In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Environment Energy and Climate Change Committee

New Zealand Emissions Trading Scheme tranche two: a phase-down of industrial allocation

Proposal

1. This paper seeks decisions to amend the Climate Change Response Act 2002 (CCRA). It is part of the second tranche of amendments to improve the New Zealand Emissions Trading Scheme (NZ ETS).
2. I propose to begin phasing down industrial allocation in the NZ ETS from 2021, to better align the scheme with the Paris Agreement and the emissions budgets set under the Climate Change Bill (CCB), while continuing to mitigate any risk of emission leakage.
3. This phase-down would be achieved by inserting two complementary provisions into the CCRA:
   3.1. Establishing a minimum phase-down rate that applies equally to all eligible activities. I propose that this is set in legislation as an annual reduction of 0.01 to apply from 2021 to 2030, and to enable higher rates from 2031.
   3.2. Establishing a legislated process to set higher activity-specific phase-down rates that would lead to additional reductions in assistance for those activities at low risk of emissions leakage.
4. Decisions requested in this paper would have a financial implication within the forecast period, and so are requested for drafting purposes only and will be subject to a subsequent Cabinet decision after the Budget is delivered. This paper does not seek policy decisions.

Executive summary

5. The Government is reforming the NZ ETS to ensure the scheme is effective in assisting to meet emissions targets, supporting the transition to a low-emission, climate resilient New Zealand. This requires amending the CCRA to provide:
   5.1. certainty to the market of long-term credibility and effectiveness by signalling the trajectory of our transition to a low-emissions economy
   5.2. flexibility for the government to manage the NZ ETS in changing circumstances.
6. The amendments are in two tranches, which will form a single bill to amend the CCRA, to be introduced to the House in mid-2019 and enter into force in 2020.
7. In this paper, I am seeking decisions on a specific tranche two proposal: phasing down industrial allocation in the NZ ETS beginning in 2021. The proposal in this

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paper affects only industrial allocation. It has no implications for any decisions the Government may make on agriculture in the NZ ETS, and on allocation or other support for agricultural participants.

Background

Reform of the NZ ETS

8. As part of the Government's programme of action on climate change, the NZ ETS is being reformed to ensure it is an effective tool to assist New Zealand in meeting emissions reduction targets, increasing emissions removals, and transitioning to a low-emission future.
9. Decisions about the design and operation must be considered in the light of their impact on New Zealand's ability to access offshore emission reductions with environmental integrity in the future. Cabinet has agreed to retain the option to use international carbon markets after 2020 [CAB-18-MIN-0248 refers]. The proposed changes to the CCRA will reduce barriers to creating such links.
10. Proposals to amend the CCRA are being progressed in two tranches, which will form a single CCRA amendment bill, to be introduced to the House in mid-2019 and to enter into force in 2020:
    - 10.1. Tranche one was agreed by Cabinet in December 2018 [CAB-18-MIN-0606.01 refers] and the Parliamentary Counsel Office (PCO) has commenced drafting.
    - 10.2. I am currently seeking tranche two decisions through a series of papers I am bringing to Cabinet in March to May 2019 (forestry papers are being co-led with Hon Shane Jones, Minister of Forestry).

About industrial allocation

11. Industrial allocation is the provision of free New Zealand Units (NZUs) to entities that carry out 'eligible activities' whose competitiveness is considered at risk due to costs placed on the activity by the NZ ETS.[1] These costs create a risk of emission leakage if these entities were exposed to the full cost of NZ ETS surrender obligations. The purpose of industrial allocation is to mitigate this risk.
12. Emission leakage would occur if New Zealand companies lost market share or shifted production overseas to avoid a domestic price on emissions. This is a significant concern due to the potential economic and employment impacts, particularly for regions where a single emission-intensive facility may be an important part of the local economy.
13. Emission leakage is also an issue of environmental integrity. If leakage occurred, this would mean that New Zealand's climate policy is driving the export of emissions rather than reducing them. As a result, New Zealand's policies could potentially increase global emissions.
14. The level of assistance offered to firms depends on emission intensity. Firms carrying out highly emission-intensive activities receive an allocation equivalent to

[1] Through sections 81 and 83 of the CCRA – the CCRA refers to entities or firms that carry out eligible activities, and may apply for industrial allocation, as 'eligible persons'. They are listed in Appendix 1.

