



Cabinet

CAB Min (09) 33/9

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Minute of Decision

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Moderated Emissions Trading Scheme: Amendments to the Climate Change Response Act 2002

Portfolio: Climate Change Issues

On 14 September 2009, Cabinet:

Background

- 1 **noted** that the Emissions Trading Scheme Review Select Committee has now reported back to Parliament;

Entry dates and transition phase, including the treatment of agriculture

- 2 **agreed** that the stationary energy, industrial processes and liquid fossil fuels sectors shall commence to accrue surrender obligations in the New Zealand Emissions Trading Scheme (NZ ETS) from 1 July 2010;
- 3 **noted** that the Climate Change Response Act 2002 requires participants in the stationary energy, industrial processes and liquid fossil fuels sectors to monitor and report on emissions from 1 January 2010;
- 4 **agreed** that stationary energy, industrial processes and liquid fossil fuels participants shall be required to surrender one emission unit for every two tonnes carbon dioxide equivalent emitted from 1 July 2010 to 31 December 2012;
- 5 **agreed** to adopt a fixed price option of NZ\$25 per unit from 1 July 2010 to 31 December 2012 (which, in the case of forestry will apply to deforestation liabilities from January 2008 to December 2012);
- 6 **agreed** that, with the exception of units from the forestry sector, the export of New Zealand Units converted to Assigned Amount Units should not be permitted while the fixed price option is in place;
- 7 **agreed** that there will be no prohibition on banking, for any sector, while the fixed price option is in place;
- 8 **agreed** that agriculture's entry into the NZ ETS be delayed by 2 years to 2015;

- 9 **agreed** to adopt an intensity-based approach to free allocation to the agriculture sector with the following design features:
- 9.1 only participants will be eligible, but no trade exposure or emissions intensity tests will apply;
 - 9.2 the level of assistance will phase-out at a rate of 1.3 per cent per annum beginning in 2015 subject to a five-yearly review of free allocation (any significant changes to the provision of free allocation will require a five year notice period);
 - 9.3 allocation will be based on the current year's output;
- 10 **agreed** that the surrender obligation for all sectors should be extended from the end of April to the end of May;
- 11 **noted** that the Climate Change Response Act provides for a processor-level point of obligation for the agriculture sector;
- 12 **agreed** to keep open the option of a farm-level point of obligation for the agriculture sector in the future and remove the potential for a hybrid point of obligation; but to retain the option to stage the transition to farm level;

Intensity-based allocation to industry

- 13 **agreed** to adopt an intensity-based approach to free allocation to emissions-intensive, trade-exposed industry with the following design features:
- 13.1 eligible activities will be required to meet trade exposure and emissions intensity tests;
 - 13.2 more emissions-intensive activities will receive a higher level of assistance than less emissions-intensive activities (with initial rates set at 90% and 60% respectively);
 - 13.3 subject to paragraph 4, from 1 July 2010 to 31 December 2012 the level of assistance will be reduced by 50%;
 - 13.4 the number of units individual firms are entitled to receive will be calculated on the basis of industry average emissions-intensity for each activity;
 - 13.5 Ministers will have the flexibility to use emissions and energy use data from Australia when assessing eligibility against thresholds or determining average emissions per unit of output;
 - 13.6 only emissions for which assistance is given under the current Climate Change Response Act will be included in determining eligibility and the level of assistance; free allocation shall be given for the use of liquid fossil fuels where eligibility is conferred on the basis of eligibility in Australia (with the same approach to determining eligible emissions);
 - 13.7 allocation will be based on the previous year's output with a true up payment once actual production is known;

- 13.8 the level of assistance will phase-out at a rate of 1.3 per cent per annum beginning in 2013 subject to a five-yearly review of free allocation, with the first review conducted in 2011 (any significant changes to the provision of free allocation will require a five year notice period), and any changes from the 2011 review will apply from 2017;
- 13.9 following the first five-yearly review there shall be constrained regulation making powers to increase the rate of phase out;
- 14 **agreed** that eligibility thresholds for emissions intensity and trade exposure should be included on the face of the Bill;
- 15 **agreed** that the trade exposure test included in the Bill shall identify trade exposed activities as all activities except:
- 15.1 electricity generation; or
- 15.2 activities where there is no current international trade of the product across oceans;
or
- 15.3 activities where it is uneconomic to ship the product between New Zealand and another country;
- 16 **agreed** that the Bill shall specify a revenue based emissions intensity test with thresholds set at the same level as those in the Australian Carbon Pollution Reduction Scheme, expressed in New Zealand currency;
- 17 **agreed** the 2011 review of the NZ ETS should examine whether the emissions intensity thresholds should be altered, based on activity-level data collected during the allocation process;
- 18 **agreed** that, regardless of whether eligibility thresholds are specified, the Bill should specify that the Minister for Climate Change Issues has the flexibility to make activities which are eligible for free allocation in Australia eligible in New Zealand, at the same rate of assistance, whether or not they meet emissions intensity tests in New Zealand;
- 19 **agreed** to remove the requirement for an Innovation Fund provided for in the Act;

