**Office of the Minister for Climate Change Issues**

**Chair**

**Cabinet Economic Growth and Infrastructure Committee**

# Forestry, agriculture and other technical and operational changes to facilitate the efficient administration of the Emissions Trading Scheme

## Proposal

1. This paper seeks Cabinet decisions on a further set of proposed amendments to the Climate Change Response Act 2002 (the Act) to improve the operation of the New Zealand Emissions Trading Scheme (ETS).

## Executive summary

2. Cabinet has already agreed in principle to a number of legislative amendments to the Act to improve the operation of the ETS. The key drivers for these amendments were set out in the first Cabinet paper, submitted by the Minister for Climate Change Issues to Cabinet in February 2012 [Cab Min (12) (8/7) refers].

3. This paper outlines a third set of proposals for more minor and technical amendments. These proposals stem from experience gained in the practical application of the ETS. Many of these proposals will make the operation of the ETS smoother and simpler for many participants, and will increase flexibility. In other cases, changes are needed now to avoid loopholes or perverse outcomes in future.

4. The proposals I set out in this paper are to:

   - clarify where deforestation liabilities do not apply – by allowing existing forest management practices to be undertaken along forest land boundaries, so long as the cleared land is not put to any other use; ensuring where forest land cannot be replanted due to natural disturbance, that participants do not face a deforestation liability; and better allowing for natural regeneration and re-establishment of poplar and willow forests for erosion control;

   - continue to ensure that the ETS supports efforts to control tree weeds – by extending application rounds for pre-1990 tree weed exemptions; and by preventing tree weeds on post-1989 forest land from further participating in the ETS;

   - allow trustees appointed under the Te Ture Whenua Māori Act 1993, the Māori Trustee, and other sole trustees to apply for less than 50 hectare exemptions – by ensuring that the unrelated landholdings of such trustees are not counted towards the 50 hectare threshold;

- clarify settings for agricultural emissions under the ETS - by removing egg producers from having to participate in the ETS, to avoid a costly administrative burden for an activity with very small emissions; and by clarifying the meat processors definition;
- clarify a number of matters relating to the inclusion of energy emissions in the scheme – adding the own-use of crude oil or other liquid hydrocarbons by a miner to the list of activities facing emissions obligations, to avoid a loophole in reporting and surrender obligations; clarifying the 'user' of geothermal fluid for the purposes of obligations; and allowing purchasers of obligation fuels including petrol and diesel to opt into the scheme as voluntary participants, subject to an appropriate threshold;
- changing the way in which industrial and agricultural allocations phase out at 1.3%, so they continue to reduce each year, which was the original policy intent, rather than levelling off in the 2060s – as recommended by the ETS Review Panel;
- clarify compliance powers – by providing more explicitly in legislation for monitoring and enforcement activities by the EPA relating to allocations, to allow government to tackle improper or erroneous allocations; and by clarifying that a financial penalty for failure to surrender or repay units can be applied where the EPA has granted an extension to the surrender or repayment date;
- clarify timescales for allocation applications, to simplify administration of the scheme – by extending the period under which post-1989 forest participants can submit voluntary emission returns to 30 June, to smooth the volume of returns being processed; by requiring applications for industrial and agricultural allocations to be submitted between 1January and 30 April each year; and by placing a time limit for acceptance of allocations, to address instances where an applicant declines to open a Registry account;
- provide more flexibility for participants – by not requiring participants who undertake covered activities intermittently to deregister from the scheme; and by allowing use of a consolidated group account for allocations;
- allow the Crown more flexibility to dispose of international units surrendered by ETS participants - by allowing government to sell Kyoto units in an ETS surrender account, if they are surplus to what is required to meet any international obligation or domestic target;
- reduce fiscal risks associated with insolvent or non-paying participants – by removing the requirement for the Crown to purchase units on behalf of these participants; and
- make a number of other minor and technical amendments relating to rounding rules for the calculation of emissions; regulation-making powers for removal activities; cross-referencing errors; and other matters.

5. The fiscal implications of these amendments are modest, totalling around $7million over the forecast period. These costs, not including administrative costs, are set out below.

**Table 1: Summary fiscal impacts ($ million)**

| | Increase/(decrease) in operating balance | | | | | |
|---|---|---|---|---|---|---|
| $ million | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **Total** |
| Excluding layer hens from the ETS (not including admin. cost savings) | - | - | - | (0.013) | (0.028) | (0.041) |
| Extending the Pre-1990 tree weed exemption to 2015/16 | - | (1.04) | (2.08) | (2.08) | (2.08) | (7.28) |
| Total | - | (1.04) | (2.08) | (2.093) | (2.108) | (7.321) |

6. In addition, excluding layer hens from the ETS is projected to deliver administrative cost savings of $93,000 over the forecast period.

7. As with other proposals for ETS amendments present to Cabinet to date, I propose that Cabinet make 'in principle' decisions on these amendments at this stage, pending final decisions on those proposals that have been subject to consultation (including the second tranche of pre-1990 forest allocations). This will allow Cabinet to make final decisions on amendments to the ETS based on the fiscal implications of the package as a whole. Accordingly, I will seek final decisions on appropriations in the next paper, which is to be considered by Cabinet by July.

8. Because of the largely minor and technical nature of these amendments, I do not consider that a public consultation is required. However, it may be beneficial for officials to communicate Cabinet's in principle decisions on these matters to key stakeholders.

9. Timing remains tight on the introduction of legislation, given the desirability of passage before the end of 2012. Therefore, as with previous proposals, I am seeking Cabinet approval for PCO to begin drafting on the basis of the in-principle decisions sought in this paper.

10. I am also seeking Cabinet approval to delegate to the Minister for Climate Change Issues, in consultation with Minister of Primary Industries as appropriate, power to make final decisions to further clarify and develop policy matters in a way not inconsistent with the amendments set out in this paper.

## Background

11. In December 2010 the Minister for Climate Change Issues appointed an independent panel (the Panel) to undertake a statutory review of the ETS,

as required by the Act. The Panel delivered its final report on 30 June 2011, making 61 recommendations for change regarding the ETS.[1]

12. On 18 July 2011, Cabinet invited the Minister for Climate Change Issues to report to Cabinet by February 2012 (through the relevant Cabinet committee) with proposed changes to the ETS based on the Panel's recommendations, developments in and discussions with Australia and further analysis [Cab min (11) 27/15 refers].

13. In this context, the Minister proposed a number of significant amendments to the Act to implement key recommendations of the Panel and key commitments in the National Party's Manifesto [Cab Min (12) (8/7) refers]. These proposals were subject to a consultation which closed on 11 May 2012. My officials are currently analysing the results. I expect to report-back to Cabinet on this consultation and seek Cabinet's agreement to final policy decisions on the ETS by July 2012.