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90 per cent of estimated costs that the NZ ETS places on the activity, while moderately intensive activities receive a 60 per cent allocation[2].

15. There are 26 eligible activities. The three firms with the largest of these activities (New Zealand Steel, NZ Aluminium Smelters and Methanex) receive over 60% of all the units allocated while some horticultural businesses receive fewer than 100 NZUs per year each.

16. Emission leakage remains a risk for some emission-intensive and trade-exposed (EITE) activities and there is a continuing need for assistance. However, given that competing jurisdictions are increasingly pricing their own emissions, and in some cases considering phasing-down assistance, it is appropriate to start adjusting the level of assistance provided to industry in New Zealand.

17. Industrial allocation was intended as a transitional measure, with the expectation that it would be phased down over time and that this phase-down would start early. The proposed approach in 2007 was for total allocations to be capped, and the amount of the cap to be phased down over time.

18. Following amendments made in 2009, a phase-down was planned that would have started in 2013, at a rate of 0.01 annually. The CCRA still provides for such a phase-down but it was suspended by a further amendment in 2012. The suspension can be lifted by Order in Council at any time.

19. Since no phase-down has occurred, the levels of allocation provided now are significantly higher than was originally envisaged when the NZ ETS was established. Firms have now been receiving allocation at fixed rates for more than eight years.

20. Firms with EITE activities may be able to access assistance from the Government in other forms. The Minister for Energy and Resources' work programme on process heat is looking at a range of measures to encourage uptake of best available low emissions technology in the industrial sector, including EITE firms.

Problems with current industrial allocation settings

21. The 2015/16 review of the NZ ETS found that the current industrial allocation settings were:
    - a source of regulatory uncertainty;
    - a direct cost to the Crown;
    - an opportunity cost because freely allocated units cannot be auctioned;
    - contributing to a misalignment of the NZ ETS and New Zealand's emissions reduction targets; and
    - increasingly likely to be higher than necessary to protect against emission leakage.

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[2] Defined in the CCRA as a Level of Assistance (LA) of either 0.9 or 0.6. The estimated costs and emissions used to calculate these allocations were derived from historical data for the financial years 2006/7 to 2008/9. A reduction of 0.01 means that the LAs reduce from 0.9 to 0.89 and from 0.6 to 0.59 in the first year of a phase-down.

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22. Consultation on improving the NZ ETS was held in August and September 2018. The Ministry for the Environment consultation document set out three approaches for adjusting industrial allocation:

- making an upfront decision to start a phase-down from 2021;
- setting a test or condition that would begin a phase down; and
- establishing a decision-making process to determine allocation rates over time.

Analysis

23. Current industrial allocation settings contribute to a wider structural problem, whereby the NZ ETS will not align well with the domestic and Paris Agreement obligations it is intended to deliver.

24. Both the CCB and the Paris Agreement commit New Zealand to increasingly ambitious emissions budgets over time. As industrial allocation will constitute an increasing portion of future emissions budgets, retaining high levels of allocation increases the need for the rest of the economy to contribute to meeting those budgets.

25. It is reasonable to expect that firms will seek efficiencies and reduce their emissions where possible. Current levels of allocation will eventually lead to over-allocation, given that there is an expected trend of reducing emission intensity over time. This means that the NZ ETS would eventually reward firms carrying out EITE activities for more than 100 per cent of the relevant emission costs.

26. The current situation also perpetuates regulatory uncertainty, because it does not clearly signal how or when the legislated phase-down would be implemented. There is some evidence that this uncertainty has already affected business decisions and capital investments. This was identified as a key issue for several important stakeholders during consultation.

27. s 9(2)(j) [redacted]

28. For these reasons, I recommend that the Government begin to phase down industrial allocation in a managed way from 2021.

