



Joint Briefing: Forestry Allocation Consultation Options & CCRA Forestry Amendments

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Action Sought

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Minister for Climate Change Issues Hon Dr Nick Smith	<p>Indicate your preferred approach for consulting on changes to the allocation of units to owners of pre-1990 forest</p> <p>Agree the recommended forestry-related amendments to the CCRA</p> <p>Forward a copy of this briefing to the Minister of Finance and Associate Minister of Climate Change for their information</p>	27 August 2009
Minister of Agriculture and Forestry Hon David Carter	<p>Indicate your preferred approach for consulting on changes to the allocation of units to owners of pre-1990 forest</p> <p>Agree the recommended forestry-related amendments to the CCRA</p>	27 August 2009

Contact for Telephone Discussion (if required)

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Executive Summary

The government has indicated its preferred policy position for allocating NZ Units to owners of pre-1990 forest land, that is:

- 21 million units (less units deducted to cover deforestation of exempt land¹) will be transferred for CP1, and delay the transfer of the remaining 34 million units in CP2 in order to consider whether they are still required in the event that offsetting arrangements are introduced. It was originally intended to allocate all 55 million units in a single transfer with the remaining 34 million units only able to be surrendered or converted post 2012;
- the distribution of units will occur on a simple pro-rata approach by forest land area, not on the basis of forest age-class as currently proposed.

This briefing recommends further amendments to the Climate Change Response Act 2002 (the Act) to support these proposed changes to forestry allocation policy, and addresses outstanding technical issues relating to the tree weed exemption (for pre-1990 forest land) and carbon accounting areas (CAAs) for post-1989 forest land registration. It also discusses possible approaches for undertaking the required consultation on the revised allocation policy.

Forestry Allocation – Litigation, Stakeholder Management and, Implementation Risks

A fundamental decision facing Ministers is deciding how much of the government's policy on forestry allocation should be written into the primary legislation and when and how to consult on this. [withheld]²

If you wish to include as many aspects of forestry allocation into the primary legislation then officials recommend modifying the existing process so that an 'exposure draft allocation plan' is released once the amendment Bill is introduced.³ [withheld]

The elements of the policy that officials suggest could be incorporated into the legislation are as follows:

- make explicit that only 21 million units will be transferred during CP1;
- state that the distribution of units will be as a simple pro-rata approach based on forest land area;
- clarify that the decision to only allocate 21 million units (less units deducted to cover deforestation of exempt land) in CP1 will equally affect all eligible recipients regardless of the type of pre-1990 land they own (in other words the current levels of 18, 39 and ~60 units per hectare will each be reduced to approximately 7, 15 and ~23⁴ units per hectare in CP1 with the balance possibly transferred in CP2);
- allow for the concept of individual determinations to be made for the fixed unit allocations (i.e., 18 and 39 units per hectare);

¹ The Act specifies that the total number of units to be allocated under the forestry allocation plan must be **reduced** by the number of units required to meet the cost of estimated deforestation under the three exemptions provided: the less than 50 hectare exemption; tree weed exemption; and ongoing permitted 2 hectare deforestation exemption. Estimates indicate that approximately 5 million units may need to be deducted from the 21 million allocation pool for CP1, reducing the pool available to approximately 16 million units.

² [withheld]

³ This exposure draft allocation plan would be operational in nature with a limited scope.

⁴ These reduced values are based on estimates of the number of units required to be held back for exemptions and as a proportion (38%) of total allocation pool.

- allow for the concept of an initial individual determinations to be made for those eligible to receive ~60 units per hectare, but at the rate of the 39 unit per hectare land-owners;
- revoke the draft plan to allow for the consultation on an exposure draft allocation plan based on the revised forestry allocation process; and
- include a provision in the amendment Bill that consultation on the exposure draft allocation plan can occur prior to enactment of the Bill.

If Ministers do not wish to make amendments to the legislation and consult via the select committee process on the amendment Bill, then the alternative is to default to the existing process in the legislation to re-issue a draft FAP, stipulating the new policy on allocation in the draft FAP instead. Officials consider this strategy to be of higher risk as the legislation and draft FAP could potentially be seen as ambiguous.

In addition, from a timing perspective, this option limits the time available to forest land owners to apply for either an exemption or allocation. This option could require a further amendment to extend the 1 July 2010 date in order to provide sufficient time for applicants to choose their preferred approach.

