

Regulatory Impact Statement

Second order amendments to the Climate Change Response Act 2002

Regulatory Impact Statement

EXECUTIVE SUMMARY

The New Zealand Emissions Trading Scheme (NZ ETS) came into force on 26 September 2008. The key purpose of the NZ ETS is to enable New Zealand to comply with international obligations (such as those under the Kyoto Protocol) while providing certainty for economic growth, equity, and flexibility to respond to possible changes in the post-2012 international framework.

The governing legislation for the NZ ETS contains a number of administrative provisions which enable the implementation of the NZ ETS. Administrative powers and responsibilities are vested in a number of different government agencies. These powers and responsibilities include functions such as registering and deregistering participants, specifying the data required to comply with obligations and receive entitlements and the manner in which that data is collected, and administering exemptions to obligations under the NZ ETS.

Since the NZ ETS was introduced, a number of areas have been identified where:

- the provisions of the governing legislation do not provide desirable levels of certainty and clarity regarding administrative powers and processes;
- the absence of certain administrative powers or processes in the governing legislation makes it difficult to effectively implement the NZ ETS; and
- there is a lack of clarity regarding the inclusion of certain activities in the NZ ETS.

The preferred option is to amend the governing legislation for the NZ ETS to:

- clarify certain administrative powers and processes;
- introduce administrative powers or processes useful for effective implementation of the NZ ETS; and
- clarify the inclusion and exclusion of certain activities in the NZ ETS.

ADEQUACY STATEMENT

The Ministry for the Environment has reviewed the RIS and considers that, given the purpose and scale of the proposals, the RIS is adequate according to the adequacy criteria.

STATUS QUO AND PROBLEM

Outline of current situation

The New Zealand Emissions Trading Scheme (NZ ETS) came into force on 26 September 2008.¹ 'Emissions trading' is a market-based approach for achieving environmental objectives where emission units are traded between participants. In effect, those emitting greenhouse gases have to pay for increases in emissions and are rewarded for decreases. This encourages emissions reductions.

The NZ ETS covers emissions of the following six greenhouse gases: carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulphur hexafluoride (SF₆). These are the greenhouse gases covered by the Kyoto Protocol².

The NZ ETS covers the following sectors of the economy: forestry, liquid fossil fuels (transport), stationary energy, industrial processes, synthetic gases, agriculture and waste.

In respect of each sector covered by the NZ ETS, there are a number of 'participants'. Each participant must calculate the emissions from their activities and surrender to the government one emission unit for each tonne of greenhouse gas emissions (measured as CO₂e) for which they are responsible. There are various types of units that participants can use to meet their obligations under the emissions trading scheme.

The primary unit of trade for the New Zealand emissions trading scheme is the New Zealand Unit (NZU). The NZU is a unit issued and allocated by the government under the scheme. One NZU corresponds to one tonne of carbon dioxide equivalent emissions.

In addition, participants can use most types of Kyoto emission units for compliance. As with NZUs, this is done by transferring the Kyoto emission units to a surrender account. Kyoto emission units are units established under the rules of the Kyoto Protocol.

The Climate Change Response Act identifies who is required to be a participant under the NZ ETS. For example, in the transport sector, importers

¹ Except for the sections of the Act relating to GST which came into force on 1 January 2009.

² Under the Kyoto Protocol New Zealand is obligated to take responsibility for all emissions above 1990 levels for the first commitment period (2008-2012)

of liquid fossil fuels are required to be participants. In general, the ‘point of obligation’ is established at a high level in the supply chain so that there are relatively few participants in each sector. Householders are not participants under the NZ ETS.

Under the NZ ETS, different sectors start to have obligations under the scheme at different times. The forestry sector has an obligation to surrender units in respect of relevant emissions from 1 January 2008. Under the current legislation, further sectors will “enter” the scheme as follows:

- The stationary energy and industrial processes sectors will have obligations to surrender units in respect of their emissions from 1 January 2010.
- Participants in the liquid fossil fuels sector will have obligations to surrender units in respect of emissions from 1 January 2011.
- Participants in the waste, agriculture and synthetic gases sectors will have obligations to surrender units in respect of emissions from 1 January 2013.

A sector is said to have “entered” the NZ ETS from a certain date where it has obligations to surrender units in respect of emissions from that date.³

As well as imposing an obligation on participants whose activities are covered by the scheme, the NZ ETS provides for ‘allocation’ of units to certain participants. Introducing an emissions trading scheme will impact on certain parts of the New Zealand economy and society more than others. Allocation is a means of providing assistance or compensation to strongly affected parties.

The governing legislation for the NZ ETS contains a number of administrative provisions which enable the implementation of the NZ ETS. Administrative powers and responsibilities are vested in a number of different government agencies. These powers and responsibilities include functions such as registering and deregistering participants, specifying the data required to comply with obligations and receive entitlements and the manner in which that data is collected, and administering exemptions to obligations under the NZ ETS.

