



Options for Independent Regulation of NZ ETS as part of an EPA

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Security Level:		Number of Attachments:	1
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Action Sought

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Minister of Finance Hon Bill English		
Minister of Economic Development Hon Gerry Brownlee		
Minister for Climate Change Issues Hon Dr Nick Smith	Indicate your preferred option for including NZ ETS functions within an EPA.	2 September 2009 (in order to feed into Cabinet paper for Climate Change Response Amendment Bill if necessary)
Minister of Agriculture and Forestry Hon David Carter		

Ministry for the Environment Contacts [if required]

Name	Position	Telephone		1st Contact
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Director- Approval to send to Minister's office

Director	Date
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Options for Independent Regulation of NZ ETS as part of an EPA

You have asked for advice on how to provide for independent regulation of the New Zealand Emissions Trading Scheme (NZ ETS) in the Climate Change Response Amendment Bill (CCRAB). You have indicated an initial preference for independent regulation by 1 January 2011.

You are in the process of establishing an Environmental Protection Agency (EPA). A transitional EPA is being established from 1 October 2009 via an amendment to the Resource Management Act 1991. Cabinet has also agreed in principle to an Expanded EPA being established from 1 January 2011 in the form of a Crown agent, subject to a further report to Cabinet in October 2009.

You have indicated your preference that an EPA would carry out NZ ETS regulatory functions. We understand that Cabinet has agreed in principle to NZ ETS regulatory functions being in an EPA, excluding for the time being those applicable to the forestry sector.

This briefing and attached A3 diagram:

- Outlines which functions could be transferred to an EPA
- Presents two options for how such functions could be transferred.

The options are:

1. Changes through CCRA Amendment Bill

In the CCRA Amendment Bill scheduled to be introduced in September 2009, include a provision for functions to be transferred to an 'administrator' and for the creation of a new 'statutory officer for allocation' (excluding forestry allocation).

Functions would be grouped and assigned to MED and to MAF for forestry (the status quo) and then transferred (excluding forestry) to an EPA in January 2011. The new 'statutory officer for allocation'¹ would be created (in MfE) to enable an independent process for assessment of allocation applications to occur from 1 January 2010 (and then later be transferred to an EPA).

2. Government statement soon, then changes through proposed EPA Bill (recommended option)

When the CCRA Amendment Bill is introduced in September 2009, include provision for the creation of a new 'statutory officer for allocation' and at this time, announce government's intention for NZ ETS administrator functions to go to an EPA from January 2011, with changes to be introduced via the proposed 2010 EPA Bill.

As with the above option the 'statutory officer for allocation' would transfer to the EPA when the EPA is established.

Note that under both options we have identified the need for a transitional statutory officer of allocation. We are investigating further whether the nature of the transitional Phase 1 EPA would be sufficient to undertake these functions or if a stand-alone role is required.

¹ As part of designing the amended allocation process in the CCRA, officials will determine whether a statutory office that is separate to the transitional EPA would be necessary to achieve the required level of separation of functions.

As both options require the use of the CCRA Amendment Bill (albeit to different degrees), your preferred option will need to be included in the Cabinet paper on the Amendment Bill that is due to be considered this week.

It is not proposed that regulatory functions relating to the forestry sector be transferred to an EPA (or statutory officer for allocation), however, officials recommend designing any amendments to legislation so that this could occur if desired in the future.

Final decisions have yet to be made at Cabinet level about the point of obligation for agriculture. The administrative functions would be significantly different if this were to be processor or individual farmers. We therefore suggest that no provision be made to separate out agricultural administrative functions at present.

Any transfer of Registry functions during 2010-2012 will impact at a critical time – that is, when operational policies and processes, including ICT platforms, are being phased in and being tested with many market participants for the first time. Hence, a transfer of functions raises the risk that phased implementation of NZ ETS operational policies and administrative systems could be compromised by the development of new institutional arrangements. This could result in administrative inefficiencies and higher compliance costs than necessary for business.

In particular, the following risks may arise from the transfer, namely potential loss of:

- key management staff and related knowledge of Registry functions (Emission Unit Register and NZ ETS administration) and related international and local business relationships
- business and IT system support staff with knowledge and experience of business registries
- contracted ICT vendors sourced to supply the hosting of the system and its continued development and ongoing technical support.

These risks are common with any administrative and institutional change of this order and will need to be mitigated via a carefully developed and resourced change management processes. Failure to do so will result in the new Authority inheriting a strategically critical and highly complex government function in poor condition, which would be sub-optimal for both the Crown and for NZ ETS participants. Business will need assurance that a resourced change management process is being developed so that these risks do not further exacerbate existing regulatory uncertainty in carbon markets.

Recommended Action

We recommend that you:

- (a) **Indicate** your initial preference for including NZ ETS functions within an EPA, either:
1. Changes through the CCRA Amendment Bill (with statutory officer for allocation) **Yes / No**
 2. Government statement and statutory officer for allocation soon, then changes through proposed EPA Bill (with statutory officer for allocation through the CCRA Amendment Bill). **Yes / No**
- (b) **Agree** in-principle that under either option the administrative, compliance and registry functions (excluding those applicable to the forestry sector) should transfer to an EPA from 1 January 2011. **Yes / No**
- (c) **Note** that as both options require some use of the CCRA Amendment Bill, your preferred option will need to be included in the Cabinet paper on the Amendment Bill due to be considered this week.
- (d) **Note** that initially the function of 'emissions rulings' may not be appropriate for transfer to an EPA.

Stuart Calman

Director, Climate and Risk Policy

Date

Referred to Ministry Communications Staff:

No

Hon Dr Nick Smith

Minister for Climate Change Issues

Date