

In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Environment, Energy and Climate Committee

Approval to consult on proposed New Zealand Emissions Trading Scheme and Synthetic Greenhouse Gas Levy Regulation Updates 2021

Proposal

- 1 I seek Cabinet approval to undertake public consultation on changes to regulations for the New Zealand Emissions Trading Scheme (NZ ETS) and Synthetic Greenhouse Gas Levy (SGG Levy). The proposed changes seek to improve the consistency between regulations and the objectives of the Climate Change Response Act 2002 (the Act), as well as improving accuracy and efficiency of the NZ ETS and the SGG Levy. Consultation will be during April and May 2021.

Relation to government priorities

- 2 The proposals in this paper relate to the Government's priorities to grow and share New Zealand's prosperity more fairly, and in particular to transition to a clean, green carbon neutral New Zealand and address the climate emergency.

Executive Summary

- 3 This paper seeks Cabinet agreement to initiate public consultation on updates to NZ ETS regulations by releasing a consultation document covering the regulatory proposals.
- 4 The Act requires consultation with directly affected persons (or their representatives) who appear likely to be substantially affected by any regulatory change. Consultation will test the proposed changes and help address information gaps.
- 5 Amendments and updates to NZ ETS and SGG Levy regulations are considered every year to ensure they are accurate. Some of the proposed changes this year are more substantial than in previous years. This includes the update to price controls in NZ ETS auctions. I propose to consult on updates to NZ ETS and SGG Levy regulations over six weeks between April and May 2021.
- 6 The updates being consulted on would amend existing regulations and create new regulations to meet both legislative requirements and to address any policy issues that have arisen. These updates are distinct from the broader

and more substantive ongoing reform programme associated with the NZ ETS.

- 7 The consultation document would be publicly available on the Ministry for the Environment's website. Persons likely to be substantially affected by the proposed changes will be contacted by officials at the start of the consultation.
- 8 Following consultation, I will seek policy approvals and agreement for drafting instructions from Cabinet's Environment, Energy and Climate Committee (ENV) in August.
- 9 Subject to drafting timetables, I anticipate bringing a paper to the Cabinet Legislation Committee early in September 2021.

Background

- 10 The NZ ETS is New Zealand's primary tool for assisting New Zealand to meet its international emissions reduction contribution under the Paris Agreement; and assisting New Zealand to meet its 2050 emissions targets. The SGG levy imposes NZ ETS equivalent costs on importers of goods that contain synthetic greenhouse gases to assist New Zealand in meeting its climate reduction targets.
- 11 Updates to regulations are needed to ensure the NZ ETS and SGG levy operate efficiently and remain accurate. Regulations are regularly updated to achieve this. Some regulations made under the Act are required to be updated every year, other updates occur to address policy issues as they arise. Additionally, recent changes to the Act enable new regulations to be made to further support operational efficiency and integrity.
- 12 Section 3B of the Act requires me to consult with people (or their representatives) who appear likely to be substantially affected by any regulatory change. Section 3A of the Act requires me to consult representatives of iwi and Māori that appear likely to have an interest in the regulations I recommend. I seek Cabinet's agreement to consult on the proposals described below.

Proposed changes

- 13 Some amendment proposals have been carried over from 2020. They were not able to be progressed through regulation update processes in 2020 due to a reprioritisation of Cabinet time to responding to the COVID-19 crisis.
- 14 In addition, there are proposed operational amendments to regulations for the NZ ETS and SGG Levy and new regulations to enable the appointment of an auction monitor for NZ ETS auctions.
- 15 Four of the proposals are significant:
 - 15.1 Increasing the cost containment reserve (CCR) trigger price in NZ ETS auctions from \$50 to \$70 from 2022.

