

Office of the Minister for Climate Change Issues

Cabinet Legislation Committee

**Climate Change Response (Moderated Emissions Trading) Amendment Bill:
Approval for Introduction**

Proposal

1. I propose that Cabinet approve the Climate Change Response (Moderated Emissions Trading) Amendment Bill (the Bill) for introduction into Parliament, with a view to passing the Bill in time for the United Nations climate change conference in Copenhagen, December 7-18, 2009.

Policy

Policy to be implemented by the Bill

2. The Bill introduces a number of amendments to the Climate Change Response Act 2002 in order to modify the New Zealand Emissions Trading Scheme (NZ ETS), [Cab Min 09-33/9 of 14 September 2009 and Cab Min of 21 September 2009 (reflecting Cabinet Paper (09) 566) 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 \$25.¹
- The export of New Zealand units will not be permitted while the fixed price option is in place. However this 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 industries 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 industries 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 allocation.

¹ Units issued under the \$25 fixed price option must be immediately surrendered.

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 and will phase out at 1.3% starting from 2016.
 - 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).
 - Provision will be made for a domestic '50 by 50' emissions reduction target for New Zealand to be set by regulation.
 - Initial allocation of New Zealand units to the agriculture sector for the year 2015 will be 90 per cent.
 - 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.
 - 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.
 - Allocation to owners of fishing quota will be based on tonnage of quota, or equivalent, held (on a one-off basis).
3. The Bill also introduces a number of clarifications and second order amendments agreed by Cabinet that are largely technical in nature and would assist with the effective functioning of the Act.

Possible contentious issues

4. I have already announced the high-level policy changes introduced by the Bill, but the details of various aspects of the Bill are likely to be contentious, including the details of allocation (in particular, allocation to industry), forestry (for which provisions have changed relatively little), and entry of the agriculture sector.

Forestry exposure draft allocation process

5. Cabinet agreed to run an exposure draft allocation process in relation to the allocation plan for forestry concurrent with the Select Committee process for the Bill. It will be necessary to amend the forestry allocation plan to give effect to changes introduced by the Bill. These amendments are to reduce litigation risk and retain flexibility over the second tranche of allocation for forestry.
6. I propose to release a consultation document in the week beginning 12 October 2009 explaining the proposed amendments to the forestry allocation plan and attaching the draft plan (note that the Bill includes far more detail than the

current Act meaning that the allocation plan process is likely to be less contentious). Consultation with forestry sector stakeholders will run for a six week period in the week beginning 12 October 2009 with a view to issuing the final allocation plan by the end of 2009. Consultation will run in parallel with the Select Committee process, enabling stakeholders to see and comment on the proposed changes to the forestry allocation plan in light of the Bill.

Regulatory impact analysis

7. Two Regulatory Impact Statements were submitted to Cabinet at the time that approval of the policy relating to the Bill contained in Cabinet Paper (09) 531 was sought:
 - a. Regulatory Impact Statement (RIS) on the major amendments for a moderated NZ ETS.
 - b. RIS on second order amendments.
8. In respect of the major amendments for a moderated NZ ETS, the Ministry for the Environment does not confirm that the principles of the code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation regulatory impact analysis requirements, have been complied with.
9. The RIS on the major amendments for a moderated ETS was independently reviewed by Treasury's Regulatory Impact Analysis Team (RIAT). RIAT formed the view that the level and quality of analysis presented is not commensurate with the significance of the proposals, which represent major design changes to the NZ ETS, and that the RIS does not provide an adequate basis for informed decision-making. Some key risks identified by RIAT include (but are not limited to) the following:
 - There is no clear analytical basis for the proposal to align some key design elements of the NZ ETS with those in the currently proposed Australian Carbon Pollution Reduction Scheme (CPRS). For example, there is no discussion of the overall suitability or benefits of applying these elements to New Zealand's unique emissions profile and industrial structures.
 - There is no discussion of the risks of harmonising with an overseas scheme that has not yet been finalised or agreed and may yet be subject to significant revision. Such risks may include the potential impacts on business certainty and investment decisions, and the overall credibility, sustainability and effectiveness of the NZ ETS.
 - There is no information on the implied transition path for firms over the medium-long term, particularly given that the proposal is for a temporary period of greater assistance coupled with an ambitious long-term emissions reduction target. Without this, it is hard to assess whether it is likely that the design changes will allow for a smoother transition for business.
10. In respect of the second order amendments, the Ministry for the Environment confirms that the principles of the code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements, have been complied with. The Ministry for the Environment

considers the RIS on the second order amendments to be adequate, given the purpose and scale of the proposals. The draft RIS was circulated with the Cabinet paper for departmental consultation.

