

In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Environment, Energy and Climate Change Committee

New Zealand Emissions Trading Scheme: confirming in-principle decisions and finalising minor issues

Proposal

1. This paper seeks approval to confirm in-principle decisions made by Cabinet to amend the Climate Change Response Act 2002 (**CCRA**). In addition, I am seeking approval for further proposals on minor issues.
2. This paper, and a forestry paper also before Cabinet, will complete tranches one and two of improvements to the New Zealand Emissions Trading Scheme (**NZ ETS**) through amendments to the CCRA. This paper does not include decisions on agriculture or any allocations or other support for agricultural participants.

Executive summary

3. Over the last seven months, Cabinet has approved two tranches of amendments to the CCRA that will reform the NZ ETS, including joint submissions with the Minister of Forestry to improve forestry settings. These amendments will ensure the NZ ETS is effective in assisting New Zealand to meet emission reduction targets and transition to a low-emission and climate-resilient country.
4. For both tranches, Cabinet agreed in principle to some decisions, subject to certain conditions. Those conditions have now been met. This paper confirms those in-principle decisions and seeks approval for further minor proposals.

Updating the purpose of the CCRA

5. I am seeking Cabinet confirmation of an in-principle decision to amend the purpose of the CCRA to assist New Zealand to meet targets and emissions budgets [CAB-18-MIN-0606.01]. This can now be confirmed with the introduction of the Climate Change Response (Zero Carbon) Amendment Bill (**ZCB**), which will amend the CCRA to provide those domestic targets and emissions budgets. As already agreed by Cabinet, the purpose of the CCRA will also be to assist New Zealand to comply with international emission reduction and reporting commitments for the purposes of the Paris Agreement.

Cancellation and replacement of Kyoto units in private accounts

6. In April 2019, Cabinet decisions on privately-held emission units from the first commitment period (**CP1**) to the Kyoto Protocol were made in principle subject to targeted stakeholder engagement [CAB-19-MIN-0145]. The proposal Cabinet considered at the time was to cancel all CP1 Kyoto units held in private accounts without compensation, and to replace privately-held New Zealand-issued Assigned Amount Units (NZ AAUs) with New Zealand Units. CP1 Kyoto units (excluding NZ AAUs) are of negligible value as they have not been eligible for use

in the NZ ETS or able to be sold offshore since 2015. Internationally, these units are worth very little, and the Crown currently values them at zero.

7. Officials have re-engaged with affected stakeholders and the majority of those who responded supported the proposal. Of those who did not support it, most mistakenly believed that all CP1 Kyoto units could still be used to meet surrender obligations in the NZ ETS, whereas in fact, only NZ AAUs are eligible to do so.
8. Given this feedback, I am comfortable with proceeding and am seeking Cabinet's final approval of these decisions.

Improving compliance and penalties

9. In April 2019, Cabinet made decisions on improving compliance and penalties in the ETS [CAB-19-MIN-0153]. A decision on setting the surrender/repayment penalty at three times the current carbon price was made in principle, s 9(2)(i)

10. I am also seeking to confirm that the reporting penalty agreed by Cabinet in April 2019 [CAB-19-MIN-0153], applies to errors and omissions in, and failures to submit both emissions returns and applications for industrial allocation.

Phase-down of industrial allocation

11. In May 2019, Cabinet agreed in principle to proposals to phase down industrial allocation, with financial implications from 2020/21 onwards [CAB-19-MIN-0209]. As decisions were made during the Budget moratorium, Cabinet noted the decisions were for drafting purposes only and required final approval after the Budget is delivered. With the Budget moratorium now over, I am seeking Cabinet's final approval of the decisions.
12. I can also report back to Cabinet that following consultation with other Ministers, I will not be pursuing the bringing forward of free allocation to incentivise technological change to low carbon alternatives.

Minor matters

13. In addition, I am seeking approval on two minor matters to:
 - validate consultation on regulations prior to the CCRA Amendment Bill being enacted
 - confirm that all participants required to surrender or repay units under the NZ ETS can use the fixed price option, addressing an oversight from when the fixed price option was first introduced in 2009.