- 15.2 Updating default emissions factors and other reference data used to calculate emissions, levies, and obligations across NZ ETS and SGG Levy regulations based on updated global warming potentials.
- 15.3 Updating the electricity allocation factor (EAF) methodology and value used in industrial allocation.
- 15.4 Implementing new regulations for an NZ ETS Auction Monitor.
- 16 For some of the proposed changes, options relate to draft advice from the Climate Change Commission (the Commission). These changes are:
 - 16.1 Updating unit limits. The Commission’s draft advice includes recommendations for three emissions budgets to 2035, including the first for 2022-2025. Changing the existing settings will impact the volume of emission units for auction.
 - 16.2 Updating auction price control settings. The Commission’s draft advice included increasing the auction floor price to \$30 (from \$20) and the cost containment reserve price to \$70 (from \$50), and then to have these increase annually at a rate greater than currently prescribed in regulation.
 - 16.3 Amending NZ ETS and SGG levy reference data to reflect updates to the global warming potentials of greenhouse gases.
- 17 Final advice is due from the Commission at the end of May 2021, at which stage their advice can be considered as part of the wider policy package by Government. This may include decisions that affect some of these proposals. It is important to note that policy responses to the Commission’s advice will go beyond the NZ ETS and SGG levy, for example also considering non-price policies and a just transition.
- 18 Attached to this Cabinet paper is a consultation document to support public consultation on regulation changes to address eight distinct issues. Table 1 below sets out a summary of each issue, the proposed change and reason for change, and those parties proposed for consultation.

Table 1: List of proposed NZ ETS and SGG levy regulation updates and new regulations for 2020

Proposed change	Regulations	Reason for change	Effect of proposed change on consulted parties	Sectors impacted and to be consulted
Update unit limit and auction price control settings	Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020	Annual update required by legislation	Any change to unit supply could affect the NZU price. An increase to the cost containment reserve trigger price would allow the NZU price at auction to rise higher than the current ceiling of \$50. Increases in NZU prices would have impacts across	All sectors

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Proposed change	Regulations	Reason for change	Effect of proposed change on consulted parties	Sectors impacted and to be consulted
			the NZ ETS, and affect SGG levy rates.	
Update the default emissions factor for waste to reflect updated data on waste composition.	Climate Change (Waste) Regulations 2010 Climate Change (Unique Emissions Factors) Regulations 2009	Maintain accuracy.	Landfill operators will report lower emissions and have reduced costs.	Approximately 30 waste participants in the NZ ETS
Update the default emissions factors for natural gas fields to reflect updated data on gas composition.	Climate Change (Stationary Energy and Industrial Processes) Regulations 2009, Table 10, Schedule 2	Maintain accuracy and avoid administrative costs for participants.	Minor	Approximately 40 mining natural gas and 2 natural gas opt-in participants in the NZ ETS.
Update default emissions factors and other reference data across ETS and SGG Levy regulations based on updated global warming potentials.	Most NZ ETS and SGG Levy regulations.	Consistency with reporting of New Zealand's emissions in the Greenhouse Gas Inventory.	Varied. For most sectors, this will have a minor or nil effect on reported emissions and NZ ETS costs. For some sectors the effect will be small-medium. There will be small-medium impacts on SGG levy costs in some instances.	All sectors.
Update the electricity allocation factor (EAF) methodology and value used in industrial allocation.	Climate Change (Eligible Industrial Activities) Regulations 2010.	Increase accuracy.	Increased costs if this update is subsequently factored into industrial allocation. Varied effect, significant for electricity intensive firms receiving industrial allocations. A decision on the approach taken to update the EAF will have an effect on allocations if allocative baselines are updated..	Approximately 80 recipients of industrial allocation.
Improve the methodology that accounts for the re-disposal of waste in the NZ ETS.	Either: Climate Change (Unique Emissions Factors) Regulations 2009 Or: Climate Change (Waste) Regulations 2010 Or: Climate Change (General Exemptions) Order 2009	Increase accuracy and reduce the risk of NZ ETS cost considerations causing decisions on managing closed landfills that result in poor environmental outcomes (an example is re-disposing the Fox Glacier Landfill waste incurring NZ ETS costs prior to an exemption being added to regulation for this specific waste class).	Reduced cost, but small - this will reduce NZ ETS costs for affected parties.	Landfill operators and local government authorities responsible for vulnerable closed landfills; Approximately 30 waste participants in the NZ ETS.