Proposals

29. I propose that Cabinet should make an upfront decision to phase down industrial allocation beginning in 2021. This can be achieved through two complementary proposals:

- Establishing minimum phase-down rates that will apply equally to all industrial activities. I propose to set the minimum rate as an annual reduction of 0.01 in all levels of assistance (LAs), from 2021 to 2030; then 0.02 from 2031 to 2040; and then 0.03 in from 2041 to 2050.
- Establishing a legislated process that will allow the responsible Minister to make regulations to set activity-specific phase-downs, leading to additional reductions in industrial allocation beyond the minimum phase-down rate.

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30. Such additional reductions will be based on detailed analysis and advice from the Climate Change Commission (the Commission). They will be informed by the specific circumstances of each activity, particularly any ongoing risk of emission leakage. This process can only become operational after the Commission is established. Phase-downs of each activity would continue until the level of assistance reaches zero.

Setting the minimum annual phase-down rates

31. I propose setting a minimum annual phase-down rate that will apply to all eligible activities equally from 2021. I propose that the minimum phase-down rate is set in legislation, as this will send a strong signal to industry that the level of assistance will be reduced through the 2020s.

32. However, as this risks locking in a phase-down rate that could create a risk of emission leakage for some sectors over time, I propose the Government should set a low minimum rate of 0.01 annual reduction that will apply for the first ten years. The CCRA specifies this same rate now, but does not specify a start date.

33. After 2030, it will be necessary to reduce the overall number of units allocated at higher rates than this, to enable New Zealand to meet its emission budgets and any future NDCs. I propose that the minimum phase-down rate be increased in two steps as indicated above.

34. However, there is a possibility that slow progress in climate policy internationally may mean that there is an ongoing risk of emission leakage for some activities after 2030 at these rates of phase-down. Therefore, the two increases in the minimum rate should each be subject to a review by the Commission. The Commission would carry out these reviews in advance for each ten-year period, and would base its recommendations on only one issue: whether there is an ongoing and substantial risk of emission leakage.

35. To give this effect, I propose specifying in legislation that:

    35.1. There must be a minimum phase-down rate for every year, set in advance for the ten-year periods 2021–30, 2031–40, and 2041–50. Any activity-specific phase-downs will be in addition to the minimum rate.

    35.2. The minimum phase-down rates will be:

        35.2.1. annual reduction of 0.01 for each of the years 2021–30

        35.2.2. annual reduction of 0.02 for each of the years 2031–40

        35.2.3. annual reduction of 0.03 for each of the years 2041–50.

    35.3. The responsible Minister may make regulations to set a lower minimum phase-down rate for each of the periods 2031–40 and 2041–50, if the Commission recommends this.

    35.4. The Commission may not recommend a minimum phase-down rate of less than 0.01 for any year up to 2040, or less than 0.02 for any year 2041–50.

36. These rates represent a conservative approach to phasing down allocation over the first ten to twenty years. However, over time they will result in significant increases to the currently low net cost of the NZ ETS for highly emission-intensive activities.

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37. Only a few highly emission-intensive activities would see cost impacts of up to a few percent of revenue before 2030. The cost impacts would be minimal for others with many seeing additional costs less than one percent of revenue by 2030 at current NZU prices. The minimum phase-down rate that I am proposing for 2021–30 is set low to mitigate any risk of emission leakage for the most vulnerable activities. Appendix 2 provides some cost estimates.

Activity-specific rates

38. In addition to setting a minimum phase-down rate, I propose that Cabinet establish a process in legislation that could apply further phase-downs to any one or more eligible activities that are at lower risk of emissions leakage. Activity-specific rates of phase-down would be determined in advance for each five-year budget period set under the CCB. In practice, this is likely to mean that the first set applies from the start of the second budget period in 2026.

39. I propose that the Commission should prepare advice on proposed activity-specific rates, and provide the responsible Minister with a report detailing its recommendations. The Government would make final decisions and regulations to implement them, based on advice from the Commission.

40. If final decisions are different from the Commission's recommendations, I propose that the Minister must provide a report giving reasons for any decisions that differ from the Commission's advice, present the report to Parliament, and make it publicly available.