Making the pro-rata approach to the 21 million units operational

Ministers should note that it is recommended that the allocation in CP1 occur on a pro-rata basis relative to the current levels of 18, 39 and ~60 units per hectare set out in the CCRA. These would be reduced to (approximately) 7, 15 and ~23 units per hectare in CP1.⁵

An alternative approach would be to allocate the available CP1 units (21 million less deductions for exemptions) evenly across all of the pre-1990 land, and not reflect the split of 18, 39 and ~60 in the CP1 split. Such an approach is not recommended.

The reason for the development of the distinction of 18, 39 and ~60 units per hectare relates to an assessment of which party bears the loss associated with the introduction of the ETS.⁶ While these assessments are never perfect, officials consider that the best approach would be to continue with this distinction.

Assuming Ministers are comfortable with including the pro-rata approach in legislation, the drafting would have to ensure that no particular group is advantaged or disadvantaged due to rounding issues. As such, the draft legislation could either include a number of units to be allocated per hectare expressed to (most likely) 3 decimal places, or a methodology for determining how the pro-rata approach is to be made operational.

Implementation

MAF officials have recently revised their timelines for receiving and processing exemption and allocation applications, and subsequently publishing the required determination and transferring the units to successful applicants. As more work has been undertaken it has become clearer that there is considerable uncertainty and risk around the overall time that this process will take.

The degree to which MAF assesses the eligibility of each individual applicant will have a significant impact on timelines. MAF considers that verifying allocation and exemption

⁵ Note: pre-1990 forest landowners will still be determined to be eligible for the existing unit values per hectare stated in the CCRA (i.e., 18, 39 and higher value). They will however only receive a proportion of these amounts in CP1.

⁶ These distinctions are based on the time of land acquisition by the current owner. More recent owners of land are more likely to have factored the effects of the ETS into their land purchase decisions.

applications is likely to be similar to the processing of post-1989 registration requirements, albeit with much greater volumes (up to 4,000 applications), requiring greater resources and longer timeframes. Given the large financial sums being allocated and potential for litigation, officials recommend that each individual application be relatively thoroughly assessed. But this is a time consuming and resource intensive process. An elapsed time of approximately 9-12 months is estimated to be needed to process exemption and allocation applications on this basis, involving substantial staffing numbers.

It may be possible to reduce the processing component of this timeframe through a significant increase in personnel. However, while administrative processing staff may be readily available from the labour market, highly skilled Geographical Information System (GIS) specialists capable of interpreting LUCAS forest imagery are in very short supply. Additional funding would need to be found for any such increase in this skill set. In addition, actual experience with the post-1989 forest registrations indicates that:

- applicants wait until the last moment to file an application (creating major processing spikes and processing backlogs)
- individual applications can have long elapsed times to resolve eligibility issues

Given the above, officials now consider that given current resources there is a relatively high likelihood that the forestry units will not be able to be fully distributed prior to the first surrender date for the forestry, fossil fuel and stationary energy sectors (30 April 2011).

If these forestry units are not distributed prior to the first surrender date for these three sectors there is a likelihood that the domestic supply of units, across all sectors, will be insufficient to meet demand. This could see an increase in the number of units imported into the scheme from international sources, and/or an increase in the use of the price cap mechanism. This impact could be minimised to an extent by amending the Determinations process (section 82) of the Act to allow for individual determinations for the fixed unit allocations (18 and 39 units per hectare) only. Allocation of units for the remainder of participants (~ 60 units per hectare) would happen later once the allowance for exemptions have been made, although it is proposed that an initial allocation to those parties (assuming their eligibility is confirmed) be made at the rate pertaining to the 39 unit per hectare group. This would give MAF greater flexibility in when and how it could process and transfer units into holding accounts.

[withheld]

Other Legislative Amendments

Tree Weed Exemption

The Minister for Climate Change Issues has confirmed that all deforestation liabilities that accrue under this exemption will be funded from the 55m unit forestry allocation pool. Accordingly, the number of units required for the exemption must now be estimated and deducted at the time(s) the allocation is made.

Amendments are required to ensure the exemption's effective operation and relate to extending the time limits on the pre-1990 tree weed exemption and enabling the Chief Executive to limit tree weed approvals per commitment period⁷. Recent work done on estimating likely tree weed removal suggests a cap of approximately 1 million units for CP1 would be appropriate.