Summary of Problem

Since the NZ ETS was introduced, a number of areas have been identified where:

- the provisions of the governing legislation do not provide desirable levels of certainty and clarity regarding administrative powers and processes;
- the absence of certain administrative powers or processes in the governing legislation makes it difficult to effectively implement the NZ ETS; and

³ A sector may have obligations to report on its emissions (but not surrender units) prior to its “entry” date.

- there is a lack of clarity regarding the inclusion of certain activities in the NZ ETS.

The issues noted above make it more difficult for the NZ ETS to function effectively.

If the NZ ETS is implemented in its current form, administrators and participants would have to reach their own views as to the correct interpretation of certain ambiguous provisions. This is not considered a desirable outcome because different views may be reached leading to confusion and likely legal challenge of exercise of administrative powers. The absence of administrative mechanisms could lead to a number of inequitable outcomes for participants and costs incurred by the Crown. Finally, a lack of clarity regarding coverage of certain activities would create confusion and could have inequitable outcomes.

OBJECTIVES

The objective of the proposal is to increase certainty for participants and administrators and enable more effective implementation of the NZ ETS, thereby enhancing the credibility and effectiveness of the NZ ETS.

ALTERNATIVE OPTIONS

An alternative option would be that any administrative powers considered to be ambiguous are not exercised. However, the administrative powers in question are necessary to the functioning of the Act. Accordingly, taking this option would result in an NZ ETS that is not functional in certain respects. It is also likely that there could be legal challenge of the failure to exercise some of the powers in question.

PREFERRED OPTION

The preferred option is to amend the governing legislation for the NZ ETS to:

- clarify certain administrative powers and processes;
- introduce administrative powers or processes necessary to effectively implement the NZ ETS; and
- clarify the inclusion and exclusion of certain activities in the NZ ETS.

Further information regarding the amendments falling into each of these categories is set out below.

Clarifying administrative powers and processes

Amendments are proposed to clarify certain provisions where the current wording could be considered to be ambiguous. These amendments are primarily recommended to reduce the risk of legal challenge to the exercise of administrative powers. Although in some cases the risk of challenge is considered to be low, the consequences of a successful challenge would be serious. Clarifying the meaning of these provisions will create greater certainty which will be beneficial for both participants and administrators.

Clarifying cost benefit analysis requirements in exemption provision

Section 60 provides for exempting persons from NZ ETS obligations by Order in Council. Amongst other things, the process under section 60 requires the Minister to be satisfied of certain matters before recommending the making of an order, and includes requirements for a comparison of costs and benefits. However, as currently drafted the cost-benefit analysis requirements are unclear. Consequently, there is a high risk that it will not be possible to satisfy the process requirements for making an exemption.

It is recommended that section 60 is amended to clarify the Minister must be satisfied the costs of an exemption do not exceed the benefits of an exemption. Costs may include economic costs as a result of exempted persons not facing incentives for mitigation. Benefits may include reduced administrative and compliance costs from not requiring exempted participants to monitor and report emissions.

Clarifying the Chief Executive's forestry-related reporting obligations

Section 89 requires the Chief Executive to report information separately for each of the activities in Part 1 of Schedule 4 (which covers removal activities in post-1989 forests). There are four forest removal activities listed under that Schedule: owning post-1989 forest land; holding a registered forestry right or being the leaseholder under a registered lease of post-1989 forest land; and being a party to a Crown conservation contract.

A number of parties are likely to undertake more than one of those four activities, but only provide one combined emissions return. The Chief Executive will in practice therefore not have sufficient information to meet an obligation to report separately for each of these activities.

An amendment is desirable to specify that the Chief Executive only needs to report emissions and removals in relation to the four activities in Part 1 of Schedule 4 in aggregate, rather than separately for each activity.

Clarifying ability to make changes to composition of joint participant registrations

Under the Act, a participant can be made up of more than one person (natural or corporate). All of these persons are jointly and severally liable for the obligations of the "participant". The Act does not contain provisions specifying how the Chief Executive is to manage changes to the

composition of a multi-person participant. A risk exists that the adding of people to, or removing of people from, a participant by the Chief Executive is unlawful and not valid. The risk of invalidity:

- to people leaving the participant is that they remain liable for the other people who continue to be the participant;
- to people remaining the participant is that the leaving person continues to have rights to participant benefits;
- to the Government is that if a person suffers loss due to an unlawful process, then that person may seek to recover that costs from the Government.

Therefore it is recommended that the Act be amended to specify the process for changing the people who make up a multi-person participant.

Clarifying ability to specify the “Land Transfer Date” in the Forestry Allocation Plan

Section 71 of the Act sets out the issues that must or may be set out in the Forestry Allocation Plan. One of the issues that may be covered in the Draft Allocation Plan is a date or event on which the land is to be treated as transferred.

The proposal set out in the Draft Allocation Plan confirms the Act’s default that the land is to be treated as transferred on the “settlement date”, which in a sale and purchase situation would have been agreed by the seller and purchaser. This is effectively the date when the new owner would have taken control of the land and paid any outstanding monies.

