Climate Change (Emissions Trading and Renewable Preference) Bill

Government Bill

As reported from the Finance and Expenditure Committee

Commentary

Recommendation

The Finance and Expenditure Committee has examined the Climate Change (Emissions Trading and Renewable Preference) Bill and recommends by majority that it be passed with the amendments shown.

Introduction

The bill seeks to amend the Climate Change Response Act 2002 to introduce a greenhouse gas Emissions Trading Scheme in New Zealand (the NZ ETS). The bill also proposes the amendment of the Electricity Act 1992 to create a preference for renewable electricity generation by implementing a restriction on new fossil-fuelled thermal electricity generation, except to the extent necessary to ensure the security of New Zealand's electricity supply.

Over time the NZ ETS will cover all gases and all sectors, in order to minimise overall costs to the economy and in the interests of ef-

ficiency and equity. The scheme will apply an economy-wide price signal to activities that contribute to climate change.

By the closing date of 29 February 2008 the bill had attracted 259 submissions representing a wide range of the sectors and interests that will be affected by the introduction of emissions trading in New Zealand and by the restriction on new fossil-fuelled generation. We heard from 161 of these submitters during 58 hours of hearings in Auckland, Wellington, and Christchurch in April and May 2008. Although most of the submitters supported the introduction of an emissions trading scheme, they raised substantive issues which we considered at length during the hearings phase, in addition to the regular post-hearing consideration, which took almost 16 hours.

During the hearing of submissions, we were informed of two significant policy decisions taken by the Government: to defer the introduction of transport fuels into the scheme for two years; and to defer starting the phasing-out of free allocations of New Zealand carbon credit units (NZUs) to eligible trade-exposed firms by five years. We provided an interim report to the House in May 2008, indicating our intention of discussing these issues publicly together with options for the introduction of synthetic greenhouse gases into the scheme. We considered these policy changes alongside the bill.

This commentary covers the major amendments we recommend to the bill. It does not cover minor or technical amendments. The views of the New Zealand National Party and the Green Party are summarised in their minority views.

Staged entry into the NZ ETS

Clause 4 of the bill inserts new section 2A, which concerns the application of the various Parts of new Schedules 3 and 4 to the Climate Change Response Act. The bill provides that by 1 January 2013 the NZ ETS will cover all listed sectors, so that all major sectors of the New Zealand economy will be exposed to the international price of emissions, at the margin, for all operations.

We recommend amendments to clause 4 to avoid causing uncertainty to those sectors entering the NZ ETS now, and to those sectors that will enter subsequently. These amendments would

- bring liquid fossil fuels fully into the NZ ETS from 1 January 2011, with voluntary reporting from 2009 and mandatory reporting from 2010
- bring imported hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs) into the NZ ETS from 1 January 2013 instead of 1 January 2010, with voluntary reporting from 2011, and mandatory reporting from 2012
- provide for voluntary reporting in the agriculture and waste sectors from 2011, and require mandatory reporting from 2012
- ensure that allocation plans are developed in advance of the relevant Schedules to the Climate Change Response Act coming into force.

Trading partners

Many submitters suggest that New Zealand should move in line with rather than ahead of its trading partners to address climate change. Growing numbers of emissions trading schemes are being established around the globe. The NZ ETS is taking an all-sectors approach to imposing obligations on emitters. This is consistent with the initial indications as to the design of the Australian scheme. Developing countries do not have quantified emission reduction targets for the first commitment period, but contribute to climate change mitigation in other ways, consistent with the principle of "common but differentiated responsibilities" applied under the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol. How this principle will shape the international emissions trading architecture is a key part of the current negotiations.

We understand that by progressively placing a direct obligation on all sectors, the NZ ETS would mirror the obligations placed on Annex I Parties to the Kyoto Protocol. Countries that choose not to include some sectors in their trading schemes must still bear the cost of those emissions in other ways. They may devolve the costs to taxpayers if the emissions price signal does not influence the behaviour of emitters, or rely on policies, regulations, or other price measures such as

higher fuel taxes. For example, the European Union Member States place high taxes on transport fuels. The European Commission has also created incentives for reducing emissions from transport fuels by improving the efficiency of vehicles and setting renewable energy targets.

While the proposed NZ ETS has broader sectoral coverage than other domestic trading schemes in that it includes the transport, forestry, agriculture, and waste sectors as direct points of obligation, this reflects New Zealand's unique emissions profile. We believe that the NZ ETS would promote equity and cost-efficiency in managing emissions.

Sector entry dates

Sectors' entry into the NZ ETS would ideally coincide with that of forestry, and be set at the earliest practicable date. However, in recognition of the complexity of choosing points of obligation, calculating emissions, and designing assistance to the industrial and agricultural sectors (allocation), we agreed that some sectors should be given more time to prepare for entry.

We believe that the proposed staging of entry into the NZ ETS would balance the readiness of sectors to monitor, report, and verify their emissions against a desire to manage overall administrative and price effects in the economy.

Forestry

The bill provides for forestry to enter the NZ ETS from 1 January 2008. We do not propose any change to this date of entry. We understand that this date was based on an assessment of the readiness and capability of the sector to enter the ETS, and a recognition of the importance of forestry entering as soon as possible. We were advised that a delay of just one year could result in an additional 12 to 24 million tonnes of emissions from deforestation.

Liquid fossil fuel

The liquid fossil fuel sector was to enter the NZ ETS on 1 January 2009. However, we recommend an entry date of 1 January 2011. The world's economic climate is somewhat uncertain at the moment, and the economy also faces domestic challenges, one of these being the

inflation rate. We therefore support the entry of liquid fossil fuels into the NZ ETS being delayed by two years to reduce inflation pressures and to help lower inflation expectations.

Given the recommended delayed entry of the liquid fossil fuels sector and the proposal for a voluntary and mandatory reporting regime to apply to later entrants to the NZ ETS, we recommend that the liquid fossil fuels sector be subject to voluntary registration and reporting in 2009 and mandatory registration and reporting in 2010, with no obligations to surrender NZUs in either year. The Green Party opposes the delayed entry of liquid fossil fuels into the ETS.

Industrial processes and stationary energy

We believe it is important that the stationary energy and industrial process sectors enter the NZ ETS simultaneously, because of their interdependence and the need to develop a comprehensive assistance package. In our view, a 2010 date of entry remains appropriate, with an exception for the treatment of imported HFCs and PFCs. We note the wish of some submitters to delay the inclusion of HFCs in the scheme until at least 2013, to allow more time for the development of non-greenhouse gas alternatives, and of programmes for the collection and destruction of HFCs. We agree that it would be useful to delay the inclusion of HFCs and PFCs until 2013 for these reasons and because of the complexity created by the number of participants in the HFCs sector. This would allow time for firms to develop their capacity to participate in the NZ ETS.

The bill as introduced was silent on whether the obligation on imported HFCs and PFCs applied only to bulk imports of the gas or included imports of the gas contained in equipment. We recommend the activity description of "importing hydrofluorocarbons" (or perfluorocarbons) be amended to include both bulk imports of the gases themselves and imports of products containing these gases (Part 4 of Schedule 3).

Agriculture

We considered thoroughly the timing of the entry of the agriculture sector (non-CO_2 emissions) into the NZ ETS and support the later inclusion of this sector.

There are valid arguments both for and against the earlier inclusion of the sector. The most compelling argument for earlier inclusion is the fact that emissions from this sector represent nearly half of New Zealand's total greenhouse gas emissions, and the total quantity of emissions continues to grow. Earlier inclusion would ensure that participants took the full cost of emissions into account during the first commitment period.

However, from a practical perspective, earlier inclusion of the agriculture sector would be challenging. The operational details of monitoring, reporting, and verifying emissions, and an approach to allocating NZUs, will take some time to develop, and there would be risks in accelerating the timetable, particularly if a farm-level point of obligation is brought into effect. An alternative to the full inclusion of the agriculture sector earlier than 2013 would be to require emissions reporting in the meantime.

We recommend therefore a staged approach to reporting, with voluntary reporting beginning in 2011, followed by full mandatory reporting in 2012. We consider that early mandatory reporting of agriculture emissions would

- allow the reporting system to be trialled in the absence of unit obligations
- encourage farmers to be prepared to respond to the price of carbon and participate in the NZ ETS by 2013
- promote transparency and liquidity in the carbon trading market before the sector began receiving and surrendering NZUs
- incentivise preparation for and voluntary action towards reducing emissions before 2013.

The Green Party opposes the late entry of agriculture into the ETS.

Waste

We consider the current date set for the waste sector's entry into the NZ ETS to be appropriate. The Local Government and Environment Committee has reported to the House on the Waste Minimisation (Solids) Bill and recommends that the bill proceed. Enactment of this bill would reduce emissions from municipal landfills by pricing waste by imposing a levy to fund minimisation and diversion activities and infrastructure. We understand that although the rate of the levy does not attempt to reflect environmental externalities, it is still

in effect a price measure that would result in lower emissions. Furthermore, the 2004 National Environmental Standard on air quality is in effect an existing regulatory control on landfill greenhouse gas emissions, because it requires operating landfills to collect and destroy methane.

Obligations on the waste sector under the NZ ETS through the Climate Change Response Act are proposed from 1 January 2013. Under the Waste Minimisation (Solids) Bill, as reported to the House, the effectiveness of the levy must be reviewed not later than 2011, and then at intervals of not more than three years. These reviews could result in changes to the rate of the levy.

Importation of sulphur hexafluoride

Importation of sulphur hexafluoride (SF_6) is currently included in Schedule 3 Part 4 of the Climate Change Response Act and will enter the NZ ETS from 1 January 2013. Sulphur hexafluoride is a potent greenhouse gas with a global warming potential of 23,900 times that of an equivalent weight of CO_2. It is used in electrical switching equipment and accounted for approximately 13,000 tonnes of CO_2-equivalent emissions in 2005. Most users of sulphur hexafluoride have memoranda of understanding with the Government, valid until 31 December 2012, under which they agree to adopt best practice in managing it.

We believe it would be desirable to extend the early reporting requirements proposed for agriculture, waste, HFCs and PFCs to importing SF_6, to prepare the sector to participate in the NZ ETS from 1 January 2013. In line with the early reporting provisions proposed for HFCs and PFCs, we recommend that importers of SF_6 be able to voluntarily register and report under the NZ ETS from 1 January 2011, with registration becoming mandatory from 1 January 2012. Obligations to surrender NZUs would not arise in respect of imports of SF_6 prior to 1 January 2013.

The bill as introduced was silent on whether the obligation would apply only to bulk imports of the gas, or include gas contained in imported equipment. We recommend therefore that the activity description of "importing sulphur hexafluoride" be amended to explicitly include both bulk imports of and imported products containing SF_6.

Purpose

We recommend an amendment to clause 5 of the bill to

- make it clear that the purpose of the bill in relation to the NZ ETS is independent of New Zealand's international obligations
- state the purpose of the NZ ETS.

Virtually all the features of the NZ ETS relate to New Zealand's obligations under the UNFCCC and the Kyoto Protocol. However, the NZ ETS is intended to continue in force even if there is no second commitment period under the Kyoto Protocol and no new international agreement for emissions trading in its place. We consider that the purpose clause should reflect the intention that the NZ ETS signal New Zealand's commitment to reducing its carbon emissions irrespective of its international obligations.

We consider that the purpose of the NZ ETS should be expressed explicitly in the bill by stating that it supports and encourages global efforts to reduce greenhouse gas emissions by assisting New Zealand to meet its obligations under the Convention and the Protocol, and by reducing New Zealand's net emissions below business-as-usual levels. This specifies that the NZ ETS should reduce New Zealand's net emissions below business-as-usual levels, and the way in which it is designed to assist New Zealand's contributions to global effort to reduce emissions.

Interpretation

We recommend three significant amendments and a number of minor amendments to the definitions in clause 6, which amends section 4 of the Climate Change Response Act.

Definitions relating to forestry

We recommend a new definition of "clear" to cover the various scenarios for the removal of trees, for clarity, and to define more precisely the intended scope of the forestry provisions in the Climate Change Response Act.

We note that the deforestation assumptions in sections 4(4) and 164(1) of the Act refer to harvesting and felling, and as regards felling rely on a calculation of the time between harvesting and

felling. We are concerned at the inconsistent use of the terms "harvesting" and "felling" in the bill, and consider that this wording may be too narrow to cover all the possible scenarios in which trees might be killed or removed during the deforestation process.

We recommend amending the definition of "forest land" for simplicity and for the sake of clarity. The key changes we recommend would define forest land as an area of land of at least 1 hectare that has, or is likely to have when the forest species reach maturity, tree crown cover from forest species of more than 30 percent in each hectare; and the definition would include an area of land that temporarily does not meet the definition but is likely to revert to a state meeting the definition.