⁷ It is also noted that officials will shortly provide a separate briefing about new regulations that are needed to implement the tree weed exemption. The regulations need to be developed this year, and Ministers' approval to undertake targeted consultation will be sought.

Carbon Accounting Area

A carbon accounting area (CAA) is the area of forest land for which a post-1989 Participant is required to report the change in forest carbon stocks over time. CAAs, and their associated carbon accounting records (CARs), provide the fundamental mechanism by which the total NZUs issued and surrendered for a given area of forest land are tracked through time.

Early implementation experience suggests that some aspects of the provisions relating to CAAs (i.e. for post-1989 forest land only) are overly cumbersome, likely to lead to unnecessarily high transaction costs, and could create unintended liabilities for participants. Several amendments are therefore proposed to make the provisions work more effectively and minimise unnecessary costs.

The first amendment sought would ensure that an existing participant is able to redefine the way in which their forest land is assigned to CAAs without incurring any additional obligation to surrender emissions units or having to pay any fee for reapplication.

A further amendment is to clarify the existing provision to make it clear that the Chief Executive must keep an up-to-date record of the net balance of units in relation to a carbon accounting area including one that is redefined.

The remaining amendments relate to the treatment of CAAs in the event of a transfer of land (e.g., due to sale of land) and seek to make the process of transfers and carbon accounting more transparent and simpler for both a vendor and purchaser.

Recommended Action

We recommend that you:

- a) [withheld].
- b) **Indicate** your preferred approach for consulting on changes to the forestry allocation policy, being **EITHER**:
- i.) To include as much detail as practicable in primary legislation and run an 'exposure draft allocation plan' process run concurrently with the Amendment Bill select committee process; **OR**
YES/NO
 - ii.) issue a revised Draft Forestry Allocation Plan after the Amendment Bill is enacted
YES/NO
- c) **If your preference is option b (i) above, direct** officials to prepare legislative amendments to:
- i. make explicit that only 21 million units will be transferred during CP1 (to minimise potential for legal challenge);
YES/NO
 - ii. state that the distribution of units will be as a simple pro-rata approach based on forest land area;
YES/NO
 - iii. clarify that the decision to only allocate 21m units in CP1 will equally affect all eligible recipients regardless of the type of pre-1990 land they own (in other words the current levels of 18, 39 and ~60 units per hectare will each be reduced to approximately 7, 15 and ~23 units per hectare in CP1);
YES/NO
 - iv. allow for the concept of individual determinations to be made for the fixed unit allocations (i.e., 18 and 39 units per hectare)
YES/NO
 - v. allow for the concept of an initial individual determination to be made for those eligible to receive ~60 units per hectare, but at the rate of the 39 unit per hectare land-owners;
YES/NO
 - vi. revoke the draft plan to allow for the exposure draft allocation plan; and
YES/NO
 - vii. include a provision in the amendment Bill that consultation on the exposure draft allocation plan can occur prior to enactment of the Bill.
YES/NO
- d) **Direct** officials to prepare legislative amendments to:

Tree Weed Exemption

- i. amend timing requirements on successful applicants so that the current requirement to complete deforestation within 24 months is extended to complete within the first commitment period; and

YES/NO

- ii. enable the Chief Executive to limit tree weed approvals per commitment period within a fixed budget.

YES/NO

Carbon Accounting Areas

- iii. allow an existing participant to apply, in circumstances specified in regulations, to redefine the way in which their forest land is assigned to carbon accounting areas without incurring an obligation to surrender emissions units or pay a fee.

YES/NO

- iv. to require that whenever a participant's status is transferred from one party to another (such as due to the sale of land or termination of a forestry right) the area of land included must be an entire carbon accounting area; and

YES/NO

- v. that the transferor is required to submit an emissions return that accounts for emissions or removals from the date of the last return to the date of transfer within 20 working days of transfer and surrender any units required to be surrendered in accordance with the Act.

YES/NO

- e) **Agree** to issue drafting instructions to the Parliamentary Counsel Office to give effect to the directions listed above.