41. I propose that the responsible Minister will make regulations providing for:

    41.1. Firm decisions on activity-specific phase-downs covering the upcoming five-year budget period

    41.2. Indicative decisions on phase-downs during the following budget period.

42. I propose that, in making regulations for the upcoming budget period, the Minister should be satisfied that collectively the proposed phase-down rates are generally not inconsistent with New Zealand's meeting the emission budget set under the CCB for that period.

43. In making regulations for an individual activity-specific phase-down of allocation the Minister should be required to have regard to:

    43.1. New Zealand's targets and indicative future emission budgets as set under the CCB and New Zealand's Nationally Determined Contributions under the Paris Agreement

    43.2. The risk of emission leakage on an activity-specific basis, including:

        43.2.1. emission pricing and other policies in competing jurisdictions, their cost, any assistance such as allocation, and its phase-out;

        43.2.2. the markets for international trade in the specified products produced by eligible industrial activities;

        43.2.3. any ability of industrial allocation recipients in New Zealand to pass on increased costs to customers

    43.3. Any risk that the value of the industrial allocation for an eligible activity exceeds the cost of meeting NZ ETS obligations affecting the activity

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43.4. Other sources of supply into the NZ ETS, including offshore emission reductions obtained by the Government or available to NZ ETS participants

43.5. The availability of low-emission technologies related to each activity

43.6. New Zealand's relevant international obligations

43.7. The proper functioning of the NZ ETS

43.8. The cost to the taxpayer of providing allocation

43.9. Recommendations of the CCC

43.10. Any other matters that the Minister considers relevant.

44. The Commission would be expected to consult stakeholders and the public as part of its assessment. I propose that the Minister should be required to be satisfied that adequate consultation has occurred. This means that the Minister would need to consult further with affected parties on any proposal that the Commission has not already covered in consultation.

45. I propose that consultation by the Commission or the Minister on any proposed activity-specific phase-downs should include the preparation and publication of a draft proposal, and a period of at least 20 working days for submissions.

46. Regulations should be made as early as possible to provide certainty for those carrying out EITE activities. Regulations will need to be in effect before the start of the budget period so that provisional allocations can be made for the first year of the budget period. This means that the Commission will need to prepare its advice at least a year in advance.

47. This is similar timing to the Commission's preparation of advice on plans and policies for the same period, but advice on industrial allocation will be a separate piece of work dealing with quite different, and specific, subject matter.

48. It will be possible for emission budgets set under the CCB to be revised during the budget period, under defined circumstances [ENV-18-MIN-0053 refers]. I propose that activity-specific phase-downs may also be revised under specific, and exceptional, circumstances:

48.1. If the relevant budget is revised;

48.2. If, under exceptional circumstances, the matters the Minister considered in making the regulation may need urgent reconsideration, for example to avoid significant over-allocation or an imminent and substantial risk of emission leakage.

49. I propose that the Minister may only amend regulations to make such a revision if the Commission recommends that it be made.

The idea of applying a test before phasing down allocation

50. During consultation, several submitters advocated for the adoption of a '70 per cent of competitors test' as a trigger before any phase-down of industrial allocation. The 70 per cent test would delay any phase-down of industrial allocation until at least 70 per cent of competitors globally faced a similar net cost from emissions reduction measures in their home countries.

51. In my view, such a test would be challenging to implement and would risk being too prescriptive. It would encumber the Government, and potentially prevent a

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phase-down necessary to ensure a level of assistance that aligns the NZ ETS with New Zealand's emissions budgets, as well as preventing the over-allocation of units. We may also note that if other countries applied a similar test, none would ever start phasing down allocation.

52. Officials assess that such a test would most likely be useful as part of the Commission's assessment and recommendations to the Government on any activity-specific phase-down.

Other policy option for industrial allocation

53. I have also considered the possibility that the Government might cap the amount of allocation so that any growth in outputs and emissions faces the full emission price. This approach would be in line with the approach that was foreshadowed – but not detailed or implemented – in the 2007 amendments that established the NZ ETS.