We heard arguments that the current definition of "forest" will create issues for farmers with regenerating scrub on their farms. There are two distinct concerns, both stemming from the extent to which the Kyoto definition of "forest" affects the treatment of scrub (manuka and kanuka) with a history of being cleared and grazed. One concern is whether farmers could continue to intermittently clear regenerating scrub to retain pasture without incurring pre-1990 forest deforestation liability. The other concern is whether all regenerating scrub on grazing land should be excluded from the definition of forest so that it could all qualify to enter the ETS as "post-1989 forest land" and thus be able to earn carbon credits.

We consider that the first concern is addressed by the exclusion of the deforestation of pre-1990 indigenous forests from the NZ ETS. This would allow the regular clearance of scrub back to pasture, provided that this was a permitted activity or received resource consent under local planning rules.

We consider that the second issue is more complex. Under the NZ ETS, credits are provided only where they are matched by corresponding Kyoto Protocol units. Following this principle, such areas should not be able to enter the ETS, since the taxpayer would have to pay for the NZUs. However, we recognise that there are clear benefits to New Zealand and the environment generally in allowing such regenerating scrub into the NZ ETS as post-1989 forest land. The "on-the-ground" assessment of whether or not land qualifies as post-1989 forest land would also recognise that the eligibility of land for the NZ ETS needs to stand up to international scrutiny.

We recommend amending the definition of "pre-1990 forest land" to provide that land ceases to qualify as such once it has been deforested and any liability to surrender units for that deforestation has been met. We also consider that an amendment is needed to make it clear that the predominant species should be considered in designating land for this purpose.

We also considered a number of arguments from groups representing Māori interests who sought the inclusion of pre-1990 indigenous forests in the NZ ETS to encourage the retention and regeneration of indigenous forests.

We consider that there are arguments both for and against the inclusion of indigenous pre-1990 forest in the NZ ETS. The key argument for including it is to avoid the risk of increasing deforestation in response to changing economic drivers or to the possibility of the Government increasing deforestation controls on indigenous forest. There is also a risk that excluding indigenous forest from the NZ ETS could weaken New Zealand's position when it called for effective international action on controls over the deforestation of indigenous forest in other countries.

However, we understand that indigenous deforestation rates are currently very low, and the existing deforestation controls will help to prevent them from increasing significantly. We consider it impractical at present to include regenerating indigenous scrub forest in the deforestation activity as it is technically difficult to differentiate in practice between pre-1990 and post-1989 scrub.

We therefore recommend minor changes only to the definition of pre-1990 forest land.

Minister may direct Registrar

We recommend amendments to clause 7 of the bill to place limits on the Minister of Finance's power to give a direction to transfer units from an account held by an account holder, other than the Crown, to a Crown account in the Registry.

As introduced the bill provides that the Minister would require the written consent of the account holder or would have to give the account holder reasonable notice. Such transfers will be necessary for New Zealand to comply with its obligations under the Kyoto Proto-

col; or they may occur because of failure to comply with Part 2 of the bill or any regulations made in accordance with section 30G.

Some submitters were concerned that the Minister's proposed power to transfer units from individual accounts to Crown accounts provided insufficient protection for account holders. We agree that the clause as introduced does not protect account holders sufficiently. We therefore support an amendment to clause 7 to place additional limits on the exercise of the Minister's power.

We also recommend a number of minor changes to clauses 7, 8, 10, 11, 14 and 16, which concern the operation of Registry functions.

Unit of trade

We recommend amendments to clauses 17 and 18 (inserting new sections 18CB and 19) and adding new section 30G to the Climate Change Response Act (via clause 28 of the bill) in order to

- apply safeguards to the inclusion of imported Assigned Amount Units (AAUs) by prohibiting the surrender of imported AAUs issued during the first commitment period for compliance with NZ ETS obligations that accrue after the first commitment period
- provide more protection of commercial information about participants, by tightening up the provisions on access to individual accounts and requiring consultation on regulations made under sections 30G(1)(b)(i), (c), (d) and (k) (clauses 25, 27 and 28 inserting new section 30G).

We do not recommend extending this prohibition to other Kyoto units (New Zealand AAUs, Certified Emission Reductions (CERs), Emission Reductions Units (ERUs), and Removal Units (RMUs)).

Eligibility of units

We considered a wide range of arguments about the exclusion or inclusion of international units in the NZ ETS, particularly AAUs. We consider that a balance needs to be struck between ensuring that participants in the NZ ETS have access to as large a pool of Kyoto-compliant units as possible to ensure that compliance costs are kept to a minimum on the one hand, and ensuring that New Zealand does not preclude future linking opportunities on the other. Striking the right balance is difficult given uncertainties about the market for AAUs in

particular, and the emerging design of emission trading schemes in other countries.

The inclusion of imported AAUs in the NZ ETS could be an obstacle in the future to linking the NZ ETS to other trading schemes that prohibit such units. To facilitate linking we consider that NZ ETS participants should be prohibited from surrendering AAUs imported during the first commitment period of the Kyoto Protocol, 2008–2012 (CP1), to meet obligations that accrue after the first commitment period. The same prohibition should also apply to the Crown's retirement of imported AAUs to meet its international obligations that accrue after CP1. This provision would not block the holding in the Registry of imported AAUs issued during CP1 post 2012, but would block their surrender or retirement against NZ ETS obligations that accrued after 2012.

We consider that the recommended amendment would facilitate linking with other domestic schemes post 2012, which would allow broad trading of AAUs.

Information accessible by search

Under the Kyoto Protocol, the Registry must provide public access to non-confidential information, including the name and holdings of each account holder in the Registry. In the bill as introduced, clause 25 provides that information on individual and business account holdings may be publicly accessible by Internet search.

We recommend an amendment to clause 25 to restrict public access to information on individual and business account holdings within the relevant compliance period, allowing it to be accessed in aggregate form only.

We heard arguments that information in private accounts should be accessible only to account holders or their authorised representatives, at least until the end of the surrender period to which the information relates. We agree that there is no compelling public-interest argument for disclosing individual account details that could not be served as well by timely disclosure of aggregate information during the compliance period.

Delaying the availability of individual account information until after the compliance period would ensure no potentially commercially sensitive information would be accessible by third parties in the com-

pliance period to which it relates. However, in the interests of maintaining an informed market, we recommend that this information in aggregate form be accessible by search within the relevant compliance period.

Extent of regulatory powers

Clause 28 of the bill as introduced inserts new section 30G into the principal Act. It proposes to replicate the regulation making power in force under section 50 of the principal Act and extend the powers to cover Kyoto units, NZUs, and approved overseas units.

We recommend an amendment to clause 28 (new section 30G) to require consultation on regulations affecting units and a lead-in time for the coming into force of any regulations affecting the holding of units in the Register.

We heard concerns about the extent and nature of the powers delegated to regulation, and particularly the potential for the Government to intervene in the market through delegated regulatory powers, in ways such as altering the eligibility of units for inclusion and the acceptance criteria. We heard arguments that additional procedural safeguards are necessary if these powers are not to be incorporated in the primary legislation.

We consider that the bill retains appropriate flexibility to make subsequent changes to eligibility criteria, to respond to future decisions on rules and methodologies, to ensure the environmental integrity of the NZ ETS despite an evolving international carbon market and uncertainty about future commitment periods, and to adjust eligibility requirements to maximise linking opportunities with potential trading partners.

However, this flexibility could cause uncertainty for participants as they seek to manage liabilities under the NZ ETS, or to invest in the market in a more speculative way. We accept that it is appropriate to make an explicit requirement in the legislation for consultation on regulations affecting units because of their potential impact on participants and on the market.

We also consider that a lead-in time for any regulations that prescribe what units may be held in the Register is desirable to provide certainty.

Definition and obligations of participant

We recommend an amendment to the definition of participant under clause 43 (new section 54) of the bill, to address instances where one person may be required to be treated as the participant under the Climate Change Response Act while another physically carries out the relevant activity.

The bill generally seeks to place obligations at an appropriate point in the market supply chain, so as to limit the number of participants, facilitate administration of the scheme, and provide appropriate incentives to reduce emissions. In many cases this obligation falls on a party who is not the actual emitter. We considered the argument that the definition of participant should be changed to capture all parties who actually emit carbon into the atmosphere, but do not agree that section 54 requires more than minor amendment for clarity.

We also considered that the scope of section 54 as drafted could be erroneously understood to include "entitlements" as well as obligations. We understand that it was not intended that section 54 should capture entitlements to free allocation of NZUs under allocation plans, as the allocation plans themselves would deal with the allocation implications (if any) of a person ceasing to be a participant. For this reason we recommend an amendment for clarity.

Registration requirements

We recommend amending clause 43 (new sections 56, 57 and 61) to provide for the sequencing of registration, notification, and the requirement in section 61 for participants to have a holding account in the Registry. Re-sequencing the registration procedure in this way is crucial because participants must have a holding account to meet their surrender obligations.

We were also concerned that section 57 as introduced may require the chief executive to register a person who is performing more than one Schedule 4 activity for each activity. We consider this to be unnecessary. We recommend that a person undertaking more than one Schedule 4 activity should be registered only once under this section and that registration may be able to cover more than one activity.

The provisions in sections 58 and 59 for removing participants from the Register do not address the situation where a participant is reg-

istered in respect of several activities, and applies to deregister in respect of only one of those activities, or ceases to do only one of those activities. In such a situation, we recommend that the participant should be deregistered only in respect of that particular activity.

Exemptions

We recommend an amendment to clause 43 (new section 60) to clarify the consultation process regarding proposed exemptions from mandatory participation and to clarify that exemptions could be considered in response to a request by a person, or upon the Minister of Finance's own initiative.

We heard arguments that section 60 gives unduly wide powers to the Minister to grant exemptions. We acknowledge that section 60 potentially has wide application, but consider that this flexibility is necessary to exclude participants where the costs of including them in a scheme (particularly for smaller participants) outweigh the benefits of inclusion. We do not consider that it is possible to exempt every appropriate participant or class of participants in the primary legislation before the implementation of the NZ ETS.

We were concerned, however, that section 60 requires the Minister to satisfy a "two part" subjective test, which may be difficult. We instead recommend that the Minister be required to consult persons who may be substantially affected.

Section 60 is silent on whether a person or class of persons can request an exemption or whether the Minister can initiate an exemption him- or herself. We recommend that both possibilities be provided for in section 60.

Liability to surrender units to cover emissions

Clause 43 (new section 63) of the bill imposes an obligation on participants to surrender one emission unit for each tonne of whole emission from their activities in each year. This represents an absolute obligation (as opposed to an intensity-based obligation).

We heard arguments that an intensity-based approach (as opposed to the current absolute basis) should be used to define participants' core obligation under the NZ ETS. Under one possible intensity-based approach participants would need to surrender NZUs to cover only the portion of their emissions that exceeded the level that a firm operat-

ing at "world's best practice" would have emitted when producing the same output.

We do not recommend the introduction of an intensity-based approach to defining emission obligations because it is inconsistent with the long-term goal of a lower-carbon economy, and has several serious weaknesses. We understand that such approaches are administratively difficult and do not provide an incentive for firms to limit their growth to support an emissions price. Moreover, New Zealand's obligations under the Kyoto Protocol are expressed in absolute terms. We understand that future international emission reduction commitments under the Kyoto Protocol will probably be absolute in nature, and may be more stringent than the first commitment period.

While we acknowledge that some specific investments may be unlikely under the absolute approach of the bill as introduced, we consider that if those investments went ahead they would incur real carbon costs on the economy. The carbon cost of such an investment would probably be covered by increased taxation, and an intensity-based approach would thus not significantly aid adjustment to a lower-carbon economy, although the way in which any new entrant allocation is made could minimise this (which is enabled under the bill). We therefore did not support amendments to clause 43 (new section 63).

Entitlement to receive New Zealand units for removal activities

We recommend an amendment to clause 43 (new section 64) to allow participants undertaking non-forestry removal activities to obtain their entitlements on a quarterly basis, and to provide a timeframe for notification of entitlement to NZUs.

We consider that more certainty is desirable for participants about when they will receive the NZUs to which they are entitled. Specifying more clearly when the NZUs will be transferred would minimise the differences in the times when different participants receive NZUs, which would be important in a market situation where the price of NZUs will change.

Annual emission returns

We recommend that the requirements for submitting annual emission returns in clause 43 (new section 65) be clarified to ensure that par-

ticipants are only required to submit one annual return that covers all their activities. We are concerned that the provisions as introduced would place a heavy burden on participants. We are also advised that default emission factors will be provided in methodology regulations where appropriate to simplify the system for participants.

Allocation of New Zealand units

Clause 43 of the bill inserts a new Part 4 into the Climate Change Response Act. Subpart 2 of Part 4 concerns the allocation of New Zealand units to participants under new sections 67 to 76 of the Act.

Allocation is one of the more complex aspects of an NZ ETS, as allocation decisions must ensure that the burden is shared equitably between taxpayers, consumers, firms, and sectors. Having considered arguments on the proposed amounts and methods of allocation, we recommend several amendments to distribute the cost burden more fairly, and to keep the NZ ETS as administratively simple as possible.