YES/NO

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Mike Jebson
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Hon Dr Nick Smith
Minister for Climate Change Issues
Purpose of Report

Hon David Carter
Minister of Agriculture and Forestry

1. This briefing note is one of a number seeking instructions from you in relation to further detailed policy for amendments to the New Zealand Emissions Trading Scheme (NZ ETS). This will enable Parliamentary Counsel Office to draft amendments to give effect to further detailed policy. It outlines options to consult on the amended forestry allocation policy and recommends amendments to the Act in relation to allocation policy, the tree weed exemption (for pre-1990 forest land) and carbon accounting areas (CAAs) for post-1989 forest land registration.
2. In addition to this note, further joint MfE/MAF advice has been provided on the following outstanding policy issues:
 - i) Content of an amendment bill in relation to agriculture, including free allocation and the sector point of obligation.
 - ii) Exports of units from the forestry sector.

Background

3. At its meeting on 10 August 2009 Cabinet considered a paper on “Amendments for a Moderated NZ ETS and Second Order Amendments to the Climate Change Response Act 2008”. Cabinet agreed ‘in principle’ to the amendments outlined in the Cabinet paper. In addition, the government has finalised its approach to allocating NZ Units to owners of pre-1990 forest land.

Forestry Allocation

4. The Act sets out the statutory⁸ process for the allocation of NZ Units in respect of pre-1990 forest land including the total number of NZ Units available for allocation, the rules for calculating NZ Units available per hectare, criteria to determine who is eligible and how many emission units they are entitled to.
5. The joint MfE/MAF briefing note “Forestry Allocation Plan Methodology” (MAF briefing number B09-61 dated 4 August 2009) outlined options for amending the forestry allocation methodology and identified relevant issues the government would need to consider prior to deciding to change the existing approach to allocation.
6. We understand that your preference is to:
 - Not signal in the current legislative amendments an option to cancel the post dated units. Any decision to cancel all or a portion of the post-2012 units would be taken after the international rules on offsetting are known;
 - Transfer 21 million units for CP1, and delay the transfer of the remaining 34 million units in CP2 in order to consider whether they are still required in the event that offsetting arrangements are introduced; and
 - Distribute units based on a simple pro-rata by forest area approach, not the age-class of forest.

⁸ Refer to Appendix 1 for an outline of the statutory processes involved in issuing a Final FAP under the Climate Change Response (Emissions Trading) Act 2002.

Analysis

Issuing a Revised Final Forestry Allocation Plan

7. Officials consider there are three key risks associated with issuing a revised Forestry Allocation Plan (FAP) based on the new policy; litigation, stakeholder management and implementation risks.
8. **[withheld]**.
9. If you wish to include as many aspects of forestry allocation into the primary legislation then officials recommend modifying the existing process so that an 'exposure draft allocation plan' is released once the amendment Bill is introduced. **[withheld]**.
10. If Ministers do not wish to make amendments to the legislation and consult via the select committee process on the amendment Bill, then the alternative is to default to the existing process in the legislation to re-issue a draft FAP, stipulating the new policy on allocation in the draft FAP instead. **[withheld]**.
11. In addition, from a timing perspective, this option limits the time available to forest land owners to apply for either an exemption or allocation. This option would likely require a further amendment to extend the 1 July 2010 date in order to provide sufficient time for applicants to choose their preferred approach.
12. **[withheld]**.
13. **[withheld]**.
14. **[withheld]**.

Stakeholder Management - Engagement with Maori and Forest Sector

15. A key issue for government is how and when it communicates the new approach to allocation to the forestry sector and Māori. **[withheld]**.
16. **[withheld]**.
17. There is an established process for consulting with Māori around the ETS - the Māori Reference Group Executive (MRGE) and Iwi Leadership Group (ILG). This also included an agreed approach between iwi and the Crown for allocation of NZ Units for pre-1990 forest land. Therefore the Crown has a Treaty obligation to act in good faith to actively protect its agreement with iwi. **[withheld]**.

Implementation and Timing Risk

18. Once a final FAP is issued, Ministers also need to be aware of the need to maximise the time available to applicants to choose whether to apply for an exemption or allocation and the time required by MAF to process applications. This has timing implications over and above the need to consult on the new approach to allocation due to the high volumes of applications expected and the operational challenges this presents.

Informing the forestry sector

19. Anecdotal evidence indicates that the forestry sector in general, and small landowners in particular, do not yet feel adequately informed to make a decision about whether to opt for an exemption or allocation. Choosing between a free allocation or exemption is a one-time only opportunity for forest landowners – if they do nothing they will be worse

off and there will be long-term implications for the landowner. This will be an important decision for many landowners, given the size of the potential financial sums involved.