Forestry

- 20 **agreed** that emission liabilities from the pre-1990 forestry and post-1989 forestry sectors will be covered by a fixed price option of NZ\$25 per unit from 1 January 2008 to 31 December 2012;
- 21 **noted** that the Act provides for offsetting after 2012 for the pre-1990 forestry sector, subject to international offsetting rules permitting New Zealand to offset deforestation of pre-1990 forest land by the planting of new forest land;
- 22 **agreed** to allow the export of units from the forestry sector while a fixed price option is in place;
- 23 **agreed** that it be clearly communicated to the forestry sector that it is New Zealand's intention to harmonise with the Australian Carbon Pollution Reduction Scheme, if it eventuates, and that therefore the exporting of forestry units cannot be assured in the future;

- 24 **agreed** to include as much detail on forestry allocation as practical in primary legislation; specifically to state that only 21 million units will be transferred during CP1, and to set out the approach to distributing units;
- 25 **agreed** to run an ‘exposure draft allocation process’ concurrently with the Amendment Bill select committee process;
- 26 **noted** that the exposure draft allocation process is likely to prompt a negative response from stakeholders, including Māori;

Other changes

- 27 **agreed** to increase the total pool of free allocation to the fishing sector from being equivalent to 50% of 2005 emissions for three years, to being equivalent to 90% of 2005 emissions for the number of years that the fixed price period applies to liquid fossil fuels (2.5 years – July 2010 to December 2012);
- 28 **agreed** that the number of units allocated to the fishing sector will be reduced by 50% reflecting the transition phase;
- 29 **agreed** that legislation shall specify 700,000 NZU for free allocation to the fishing sector as specified in Appendix 2 of the paper under CAB (09) 531, as opposed to including a formula in legislation;
- 30 **agreed** that the recipients of free allocation shall be the owners of fishing quota rather than registered fishing vessel operators;
- 31 **agreed** to introduce a New Zealand target of a 50% reduction of net greenhouse gases from 1990 levels by 2050 through regulation;
- 32 **agreed** that, if necessary, the bill amending the Climate Change Response Act 2002 should include a provision stating that the Act will bind the Crown;

Processing of applications for allocation

- 33 **agreed** that the processing of participants' applications for allocation (excluding forestry) be assigned to the Chief Executive of the Ministry for the Environment rather than the Minister for Climate Change Issues;

Fiscal impacts

Entry dates and transition phase for the stationary energy, industrial processes and liquid fossil fuels sectors

- 34 **noted** the following forecast change in non-tax revenue resulting from the proposed changes to the entry date and progressive obligation for the stationary energy, industrial processes and liquid fossil fuels sectors:

Vote Climate Change	\$m – increase/ (decrease)				
	2009/10	2010/11	2011/12	2012/13	2013/14 & outyears
Non-Tax Revenue:					
Emissions Trading	(88)	(88)	(275)	(138)	0
Total	(88)	(88)	(275)	(138)	0

- 35 **noted** that these reductions in revenue will reduce the between Budget contingency;
- 36 **agreed** to establish in Vote Energy a new non-departmental other expense appropriation “Fixed Price Option” to be the responsibility of the Minister for Climate Change Issues;
- 37 **agreed** that the scope of this appropriation will be “This appropriation is limited to the expenses incurred in relation to the fixed price option provided for in the Climate Change Response Act 2002 if and when the international price exceeds \$25 per tonne carbon dioxide equivalent”;
- 38 **noted** that it is not known if and when the international price will exceed \$25 per tonne carbon dioxide equivalent and therefore in which financial year this appropriation will first be required;
- 39 **authorised** the Minister of Finance and the Minister for Climate Change Issues, after the fixed price option comes into force, jointly to activate this appropriation if and when it is required and to agree to the amounts of the appropriation;
- 40 **agreed** that any amounts of the appropriation agreed jointly by the Minister of Finance and the Minister for Climate Change Issues be included in the Supplementary Estimates for the relevant financial year and, in the interim, the expenses be met from Imprest Supply;
- 41 **approved** the following changes to appropriations to implement the proposed fixed price option:

Vote Energy	\$m – increase/ (decrease)				
	2009/10	2010/11	2011/12	2012/13	2013/14 & outyears
Non-Departmental Other Expense: Fixed Price Option	0	0	0	0	0
Total	0	0	0	0	0