14. I have also proposed a number of changes to improve the current treatment of the synthetic greenhouse gas (SGG) sector in the ETS [Cab minute EGI Min (12) 8/4 refers].

15. This is the third Cabinet paper, containing the last significant set of proposals for amendment. The proposals in this paper are largely of a more minor and technical nature than those in the first two papers. They arise from issues identified the Panel, stakeholders and officials involved in the implementation and operation of the ETS and are aimed at improving the operational effectiveness of the scheme. In other cases they correct issues that are likely to create costs, perverse incentives or other problems for the operation of the scheme in the future if they are not addressed.

## Comment

16. There are a total of 27 specific changes proposed in this paper. These changes are divided into the following sections:

    a: Forestry
    b: Forestry and Māori Land issues
    c: Agriculture
    d: Energy Sector
    e: Allocation
    f: Registry, compliance and crown accounts
    g: Minor technical amendments

17. The changes are set out in more detail below.

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1 Doing New Zealand's Fair Share, ETS Review 2011: Final report, ETS Review Panel, 30 June 2011.

### *A: FORESTRY*

18. Forestry was the first sector to enter the ETS, with full obligations and entitlements applying from 1 January 2008. The pre-1990 planted forest estate is estimated to be about 1.3 million hectares. In comparison, the post-1989 estate is approximately 600,000 hectares.

19. The proposed changes set out below will improve regulatory practice for both the government and the forestry sector by reducing compliance uncertainty and ensuring industry best practice can be implemented without penalty. The proposals will not affect New Zealand's Greenhouse Gas Inventory accounting under Articles 3.3 or 3.4 of the Kyoto Protocol.

### *A.1 De minimus deforestation and boundary management*

20. The ETS permits two hectares each five years to be deforested without penalty for each pre-1990 forest land owner. Most commercial forest land owners are likely to breach this threshold through normal forest management activities when replanting along outer boundaries. These activities include access roading, set backs and meeting safety standards.

21. If forest land is not exactly replanted then any reduction no matter how small must be treated as deforestation. Existing guidelines and mapping standards that are prescribed under the Act cannot be relaxed. **[Withheld under s6(c) and s9(2)(k)]**.

22. These minor cleared areas no longer meet the definition of 'forest land' under the Act, even though there is no change in land use. They then contribute cumulatively to a participant's two hectare deforestation threshold. These areas are not considered to be deforested under international rules as there has not been a change in land use.

23. These issues have been raised previously, most recently in submissions to the 2011 ETS Review Panel. The proposed amendment will not affect the commercial incentive for foresters to maximise their planted area.

24. I therefore propose that the Act be changed to allow minor clearing to occur along boundaries, without these areas being treated as deforestation. Specifically, the replanted boundaries would be compared to those that existed on 31 December 2007 for pre-1990 forest land, or those registered for post-1989 forest land, and the following conditions would apply:

    - each cleared area is less than 1 hectare, or less than 30m wide; and
    - the reduction is part of normal forest management; and
    - the cleared area is not used for any other land use

### *A.2. Tree Weeds*

25. Tree weeds, such as wilding conifers, can adversely affect pastoral farming, biodiversity, conservation, landscape values and catchment water yields. Central and local government spend approximately $6 million annually controlling wilding pine species. Tree weed stands can create a continual "seed rain" in the environment, if left untreated.

26. The ETS can discourage the removal of tree weeds, as a participant could face a deforestation liability for pre-1990 forests. The ETS can also encourage tree weeds, as NZUs can be received for post-1989 forests. This section considers the existing pre-1990 tree weed ETS provisions, and then post-1989 tree weeds.

*Pre-1990 tree weed exemptions*

27. The Act allows for exemptions for clearing tree weeds on pre-1990 forest land so that tree weed clearance is not discouraged by owners facing a deforestation liability. An appropriation of 1 million New Zealand Units (NZUs) was set aside to cover deforestation emissions in the first commitment period. To date, two rounds of tree weed exemptions have been run and exemptions have been granted for 783 hectares (approximately 490,000 NZUs, which equates to about $5.1m at a carbon price of $10.41). The Ministry for Primary Industries is currently running a third application round during 2012.

28. Tree weeds will continue to be a management issue into the future. Uptake is dependent on the ability of land owners and councils to resource weed control and clearance will continue in the second commitment period and beyond. The ETS Review Panel considered the issue and recommended that tree weed exemptions be available after the first commitment period. I therefore propose that pre-1990 tree weed exemptions be continued into the second commitment period.

29. In the government's accounts, tree weed exemptions reduce revenue from general deforestation revenue. Extending the tree weed exemption will not require any changes to the existing New Zealand Unit appropriation but will reduce ETS revenues. The reduction in revenue and the impact in the operating balance is 100,000 NZUs ($1.04m at a carbon price of $10.41) for 2012/2013 and 200,000 NZUs ($2.08m at a carbon price of $10.41) for 2013/14 and out years.

*Post-1989 tree weeds*

30. Before a post-1989 forest can be registered in the ETS, compliance is required with the Biosecurity Act 1993 and the Resource Management Act 1991. However, plans and strategies prepared prior to the ETS may not consistently or adequately address tree weeds. In this case, post-1989 tree weeds may be registered in the ETS and earn carbon credits.

31. Approximately 380 hectares of Pinus contorta (a common tree weed) have been registered so far in the ETS. This figure does not include any applications that are in the process of being assessed. However, it is clear

that significant areas are at risk of future infestation[2] and will, if untreated, be eligible to join the ETS.

32. I propose that post-1989 forest lands that are predominantly naturally regenerated tree weeds should no longer be eligible to participate in the ETS, unless the EPA is satisfied that the risk of spread is low. Areas of post-1989 tree weeds already registered would not be withdrawn from the ETS.

### *A.3. Natural regeneration of indigenous species*

33. After harvest, the ETS requires that forest land must have 500 stems per hectare at four years to be considered forested, otherwise the land is treated as deforested and participants must surrender NZUs. This is a generous timeframe for exotic plantations but the natural regeneration of indigenous forest species takes longer. Natural regeneration can be used to meet setbacks, including riparian or road, as well as improve biodiversity and water quality values. However, landowners incur additional costs to plant indigenous species ($10,000 to $15,000 per hectare) or face deforestation liabilities. The current four year requirement is a barrier to natural regeneration and realising the associated co-benefits.

34. The scale of the issue is relatively small; officials estimate that about 450 hectares of pre-1990 forest land could be affected, and less for post-1989 forest land. A pragmatic solution is to change the requirement of 500 stems per hectare at four years to allow for the slower indigenous regeneration and add a test at 10 years to ensure there is enough forest species to qualify as forest land. The deforestation signal would not be compromised, as the existing 20 year rule remains in place. No cost to the government is anticipated from the recommended change nor will it affect international accounting requirements.