20. This suggests that a relatively long, comprehensive process to inform potential applicants is desirable (e.g. 6 months). Exacerbating this concern, officials do not have any detailed information on who owns many of the smaller forest holdings in New Zealand. It is estimated that 4,000⁹ separate landowners may be affected. It is therefore not possible for officials to directly contact all of those who are likely to be affected. As a result, it is possible that some small landowners are still unaware of their right to apply for a free allocation of units, or exemption from the scheme altogether if their pre-1990 forest landholdings are smaller than 50 hectares. This concern is of particular relevance to Maori landowners.
21. **[withheld]**.
22. Furthermore, forest landowners who are eligible for both a free allocation and exemption cannot sensibly choose between the two options until the final FAP is issued. The Act currently provides that the deadline for the less than 50 hectare exemption is 1 July 2010¹⁰. It is therefore preferable the time between issuing the final FAP and closing date for exemption applications be as long as possible.

Processing Timeframes

23. MAF officials have recently revised their timelines for receiving and processing exemption and allocation applications, subsequently publishing the required determination and transferring the units to successful applicants. As more work has been undertaken it has become clearer that there is considerable uncertainty and risk around the overall time that this process will take.
24. The key factors that will affect the total length of time required are:
 - the extent of eligibility checking that is undertaken
 - the volume of applications
 - the level of resources available
 - the process used to consult on the revised allocation policy
 - the level and nature of any legal action taken by applicants
25. The degree to which MAF assesses the eligibility of each individual applicant will have a significant impact on timelines. MAF considers that verifying allocation and exemption applications is likely to be a similar to the processing of post-1989 registration requirements, albeit with much greater volumes (up to 4,000 applications), requiring greater resources and longer timeframes. **[withheld]**. But this is a time consuming and resource intensive process. An elapsed time of approximately 9-12 months is estimated to be needed to process exemption and allocation applications on this basis, involving significant staffing numbers.
26. It may be possible to reduce the processing component of this timeframe through a significant increase in personnel. However, while administrative processing staff may be readily available from the labour market, highly skilled Geographical Information

⁹ MAF's working assumptions are that 4,000 applications from pre-1990 forest landowners will need to be processed: 2,000 less than 50 hectare exemption applications and 2,000 allocation applications. The resource effort and cost of this processing is still being estimated and is heavily influenced by the degree of eligibility checking that should be undertaken to mitigate risks (that may lead to legal challenge) such as: exemptions are granted for ineligible land; units are allocated to ineligible landowners; the wrong number of units are allocated to eligible landowners .

¹⁰ This was moved by 12 months in the recent amendment Act.

System (GIS) specialists capable of interpreting LUCAS forest imagery are in very short supply. Additional funding would need to be found for any such increase in this skill set. In addition, actual experience with the post-1989 forest registrations indicates that:

- applicants wait until the last moment to file an application (creating major processing spikes and processing backlogs)
 - individual applications can have long elapsed times to resolve eligibility issues
27. Given the above, officials now consider that given current resources there is a relatively high likelihood that the forestry units will not be able to be distributed prior to the first surrender date for the forestry, fossil fuel and stationary energy sectors (30 April 2011).
 28. If these forestry units are not distributed prior to the first surrender date for these three sectors there is a likelihood that the domestic supply of units, across all sectors, will be insufficient to meet demand. This could see both an increase in the number of units imported into the scheme from international sources, and an increase in the use of the price cap mechanism.
 29. One possible way to minimise this risk is to amend section 82 of the Act relating to the 'determinations process'. The current provisions contemplate one determination process only, which means all exemption and allocation applications must be assessed prior to a determination being made. However this seems unnecessarily restrictive given that two classes of eligible persons have a fixed allocation (i.e., 18 and 39 units per hectare) and do not rely on estimating exemption deductions. In addition, the allocation of units for the remainder of participants (~ 60 units per hectare) could also be modified so that an initial allocation to those parties (assuming their eligibility is confirmed) be made at the rate pertaining to the 39 unit per hectare group. Amendments to this effect would give MAF greater flexibility in when and how it could process and transfer units into holding accounts.