We recommend amendments to clause 43 (Part 2 of new Part 4) of the bill for the following purposes:

- increasing assistance to owners of pre-1990 forests purchased before the stipulated date in late 2002 from 39 NZUs per hectare to an estimated 60 NZUs per hectare and allocating 18 NZUs per hectare to future treaty claimants who receive Crown Forest lands (clause 43, new section 69)
- maintaining the size of the pool for free allocation of units for the agriculture, stationary energy, and industrial sectors up to 90 percent of 2005 levels (including direct emissions and units sufficient to offset cost increases associated with electricity use in the stationary energy and industrial sectors) until 2018, then phasing it out over the 2019–2030 period (clause 43, new sections 70, 71). This matter is dealt with further in the discussions about allocation plans.
- extending the range of "specified emissions" eligible for free allocation in the industrial sector to include those from the combustion of waste oil for stationary energy (new section 70)
- making it clear that allocation to new entrants or growth in emissions by incumbents is permitted (but not required) within the overall capped allocation provided (clause 43, new sections 70, 71).

We also recommend that the parameters of the allocation approach should be included within the bill (clause 43, new section 69).

A revised allocation proposal for pre-1990 exotic forests

The bill does not currently prescribe an approach to distributing units within the 55-million-unit envelope, but sets out a process for this to be done through allocation plans. We understand that the Government had indicated a preference for distributing these 55 million NZUs on a simple pro rata basis, providing each landowner with an allocation of 39 units per hectare. Units allocated in respect of Crown Forest Licence (CFL) land not yet passed to Treaty of Waitangi claimants were to be received by the Government.

We recommend increasing the amount of assistance to two particular groups, because we were concerned that the proposed allocation of NZUs to owners of pre-1990 forests would not adequately assist those facing the greatest costs under the ETS, nor provide sufficient incentives to introduce alternative land uses. The two groups are (1) owners of pre-1990 forests purchased prior to the stipulated date in late 2002 (whose allocation will increase from 39 NZUs to an estimated 60 NZUs per hectare); and (2) any Treaty claimants who receive CFL land under a settlement at any time after 31 December 2007 (whose allocation will increase from zero to 18 NZUs per hectare).

In general, any iwi that settled a Treaty claim involving CFL land before the NZ ETS came into force would receive the same level of free allocation as any other land owner that purchased land at the same time. However, there are two specific instances where Ministers may need to make an explicit decision on the amount that should be allocated. In one case, the land was transferred in November 2002, and may therefore only be eligible to receive 39 units per hectare, despite the fact that the negotiations and land valuation were carried out a number of months earlier. In the other case, the claimant explicitly chose to value the land transferred to them on the basis of the NZ ETS being in place, and agreed to forgo all future claims to compensation in relation to limitations on the use of the land for forestry. We consider that a specific provision in the bill is needed to allow Ministers to stipulate that these two landowners will receive a different number of units from other landowners that bought their land at the same time.

We consider that the key parameters of this allocation approach should be included in the bill to provide more certainty about allocations.

Additional free allocation in the industrial sector

Emissions from the combustion of waste oils for stationary energy are not included among those eligible for free allocation to industrial producers under the bill as introduced. We consider that trade-exposed industrial firms that switched from coal to waste oil for stationary energy production in 2005 would be disadvantaged relative to those that continued to use coal in 2005, which would receive free allocation for those emissions. We consider that trade-exposed firms that use waste oil in place of coal or other fossil fuels for stationary energy should be eligible for free allocation of units.

Phasing-out of free allocation

We understand that a major area of concern for stakeholders in both energy-intensive industry and agriculture is the proposed phasing-out of free allocation. We are also concerned that this phasing-out would erode the competitiveness of New Zealand firms by making them face the price of emissions while many of their international competitors were not covered by controls of a similar stringency. We therefore recommend that the start of the phase-out be delayed for five years. The Green Party strongly opposes the delayed phase-out.

New entrant reserve

We were also concerned that the focus in the NZ ETS on absolute obligations and allocation might stifle economic growth, by encouraging emissions-intensive investment elsewhere. We heard arguments for a pool of NZUs to be set aside for allocation to new entrants (or to cover growth in emissions from incumbents in the market) if they were operating in a carbon-efficient way.

Providing some free allocation to cover growth in emissions (below the cap) would become more relevant if the period for the phase-out of free allocation was extended beyond 2025. This end could be pursued largely within the framework set out in the bill, with minor changes.

Allocation plans

We recommend amendments to the allocation plan processes for trade-exposed industrial firms in clause 43 (new sections 73 and 74), to

- combine the statement of intention and allocation plan processes into a single process that must be undertaken for each sector receiving free allocation (forestry, industry, and agriculture)
- include criteria to guide the Minister of Finance's decisions on allocating free NZUs to the agriculture and industrial sectors
- clarify the meaning of section 69 to ensure that ETS-related electricity price rises are referred to in the bill.

We consider that new sections 73 and 74 are drafted sufficiently broadly so that allocations of free units could be made to a new entrant reserve within the pool of 90 percent of 2005 emissions. Furthermore, adjustments could be made for substantial reductions in firm output if so desired, while flexibility in determining the base year for allocation purposes is also permitted.

Under this approach, a single document, the allocation plan, would set the criteria and methodologies for distributing the free allocation. Although the application of those criteria might result in changes to the total number of NZUs available for allocation, this number would remain capped at 90 percent of 2005 emissions for the industrial and agriculture sectors. The final determination resulting from the application of the allocation plan would be gazetted.

We considered a number of arguments regarding a threshold for eligibility for free allocation in the industrial sector, particularly from small and medium sized enterprises (SMEs). Although nothing is included in the legislation with respect to a threshold (as this is to be determined through the allocation plan process) we understand that a figure of 50,000 tonnes has been mooted.

While we consider that there is a case for using a threshold (or some form of test) to ensure the administrative workability of the free allocation plan, we recommend that no threshold be specified in legislation. However, we would like to record our view that a threshold significantly less than 50,000 tonnes per annum would be appropriate.

We consider that a balance must be struck between maximising certainty for business and investment, and maintaining flexibility to adapt to changes in international arrangements or circumstances. The revised allocation plan process would provide business and investors with certainty over the life of the plan, while allowing adjustments to the precise levels of allocation as circumstances change.

An important objective of the NZ ETS is to encourage the development and application of new technologies, and we consider that providing businesses with certainty as to the method of calculating the free allocation they will receive is a key way of achieving this.

We also consider that specifying the methodology that the Minister will use and the criteria he or she may have regard to in determining allocation plans will increase the transparency of these important decisions.

Section 69 caps the total pool of allocation for industry at 90 NZUs for each 100 tonnes of direct emissions from industrial and stationary energy use by eligible firms in 2005. In addition, the pool would include units sufficient to offset 90 percent of the increased price of electricity and would be based on electricity consumed in 2005. The basis for allocation of that pool relates to increases in the cost of electricity. As introduced, the bill does not make it clear that eligible firms would be compensated for the increase in the cost of electricity, rather than for the level of emissions associated with producing that electricity.

Allocation of New Zealand units by public tender

We recommend that clause 43 (new section 75 as introduced) be deleted. We considered a number of arguments about the process for allocating NZUs by public tender. While most submitters supported this provision, they raised issues about the transparency and commercial terms of the sales process.

Having considered their concerns we remain of the view that there are sufficient legal and political constraints to prevent any abuse of the power to sell NZUs. Moreover, we note that the sale process established in section 75 is not the only way in which the Crown may sell units. Section 6 of the Climate Change Response Act already provides the Minister of Finance with a power to sell or otherwise

dispose of units. However, we consider that section 6 is broad enough to enable the Crown to sell NZUs via the method deemed most appropriate at the time, whether it be tender, auction, or another sale method; and therefore we recommend deleting section 75 (as introduced) from the bill.

Price caps

Price caps are sometimes used in emissions trading schemes to reduce the uncertainty faced by participants, and to a lesser extent downstream consumers, about carbon prices. They effectively act as a safety valve to protect participants against unexpectedly high prices. Providing a price cap might help to increase business confidence in the NZ ETS as well as its public acceptability.

We heard arguments for and against introducing a price-cap mechanism to the ETS. We consider that price caps do not reduce the impact of price volatility on the economy as a whole, as they work by transferring the cost of volatility from scheme participants to taxpayers. We understand that setting the level of a cap would be highly problematic. A low price cap would undermine the effectiveness of the NZ ETS. A high price cap would not have the effect desired by those who favour such a cap.

The disadvantages of a price cap include the difficulty of setting and updating the cap, a less efficient response by the New Zealand economy to emissions pricing, the potential impact on long-term investment decisions, and the need for consequential changes to international linking and banking provisions in the NZ ETS which could disrupt the development of a comprehensive carbon market. Although a price cap could shield net buyers against price increases, it could hurt net sellers who would otherwise benefit from price increases. Also, a price cap, especially a low one, would probably slow the development of the carbon market in New Zealand.

The need for a price cap increases if there are significant restrictions on either the number or the type of units that can be used for compliance purposes under the NZ ETS. The bill as introduced does not place significant barriers on the importing of units into the ETS and we see no reason to alter this. We consider that price caps present a barrier to linking with other schemes.

General administrative provisions—Directions by Minister

We recommend an amendment to clause 43 (new section 78(3)) to provide that directions by the Minister of Finance to the chief executive in relation to functions under clause 43 (new section 77) must also be tabled in Parliament. Requiring directions to be laid before the House of Representatives would be consistent with other similar legislation.

Recognition of verifiers

Clause 43 (new section 81) provides that the chief executive may, in accordance with regulations, recognise a person or organisation to undertake verification functions for the purposes of collecting information and calculation of emissions and removals. The criteria for such recognition would be set by regulation.

As a consequence of a recommended amendment, we will recommend the insertion of a provision into the bill (section 148) for a new process to approve the use of unique emissions factors. We recommend that section 81 be amended to provide for this wider role.

Obligation to maintain confidentiality

We considered arguments that the interests of large corporates may not be sufficiently protected by clause 43 (new section 88(4)). On balance, we are satisfied that 88(4)(b), which allows the release of statistical information in a form that does not identify any individual, provides sufficient protection. However, we consider that section 88 should be amended to clarify that if any enactment required a person to disclose information that would otherwise be confidential under section 88 the disclosure would not be an offence.

We were also concerned that the interface between new sections 88 and 136 (which provides for the sharing of information between those with functions under different parts of the Climate Change Response Act) may not be clear. We consider that new section 88 should not limit the flow of information to the inventory agency or Registry under the Climate Change Response Act, and recommend an amendment to this effect.

Emissions rulings

We recommend amendments to clause 43 (new sections 96 to 105) to give better effect to the intention that emissions rulings should work in a similar way to provisions allowing binding rulings under tax legislation and customs and excise legislation. These amendments include a new provision akin to section 91E of the Tax Administration Act 1994, to empower the chief executive to decline to make rulings under certain conditions.

Emissions returns

We recommend amendments to clause 43 (new section 112) to improve the efficiency of the process for the filing of final emission returns and the surrender of units.

We heard arguments that participants should have a say in which units are reimbursed to them of those they surrendered. We agree, and recommend that a new provision be inserted into clause 43 (new section 112) to explicitly require the chief executive to take into account the views of the participant in relation to the units to be reimbursed.

We also recommend reducing the time limit for emissions returns from seven years to four years for all participants other than post-1989 forestry participants. Under the self-assessment model and since the recognition of discrepancies will rely on risk-based audits, we consider that seven years may be too long except for post-1989 forestry participants, who would be required to file returns only every five years, rather than annually. This would also align with the time limits relating to tax assessments.

Offences and penalties

Criminal offences and penalties

We recommend only minor and technical amendments for clarity to sections 116 to 120. We heard arguments that the penalties were too punitive, especially if they were to apply to reporting errors, and too stringent compared with other legislation. Concerns about penalties being imposed for genuine mistakes recognise that the first few years of the NZ ETS will involve a great deal of learning, and we consider that various measures should help to address these concerns: ongoing work with industry to prepare it for entry into the NZ ETS,

transitional provisions for reporting errors, and the ability to reduce the excess emissions penalty. We therefore do not think any major amendments are called for.

Civil penalties

We recommend amendments to clause 43 (new section 122) to allow the chief executive to reduce the penalty by up to 100 percent. We also recommend amendments to clause 43 (new section 123) so that an additional penalty would also apply when a person had been convicted under section 120 of the Act of failing to comply with intent to deceive, and for clarification.

We heard arguments that the proposed civil penalties were too low, too high, not subject to the same standards of proof as criminal penalties, and should not be applied in cases of genuine mistakes. We consider that minor amendments should address these concerns.

Liability of companies and persons

We recommend amending clause 43 (new section 128) to include a defence to a charge if the principal proves that he or she took all reasonable steps to prevent the commission of the offence or the commission of offences of that kind, and to make other minor technical or consequential changes.

We also recommend that the reference to a group of persons be removed so that the proposed defence could apply to each member of a group individually.

Transitional provisions for penalties

Participants would not be subject to the excess emissions penalty for any shortfall in the number of units they were supposed to surrender if the shortfall were caused by reporting errors in the first year.

