Cabinet Policy Committee

POL Min (03) 21/7

Copy No: 37

Minute of Decision

Climate Change: The Projects Mechanism: Details of Model Projects Agreements

On 27 August 2003 the Cabinet Policy Committee:

Background

1 **noted** that in March 2003 Cabinet agreed to key elements of the Climate Change Projects Mechanism around eligibility, the nature of the incentive, and the process of selection [POL Min (03) 6/4];

Obligations of Parties to the Agreement

2 **noted** that key features of the Crown's promise of emission units (units) are that the promise is specific to a project, and the promise will be met only if abatement is delivered by the project during the First Commitment Period (CP1);

3 **noted** that units transferred to companies, individuals, or other bodies that are selected to undertake emission abatement projects (referred to as "Project Cos" in the paragraphs that follow) should correspond to the abatement achieved during CP1 at the agreed ratio of units to emission reductions, up to the specified maximum number of units, and that the transfer of units from the Crown is entirely conditional on the achievement of contracted abatement during CP1;

4 **agreed** that the Government will not form any contractual relationships through the Project Agreement with, or provide undertakings to, any third parties that Project Cos deal with;

5 **noted** that there may be some circumstances where the Government may wish to enter into agreements with third parties that are outside the Project agreement to assist to maximise the value of units allocated;

6 **agreed** that the Government will be indifferent to the form, governance, and ownership of Project Cos, provided these are compliant with New Zealand law, and except to the extent that these significantly bear on capacity to comply with an agreement or to manage a project;

7 **agreed** that the Projects Agreement will not incorporate any provisions for damages for non-performance by a Project Co;

Assessment

8 **agreed** that all projects be assessed on the basis of an emissions baseline against which additionality is determined, and which will not be changed for the purposes of any additionality assessment through the life of the project, except where both the Crown and the Project Co agree to a departure from this approach;

Non-Performance by the Crown

9 **noted** that there are four key circumstances in which a Project Co would not be able to execute a successful trade in units because of non-performance by the Crown:

9.1 the Kyoto Protocol does not come into force;

9.2 a change of policy by a future government (e.g. a withdrawal from the Protocol);

9.3 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

9.4 the Crown is unable to trade from its registry due to the government not meeting its inventory or registry requirements under the Protocol rules;

10 **agreed** that Project Cos should explicitly bear the risk referred to in paragraph 9.1 above, and that this should be specified in the Project Agreement;

11 **noted** that future governments will be bound by agreements with Project Cos, but that Project Cos will bear the risk that a future government legislates to extinguish its liability;

12 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

13 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

14 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

15 **agreed** that the Crown should bear the risk referred to in paragraph 9.4 above;

Termination

16 **agreed** that the Crown retain the right to terminate agreements with a Project Co in the following circumstances:

16.1 a Project Co's tender is discovered to have been materially incomplete, inaccurate, or misleading;

16.2 there is significant delay in constructing or commissioning the project;

16.3 there are material breaches by a Project Co of its reporting obligations (including any such reports being materially incomplete, inaccurate, or misleading);

16.4 there is a failure to deliver a specified minimum level of emission reductions in any year; or

16.5 a Project Co becomes insolvent;

17 **noted** that a Project Co will be entitled to terminate an agreement for material breach by the Crown;

Allocation and Assignment of Units

18 **noted** that the emission unit types most likely to be relevant for the Projects Mechanism are the Assigned Amount Units (AAUs) and the Emission Reduction Units (ERUs);

19 **agreed** that the Project Agreement provide that AAUs will be supplied, but Project Cos would be able to elect to receive ERUs where they meet the criteria for allocation of ERUs and agree to pay any extra compliance costs associated with the allocation of ERUs;

20 **noted** that a "grey market" for emission reductions exists in advance of formal trading either under national schemes or the Kyoto Protocol;

21 **agreed** that Project Cos be free to sell emission abatements into this market, but only after they have fulfilled their obligations to deliver abatement to the Crown;

Taxation

22 **agreed** that the Project Agreement should be structured as an agreement for services;

23 **noted** that it is expected that the delivery and subsequent sale of the emission units will be subject to income tax and a Project Co would be able to claim any tax benefits for which it is eligible;

24 **noted** that when the units are transferred to a Project Co, upon delivery of abatement, the Crown will be required to add the goods and services tax (GST) to the transaction;

[Withheld under the OIA s. 6(a) and s. 9(2)(h)]

25 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

26 [Withheld under the OIA s. 6(a) and s. 9(2)(h)]

Dispute Resolution

27 **agreed** that the Project Agreement will specify a process for dispute resolution by mutually agreed independent experts;

Next Steps

28 **directed** officials to report back to the Cabinet Policy Committee by February 2004 on progress with the first Projects tendering round;

29 **authorised** the Minister of Finance and the Convenor, Ministerial Group on Climate Change to finalise any further details of the first Projects round, provided that these are not inconsistent with the above recommendations;

Consultation

30 **noted** that the Minister of Finance and the Convenor, Ministerial Group on Climate Change indicate that consultation is not required with the government caucuses or with other parties represented in Parliament.

Hilary Troup

Hilary Troup
Secretary

Reference: POL (03) 240

Present:
Rt Hon Helen Clark (Chair)
Hon Dr Michael Cullen
Hon Jim Anderton
Hon Steve Maharey
Hon Phil Goff
Hon Annette King
Hon Jim Sutton
Hon Trevor Mallard
Hon Pete Hodgson
Hon Margaret Wilson
Hon Lianne Dalziel
Hon George Hawkins
Hon Paul Swain
Hon John Tamihere

Officials present from:
Office of the Prime Minister
Department of the Prime Minister and Cabinet

Copies to: (see over)

Copies to:
Cabinet Policy Committee
Chief Executive, DPMC
  Mary Anne Thompson, DPMC
Secretary to the Treasury
  Commissioner of Inland Revenue
Chief Executive, Ministry of Economic Development
Secretary of Foreign Affairs and Trade
Director-General, Ministry of Agriculture and Forestry (Agriculture)
  Director-General, Ministry of Agriculture and Forestry (Forestry)
Director, New Zealand Climate Change Office, MfE
  Secretary for the Environment (Energy Efficiency Conservation Authority)
State Services Commissioner
Chief Executive, Te Puni Kokiri
Minister of Transport
  Secretary for Transport
Minister for the Environment
  Secretary for the Environment