54. However, there has been little growth in emissions from EITE activities in the ten years that they have been receiving allocation. Substantial growth is not likely in the future. Consequently, capping allocations would result in a similar outcome to the proposed gradual phase-down of LAs. It would raise complicated and time-consuming implementation issues.

Consultation

55. Consultation sought submitter views on the conditions, timing and rates for phasing-down industrial allocation. There was a mixed response – some submitters supported a decision-making process, while others supported an upfront decision to phase-down industrial allocation.

56. Firms that carry out EITE activities generally supported a test or decision-making process for phasing-down industrial allocation. Several submitters advocated for a '70 per cent of competitors test' as a prerequisite for a phase-down.

57. Submitters who did not receive free allocations were more likely to place emphasis on the pressures that allocations place on domestic emissions budgets and New Zealand's NDC, and indicated a preference for a more rapid phase-down of allocations.

58. Submitters considered New Zealand's domestic emissions budgets and NDC, and emissions leakage, as important factors decision-makers should consider when phasing-down industrial allocation.

59. There was a range of views on the phase-down rate. Approximately half of the submitters preferred a rate of 0.03 or more per year, while the rest supported lower rates or a decision-making process.

60. Sectors had varied views on the impacts of a phase-down of industrial allocation. Firms carrying out EITE activities largely indicated that a phase-down would have a negative impact, while foresters and other submitters believed that it would have positive impacts.

61. The following agencies were consulted on this paper: the Ministry of Business, Innovation and Employment, the Treasury, the Ministry of Foreign Affairs and Trade, the Environmental Protection Authority, the Department of Conservation,

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the Ministry for Primary Industries, the Ministry of Transport and the Ministry of Justice. Te Puni Kōkiri and the Department of the Prime Minister and Cabinet were informed.

62. Implementing the package of proposals to improve the NZ ETS (tranches one and two) will have costs for the EPA. s 9(2)(f)(iv) [redacted]

Financial implications

63. This paper seeks authority for drafting of provisions for a phase-down of allocation from 2021. Should Cabinet make a subsequent decision to proceed with this phase-down, the financial implications would be as noted below.

64. Allocation of units is recorded as an expense to the Crown in the year units are allocated. Phasing down or reducing the amounts allocated will reduce the expense, with no corresponding change in revenue recorded when units are surrendered.

65. The table shows the estimated effect on expenses of phasing down industrial allocation at a rate of 0.01 per year starting in 2021. Any further change due to activity-specific reductions in allocation would be seen in the 2025/26 and subsequent financial years.

	FY 19/20	FY 20/21	FY 21/22	FY 22/23	FY 23/24
Reduction in units allocated (million NZUs)	0	0.065	0.208	0.368	0.515
Reduction in expense (M$)	0	1.63	5.19	9.19	12.86

66. The need to carry out analysis and make recommendations on minimum and activity-specific reductions will be an ongoing operational cost that the CCC will need to manage as part of its overall work programme.

Legislative implications

Legislative amendments

67. The policy decisions from this paper will require legislative amendments to the Climate Change Response Act 2002.

68. The amendments were given a category 2 priority on the 2019 Legislation Programme (meaning the bill must be passed by the end of 2019). The Parliamentary Counsel Office has already commenced drafting tranche one amendments.

Regulation development

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69. Regulations will set activity-specific phase-down rates, if any, and will need to be made in the year before the start of the budget period in which they will apply so that the first set will be made in 2025. Primary legislation will specify the minimum phase-down starting in 2021, and it can then be implemented with no need for regulations.

Human rights

70. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Crown-Māori Partnership

71. Māori have a significant stake in climate change action, and a significant interest in the NZ ETS. Māori have a large economy and asset base sitting largely in the primary industries, as well as Treaty-based rights and interests in natural resource use and management. It will be critical when implementing the proposals to maintain Treaty of Waitangi principles as provided by section 3A of the CCRA

72. A Māori leaders' Forum was held in Wellington on 17 September 2018 as part of consultation on improvements to the NZ ETS. The Ministry for the Environment plans to engage with iwi/Māori on a range of environmental issues through a series of hui in May. This will include discussions on the NZ ETS and seek views on how we can best support iwi/Māori ahead of consultation on regulations anticipated for the second half of this year.