35. I therefore propose that the Act should be amended so that the requirement of 500 stems per hectare at four years is changed to allow for slower indigenous natural regeneration and that an additional test is added at 10 years.

### *A.4. Re-establishment of poplar and willow forest lands*

36. Willows and poplars are common species to manage soil erosion. Officials estimate that the poplar and willow forest land area ranges between 1,000 to 5,000 hectares. Once established, these species usually meet the requirement for forest land. The recommended stocking rates for these species are between 100 to 200 stems per hectare, so if areas are cleared and replanted, they will not meet the ETS requirement of 500 stems per hectare at four years. Similar to the earlier example of indigenous regeneration, the land will be treated as deforested.

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[2] Wilding Conifers in New Zealand: Current Situation, Policy and Management, and Options for the Future, V Froud, December 2011.

37. To replant areas under current settings, 350 extra plants costing $10 each to establish would be required  ie, a compliance cost of $3,500 per hectare The four year rule was not designed to cover these species and does not achieve the rule's purpose as a test for deforestation.

38. I therefore propose that the requirement for 500 stems per hectare at four years is replaced with a requirement to replant at 100 stems per hectare to re-establish poplar or willow trees planted for erosion control. This will remove unnecessary compliance costs for landowners. No cost to the government is anticipated from the recommended change nor will it affect international accounting requirements.

### *A.5. Natural disturbance events preventing forest land re-establishment*

39. On occasion, forests cannot be re-established due to a natural disturbance, for example, erosion where there is no soil or where the land becomes an active riverbed. These events are beyond the landowners' control and cannot be insured against. Under the ETS, landowners incur deforestation liabilities when land is lost in this way. Approximately 20 hectares of exotic forests are affected annually but this figure could become higher, if there was a significant event.

40. There are no direct fiscal costs from the proposed change, as deforestation from natural disturbances is not included in the Crown's ETS forecasts. The government may receive fewer NZUs as a result. However, the potential loss of revenue from 20 hectares annually is immaterial, when compared with a total planted forest estate of nearly 2 million hectares. Internationally, New Zealand does not need to account for natural disturbance from non-anthropogenic sources.

41. I therefore propose that the Act is amended so that where forest land cannot be re-established because of a natural event it is not treated as deforested.

### *A.6 Emission return period for post-1989 forest lands*

42. Post-1989 forest participants in the ETS can submit voluntary emission returns annually from 1 January to 31 March. These returns must be processed in 20 working days. Emissions returns submitted to date are primarily for applicants to receive NZUs. The current value of emission returns submitted annually by post-1989 forest participants is approximately $90-$180 million (depending on carbon price).

43. Experience to date has shown this is too short a window, resulting in a large peak of emission returns that presents resourcing difficulties.

44. I recommend spreading post-1989 emissions returns processing over a longer period to 30 June each year, to smooth the peak and provide more flexibility for participants.

## *B. FORESTRY, MĀORI LAND AND THE MĀORI TRUSTEE*

45. A number of issues have been identified that relate to the interaction between ETS, multiply-owned Māori land and Te Ture Whenua Māori Act

1993. To date these issues have related primarily to the treatment of forestry within the ETS. These are addressed in the proposals below.

46. The ETS Review Panel noted the Te Ture Whenua Māori Act 1993 places particular constraints on owners of Māori land and recommended the government address the application requirements so that the Māori Trustee could apply for exemptions.

47. It may be that, in future, further issues are identified for Māori land under other parts of the ETS. My officials will continue to work with iwi to identify these issues and propose appropriate solutions.

### *B.1. Eligibility issues relating to the less than 50 hectare exemption*

48. If the total landholdings of a sole professional trustee are greater than 50 hectares, then they cannot apply for a less than 50 hectare exemption. This is particularly problematic for the Māori Trustee, who cannot apply for exemptions for small, unrelated blocks. Other examples of sole trustees who may be affected are Guardian Trustees Ltd, Public Trust Ltd, and Trustees Executors Ltd.

49. Similarly, trustees appointed under Te Ture Whenua Māori Act 1993 are not recognised as professional trustees under the Climate Change Response Act and may therefore also be prevented from seeking an exemption for small forest blocks.

50. I propose that the Act be amended so that:

- unrelated pre-1990 forest landholdings of a sole professional trustee, including the Māori Trustee, are not counted towards the 50 hectare threshold for an exemption application;
- for the purposes of an application for the less than 50 hectare exemption, a trustee appointed under the Te Ture Whenua Māori Act 1993 is treated as a professional trustee; and
- unrelated pre-1990 forest landholdings of a trustee appointed under the Te Ture Whenua Māori Act 1993 are not counted towards the 50 hectare threshold for an exemption application.

51. As there are likely to be few trustees caught to date, officials suggest that this ‘fix’ should not apply retrospectively.

### *C. AGRICULTURE*

52. Agricultural emissions account for a significant proportion of New Zealand’s greenhouse gas emissions (47% or 32.8 million tonnes $CO_2$-e). Agriculture processors (mainly milk and meat processors and nitrogen fertiliser importers/manufacturers) already report agricultural emissions on behalf of farmers. From 2015, at the earliest, participants will be required to surrender units but will also receive a 90% allocation. Net ETS obligations for

agriculture[3] equate to approximately 3.9 million units from 2015 onwards (based on 10% of agricultural emissions from current production forecasts).

53. The government supports the entry of agricultural emissions into the scheme only under two conditions:

    - there are technologies available to reduce emissions
    - international competitors are taking sufficient action on emissions

54. In the previous paper, Cabinet agreed in principle, subject to consultation, to introduce a discretionary power to defer surrender obligations for agriculture for up to 3 years, subject to a review in 2014 on whether the above conditions have been met [CAB Min (12) 8/7 refers].

55. In 2010, Ministers appointed the Agriculture ETS Advisory Committee to look at the implementation of agriculture into the ETS. The following proposed changes are consistent with the Committee's recommendations to date.

### *C.1 Excluding egg producers from the ETS*

56. The Agriculture ETS Advisory Committee recommended excluding egg producers from reporting and facing surrender obligations. Exclusion will not undermine the primary purpose of the ETS. The sector is a small contributor to agricultural emissions (0.08%) annually and it places a relatively large and costly administrative burden for reporting.

57. For the period 2012/13 to 2015/16, the fiscal cost to the Crown of excluding egg producers is estimated to be approximately $41,000 (at a carbon price of $10.41), due to forgone emissions revenue. Fiscal savings from administration are $93,000. The net impact for the Crown is a saving of $52,000 for the period 2012/13 to 2015/16, and a saving of $8,000 over the period 2012/13 to 2019/20.

