



Cabinet

CAB Min (05) 14/10

Minute of Decision

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Convenor, Ministerial Group on Climate Change

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Review of Operation of Negotiated Greenhouse Agreement Policy

On 18 April 2005, following reference from the Cabinet Policy Committee (POL), Cabinet:

Background

- 1 **noted** that in April 2003 Cabinet directed officials to report on:
 - 1.1 how frequently firms or industries should be allowed to reapply for eligibility, or renegotiation of a Negotiated Greenhouse Agreement (NGA);
 - 1.2 consideration of experience with NGAs to date;
 - 1.3 applicability of the proposed NGA eligibility criteria and processes;
 - 1.4 recommended improvements to the NGA policy;

[POL Min (03) 8/8]

- 2 **noted** that the time required to complete a NGA is significantly greater than foreseen and there is a significant risk that NGA negotiations will not be complete by the time the carbon tax is introduced;

Frequency of reapplication for NGA eligibility and eligibility for a greater exemption

- 3 **noted** that:

3.1 in April 2003 POL agreed that 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 – which is the current policy [POL Min (03) 8/8]

3.2 officials have interpreted the “renegotiation of a NGA” to refer to the NGA participant’s eligibility to seek a greater exemption from the carbon tax;

- 4 **agreed** to retain the current policy with respect to reapplication for NGA eligibility and eligibility for a greater exemption;

Applicability of the NGA eligibility criteria and process

- 5 **noted** that, whilst to date there is limited information to assess the applicability of the eligibility criteria, there is no evidence to suggest that the NGA eligibility criteria are inappropriate;

- 6 6.1 **noted** that to be eligible for a NGA, a NGA participant’s international competitiveness must be considered at risk as a result of the carbon tax;

6.2 **noted** that in April 2003, POL agreed that one of the criteria for assessing that risk was:

“Will the charge move the firm significantly below the appropriate industry weighted average cost of capital?”

[paragraph 8 of POL Min (03) 8/8]

- 7 7.1 **noted** that information on industry weighted cost of capital is not readily available and difficult to obtain;

7.2 **rescinded** the decision referred to in paragraph 6.2; and instead

7.3 **agreed** to replace the wording referred to in paragraph 6.2 with:

“Will the charge move the firm significantly below the firm’s weighted average cost of capital?”;

Proposed policy improvements

Establishing a standard end date for all NGAs

- 8 **noted** that NGA policy does not explicitly specify the end dates of NGAs;

- 9 **agreed** that the end date for NGAs be no later than 31 December 2012 until such time as the government decides otherwise, which may occur in conjunction with the development of the government's future climate change policies;

Determining the NGA participant's emissions intensity targets

- 10 **noted** that in April 2003 POL agreed that, "unless specifically modified in individual NGAs, emissions intensity targets will, where possible, be based on world's best practice (WBP) (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement" [paragraph 19 of POL Min (03) 8/8];
- 11 11.1 **noted** that the Crown needs to be satisfied that the emission intensity targets are sufficiently stringent, and this has required officials to develop an in-depth understanding of a NGA participant's business and operation, which has contributed to the complex and lengthy negotiations;
- 11.2 **rescinded** the decision referred to in paragraph 10; and instead
- 11.3 **agreed** to replace the existing policy referred to in paragraph 10 with the following:
 "Emissions intensity targets (the Target Pathway) will be a straight line between the following points:
- a start point defined as a NGA participant's actual average emissions intensity for the 2004 calendar year, or as agreed by the Crown and the NGA participant if:
 - the NGA participant's performance in 2004 is atypical; or
 - the business activity was not in operation for a full calendar year ending 31 December 2004;
 - an end point defined as the normalised WBP emissions intensity (nWBP) at 31 December 2012;"
- 11.4 **agreed** that the Target Pathway will take effect from the date the carbon tax takes effect;
- 12 **agreed** that on signing the NGA agreement, the end points of all Target Pathways used to determine the NGA participant's Target Pathway will be made public;