- 42 **agreed** the changes to appropriations for 2009/10 above be included in the 2009/10 Supplementary Estimates and that, in the interim, the changes be met from Imprest Supply;
- 43 **noted** that these costs will reduce the between Budget contingency;

Intensity-based allocation to industry

- 44 **approved** the following changes to appropriations to implement intensity-based allocation to industry:

Vote Climate Change	\$m – increase/ (decrease)			
	2009/10	2010/11	2011/12	2012/13
Non-Departmental Other Expense: Allocation of New Zealand Units	0	(72)	(70)	(35)
Total	0	(72)	(70)	(35)

- 45 **noted** that these savings will increase the between Budget contingency;

- 46 **noted** that the additional fiscal impacts of intensity-based allocation to industry, relative to current legislation (adjusted for the proposed entry date and progressive obligation for the stationary energy, industrial processes and liquid fossil fuels sectors) are as follows:

Fiscal cost (\$m, costs shown as positive and savings as negative)

2013	2015	2017	2013-2017	2020	2030
-181 to -351	-179 to -350	-177 to -348	-896 to -1748	-49 to -221	411 to 586

- 47 **noted** that the costs of the New Zealand Emissions Trading Scheme post-2012 have yet to be budgeted for, so the additional fiscal costs post-2012 currently do not count against the budget allowance;

- 48 **noted** that when international obligations are agreed to for the period post-2012, the net fiscal impact of the New Zealand Emissions Trading Scheme will be considered as part of the budget, in conjunction with decisions on the treatment of New Zealand Emissions Trading Scheme net revenues or expenses;

Agriculture

- 49 **noted** that the fiscal costs of the proposed 2015 entry date for agriculture, relative to current legislation are:

Fiscal cost (\$m, costs shown as positive and savings as negative)

2013	2014	2015-2017	2013-2017	2020	2030
281	292	0	573	0	0

- 50 **noted** that the fiscal costs of intensity-based allocation to agriculture, relative to current legislation (adjusted for the proposed entry date) are:

Fiscal cost (\$m, costs shown as positive and savings as negative)

2013	2015	2017	2013-2017	2020	2030
0	106	74	270	305	1,581

- 51 **noted** that the costs of the New Zealand Emissions Trading Scheme post-2012 have yet to be budgeted for, so the additional fiscal costs post-2012 currently do not count against the budget allowance;

- 52 **noted** that when international obligations are agreed to for the period post-2012, the net fiscal impact of the New Zealand Emissions Trading Scheme will be considered as part of the budget, in conjunction with decisions on the treatment of New Zealand Emissions Trading Scheme net revenues or expenses;

Other changes

53 **approved** the following changes to appropriations to implement proposed changes to allocation to the fishing sector:

Vote Climate Change	\$m – increase/ (decrease)			
	2009/10	2010/11	2011/12	2012/13
Non-Departmental Other Expense: Allocation of New Zealand Units	0	4	0	0
Total	0	4	0	0

54 **noted** that these costs will reduce the between Budget contingency;

55 **noted** that changes to free allocation to the fishing sector also generate a \$14 million saving in 2013;

56 **noted** that the costs of the New Zealand Emissions Trading Scheme post-2012 have yet to be budgeted for, so the fiscal savings post-2012 currently do not count against the budget allowance;

57 **noted** that when international obligations are agreed to for the period post-2012, the net fiscal impact of the New Zealand Emissions Trading Scheme will be considered as part of the budget, in conjunction with decisions on the treatment of New Zealand Emissions Trading Scheme net revenues or expenses;

Second order amendments

58 **noted** that a number of further amendments to the Act of a more administrative nature have been identified that would improve the effective functioning of the Act;

59 **agreed** to make the following amendments (as described in Appendix 1 to the paper under CAB (09) 531):

High priority amendments

59.1 clarifying that the Chief Executive has power to specify and approve locations in the forest area where information will be collected;

59.2 creating the ability to apply for a tree weed exemption for deforestation between 1 January 2008 and the date exemptions are granted;

59.3 enabling the delegation of the Registrar's powers;

59.4 creating the ability to waive fees and charges;

59.5 creating the ability to charge fees for emissions rulings;

59.6 requiring record keeping by primary participant following opt-in;

59.7 clarifying the inclusion of emissions from solid biofuels combusted for electricity generation or industrial heat;

59.8 removing "Producing cable using a nitrogen cure process" as a mandatory activity;

- 59.9 clarifying ability to make changes to composition of joint participant registrations;
- 59.10 defining farming in relation to land ownership;
- 59.11 including egg producers and live animal exporters in the scheme;
- 59.12 clarifying ability to specify the “Land Transfer Date” in the Forestry Allocation Plan;
- 59.13 clarifying cost benefit analysis requirements in exemption provision;