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Proposed change	Regulations	Reason for change	Effect of proposed change on consulted parties	Sectors impacted and to be consulted
Update the schedule of goods covered by the SGG levy.	Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013	Improve coverage and reduce risk of greenhouse goods being imported in goods but not captured by the levy	Increased costs but minor.	Importers of a subset of goods containing synthetic greenhouse gases.
Implement new regulations for an NZ ETS Auction Monitor.	New regulations	Enable the appointment of an auction monitor for ETS auctions.	Negligible, however appointment of an auction monitor will strengthen auction integrity and reporting on the results of auctions.	All sectors

Updating unit limit and auction price control settings

- 19 The Act requires under section 30GB(3)(b) that updates to the Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020 are made annually by 30 September to prescribe limits for each of the following five calendar years for:
- 19.1 A limit on the New Zealand units (NZUs) available by auction (annual auction volume plus volume available within the cost containment reserve)
 - 19.2 A limit on approved overseas units
 - 19.3 An overall limit on units (being calculated by adding together annual auction volume, cost containment reserve volume, projected free allocation volume and any approved overseas units)
 - 19.4 The minimum price that units can be sold at auction (price floor)
 - 19.5 Cost containment reserve (CCR) unit volume.
 - 19.6 The cost containment reserve (CCR) trigger price
- 20 This is the first year that updates to these will take place since being prescribed in regulations in September 2020.
- 21 The draft Commission advice recommends new emissions budgets. Incorporating the draft budgets into unit supply settings would have only a small impact on available auction volumes, due to concurrent updates to projected allocations and emissions.
- 22 The draft Commission advice also recommends new price control settings. The draft advice is to increase the auction floor price to \$30 (from \$20) and the cost containment reserve price to \$70 (from \$50), and then to have these increase annually at a rate greater than prescribed in regulation.
- 23 Updates to these settings will influence NZ ETS costs faced within the economy. Any change to unit supply could affect the NZU price, while any

increase to the CCR would allow the NZU price at auction to rise higher before reserve volume is released to auction. The consultation seeks feedback on whether to update these settings to align with new information, including draft Commission advice.

Updating the default emissions factors for waste

- 24 Emissions factors are used in the NZ ETS to calculate emissions from activities carried out by participants who operate municipal landfills.
- 25 The overall composition of waste going to landfill changes over time, causing changes to the greenhouse gas emissions from this waste. The 'default emissions factor' for waste needs to be updated to align with most recent waste composition analysis so that NZ ETS reported emissions are accurate.

Updating the default emissions factors for natural gas fields

- 26 Emissions factors are used in the NZ ETS to calculate emissions from activities carried out by participants mining or purchasing natural gas. These emissions factors are published in a schedule to the Climate Change (Stationary Energy and Industrial Processes) Regulations 2009.
- 27 The composition of mined gas in producing gas fields changes over time. This causes changes to the greenhouse gas emissions per unit of energy produced from natural gas. Natural gas emissions factors are regularly updated in regulations so that emissions calculated in the NZ ETS remain accurate.
- 28 The proposed option for consultation is to update default emissions factors for natural gas to align with the most recent data.

Updating default emissions factors and other reference data to take into account new global warming potentials

- 29 The NZ ETS uses global warming potential relative to carbon dioxide (CO₂) over a 100-year time horizon, also known as GWP₁₀₀, in line with our international climate change obligations.¹ The GWP₁₀₀ of greenhouse gases is assessed by the Intergovernmental Panel on Climate Change (IPCC). The IPCC released its Fifth Assessment Report (AR5) in 2014 and updated the GWP₁₀₀ values for all greenhouse gases, including methane and nitrous oxide.
- 30 New Zealand's international emissions reduction targets, 2050 target, and emissions budgets are denominated with reference to GWP₁₀₀ values from the IPCC's Fourth Assessment Report (AR4).