Background

14. This Government has approved a series of amendments to the CCRA to reform the NZ ETS over the last seven months, as outlined below.

Tranche One

15. In December 2018, Cabinet approved amendments [CAB-18-MIN-0606.01] to:

- Align the CCRA with the Paris Agreement and proposed Climate Change Bill, now the ZCB
- Establish unit supply decision-making framework to manage a cap on emissions covered by the NZ ETS
- Improve the administration and operation of the NZ ETS by improving the compliance regime and other improvements
- Reduce barriers to establishing permanent forests and improve the way the ETS works for forestry participants [CAB-18-MIN-0606].

Tranche Two

16. In March and April 2019, Cabinet approved amendments to:

- Improve compliance and penalties [CAB-19-MIN-0145]
- Enable future price controls [CAB-19-MIN-0145]
- Cancel and replace Kyoto units in private accounts [CAB-19-MIN-0145]
- Improve transparency of the scheme [CAB-19-MIN-0145]
- Make rotational and permanent forests more viable and attractive options [CAB-19-MIN-0109; CAB-19-MIN-0127].

17. In May 2019, Cabinet approved further amendments to:

- Phase down industrial allocation [CAB-19-MIN-0209]
- Support a fit-for-purpose auctioning system [CAB-19-MIN-0209]
- Confirm the design details of averaging accounting for post-1989 forestry [CAB-19-MIN-0213].

18. Cabinet also agreed to a market governance work programme that is likely to result in a separate amendment bill to the CCRA in the future [CAB-19-MIN-0209].

Remaining proposals to amend the CCRA

19. At the same time as considering this paper, Cabinet will be considering a paper on forestry in the ETS that I have submitted with the Minister for Forestry. This package of amendments outlined above will make up a single amendment bill for introduction to the House of Representatives later this year.

20. I intend to report back to Cabinet to recommend policy decisions on reducing agricultural emissions later this year.

Issues covered in this paper

21. The in-principle decisions to be confirmed in this paper cover these issues:

- updating the purpose of the CCRA
- the cancellation and replacement of Kyoto units from private accounts
- improvements to compliance and penalties in the ETS
- the phase-down of industrial allocation.

Confirming an in-principle decision on aligning purpose of CCRA with domestic emissions budgets and targets

22. In December 2018, Cabinet noted [CAB-18-MIN-0606.01] that the purpose statement of the CCRA needs to be updated to reflect the Paris Agreement and proposed Climate Change Bill (CCB). Amongst other things, Cabinet agreed to:

- 22.1. amend the purpose section of the CCRA to assist New Zealand to comply with its emission reduction¹ and reporting commitments for the purposes of the Paris Agreement
- 22.2. in principle, subject to final decisions on the CCB, to amend the purpose of the CCRA to assist New Zealand to meet target(s) and emissions budgets set under the CCB.

23. The CCB is now the **ZCB** and was introduced into the House in May 2019. With the introduction of the ZCB, the in-principle decision above can be confirmed.

Cancellation and replacement of Kyoto units in private accounts: confirming in-principle decisions

24. In April 2019, Cabinet considered proposals to address an operational issue concerning privately-held emissions units from the first commitment period to the Kyoto Protocol (CP1) [CAB-19-MIN-0145]. Specifically, Cabinet:

- 24.1. **agreed in principle**, subject to targeted engagement with relevant stakeholders to amend the CCRA to:
 - 24.1.1 cancel New Zealand-issued Assigned Amount Units (NZ AAUs) in private accounts
 - 24.1.2 replace NZ AAUs in private accounts with an equivalent number of New Zealand Units (NZUs)
 - 24.1.3 cancel, without compensation, Assigned Amount Units from overseas registries, Certified Emissions Reduction Units, Emission Reduction Units and Removal Units from the first Kyoto commitment period held in private accounts
 - 24.1.4 implement these decisions on 30 November 2020.