[3] Subject to the possible deferral powers currently being consulted on.

**Table 2: Fiscal Impacts of Excluding Egg Producers ($ million)**

| | | 2012/13 | 2013/14 | 2014/15 | 2015/16 | **Total** 2012/13 to 2015/16 | **Total** 2012/13 to 2019/20 |
|---|---|---|---|---|---|---|---|
| Fiscal savings (administration) | $ million | $0.0025 | $0.028 | $0.038 | $0.025 | $0.093 | $0.191 |
| Fiscal cost (forgone revenue)[1] | $ million | | | ($0.013) | ($0.028) | ($0.041) | ($0.183) |
| | Units | | | 1300 | 2700 | 4 000 | 17 550 |
| Net | $ million | $0.0025 | $0.028 | $0.025 | ($0.003) | $0.052 | $0.008 |

[1] This value will halve when the national inventory is up-dated with New Zealand-specific data for layer hen emissions in April 2012.

58. I therefore propose that the Act be amended to exclude egg producers from the ETS as the cost of including them exceeds the value of their liabilities.

### *C.2. Meat processors: de minimus threshold*

59. Meat processors are participants in the ETS[4] but retail butchers are exempted to exclude smaller operators, like small local butcheries. However, any meat processor with a "retail butchery" outlet could also be excluded, which includes many of the larger slaughterhouses. While the potential impact is low in the reporting only period, the impact may be greater when surrender obligations are faced.

60. To make clear who the participants are, I propose removing the retail butcher exemption from schedule 3 and clarifying the existing activity definition. There are no fiscal risks or costs associated with these changes.

## *D: THE ENERGY SECTOR*

61. Since the ETS was established, changes in the energy sector have given rise to a need for some minor changes to the Act as it affects the sector's reporting and surrender obligations.

### *D.1. Reporting and surrender obligations for oil use by miners*

62. Under the ETS as currently legislated, miners have reporting and surrender obligations for their own use of gas or coal in mining operations. However own use of oil by a miner does not create any obligations. This difference in

[4] Meat producers that slaughter ruminant animals, pigs, horse or poultry under a risk management programme registered under the Animal Products Act 1999 are deemed to be ETS participants under the Climate Change Response Act 2002.

treatment is not due to any policy-related reason, but simply because at the time the ETS was established there was no own use of oil by miners.

63. The Maari oil field has started production since the ETS was established, and a relatively small amount of crude oil is used in the mining operation.

64. I propose an amendment which will add the own-use of crude oil or other liquid hydrocarbons, by a miner, as an activity in Schedule 3.

### *D.2. Voluntary participation for petrol and diesel purchasers*

65. Under the ETS as currently legislated, purchasers of obligation jet fuel may opt in as voluntary participants. However this option is not available to purchasers of petrol or diesel. At the time the ETS was established the airlines were the only parties buying large volumes of liquid fuel domestically, and who appeared likely to wish to opt in.

66. The retail liquid fuels market has changed since that time. Retailers now buy substantial volumes of petrol and diesel from ETS participants. These retailers also export fuel and sell fuel for use in international transport. Because they are not participants, retailers cannot account for such transactions in an emissions return. They can only supply information to the oil company that sold the fuel to them, and the oil company may modify its emissions return accordingly.

67. I propose an amendment which will extend the application of Part 3, Schedule 4 to include all obligation fuels including petrol and diesel. This will allow large retailers, and possibly some other liquid fuel purchasers, to opt in as ETS participants.

68. Schedule 4 allows jet fuel purchasers to opt in if they buy over 10 million litres of fuel in a year. This is a comparatively low threshold for opting in. Ten million litres of fuel equates to about 8000 tonnes, in contrast to the 250,000 tonnes of coal that must be purchased before a coal buyer can opt in. If the existing jet fuel threshold was applied to petrol and diesel, relatively small buyers such as road transport firms would be allowed to opt in.

69. An appropriate threshold for petrol and diesel purchasers can be determined after consultation with affected parties, and given effect by regulation.

### *D.3. Clarifying the obligation for geothermal participants*

70. Schedule 3 defines ‘using geothermal fluid for the purpose of generating electricity or industrial heat’ as an activity that makes a person a mandatory participant. However geothermal fluid may be handled and used by more than one party before it is discarded or reinjected. This has led to a perception of ambiguity in determining who is, or is not, a mandatory participant.

71. Geothermal users are now registered as participants and are reporting their emissions, on the basis that the first user is the only participant. People who use exhaust steam or other geothermal fluid, after it has been reported by its first user, have not registered and are not reporting any emissions. This approach is technically robust and ensures accurate reporting of emissions.

72. I propose a technical amendment to clarify that in these cases the first user is a mandatory participant, and the second user is not.

## *E. ALLOCATION CHANGES*

73. The EPA's experience of operating the allocation regime over two years has revealed a number of issues that can be addressed by minor amendments. Also, fishing allocations were intended as a one-off compensation measure which would not be expected to create ongoing administration and other costs once the allocation process has been completed. A minor amendment is proposed that will allow this process to be closed off.

### *E.1. Straight-line phase-out of allocations*

74. Industrial and agricultural allocations are to be phased out over time, at a nominal rate of 1.3% of the previous year's allocation rate each year. The allocations are to be reduced each year after 2012 for industrial allocations, and each year after 2015 for agriculture.

75. The phase-out works by adjusting the allocation rate, which is the proportion of the estimated ETS costs covered by allocation. The allocation rate is initially set to 0.9 for highly emission-intensive industrial activities and agriculture, and 0.6 for moderately emission-intensive activities.

76. However, because the phase-out rules apply to each previous year's changing rate, this phase-out will never actually reach zero. Under the phase-out rules currently specified in the Act, the allocation rate will be reduced by 0.01 each year until it reaches a value of 0.38, after which it will remain at that level indefinitely. This was not what was intended when the policy was agreed by Cabinet in 2009.

77. The ETS Review Panel recommended that the phase-out rules should be changed. Instead of 1.3% of the previous year's allocation being removed, 1.3% of the first year's allocation will be removed. This will mean that rather than levelling off at 0.38, the allocation rates will continue to be reduced each year by the same amount until they reach zero in the first decade of the next century. The Panel noted that this change would have a negligible effect on allocation levels until the middle of this century.

78. I propose an amendment to give effect to this recommendation.

### *E.2. Compliance function for allocations*

79. The Act (s 87) specifies a number of aspects of operating the ETS as functions of the EPA. These include ensuring that participants comply with their ETS obligations, and taking any appropriate action to enforce the provisions of the Act and regulations made under it (s 87(1)(e)).