The transfer date is important because it affects the amount of allocation that pre-1990 land receives. The rationale behind the decreased allocation for land that was transferred after 31 October 2002 was that once the previous government first announced its intention to introduce policies to control rates of deforestation, a willing buyer could have factored that into the purchase price they were willing to pay for the land. However, this rationale does not apply to land that was transferred after 31 October 2002 by operation of law, for example by order of the Court, or by transmission on the death of a joint owner.

The drafting of section 71 may inadvertently catch such situations and could result in such a new owner receiving a reduced allocation. Recent legal advice casts doubt over whether the wording of section 71 unambiguously gives the Minister the power to clarify the meaning of “transfer” via the Allocation Plan to ensure that the above policy intent is met, and that land that has been transferred by operation of law is not automatically ineligible for a higher allocation of units.

In order to remove the risk of legal challenge on this point, it would be desirable to amend section 71 to clarify that the Forestry Allocation Plan whether issued before or after this amendment may define what is meant by the concept of ‘transfer’ for the purposes of allocation.

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

MAF is developing methodology to measure emissions and removals for forest land, rather than relying on generalised lookup tables. This methodology will be reflected in the forestry sector regulations. One of the features of this measurement approach is the requirement that an applicant's forest land-holding be divided, and information collected at locations within each divided area, in a manner to be further prescribed in regulations and/or standards. Information collected at the specified locations will be used to calculate forest emissions and removals.

The Act does not currently provide the Chief Executive with a clear authority to specify either how an applicant's land-holding should be divided, or the locations in the forest where prescribed information should be collected. The division of forest land area and the location of the information collected will have a significant impact on the carbon measurement accuracy. This power is therefore crucial to ensuring that the areas and locations within which the information is collected are not the subject of debate or challenge by participants, nor to arbitrary relocation, say to a less representative forest area. This issue can be addressed by making a small amendment to the regulation making power, to make it clear that the chief executive can specify the areas and locations from which data must be collected.

Clarifying of the treatment of mining natural gas within the exclusive economic zone (EEZ)

It is necessary to amend the Act to clarify that a person carrying out the activity of mining natural gas, other than for export, within the exclusive economic zone (EEZ) or in, on or above the continental shelf is not also carrying out the activity of "importing" natural gas under Part 3 of Schedule 3.

The Act, as currently drafted, is ambiguous on this point as the provisions regarding the activity of 'importation' are defined by reference to the Customs and Excise Act 1996 which could result in gas mined in New Zealand's gas fields located outside a 12 nautical mile limit being considered to be 'imported'. However, Section 205 of the Act expressly provides that the activity of mining natural gas that occurs in the EEZ is mining activity for the purposes of the Act. There is an argument that a person mining gas in the EEZ falls under both the activity of mining and is also technically importing gas which would require that person to register as an importer of gas and comply with the provisions of the Act.

This ambiguity should be clarified by an amendment to provide that a person carrying out the activity of mining natural gas that occurs in the EEZ does not also carry out the activity of "importing" natural gas simply because it is mining gas from a field located outside the 12 nautical mile limit.

Clarifying relevance of subsequent commitment periods to NZU issuance

Section 69 prescribes the process for the issuance of NZUs into a Crown holding account, in accordance with a direction from the Minister for Climate Change Issues to the New Zealand Emissions Unit Registrar. Section 69(2)(c)(i)-(iv) lists a number of matters the Minister must have

regard to if there is no subsequent commitment period specified or determined under the Protocol or no successor international agreement to the Protocol. This subsection was only intended to guide the issuance of units in subsequent commitment periods (rather than be considered as part of the CP1 issuance process). The section needs to be amended to clarify this policy intention.

Clarifying that only a nominated entity can submit a return for a consolidated group

The consolidated group provisions are proving very difficult for MAF and MED to operationalise for what is likely to be a very small number of participants who would qualify, and elect to form, a consolidated group for emissions reporting purposes. Allowing multiple corporate entities that are participants in multiple sectors with different reporting timetables and bases is proving unworkable.

At the very least, the Act should be amended to clarify that only the nominated entity can submit an emissions return on behalf of the members of the consolidated group, and that only one emissions return per calendar year can be submitted for the consolidated group.

Clarifying the ability to delay registration of forestry participant until fees and charges paid

Section 167 empowers the making of regulations to prescribe fees and charges. Regulations under this section have already been brought into force for post-1989 forest participants. Those regulations specify that an applicant wanting to join the scheme must pay an upfront fee with his or her application. If the processing of their application is particularly time consuming, they will then be charged an additional amount based on the number of hours worked.

Under the Act as currently drafted it is not clear that the scheme administrator has the ability not to register a forestry participant in the scheme if that participant has failed to pay any additional amount charged. This is likely to make it more difficult for the administrator to recover any outstanding charges.

An amendment is desirable to make it clear that the administrator is not required to register a participant until all fees and charges relating to the application have been paid.

Confirming pro rata approach for NZUs earned when land within a Carbon Accounting Area is transferred

NZUs are earned for increases in carbon stocks in a Carbon Accounting Area (CAA). Where part of the land of a CAA is transferred to another participant it is necessary to apportion NZUs earned between the transferor and transferee. It was always envisaged that the apportionment should be made on a pro rata per hectare basis. As drafted, the Act permits a pro rata apportionment, but does not exclude the possibility of another basis for apportionment and officials consider that the Act should be amended to explicitly provide that the apportionment will only be made on a pro rata per hectare basis.