We recommend an amendment to clause 43 (new section 178) to clarify the circumstances in which this clause would apply and the requirement to make good. We also recommend an explicit provision that it is not an offence to fail to collect data for the deforestation of pre-1990 forest land participants from 1 January 2008 until the regulations come into force.

Voluntary reporting is being recommended for later-entrant sectors before they enter the NZ ETS fully, so that they can undertake a trial run with no penalties or obligations. Mandatory registration and reporting have been recommended for sectors that enter in 2011 (liquid fossil fuels) and in 2013 (agriculture and waste and synthetic gases). Mandatory reporting would mean that participants were subject to penalties for failure to report but would not have to surrender units for their emission obligations. Given the timetable for entry into the NZ ETS mandatory reporting could not be introduced for any sectors that enter earlier than 2011 without moving their obligation to surrender units back by a year.

Miscellaneous provisions—Joint activities

We recommend an amendment to clause 43 (new section 142) to allow joint owners of land in multiple ownership, other than trustees, to be entered in the register of participants as "the owners". We also recommend that section 142 apply to participants under Schedule 3 and Schedule 4.

This amendment would remove the requirement to nominate one member of a joint venture or other partnership arrangement to act as the agent for the parties, as the existing registry regulations permit the opening of joint accounts. We also recommend that this section be extended to include Schedule 4 participants to allow post-1989 forestry partnerships to obtain the benefits of this section.

Future development of emissions trading scheme

We are recommending a substantial revision of clause 43 (new section 146) and consequential amendments to clauses 5 and 43 (new section 67) so that

- any decisions on the future development of the NZ ETS would follow the review of the ETS (clause 43, new section 147 of the bill)
- the Minister of Finance would not be required to recommend a declaration regarding the international market
- the Minister would be required to notify the intention to issue units no later than nine months before the end of a commitment period (or of a five-year interval if there were no commitment

periods), regardless of whether there was a future international agreement

- any such notification would be required to indicate the number of units that would be issued, the timeframe for issuance, and the method of issuance
- in the absence of a subsequent commitment period or future international agreement, before the Minister gave direction to issue units for a period following the end of a commitment period (or five-year interval), the Minister would have to consider a number of factors including New Zealand's annual emissions for the previous five years, the outcome of any relevant review undertaken under clause 43, section 147, New Zealand's international obligations, and the proper functioning of the emissions trading scheme established under the Act.

Under the bill as introduced, the Minister is required to recommend a declaration on the future of the scheme if no subsequent commitment period is determined under the Kyoto Protocol, and no future international agreement existed. The Governor-General would declare either that an international market continued, or that no such market existed. If an international market continued, section 146, as introduced, provides for the issue of a number of NZUs into a Crown holding account. If there were no market, those units would be auctioned under a statutorily determined formula.

We were concerned about the current uncertainty of the scheme beyond the life of current international agreements, as the current agreement sets a cap on the issue of units in New Zealand. In the absence of an agreement, New Zealand would lose the cap. To enable the ETS to continue to function with environmental integrity we consider it important to signal clearly that the NZ ETS would continue after 2012, and to set out the process to be followed by the Minister. Otherwise, any uncertainty could affect investment decisions and the operation of the NZ ETS from 2008 to 2012.

We consider that the recommended revision would also address some operational difficulties with section 146, including how to determine whether an international market exists and how to define the spot price of emissions.

Reviews of emissions trading scheme

Clause 43 (new section 147) requires that the Minister responsible for the administration of the Climate Change Response Act must review the operation and effectiveness of the NZ ETS before the end of the first commitment period and each subsequent commitment period (or five-year period). We recommend amending section 147 to

- require the reviews to be completed no later than 12 months before the end of a commitment period (or five-year interval if there are no commitment periods), instead of nine months as currently provided
- require the Minister to appoint an independent panel to review this Act as regards the emissions trading scheme, or the operation of the NZ ETS
- expand the factors that must be considered in the reviews

Although the review clause of the bill received strong support from submitters, we agreed with suggestions to strengthen the review provisions to provide certainty about the management of non-greenhouse-gas environmental impacts of the NZ ETS, the evolution of international agreements, and their impact on allocation plans. We recommend that the review date be brought forward. We also recommend that provisions are made for independent review of the NZ ETS.

The timing of the review represents a trade-off between having the best information available on the international situation and providing certainty for participants on how the NZ ETS will operate in the next period. Our recommended amendment seeks to allow enough time for the outcome of the review to be considered and any changes promulgated.

We also agree that it would provide more reassurance regarding the integrity of the review process if some degree of independence were included in the process.

We also recommend that the reviews be required to consider some additional factors: any social, economic, and environmental effects of the NZ ETS (other than those that have been considered under other parts of the review); types of Kyoto units or approved overseas units that can be surrendered for NZ ETS compliance; the operation of the commitment period reserve (if any); the potential for linking the NZ ETS to other greenhouse gas emissions trading schemes; the

opt-in thresholds in Schedule 4; any consequential changes to allocation plans resulting from the climate change obligations and emission policies of New Zealand's major trade competitors and trading partners; significant changes in emissions mitigation technology; the cost to the taxpayer and the economy of providing free allocation; any implications for the notification of intention to issue units in the absence of a subsequent commitment period or future international agreement as to New Zealand's annual emissions for the previous five years and average price of emissions for the previous two years.

Regulations

We recommend amendments to clause 43 (new section 148) to

- require consultation on draft regulations regarding data collection methodologies and verification
- provide a lead-in period for regulations to come into effect
- narrow the scope for recovery of the costs of administering the NZ ETS to costs in relation to post-1989 forest land and other removal activities
- require the Minister to consider New Zealand's international obligations before making regulations governing the collection of data and information on, and the measurement of, emissions and removals
- provide an additional regulation making power relating to the process for approval of the use of unique emission factors
- provide an indication at a high level of what methodologies could cover, such as upstream or downstream emissions related to the product that is the subject of the activity.

Need for consultation

Many submitters expressed concern at the lack of clarity as to what will be specifically covered in the regulations, and their ability to influence the regulations.

Informal consultation is already taking place on draft regulations. Given the significant impact the details of the NZ ETS will have on participants, however, we consider it desirable to provide specific requirements for consultation in section 148.

Lead-in time

We are also concerned that the bill as introduced does not provide sufficient lead-in time to participants before their reporting obligations under the regulations arise. The bill provides that pre-1990 forest landowners have participant obligations dating from 1 January 2008. We understand that the forestry and liquid fossil fuels regulations would be introduced as soon as possible after the passing of the bill, and that public consultation for pre-1990 forestry regulations land and liquid fossil fuel regulations took place in February and March 2008 and in May 2008 for post-1989 forest land. We recommend additional provisions to ensure that such consultation is treated as consultation for the purposes of the Act and to ensure that the standard lead-in period for regulations would not be required for the regulations where consultation has been undertaken prior to the bill coming into force.

Cost recovery

We recommend that cost recovery regulations be restricted to costs in respect of post-1989 forest land and other removal activities only. We also recommend a separate power to prescribe the matters in respect of which fees must be paid, the amount of fees, and procedures for paying them.

Compliance with international agreements

In the bill as introduced there is no provision for the Minister to consider the provisions of the Convention and Kyoto Protocol before making regulations. To ensure New Zealand's compliance with international obligations, we consider it is important to ensure that provisions for the collection of data and information relating to the calculation of emissions, the use of methodologies, and other requirements of participants are not inconsistent with the Convention or the Protocol.

Procedures for amending methodologies

The current provision envisages that amendments to default methodologies may be made by amendment to regulations. We agree that this process might be too inflexible and unresponsive and might provide a disincentive to participants to seek cleaner technologies. We

therefore recommend that the bill be amended to include a new provision covering approval of the use of unique emission factors, which would be determined, in accordance with regulations, by the chief executive. Section 81 would also require amendment to provide for this wider role, as it affects verification.

Verification requirements

We note that the bill as introduced does not specify the requirements for verifiers. We consider it is important that the regulations specifying these requirements be open for consultation to ensure the market's confidence is maintained in the verification function.

We also agree that it will be necessary to ensure that adequately skilled organisations and individuals are specifically recognised as approved verifiers for the same reason.

Pre-1990 forest issues

We have previously recommended increasing the amount of free allocation to the owners of pre-1990 forests (section 69). We also recommend that new Part 5 Subpart 1 be amended to

- add a new provision regarding land offsetting, to the effect that if the Minister is satisfied that future international rules will provide for it, then such provisions will be included in the NZ ETS
- add a provision allowing regulations to be made to define the parameters of the permitted land offsetting.

Offset provision

Several submitters proposed that the bill be amended to include a forestry offset provision. We considered whether landowners who deforest pre-1990 forest land should be allowed to replant, either on the same land or elsewhere, on a hectare-for-hectare basis of equivalent carbon absorption capacity.

Under the Kyoto Protocol there is no provision for offset planting without incurring liability for the land on which the deforestation actually occurred. However, if the international rules change for the second Kyoto commitment period, the cost to New Zealand of an offset provision would be minimal. We consider that there are ad-

vantages in providing a clear indication in the legislation that, should future international rules provide for offsetting, such provisions will be reflected in the NZ ETS. This would allow landowners and investors to make investment and management decisions without further legislative amendment incurring delay and uncertainty.

Pre-1990 and post-1989 forests split

We considered arguments for and against retaining the distinction between pre-1990 and post-1989 forests, but recommend no change because we are concerned that this would have a significant fiscal and economic impact resulting from the allocation of many units not backed by Kyoto units.

Exclusion of deforestation of indigenous pre-1990 forest

We also considered arguments for and against the inclusion of deforestation of indigenous pre-1990 forest in the NZ ETS, but do not recommend amending the bill because we believe there are sufficient existing deforestation controls for indigenous forests. Although we were particularly interested in the arguments for the inclusion of regenerating indigenous scrub forest in the NZ ETS, we do not recommend its inclusion as it is technically difficult to differentiate between pre-1990 and post-1989 scrub in practice.

Registration

We recommend an amendment to Schedule 4 to allow registration as a participant by a person who has a written contract with the Crown for removal of greenhouse gases from the atmosphere by means of a forest species on post-1989 forest land that is Crown conservation land.

Participant in respect of pre-1990 forest land

We recommend amending clause 43 (new section 158) to clarify that only a participant under section 158 is a participant in respect of deforestation of pre-1990 forest land. This would remove any ambiguity from the interface between section 158 and section 54.

We also recommend inserting a new section before section 158, setting out the presumptions as to deforestation in section 164 but covering both pre-1990 forest land and post-1989 forest land.

We considered but did not support exemptions for Māori-owned land, as deforested Māori land would create greenhouse gas emissions that would be recognised under international agreements. Neither do we consider that renewable energy projects that involve deforestation should be exempt. We consider that all investment projects, including those generating renewable energy, should face the emission costs of their activities.

Methodology for pre-1990 forest land

Section 162 provides that where pre-1990 forest land is deforested and the trees on the land are less than nine years old, emissions are to be calculated on the basis of the age of the trees from the previous harvest (or, if they were eight years or younger, on the basis of age nine) and units surrendered according to this calculation.

We recommend amending section 162(2)(a)(i) to clearly provide that if the trees cleared from the pre-1990 forest land are eight years old or younger, for the purposes of calculating emissions the trees cleared would be treated as if they were the age and species of the trees last harvested.

The eight-year rule was included in the bill to ensure the environmental integrity of the NZ ETS by avoiding the exploitation of an unintentional loophole: that the Kyoto Protocol does not require emissions from the harvesting of pre-1990 forests to be accounted for (by parties electing not to report under Article 3.4 of the Kyoto Protocol), at least in the first commitment period. The current provision makes it clear that for the purposes of this calculation the age of the earlier trees is to be used, but is unclear that the species of the earlier trees must also be used.

The recommended amendment seeks to clarify that where young trees are cleared, the policy intent is that the emissions from the deforestation be calculated in relation to the trees last cleared from the land.

We also considered whether we should recommend not closing the loophole at all, or adopting a threshold other than eight years, given that the threshold is somewhat arbitrary. We recommend no change at

this stage because we consider that the better policy response would be the provision of a forestry offset in future international agreements for the commitment period beyond 2013.

Post-1989 forest land—Participant in respect of post-1989 forest land

We recommend amendments to clause 43 (new section 165) of the bill to clarify who may register as a participant in relation to post-1989 forest land, and to define requirements for surrendering units for activities on exempt pre-1990 land that has been deforested.

We also considered whether restrictions should be placed on the planting of plantation species in native ecosystems, in response to concerns that the allocation of units for carbon sequestration will not protect against environmental degradation (particularly loss of biodiversity) from afforestation. However, we consider that the NZ ETS is not the appropriate mechanism for addressing issues of biodiversity on private land. The Resource Management Act 1991 is the primary environmental statute for managing adverse environmental effects.

We considered whether to make the crediting of post-1989 afforestation activities contingent on a declaration by the landowner of compliance with Resource Management Act rules (and potentially other environmental legislation), but decided that this would not be appropriate as each piece of legislation addresses non-compliance issues. The Green Party differs and believes that the NZ ETS does have a role in addressing the issue of biodiversity.