80. This compliance function only applies to ETS participants, ie, persons who have obligations as a result of carrying out activities listed in Schedule 3 or opting in for activities in Schedule 4. Persons who receive allocations (eligible persons) are not participants and are not affected by s 87(1)(e). The function of the EPA in relation to eligible persons is only to 'administer allocations' (s 87(1)(ba)).

81. Some monitoring and enforcement activities are clearly essential for the effective administration of allocations, given the large value involved and the risks of improper or erroneous allocations being made. Compliance over eligible persons was intended in the original policy and drafting, and the EPA is currently monitoring and enforcing eligible persons' obligations. **[Withheld under s9(2)(h)]**.

82. I propose an amendment which will clarify that the functions of the EPA include monitoring and enforcement activities over eligible persons.

### *E.3. Changes to rules for allocation applicants*

83. The Act (s 86) specifies that an eligible person wishing to receive an allocation for a particular year must apply:

    a) For a provisional industrial allocation by 30 April in the year;

    b) For an industrial allocation other than a provisional allocation (including final allocations) by 30 April in the year following; or

    c) For an agricultural allocation between 1 January and 30 April in the year following.

84. Provisional and final industrial allocations have to be based on data that the applicant will collect in the preceding year, so it is not normally possible for an application to be made before 1 January. However, some applicants who carry out seasonal or intermittent activities are in a position to apply before this time.

85. The need to cater for this possibility means that the EPA must be prepared to process applications that arrive at any time, instead of being able to plan for applications to be processed during a predictable time window. Also, two calculators have to be made available at the same time – one for the current year and one for the next year. This is unnecessarily complex and potentially confusing for applicants.

86. I propose an amendment to require that applications for allocations, including industrial allocations, must normally be submitted between 1 January and 30 April. Applications for new activities, and for activities that are being discontinued, may still need to be accepted at other times.

## *F: REGISTRY, COMPLIANCE AND CROWN ACCOUNTS*

### *F.1. Ability to impose a penalty for failure to surrender or repay units*

87. The Act (s 134) provides for an 'excess emissions penalty' of $30 per emission unit owed if a participant or eligible person has not surrendered, or repaid, emission units when they are due. The person will have 20 days to pay the penalty amount, and 90 days to surrender or repay the outstanding units.

88. However, discrepancies in emission returns or repayments are usually the result of genuine errors or oversights. Under those circumstances s 135 of the Act allows the EPA to reduce or waive the penalty. In most cases it will

be waived entirely. The EPA will issue a notice amending the return and setting a due date for the surrender or repayment of any outstanding units.

89. When the $30 penalty has once been waived, there is currently no ability to re-impose it. The EPA will set a due date, but is not able to impose any penalty if that date is not met.

90. The Act (s 136) also provides for a penalty of $30 per NZU where there is a 'knowing failure to comply' in the case of an amended return, or with a requirement to repay units. However, in this case the penalty only applies if the person has actually been convicted of an offence. Also, a penalty under s 136 is not available if the participant fails to surrender or repay the units owed. It only applies to other matters like a failure to keep records, and not to a failure to surrender units.

91. This lack of an effective penalty creates a risk for the Crown because there is no clear incentive to comply with the requirement to surrender or repay units by the due date. This is unlikely to have been the original policy intention.

92. Options to create an effective penalty are:

- Amend s 134 to also make the $30 per unit excess emissions penalty available when there is a failure to surrender or repay under a notice issued by the EPA.
- Amend s 132 to add an offence of 'knowing failure to surrender or repay units' and amend s 136 to make that offence the basis of an additional penalty on conviction.

93. The preferred option is to amend s 134. This will mean that a person who fails to meet a new surrender or repayment date will have the same penalty they would have faced under the original obligation. I propose an amendment which will make the excess emissions penalty of $30 per unit available in all cases of failure to surrender or repay units.

### *F.2. Rules for participant registration*

94. A person becomes a mandatory participant when they carry out an activity specified in Schedule 3, such as mining more than 2000 tonnes of coal in a year. If a person stops carrying out the activity, eg, if they mine less than 2000 tonnes of coal in a particular year, they are required to deregister.

95. Some participants may carry out an activity intermittently, or sometimes fall below the threshold for a particular year. The need to deregister and re-register creates an unnecessary administrative burden in such cases. The EPA can manage this situation effectively if the participant is able to remain registered, and use the emission return system to report the fact that they have no emissions or surrender obligation for a particular year.

96. I propose an amendment which will:

a) require a participant to deregister only when they stop the activity permanently; and

b) ensure that a registered participant is able to submit a nil return (reporting zero emissions) if they are temporarily below any thresholds for the activity.

### *F.3. Government's ability to sell Kyoto units from the surrender account*

97. As well as NZUs, ETS participants can surrender (subject to certain restrictions) international units generated under the Kyoto Protocol, which can be used by countries to meet their First Kyoto Commitment Period (CP1) obligations. These Kyoto units include Certified Emission Units (CERs) and Emission Reduction Units (ERUs).

98. The Act (s 65(4)) requires that when a participant has surrendered Kyoto units, these units need to be transferred to the surrender account. Once a Kyoto unit enters the surrender account, it can only be further transferred in limited situations.

99. Because of the way the Act is drafted, even if the Crown were to be able to sell or auction the units in the surrender account, the Kyoto units could not be subsequently transferred to the buyers. When the Act was drafted it was anticipated that New Zealand would not have a surplus of units above its Kyoto obligations. This would mean that all Kyoto units in the surrender account were expected to be required for New Zealand's international compliance. **[Withheld under s9(2)(j)]**.

100. **[Withheld under s9(2)(j)]**.

101. Introducing an auction of NZUs, as the Minister for Climate Change Issues proposed in the first Cabinet paper, would go a significant way to addressing this issue in future. Auctioning would give the government more flexibility to increase NZU supply and therefore reduce the number of Kyoto units that participants will need to purchase offshore and surrender. However, this proposal is still subject to consultation.

102. To provide the government with further flexibility, I propose to amend the Act to allow for the possibility for the government to sell units from the surrender account, if they are surplus to what is required for NZ to meet its current obligation or equivalent level of domestic effort. This is not a complete solution, as it may still be challenging to find a buyer for significant volumes of surplus units - particularly after the end of the CP1 'true up' period in 2015. However, it will provide the government with more options to dispose of surplus units than the Act currently allows.

### *F.4 Amendments to S159 regarding the Crowns recovery of debt*

103. Section 159 of the Act currently requires the Crown to purchase units on behalf of a participant if the participant fails to meet its surrender obligations or is unable to do so because of insolvency. This provision links to the backing provision, that I sought Cabinet's agreement to remove in the first Cabinet paper [EGI (12) 16; CAB Min (12) 8/7].