25. At the same time, Cabinet:

- 25.1. **directed** the Ministry for the Environment, to undertake targeted engagement with relevant stakeholders on the in-principle proposal [set out in 23.1 above].

26. The proposal will resolve an operational issue that arose from New Zealand's decision not to take a binding second commitment period under the Kyoto Protocol. The previous Government made much the same decision as outlined in paragraph 24.1 in 2013, communicated this to the market, but did not implement it. With the exception of NZ AAUs, Kyoto units from the first commitment period are of negligible value as they are not eligible for surrender in the NZ ETS and cannot be sold offshore. NZ AAUs remain eligible for use in the NZ ETS. Implementing this decision now will provide regulatory predictability.

¹ Emission reduction commitments in the Paris Agreement are provided through National Determined Contributions

Targeted consultation has confirmed that the April 2019 decisions should go ahead

27. In May 2019, officials consulted with the over 300 owners and operators of accounts holding NZ AAUs and other Kyoto CP1 units. This took the form of an email inviting stakeholders to comment on whether or not they supported the proposal in paragraph 24.1.
28. This consultation had a response rate of about 3 per cent with 12 submissions received, the majority of which supported the proposal. Those submitters that opposed the proposal largely did so on the basis that this would prevent them from surrendering these units in order to fulfil their NZ ETS obligations. However, with the exception of NZ AAUs, these units have not been eligible since 2015. There was extensive communication about this at that time.
29. I do not consider the issues raised by submitters opposed to the proposal to outweigh the rationale for implementing the proposal, which remains sound. I am, therefore, seeking Cabinet's final approval of the April 2019 decisions. I have asked officials to prepare communications material for those who will be affected.

Improving compliance and penalties: confirming an in-principle decision and clarification on a minor matter

30. In April 2019, Cabinet agreed to restructure relevant offences and penalties for non-compliance in the NZ ETS into two separate penalties: a surrender/repayment penalty; and a reporting penalty [CAB-19-MIN-0153]. Furthermore, Cabinet:
- 30.1. agreed the surrender/repayment penalty will apply only when a person fails to surrender or repay units by a due date
- 30.2. agreed in principle, subject to confirmation that this will not create a barrier for linking with international carbon markets, that the surrender/repayment penalty will be three times the current carbon price, and will be updated annually in regulations
- 30.3. s 9(2)(j) [REDACTED]

A penalty of three times the current carbon price will not create a barrier for linking

31. s 9(2)(j) [REDACTED] I am now comfortable proceeding with this approach and no further report back on this issue is necessary. I am seeking Cabinet's confirmation of the in-principle decision.

Minor clarification on penalties

32. As noted in paragraph 30, Cabinet has agreed to create a reporting penalty. In my submission to Cabinet, the paper implied that this penalty would apply to errors and omissions in, and failures to submit, emissions returns and applications for industrial allocation. However, the recommendations Cabinet agreed were unclear on this point. I now seek agreement to clarify that the reporting penalty will apply as described above.

² s 6(a) [REDACTED]

Industrial allocation: confirming in-principle decisions and approval to make no further change to industrial allocation

33. In May 2019, Cabinet agreed in principle to a set of decisions to phase down industrial allocation in the NZ ETS [CAB-19-MIN-0209], set out in full in recommendation 23 of this paper.
34. As the decisions have financial implications and were considered during the Budget moratorium, Cabinet noted the decisions would be agreed subject to a subsequent Cabinet decision after the Budget was delivered. As the Budget moratorium is over, these decisions can now be confirmed.
35. This will provide for a phasing down of industrial allocation in the NZ ETS from 2021, to better align the scheme with the Paris Agreement and domestic emission budgets. The decisions will continue to mitigate any risk of carbon leakage.

