

I N C O N F I D E N C E

In Confidence

Office of the Minister of Climate Change

ENV – Cabinet Environment, Energy and Climate Committee

Approval to consult on proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022

Proposal

- 1 I seek Cabinet approval to publicly consult on proposals for amendments to regulations for the New Zealand Emissions Trading Scheme (NZ ETS regulations) set under the Climate Change Response Act 2002 (the Act). These proposals will improve the accuracy of the NZ ETS to ensure it continues to support New Zealand's climate change objectives.

Relation to government priorities

- 2 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].
- 3 Enabling a just transition to a low-emissions, climate resilient future is also a government priority. This was emphasised by the CBC when they noted the intention to “put the climate at the centre of government decision-making” and agreed that “climate change requires decisive action by all levels of government, the private sector, and communities” [CBC-20-MIN-0097 refers].
- 4 The proposals in this paper relate to the Cooperation Agreement between the Labour and Green Parties. Achieving the purpose and goals of the 2019 zero carbon amendments to the Climate Change Response Act 2002 (CCRA) is an agreed area of cooperation.

Executive Summary

- 5 The NZ ETS is one of our key tools for meeting New Zealand's domestic and international climate change targets, including the 2050 target set by the Act. The Act enables regulations to be made to support the implementation and operation of the NZ ETS. From time to time, some of these regulations need adjustment to maintain their accuracy and to address operational issues that have surfaced.
- 6 Four issues need consideration this year:

IN CONFIDENCE

- 6.1 Removing a redundant regulation allowing New Zealand Units (NZUs) to be exchanged for Kyoto Protocol Assigned Amount Units (AAUs) which are then cancelled.
 - 6.2 Removing regulatory barriers to encourage greater collection of synthetic greenhouse gases for export or destruction.
 - 6.3 Updating the schedule of default emissions factors for natural gas fields to reduce compliance costs for large gas users.
 - 6.4 Changes to emissions calculations for the supply of biofuel to aviation.
- 7 I have appended the consultation document, *Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022*.
- 8 Consultation is intended to take place between mid-March and late April 2022. After considering submissions, in August 2022, Cabinet agreement will be sought for the policy changes and to issue drafting instructions to the Parliamentary Counsel Office. These regulations must be notified in the New Zealand Gazette by the end of September to ensure statutory timing requirements for regulations coming into force are met.
- 9 The proposals being consulted on are technical improvements to the NZ ETS to maintain its accuracy. Areas out of scope for this consultation are:
- 9.1 The development of the emissions reduction plan (ERP).
 - 9.2 ETS forestry policy changes.
 - 9.3 ETS industrial allocation reform.
 - 9.4 ETS market governance policy work.

Background

- 10 The NZ ETS regulations under the Act need updating from time to time to ensure the NZ ETS operates in line with the objectives of the Act. Maintaining the accuracy of the NZ ETS supports New Zealand's ability to meet the 2050 emissions reduction target and the 2030 Nationally Determined Contribution under the Paris Agreement.
- 11 Section 3A of the Act requires the Minister to consult iwi and Māori representative organisations that are likely to have an interest in the regulations I recommend. Section 3B of the Act requires the Minister to consult with persons that are likely to be affected by certain regulatory amendments.

Proposed amendments

- 12 Amendments to four sets of regulations for the NZ ETS are proposed this year. The following table outlines the proposed changes, with high-level reasoning and impact analysis. Further detail on each proposal is provided after the table, and in the appended consultation document.

IN CONFIDENCE

Table 1: Summary of proposed regulation amendments for the NZ ETS

Regulations	Proposal	Reasoning and impacts
Climate Change (Unit Register) Regulations 2008	Repeal Regulation 11D to remove an accounting transaction which relates to voluntary emissions offsetting activity during the Kyoto Protocol commitment periods (2008–12 and 2013–20 inclusive).	<p>The use of Kyoto Protocol-era emission units is no longer consistent with our updated guidance on voluntary emissions offsetting.</p> <p>We have recently published new interim guidance on offsetting activities for post-2020 emissions and will further update this guidance over time. According to the most recent Environmental Protection Agency data, no participants are using this method anymore.</p>
Climate Change (Other Removal Activities) Regulations 2009	Update to the regulations to remove the criteria for registering as a participant in relation to specific potent greenhouse gas removal activities.	Updating these regulations may increase the number of people that register to participate in the New Zealand Emissions Trading Scheme for exporting or destroying specific potent greenhouse gases and increase the amount of gases that are exported or destroyed.
Climate Change (Stationary Energy and Industrial Processes) Regulations 2009	Update the schedule of emissions factors listed in regulations to reflect changes to the chemistry of mined natural gas.	Emissions factors for sources of mined natural gas change over time. These regulations need to be updated periodically to reflect those changes so 24 natural gas mining participants can minimise their New Zealand Emissions Trading Scheme administration costs.
Climate Change (Liquid Fossil Fuels) Regulations 2008	Change the methodologies that opt-in and obligation fuel participants use to calculate emissions, so the reduction in emissions caused by the opt-in participant's supply of biofuel is part of their emissions return.	If opt-in participants can use the total volume of biofuel they supply to reduce their surrender obligations, instead of only the volume they use, this will reduce the cost of supplying biofuel which in turn could potentially increase its use.