11. No RIS was prepared in respect of the proposals contained in the Cabinet Paper (09) 556 on the basis that those proposals are of a minor or machinery nature and do not substantially alter existing arrangements.

Compliance

12. The Bill complies with the principles of the Treaty of Waitangi and the principles and guidelines set out in the Privacy Act 1993.
13. The LAC Guidelines have been consulted in the preparation of the Bill. Specific issues arising in relation to the LAC Guidelines are referred to below.
14. I have had high-level engagement with the Iwi Leadership Group in relation to the matters to be included in the Bill. I will work with the Maori Party on the introduction of a Treaty of Waitangi provision into the Bill at the committee stage. I will take time to further discuss and carefully consider the drafting of any such clause.
15. The provisions of this Bill do not appear to be inconsistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.
16. The provisions of this Bill have been shaped in order to mitigate risks concerning consistency with international obligations, including trade obligations.

Consultation

17. 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.
18. The Department of the Prime Minister and Cabinet has been informed.
19. There has been limited opportunity for consultation outside of Government due to the commercial sensitivity of the issues proposed in the Bill. Scope for consultation has also been limited by timing constraints. My intent is that the Bill be passed in time for the United Nations climate change conference in Copenhagen, December 7-18, 2009. This implies that the Bill be introduced and passed as early as possible.
20. Due to the high profile of the Bill, all parties are aware of its major policy elements. I have held discussions on the Bill with a number of parties, in particular the ACT, Labour, Maori, and United Future Parties.

Binding on the Crown

21. Cabinet has agreed that the Bill will bind the Crown.

Creating new agencies or amending law relating to existing agencies

22. Not applicable. It is proposed that certain functions relating to the assessment and processing of individual applications for allocation will be transferred to an Environmental Protection Authority (EPA) at some point after it is created in 2011. The Bill does not contain any amendments effecting this. These will be made through the legislation that establishes the EPA. It is also likely that other NZ ETS administrative functions will be transferred to the EPA.

Allocation of decision making powers and associated regulations

23. The Bill allocates power for decisions relating to the following matters to be made by regulation:
- Amending Schedule 1 of the Act, which contains the United Nations Framework Convention on Change, to reflect any changes made to the Convention or amending Schedule 2 of the Act, which contains the Kyoto Protocol to the United Nations Framework Convention on Climate Change, to reflect any changes made to the Protocol.
 - Giving notice of the Crown's intentions to issue and sell or allocate free of charge New Zealand units.
 - Setting allocation plans in respect of pre-1990 forest land and fishing and to correcting such allocation plans if necessary.
 - Specifying a date by which the Crown must hold a number of Kyoto units or approved overseas units.
 - Determining which industrial activities are eligible for allocation, determining allocation to industrial activities and agricultural activities, and requiring information of persons carrying out industrial activities.
 - Prescribing the payment of fees and charges in relation to the NZ ETS.
 - Prescribing the circumstances in which carbon accounting areas can be redefined.
 - Setting, amending or revoking emissions reduction targets.
24. The LAC Guidelines state that matters of significant policy should ordinarily be included in primary legislation, and only included in regulations if objectively justifiable reasons for doing so exist. Although some of the above matters to be included in regulations could be considered matters of significant policy (particularly those relating to allocation), there is justification for including them in regulations.
25. The LAC Guidelines identify that a need for flexibility is among the matters that may justify a delegation of law-making power by Parliament. Enabling the above decisions to be made by regulation is appropriate to provide a level of flexibility that is desirable in light of international developments in emissions trading and international agreements on climate change. For example, it will be desirable for the New Zealand government to be aware of the final shape of other countries' policies on emissions trading (particularly Australia's policy on its proposed CPRS) and of the outcome of current international negotiations (regarding a post-2012 international climate change agreement) prior to finalising New

Zealand's policy settings.