Options for Issuing a Revised Final Forestry Allocation Plan

Option A: Release the government's position on the allocation of NZ Units via an 'exposure draft allocation plan' and make supporting changes to the Amendment Bill

30. This option would be used in conjunction with changes to allocation specified in the amendment Bill and involves modifying the existing process so that an 'exposure draft allocation plan' is released once the amendment Bill is introduced
31. Under this option the existing draft FAP would be withdrawn by public notice under section 196A of the Act and an amended draft document outlining the government's position on allocation released in its place.
32. As with the previous draft FAP, the exposure draft allocation plan would also provide the opportunity for person's to comment on aspects not expressly provided for in the Amendment Bill (i.e., information requirements, land and owner eligibility criteria etc).
33. As well as releasing and consulting on the exposure draft allocation plan the amendment Bill will need to include some amendments to reflect the new policy for allocation – particularly the change to transfer only 21 million units at this time and the different method for distributing those units (from age class to a simple pro-rata approach). The Amendment Bill would also remove the concept and processes related to issuing a draft FAP, and substitute with an 'exposure draft allocation plan' mechanism to be used instead. The Amendment Bill would require consultation on the exposure draft allocation plan but allow consultation to occur before the amendment

Bill is enacted. The Parliamentary Counsel Office has advised this process would be appropriate.

34. In relation to timing, officials recommend issuing a public notice withdrawing the existing draft FAP and then releasing the exposure draft allocation plan either at the same time or just after the Amendment Bill is introduced. Consultation on the exposure draft allocation plan regulation could run till the end of the select committee process – thereby allowing up to six weeks for submissions. Once the select committee process has concluded and the Amendment Bill enacted, a final FAP would be issued by the Governor-General (on the recommendation of the Minister) via an Order in Council (OIC), as is the current process. Government should aim to finalise the Forestry Allocation Plan and invite applications for exemptions and an allocation of NZ Units upon enactment of the amendment Bill.
35. Having both the Amendment Bill and exposure draft allocation plan presented together enables ‘no surprises’ and landowners will see the full details of allocation and be able to comment on the complete package. The matters to be specified in the exposure draft allocation plan would be limited and relate mainly to information requirements for applicants.
36. While this option maximises the time available (allowing six months up to 1 July 2010) for forest landowners to understand the implications of applying for either an allocation or exemption and maximises the time available for implementation it would limit the time available for consultation on the FAP and may therefore be subject to criticism by stakeholders. **[withheld]** This could be mitigated by Ministers engaging as early as possible with them after the report back of the current select committee.
37. **[withheld]**, it is noted that a six month consultation period on the existing Draft FAP occurred between 11 October 2008 and 30 April 2009. Although only ten submissions were received, there was support¹¹ for allocating on a pro-rata basis versus the current age class approach. A shorter consultation process on the revised allocation plan may be acceptable given that a degree of consultation (albeit limited) on allocation has already been undertaken.

Option B – Maintain existing process - release a revised draft Forestry Allocation Plan after the legislation is enacted.

38. If Ministers do not wish to make amendments to the legislation and consult via an ‘exposure draft allocation plan then the alternative is to default to the existing process in the legislation to re-issue a draft FAP, stipulating the new policy on allocation in the draft FAP instead. Officials consider this strategy to be of **[withheld]**. Fisheries experience suggests that any ambiguity in the legislation will increase this litigation risk.
39. This option also limits the time available to forest owners to apply for either an exemption or allocation and may require a further amendment to extend the 1 July 2010 date.
40. This process would see the re-issue a draft FAP as soon as the amendment Bill is enacted. Assuming the amendment Bill is enacted in early December 2009, the earliest a revised draft FAP could be issued would be late December/early January (depending on your availability over this period). Public consultation would be required for a minimum of 40 working days and would result in a final FAP being issued mid to late March 2010 at the earliest.

¹¹ Ngai Tahu Property Ltd and Matariki Forests supported such an approach.

41. If the final FAP is not issued until March 2010, that leaves only three months for exemption applications to be submitted prior to the 1 July 2010 deadline¹². Officials do not consider this time is adequate.
42. This option increases the risk of litigation and would reduce the time available to MAF to process applications and increases the time by which units could be transferred into holding accounts relative to Option A..

CCRA Amendments Required

43. The sub-sections below outline the amendments recommended in relation to:
 - i) the amended forestry allocation policy and consultation approach;
 - ii) operation of the tree weed exemption now that the policy position to fund the exemption from the 55m forestry allocation pool has been confirmed; and
 - iii) administrative procedures around the Carbon Accounting Areas.

