



Cabinet Policy Committee

POL Min (03) 8/8

Copy No:

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Climate Change: Final Policy for Negotiated Greenhouse Agreements (NGAs)

On 9 April 2003 the Cabinet Policy Committee:

Background

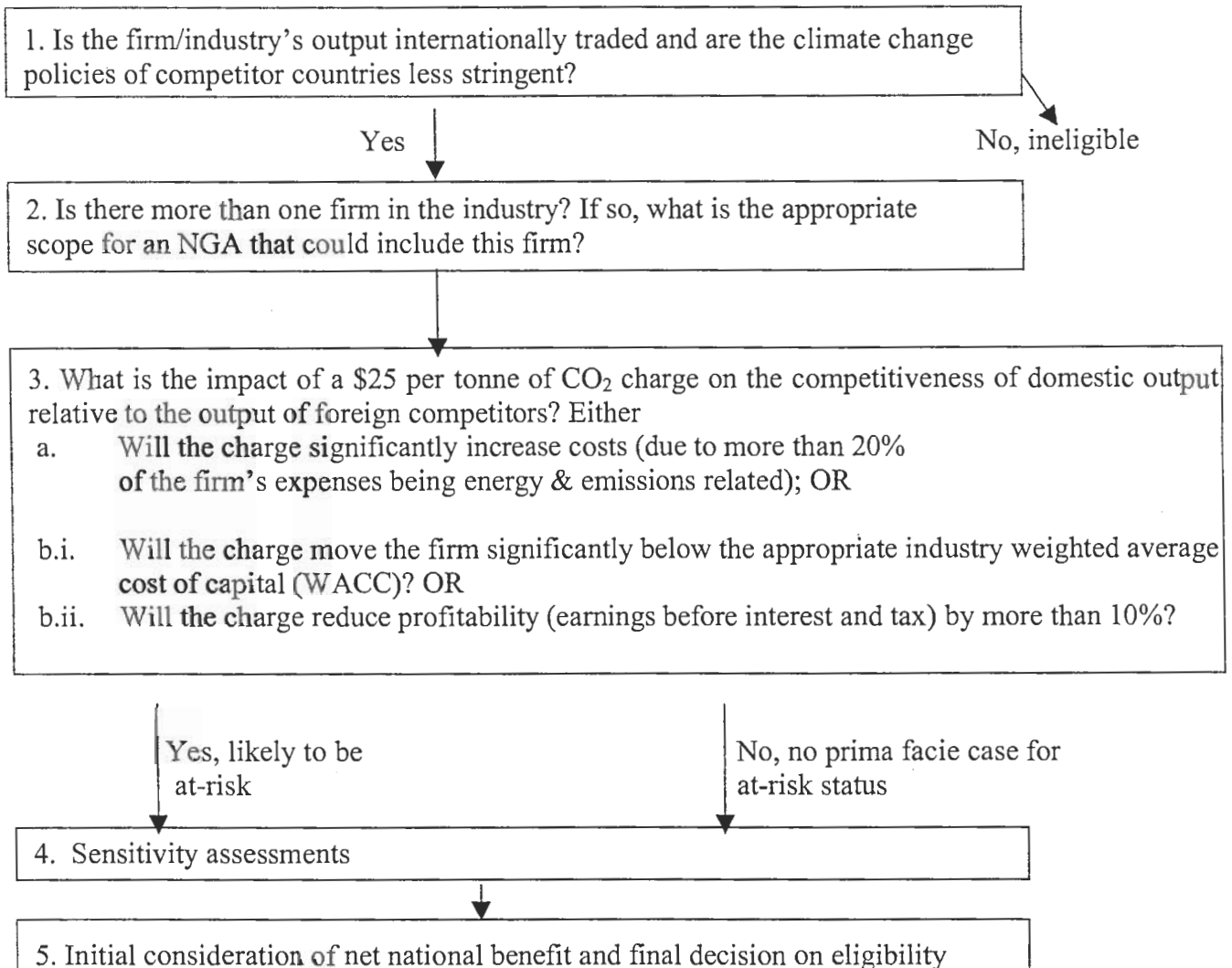
- 1 **noted** that in October 2002 Cabinet directed officials ~~to consult with stakeholders~~ on the proposed criteria for determining whether a firm is “competitiveness-at-risk” and eligible to negotiate a Negotiated Greenhouse Agreement (NGAs), and on institutional arrangements for the NGAs and report back to Cabinet [POL Min (02) 21/12];
- 2 **noted** that Cabinet has previously agreed that new climate change policies (including NGAs) for the first commitment period will not be implemented until the Kyoto Protocol comes into force [CAB Min (02) 13/10];
- 3 **noted** that the main feedback from consultation concerned:
 - 3.1 the level and appropriateness of the proposed criteria;
 - 3.2 the appropriateness of political decision makers in determining eligibility;
 - 3.3 the equity of the proposed cost-sharing regime;