26. The LAC Guidelines also identify technicality of subject matter as a justification for Parliament to delegate law-making power. Enabling several of the above decisions to be made by regulation is appropriate on this basis, for example, decisions in relation to determining allocative baselines and eligible activities, prescribing fees and charges, and redefining carbon accounting areas.

Deemed regulations

27. The Bill contains provisions deeming the allocation plans for pre-1990 forest land and fisheries to be regulations for the purposes of the Regulations (Disallowance) Act 1989 and the Acts and Regulations Publication Act 1989. Similarly, *Gazette* notices that require people to provide financial, emissions and other information relevant to allocation to trade-exposed industry are deemed regulations for the purpose of the Regulations (Disallowance) Act 1989.
28. It is considered appropriate for these instruments to be deemed rather than traditional regulations because they will contain technical matters relevant to particular groups. Nonetheless, it is also considered appropriate (in accordance with LAC guidance) to subject these instruments to the jurisdiction of the Regulations Review Committee, and in the case of the allocation plans, to ensure they are published in the *SR Series*.

Definition of Minister/Department

29. Not applicable.

Commencement of legislation

30. The Bill will come into force on the day after the date of assent.

Parliamentary stages

31. I propose 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).
32. I propose that the Bill be referred to the Emissions Trading Scheme Review Committee.

Recommendations

33. The Minister for Climate Change Issues recommends that the Committee:
 1. **note** that the Climate Change Response (Moderated Emissions Trading) Amendment Bill (the Bill) holds priority 2 on the 2009 legislation programme (must be passed in 2009);
 2. **note** that the Bill introduces a number of amendments to the Climate Change Response Act 2002 for a moderated NZ ETS [Cab Min 09-33/9

and Cab Min of 21 September 2009 (reflecting Cabinet Paper (09) 566) refers], including:

- the stationary energy, industrial processes and liquid fossil fuels sectors will enter the NZ ETS on 1 July 2010;
- a transition phase will operate from July 2010 to December 2012, 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 fixed price option is in place, with the exception that forestry-related units may be exported and 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, with eligibility thresholds set to reduce trans-Tasman competitiveness risks;
- the level of free allocation assistance to industry will initially phase out at a rate of 1.3% per annum beginning in 2013 and the phase out of free allocation will also be considered through a five-yearly review;
- the progressive obligation will not apply to the forestry sector, but the \$25 fixed price option will apply to all forestry surrender obligations incurred before 1 January 2013;
- the entry of agriculture into the NZ ETS will be delayed until 1 January 2015;
- free allocation to the agriculture sector will be provided on an intensity basis and will phase out at 1.3% starting from 2016;
- 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);
- provision will be made for a domestic ‘50 by 50’ emissions reduction target for New Zealand to be set by regulation;
- initial allocation of New Zealand units to the agriculture sector for the year 2015 will be 90 per cent;
- 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;
- allocation of New Zealand units to owners of fishing quota will be based on tonnage of quota, or equivalent, held (on a one-off basis);
- decisions as to persons eligible for allocation in the fishing sector will be taken by the Minister for Climate Change Issues under the fishing allocation plan;

3. **note** that the Bill also introduces a number of clarifications and second order amendments that are largely technical in nature and would assist with the effective functioning of the Act;
4. **approve** the Bill for introduction;
5. **agree** that the Bill be introduced and passed by 10 December 2009;
6. **agree** that the government propose that the Bill be:
 - 6.1. referred to the Emissions Trading Scheme Review Committee;
 - 6.2. passed by 10 December 2009;
7. **authorise** the Minister for Climate Change Issues to make any minor or technical or consequential amendments to the Bill prior to its introduction to the House;
8. **note** that my intent is that there will be some further policy changes introduced to the Bill at the Select Committee stage and that I will bring the relevant policies to Cabinet by 31 October 2009.

Hon Dr Nick Smith
Minister for Climate Change Issues

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