¹ See "carbon dioxide equivalent" definition in section 4 of the Climate Change Response Act 2002. <https://legislation.govt.nz/act/public/2002/0040/latest/DLM158592.html>

- 31 In its draft advice, the Commission recommended the use of AR5 values for measuring progress of New Zealand's domestic emissions budgets.² The report highlighted that updating the NZ ETS and SGG Levy to use AR5 data would also improve consistency with emissions reported in New Zealand's Greenhouse Gas Inventory, which will use AR5 data to report on calendar year 2021 emissions.
- 32 The proposed options for consultation are to update emissions factors and associated reference data used in the NZ ETS and SGG levy from 1 January 2022 or from a later date.

Updating the electricity allocation factor methodology and value used in industrial allocation

- 33 Firms in some industrial activities receive allocations of emissions units to manage the risk of emissions leakage³. This considers the pass-through of NZ ETS costs, some of which is due to their electricity use.
- 34 The impact of the NZ ETS on electricity prices is measured by the electricity allocation factor, and this is a component of allocative baselines in the Climate Change (Eligible Industrial Activities) Regulations 2010.
- 35 The EAF is a measure of the NZ ETS impacts on electricity prices. Evidence shows its methodology needs revision and its value needs updating as there is a risk it is materially overstated, resulting in unnecessary allocations of emission units.
- 36 The consultation proposes several options for updating the EAF methodology and value. Any change to the EAF could be used in a subsequent process to update allocative baselines, which are used to determine the number of emission units firms in eligible industries are allocated.

Improving the methodology that accounts for the re-disposal of waste in the NZ ETS

- 37 The effects of climate change are increasing the risks to closed landfills from flooding and erosion, creating challenges for ongoing management. This means that waste from closed landfills which are vulnerable to the effects of climate change may need to be excavated and disposed of elsewhere.
- 38 When this waste is excavated and redispersed in an operating landfill, the operator faces an emissions cost as the regulations assume this is new waste, even though it is generally completely biodegraded. This inaccuracy disincentivises work to address climate related environmental risks associated

² <https://ccc-production-media.s3.ap-southeast-2.amazonaws.com/public/evidence/advice-report-DRAFT-1ST-FEB/ADVICE/CCC-ADVICE-TO-GOVT-31-JAN-2021-pdf.pdf>

³ Emissions leakage is where differing climate policies between countries could result in the displacement of New Zealand production, the loss of market share, or the displacement of investment to higher emissions alternatives overseas with the intent to reduce NZ ETS compliance costs.

with closed landfills and may result in the choice of a lower cost, but more environmentally costly, redisposal option.

39 Several options to address this issue are presented in the consultation document. In summary, these options are:

39.1 Exempting this waste stream from NZ ETS costs, or

39.2 Various approaches to specific default emissions factors for this class of waste.

Updating the schedule of goods covered by the synthetic greenhouse gas levy

40 It has been identified that several unlevied synthetic greenhouse gas blends are likely to be contained in goods being imported into New Zealand. This creates a gap in coverage of the levy, where some goods face an emissions price and some do not. There is a need to improve the SGG goods levy coverage to include these goods.

41 The proposed options for consultation are various approaches to increase the coverage of the SGG levy to address these gaps.

Implementing new regulations for an NZ ETS Auction Monitor

42 Auctioning in the NZ ETS commenced in March 2021. Section 30GD of the Act enables the making of regulations for an auction monitor to perform functions including validating auction results and publishing reports on the results of auctions. These functions may also include monitoring conduct in auctions, and assessing the auction system.

43 Regulations for an auction monitor include their appointment process and their functions. I propose to consult on the development of these regulations.