104. If the requirement to back NZUs with Kyoto units is removed, there is no longer any justification for the Crown to be required to explicitly purchase units to cover the obligations of an insolvent or non-paying participant.

105. Currently s159(3) states that costs incurred constitute ‘an unsecured debt to the Crown’. This is a fact that is not dependent on this Act and does not need to be stated in the Act. The Crown’s status as an unsecured or other creditor is determined by other legislation.

106. I propose an amendment which will remove the requirement to purchase units on behalf of an insolvent or non-paying participant, and delete the statement that a debt to the Crown under this section is unsecured.

### *F.5 Consolidated groups for allocations*

107. Some ETS participants, particularly in the gas sector, have quite complex ownership structures. Subsidiary companies within a group may be required to submit emissions returns for activities they carry out. The Act (s150) allows for a ‘consolidated group’ account and for one entity, such as a holding company, to submit a single emissions return for the group.

108. It is not currently possible for such a participant to use its consolidated group account for allocations. Subsidiaries are required to hold separate accounts and deal with allocations and repayments individually.

109. I propose a technical amendment which will allow the use of a consolidated group account for allocation purposes.

### *F.6 Rounding rules*

110. The Act (s 63) makes participants responsible for ‘each whole tonne of emissions’ from their activities. This could be argued to mandate that emissions can only be rounded down to the nearest whole tonne in calculating a participant’s obligations; and that rounding up is not acceptable. This is not the policy intention.

111. This restriction would create operational problems for the EPA in setting up online reporting tools, particularly in the context of obligations that require the surrender of less than one NZU per tonne of emissions. If such a restriction was applied when participants are required to surrender units covering 67% and then 83% of their emissions, the rounding rules needed to give it effect would become cumbersome and difficult to apply.

112. I propose a technical amendment which will clarify that rounding up or down to the nearest tonne is permissible under the Act. This will confirm the EPA can apply rounding rules designed to provide the most accurate possible calculation.

### *F.7 Regulation-making abilities for Other Removal Activities*

113. The Act (s 168) provides for regulations to be made to set thresholds for all ‘other removal activities’, ie, activities in Part 2 of Schedule 4. However it only provides for criteria other than thresholds to be set for activities in Subpart 2 (carbon capture and storage) and not in the case of Subpart 1 (producing a product that embeds a substance that would otherwise be emitted).

114. Subpart 1 is used for exports of methanol, and small-scale exports of liquefied petroleum gas. I propose to extend the ability to set criteria to these activities, to clarify that the provision of emission units for these activities can be determined by regulation. This will align Subpart 1 with Subparts 2 and 3.

### *G: MINOR TECHNICAL AMENDMENTS*

115. Successive amendments to the Act have resulted in some cross-referencing errors, including references to sections of the Act that have been repealed.

116. The Act specifies many actions that either participants or agencies must take, with allowable time periods such as 'within 90 days' of some other event. These refer variously to 'days' or to 'working days', and use slightly inconsistent terms like 'within 20 days of' or 'within 20 days after'. The precise intention is not always clear.

117. The act (s 204) specifies that the holder of a coal or gas mining permit 'under any Act' is the mandatory participant for these activities. In practice this refers to the holder of a mining permit under the Crown Minerals Act, and should not be confused with the holding of a consent or permit under any other current legislation.

118. I propose technical amendments which will:

    a) Correct cross-referencing errors where these have been identified.

    b) Adopt a consistent approach to specifying time periods, with all actions required by 'within *X* working days of' the prior event or similar wording.

    c) Insert a specific reference to the Crown Minerals Act in s204.

### Consultation

119. The following agencies were consulted in the preparation of this paper: the Ministry for Primary Industries, the Treasury, the Ministry of Foreign Affairs and Trade, the Ministry of Economic Development, the Department of Conservation, Inland Revenue, the Ministry of Justice, Te Puni Kōkiri and the Environmental Protection Authority. The Department of Prime Minister and Cabinet was informed.

120. As these proposals are more minor and technical in nature, and as most are unlikely to be controversial with stakeholders, I do not consider that a public consultation is needed. However, a number of stakeholders are likely to be interested in the proposed amendments. Officials will make contact with these stakeholders following Cabinet's in principle decisions, to communicate these decisions. This will enable us to gauge reactions prior to the introduction of legislation.

## Financial implications

*Summary fiscal implications*

121. The decisions contained in this paper will have modest fiscal cost of around $7million over the forecast period. The operating balance impacts of the proposed decisions in this paper, not including administrative cost savings from the removal of layer hens from the ETS, are summarised in the table below.

**Table 3: Summary fiscal impacts ($ million)**

| | Increase/(decrease) in operating balance | | | | | |
|---|---|---|---|---|---|---|
| $ million | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **Total** |
| Excluding layer hens from the ETS (not including admin. cost savings) | - | - | - | (0.013) | (0.028) | (0.041) |
| Extending the Pre-1990 tree weed exemption to 2015/16 | - | (1.04) | (2.08) | (2.08) | (2.08) | (7.28) |
| Total | - | (1.04) | (2.08) | (2.093) | (2.108) | (7.321) |

122. The administrative savings from excluding layer hens will be taken into account in proposals for the contingency fund Cabinet has agreed to establish for new ETS administration costs [Cab min (11) 27/15 refers].

123. The overall fiscal impact of the ETS amendment package will depend on final decisions to be made on those elements of the package which have recently subject to consultation, including treatment of the second tranche of pre-1990 forest allocation. Therefore, as with proposals in previous Cabinet papers, I am only seeking in principle decisions on the proposals in this paper at this stage. Final decisions can be made on the package as a whole, in light of its overall fiscal implication following my report back on the results of the consultation mentioned above.

### *Next steps*

124. I intend to report back to Cabinet by July 2012 with final policy proposals and associated budget decisions. This will include Cabinet approvals for the necessary appropriations for proposals in this paper and others.

125. As noted in previous papers, timing will be tight for the introduction of legislation as it is highly desirable to pass an amendment bill by December 2012. As with previous proposals, I am seeking approval for PCO to begin drafting on the in principle decisions made in response to this paper.

126. I am also seeking Cabinet approval to delegate to the Minister for Climate Change Issues, in consultation with Minister of Primary Industries as

appropriate, power to make final decisions to further clarify and develop policy matters in a way not inconsistent with the amendments set out in this paper.

## Human rights

127. There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

## Legislative implications

128. A bill will be required to implement a range of modifications to the ETS.

129. The Act binds the Crown. The bill for the proposed amendments to the Act will also bind the Crown. New regulations will be required to specify details of proposed amendments. Consequential amendments to a number of regulations under the Act will also be required within 12 months of enactment of the bill to give effect to certain provisions in the bill.