Proposed competitiveness-at-risk criteria

- 4 **confirmed** that NGAs be limited to firms or industries that, as a result of an emissions charge, face significant risk to their competitiveness relative to producers in countries with less stringent climate change policies;
- 5 **agreed** that the following principles should guide decision making on eligibility assessments:
 - 5.1 NGAs should contribute to the Government’s overall climate change objective that New Zealand will make significant greenhouse gas reductions on business as usual and be set towards a permanent downward path for total gross emissions by 2012;
 - 5.2 eligibility assessment processes should be simple and low cost to reduce barriers to at-risk firms accessing NGAs;
- 6 **noted** that the principle in paragraph 5.2 above is more likely to result in competitiveness-at-risk firms being able to apply for and receive NGAs, but is also likely to result in some firms who are not at risk also receiving NGAs;

- 7 **noted** that the number of NGAs granted has implications for the efficiency of any emissions charge;
- 8 **agreed** to the proposed five step approach set out in Figure 1 below, for assessing at-risk status;

Figure 1 – At-risk Criteria



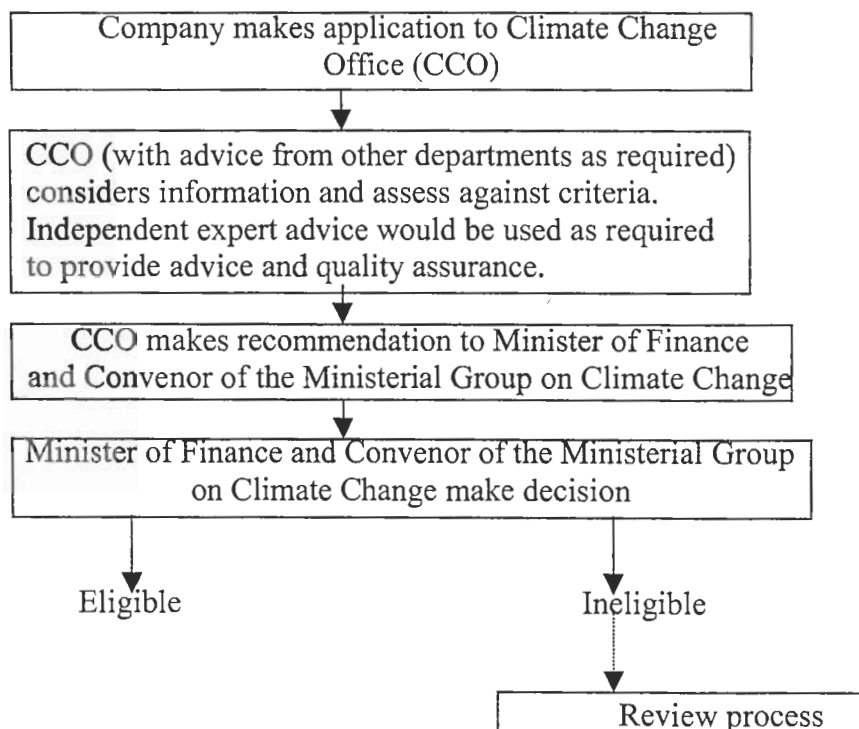
- 9 **noted** that under the proposed five step approach firms or industries will be eligible to apply for an NGA if as a result of the charge:
- 9.1 the firm would face significant cost increases (due to more than 20% of the firm's total expenses arising from direct energy use & emissions); OR
- 9.2 an appropriate and verifiable industry WACC exists, and a \$25 per tonne of CO₂ charge would result in the firm's returns being significantly below the appropriate industry WACC; OR
- 9.3 \$25 per tonne of CO₂ charge will decrease profitability (earnings before interest and tax) by more than 10%;
- 10 **agreed** that climate change officials, in consultation with applicants, will determine the appropriate criterion to apply for a given firm or industry;

