



BELL GULLY

Kyoto Protocol Response Guide

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INTRODUCTION

The Government released its Preferred Policy Package on New Zealand's response to climate change and the Kyoto Protocol at the end of April 2002. Now, the Government has introduced into Parliament the Climate Change Response Bill.

This guide covers what the Climate Change Bill contains, how it fits with the Preferred Policy Package and what both developments could mean for you. No matter what your view on ratification, the need to prepare for the possibility of obligations under the Kyoto Protocol has become a reality.



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1 CLIMATE CHANGE RESPONSE BILL

The Climate Change Response Bill (the Bill) was introduced into Parliament on 20 May 2002. The explanatory note outlines that the Bill will:

- put in place a framework to allow New Zealand to meet its international obligations under the Kyoto Protocol (the Protocol); and
- formalise the powers and institutions necessary for New Zealand to continue to meet its obligations under the United Nations Framework Convention on Climate Change (the UNFCCC).

Why has the Government introduced the Bill now?

Since last year, the Government has made it clear that it intends to ratify the Kyoto Protocol at the Earth Summit to be held in Johannesburg in August/September this year. Before the Government will ratify any treaty, it is conventional for it to have the mechanisms in place under domestic law which will allow New Zealand to meet its obligations under that treaty. Accordingly, the aim of the Bill is to provide for the establishment of the administrative powers and bodies that are required under the Protocol (or that are necessary if we are to get the benefits of the compliance mechanisms available under the Protocol) with a view to allowing for ratification.

In addition, the Bill will enhance the ability of government agencies to collect information on our greenhouse gas emissions and report to the United Nations on them, as we are already obliged to do under the UNFCCC.

With the advent of an early election, however, the timetable for ratification of the Protocol will have to change. Just how much it will have to change is impossible to gauge at this stage, given the variables around which parties will be elected into power, whether a coalition will have to be formed, and how long the forming of any coalition might take. If a Labour-led government or coalition takes power quickly, the Bill could be passed around September or October.

What, in particular, does the Bill do?

In essence, the Bill deals with three quite technical matters, which can be seen as the minimum that must be dealt with in order to enable New Zealand to comply with the Protocol. The Bill:

- **Confers powers allowing the Minister of Finance to manage New Zealand's stock of emission units.** At the beginning of the first commitment period under the Protocol, which is 1 January 2008 to 31 December 2012, New Zealand will receive for that period an assigned amount of human-induced greenhouse gas emission capacity. The Bill envisages that the Minister will hold the initial assigned amount as "assigned amount units" in the registry (see below). The Bill also envisages that the Minister can direct the creation of "removal units" (or sink credits). Moreover, the Minister will be empowered to buy and sell units on the international market.
- **Establishes a registry to keep account of the units held in, and transferred into and out of, New Zealand.** The registry will also exchange information on transfers with other registries around the world and with the independent transaction log, which is a unit accounting system operated by the UNFCCC Secretariat intended to act as a

double check on domestic unit accounting. It will ensure that countries do not allow their stock of emission units to fall below the “commitment period reserve”. The reserve is intended to prevent countries selling off all their units and then being unable to comply with their obligation to hold sufficient units to meet their actual greenhouse gas emissions. The registry functions would be carried out by the Ministry of Economic Development.

- **Establishes a national inventory agency with authority to collect information on New Zealand’s emissions of greenhouse gases (and removals by sinks).** The inventory agency would be the Ministry for the Environment.

How will the Bill affect me?

Importantly, the Bill itself does not impose any obligations on businesses or individuals to take responsibility for their emissions, either by paying an emissions charge or by holding sufficient emission units to offset their emissions; scenarios that have been raised as possibilities in the two consultation papers released by the Government this year. In other words, it is not envisaged under the Bill that anyone other than the Crown will be responsible for meeting New Zealand’s emissions target under the Protocol.

Even this potential responsibility will not become a reality, despite New Zealand’s ratification of the Protocol, until 55 countries (including developed countries representing 55% of developed countries’ carbon dioxide emissions in 1990) ratify the Protocol. Without that level of support, the Protocol does not enter into force.

However, despite the fact that the Bill does not impose on businesses and individuals any direct costs at this stage in relation to the level of their emissions, certain provisions of the Bill may yet impact on the costs that some participants in the economy incur.

Information Collection Obligations

The Bill expands the powers of the minister responsible for the inventory agency to collect and compel the provision of information on greenhouse gas emissions. Compliance costs to businesses could increase where there is a requirement under regulations (which are yet to be developed) to provide certain information on emissions to the inventory agency. Clause 48(2) of the Bill sets out a varied catalogue of the sorts of information that the regulations might require – and enquiries can go back as far as 1989. Some examples include:

- volumes of fuel produced, distributed, sold, or used, and the nature of the use of that fuel;
- composition of vehicle fleets and the use of vehicles, including distances travelled; and
- numbers of ruminants and other farmed livestock and their performance.

Under the Bill, penalties may be imposed for failure to provide that information without reasonable excuse – up to \$5,000 for an individual and \$30,000 for a company.