Amendments to Support a Revised Forestry Allocation Plan

44. Changes to the legislation are not strictly needed to delay issuance of the second tranche of 34m units, and shift towards a simple pro-rata approach based on forest land area. However, changes are strongly recommended in order to reduce the risk of litigation. Fisheries experience suggests that any ambiguity in the legislation will increase this litigation risk. The more ambiguity that exists between the legislation and the FAP over the approach to allocation, the greater the likelihood a legal challenge could be made.
45. To reflect the government's approach to allocating NZ Units to owners of pre-1990 forest land – the following amendments to the Act are recommended:
 - make explicit that only 21 million units will be transferred during CP1 (to minimise potential for legal challenge on this point); and
 - state that the distribution of units will be as a simple pro-rata approach based on forest land area; and
 - clarify that the decision to only allocate 21 million units (less units deducted to cover deforestation of exempt land) in CP1 will equally affect all eligible recipients regardless of the type of pre-1990 land they own (in other words the current levels of 18, 39 and ~60 units per hectare will each be reduced to approximately 7, 15 and ~23 units per hectare in CP1 with the balance possibly transferred in CP2); and
 - allow for the concept of individual determinations to be made for the fixed unit allocations (i.e., 18 and 39 units per hectare); and
 - allow for the concept of an initial individual determinations to be made for those eligible to receive ~60 units per hectare, but at the rate of the 39 unit per hectare land-owners; and
 - revoke the draft plan to allow for the consultation on an exposure draft allocation plan based on the revised forestry allocation process; and
 - include in the amendment Bill a requirement for consultation on the revised forestry allocation model; and

¹² Although the Chief Executive does have some discretion to accept late applications.

- include a provision in the amendment Bill that consultation on the exposure draft allocation plan can occur prior to enactment of the Bill.
46. Officials also recommend amending the Act to allow for individual determinations to be made for the fixed unit allocations (18 and 39 units per hectare) only. This would not only decrease processing bottlenecks and resourcing pressures but would allow a portion of units to be transferred into holding accounts prior to 30 April 2011.

Tree Weed Exemption Amendments

47. The Minister for Climate Change Issues has confirmed that all deforestation liabilities that accrue under this exemption will be funded from the 55m unit forestry allocation pool. Accordingly, the number of units required for the exemption must be estimated and deducted at the time(s) the allocation is made.
48. Amendments are required to the Act to change the time limits on the pre-1990 tree weed exemption and enabling the Chief Executive to limit tree weed approvals per commitment period¹³.
49. Further, officials recommend the time limits in the Act be amended to extend the current requirement to complete deforestation within 24 months, to a requirement to complete it within the first commitment period (as is the case with the 2 ha allowance). This will address stakeholder concerns that the two-year period was unachievable for practical and financial reasons.
50. Another round of tree weed exemption applications should occur in CP2 (this is in line with the allowance for the 50 hectare and 2 hectare exemptions that will be deducted (on a pro-rata basis) from the pool of units available for each commitment period).
51. Finally, to maintain control over the level of liabilities under this exemption it is recommended a provision be included enabling the Chief Executive to limit tree weed approvals to remain within a fixed emissions cap to be determined by the Chief Executive for each commitment period. Recent work done on estimating likely tree weed removal suggests a cap of approximately 1 million units for CP1 would be appropriate.

Carbon Accounting Areas – Post-1989 Registration Amendments

52. A carbon accounting area (CAA) is the area of forest land for which a post-1989 Participant is required to report the change in forest carbon stocks over time. A CAA comprises a set of one or more forest land polygons and each forest land polygon can belong to only one CAA. CAAs, and their associated carbon accounting records (CARs), provide the fundamental mechanism by which the total NZUs issued and surrendered for a given area of forest land are tracked through time.
53. Implementation experience has shown that some of the provisions relating to carbon accounting areas (i.e. for post-1989 forest land only) while technically workable are overly cumbersome, likely to lead to unnecessarily high transaction costs, and could create unintended liabilities for participants. Several amendments are proposed to make the provisions work more effectively, minimise costs, and to clarify the record-keeping required to be performed by the Chief Executive.

¹³ It is also noted that officials will shortly provide a separate briefing about new regulations that are needed to implement the tree weed exemption. The regulations need to be developed this year, and Ministers' approval to undertake targeted consultation will be sought.