Industrial allocation for low emission technology investment

36. Cabinet also agreed [CAB-19-MIN-0209] that the Minister for Climate Change, in consultation with the Ministers of Finance, Energy and Resources, and Economic Development, can make in-principle policy decisions to allow the bringing forward of free allocation to incentivise technological change to low-carbon alternatives for emissions-intensive trade-exposed industries, other than agriculture.
37. This proposal would run implementation risks including firms failing to use their allocation to protect against emission leakage and the additional supply of units to an already over-supplied market. The proposal is unlikely to be acceptable to prospective linking partners. Following consultation with these Ministers, I now recommend that Cabinet not make any further change to industrial allocation on the basis of this decision.

Further decisions on minor matters

Validating consultation on regulations prior to enacting the Bill

38. Some policy decisions in tranches one and two empower regulations to be made that will give effect to the provisions. For the sake of coherency, the Legislative Design and Advisory Committee recommend developing regulations in tandem with legislation as much as possible.
39. I therefore intend to consult on certain regulations alongside the Select Committee process to ensure the public and Parliament are given the opportunity to scrutinise the substantive changes. To ensure this process works as intended, I am seeking approval to include a clause in the CCRA Amendment Bill validating consultation on regulations undertaken prior to the Bill being enacted.

Addressing a technical issue preventing some participants in the NZ ETS from accessing the fixed price option

40. I also propose to address an oversight from when the fixed price option (FPO) was first introduced in 2009. This oversight has meant that some participants who have obligations to surrender or repay units are prevented from accessing the FPO. This was not the policy intention. The FPO currently allows a participant to pay \$25 to the Crown in place of surrendering or repaying an NZU. The participants affected are those with late emission returns or who have had their returns

amended. Affected participants face compliance and transaction costs that other participants may not have to incur.

41. I therefore seek approval to confirm that all participants with obligations to surrender or repay units under the NZ ETS have the ability to use the FPO while that option remains available.

Consultation

Public consultation on policy decisions

42. The Cabinet decisions in tranches one and two, including in-principle decisions being confirmed in this paper, were informed by submissions from a public consultation process held in 2018. When the CCRA Amendment Bill is referred to Select Committee there will be a further opportunity for NZ ETS participants and the general public to share their views.

Agency consultation on policy decisions

43. This paper was prepared by the Ministry for the Environment. The Treasury, Environmental Protection Authority, Ministry of Foreign Affairs and Trade, Ministry for Primary Industries, Department of Conservation, Ministry of Transport, Ministry of Business, Innovation and Employment and Ministry of Justice were consulted in the preparation of the in-principle decisions being confirmed in this paper. The Department of Prime Minister, Cabinet and Te Puni Kōkiri were informed.

Public consultation on regulations

44. I expect to return to Cabinet later this year for approval of a process of public consultation on the regulations needed to fully implement policy decisions (see appendix 1). As signalled in earlier submissions, public consultation on some regulations will take place alongside the Select Committee process for the amendment bill, with the aim of regulations coming into effect in 2020. Consultation on other regulations will take place in 2020.

Financial implications

A phase-down of industrial allocation has financial implications

45. As noted in the original Cabinet paper [CAB-19-MIN-0209], 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.

46. The table shows the estimated effect on expense 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. I am seeking Cabinet's approval for the Minister of Finance and the Minister for Climate Change to make necessary forecasting changes to this appropriation.

	\$M – increase/(decrease)				
Vote Environment Minister for Climate Change	2019/20	2020/21	2021/22	2023/23	2023/24 & outyears
Non-Departmental Other Expense: Allocation of New Zealand Units	0	(1.630)	(5.190)	(9.190)	(12.860)

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

Cancellation and replacement of Kyoto units in private accounts

48. As noted in the previous Cabinet paper [CAB-19-MIN-0145], the cost of swapping NZ AAUs for NZUs was recognised as an expense to the Crown in 2014/15. Since then, the Ministry for the Environment has revalued these units annually. This will continue until the swap-out occurs. The revaluation expenses are recognised as a re-measurement cost in the Crown accounts. This cost will be balanced by revenue over time as the NZUs are surrendered back to the Crown.