Requiring the Registrar to give effect to directions

While it is implicit in the Act that the Registrar must follow a Chief Executive's direction under section 18B, unlike every other direction from ministers and the Chief Executive referred to in the Act, it is not explicitly stated that the Registrar must follow the direction. Clarity, and consistency with all other directions in the Act, is important here because section 18B directions can relate to actions that include closing a person's holding account and potential forfeit of that person's emission units to the Crown.

Clarifying obligation to retain records

For the avoidance of doubt, it should be made clear that the obligation in section 67(2) to retain records continues whether or not the person continues to be a participant.

Clarifying that one emissions return only to be filed per year

For the avoidance of doubt, it should be made clear in section 189 that a specific post-1989 participant can only file one emissions return per year (this reduces implementation complexity), albeit that they can still mix and match the Carbon Accounting Areas they include in each return.

Clarifying treatment of returns in respect of less than a hectare

Clarify the Act so that a person must calculate the number of units to be surrendered where the area of post -1989 forest land is being deregistered by making the calculation in relation to a whole or part of a hectare. Current section 190 (2) assumes that the areas of post -1989 forest land being deregistered are whole hectares when this will not always be the case.

Amending timing of surrender relative to date of emissions return

In section 191(3), replace "by the same" with "within 20 working days of" (at present the final surrender date is the same as the final date for submission of the emissions return).

Clarifying timing for notification of ceasing to carry out activity

Insert "as soon as practicable" after "must notify" in section 188(3)(b) (at present the timing for notification is not specified).

Introducing or amending administrative powers and processes

Amendments are proposed to make the administration of the Act more straightforward. Although the Act is workable in its current form, there are a number of areas where administration of the Act is cumbersome and/or could prove costly or create unintended liabilities for participants. Some changes are therefore required to make the Act work more effectively.

Creating the ability to waive fees and charges

It is proposed to introduce regulation making powers that provide a power to exempt, waive and refund fees and charges to correct administrative errors (e.g. inadvertent double payments by an ETS participant). Similar

powers exist under many enactments including the Biosecurity Regulations. MAF's internal legal advice has been that without an explicit power, MAF is unable to make refunds to correct administrative mistakes. This has already raised issues of equity and fairness in one case. While this is a minor technical amendment it is important to avoid any risk of bringing the ETS into disrepute through perceptions of inequity or unfairness in the administration of the ETS.

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

The NZ ETS contains provisions to allow deforestation of "tree weeds" (e.g. wilding pines) to apply for and receive an exemption from the deforestation provisions of the Act (becoming a mandatory participant, filing an emissions return and surrendering emissions units). These exemption provisions were inserted so that efforts to eradicate tree weeds would not be discouraged by the NZ ETS.

As currently drafted, the Act restricts the availability of exemptions to land that was forested at the time the exemption is granted. Exemptions therefore cannot be granted to landowners who have already deforested since 1 January 2008 (this amounts to an estimated 800ha to date). This situation means that land owners may be penalised for carrying out weed eradication activities because, due to timing issues, the tree weed exemption is not available to them. This is particularly concerning because landowners are often required to deforest weed trees by regional councils as part of the regional pest management strategy to manage the spread of the trees. Further, it affects the ability of government departments like DOC and LINZ to pursue their mandates of removing tree weeds under other legislation and government policy.

The existing situation is unfair to those landowners who have continued their efforts to eradicate tree weeds and now face a liability. It also risks worsening the spread of tree weeds where control programmes have ceased.

Accordingly, it is proposed that the Act be amended to allow tree weed forest land that has been deforested since 1 January 2008 to be eligible for an exemption (once an exemption process is available). This does not result in an increased level of deforestation or increased fiscal costs over and above what was estimated to be incurred by the tree weed exemption overall – as the area of pre-1990 tree weed forest is finite.

Creating the ability to charge fees for emissions rulings

The Act currently provides for fees to be charged in respect of persons who opt-in to the NZ ETS. However, the Act does not currently provide for fees to be charged in respect of persons who are mandatory participants in the NZ ETS. This presents a problem because mandatory participants are able to make binding ruling applications. These applications are likely to be complex and will require significant time to process. It is also likely that external legal advice (from Crown law) and expert technical advice may be required in respect of some or all applications. Accordingly, it is

strongly recommended that the Act be amended to allow for cost recovery in respect of applications for binding rulings by mandatory participants.

Enabling the delegation of the Registrar's Powers

Under the Act as currently drafted, the Registrar of the Emission Unit Register cannot delegate his or her powers.

Officials consider that a delegation of the Registrar's powers is critical for the workability of implementing the NZ ETS. The complexity and volume of work required of the Registrar means that these tasks will need to be completed by staff reporting to the Registrar.