Payment of units for deforestation of exempt land

We recommend inserting a new section to provide a registration process for an activity in Part 1 of Schedule 4 in respect of exempted pre-1990 (deforested) land for clarity.

Transfer of registration (post-1989 forest land)

We recommend amending the provisions under clause 43 (new section 169) for the sale and transfer of registration of post-1989 forest land to provide that the new owner of a land or forestry right, lease,

or conservation land project will automatically become a participant, with the associated liabilities and entitlements.

In the case of the expiry of a forestry right, lease, or conservation land project, we recommend that the bill provide that the transfer of the registration of a participant for post-1989 forest land from the forestry right or leaseholder to the landowner is automatic from the date of expiry of the forestry right or lease or contract. We also recommend minor amendments to clause 43 (new sections 159, 160, 162, 163, 164, 166, 167, and 168) for clarity.

Traceability of New Zealand units and assigned amount units

We recommend that the bill be amended to ensure that it does not prevent giving all participants sufficient documentation about the ownership and source of NZUs and NZAAUs (recognising the desirability of this for the forestry sector in particular) as this documentation would enable third-party certifiers to link NZUs or NZ AAUs to specific post-1989 forest. This should enable forest owners to market their NZUs, and thus provide an incentive for appropriate afforestation activity.

Liquid fossil fuels—Mandatory activities in the liquid fossil fuels sector

We have previously recommended an amendment to clause 4 of the bill to provide for firms in the liquid fossil fuel sector to voluntarily register and report their emissions from 1 January 2009, and to require these firms to register and report their emissions. These firms would face no obligations to surrender NZUs for emissions until 1 January 2011.

We heard arguments in favour of altering the point of obligation for Schedule 3 participants by excluding the liquid fossil fuel sector from the NZ ETS, and allocating free units for liquid fossil fuels used for stationary energy and transport purposes. However, we do not recommend further amendments (with the exception, noted earlier, of providing free allocation to eligible industrial firms for emissions from the combustion of waste oil for stationary energy). We consider that locating the point of obligation upstream in the transport sector is practical and allows costs to be passed down, thus potentially influencing behaviour. While transport fuels are not included

in other schemes around the world, this is balanced by other factors such as high fuel taxes in Europe and greenhouse-gas-oriented taxes.

Treatment of obligation fuels

We recommend that a new provision be inserted into clause 43 (new section 174) to enable additional activities to be added to Part 2 of Schedule 3 in respect of coastal shipping and fishing within the New Zealand exclusive economic zone. Given that adding these activities would amount to a regulation amending primary legislation, we recommend that the regulation be subject to approval by a resolution of the House within 12 months.

If brought into effect by Order in Council, this would create an obligation on international shippers to surrender emission units in respect of fuel used on the domestic legs of international voyages where cargo was picked up and dropped off in New Zealand. In the case of domestic fishing operations, it would place an obligation on foreign fishing vessels that did not refuel in New Zealand but fished under New Zealand quota to surrender emission units.

We considered arguments that a case should be made for special treatment of coastal shipping and the domestic fishing operations, with either exemption or access to free emission units for industries that would face higher costs in respect of their emissions than competing firms that do not face comparable emissions obligations. We understand that domestic coastal shipping competes with international shipping on some of their routes, but the extent of trade exposure faced by the domestic fishing industry is not as clearly defined.

We think that a special case might be made to recognise coastal shipping and domestic fishing operators as trade-exposed, because they face higher costs in respect of their emissions than competing firms that do not face comparable emissions obligations. Our preference is to allow for the possibility of imposing a unit obligation on the consumption of fuel used by foreign vessels in the coastal shipping trade or fishing within New Zealand waters that is compliant with international law. We therefore recommend the insertion of an enabling provision into the legislation so that additional activities related to coastal shipping and fishing can be brought into the NZ ETS by Order in Council.

Opt-in activities in the liquid fossil fuels sector

We recommend an amendment to Part 3 of Schedule 4 of the bill to align the obligations of participants with those proposed for participants under Part 2 of Schedule 3 (this may require the inclusion of transitional arrangements for the first year). We also recommend that the start date for surrender obligations of large purchasers of jet fuel who opt in for their domestic jet fuel use be changed from 1 January 2008 to 1 January 2010, to reflect the recommended delay of surrender obligations for the liquid fossil fuels sector until 1 January 2011.

Registration as participants by purchasers of jet fuel

We recommend an amendment to new section 173 to provide more detail of the requirements for registration and deregistration for voluntary jet fuel participants. We recommend further changes to sections 173 and 176 to clarify how these sections will be implemented, and for alignment with sections 58 and 59 (covering deregistration), and with the treatment of participants who register in respect of their coal and gas purchases.

Stationary energy sector

Coal seam gas

Part 3 of Schedule 3 of the bill lists the activities that are subject to the NZ ETS. The bill does not explicitly exempt fugitive coal seam gas emissions from the scheme. Fugitive coal seam gas includes emissions that result from coal-mining activities, including venting and flaring, but not methane extracted or captured for sale as an energy source. Where coal seam gas is captured for sale it is included under the activity "mining of natural gas".

We recommend an amendment to the legislation to explicitly include fugitive emissions from coal seam gas in the scheme.

We heard arguments for including fugitive emissions of coal seam gas on the grounds that they affect New Zealand's Kyoto liability and influence the emissions pricing of coal. On the other hand we considered the technical and equity challenges of measuring and attributing fugitive emissions from coal seam gas. On balance we consider that coal seam methane gas should be included in the scheme to provide the correct incentive for coal companies to convert coal seam gas into

carbon dioxide, where possible, rather than allow fugitive emissions to be released into the atmosphere.

Combustion activity and waste oil

Waste oil is mostly used lubricating oil. While emissions associated with the processes of refining lubricating oil are captured by the NZ ETS the bill as introduced places no obligations under Part 2 of Schedule 3 for producing or importing lubricating oil, or the release of emissions when lubricating oils are combusted in engines. However, the bill places obligations on emissions from the combustion of waste oil for stationary energy (electricity and industrial heat) under Part 3 of Schedule 3.

We recommend an amendment to the bill to clarify the activity description of the combustion of waste oil and to ensure that no emissions are counted twice.

Geothermal steam

We recommend deleting the activity description of geothermal steam where it is separated from geothermal fluid, because the description is superfluous.

Definition of activity for refining petroleum

We recommend amending the definition of "refining petroleum" to clearly capture refining petroleum where the refining involves the use of intermediate crude oil products such as refinery fuels and gases, for energy or feedstock purposes.

Opting-in

We recommend amendments to Part 4 of Schedule 4 to enable a participant to opt in for coal or natural gas or both, and to clarify the threshold requirements.

We also agreed with some submitters that the current opt-in provisions do not adequately reflect the complexity of the gas market, and specifically that the ability to opt in only one step down the supply chain is too restrictive. We recommend that opting-in should be available to the first person in a supply chain outside the corporate groups (of wholly-owned companies) of participants.

We were also concerned that it would be too restrictive and defeat the purpose of the opt-in provisions to require an entity to purchase all the threshold level of coal or gas from one participant. We also recommend a change to Part 4 to clarify the way it would be implemented.

Registration as participants by purchasers of coal or natural gas

We recommend amendments to clause 43 (new section 176) of the bill to provide more detail on registration and deregistration processes, including a provision allowing the registration of large coal or gas purchasers from 1 January 2010.

We also considered whether section 176 might require participants to submit commercially sensitive contracts as proof of meeting threshold limits. We recommend that a new subsection be inserted to clarify that the chief executive may be satisfied on the basis of historic information, but leave discretion for the chief executive to request prospective information where necessary.

Further changes to clause 43 (new section 176) are also recommended to clarify how this section will be implemented and to align it with clause 43 (new section 173).

Industrial processes sector

Treatment of synthetic gases

We have previously recommended an amendment to clause 4 to delay the entry of imported hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs) into the NZ ETS from the currently proposed entry date of 1 January 2010 until 1 January 2013 but provide for firms that import HFCs, PFCs, and sulphur hexafluoride (SF_6) to voluntarily register and report emissions from 1 January 2011, and to be required to register and report emissions from 1 January 2012. Firms would face no obligation to surrender NZUs for emissions until 1 January 2013.

We now recommend amendments to the bill to

- explicitly provide that imported products containing HFCs and PFCs will be included in the NZ ETS, except for products imported for certain personal and medical uses
- define the obligations and entitlements of people who export HFCs and PFCs

- define the obligations and entitlements of people who collect and destroy HFCs and PFCs

Exporters of HFCs and PFCs (including products containing HFCs and PFCs) and people who collect and destroy HFCs and PFCs would be entitled to earn NZUs either for each tonne of CO_2-equivalent emissions attributable to those exported HFCs or for each tonne of CO_2-equivalent emissions that is prevented by these collection and destruction activities from 1 January 2013. Such exporters would have the opportunity to register and report their emissions on a voluntary basis, then if registered would be required to report for 2012 but would not be eligible to earn units until the 1 January 2013 to 31 December 2013 year.

Almost all submitters on HFCs and PFCs expressed strong concerns that if these gases remain in the NZ ETS, the bill does not explicitly include imports of equipment containing HFCs and PFCs, and does not provide for exemptions or rebates for exports of HFCs and PFCs. We are concerned that the approach does not cover a significant proportion of HFCs and PFCs. It potentially disadvantages domestic manufacturers of equipment containing HFCs and PFCs relative to overseas manufacturers of competing products (on both the domestic and export markets). In particular it does not directly create incentives to collect and destroy HFCs and PFCs.

We understand that the exclusion of imports of pre-charged equipment from the scheme was initially proposed to limit the number of points of obligation (and thus the administration and compliance costs) of the scheme; and it was considered that an exemption mechanism could be developed.

However, we share many of submitters' concerns about this approach. We recommend that the bill be amended to include HFCs and PFCs imported in products, to provide for entitlements to units for exporters of products containing HFCs and PFCs, and to exclude from the NZ ETS people who import pre-charged equipment for personal use. "Personal use" is intended to exclude only imports of HFCs and PFCs contained in goods that are included in the personal or household effects of people arriving in New Zealand. This approach would address the concerns that the NZ ETS would significantly disadvantage local manufacturers of products containing HFCs and PFCs relative to overseas manufacturers.

We are of the view that the provision for entitlements to units for exports under the NZ ETS would also create an incentive to collect and export HFCs and PFCs for destruction. Although HFCs are currently exported to Australia for destruction, we also recommend that collection and destruction of HFCs and PFCs be included as a "removal activity" under Schedule 4 (and therefore be entitled to receive units) in the event that New Zealand develops its own capacity for the destroying of HFCs.

We consider that the recommended amendments to apply the NZ ETS to HFCs and PFCs contained in products and to provide entitlements to units for exports of HFCs from the NZ ETS will meet the competitiveness concerns of local manufacturers of products containing these gases. We also note that free allocation under section 70 can also apply to emissions from the "industrial processes" set out in Part 4 of Schedule 3 (which includes importation of HFCs and PFCs).

HFCs are used as a propellant in certain inhalers used for medical purposes. As they are essential products and there are no cost-effective alternatives to HFC propellants for this purpose we recommend an exclusion for imports of HFCs to cover their use in inhalers.

We recommend that the activity description for importing sulphur hexafluoride be clarified to apply to both bulk imports and imports of goods containing sulphur hexafluoride, for the same reasons given regarding HFCs and PFCs above.

Activity descriptions for producing clinker and gold

We recommend minor amendments to the activity description for producing clinker to clarify that this activity refers to calcinations of calcium carbonate in addition to limestone, and to the activity description for producing gold to ensure that it appropriately captures all industrial process emissions.

Agriculture

We have previously recommended that the bill provide for voluntary registration of and reporting by the agriculture sector from 1 January 2011 and mandatory registration and reporting from 1 January 2012, as preparation for full entry into the NZ ETS on 1 January 2013.

We now recommend amendments to Part 5 of Schedule 3 to bring forward the deadline for deciding whether the agriculture point of

obligation is to be set at the processor level or farm level from 31 December 2012 to 30 June 2010. As introduced, the bill allows a farm-level point of obligation to be given effect by Order in Council until 31 December 2012.

We considered many submissions on the appropriate point of obligation in the agricultural sector and consider that while a processor-level obligation is feasible to implement by 2013, it is not likely to be as effective as a farm-level obligation in changing behaviour. However, we understand that there remain technical issues to resolve for farm-level obligation, regarding the methodology for estimating emissions, reporting and verification. Nevertheless we consider that a Government decision on the point of obligation for agriculture is needed earlier than this date, and therefore recommend that the ability to bring a farm-level point of obligation into force by an Order in Council expire on 30 June 2010.

We also recommend an amendment to enable farmers to opt into a farm-level obligation if a processor-level point of obligation comes into effect.