Medium priority amendments

- 59.14 clarifying of the treatment of mining natural gas within the exclusive economic zone (EEZ);
- 59.15 clarifying that section 64 directions will not be published;
- 59.16 clarifying the Chief Executive’s forestry-related reporting obligations;
- 59.17 clarifying the ability to delay registration of forestry participant until fees and charges paid;
- 59.18 confirming pro rata approach for New Zealand units earned when land within a Carbon Accounting Area is transferred;
- 59.19 providing for removal from the Register of Participants after obligations have been met;
- 59.20 clarifying that only a nominated entity can submit a return for a consolidated group;
- 59.21 restricting timing for electing to have activities removed from consolidated group;
- 59.22 clarifying when forest land is treated as being deforested before 1 January 2008;
- 59.23 amendment to the definition of forest land;

Lower priority amendments

- 59.24 requiring the Registrar to give effect to directions;
- 59.25 inserting and applying a definition of “Crown holding account”;
- 59.26 clarifying relevance of subsequent commitment periods to New Zealand unit issuance;
- 59.27 streamline the process for updating the schedules to the Climate Change Response Act to reflect amendments to the Kyoto Protocol and the United Nations Framework Convention on Climate Change that are in force for New Zealand;
- 59.28 providing for authorised representatives in respect of joint activities;
- 59.29 clarifying obligation to retain records;
- 59.30 clarifying that one emissions return only to be filed per year;
- 59.31 clarifying treatment of returns in respect of less than a hectare;

59.32 amending timing of surrender relative to date of emissions return;

59.33 clarifying timing for notification of ceasing to carry out activity;

Further clarifying amendments

60 **noted** that a number of further second order amendments have been identified;

61 **agreed** to make amendments in relation to the following matters, as described in Appendix 2 of the paper under CAB (09) 531:

61.1 fishing sector allocation;

61.2 point of obligation for agriculture;

61.3 intensity based allocation for agriculture;

61.4 nitrogen fertilisers;

61.5 fixed price option mechanism;

61.6 consequential changes to other removal activities;

61.7 NZ ETS review;

61.8 setting a fixed price option post 2012;

61.9 50 by 50 target;

61.10 household fund;

61.11 joint venture participants in the natural gas sector and coal sector;

61.12 July to December 2010 surrender obligation;

61.13 further details of free allocation to industry;

61.14 forestry allocation;

61.15 pre-1990 tree weed exemption;

61.16 further amendments to Carbon Accounting Areas;

Next steps

62 **authorised** the Minister for Climate Change Issues and the Emissions Trading Scheme Ministerial Group to undertake further engagement with the Climate Change Iwi Leadership Group and the Māori Reference Group Executive on the decisions set out above;

63 **noted** that Cabinet may be invited to consider any significant feedback from the Climate Change Iwi Leadership Group and the Māori Reference Group Executive received at its meeting on 21 September 2009;

64 **directed** the Ministry for the Environment to begin engagement with industry stakeholders in relation to free allocation for emissions-intensive, trade-exposed industry;

- 65 **invited** the Minister for Climate Change Issues to undertake engagement with industry stakeholders regarding the proposed changes to the NZ ETS;
- 66 **agreed** that the Minister for Climate Change Issues, working with the Ministerial colleagues, will further develop detailed policy to be implemented through an Amendment Bill;
- 67 **noted** that Cabinet agreed on 10 August 2009 that Parliamentary Counsel Office should commence drafting a bill to give effect to the proposed modifications to the NZ ETS before Cabinet has taken final decisions [CAB Min (09) 28/10];
- 68 **authorised** the Minister for Climate Change Issues to continue to issue drafting instructions to Parliamentary Counsel Office to give effect to the decisions above and further detailed policy that is developed;
- 69 **agreed** to include a Climate Change Response Amendment Bill (the Bill) on the 2009 Legislation Programme with a category 2 priority (must be passed in 2009);
- 70 **invited** the Minister for Climate Change Issues to report to Cabinet on 21 September 2009 for final policy approval and agreement to introduce the Bill;
- 71 **noted** that given entry dates for the stationary energy and industrial processes sectors, and international climate change negotiations in Copenhagen in December 2009, it is desirable to pass an amendment bill in the week beginning 8 December 2009 at the latest;
- 72 **authorised** the Minister for Climate Change Issues to manage public announcements on the proposed package of amendments prior to the finalisation of Cabinet's deliberations on amendments to the NZ ETS.

Secretary of the Cabinet

Reference: CAB (09) 531

Distribution: (see over)