It is therefore recommended that the Act be amended to include the ability for the Registrar to delegate his or her powers. If no ability to delegate powers is included in the Bill, either the Registrar's responsibilities will go unfulfilled or there will be a question about the validity of the Registrar's actions (e.g. transfers of emission units).

Defining farming in relation to land ownership

If the participant in the agriculture sector is at farm level rather than processor level, then subpart 4 of Part 5 of Schedule 3 currently defines the activity as farming, raising or growing animals for reward or trade. This definition identifies farmers operating under a range of farm ownership structures and contractual arrangements. For example it identifies both farmer landowners and farmers who do not own land, but do raise livestock. For simplification of administration, an amendment would be desirable to make it clear that the participant is the person owning land on which animals are farmed. An amendment would provide the ability to move the obligation to another party in the event of long term land use agreements.

The amendment would significantly enhance the ability to cross check legal participants against registrations to ensure full participation, and improve consistency with treatment of the forestry sector. This is important given the number of farm level agriculture participants. The Agriculture Technical Advisory Group on emissions trading also recommended this amendment in order to minimise the compliance costs of the scheme and ensure comprehensive coverage of emissions.

Providing for removal from the Register of Participants after obligations have been met

Certain persons who become mandatory participants of the ETS are obliged to notify that they should be entered on the Register of Participants by the administrator. They then have an obligation to file an emissions return and surrender emissions units to satisfy their obligation.

Under section 59 a participant is entitled to notify the administrator that the participant has ceased to be a participant and should be removed from the Register of Participants, regardless of whether or not the participant has yet filed their emissions return and/or surrendered sufficient emissions units to meet the participant's liabilities.

A more efficient and effective de-registration mechanism would be for the participant to remain on the Register of Participants until such time as the participant has met all the obligations. At that time the administrator would initiate the de-registration. It is recommended that section 59 be amended accordingly.

Restricting timing for electing to have activities removed from consolidated group

To reduce administrative complexity, it is proposed to restrict the timing for members of consolidated groups to elect to cease being a member of that group. It is proposed that elections received by 30 September in a given year would be effective from the beginning of the following year, and elections received after 30 September in a given year would be effective from the beginning of the year following the next year. This is consistent with the timing constraints for entities to join consolidated groups, and would avoid part year reporting – bringing administrative benefits for the groups themselves as well as for the Chief Executive.

Clarifying that section 64 directions will not be published

Section 64 is concerned with the entitlement of a participant to receive units in respect of removal activities. Under section 64(3), the Minister of Finance directs the Registrar on how many units to transfer to a particular participant's holding account.

As presently drafted, the Act is ambiguous as to whether directions made under section 64 should be published on the Registrar's internet site. It is recommended that the Act be amended to clarify the position. On balance, officials recommend that directions made under section 64 should not be published.

Although principles of transparency would suggest that directions should be published, officials consider that concerns about commercial sensitivity support non-publication of section 64(3) directions. Stakeholders raised concerns regarding commercial sensitivity of emissions and removals information when the NZ ETS was being established. These concerns are reflected in a number of provisions of the Act which protect against disclosure of potentially commercially sensitive information regarding emissions and removals activity (see section 89(3)). Similarly, while the Act requires information to be available regarding individual holdings of Kyoto units, information regarding holdings of NZUs is only required to be made available in aggregate (see section 27(2) and (3)).

Requiring record keeping by primary participant following opt-in

Section 212 of the Act provides that a mandatory participant who mines coal or natural gas (a primary participant) is not required to comply with the requirements of section 62 or file an emissions return in respect of coal or gas that is purchased by an opt-in participant. Section 62 requires a participant to maintain records relevant to emissions and removals associated with the relevant activity (in this case mining coal or natural gas), and calculate the emissions and removals from the relevant activity. An emissions return reports on those emissions and contains an assessment of liability to surrender units.

A primary participant should not be required to surrender units in respect of coal or gas that is purchased by an opt-in participant. However, officials consider it important that the primary participant be required to report on and keep relevant records regarding all coal or gas produced. In the absence of such an obligation, it will be very difficult to reconcile data provided by primary and opt-in participants. There is a real risk that gaps will emerge that cannot be verified and compliance cannot be enforced.

Under the Act as currently drafted, it is not entirely clear whether a primary participant can be required to keep records regarding the coal or gas that is produced and on-sold to opt-in participants. Accordingly it is proposed that the Act be amended to clarify that record keeping and reporting obligations do apply in respect of all gas and coal mined, including that purchased by opt-in participants.

A similar issue arises under section 201 in respect of the liquid fossil fuels sector. Accordingly, it is proposed that a similar amendment be made to section 201.

Streamline the process for updating the schedules to the CCRA to reflect amendments to the KP and the UNFCCC that are in force for New Zealand

The UNFCCC and Kyoto Protocol are included in the Act as Schedules I and II.

It would be desirable to have a streamlined procedure (for example through Order in Council) for updating the Schedules of the Act to reflect changes in the international instruments that are already in force in New Zealand.

For example, the annexes to the UNFCCC set out the developed country Parties with specific obligations under the UNFCCC (Annex I), some of which have additional financial obligations (Annex II). The binding emissions reduction commitments for Annex I Parties are reflected in Annex B to the Kyoto Protocol. As new parties join these Annexes, this will need to be reflected in the Schedules to the Act.