Clarifying the treatment of fuel switching

- 13 13.1 **noted** that stakeholders have not been consulted on the exclusion of electricity generation, including co-generation from the scope of NGAs;
- 13.2 **agreed** that, **subject to** consultation, electricity generation, including co-generation, be excluded from the scope of NGAs;
- 13.2 **authorised** the Minister of Finance and the Convenor of the Ministerial Group on Climate Change to confirm the decision in paragraph 13.2 following consultation with stakeholders;

- 14 **agreed that, for a switch to a less carbon intensive fuel**, a NGA participant's Target Pathway be recalculated to reflect the fuel switch (so the NGA participant will not receive the benefit of the fuel switch), unless the NGA participant can demonstrate to the Crown's satisfaction that the fuel switch meets the following criteria:
- 14.1 it represents less than 10 percent of the NGA participant's total emissions; or
 - 14.2 it represents 10 percent or more of the NGA participant's total emissions and the fuel switch project has passed the Crown's additionality test;
- 15 **agreed that, for a switch to a more carbon intensive fuel**, a NGA participant's Target Pathway not be recalculated to reflect the fuel switch (so the NGA participant will be exposed to the carbon tax), unless the NGA participant can demonstrate to the Crown's satisfaction that the fuel switch meets the following criteria:
- 15.1 it is outside the NGA participant's control; and
 - 15.2 it has a significant impact on the NGA participant's competitiveness-at-risk status;
- 16 **agreed** that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be responsible for defining the criteria noted in paragraph 14 and 15, and the process for their application;

Clarifying the scope of relief from the carbon tax

- 17 **agreed** that only the following financial impacts of the carbon tax be included within the scope of relief in a NGA if they are material, quantifiable, and verifiable:
- 17.1 direct financial impacts – any carbon tax that is paid directly by the NGA participant (i.e., when the NGA participant is the point of obligation for payment of the carbon tax);
 - 17.2 indirect financial impacts – any carbon tax that is passed on to the NGA participant in the price paid for a product or service:
 - 17.2.1 from the purchase of electricity by the NGA participant;
 - 17.2.2 where the use of the product by the NGA participant results in emissions; and
 - 17.2.3 from the use of contractors by the NGA participant, if:
 - 17.2.3.1 the service provided by the contractor relates to the NGA participant's primary production processes (as defined in the NGA);
 - 17.2.3.2 the emissions of the individual contractor for the service to the NGA participant are not less than 5% of the NGA participant's annual emissions included in the NGA; and
 - 17.2.3.3 the emissions and the financial impacts of the carbon tax attributed to the individual contractor providing the service to the NGA participant are quantifiable and verifiable;

- 18 **noted** that with the exception of electricity, the above proposed approach would exclude second-round price increases from the scope of relief from the carbon tax in a NGA;

Removing the principle of "holding harmless"

- 19 **agreed** that NGA policy no longer includes a commitment by the Crown to hold the NGA participant "harmless" from the material and reasonably quantifiable impacts of the carbon tax (or part thereof);