We consider that in the event that a processor-level obligation is selected, farmers should be permitted to opt into a farm-level obligation, in the same way that users in the liquid fossil fuels and stationary energy sectors can opt to take on their obligations. We recommend that the bill include an enabling provision to allow farmers to opt in to a farm-level point of obligation. This would require a new activity to be listed in Schedule 4, a regulation making power to set a threshold for opting in, and other consequential amendments. However, we understand that there are technical issues yet to be resolved regarding farm-level obligation. We recommend that the opt-in provision be brought into force by Order in Council and that it should also expire if not brought into force by 31 December 2012.

Other removal activities

Part 2 of Schedule 4 outlines the non-forestry removal activities with respect to which a person may become a participant in the scheme. Part 2 applies on or after 1 January 2010, and deems the export of a product that contains an embedded substance which if combusted would create an emission to be a removal activity under the bill.

We recommend amendments to Part 2 of Schedule 4 to

- clarify that Part 2 of Schedule 4 would apply only where an entity directly faced an increased cost of their feedstock as a result of the NZ ETS assumption that the feedstock would be combusted or emissions ultimately released, when in that entity's case the feedstock was in fact embedded in another product
- clarify that where the embedding of a substance in a product would not result in a corresponding reduction in New Zealand's emission liabilities under the Kyoto Protocol, then the producer of the product would not be eligible to receive units under Part 2
- provide for the inclusion of carbon capture and storage activities, with the technical definition, the start date, and the methodology to be determined in regulations
- enable new removal activities to be added to Part 2 of Schedule 4 by Order in Council, with a consultation provision and a requirement that the amendment be confirmed by Parliament.

The NZ ETS generally assumes that fuels such as natural gas or coal supplied upstream will be combusted, and that the associated emissions will be released to the atmosphere. However, in some circumstances, these fuels are not combusted but are used by downstream consumers as feedstocks in chemical processes. This can result in some emissions being permanently or temporarily embedded in the final product. Such embedded emissions are not included in New Zealand's inventory and will carry no obligations for New Zealand. Nonetheless, the NZ ETS would impose the obligation, leading the downstream consumer to pay the passed-through carbon price when no emissions actually occur.

Many submitters proposed that the bill should allow more generally for the inclusion of new technologies for carbon capture and storage. We agree that carbon capture and storage should be included in the NZ ETS at some stage, but are advised that further work needs to be done in New Zealand's domestic regulatory environment. We therefore recommend amending the bill to provide for the inclusion of carbon capture and storage activities (CCS) in the NZ ETS once a robust domestic regulatory framework has been established for CCS (possibly in advance of 1 January 2010).

Many submitters proposed that the bill be amended to allow the addition of removal activities to Schedule 4 by regulation. We note that amendments to a statute by regulation are rarely contemplated and should be used only in exceptional circumstances.

We consider that including a power to add removal activities to Schedule 4 by Order in Council would be justified. Climate change is a very fast-moving area, and adding such provision would make the principal Act responsive to changes in technology and in the international agreements governing action in this area. Adding further removal activities can only benefit participants, and cannot act to their detriment. Any removal activities added would need to be consistent with the definition of "removals" in the principal Act. It would be inappropriate for the addition of the activity to be time-limited.

We also consider that a requirement to consult before making the Order in Council should be included, and the addition should be subject to confirmation by Parliament.

We consider that the activity description in the bill as introduced is not sufficiently clear as to what activities fall within Part 2. In particular, persons should not be eligible to receive units for activities under Part 2 where they have not faced an increased cost as a result of the implementation of the NZ ETS. Producers of products containing embedded substances could "double dip" by also claiming emission units for those embedded emissions. The recommended amendments seek to close this loophole.

Income tax—Disposal of emissions units

Clause 48 inserts a new section CB 29 into the Income Tax Act 2004, specifying the extent to which the disposal of a unit, by way of surrender or conversion, gives rise to an amount of income. Generally, a disposal of a unit to a third party (other than on surrender) gives rise to an amount of income for tax purposes. More specific rules provide that the disposal of NZUs issued to owners of pre-1990 forest land by the person who was issued those NZUs is effectively tax-free. Clause 57 of the bill inserts a new section CB 36 into the Income Tax Act 2007, which has the same effect.

We recommend amendments to clauses 48 and 57 to amend new section CB 29 of the Income Tax Act 2004 and new section CB 36 of the

Income Tax Act 2007, to allow a deduction to be claimed for the purchase of emission units required to meet a liability for deforestation of pre-1990 forestry land by a person who holds that land on revenue account.

The underlying concern of submitters is the availability of a tax deduction for the additional units that the owner of a pre-1990 forest would need to acquire to meet the liability to surrender units imposed upon deforestation. Owners of pre-1990 forests are expected to receive approximately 5 percent of the number of units they will need to surrender, in total, on deforestation by way of free allocation from the Government, so will need to acquire the remaining 95 percent on the market if they completely deforest.

The legislation allows a deduction for the purchase of emission units. This deduction is timed to coincide with their disposal. However, on surrendering the units acquired to meet a liability arising from the deforestation of pre-1990 forest land, any units purchased in addition to the original free allocation are treated as being sold for cost. This would cancel out the deduction claimed on the acquisition of these units.

We think that the characterisation of deforestation of land as a capital account transaction is correct where the owner holds that land on capital account. A firm that has operated a forestry business for some time, and then decides to deforest, would fall into this category.

However, we agree that the cost of acquiring emission units for deforestation should not be on capital account for someone who does not hold the land on capital account. A property developer, for example, would hold the land on revenue account, and costs incurred in the physical process of developing the land would be on revenue account. It is inconsistent from a policy perspective to deny such a business revenue account treatment for the costs of acquiring the emission units required to deforest.

Allowing a deduction for the purchase of emission units by a business that holds the land on revenue account should not cause any undesirable tax planning behaviour. This is because a revenue account business would be taxable on the proceeds of the sale of the land and so, if the deforestation increased the value of the land, would have a tax liability when the land is sold. This is less attractive from a tax perspective than carrying out the development on capital account, when no tax liability would arise on sale.

Income tax—Cost flow method to identify emission units

Clause 52 inserts a new section EA 2B into the Income Tax Act 2004 and generally requires a first in, first out cost flow method to be used to identify the units held by a person at any time. It also sets an ordering rule for the disposal of units, requiring disposals to be treated as being made in the following order:

- pre-1990 forest land emission units
- post-1989 forest land emission units
- replacement NZ ETS units.

Clause 61 inserts new section EA 2B into the Income Tax Act 2007, which has the same effect.

We recommend not proceeding with clauses 52 and 61, and inserting provisions to treat emission units as excepted financial arrangements. We consider that emission units should be expressly excluded from the financial arrangement rules by being defined as excepted financial arrangements, and that as much as possible, they should be brought within the standard rules that apply to excepted financial arrangements. This decision affects some of the matters raised below.

Ordering rule

Under the bill as introduced, each unit would have a unique identifier, which would allow individual tracking. The rule requiring units to be disposed of by order of classes was proposed to ensure that taxpayers did not seek to exploit the different tax treatment of units of different classes. However, we consider that the market may differentiate between those units which were awarded for forestry activities and those units which were acquired on other grounds. Accordingly, sellers of emission units holding more than one class may decide to sell emission units of a particular class for commercial, and not just tax, reasons.

We consider that adopting a rule which deemed a particular class of units to be sold when the units sold were actually units of another class could give rise to compliance issues, and this could weaken the credibility of the tax system. Accordingly, we think it is appropriate for the tax treatment to reflect the emission units which are actually sold, and that this ordering rule should not proceed.

Valuation methodology

Treating the units as excepted financial arrangements means that the weighted average costs method would be available, as well as the first-in first-out method originally proposed. This method is appropriate, and consistent with the approach taken to all other excepted financial arrangements.

We note that neither the bill nor this recommendation requires units held at year end to be revalued to market value.

Removing the ordering rules for separate classes of emission units and bringing emission units within the standard excepted financial arrangement rules as we recommend would mean that new section EA 2B would no longer be necessary.

Goods and Services Tax

As introduced the bill does not address the Goods and Services Tax (GST) treatment of emission units. Sales and purchases of emission units are subject to GST under the current law. We understand that tax matters for sectors other than forestry, and GST will be addressed in a tax bill expected to be introduced in June 2008 to allow a full consultation process.

Renewable preference

Clause 67 of the bill inserts new Part 6A into the Electricity Act 1992. We recommend that clause 67 be amended to make it clear that the amendments are intended to restrict baseload fossil fuel generation. As introduced, new section 62A (to be inserted by clause 67) refers only to "fossil-fuelled thermal electricity generation". We consider that this oversight should be addressed.

We recommend a number of amendments to definitions in clause 67. We recommend that the definition of "specified generation plant" be amended to make it clear that a specified generation plant does not include a plant operating under a reserve contract with the Electricity Commission, and such a plant would therefore not be captured under this regime. We are concerned that if the definition did not exclude these plants, the security of energy supply could be compromised.

We recommend amendments to clause 67 to ensure that existing plants that operated at more than 10 percent above their initial name-

plate capacity on commencement would be captured by the bill. Refurbishments of existing plants (resulting in higher capacity) are not explicitly addressed in the bill as introduced. We are concerned that existing plants could increase their capacity by significant amounts without being captured by the renewable preference restrictions. The amendments we recommend would ensure that the prohibition created by the bill would cover an existing plant that operated after an upgrade at more than 10 percent above its initial nameplate capacity at commencement of the Part.

The bill as introduced provided that "specified generation plant" does not include "an electricity generation plant that is in operation before the commencement of this Part". We consider that this reference is unclear. We recommend amendments to clause 67 to clarify that references to "existing plant" would include a plant commissioned before commencement of the bill that was temporarily not in operation at the commencement, as a result of maintenance or a similar outage, or was not in operation but was available to come back into operation at less than one week's notice.

We recommend that the term "moratorium" be replaced with the term "restriction" where it is used throughout clause 67. A moratorium is a temporary suspension or cessation of an activity. The bill does not purport to impose a blanket suspension of baseload fossil fuel operation or investment, but it would impose specific restrictions. We consider that the term "restriction" is a more accurate expression of what the bill seeks to achieve.

We recommend an amendment to clause 67 (new section 62F), to provide that the Minister of Energy may only accept or reject the Electricity Commission's recommendations in regard to exemptions, and may not materially alter them. As introduced, the bill allows the Minister to vary an exemption without seeking advice or consulting the Commission. We are concerned that such broad ministerial discretion could unduly prolong the exemption process, and could elevate the risk of legal challenge if the Minister could apply different decision making criteria from the Electricity Commission.

In addition, we acknowledge the Electricity Commission's special expertise and consider that it would be invaluable in determinations regarding exemption applications. We note that the amendments we recommend are analogous to those for decision making by the Minister of Energy in respect of Electricity Governance Rules under the

Electricity Act 1992, where the process requires the Electricity Commission to recommend rules or regulations and the Minister may only accept or reject these recommendations, and may not alter them in any way.

We also recommend a new provision for the avoidance of doubt about the status of an exemption. This would clarify that exemptions were regulations for the purposes of neither the Regulations (Disallowance) Act 1989 nor the Acts and Regulations Publication Act 1989.

Non-baseload exemption

We recommend an amendment to section 62G(1)(a). This reflects advice from the Parliamentary Commissioner for the Environment, albeit that she did not support this policy instrument and believed that other measures would better achieve the overall policy objective.

Section 62G(1)(a), as amended, requires a plant to satisfy three limits (load factor, emissions, and start-up time). Previously a single limit may have been prescribed. We consider that the exemption as introduced was too broad and that amendments were necessary to clarify its application. However, we are satisfied that more than one combination may be prescribed to cater for different plant types or circumstances.

Emergency, reserve, isolated community, and cogeneration exemptions

We recommend amendments to the emergency purposes exemption application process under new section 62G(1)(b) to facilitate the expedient granting of exemptions in genuine emergencies. The amendments we recommend would provide for temporary emergency exemptions, clarify that the emergency exemption process might apply to future emergencies, and clarify that an emergency exemption might be granted for other purposes. These amendments are intended to ensure that the emergency exemption process is simple, can be readily employed wherever necessary, and will not give carte blanche to types of plant that are environmentally inappropriate.

We recommend amendments to remove providing reserve energy and providing electricity to a small isolated community as grounds for the Minister of Energy granting an exemption. We consider that it is unlikely a small isolated community would need more than 10

megawatts of baseload generation. Accordingly, we recommend that the exemption category for small isolated communities be removed. We consider that exemption for providing reserve energy should be permissible only if a plant is contracted by the Electricity Commission. We have recommended an amendment to the definition of "specified generation plant" which would ensure that a plant contracted to provide reserve energy by the Electricity Commission would not need to apply for an exemption.

Fossil fuel and renewable combination exemption, and waste generation exemption

We recommend amendments to streamline the provisions under new sections 62G(1)(c) and 62G(1)(d) in the bill relating to exemptions for fossil fuels and the renewable combination exemption, and waste generation exemption. We consider that these exemptions could be covered by a single exemption category for combinations of fossil fuel and other energy sources, subject to a prescribed maximum proportion of fossil fuel and any overall efficiency requirement and any prescribed maximum level of greenhouse gas emissions.