Providing for authorised representatives in respect of joint activities

Under the Act, landowners who are joint participants may be recorded on the register of participants in the manner prescribed in regulations. From an ease-of-implementation perspective it is preferable to require one of the joint participants to be appointed when there are more than 25 joint participants. This person will be an authorised representative and will be entered on the Register of Participants ("on behalf of" all joint owners). This will mean the Chief Executive can deal with that person in relation to all matters relating to the participation of those persons in the NZ ETS.

Inserting and applying a definition of "Crown holding account"

It would be desirable for the Act to distinguish between (i) holding accounts held by the Crown and controlled by the Minister of Finance ("Administrative Accounts") and (ii) accounts held by Ministers (e.g. Minister of Conservation) as participants in the NZ ETS ("Participant Accounts").

Administrative Accounts are held by the Crown for:

- (a) Kyoto compliance; and
- (b) administrative aspects of the ETS (i.e., surrender accounts, conversion accounts, holding accounts for pools of NZUs, etc).

Inserting a definition distinguishing Administrative Accounts from Participant Accounts is desirable because a number of sections in the Act refer to Crown Accounts. These sections contemplate Administrative Accounts, but do not contemplate, and should not apply to, Participant Accounts.

Clarifying when forest land is treated as being deforested before 1 January 2008

The current wording in the Act results in an interpretation contrary to the previously announced policy intent of treating as deforested on 31 December 2007 any area which meets solely the conditions in s4(5)(a) and (b), namely where:

- (a) no standing exotic forest species (dead or alive), other than a strip of standing exotic forest species that had, or was likely at maturity to have, tree crown cover of an average width of less than 30 metres; and
- (b) no other merchantable timber from exotic forest species.

The Act adds in an additional test by requiring that where land-use change has not commenced prior to 31 December 2007, an area that is cleared and meets section 4(5) of the Act should not be regarded as deforested unless independent evidence exists that deforestation had commenced prior to 31 December 2007. This interpretation is proving difficult for Participants to prove and MAF to verify.

To minimise confusion and provide clarity for participants it is recommended the Act be amended to clarify that deforestation is deemed to have occurred before 1 January 2008 if on 31 December 2007 the land had:

- (a) No standing exotic forest species (dead or alive), other than a strip of standing exotic forest species that had, or were likely to have, tree crown cover of an average width of less than 30 metres; and
- (b) No other merchantable timber from exotic forest species; and
- (c) Conversion to land that is not forest land is complete within four years of the date of clearing.

Advice from the national Kyoto inventory agency is that New Zealand will not incur any cost under Kyoto from this amendment.

Amendment to the definition of forest land

The current interpretation of the definition of forest land under the Act unnecessarily disadvantages participants compared with interpretation under the Kyoto Protocol, and is also more difficult to implement operationally than the Kyoto definition. This is because the existing definition of forest land is satisfied by relatively small numbers of juvenile trees being forest species. That is, it does not take many trees to meet the crown cover threshold test at maturity and therefore become forest land.

It is proposed to amend the definition of forest land in the Act to remove problematic and unnecessary differences with the international rules.

Joint venture participants in the natural gas sector and coal sector

Under the current provisions of Act, persons who carry out activities jointly are together treated as being the participant for the purposes of the NZ ETS. The joint participants are required to report jointly on their emissions, and have joint and several liability for the participant's obligations under the NZ ETS.

The oil and gas sector has advised that requiring joint venture partners carrying out the activity of mining natural gas to be joint participants under the NZ ETS would create a number of problems. The sector argues that the current rules would:

- a. result in confidential information being disclosed to the other joint venture partners;
- b. require a level of cooperation that joint venture partners in this industry do not usually undertake (because joint venture partners would have to manage their liabilities jointly under the NZ ETS); and
- c. give rise to difficulties around opt-in by downstream purchasers (as joint venture parties often separately market their respective offtake).

It is proposed to amend the Act to address these concerns. There remain strong policy reasons for retaining the joint participant requirements in respect of other activities. However these policy reasons do not apply to the same extent to persons mining natural gas through the vehicle of an unincorporated joint venture. Notably, the number of participants is likely to be manageable and there will be ways to ensure that all emissions are accounted for.

It is therefore recommended that the Act be amended to provide that where more than one person is named on a permit relating to mining natural gas, each of the permit holders is to be treated as the person carrying out the activity of mining natural gas and must comply with the obligations of a participant under the Act. Following this amendment, joint venture participants would no longer be required to be joint participants under the NZ ETS, although related companies appearing on the same permit would still have the option to do so.

If the Act is amended as proposed (to provide for individual permit holders to be the participant under the NZ ETS) a number of consequential changes will also be required. These consequential amendments include providing sufficient flexibility regarding joint reporting for related companies carrying out the activity of mining natural gas, as well as ensuring that opt-in provisions work effectively where gas is purchased from a member of the group which is not in fact the participant, such as a parent company of the company carrying out the mining activity.