World's best practice identification and assessment

- 20 **noted** that to ensure consistency across NGA agreements, it is proposed to set an appropriate level of stringency for normalised world's best practice (nWBP);
- 21 **agreed** that normalised world's best practice (nWBP) be the top 10 percentile point of the data set of the world-wide range of like-for-like practice, or if there is an inadequate data set to identify the top decile, nWBP be an equivalent level of stringency based on the WBP advisor's best judgment and the available data set;
- 22 **agreed** that WBP will only be modified for appropriate technical factors when determining nWBP;
- 23 **noted** that in April 2003 POL agreed that "parties appoint joint advisor on world's best practice" [paragraph 22.3 of POL Min (03) 8/8];
- 24 24.1 **noted** that stakeholders and officials recognise that the proposed change to the determination of the Target Pathway may result in the NGA participant being more cautious in selecting the WBP advisor and agreeing to the WBP scope and methodologies for determining WBP;
- 24.2 **rescinded** the decision referred to in paragraph 23;
- 24.3 **agreed** to replace the decision referred to in paragraph 23 with:
- 24.3.1 the NGA participant and the Crown agree on terms of reference for the appointment of an independent advisor to the NGA participant on world's best practice;
- 24.3.2 the NGA participant and the Crown enter into an Agreement;
- 24.3.3 the NGA participant appoints its advisor on world's best practice; and
- 24.3.4 the Crown appoints its advisor to validate the WBP methodology and study;
- 25 **agreed** that the Crown make no contribution to the costs of the WBP study, and that the Crown pay for the cost of the Crown's advisor;
- 26 **noted** that:
- 26.1 the normalised WBP in emissions intensity in 2012 is a combination of WBP in energy intensity, the NGA participant's fuel mix, and WBP in process emissions (if any);

- 26.2 an NGA participant's fuel mix will vary over time and the assessment of a NGA participant's future fuel mix creates a level of complexity and uncertainty;
- 27 **agreed** that, to keep the negotiation process simple, the NGA participant's fuel mix for the 2004 calendar year (or other year as defined in accordance with recommendations on the start point of the Target Pathway) will be the assumed fuel mix when calculating nWBP emissions intensity at 31 December 2012;

Amending the standard NGA agreement

- 28 **agreed** that subsequent to the approval of the changes to NGA policy and processes proposed above, the NGA agreement will contain standard terms and conditions that are consistent across all NGAs;
- 29 **noted** that following further consultation with stakeholders, officials will submit a revised NGA agreement for approval by the Minister of Finance and the Convenor of the Ministerial Group on Climate Change;

Updating the documentation on NGAs

- 30 **noted** that, following further consultation with stakeholders, officials will revise the NGA guideline documentation;

Transitioning NGA participants to the revised NGA policy

- 31 **agreed** that the decisions set out above will apply to all NGA applicants with the exception of:
- 31.1 the two NGAs that the Crown has already entered into;
- 31.2 the four firms that have commenced a WBP study (those four firms may elect that the current policy will apply to their NGA with respect to WBP identification and assessment and determination of emissions intensity target);
- 32 **authorised** the Minister of Finance and the Convenor of the Ministerial Group on Climate Change to make modifications as required to a NGA for any of those four firms referred to in paragraph 31.2 that have commenced a WBP study to accommodate any retention of the current policy for WBP identification and assessment and determination of emissions intensity targets;
- 33 **agreed** that in the event there is any discrepancy between NGA policy approved in POL Min (03) 8/8 and the decisions set out above, the decisions set out above shall prevail;

Implications for SMEs

- 34 **noted** that some small to medium enterprises (SMEs) have explored NGAs and rejected this option because they consider the transaction costs are too high;
- 35 **noted** that the reduction in transaction costs associated with the proposed changes to NGA policy and processes may attract some energy-intensive SMEs to make an application for a NGA;

Financial implications

- 36 **noted** that the decisions set out above are unlikely to substantially alter the estimated relief provided to NGAs;

Legislative implications

- 37 **noted** that further details regarding exemption legislation are addressed in the paper on “Carbon tax: key design features and release of consultation paper on implementing the tax” [CAB Min (05) 14/9];

Publicity

- 38 **agreed** that changes to the NGA policy be announced as soon as possible and that, with appropriate withholdings, the paper under CAB (05) 164 and the associated Cabinet minute be made available to the public, subject to the provisions of the Official Information Act;

Consultation

- 39 **noted** that the Convenor, Ministerial Group on Climate Change, indicates that consultation is not required with the government caucuses or other parliamentary parities.



Secretary of the Cabinet

Reference: POL Min (05) 9/9; CAB (05) 164