### *Regulatory impact analysis*

130. In respect of the proposed major amendments for a revised ETS, the Ministry for the Environment confirms that the principles of the code of Good Regulatory Practice and the regulatory impact analysis (RIA) requirements, including the consultation requirements, have been complied with. The final Regulatory Impact Statement (RIS) was circulated with the Cabinet paper for departmental consultation.

### *Regulatory Impact Analysis requirements*

131. The Regulatory Impact Analysis (RIA) requirements apply to the proposal in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached.  Quality of the Impact Analysis

132. Treasury's Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by the Ministry for the Environment and associated supporting material, and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.

### *Consistency with Government Statement on Regulation*

133. I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- are required in the public interest
- will deliver the highest net benefits of the practical options available, and
- are consistent with our commitments in the Government statement "Better Regulation, Less Regulation".

**Publicity**

134. Cabinet previously agreed that the Minister for Climate Change issues would manage public announcements/ engagement on the proposed package of amendments prior to the finalisation of Cabinet's deliberations on amendments to the ETS.

**Recommendations**

The Minister for Climate Change Issues recommends that the Committee:

***Background***

1. **Note** that a statutory review of the ETS was completed in 2011 and that the ETS Review Panel (the Panel) made 61 recommendations, largely focused on improving the operation of the ETS and slowing the transition to full obligations under the scheme;
2. **Note** that on 18 July 2011 Cabinet invited the Minister for Climate Change Issues to report to Cabinet through the relevant Cabinet committee by February 2012 with proposed changes to the ETS based on the Panel's recommendations, developments in and discussions with Australia and further analysis [Cab min (11) 27/15 refers];
3. **Note** that this is the third Cabinet paper in this series proposing changes to the ETS;
4. **Note** that a number of the proposed changes, aimed at implementing key recommendations of the Panel and key commitments in the National Party's Manifesto [Cab Min (12) (8/7) refers] have recently been subject to a public consultation;
5. **Note** that the Minister for Climate Change Issues will report back to the Cabinet Committee by July 2012, reporting on the results of the consultation and seeking final policy decisions on proposed amendments to the Act;

***Proposals for amendment to the Act in 2012***

6. **Note** that this paper proposes 27 specific technical and operational changes to the ETS, that are more minor in nature to those previously considered by Cabinet and aimed at improving the operational effectiveness of the ETS;
7. **Note** that these changes related to:

- Forestry
- Forestry, Māori land and the Māori Trustee
- Agriculture
- Energy Sector
- Allocation
- Registry, compliance and crown accounts
- Minor technical amendments

8. **Note** that, as with previous papers, in principle decisions are requested at this stage, pending final decisions on the overall package of ETS amendments and their fiscal implications by July 2012;

### *A: Forestry*

*De minimus deforestation and boundary management*

9. **Note** that pre-1990 forest landowners are likely to breach the two hectare deforestation threshold through routine forest management activities; and that there is no *de minimus* threshold available to post-1989 forestry participants;
10. **Note** that any deforested area on the outer boundary of an area of forest land counts towards a pre-1990 forest landowner's or post-1989 forestry participant's deforestation, but internal gaps that are less than 1 hectare or have an average width of less than 15 metres are permitted;
11. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that clearing on the outer boundary of a forest land area that results in a reduction compared to the forest land area that existed on 31 December 2007 for pre-1990 forest land, or that was registered in the ETS for post-1989 forest land, is not treated as deforestation provided:
    11.1. each cleared area is less than 1 hectare, or less than 30m wide; and
    11.2. the reduction is part of normal forest management; and
    11.3. the cleared area is not used for any other land use

*Tree Weeds*

12. **Note** that the control of tree weeds on pre-1990 forest lands will be an ongoing activity;
13. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to extend pre-1990 tree weed exemptions beyond 2012 for up to 200,000 NZUs per year;
14. **Note** that post-1989 tree weeds may be registered in the ETS and earn carbon credits, and this creates financial incentive for landowners to retain tree weeds;
15. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to prevent the registration in the ETS of naturally regenerated tree weeds on post-1989 forest land, unless the EPA is satisfied that the risk of the tree spread is low;

*Natural regeneration of indigenous species on pre-1990 forest lands*

16. **Note** that after clearing, land that is regenerating to indigenous forest often takes longer to meet the forest land definition than currently permitted in the Act which inadvertently creates deforestation liabilities;

17. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that forest land that is regenerating to indigenous forest is not to be treated as deforested where:

    17.1. 4 years after clearing, the land is regenerating to forest land; and

    17.2. 10 years after clearing the land is forest land; and

    17.3. 20 years after clearing, predominantly indigenous forest species are growing that has tree crown cover of more than 30% from forest species that have reached 5 metres in height;

*Re-establishing poplar and willow forest lands*

18. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that land is not to be treated as deforested where the forest land was established for erosion control, and four years after clearing the land is forest land where the forest species are poplars or willows provided that at least 100 stems per hectare are established;

*Natural disturbance events preventing forest land re-establishment*

19. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that where forest land is cleared due to natural cause or event and the area cannot be re-established due to the land conditions, then the land is not considered to be deforested;

*Forestry Operational Issues*

20. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to extend the emissions return period for post-1989 forest land activities to be six months from the end of the period to which the return relates;

### *B: Forestry, Māori Land and the Māori Trustee*

*Māori Trustee and the less than 50 hectares exemption for pre-1990 forests*

21. **Note** that unrelated pre-1990 forest landholdings of a sole professional trustee, including the Māori Trustee, are counted towards the 50 hectare threshold for a less than 50 hectare exemption, preventing an exemption application for these land holdings;

22. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that unrelated pre-1990 forest landholdings of a sole professional trustee, including the Māori Trustee, (ie, landholdings of unrelated trusts or of a Trustee in personal/non-trustee capacity), are not counted

towards the 50 hectare threshold for an exemption application by such trustee, in respect of a trust;

23. **Note** that a trustee appointed under the Te Ture Whenua Māori Act 1993 is not a professional trustee under the Climate Change Response Act 2002;

24. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act so that

    24.1. for the purposes of an application for a less than 50 hectare exemption, a trustee appointed under the Te Ture Whenua Māori Act 1993 is treated as a professional trustee;

    24.2. unrelated pre-1990 forest landholdings of a trustee appointed under the Te Ture Whenua Māori Act 1993, is not counted towards the 50 hectare threshold for an exemption application by such trustee, in respect of a trust;

### *C. Agriculture*

*Exclusion of egg producers from the ETS*

25. **Note** that including egg producers in the ETS imposes significant administration and reporting costs on both the sector and government relative to future emissions charges recovered;

26. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to remove egg producers as an activity under schedule 3 of the Climate Change Response Act 2002;

