

Overview of the changes to the Climate Change Response (Emissions Trading Reform) Amendment Act

On 22 June 2020, the Climate Change Response (Emissions Trading Reform) Amendment Bill received royal assent, introducing updates to the Emissions Trading Scheme (ETS)

In pursuit of improving the ETS, the Climate Change Response (Emissions Trading Reform) Amendment Bill (**Bill**) has received royal assent, amending the Climate Change Response Act 2002 (**CCRA**). The changes will come into force at different stages, with the majority of the changes coming into force this year followed by further changes coming into force on 1 January for the years 2021, 2023 and 2024. The aim of the changes are to reduce New Zealand's overall emissions and bring international climate change targets within reach.

The key changes that result from the Bill are as follows:

- **Updating the purpose of the CCRA**

The purpose of the CCRA has been updated to support implementation of New Zealand's international climate commitments under the Paris Agreement and domestic targets and emissions budgets, to be set under the Climate Change Response (Zero Carbon) Amendment Bill (**Zero Carbon Bill**). See our comments on the Zero Carbon Bill [here](#).

- **Allowing for cost containment reserve / robust and transparent auctions**

Currently participants within the ETS can purchase unlimited New Zealand Units (**NZUs**) from the Government at a fixed price of \$25 per NZU for immediate surrender. This arrangement will be replaced with an ETS auction mechanism coined the cost containment reserve (**CCR**). The CCR operates by ensuring there is initially a limited reserve supply of NZUs at auction, however additional NZUs will be released when NZU market prices reach a certain level. In 2021, the trigger price for the CCR to

release additional NZUs at auction will be \$50, which increases by 2% each following year.

The purpose of the CCR is to control the market price of NZUs. Releasing more NZUs matches high market demand, which reduces the market price of NZUs when it gets too high. Conversely, where the market price of NZUs gets too low, the CCR provides a minimum price for NZUs at the auction to increase the market price. As part of this process, the Minister of Climate Change (**Minister**) must ensure that emissions are reduced, or removals are increased, to match the reserve amount of NZUs released.

To support robust and transparent auctions, the Minister may also appoint an independent auction monitor to validate auction results, monitor anti-competitive behavior, and produce public reports on the results of auctions.

The auction process

Auctioning will be quarterly, with an auction notice published at least 30 days prior to the auction date, and is expected to begin in 2021. The auction process will involve:

- each bidder submitting a single bid at their preferred price;
- all bids will be ranked from highest to lowest, with the clearing price set as the lowest successful bid price;
- uniform price means that all bidders will pay the clearing price regardless of the preferred price enclosed in their bid;
- successful bids are awarded NZUs from the auction.

NZU fixed price increase

The fixed price will increase from \$25 to \$35, to reflect the new price of NZUs under the new ETS. The \$35 fixed price option (**\$35 FPO**) will be available to bidders depending on when the first

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auction begins. Generally, the \$35 FPO will cover emissions from the year previous to the auction, up until 31 May of the year the action is held. However, if the auction takes place in 2022, the \$35 FPO will cover emissions from this year and next year, up until 31 May 2022.

Post-1989 forestry participants can use the \$35 FPO to cover multiple years of emissions. The proportion of how much the \$25 or \$35 FPO will be used for a particular part of the emission period is determined on a pro-rata basis.

• Enabling cap on emissions covered by ETS

The Government will start introducing regulations to set an overall limit for the supply of NZUs for each year to apply for a period of five years. This means that in each year the Government will set a limit on the supply of the total NZUs available in the ETS whether by means of auction, other means, or approved overseas units. The details of overall limits and price controls will be set out in the regulations, which the Ministry have stated will likely be published by the end of 2020. These regulations must be generally in accordance with the relevant emissions budget, the relevant nationally determined contribution for New Zealand under the Paris Agreement and the target to be carbon neutral by 2050. However, this is subject to the discretion of the Minister when considering the factors set out at new sections 30GC(5) and 30GC(6) of the CCRA.

The new section 30GC(5) records the **main matters** to be considered by the Minister as:

- the projected trends for New Zealand's greenhouse gas emissions in the 5 years after the current year;
- the proper functioning of the emissions trading scheme;
- international climate change obligations and instruments or contracts that New Zealand has with other jurisdictions to access emissions reductions in their carbon markets;

- the forecast availability and cost of ways to reduce greenhouse gas emissions that may be needed for New Zealand to meet its targets for the reduction of emissions;
- any recommendations of the Climate Change Commission that are made after an emissions budget is first set, including any desirable carbon price path (if available); and
- any other matters that the Minister considers relevant.

The new section 30GC(6) records the **additional matters** to be considered by the Minister, but only in relation to regulations on price controls, as:

- the impact of emissions prices on households and the economy;
 - the level and trajectory of international emissions prices (including price controls in linked markets); and
 - inflation.
- **Phase-down of industrial allocation**

The ETS will require a phase-down of all industrial allocations from 2021. Currently, those that meet the criteria prescribed in the CCRA may be eligible to receive an industrial allocation of NZUs. Industrial allocation is targeted at activities (production processes) that are both emission-intensive and trade-exposed.