Proposal to consult

44 Attached to this Cabinet paper in Appendix 1 is a consultation document that outlines the full detail of proposals, to support public consultation on proposed NZ ETS and SGG Levy updates for 2021.

45 The regulation updates will directly affect a small number of people, most being NZ ETS participants or SGG levy importers. The magnitude of these effects will vary according to the activities a person carries out.

46 These updates could result in indirect flow-through cost impacts to purchasers of some goods and services through effects on emissions prices.

47 The proposals describe no significant policy changes with respect to the purpose of the NZ ETS and SGG levy. Some proposals consider draft advice from the Commission, noting that this is yet to be finalised and considered as part of the wider policy package by Government. While most of the proposed changes are expected to have minor economic impacts, some stakeholders

could be significantly affected. I seek to improve our understanding of this through consultation.

- 48 Several other updates to existing regulations, and one set of new regulations are also anticipated to take effect from 2022. These are not being consulted on as part of this consultation, however they are briefly described in an appendix to the consultation document for information and context. These matters have either already been consulted on, already have policy approvals, or are minor and technical and do not require consultation or policy decisions from Cabinet.
- 49 I seek approval to make minor design, editorial and technical changes to the consultation document as needed.

Financial Implications

- 50 The proposals in this paper to publicly consult have no financial implications beyond existing departmental baselines.
- 51 If the proposals being consulted on are implemented, there will be financial implications to the Crown, to participants in the NZ ETS and importers of goods containing synthetic greenhouse gases.
- 52 For context, if subsequent steps are taken to incorporate the proposed update to the EAF into the allocative baselines used for industrial allocation, this would decrease the cost of NZU allocations from the Crown to emissions intensive, trade exposed industries by approximately 11%, which equates to approximately \$36 million at current NZU prices. The proposed decrease to the waste default emissions factor would have an approximately \$11 million reduction in Crown revenue due to lower reported emissions, and corresponding lower obligations to surrender units by waste participants. I will provide precise financial impact estimates on impacts of proposed updates following consultation.
- 53 These include possible impacts on the price of NZUs at auction and in the secondary market.

Legislative implications

- 54 This proposed consultation has no direct legislative implications.
- 55 Regulatory changes will be required to implement the proposals. Drafting approval for these would be sought at the time of policy decisions in June 2021. Depending on which options are implemented, the following regulations could be amended:
- 55.1 Climate Change (Agriculture Sector) Regulations 2010
- 55.2 Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020.

- 55.3 Climate Change (Eligible Industrial Activities) Regulations 2010
- 55.4 Climate Change (General Exemptions) Order 2009
- 55.5 Climate Change (Liquid Fossil Fuels) Regulations 2008
- 55.6 Climate Change (Other Removal Activities) Regulations 2009
- 55.7 Climate Change (Stationary Energy and Industrial Processes) Regulations 2009
- 55.8 Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013
- 55.9 Climate Change (Unique Emissions Factors) Regulations 2009
- 55.10 Climate Change (Waste) Regulations 2010

Te Tiriti o Waitangi Implications

- 56 Provided required engagement with Māori occurs, comprehensive Treaty analysis is not required with respect to these proposals. Links to the consultation document will be widely circulated among ETS stakeholders to ensure sufficient engagement occurs.

Impact analysis

Regulatory Impact Statement

- 57 The Regulatory Quality Team at the Treasury has determined that the consultation document will substitute for a Regulatory Impact Assessment. This is on the condition that the consultation document contains the key elements of the Impact Analysis Framework and that this be verified by the responsible agency's Quality Assurance panel or independent QA expert.
- 58 The RIA panel at the Ministry for the Environment has reviewed and confirmed that the discussion document substitutes for an interim Regulatory Impact Statement. The Discussion Document is likely to lead to effective consultation and support the delivery of a quality Regulatory Impact Analysis.

Climate Implications of Policy Assessment

- 59 The Ministry for the Environment has been consulted and confirm that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population implications

- 60 Public consultation involves no population implications.