The amendments we recommend would ensure that combinations of fuel types could be exempted, subject to a prescribed maximum proportion of fossil fuel and any overall efficiency requirement and any prescribed maximum greenhouse gas emissions level.

We recommend amendments to remove reference to landfill gas from these new exemption provisions. Landfill gas is not a fossil fuel or an obligation fuel (as defined in the Climate Change Response Act), and therefore we consider that landfill gas generation should be excluded from the renewable preference regime.

Plant retirement exemption

We recommend amendments to the plant retirement exemption provisions under new section 62G(1)(e) to provide that the requirement to significantly reduce emissions should be quantified at 20 percent of emissions. This amendment would provide clear guidance for those seeking to abide by the regime.

We recommend an amendment to allow regulations to be made prescribing a methodology for assessing impact on security of supply. We acknowledge that the relevant security margin is defined by the

Electricity Commission, and may change from time to time, depending on the evolving character of the power system.

We understand that this section is not intended to require a strict megawatt for megawatt swap, but consider that it could be interpreted this way. We recommend amending the rationale to one of not reducing security of supply below a prescribed margin. Accordingly, we recommend that the impact on security of supply be assessed according to a methodology prescribed in regulations.

Grounds and terms and conditions of exemption

We recommend amending the provisions for granting exemptions under new section 62H to permit the Electricity Commission to alter the terms and conditions of existing exemptions to allow for increased generation during emergencies.

We also recommend adding a new section providing for a temporary exemption process. Such a process would allow the rapid granting of a temporary exemption during a declared emergency without requiring the usual consultation processes. This exemption would be granted by the Electricity Commission in an emergency declared by the Electricity Commission, and could last no longer than three months.

Both amendments and some minor changes are recommended to ensure a timely response to emergency conditions.

Public consultation on draft exemptions

We recommend amendment of the provisions for consultation in relation to exemptions under new section 62I, for clarification and to streamline processes. We also recommend amendment of the provisions for publication of decisions in relation to exemptions under new section 62J, requiring the Minister of Energy to publish the reasons for declining exemptions recommended by the Electricity Commission.

Revocation of exemption

We recommend an amendment to the process for revoking an exemption under new section 62K to

- require that any revocation be subject to a recommendation from the Electricity Commission
- require the Minister of Energy to take any matters prescribed under section 62N into account
- give generators an opportunity to respond within a given time.

We consider that the bill as introduced grants too much discretion to the Minister of Energy to revoke exemptions, and has the potential to increase investment risk. The changes we recommend would provide further safeguards to this process.

We recommend that section 62L be deleted. We consider that the powers granted in section 62L for the Minister of Energy to temporarily suspend an exemption are unnecessary because sufficient deterrence is provided by the ability to revoke an exemption under section 62K and the availability of injunctions under section 62M.

Regulation making powers

We recommend amending the regulation powers under section 62N to

- limit section 62N(1)(a) to the circumstances where the Electricity Commission has made a recommendation with due regard to public submissions
- amend section 62N to allow the Commission to recover any reasonable costs incurred during the consideration of an application.

We understand that the power under section 62N(1)(a) would provide for potential technology developments that are not catered for in the current exemption categories. However, we consider that the bill as introduced would allow a wide-ranging power which, if abused, could effectively defeat the purpose of the section 62D restriction. We therefore recommend that section 62N(1)(a) be strictly limited to the circumstances where a prior recommendation is received from the Electricity Commission, and that any recommendation be permitted to be made only after public consultation.

We understand that, notwithstanding section 169 of the Electricity Act which governs the prescribing of fees under the Electricity Act, the bill as introduced does not allow the Electricity Commission to recover costs (such as those of obtaining expert opinions) incurred in considering an application. Accordingly, we recommend an amendment to section 62N to allow the recovery of costs arising from the requirements of this Part.

National Party minority view

Global climate change is the most important environmental challenge of our time. The National Party has consistently advocated a well designed, carefully balanced Emissions Trading Scheme as the best tool for efficiently reducing emissions.

The National Cabinet in 1999 decided that an ETS was the right way forward on climate change policy. We expressed concern when the ETS approach was dropped in favour of a carbon tax when the current Government took office. We promoted an ETS in our Bluegreen Vision document in 2006. We supported the Government's decision, in principle, in favour of an ETS last year and voted for the first reading of this bill. However, the rushed legislative process has resulted in a bill that has major deficiencies.

The importance of getting this legislation right cannot be overstated. This bill represents the most significant economic reform since the deregulation of the economy in the late 1980s. The New Zealand Institute of Economic Research analysis indicates that the ETS in its current form will cost 22,000 jobs and a loss of $900 million to the economy by 2012 and a loss of $5.9 billion in GDP by 2025. The Government's own analysis by Infometrics concludes job losses of 50,000 from the scheme.

Getting this bill right is also important for the environment. New Zealand's recent history has repeatedly seen poorly thought through climate change policy failing with the result that emissions have grown unabated. Poor policy can also have unintended adverse environmental consequences such as the record levels of deforestation in 2007.

Process concerns

The legislative process has been rushed and inadequate given this bill's complexity and significance. The public has not had adequate time to examine and submit on the bill, and it is evitable that serious mistakes will be made that will adversely affect New Zealanders.

We are also disappointed that the Government has chosen not to engage with National given our clearly stated support for an ETS and the finely balanced nature of the current Parliament. We wrote to the Climate Change Minister inviting such a process in December 2005 but received no response. There was no consultation with National over the ETS proposal or the bill.

National has attempted to constructively engage at select committee level with Government members and officials. Our concerns over rushed submissions have been ignored. The NZIER was given a totally inadequate length of time to present their 100-page economic analysis. Concerns from submitters such as Temperzone who said they were "summoned to appear in a group with non-affiliated parties. We wonder why we were not consulted on this forcible grouping. We had to shorten our submission to five minutes. We had no time to present and debate the issues".

Our members have repeatedly been shut down in pursuing legitimate questions over important details of the bill in the haste to advance it. Significant policy changes have been made by Government midway through the select committee process without any consultation with the committee or opportunity for submitters to comment. Further policy changes were introduced by the Minister in the last week of consideration.

The select committee consideration and deliberation process has been rushed and reckless. Only approximately 16 hours of the committee time was allocated for considering the 483 page departmental report and 60 supplementary departmental reports on specific issues. Committee members received over 1000 amendments to this 237 page bill only three days prior to its final deliberation. There has been no serious engagement by Government members on the critical issues to New Zealand in this bill, as evidenced by the 24 different Government members that have subbed onto the committee throughout the process. National members, in querying important issues, have repeatedly been told that things are a certain way simply because it is Government policy.

This process has not been conducive to getting such an important bill right nor in getting the cross-party support needed to ensure the stability and longevity of New Zealand's ETS.

National's major concerns—Balancing environmental and economic interests

National's first concern with the bill is the cost to New Zealand families and businesses of being a world leader in emissions trading and in reducing greenhouse gas emissions. The problem is well illustrated by the submission by global cement giant Holcim, which operates 151 manufacturing plants worldwide. They note that despite only operating one moderately sized plant here, the proposed New Zealand ETS will cost more in carbon emissions than the 23 plants operated within the EU ETS. These high cement costs will be passed onto New Zealand families and businesses through the increased cost of housing and building community infrastructure.

New Zealand accounts for just 0.2 percent of global emissions. Our unusual emissions profile is going to make the task of reducing emissions very challenging. Agriculture contributes 50 percent of emissions but the sector has very limited technologies for emissions reduction. We already have one of the highest proportions of renewable electricity. Transport emissions are more difficult to reduce in a thinly populated country like New Zealand. The ETS should be designed around the more modest goal of ensuring New Zealand does its fair share in reducing global greenhouse gas emissions.

That is why National has advocated, in contrast to the Government's goal of carbon neutrality, a 50 percent reduction in New Zealand's 1990 greenhouse gas emissions by 2050. This goal is in line with that of the new Australian Government which is committed to a 60 percent reduction in emissions from 2000 levels by 2050, and that proposed by Unites States presidential candidates. National believes our -50 percent by 2050 goal should be included in the purpose clause of the bill.

Windfall profits to Government

National's second concern is the windfall profits to the Government from the way this ETS is designed. Officials have advised the committee that the scheme will generate an estimated $21 billion in rev-

enue to the Government from the sale of emission permits. This is double that provided in the Budget 2008 tax reductions. There are also additional indirect windfall gains to Government from its electricity Stateowned enterprises. Meridian has advised the committee of an increase of $750 million in its valuation as a consequence of the ETS. Including Mighty River Power, the windfall gain to the Government from it SOEs will be in excess of $1 billion. This is significantly greater than the latest projection of New Zealand's Kyoto liability at $481.6 million.

Climate change is not an excuse for the Government to profit at the expense of businesses and consumers who are already under budgetary pressure. The scheme can and should be redesigned to be fiscally neutral by transparently returning any windfall profits from the ETS to consumers and taxpayers.

Alignment with Australia's developing ETS

National's third concern with the bill is in rushing to pass this legislation before seeing the proposed design of an Australian ETS. There are real advantages for New Zealand in aligning our ETS as closely as possible with Australia given the free trans-Tasman movement of goods, people and investment. The Australian Government is proposing to release a green paper on its ETS design in July with legislation being introduced to their Parliament in December. The decision by Government here to defer the entry of liquid fuels by two years until 2011 and the delay in forestry regulations that means forest owners will not get units until mid-2009 gives a window of opportunity to consider the Australian design features before finalising New Zealand's ETS legislation.

Industry incentives to exit New Zealand

National's fourth concern is the perverse incentives in the bill to export jobs and emissions offshore. The ETS in its current form would encourage major industries like cement, steel, aluminium and agricultural products to progressively relocate offshore where, in most cases, this would result in increased global emissions.

The impact is practically illustrated by the Holcim Cement submission. The company has resource consents, subject to appeal, for a new $500 million plant in Oamaru. Emissions per unit of product

will be approximately 50 percent less as a consequence of replacing the old wet technology process of their Westport plant with a new dry technology process. Overall emissions in New Zealand will be 200,000 tonnes greater because of increased production to offset imported cement currently being manufactured offshore. Despite producing fewer emissions globally, the New Zealand investment is not viable under the ETS as designed. Holcim goes further stating it would be virtually impossible to sustain their existing businesses in the medium term under this ETS. Submissions from other energy intensive industries made similar sobering statements.

The incentives should be for industries to be located globally where they will be most efficient and to drive investment in new technologies that will minimise emissions. It is well documented that New Zealand produced aluminium and dairy products have less emissions than those from competitor countries, and to inadvertently shift new or existing production offshore is doing nothing for the global climate. The bill needs an improved process for dealing with industry allocations to ensure this does not occur.

Importance of small and medium enterprises

National's fifth concern is that the bill discriminates against SMEs that will not be eligible for free allocation of emissions units New Zealand is very dependent on SMEs for its economic strength and the design of the ETS needs to better recognise them. The initial proposal of a 50,000 annual tonne threshold would eliminate all but New Zealand's largest emitting industries. The committee discussed a lower threshold but no decision was made and the question has been left to regulations. This issue is too important to the successful functioning of New Zealand's ETS to be deferred. Parliament needs to take a direct interest in the competitiveness and survival of our SMEs.

Unilateral phasing out of industry support

National's sixth concern is that the bill rigidly sets a timetable for phasing out industry support through to 2030 without reference to progress in international negotiations. The five-yearly review provisions do not allow changes in the phase out of emission allocations, which are fixed in legislation. The justification that this provides

business with certainty is misplaced. The most important consideration for business is not the absolute allocation but how it may affect their international competitiveness. A better approach would be to provide for a more flexible phase out regime that reduces the allocations to industry in line with New Zealand's major trading partners.

Major sector issues

There are major impacts of this legislation on sectors that also needs further consideration, particularly in respect of the impact of the ETS on New Zealand's primary industries.

Agriculture

Agriculture is New Zealand's most important industry and any policy that puts it at risk puts the entire New Zealand economy at risk. New Zealand is the first country to attempt to include the emissions from farm animals into an ETS. Care needs to be taken that it does not compromise New Zealand agriculture's international competitiveness.

The bill fails to resolve the issue of how to deal with the uncertainties in the estimate of animal emissions that officials advised may vary from 50 percent above or below estimates. A market cannot function efficiently with this level of estimate uncertainty. The bill fails to resolve the issue of whether the point of obligation is to be at farmer or processor level. This is a fundamental design issue that needs resolution by Parliament rather than being deferred to regulations. It is as though New Zealand wants the international accolades for a comprehensive ETS when it is just a shell with none of the necessary machinery to make it function. It is all very well in theory to have agriculture included in the ETS but the detail needs to be worked through so Parliament can be confident it will work in practice.

National does not believe the agricultural sector can or should be excluded from this bill, as it is such a large contributor to New Zealand's emissions. However, the purpose of including any sector in the ETS must be to provide incentives to lower emissions. A scheme that crudely imposes average costs on farmers regardless of their farm management decisions will achieve nothing other than encourage them to reduce stock numbers.