- 11 **noted** that the use of reasonable projected (WACC and change in profitability) estimates should allow new entrants and new investment to be assessed on a basis that is reasonably consistent with that for existing firms;
- 12 **agreed** that for assessing applications from cooperatives where profitability is not normally defined, climate change officials be responsible for defining an appropriate measure of at-risk status (based on the change in income and expenses);
- 13 **noted** that the proposed criteria provide indicative rather than conclusive proof of at-risk status and the final assessment of at-risk status may require some subjective judgement;
- 14 **noted** that some at-risk small and medium sized enterprises will be unable to access NGAs due to cost (a separate report to Cabinet is being prepared on this issue);

Process for applying the competitiveness-at-risk criteria

- 15 **agreed** to the proposed process for applying competitiveness-at-risk criteria set out in Figure 2 below;

Figure 2: Proposed Process for Applying Criteria



- 16 **agreed** that the Climate Change Office be responsible for collecting the information for at-risk assessments, application of criteria, and recommendation on status;
- 17 **confirmed** Cabinet's previous decision that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be responsible for final decisions on firms' eligibility to apply for an NGA [POL Min (02) 21/12];

Competitiveness-at-risk applications

- 18 **agreed** that:

- 18.1 there be no fixed cut-off date at this time for application for at-risk status;
- 18.2 firms rejected for an NGA or only offered a partial exemption be eligible to reapply if they can demonstrate that due to changing circumstances they should now be eligible, or eligible for a greater exemption;
- 18.3 new entrants and new investment be subject, as far as possible, to the same rules and application process as existing firms;
- 18.4 applicants can apply for at-risk status for only part of a firm (e.g. for a specific process, plant or regional activity) provided that the coverage of a partial exemption can be clearly identified for the purposes of an NGA;
- 18.5 where officials consider that only part of a firm or industry is at-risk then officials can recommend that only that part of the firm or industry be eligible for an NGA;
- 18.6 in certain cases it may be appropriate to deem an entire industry at-risk and eligible to apply to negotiate collective or individual NGAs;

Negotiated greenhouse agreements

- 19 agreed that, unless specifically modified in individual NGAs:
 - 19.1 industry or part-industry agreements be allowed where the granting of an NGA to an individual firm would otherwise raise intra-industry competitiveness concerns and
 - 19.1.1 the industry or part-industry is deemed at-risk and eligible to negotiate an NGA;
 - 19.1.2 a suitable industry body or agreed representative exists;
 - 19.1.3 industry processes and structure are sufficiently homogenous that appropriate World's Best Practice (WBP) target(s) can be identified for the industry;
 - 19.1.4 there is industry agreement on cost-sharing within the industry and certainty that the industry body will be able to enforce this agreement;
 - 19.1.5 industry participants who would be subject to an industry agreement can be clearly identified;
 - 19.2 emissions intensity targets will, where possible, be based on WBP (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement;
 - 19.3 once agreed, NGA targets cannot be varied prior to 2008 and can be varied after this date only upon mutual agreement of the parties involved;
 - 19.4 where WBP targets do not exist or cannot be ascertained at reasonable cost, then appropriate challenging targets be agreed by negotiation;
 - 19.5 there be milestones for assessing performance against targets;
 - 19.6 the timing of milestones be influenced by the investment profile of the firm and the Government's international reporting obligations;

- 19.7 audited milestone reports be submitted for each milestone period;
- 19.8 there be annual reports on performance;
- 19.9 NGA participants will have access to flexibility provisions including offsite projects, trading of under- and over-achievement, and banking;
- 19.10 failure to rectify emissions in excess of target within 60 working days of written notification will result in a 30% penalty;
- 19.11 failure to pay the penalty and rectify within 30 working days of written notification will result in termination of the agreement;
- 19.12 the form of any exemption will depend on the final design of the emission charge, and could include refunds, rebates or credits rather than “exemptions” per se;
- 19.13 the coverage of an exemption be consistent with the coverage of the at-risk assessment including direct and indirect (e.g. electricity) inputs if they are material and reasonably quantifiable;
- 19.14 the level of the exemption be linked to the degree to which the firm is at-risk and the net national benefit of the exemption;
- 19.15 exemption commitments given prior to the detailed design of the emission charge be based on the principle of a commitment to hold the firm “harmless” from the material and reasonably quantifiable impacts of an emissions charge (or part thereof);
- 19.16 in the case of takeover or other change of ownership of the firm or business unit the coverage of the NGA extends no further than the scope of the exemption granted prior to the change in ownership;
- 19.17 review is an important component of an NGA;
- 19.18 the timing of reviews be determined on a case by case basis as influenced by the investment and operational profile of the firm, information availability, duration of the agreement and the Government’s international reporting obligations;