International obligations

73. The proposed amendments are consistent with New Zealand's obligations under the Paris Agreement. s 9(2)(h) [redacted]

Gender implications

74. There are no gender implications for the proposed amendments.

Disability perspective

75. There are no disability implications arising from this paper.

Regulatory impact analysis

76. A Quality Assurance Panel with representatives from the Ministry for the Environment and the Treasury Regulatory Quality Team has reviewed the 'Phase-down of industrial allocation' Regulatory Impact Assessment (RIA) produced by the Ministry for the Environment and dated April 2019.

77. The Panel considers that the RIA **meets** the Quality Assurance criteria.

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Publicity

78. Announcements about the NZ ETS need to be managed carefully to avoid any inconsistencies and market risks, including sudden NZU price rises. In addition, information should not be disseminated in a way that advantages some market participants over others and compromises NZ ETS investments.

79. I intend to make public announcements on the proposed amendments to the CCRA and the amendment bill as part of a wider climate change communications plan, in consultation with other Ministers.

Proactive Release

80. I propose to proactively release this paper on the Ministry for the Environment's website in whole, subject to redactions as appropriate equivalent to those under the Official Information Act 1982, once public announcements have been made.

Recommendations

The Minister for Climate Change recommends that the Committee:

1. **note** the New Zealand Emissions Trading Scheme (NZ ETS) is the Government's key tool to assist New Zealand to meet its climate change targets, and that:
   1.1. the Government is reforming the NZ ETS to ensure it can support the transition to a low-emissions and climate resilient New Zealand
   1.2. this requires amendments to the Climate Change Response Act 2002 (CCRA)
2. **note** these amendments are being developed in tranches;
   2.1. in December 2018 Cabinet agreed to tranche one of amendments to the CCRA and drafting has commenced [CAB-18-MIN-0606.01]
   2.2. tranche two comprises of a series of papers with discrete proposals which will be considered by Cabinet over March to May 2019
   2.3. tranche one and two will result in a single bill amending the CCRA to be introduced to the House in mid-2019, and to enter into force in 2020
3. **note** this tranche two paper focuses on phasing down industrial allocation in the NZ ETS
4. **note** that the proposals in this paper relate only to industrial allocation and have no implications for any future decisions on agriculture or for any allocations or other support for agricultural participants
5. **note** that decisions requested in this paper are for drafting purposes only and will be agreed subject to a subsequent Cabinet decision after the Budget is delivered
6. **note** that the purpose of industrial allocation in the NZ ETS is to mitigate the risk of emissions leakage
7. **note** that while emissions leakage continues to be a risk for some eligible persons carrying out EITE activities, individual improvements in emissions-

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intensity and competing jurisdictions increasingly pricing their own emissions justify some adjustments to levels of industrial allocation