The most important priority for addressing methane emissions is in boosting the research and development effort in respect of these emis-

sions from farm animals. The second priority must be in providing incentives for farmers to reduce nitrous oxide, which accounts for 20 percent of farm emissions. National wants to work with the agricultural sector to explore options, including the earlier entry of nitrous oxide to the scheme, so as to encourage better use of modern fertiliser technologies that are available and would reduce emissions. There are also strong water quality arguments for advancing this work.

Forestry

Forestry is one of New Zealand's critical exporting industries and has enormous potential to contribute positively to New Zealand's carbon balance. The reversal from 50 years of very significant new forest plantings every year to significant deforestation over the past four years is the principle reason New Zealand is now set to fall short of its Kyoto targets. Confused public policy over carbon credits has contributed to this reversal. This should have acted as a caution about the potential unintended consequences of how carbon credits in the forest sector are treated.

The scheme is the first internationally that attempts to include forestry. The situation is more difficult than agriculture that enters the scheme in 2013 in that the provisions are designed to take effect retrospectively from the beginning of 2008.

The bill as introduced makes the artificial distinction between pre-1990 and post-1990 forests, as per the Kyoto Protocol, with hugely different financial implications for landowners. The redrafted bill makes a further distinction between those pre-1990 forests purchased prior to 2002, those purchased after 2002 and those forestlands involved in future Treaty of Waitangi settlements. These arbitrary distinctions are not well justified and raise serious inequities over property rights that cannot be dismissed lightly.

The bill reinforces arbitrary definitions from the Kyoto Protocol that are inconsistent with the real carbon cycle of plantation forestry. It is a fallacy to legislate that all the carbon is released into the atmosphere at the time of forest harvest and discounts the ongoing benefit of carbon stored in timber products. It is also erroneous to legislate that the same land must be replanted to avoid deforestation liabilities when the atmospheric concentrations of greenhouse gases are not dependent on where the trees are planted. The revised bill defers the

questions over the forestry offset proposal to beyond 2013 (and then only if countries agree to changes) leaving landowners with forests due for harvest in the intervening years facing severe penalties for activities that would have no net effect on emissions.

The bill also contains arbitrary provisions, like those in Section 162 that gives perverse incentives for unintentional negative consequences. A pre-1990 forest owner is able to significantly reduce their deforestation liabilities by initially replanting and then deforesting once the trees are eight years old. National is aware of significant forest owners planning to progressively bulldoze forests of this age class for no return. An analysis of the land values and deforestation costs makes this commercially sound, despite it being a gross waste of productive land and of no benefit to the environment.

The benefits of the bill to the forestry sector from carbon credits for post-1990 forests have been significantly devalued by the decision to defer entry of liquid fuels until 2011. This has reduced the buyers for New Zealand Units by 40 million tonnes. These credits cannot currently be sold internationally as the only other Kyoto-compliant ETS, in Europe, does not accept forestry carbon credits. There is also a problem in selling the large numbers of forestry units internationally in respect of the Kyoto Protocol's Commitment Period Reserve that requires New Zealand to hold a minimum of 90 percent of our AAUs in our registry.

It is abundantly clear to National that the forestry provisions of this bill are seriously deficient. It will not restore confidence to this sector nor reverse the very damaging recent deforestation. There is an urgent need for a fresh process of engagement with the forestry sector to develop a far more sound and practical approach to greenhouse gas emissions and plantation forestry.

Fishing

New Zealand's fishing industry exports 92 percent of its output, earning $1.3 billion per annum. It is an energy intensive sector with fuel making up around 40 percent of the operating costs of vessels. The bill provides for an allocation of units to sectors such as dairy, meat, cement, steel, forestry and aluminium, but excludes the fishing industry. This arbitrary exclusion does not seem well justified.

A further concern is the incentive to use foreign fishing vessels that will not face the cost of the ETS for imported fuel. The 1980s and 1990s saw a decline in the use of foreign fishing vessels and crew to New Zealand's advantage. This has reversed over the last five years. This bill may inadvertently encourage ongoing job losses for New Zealanders and the replacement by foreign vessels. The last minute amendments to address this problem are inadequate.

The fishing industry is under substantial pressure as evidenced by the recent 320 redundancies announced by Sealord. No other country is imposing these costs on their fishing industry. This industry should be considered trade exposed and receive appropriate allocations.

Refrigeration and air conditioning industry

National is seriously concerned about the implications of this bill for New Zealand's refrigeration and air conditioning industry through the provisions that include the refrigeration chemicals HFCs and PFCs. These gases make up 1 percent of New Zealand's greenhouse gas emissions. The ETS has huge cost implications for the sector that will cost tens of millions of dollars and which could put thousands of jobs in both the export and domestic industry at risk. That this sector was first consulted by officials in May 2008, and then only at the insistence of the select committee, is an appalling way to treat successful New Zealand businesses like Fisher and Paykel, Temperzone, Skope and McAlpines.

Although refrigerant gases only impact negatively on climate change if released, the bill imposes the cost at importation. The Australian Government has approached this issue by extending their regulatory system for collecting ozone-depleting chemicals to these particular greenhouse gases. The New Zealand industry also believes this approach would have better environment outcomes than by inclusion in the ETS.

The "all gases, all sectors" approach should not be a mantra that overrides a focus on outcomes. This sector has proved that the collection approach can work successfully with its responsible approach to ozone depleting chemicals. National believes that if this small sector can show it can better manage emissions of these gases at less cost through its alternative approach, they should be given the opportunity to do so before being included in the ETS in 2013.

Moratorium on thermal generation

Electricity is a sector in which the Government's climate change policies have failed. Far from moving New Zealand towards the goal of 90 percent renewables, the proportion has fallen from 72 percent in 1999 to 66 percent in 2007. The Government's interventions in the electricity industry have been contradictory. Renewable developments like Project Aqua and the Dobson Hydro Project were stopped by Government decisions. Thermal projects like the new oil powered Whirinaki Power Station have been directly funded by a consumer levy and the massive new 385 MW E3P Combined Cycle Gas turbine built by Genesis was unusually underwritten by the Government. Of the new generation built by this Government, 75 percent has been thermal and so the moratorium proposed here represents a radical shift in policy.

National's first concern is security of supply. Many submitters from industry believed the moratorium would put this in jeopardy. That these provisions are being advanced in the middle of a winter power crisis defies common sense.

National's second concern is the effectiveness of the proposed moratorium. It is a very blunt instrument that does not seem to be part of any coherent policy. There is no guarantee that it will reduce emissions as it only affects new builds. The trebling in emissions from the existing Huntly Station between 1999 and 2005 would be unaffected. The moratorium may increase emissions in preventing the substitution of old dirty technology with new efficient gas technology that produces less than half the emissions per unit of electricity produced.

The distinction in the bill between new power stations being either base load or peak load is nonsensical. Ironically, New Zealand's biggest greenhouse gas emitter, Huntly, was built as a peak load station in 1987, and technically another could be built under the exemptions in this bill. National sees no place in New Zealand for any new coal generation until such time as carbon sequestration technology becomes viable.

The smart way to provide an incentive for renewable energy over thermal generation is through the price signal of an ETS. That is why we have consistently advocated that electricity be the first sector to be introduced to an ETS. It provides a signal every day to the electricity sector to favour renewable over thermal, and not just when build-

ing. It avoids the artificial distinctions between peak and base load stations. The ETS will encourage substitution for more efficient thermal generation where possible, and for the earlier retirement of old, dirty technology. It is noteworthy that renewable generator Meridian and the Parliamentary Commissioner for the Environment have rejected the moratorium.

National supports the 90 percent renewable energy target. We have confidence that the pricing signal of the ETS, as well as National's proposed reforms of the Resource Management Act, will give the impetus to new renewable generation without the arbitrary and inefficient moratorium proposal in this bill.

Conclusion

This bill requires substantial amendment if New Zealand is to have a workable emissions trading scheme. National cannot support it in its current form. The Government decision to defer implementation by two years means there is time to get this legislation right without having to delay implementation.

It is not a satisfactory process for Parliament to defer the many significant design issues raised in submissions to regulations to be determined in the future. Issues such as where the point of obligation is for agriculture, whether there will be an industry allocation for new entrants, where the threshold will be for trade exposed industries, whether the allocations will be intensity based, and whether forestry will be allowed an offset provision are fundamental to the success of the ETS.

The correct way forward is for the Government to table a substantive amending Supplementary Order Paper in Parliament to address the major concerns with the bill. These amendments should be sent alongside the existing bill back to the select committee for submissions, careful analysis and final deliberation. The bill should then be advanced through its second and third readings. It would be possible to conclude this process prior to the General Election but it is more likely to be done properly in the less politically charged post election period.

National will proceed with an ETS amended in line with this minority report if we are successful at this year's general election. We would work as cooperatively as possible with other political parties

to achieve this. Our objective is a widely supported and robust ETS that will deliver on New Zealand's ambitions for a responsible approach to climate change and a strong economy.

Green Party minority view

The Green Party has long called for a price on carbon to encourage reducing emissions, but believes a carbon charge, recycled into other tax reductions and into energy and transport efficiency programmes would be far more transparent, simple, cheap to administer and cost effective.

An emissions trading scheme could be made to work, but this bill as reported back has major flaws. Our continued support for the bill is contingent on considerable change being made in the house.

This ETS is not a cap and trade system because there is no New Zealand cap on emissions—units can be imported up to the full requirement to meet our Kyoto obligation. We believe that at least there should be targets for domestic emissions reduction specified in the bill as part of the purpose.

Further, the creation of NZUs allows the possibility of a future government allocating more of them to keep the price down, reducing the return to those who have invested in carbon efficiency. It would be entirely possible to use international Kyoto units to trade.

The ETS will take a long time to have any effect on emissions because some sectors are slow to enter and are grandparented for most of their emissions for far too long. In particular, agriculture which produces half of our emissions is not brought in until the first Kyoto period is over, in 2013. We do not accept the rationale for this, that there is little farming can do to reduce emissions. Evidence given to the select committee shows there are a number of possibilities to reduce nitrous oxide in particular and that these are more cost-effective than the opportunities open to some energy intensive industries.

We disagree with the decision to delay the entry of transport to 2011. We have been offered no evidence that oil prices will be lower by then, and that the effect on inflation or on affordability will be any less. We believe a phased entry by transport would be fairer, beginning next year.

There is also no reason to legislate for extending the phase out of free units until 2019, while we have no idea how quickly our competitors will accept carbon pricing themselves.

We are concerned that most of this bill is about enabling regulations to be made and that the effect and even the intent of those regulations is not being determined in the legislation. In particular, all the key allocation decisions are being left to regulation and it is impossible to tell from this bill whether allocation will be effective or fair. We are pleased that the select committee has adopted our proposal to insert in the legislation criteria for the minister to take into account when making allocation decisions, but these are still very high level.

Submitters have presented us with analysis that costs and the effort required by the ETS are very unequally distributed, with those who produce 30 percent of the emissions paying 90 percent of the cost. A large part of this unfairness is because agricultural emissions are to be met by the taxpayer for the first five years. We believe it is essential to create a sizeable fund to assist low income households meet higher electricity costs by insulating their homes and making them more energy efficient; to accelerate public transport solutions; and to help small business improve their efficiency.

We are concerned that the environmental effects of afforestation incentivised by the ETS could be very damaging. There is no obstacle to regenerating indigenous forest being crushed and burned and replaced with pines, or to planting exotic forests over other rare ecosystems like tussock lands. We cannot afford this loss of biodiversity.

Renewable preference

We strongly support the restriction on further thermal power stations but believe that Part 2 as written will enable any kind of power station to be built as an exemption. The definitions of baseload, efficiency, start-up and co-generation will determine the scope of these exemptions and are being left for regulations. We believe those values should be given in the legislation.

We note that if the Government's goal of 90 percent renewable electricity by 2025 is to be met both the Huntly power station and one other thermal station will need to be closed by that date and replaced by renewable generation. If a new baseload station is allowed to be built under the exemption in 62G(1)(e) then a further existing station

will need to be closed. We believe the exemption for new plant that is replacing less efficient plant should be removed.

Appendix

Committee process

The committee called for public submissions on the bill. The closing date for submissions was 29 February 2008. The committee has received 259 submissions from various organisations and individuals. We received advice from the Emissions Trading Group and the Parliamentary Commissioner for the Environment. We also considered a report from the Regulations Review Committee on the powers contained in clause 67.

Committee membership

Charles Chauvel (Chairperson)
Hon Bill English
Jeanette Fitzsimons
Craig Foss
Hon Mark Gosche
Hone Harawira
Rodney Hide
Moana Mackey
Dr the Hon Lockwood Smith (Deputy Chairperson)
Hon Paul Swain
Chris Tremain
Judy Turner
R Doug Woolerton

Hon Dr Nick Smith replaced Chris Tremain and Hon David Carter replaced Craig Foss for this item of business.