I am not seeking additional funding for other proposals in this paper

49. I am not seeking additional funding for other in-principle decisions being confirmed in this paper, or for other minor proposals. Additional funding may be required to operationalise the proposals in this paper once they are implemented, which will be from 2020 onwards. Additional funding, if required, will be sought through further implementation decisions or through Budget.
50. Implementing the package of proposals to improve the ETS (tranches one and two) will have costs for the Environmental Protection Authority (EPA), including third party costs. I expect that the EPA will seek additional funding to operationalise the proposals either through Budget 2020 or further implementation decisions. However, to operationalise some of the initiatives additional funding will be needed by the EPA in the 2019/20 financial year to avoid a delay in implementation.

Legislative implications

51. The policy decisions confirmed in this paper will require legislative amendments to the Climate Change Response Act 2002.
52. 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 amendments.
53. As already noted, regulations will be needed to fully implement the wide range of policy decisions in tranches one and two to improve the NZ ETS.

Regulatory impact analysis

54. Regulatory impact analyses were completed for the earlier Cabinet decisions on a phase-down of industrial allocation and improving compliance and penalties. For the April 2019 Cabinet decisions on cancelling and replacing Kyoto units in private accounts, the Regulatory Quality Team determined that a Regulatory Impact Assessment was not required because the relevant issues have already been addressed by existing impact analysis. The Regulatory Quality Team has determined that additional regulatory impact analysis is not required.

Human rights

55. 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

56. 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 tranche one and two proposals to continue to adhere to Treaty of Waitangi principles, as provided by section 3A of the CCRA.

57. A Māori Leaders' Forum was held in Wellington on 17 September 2018 as part of consultation on improvements to the NZ ETS. Feedback from the hui and ongoing engagement with iwi/Māori will form part of a work programme on climate change responding to the Ministry's recently confirmed Te Ao Māori Strategy.

Gender implications

58. There are no gender implications arising from this paper.

Disability perspective

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

Publicity

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

Proactive Release

61. I propose to proactively release this paper on the Ministry for the Environment's website, subject to redactions as appropriate 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 the first tranche of amendments and drafting has commenced [CAB-18-MIN-0606.01]
 - 2.2. from March to May 2019, Cabinet considered tranche two, comprising a series of papers with discrete proposals, including proposals on forestry
 - 2.3. Cabinet agreed, or agreed in principle, to tranche two amendments to the CCRA so that drafting could get underway

- 2.4. this paper, and a further paper on forestry, will complete tranche two of amendments to the CCRA
- 2.5. all amendments outlined above will result in a single bill amending the CCRA to be introduced to the House later this year
- 3. **note** that this paper does not include decisions on agriculture or any allocations or other support for the agricultural sector
- 4. **note** that the Minister for Climate Change will report back to Cabinet to recommend policy decisions on reducing agricultural emissions later this year

Amending the purpose of the CCRA

- 5. **note** in December 2018, Cabinet approved the following recommendations as part of a first tranche of proposals to amend the CCRA to support New Zealand's implementation of the Paris Agreement and improve the NZ ETS [CAB-18-MIN-0606.01]
 - 5.1. **agreed** to amend the purpose section of the CCRA to assist New Zealand to comply with its emission reduction and reporting commitments for the purposes of the Paris Agreement
 - 5.2. **agreed in principle**, subject to final decisions on the Climate Change Bill (CCB), to amend the purpose of the CCRA to assist New Zealand to meet target(s) and emissions budgets set under the CCB
- 6. **note** that the CCB is now named the Climate Change Response (Zero Carbon) Amendment Bill (ZCB) and was introduced into the House in May 2019
- 7. **note** that the ZCB will set an emissions reduction target for 2050 and establish a series of emissions budgets to achieve the 2050 target
- 8. **note** that the conditions of the in-principle agreement set out in recommendation 5.2 are now met
- 9. **note** that the purpose of the amended CCRA will include to assist New Zealand to comply with its emission reduction (Nationally Determined Contributions) and reporting commitments under the Paris Agreement, as well as to meet domestic targets and emission budgets
- 10. **agree** to confirm the in-principle decision set out in recommendation 5.2 to amend the purpose of the CCRA to include assisting New Zealand to meet target(s) and emissions budgets set under the ZCB