IN CONFIDENCE*Removing the regulation allowing cancelling of Kyoto Protocol era emission units*

- 13 Regulation 11D of the Climate Change (Unit Register Regulations) 2008 permits holders of New Zealand Units (NZUs) to convert these for Assigned Amount Units (AAUs) and then apply for their cancellation. The purpose of the regulation was to support claims related to pre-2021 voluntary carbon offsetting, which required offset projects to be accounted for against New Zealand's Kyoto Protocol-related targets.
- 14 The Ministry for the Environment (the Ministry) publishes guidance on offsetting activities in the voluntary carbon market. The most recent guidance expired at the end of 2021. This guidance recommended cancelling AAUs as a means of accounting for voluntary offsets against New Zealand's international targets under the Kyoto Protocol.
- 15 This accounting exercise avoided double counting between the voluntary carbon market and New Zealand's emissions targets. Regulation 11D of the Unit Register Regulations requires the Registrar to give effect to this cancellation process.
- 16 The Ministry has published interim guidance that no longer recommends the use of AAUs to account for carbon offsetting [ENV-22-MIN-0005 refers]. How the voluntary carbon market will operate in the Paris Agreement era is still developing, and the Ministry will update guidance in line with international best practice as needed.
- 17 I propose regulation 11D of the Unit Register Regulations be repealed for reasons of redundancy. Repealing 11D will ensure regulations are in line with the Ministry's guidance and current practice in the voluntary carbon market. Stakeholders are expecting this change.

Remove eligibility criteria for receiving emission units for exporting or destroying refrigerant greenhouse gases

- 18 The Climate Change (Other Removal Activities) Regulations 2009 require persons exporting or destroying hydrofluorocarbons (HFCs) or perfluorocarbons (PFCs) to meet eligibility criteria to receive NZUs. HFCs and PFCs are potent greenhouse gases that contribute to climate change.
- 19 These criteria require that persons show gases were imported after 1 January 2013, or that they are members of an accredited product stewardship (PS) scheme. This regulation was introduced to prevent an arbitrage opportunity, where a person could import and stockpile synthetic greenhouse gases prior to 2013, then receive emission units for exporting those gases after 1 January 2013.
- 20 At present, the air conditioning and refrigeration industry supported Refrigerant Recovery Trust is the only party that collects these gases. Given the increase in emission unit prices and the value of these gases, I am aware of greater interest in this removal activity, including potential investment in recycling and destruction facilities in New Zealand.

IN CONFIDENCE

- 21 I propose updating the Other Removal Activities Regulations to remove these eligibility criteria. These criteria are acting as barriers to increasing the collection of potent greenhouse gases for export or destruction. The risk of arbitrage has passed.

Update the schedule of default emissions factors for natural gas fields

- 22 Emissions factors are an important part of the NZ ETS and are used by participants to calculate emissions and removals from their activities. The emissions factors for mining or purchasing natural gas are published in a schedule to the Climate Change (Stationary Energy and Industrial Processes) Regulations 2009, against each gas field.
- 23 I propose to update the schedule of gas fields and their emissions factors. Natural gas emissions factors need to be regularly updated and added to regulations so emissions calculations for NZ ETS obligations are accurate.

Change how obligation and opt-in participants calculate emissions for the supply of biofuel

- 24 Sustainable aviation fuel (SAF) is a direct biofuel replacement to liquid fossil fuel used in jet aircraft.
- 25 The Climate Change (Liquid Fossil Fuels) Regulations 2008 (Liquid Fossil Fuels Regulations) prescribe the methodologies that obligation fuel and opt-in participants¹ use to calculate emissions for liquid fossil fuel use in New Zealand. These allow obligation fuel suppliers to deduct biofuels from total fuel sales and opt in participants to deduct biofuels from fuel consumption.
- 26 An opt-in participant has proposed to import and supply SAF to the domestic aviation fuel market. Because of how fuel is supplied at airports, the emissions benefits are shared across all airport fuel users. According to the opt-in participant, this disincentivises their proposed supply of SAF.
- 27 I am interested in stakeholder views on allowing opt-in participants to include the total volume of biofuel they have supplied in their emissions calculations, not just the amount they use. To avoid double counting of emissions reductions, it will be necessary to adjust the emissions calculation of the obligation fuel supplier.
- 28 In effect, while the correct amount of emissions will be reported by the sector as a whole, the opt in participant will report less emissions than it actually emits. This is an unusual change compared to standard updates for NZ ETS regulations that I normally consult on each year. This change will reward the person responsible for reducing someone else's emissions, without that third party receiving any economic benefit themselves.

¹ Large users of liquid fossil fuels that are not mandatory participants in the NZ ETS can voluntarily opt-in to it. This allows large users of liquid fossil fuels to carve-out the upstream obligation from mandatory participants and take on the point of obligation themselves.