The coal sector has not made representations on these issues. However, officials have advised that it would be appropriate to extend the proposed amendments to include the coal sector. The problems identified by the natural gas sector are likely to be applicable, at least to some extent, to participants in the coal sector – although the problems are likely to be less widespread because joint ventures are a much less common arrangement in the coal sector. As in the natural gas sector, the proposed amendments would not result in a large increase in participant numbers (at present, the increase in participant numbers in the coal sector would be negligible) and there will be ways to ensure that all emissions are accounted for.

Emissions rulings

The Act contains provisions under which persons can apply for rulings from the Chief Executive on a number of matters. Rulings can cover whether something a person is doing is an activity listed in Schedule 3 or 4 of the Act, and whether the person is a participant in respect of an activity listed in Schedule 3 or 4 of the Act. Rulings can also cover the correct application of certain regulations made under the Act.

As presently drafted, the Act is not entirely clear regarding the scope of the rulings that can be obtained. In particular, the Act can be interpreted to mean that a ruling could be obtained in respect of technical questions prior to a person's compliance with the Act. This would be an inappropriate use of the rulings process as it would effectively be a request to verify information prior to compliance. Further, it would be time consuming and technically challenging for the Chief Executive to provide such a ruling.

Accordingly, it is proposed that the Act be amended to clarify the scope of the binding rulings regime. In particular, it is proposed that the Act be amended to specify that the Chief Executive will not make an emissions ruling where doing so would require the Chief Executive to determine questions of fact contained in the information supplied by the person requesting the ruling.

Streamlining access to consolidated groups

The Act makes provision for participants who are members of the same group of companies to form a “consolidated group”. Formation of a consolidated group allows members to submit a single emissions return, operate a joint holding account, and jointly meet their surrender liabilities under the Act. It is expected that the consolidated group provisions will simplify compliance for groups of companies with a large number of subsidiaries carrying out activities under the NZ ETS.

As presently drafted, the rules regarding formation of consolidated groups are reasonably restrictive. To some degree, this is necessary in order to ensure administrative efficiency. However, there are some areas where the rules could be relaxed or amended to make it easier to form or become part of a consolidated group. It would also be possible to reduce the time delays that currently apply to the formation or joining of a consolidated group in certain circumstances.

It is proposed to amend the Act to streamline the consolidated group provisions to facilitate use of these provisions whilst maintaining administrative efficiency.

Post 1989 forestry – wilding pines

Under current provisions, the Act requires applicants who register as a participant in respect of post-1989 forest land to declare that any action taken by the applicant after 1 January 2008 in relation to that land (including, but not limited to, removal of any existing vegetation prior to planting of the forest species on the land) complied with the provisions of the Resource Management Act 1991, including any plan under that Act, and the Forests Act 1949, as in force at the time that the action was taken. It is proposed that the Act also require applicants to declare their compliance with a pest management strategy under the Biosecurity Act 1993 in the same way that the Act currently reinforces the need to comply with Resource Management Act and Forestry Act requirements.

The basis for this proposal is that district plans under the Resource Management Act 1991 do not generally require the natural spread of wilding trees to be controlled, whereas the Biosecurity Act does require these controls. The proposed change does not introduce additional compliance issues, but reinforces the need to comply with pest management strategies.

Pre-1990 Tree Weed Exemption

Deforestation liabilities that accrue under the pre-1990 tree weed exemption will be funded from the 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. Amendments are required to ensure the exemption’s effective operation and relate to:

- extending the time limits on the tree weed exemption so that the current requirement to complete deforestation within 24 months is extended to within the first commitment period; and

- enabling the Chief Executive to maintain control over the level of liabilities under this exemption by limiting tree weed exemption approvals per commitment period within a fixed budget.

Carbon Accounting Areas

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. Currently, a Participant can only define a CAA when they first register the forest land into the ETS. Early implementation experience is that some aspects of the provisions relating to CAAs are overly cumbersome, likely to lead to unnecessarily high transaction costs, and could create unintended liabilities for participants. Amendments are therefore proposed to:

- 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;
- clarify that the Chief Executive must keep an up-to-date record of the net balance of units in relation to a CAA including one that is redefined; and
- make the process of transfers and carbon accounting more transparent and simpler for both a vendor and purchaser. Specifically, the area of land transferred must be an entire CAA, and the transferor will submit an emissions return that accounts for emissions or removals from the date of the last return to the date of transfer. This will be submitted within 20 working days of transfer and surrender any units in accordance with the Act.

Clarifying the inclusion and exclusion of activities

Amendments are proposed to clarify that certain activities are or are not covered by the NZ ETS. These amendments are necessary to create certainty for participants and for departments administering the NZ ETS.

Clarifying the inclusion of emissions from biofuels combusted for electricity generation or industrial heat

The Act is currently ambiguous regarding coverage of emissions from combustion of biofuels. It is unclear whether or not these emissions are covered by Schedule 3, Part 3, which includes emissions from the combustion of "...waste for the purpose of generating electricity or industrial heat".

It is proposed that the Act be amended to clarify that emissions from biofuels combusted for electricity generation or industrial heat are covered by the Act.