Cancellation and replacement of Kyoto units in private accounts

- 11. **note** on 8 April 2019 Cabinet approved the following recommendations to address an operational issue concerning privately-held emission units from the first commitment period to the Kyoto Protocol through the upcoming CCRA Amendment Bill [CAB-19-MIN-0145]:
 - 11.1. **agreed in principle**, subject to targeted engagement with relevant stakeholders to amend the CCRA to:
 - 11.1.1. cancel New Zealand-issued Assigned Amount Units (NZ AAUs) in private accounts

- 11.1.2. replace NZ AAUs in private accounts with an equivalent number of New Zealand Units
- 11.1.3. cancel, without compensation, Assigned Amount Units from overseas registries, Certified Emissions Reduction Units, Emission Reduction Units and Removal Units from the first Kyoto commitment period held in private accounts
- 11.1.4. implement these decisions on 30 November 2020
- 11.2. **directed** the Ministry for the Environment, to undertake targeted engagement with relevant stakeholders on the in-principle proposal described in recommendation 5 [11.1 in this paper]
- 12. **note** that in May 2019 the Ministry for the Environment, with the assistance of the Environmental Protection Authority, undertook targeted engagement with relevant account holders and owners as required by recommendation 11.2
- 13. **note** that the majority of account holders and owners supported the proposal in recommendation 11.1
- 14. **note** that the Minister of Climate Change is satisfied that the issues raised by submitters opposed to the proposal do not outweigh the rationale for implementing the proposal.
- 15. **agree** to confirm the in-principle decisions outlined in recommendation 11.1

Improving compliance and penalties

- 16. **note** on 8 April 2019 Cabinet approved and noted the following recommendations as part of a set of proposals to improve the compliance regime in the NZ ETS [CAB-19-MIN-0145]:
 - 16.1. **agreed** the surrender/repayment penalty will apply only when a person fails to surrender or repay units by a due date
 - 16.2. **agreed in principle**, subject to confirmation that this will not create a barrier for linking with international carbon markets, that the surrender/repayment penalty will be three times the current carbon price, and will be updated annually in regulations
 - 16.3. s 9(2)(i) [REDACTED]
- 17. s 9(2)(i) [REDACTED]
- 18. **agree** to confirm the in-principle decision outlined in recommendation 16.2
- 19. **agree** to clarify that the reporting penalty agreed by Cabinet in April 2019 [CAB-19-MIN-0145] applies to errors and omissions in, and failures to submit both emissions returns and applications for industrial allocation.

Phase-down of industrial allocation

20. **note** on 8 May 2019 Cabinet considered proposals to phase down industrial allocation in the NZ ETS [CAB-19-MIN-0209]
21. **note** that as the proposals had financial implications and were considered during the Budget moratorium, Cabinet agreed to the decisions in-principle, noting that decisions were for drafting purposes only and would be agreed subject to a subsequent Cabinet decision after the Budget is delivered
22. **note** that the Budget has now been delivered and the in-principle decisions can now be confirmed
23. **agree** to confirm the following decisions by Cabinet in May 2019, which at that time were agreed in-principle for the purposes of issuing drafting instructions:
 - 23.1. **agreed** to phase down industrial allocation with the first reduction applying to the calendar 2021 emissions reporting year
 - 23.2. **agreed** 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
 - 23.3. **agreed** 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 Climate Change Commission recommends such a reduction based on an assessment that there is an ongoing and substantial risk of emission leakage
 - 23.4. **agreed** that the Climate Change 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
 - 23.5. **agreed** 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 [now the ZCB]
 - 23.6. **agreed** that regulations will set mandatory phase-downs for the relevant budget period, and indicate intended phase-down rates for the following budget period
 - 23.7. **agreed** 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
 - 23.8. **agreed** that when making decisions on an activity-specific phase-down of allocation the Minister for Climate Change must have regard to:
 - 23.8.1. New Zealand’s targets and indicative future emission budgets as set under the CCB [now the ZCB] and New Zealand’s Nationally Determined Contributions under the Paris Agreement