IN CONFIDENCE

- 29 Consequently, these possible changes to the Liquid Fossil Fuels Regulations will be of wider interest to more than just the aviation and biofuel sectors.

The role of the NZ ETS, the Emissions Reduction Plan and other ETS policy areas

- 30 The final emissions reduction plan will be brought to Cabinet for approval in April 2022 prior to finalisation of Budget 2022 and to enable publication during May 2022. The plan will set out coherent measures that are complementary and reinforcing to describe how we are going to meet emissions budgets and progress towards our 2050 target. Emissions pricing through the NZ ETS will be a key part of the policy package.
- 31 This consultation document proposes technical amendments to some of the regulations made under the Act that maintain the accuracy of the NZ ETS. Policy decisions relating to the proposals in this consultation document are unlikely to impact the development of the ERP. Other areas of policy work related to the NZ ETS such as forestry and market governance are out of scope and will not be affected by the proposals outlined in this paper.

Proposal to consult

- 32 I have appended the consultation document, *Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022*. I propose to consult on the proposals outlined in this paper between March and April 2022.
- 33 The regulation updates will be of interest to a small number of persons, most being NZ ETS participants. The impact will vary according to the activities of persons and participants.

Legislative Implications

- 34 Regulatory amendments will be required to implement the proposals. Drafting approval for these would be sought at the time of policy decisions in June 2022. Depending on which options are implemented, the following regulations could be amended:
- 34.1 Climate Change (Unit Register) Regulations 2008
 - 34.2 Climate Change (Other Removal Activities) Regulations 2009
 - 34.3 Climate Change (Stationary Energy and Industrial Processes) Regulations 2009
 - 34.4 Climate Change (Liquid Fossil Fuels) Regulations 2008

Te Tiriti o Waitangi Implications

- 35 Māori have a significant interest in climate change action and the NZ ETS, particularly in the forestry sector. There are no direct Te Tiriti o Waitangi implications from the proposals in the consultation document outlined in this paper. Consultation materials will be provided to all account holders in the NZ ETS Register. Amendments to the Liquid Fossil Fuel Regulations to reward the

IN CONFIDENCE

supply of SAF by an opt-in participant may have impacts on the biofuel (wood processing) sector, which some Māori incorporations have economic and cultural interests in.

Impact Analysis*Regulatory Impact Statement*

36 The Ministry for the Environment's regulatory impact assessment panel has reviewed the discussion document Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022 and considers that it meets the effective consultation requirements and can function as an interim regulatory impact assessment.

Climate Implications of Policy Assessment

37 The Climate Implications of Policy Assessment (CIPA) team at the Ministry has been consulted. They confirmed the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

38 This public consultation involves no population implications.

Human Rights

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

Next steps

40 After analysing submissions, I will seek Cabinet agreement to amend the relevant NZ ETS regulations and issue drafting instructions to the Parliamentary Counsel Office in August 2022.

41 The amended regulations need to be published in the New Zealand Gazette no later than the end of September 2022. This is to align with statutory requirements under Section 166 of the Act to allow 3 months before implementation on 1 January 2023.

Consultation

42 The 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 Ministry of Transport, the Department of Prime Minister and Cabinet, and Te Puni Kōkiri were consulted on this paper. Where feedback has been received, it has been incorporated.

43 Notification of consultation will be sent to NZ ETS participants the day before release. It will then be published on the Ministry's website prior to market

IN CONFIDENCE

opening the following day. The consultation period will begin after the first NZ ETS Auction on 16 March 2022, and will end in late April 2022.

Proactive Release

- 44 I propose to proactively release this paper on the Ministry's website, subject to redactions as appropriate under the Official Information Act 1982, once consultation has begun in March 2022.

Recommendations

- 1 **Note** a large set of regulations enable the implementation and operation of the New Zealand Emissions Trading Scheme for the Climate Change Response Act 2002.
- 2 **Note** some of these regulations need amending to ensure the New Zealand Emissions Trading Scheme is meeting the objectives of the Climate Change Response Act 2002.
- 3 **Note** the following proposals will improve the accuracy of the New Zealand Emissions Trading Scheme and support increased emissions reductions:
 - a. Removing the regulation allowing the conversion of New Zealand Units into Kyoto Protocol era emission units for cancellation.
 - b. Remove the import date and product stewardship eligibility criteria for the export or destruction of certain greenhouse gases.
 - c. Update the schedule of classes and default emissions factors for natural gas fields to reflect updated data on gas composition and any new operational gas fields.
 - d. Change how obligation fuel and opt-in participants calculate their emissions due to the supply of biofuel.
- 4 **Agree** to release the attached consultation document, *Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022*, to support consultation on those proposals.
- 5 **Note** that I will seek Cabinet approval for any amendments to regulations in June 2022 following consultation.
- 6 **Agree** that I can make minor design, editorial and technical changes to the consultation document as needed prior to its release.

Authorised for lodgement

Hon James Shaw

Minister for Climate Change

Appendix 1: Consultation document: Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2022

Proactively released