Human rights

- 61 There are no inconsistencies between these proposals and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Next steps

- 62 Following consultation I will seek Cabinet approval of regulatory changes through Cabinet's Environment, Energy and Climate Committee.
- 63 The amendment regulations need to be published in the New Zealand Gazette by the end of September 2021. This is to ensure the updates apply from 1 January 2022.

Consultation

- 64 Agencies consulted in the development of this paper were: Treasury, Ministry of Foreign Affairs and Trade, Ministry for Primary Industries, Ministry for Business, Innovation and Employment, Environmental Protection Authority, the New Zealand Customs Service, the Department of Prime Minister and Cabinet, and Te Puni Kōkiri. Feedback received from those agencies is reflected in this paper.

Communications

- 65 The attached consultation document will be published on the Ministry for the Environment's website with appropriate context highlighting the nature of the consultation. Officials will email potentially interested parties to inform them of the consultation prior to the start of the consultation.
- 66 The majority of proposals are unlikely to be viewed as controversial.
- 67 The update to the EAF could lead to a subsequent process to update allocative baselines to reflect this change. Any such change could materially lower the allocation received by some emissions intensive, trade exposed firms. This could elicit strongly positioned feedback.
- 68 Updates to unit supply settings and price control settings, and changes to align with updated GWP₁₀₀ data, relate to issues on which the Commission has provided draft advice. There is a risk that this consultation could be seen as pre-empting both the finalisation of the Commission's advice and the Government's response to this advice. The consultation paper seeks to mitigate this risk by clear reference to the draft nature of the advice, and that there will be a broader policy response to the Commission's final advice once it is received.

Proactive release

- 69 I propose to proactively release this paper on the Ministry for the Environment's website, subject to redactions as appropriate to those under the Official Information Act 1982, once consultation has begun.

Recommendations

The Minister of Climate Change recommends that the Committee:

- 1 **Note** that regular amendments and additions to regulations for the New Zealand Emissions Trading Scheme (NZ ETS) and Synthetic Greenhouse Gas (SGG) Levy take place to ensure they remain accurate, to address any issues that have arisen, and to improve the consistency between regulations and the purpose of the Climate Change Response Act 2002.
- 2 **Note** that I propose to consult on the following:
 - 2.1 Updating NZ ETS unit supply settings, including auction emission unit volumes.
 - 2.2 Updating NZ ETS price settings.
 - 2.3 Updating the electricity allocation factor methodology and value used in NZ ETS industrial allocation.
 - 2.4 Updating the default emissions factor for waste in the NZ ETS.
 - 2.5 Updating the default emissions factors for natural gas fields in the NZ ETS.
 - 2.6 Updating default emissions factors and other NZ ETS and SGG levy reference data to take into account new global warming potentials.
 - 2.7 Updating the methodology for calculating waste emissions in the NZ ETS to appropriately account for emissions associated with the redisposal of waste from closed landfills.
 - 2.8 Updating the schedule of goods covered by the SGG levy.
 - 2.9 New regulations for an NZ ETS Auction Monitor.
- 3 **Note** that consultation on updates to auction emission unit volumes and price control settings include those recommended in the Climate Change Commission's draft advice.
- 4 **Note** that consultation on described updates to auction emission unit volumes and price control settings does not limit Cabinet from choosing a different set of updates if the final advice from the Climate Change Commission differs from its draft advice.
- 5 **Approve** public consultation on the proposals noted in recommendation 2 to occur between April and May 2021.

- 6 **Agree** to release the attached consultation document on the Ministry for the Environment's website to support this consultation.
- 7 **Agree** the Minister of Climate Change can make minor design, editorial and technical changes to the consultation document as needed.
- 8 **Note** that I will seek Cabinet approval of regulatory changes through Cabinet's Environment, Energy and Climate Committee in July 2021 following consultation.

Authorised for lodgement

Hon James Shaw

Minister of Climate Change

Proactively Released

Appendix: Consultation Document

Proactively Released