27. **Note** that, when administrative cost savings are included, the net fiscal impact for the Crown is a saving of $50,000 for the period 2012/13 to 2015/16, and a saving of $8,000 for the period 2012/13 to 2019/20;

*Meat processors: de minimus threshold*

28. **Note** that the current exclusion of retail butchers in the Climate Change Response Act 2002 is too broad and may exclude a wider range of meat processors than intended;

29. **Note** there are no fiscal risks or costs associated with changing the retail butcher exemption;

30. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to remove the retail butcher exemption from schedule 3 of the Climate Change Response Act 2002 and clarify the existing activity definition to the slaughter of ruminant animals, pigs horses or poultry by a person required under the Animal Products Act 1999 to operate under a risk management programme for that activity (ie, the activity of slaughtering);

### *D: Energy Sector*

31. **Note** that the own-use of crude oil or other liquid oil products by miners is a new emission source in New Zealand which did not exist when the ETS was established, and that the Act does not require these emissions to be reported;

32. **Note** that changes in the liquid fuels sector since the ETS was established have given rise to new industry participants for whom the ability to opt in would be appropriate;

33. **Note** that there is apparent ambiguity in the way the obligation for geothermal participants is defined;

34. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to:

    34.1. add the combustion of crude oil or oil products by a miner as an activity in Schedule 3;

    34.2. extend the coverage of Part 3, Schedule 4 to include all liquid fuels

    34.3. to clarify that if a geothermal user supplies exhaust steam or other geothermal material to another party, that other party is not also a mandatory participant;

### *E: Allocation changes*

35. **Note** that the ETS Review recommended a change to the phase-out of allocations which would ensure that allocations are eventually phased out entirely;

36. **Note** that monitoring and enforcement activities are essential for the effective administration of allocations, and that the Act does not explicitly include these under 'administering allocations' as a function of any agency;

37. **Note** that the current rules allow early applications for industrial allocations, and that this creates administrative costs for no real benefit to applications;

38. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to:

    38.1. change the calculation of phase out for industrial and agricultural allocations so that the phase out will continue until these allocations are entirely withdrawn;

    38.2. clarify that the EPA's functions in s 87 include monitoring and enforcement activities over eligible persons;

    38.3. specify that all applications for industrial allocations must be made between 1 January and 30 April in the relevant year;

### *F: Administration of the Unit Register, ETS accounts and emission returns*

39. **Note** that the excess emissions penalty of $30 per unit on units not surrendered or repaid is sometimes waived, and cannot be re-imposed if a participant fails to make a re-set deadline, leaving no effective penalty in these cases;

40. **Note** that participants are currently required to deregister when they stop an emitting activity, even temporarily, and re-register when they resume it;

41. **Note** that under s65 the Crown cannot sell units surrendered by participants, and that there is expected to be a surplus of Kyoto units which are currently valued in the Crown accounts at their market value;

42. **Note** that the Act (s159) requires the Crown to purchase units on behalf of a participant who is in default or is insolvent, and that this requirement will no longer be necessary if NZUs are not backed by international units;

43. **Note** that s159 specifies that the cost of units for a participant who is in default or is insolvent is an unsecured debt, and that the status of such a debt is a factual matter that does not need to be specified in this Act;

44. **Note** that participants may use a 'consolidated group account' to submit emission returns and surrender units for a group of related companies, but are not currently able to use the consolidated group account to apply for and receive allocations;

45. **Note** that s63 makes participants responsible for 'each whole tonne' of emissions, and that this may be interpreted as meaning that the rounding of numbers in an emissions calculation must be done in a way that compromises accuracy;

46. **Note** that the Act does not make provision for regulations to be made setting criteria other than thresholds to be set for all removal activities, in Subpart 1, Part 2 of Schedule 4 of the Act;

47. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to:

    47.1. make a $30 per unit excess emissions penalty available when there is a failure to surrender or repay units under a notice issued by the EPA;

    47.2. require a participant to de-register only when they stop an emitting activity permanently, and allow for the submission of a nil (i.e. zero emissions) emission return;

    47.3. allow for the possible future sale of Kyoto units in the surrender account which are surplus to New Zealand's current international obligation or equivalent level of domestic effort at the time of sale;

    47.4. remove the requirement for the Crown to purchase units on behalf of a participant, and to remove the reference to an unsecured debt to the Crown;

    47.5. allow the use of a consolidated group account for allocation purposes;

    47.6. clarify that rounding calculations can be made under the Act, which would permit rounding up to the nearest tonne as part of an emissions calculation

    47.7. create a regulation-making ability that will allow the setting of criteria for activities in Subpart 1, Part 2 of Schedule 4;

### *G: Minor technical amendments*

48. **Note** that successive amendments to the Act have resulted in some cross-referencing errors.

49. **Note** that deadlines for participants are specified in inconsistent ways in different parts of the Act, so that the exact due date for an action is not always clear.

50. **Note** that s204 specifies that the holder of a coal or gas mining permit 'under any Act' is the mandatory participant for these activities.

51. **Agree, in principle subject to final decisions on the overall ETS package,** to amend the Act to:

    51.1. correct cross-referencing errors

    51.2. specify deadlines consistently so that the due date is made clear

    51.3. specify that permits under s 204(2)(a) only refer to permits under the Crown Minerals Act 1991.

### *Fiscals costs and implications*

52. **Note** the following indicative fiscal implications, not including administrative cost savings, of recommendations 9 to 51:

| | **Increase/(decrease) in operating balance** | | | | | |
|---|---|---|---|---|---|---|
| $ million | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **Total** |
| Excluding layer hens from the ETS (not including admin. cost savings) | - | - | - | (0.013) | (0.028) | (0.041) |
| Extending the Pre-1990 tree weed exemption to 2015/16 | - | (1.04) | (2.08) | (2.08) | (2.08) | (7.28) |
| Total | - | (1.04) | (2.08) | (2.093) | (2.108) | (7.321) |

53. **Note** that administrative cost savings from the exclusion of layer hens from the ETS are likely to total $93,000 over the forecast period.

### *Process and timeline*

54. **Agree** that PCO should draft the in principle decisions by Cabinet on the policy proposals presented in this paper;

55. **Agree** to delegate power to the Minister for Climate Change Issues, in consultation with the Minister for Primary Industries as appropriate, to further clarify and develop policy matters relating to the amendments set out in this paper, in a way not inconsistent with Cabinet decisions;

***Communication and public consultation***

56. **Note** that responsibility has been delegated to the Minister for Climate Change Issues for communication and engagement regarding the proposed amendments and response to Panel recommendations.

_____

Hon Tim Groser
**Minister for Climate Change Issues**
_____ /_____ /_____