Net national benefit assessment

- 20 **agreed** that the net national benefit assessment comprise an objective and subjective element and that:
 - 20.1 the objective element would focus primarily on an assessment of the net cost to the Government of granting an exemption versus the total economic contribution of the applicant;
 - 20.2 the objective element would then be rebalanced by consideration of subjective factors such as, but not limited to, regional and investment benefits versus economic efficiency distortions;
- 21 **agreed** that firms be allowed to submit any additional information they consider relevant as part of the net national benefit test;

Process for negotiating agreements

- 22 **agreed** to the negotiation process below:
- 22.1 Government offers to negotiate with the at-risk firm. Officials prepare negotiation brief for approval by Ministers;
 - 22.2 parties meet to develop a negotiation plan;
 - 22.3 parties appoint joint advisor on world's best practice;
 - 22.4 negotiation;
 - 22.5 officials produce a report on the framework for the agreement ('heads of agreement') for ministerial approval to begin legal drafting of agreement;
 - 22.6 legal drafting;
 - 22.7 officials make recommendations to Ministers and parties take decisions on whether to ratify the agreement;
- 23 **agreed** that negotiations will be led by the Climate Change Office with support as required from Energy Efficiency and Conservation Authority (EECA), the Treasury, the Ministry of Economic Development, the Ministry for the Environment, the Ministry of Agriculture and Forestry, and Te Puni Kokiri;
- 24 **agreed** that responsibility for assessing progress against the target (including assessment of the use of flexibility provisions by firms) will rest with the Climate Change Office (supported by officials from other departments including EECA, as required).
- 25 **agreed** that the Minister of Finance and the Minister responsible for the Climate Change Office (Convenor, Ministerial Group on Climate Change) be delegated authority to finalise and sign Negotiated Greenhouse Agreements on behalf of the Crown;

Review of NGA policy

- 26 **directed** officials to report back to Cabinet by 30 June 2004 on:
- 26.1 how frequently firms or industries should be allowed to reapply for eligibility, or renegotiation of an NGA;
 - 26.2 consideration of experience with NGAs to date;
 - 26.3 applicability of the proposed NGA eligibility criteria and processes;
 - 26.4 recommended improvements to the NGA policy.;

27

[withheld under the OIA ss. 6(a) and 9(2)(h)]

28

[withheld under the OIA ss. 6(a) and 9(2)(h)]

Financial implications and cost sharing

- 29 **noted** that the estimated cost to the Crown of negotiating NGAs is anticipated to be \$50,000 to \$100,000 per agreement;
- 30 **noted** that the costs of NGAs negotiated in the 2002/03 financial year can be covered within existing Vote Environment baselines;
- 31 **noted** that a bid of \$1.125 million for 2003/04 and 2004/05 and for \$0.562 million for outyears (all GST inclusive) has been made as part of the 2003/04 Budget for funding to cover the costs to the Crown of negotiating NGAs;
- 32 **agreed** that for competitiveness at-risk applications, applicants and the Crown will each pay their own costs associated with the assessment (including the provision of information) while all other costs such as external consultants will be equally shared between the parties;
- 33 **agreed** that for NGA negotiations, applicants and the Crown will each pay their own costs associated with the assessment (including the provision of information), and the Crown make a contribution to any joint third party costs incurred as part of the negotiation of an NGA (to recognise the joint benefits for this work and to establish a duty of care to the Crown);
- 34 **agreed** that applicants be responsible for the cost of performance reports and audits;

Consultation

- 35 **noted** that the Minister indicates that consultation is not required with the government caucuses or with other parties represented in Parliament.



Sue Sharp
Secretary

Reference: POL (03) 79

Copies to: (see over)

Present:

Rt Hon Helen Clark (Chair)
Hon Dr Michael Cullen
Hon Jim Anderton
Hon Steve Maharey (part of item)
Hon Phil Goff
Hon Annette King
Hon Jim Sutton
Hon Trevor Mallard (part of item)
Hon Pete Hodgson
Hon Margaret Wilson (part of item)
Hon Parekura Horomia
Hon Lianne Dalziel
Hon Mark Burton
Hon Paul Swain
Hon Marian Hobbs
Hon Rick Barker

Officials present from:

Office of the Prime Minister
Department of the Prime Minister and Cabinet

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)
State Services Commissioner
Chief Executive, Ministry of Research, Science and Technology
Secretary for the Environment (Energy Efficiency Conservation Authority)
Director, Climate Change Project, MfE
Chief Executive, Te Puni Kokiri
Minister of Transport
Secretary for Transport
Minister for the Environment
Secretary for the Environment