CAA redefinition

54. The Act currently provides for only one circumstance in which a Carbon Accounting Area (CAA) already registered in the ETS can be changed – when part of the registered forest land is sold.
55. Under any other circumstance, the only way that redefinition of a CAA can currently occur is to withdraw the forest land from the ETS, and re-submit the land along with the redefined CAA arrangement. This is administratively clumsy, and may impose unnecessary costs on participants who must surrender the net balance of NZUs issued for the area of withdrawn forest land. This is a particular issue for owners of larger forests where it is expected the use of more accurate approaches to calculating emissions and removals, which will usually make redefinition of CAAs desirable, will be mandatory in the near future.
56. Accordingly, it is proposed to amend the Act so that an existing participant is able to redefine the way in which their forest land is assigned to CAAs, or a carbon accounting area that is redefined without incurring any additional obligation to surrender emissions units or having to pay any prescribed fee for reapplication. It is proposed that this provision only be available in circumstances, to be specified in regulations, to minimise operational cost and complexity.

Chief executive updating records¹⁴

57. The Act does not presently make it clear that the Chief Executive must keep an up-to-date record of the net balance of units in relation to a carbon accounting area including one that is redefined. A provision will be needed to require the Chief Executive to update the participant's records including when there has been redefinition of the carbon accounting areas.

Compulsory return in the event of sale or transfer

58. Under section 192, all or part of the post-1989 forest land that is registered in the ETS can be transferred to another person, for example by sale, and the new person becomes the participant. The transferor remains responsible for those obligations that existed at the time of the last emissions return prior to the transfer, but not for any liabilities (nor entitlement to removals) that have occurred since that time and the time of transfer. That is, at present the transferor is not required to submit a final return upon transfer that records the exact carbon position at that date.
59. In addition it is not clear that transfers under this section must be of a complete CAA, which if required would simplify and make more transparent the carbon accounting for both the vendor and purchaser.
60. It is therefore proposed that any transfer under s192 must be of an entire CAA, redefined as necessary before transfer, and that the transferor is required to submit an emissions return that accounts for emissions or removals from the date of the last return to the date of transfer. The transferor will have to complete this return within 20 working days of transfer and surrender any units required to be surrendered in accordance with the Act within 20 working days after that – consistent with other existing requirements under the Act.

¹⁴ Note this amendment has already been listed in 2nd order amendment Cabinet Paper.

Consultation on this Paper

61. This paper was reviewed by the Ministry of Agriculture and Forestry, Ministry for the Environment, Ministry of Justice Office of Treaty Settlements, Crown Law Office and Treasury.

Appendix 1 – Steps involved in current process for allocating NZ Units under a Forestry Allocation Plan

The key components of the allocation plan process, as set out in the Act, are:

- a) Minister gives public notice of draft allocation plan (s78).
- b) Public submissions received on the draft allocation plan (minimum 40 working days for submissions, s78).
- c) Chief executive prepares a report for the Minister and recommendations in respect of all submissions (s78).
- d) Minister considers the report and makes any changes to the plan (s78)
- e) Cabinet agrees to the final Forestry Allocation Plan
- f) Forestry Allocation Plan issued by Order in Council (s79).
- g) Forestry Allocation Plan is presented to the House of Representatives as soon as practicable after it is issued, along with the report provided to the Minister under section 79(2) and any of the Minister's decisions on the recommendations contained in the report.
- h) Minister invites people to apply for an allocation (s82)
- i) Those wishing to apply for a <50 ha exemption can apply up until 30 June 2010**. Concurrently, applications for the tree weed exemption would be called.
- j) Persons who consider themselves eligible, apply for an allocation (the deadline for which must be no earlier than 40 working days after the date on which the notice is given) s82.
- k) Minister makes draft determinations of the number of NZUs that a person is entitled to receive and notifies those who applied for an allocation (s82(4)).
- l) Persons may supply further information – minimum period required 20 working days – if they consider, for example, the draft determination does not correctly reflect the area of their pre-1990 forest land or if they are considered ineligible (s82(5)).
- m) Final determinations made as to the persons who are eligible to receive and allocation and the number of units they will receive (s82(8)).
- n) Transfer of NZUs to eligible persons (s82(8)).

Linked to the allocation of NZ Units is the exemption of eligible pre-1990 forest land from the ETS. The CCRA specifies that the total number of units to be allocated under the forestry allocation plan must be **reduced by the number of units required to meet the cost of estimated deforestation under the three exemptions provided: the less than 50 hectare threshold exemption; tree weed exemption; and ongoing permitted 2 hectare deforestation exemption. Accordingly exemption applications must be received and processed prior to the government making a Draft Determination under the allocation plan process.