Industrial allocation aims to reduce competitiveness issues for New Zealand businesses impacted by ETS costs in the global marketplace. New Zealand businesses are unable to pass on increased costs to consumers solely because they are competing with overseas businesses. This competition could lead to businesses relocating to countries which do not have equivalent climate policies. Relocation would see a loss in production in New Zealand and may also increase global emissions – this is described as emissions leakage.

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The ETS will reduce the level of allocation for every activity by 0.01 each year from 2021 to 2030, with greater reductions for 0.02 annually after 2030 and 0.03 annually after 2040. On the recommendation from the Climate Change Commission to the Minister, some industrial activities can have different rates of reductions depending on whether an activity has a higher or lower emissions leakage. The aim of reducing industrial allocation is to encourage high emission intensive businesses to slowly reduce their carbon emissions.

- **Strengthened compliance regime**

To encourage compliance with the ETS, the Bill introduces new infringement offences for low-level offending. Low-level offending will not result in convictions, but offenders will be required to pay a penalty fee (however convictions will ensue for more serious offending). Emissions related penalties are separated into two categories:

1. failure to surrender or repay NZUs; and
2. failure to report emissions or make mandatory allocation applications.

Offenders may be liable to pay infringement fees of no more than \$2,000 for a body corporate or \$1,000 for any other person other than a body corporate. Different amounts may be prescribed for infringement fees depending on whether it is the first, second or third infringement offence. In addition to paying a penalty fee, offenders will be required to remedy their failure to meet their obligations under the ETS.

- **Transparent scheme**

Information on the emissions and removals of individual businesses will be made publicly available online. This will allow market researchers to have a more complete picture on the ETS and put a public spotlight on emitters captured by the ETS.

- **Averaging accounting for post-1989 forests registered from 1 January 2019**

Averaging accounting will allow participants to account under the ETS by reference to the expected long-term average level of carbon stock of the land over multiple forest rotations, rather than on a strict 1 unit per 1 tonne basis.

From 1 January 2023, averaging accounting will be optional for forests registered from 1 January 2019 and mandatory from 1 January 2021. There are three key features for post-1989 forestry under this average accounting approach:

1. removing liabilities for carbon lost from adverse events (such as storms or fires), as long as the forest is replanted (and if the damage is so severe that it prevents re-establishment of the forest, then there will be a mechanism by which the land can be removed from the ETS);
2. enabling liabilities to be offset by planting a carbon-equivalent forest elsewhere. In such circumstances, the swapped out carbon accounting areas will be removed from the ETS and the NZU balance will be transferred to the swapped in land; and
3. closing a loophole that could allow foresters to deforest and re-register land in order to game the averaging accounting provisions.

- **Introducing new permanent forest activity into ETS**

The Permanent Forest Sink Initiative will be disestablished from 1 January 2024 and replaced with a new permanent post-1989 forest activity in the ETS.

- **Operational and technical improvements for forestry**

The Bill introduces a range of operational and technical improvements specific to the forestry sector to simplify the process and encourage the planting of new forests. The improvements include:

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1. enabling easier assessment of land eligibility for the ETS;
2. enabling new regulations to define how carbon credits are allocated in relation to grant-funded forests to ensure that the CCRA does not force forest owners to breach their 'One Billion Trees' contracts;
3. adjustments to the mandatory emission return periods to coincide with the deadlines prescribed in the Paris Agreement;
4. a number of changes to simplify the change of ownership process for registered post-1989 forest land under the ETS, including changes to the way transmissions of interest (**TOI**) for when registered post-1989 land is bought, sold or transferred. The main changes to TOI are:
 - a) making a TOI optional when a forest lease or right is granted; and
 - b) removing the need for executors /administrators of estates to become participants in the ETS and undertake a TOI when they begin to administer the estate;
5. changes to offsetting to make offsetting more effective and flexible for pre-1990 forest land owners. This will be particularly important for owners, such as Māori landowners and farm foresters, who hold large areas of pre-1990 forest land that could be suited to another land use. The improvements will provide more flexibility around how to achieve an offset forest, the ability to adjust an offsetting application after it has been approved and only apply enforcement action to the specific areas of forest land that are not offset (as opposed to liability for all deforestation from the original application / revocation of the entire application);
6. better management of tree weed exemptions in respect of deforestation liabilities; and

7. enabling owners of land with multiple owners better access to exemptions in respect of deforestation liabilities.

It is expected that these changes will be particularly beneficial to small forest owners, farm foresters and, in some cases, to trusts and forest owners of Māori land under the Te Ture Whenua Māori Act 1993.

- **Price on agricultural emissions from 2025**

One of the major changes to be implemented by the CCRA (as amended by the Bill) is the price that will be implemented on agricultural emissions from 2025. The details on this will be available by December 2022, as the amended CCRA provides for the Minister and Minister of Agriculture to prepare a report by that time outlining what this pricing system should look like. This is to be an alternative to the ETS for the agriculture industry.

Want to know more?

If you would like further information or have any queries or concerns, please do not hesitate to contact Anderson Lloyd's specialist [Renewable Energy and Carbon Team](#).