed to implement the final policy decisions;
- 71 **noted** that public consultation on regulations is expected to occur alongside the Select Committee process for the proposed CCRA bill, with the aim of having regulations in effect in 2020;
- 72 **invited** the Minister for Climate Change to issue drafting instructions to the Parliamentary Counsel Office (PCO) based on the agreed and "in principle" decisions above;
- 73 **authorised** the Minister for Climate Change, in consultation with the Minister of Forestry as appropriate, to further clarify and develop policy matters relating to the amendments proposed above, in a way not inconsistent with Cabinet's decisions;
- 74 **agreed** that the Minister for Climate Change may share paper, under ENV-18-SUB-0048, drafts of further Cabinet papers on related issues, drafting instructions to the PCO, subsequent drafts of amendments to the CCRA or regulations, and related documents, with the Environmental Protection Authority, as a key agency in the proposed amendments.

Michael Webster
Secretary of the Cabinet

Secretary's Note: This minute replaces ENV-18-MIN-0048. Cabinet amended paragraph 22, added new paragraphs 23, 24 and 62 and also amended paragraph 63.

Hard-copy distribution:

Prime Minister
Deputy Prime Minister
Minister for Climate Change