- 23.8.2. The risk of emission leakage on an activity-specific basis, including:
- emission pricing and other policies in competing jurisdictions, their cost, any assistance such as allocation, and its phase-out
 - the markets for international trade in the specified products produced by eligible industrial activities
 - any ability of industrial allocation recipients in New Zealand to pass on increased costs to customers
- 23.8.3. Any risk that the value of the industrial allocation for an eligible activity exceeds the cost of meeting NZ ETS obligations affecting the activity
- 23.8.4. Other sources of supply into the NZ ETS, including offshore emission reductions obtained by the Government or available to NZ ETS participants
- 23.8.5. The availability of low-emission technologies related to each activity
- 23.8.6. New Zealand's relevant international obligations
- 23.8.7. The proper functioning of the NZ ETS
- 23.8.8. The cost to the taxpayer of providing allocation
- 23.8.9. Recommendations of the Climate Change Commission
- 23.8.10. Any other matters the Minister for Climate Change considers relevant.
- 23.9. **agree** 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
- 23.10. **agree** that if final decisions depart from the Climate Change 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
- 23.11. **agree** 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
- 23.12. **agree** 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.

24. **approve** the following changes to appropriations to give effect to the policy decision in recommendation 23 above, with a corresponding impact on the operating balance:

Vote Environment Minister for Climate Change	\$M – increase/(decrease)				
	2019/20	2020/21	2021/22	2023/23	2023/24 & outyears
Non-Departmental Other Expense: Allocation of New Zealand Units	0	(1.630)	(5.190)	(9.190)	(12.860)

25. **authorise** the Minister of Finance and the Minister for Climate Change to make necessary forecasting changes to the Non-Departmental Other Expense: Allocation of New Zealand Units appropriation

26. **note** that Cabinet also agreed to allow Ministers to make in-principle decisions to allow the bringing forward of free allocation to incentivise technological change to low-carbon alternatives [CAB-19-MIN-0209]

27. **agree** to not proceed with any proposal to legislate to allow the bringing forward, or borrowing, of industrial allocation

Other matters

28. **note** any new funding required to implement the decisions recommended in this paper apart from those set out in recommendations 23 and 24 will either be sought through a separate Cabinet paper or through the Budget 2020 process

29. **agree** the CCRA Amendment Bill ensure that the consultation requirements for making regulations under the amended Act can be satisfied by consultation occurring before the commencement of the amended Act, provided all other requirements are met

30. **agree** the CCRA Amendment Bill ensure that all participants with obligations to surrender or repay units under the NZ ETS can use the fixed price option, while that option remains

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

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

Authorised for lodgement.

Hon James Shaw
Minister for Climate Change

Appendix 1: Regulations needed to fully implement the amended CCRA

Forestry regulations

Forestry regulations are outlined in a separate paper currently before Cabinet, submitted with the Minister of Forestry (Improving the Emissions Trading Scheme for forestry participants – Final decisions required for drafting the amendment Bill).

Unit supply regulations

The unit supply regulations will include decisions on the:

- limit on the use of international units by participants
- number of NZUs to be auctioned
- number of NZUs expected to be provided through free allocation
- number of NZUs available in the cost containment reserve
- price trigger values for any price ceiling and price floor
- further operational detail on the cost containment reserve, including when NZUs would be released, and whether there would be a single trigger level, or multiple trigger levels.

Operational detail for auctioning

Regulations will establish the operational detail for auctioning including:

- further qualifications for auction participation beyond being New Zealand Emissions Trading Register account holders
- appointing an independent auctioning monitor.

Phase-down of industrial allocation

Regulations will provide:

- firm decisions on activity-specific phase-downs of industrial allocation covering the upcoming five-year budget period;
- indicative decisions on phase-downs of industrial allocation during the following budget period.

Compliance and penalties

Regulations are required to:

- determine which offences in the Act are infringement offences
- set the new cost of carbon for the purposes of the surrender/repayment penalty.