Including egg producers and live animal exporters in the scheme

Subpart 3 of Part 5 of Schedule 3 currently does not include egg producers because chickens are not commercially slaughtered and so the

emissions will not be captured by the agricultural processor participants. Subpart 3 of Part 5 of Schedule 3 also does not include the emissions from animals that are then exported as live animals. The policy aims to cover poultry emissions comprehensively but egg producers were inadvertently excluded. Although this does not have large fiscal implications (~\$0.5 million at \$25/tonne), it would be highly inequitable for poultry meat producers.

Excluding the export of live animals may create an incentive to slaughter animals off-shore in countries not facing a price on carbon. An amendment is required to close this loophole.

Removing "Producing cable using a nitrogen cure process" as a mandatory activity

Independent expert advice has been obtained on the industrial process of "producing cable using a nitrogen cure process". This advice states that nitrogen used in the production of cable does not, of itself, generate greenhouse gas emissions.

New Zealand does not report any emissions from this source in the national GHG inventory. Officials made inquiries internationally last year and did not find any other developed parties (to the Kyoto Protocol) explicitly reporting emissions from this source in their inventories.

Consequently the activity of producing cable using a nitrogen cure process should be removed from the scope of the Act.

Nitrogen fertilisers

Currently, the activity description attributes a nitrous oxide emission to all imported and manufactured nitrogen fertilisers. However, fertiliser imported or manufactured for industrial purposes would not have an agricultural nitrous oxide emission and should not be included. Clarifying that the use of fertiliser in manufacturing and industrial processes is not subject to obligations under the Act would resolve this.

Fiscal impacts

Given the administrative nature of the amendments, none of the changes have significant fiscal impacts, although the changes do eliminate some small fiscal risks.

The table below identifies the changes that do have a fiscal impact and sets out an assessment of the fiscal implications of those changes:

	Risk of fiscal cost eliminated before 31 December 2012	Risk of fiscal cost eliminated from 1 January 2013
	(\$m)	(\$m)
Inclusion of emissions	Eliminates risk of lost revenue of approx \$0.75m	Eliminates risk of lost revenue of approx \$0.75m

from biofuel combustion	p.a.	p.a
Inclusion of egg producers	n/a	Eliminates risk of lost revenue of \$0.5m p.a.
Ability to charge fees for emissions rulings	Eliminates risk of administrative costs in the region of \$0.5m - \$1m p.a.*	Eliminates risk of administrative costs in the region of \$0.5m - \$1m p.a.*
Total Risk of Fiscal Cost eliminated	\$1.25m – \$1.75m p.a.	\$1.75m - \$2.15m p.a.

* It is very difficult to estimate the annual cost of administering the emissions rulings regime because rulings applications are demand driven so that it is difficult to estimate the volume, scope, and complexity of the rulings applications that would be received. Accordingly the figures provided are an indicative range only.

Implications for the wider economy

The proposed amendments to the NZ ETS will increase certainty for participants and administrators and enable more effective implementation of the NZ ETS. This will enhance the credibility of the NZ ETS which will have benefits to the wider economy. No negative implications for the wider economy have been identified.

Risk assessment

No significant risks have been identified in respect of this proposal. Conversely, the proposal is expected to reduce risks in respect of implementing the NZ ETS.

IMPLEMENTATION AND REVIEW

A Bill making substantive amendments to the NZ ETS is expected to be introduced into the House in late September, and is due to be passed in December 2009. The amendments proposed in this statement will be included as part of that Bill.

It will be important to inform the relevant sectors regarding clarification of inclusions and exclusions from the NZ ETS. Plans are in place to contact relevant parties once policy is clarified. As regards administrative processes, changes and clarifications will be communicated as part of the ongoing process of implementing the NZ ETS.

Agencies responsible for administering the NZ ETS will continue to monitor the effectiveness of the administrative provisions in the governing legislation and make further recommendations for amendment if required. The effectiveness of administrative provisions may also be reviewed in the context of the scheduled reviews of the operation and effectiveness of the NZ ETS, as

required by section 160 of the Act. The first review is to be completed by the end of 2011.

CONSULTATION

The Ministry for Agriculture and Forestry and the Ministry of Economic Development have important roles in implementing the NZ ETS and a large number of the proposed amendments to the governing legislation are recommended changes initiated by these agencies. The Ministry for the Environment has worked with these agencies to develop the proposed amendments, which are agreed on by all agencies involved. The following further government departments have been consulted on the proposals and have not raised any concerns: the Treasury, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Department of Prime Minister and Cabinet and Te Puni Kokiri.

The proposed amendments are largely administrative in nature. Accordingly, there has been no formal stakeholder consultation. However, some of the proposed clarificatory amendments result from questions raised by stakeholders in the course of consultation on specific aspects of the NZ ETS. In particular, a number of amendments arise from consultation with the stationary energy and industrial processes sector on draft regulations relating to that sector (for example the amendment to remove the activity of producing cable using a nitrogen cure process and the amendment to clarify the treatment of emissions from the combustion of biofuels).