8. **note** that current levels of industrial allocation will take an increasing proportion of future emission budgets within the context of meeting CCB and Paris Agreement emissions reduction targets
9. **agree** in principle, for the purpose of issuing drafting instructions, to phase down industrial allocation with the first reduction applying to the calendar 2021 emissions reporting year
10. **agree** in principle, for the purpose of issuing drafting instructions, to establish minimum phase-down rates that will be set in legislation and specified as a minimum annual reduction applied to the level of assistance for all eligible activities of 0.01 for each of the years 2021 to 2030, 0.02 for each of the years 2031 to 2040 and 0.03 for each of the years 2041 to 2050
11. **note** that an annual reduction of 0.01 means that the Level of Allocation, as defined in the CCRA, will be reduced from 0.9 to 0.89 in 2021, 0.88 in 2022 and so forth for highly emission-intensive activities, and from 0.6 to 0.59 in 2021, 0.58 in 2022 and so forth for moderately emission-intensive activities
12. **agree** in principle, for the purpose of issuing drafting instructions, that the responsible Minister may make regulations to reduce the minimum phase-down rate for the period 2031 to 2040, and for the period 2041 to 2050, if the Commission recommends such a reduction based on an assessment that there is an ongoing and substantial risk of emission leakage
13. **agree** in principle, for the purpose of issuing drafting instructions, that the Commission may not recommend, and the Minister may not make regulations for, a minimum phase-down rate less than 0.01 for each of the years 2031 to 2040 or a minimum phase-down rate less than 0.02 for each of the years 2041 to 2050
14. **agree** in principle, for the purpose of issuing drafting instructions, that there will be a decision-making process that will allow the government to set activity-specific phase-downs of any one or more eligible activities in regulations in advance for the 2026–30 emissions budget period and for each subsequent five-year budget period established under the CCB
15. **agree** in principle, for the purpose of issuing drafting instructions, that regulations will set mandatory phase-downs for the relevant budget period, and indicate intended phase-down rates for the following budget period
16. **agree** in principle, for the purpose of issuing drafting instructions, that the collective effect of the minimum phase-down rate and all of the regulations phasing down individual activities for a given budget period must generally not be inconsistent with New Zealand's meeting the emissions budget for that period
17. **agree** in principle, for the purpose of issuing drafting instructions, that when making decisions on an activity-specific phase-down of allocation the Minister for Climate Change must have regard to:
    17.1. New Zealand's targets and indicative future emission budgets as set under the CCB and New Zealand's Nationally Determined Contributions under the Paris Agreement

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17.2. The risk of emission leakage on an activity-specific basis, including:

17.2.1. emission pricing and other policies in competing jurisdictions, their cost, any assistance such as allocation, and its phase-out

17.2.2. the markets for international trade in the specified products produced by eligible industrial activities

17.2.3. any ability of industrial allocation recipients in New Zealand to pass on increased costs to customers

17.3. Any risk that the value of the industrial allocation for an eligible activity exceeds the cost of meeting NZ ETS obligations affecting the activity

17.4. Other sources of supply into the NZ ETS, including offshore emission reductions obtained by the Government or available to NZ ETS participants

17.5. The availability of low-emission technologies related to each activity

17.6. New Zealand’s relevant international obligations

17.7. The proper functioning of the NZ ETS

17.8. The cost to the taxpayer of providing allocation

17.9. Recommendations of the Climate Change Commission

17.10. Any other matters the Minister for Climate Change considers relevant.

18. **agree** in principle, for the purpose of issuing drafting instructions, that before regulations setting an activity-specific phase-down are made, the Climate Change Commission must prepare advice on the phase-down and provide the responsible Minister with a report detailing its recommendations for the regulations

19. **note** that ongoing operational costs for the Commission will be managed as part of its overall work programme

20. **agree** in principle, for the purpose of issuing drafting instructions, that if final decisions depart from the Commission’s recommendations, the responsible Minister must provide a report giving reasons for any decisions that differ from the CCC’s advice, present the report to Parliament, and make it publicly available

21. **note** that regulations will need to be in effect before 1 January 2026 and before the start of each subsequent budget period to have effect throughout that period

22. **agree** in principle, for the purpose of issuing drafting instructions, that the Minister must be satisfied that consultation with affected parties has occurred before making regulations, including publication of a draft proposal and a period of at least 20 working days for submissions

23. **note** that this means that the Minister will need to consult with affected parties on any proposal that has not already been included in consultation carried out by the Commission

24. **agree** in principle, for the purpose of issuing drafting instructions, that if a budget is revised or if, in exceptional circumstances, the matters that the Minister considered in making it require reconsideration, a regulation setting activity-specific phase-downs for a particular budget period may be amended during the budget period, if recommended by the Commission

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25. **note** that the Minister for Energy and Resources' work programme on process heat is looking at a range of measures to encourage uptake of best available low emissions technology in the industrial sector, including EITE firms

26. **authorise** the Minister for Climate Change to further clarify policy decisions relating to the amendments proposed in this paper, in a way not inconsistent with Cabinet's decisions

27. **invite** the Minister for Climate Change to issue drafting instructions to the Parliamentary Counsel Office based on the decisions presented in this paper

Authorised for lodgement.

Hon James Shaw

Minister for Climate Change

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