The Bill also confers inspectors authorised by the minister wide-reaching powers of entry and inspection in relation to land and premises to collect information on emissions or to determine whether a person is complying with the regulations (however, search warrants are required before inspectors can enter a private home without the occupier’s consent). Penalties may be imposed on persons who are obstructive in their dealings with the inspector.

The *regulatory impact and compliance cost statement* which accompanies the Bill notes that the impact of the costs which could arise due to the changes are not likely to be significant because much of the necessary information is already collected under existing voluntary and mandatory regimes (for example from industrial and energy emitters, farmers, agricultural and forestry companies and waste management companies). The extent to which these and any other parties will be affected by new information collection obligations appears to depend on whether existing collection programmes are satisfactorily maintained and how international standards for data collection develop, i.e. whether they will require more stringent or more wide-reaching data collection. Nevertheless, the Bill heralds a new era in terms of the seriousness with which environmental matters are or may be taken by government.

2 THE PREFERRED POLICY PACKAGE

The Preferred Policy Package released by the Government on 30 April 2002 details the policies it intends to put in place to respond to climate change and to meet its obligations to reduce greenhouse gas emissions to 1990 levels under the Protocol.

Significantly, however, Protocol policy remains a work-in-progress and consultation is currently under way as to its final form. Various public meetings and hui were completed in May and the official closing date for written submissions on the policy was 14 June 2002. In addition to writing submissions, it will also be important to maintain an interest as the policy develops into law. Important lobbying opportunities continue to exist, particularly in relation to the contents of any second Climate Change Response Bill that will bring into law the Government's policy decisions.

Outline of the Government's preferred policy

According to the Preferred Policy Package consultation document, the Government intends that the following measures will be utilised in the **pre-commitment period** (i.e. before 2008):

- Building on existing **foundation policies**, including the National Energy Efficiency and Conservation Strategy (NEECS), the New Zealand Transport Strategy, the New Zealand Waste Strategy, Resource Management Act reform, research and public awareness. These measures are already under way and will exist whether or not the Protocol comes into force.
- The introduction of **Negotiated Greenhouse Agreements** (NGAs) for competitiveness-at-risk firms (see discussion below). NGAs are a contract between the Government and a firm or sector to reduce emissions towards an agreed level in return for partial or full exemption from an emissions levy or charge. A particular advantage of the NGAs is that an agreed emissions path can be tailored to a firm's individual circumstances. NGAs might also include opportunities for a firm to get involved in off-site projects (see below) or emissions trading, if the regime were established, to reduce costs.
- The introduction of government and industry-funded **research in the agricultural sector**.
- The introduction of **funding and projects** to incentivise efficient emission reduction and sinks creation. Projects are specific recognised activities that are aimed at delivering defined reductions in emissions but which would be uneconomic without the payment of an incentive from the Government. Projects are intended to deliver a reduction in emissions that would not have otherwise occurred.
- The introduction of particular **strategies to deal with HFCs and SF₆**.

In addition to the measures begun in the pre-commitment period, during the **first commitment period** (2008-2012) the following policies are also intended to be introduced:

- The introduction of an **emissions charge** for carbon dioxide (CO₂) approximating the international price for emission units, but capped at \$25 per tonne of CO₂ equivalent. There will be no charge on emissions of non-CO₂ gases during the first commitment period.
- The Government is to retain sink credit assets and liabilities.

An important point to note, however, is that none of the new policies (i.e. policies that are not foundation policies) identified in the Preferred Policy Package will be implemented for the first commitment period until the Protocol comes into force. The new policy measures are specifically designed to deal with our potential Protocol obligations.

Economic groupings

Because of the differences in how emission charges in particular could affect different sectors, the charges will not be applied evenly across the economy. The Government has divided the economy into four distinct groups for the purpose of climate change policy.

The table below identifies those groups and describes the particular policy that is intended will apply to each.

| GROUP | DESCRIPTION | POLICY |
|-----------------------------------|--|---|
| 1. Competitiveness-at-risk | Sectors that would find it difficult to cope with an emissions charge because they are major emitters, have high energy use or because they export and compete with nations that have no Kyoto obligations and who might be affected to the extent that they are forced to reduce staff, close or move overseas. | The Government intends that this group will be fully (or partially) shielded from any emissions charge. NGAs are proposed as the main policy measure for this group. The terms of the agreements and hence the extent and method of shielding can be tailored to the particular business. |
| 2. General energy users | This group reflects a large group of organisations and households for which energy (electricity and transport fuels) is a cost, but may not be a major cost in their operations. It is relatively easy to measure the level of emissions of the group. Members have many options for reducing their emissions efficiently and businesses can pass costs on to consumers. | This group will face an emissions charge approximating the international price of carbon capped at \$25 per tonne of carbon dioxide (CO ²), and revenue from the charge will be recycled back into the economy (e.g. through tax cuts). The Government retains the option of introducing emissions trading rather than an emissions charge if conditions permit |
| 3. On-farm agriculture | Agriculture could be categorised in the Competitiveness-at-risk group. This group also displays the additional characteristics of having no clear way to reduce methane and nitrous oxide (short of reducing stock numbers) and no simple way of measuring and monitoring those emissions, and therefore is categorised separately. | The Government proposes to exempt this group from any non- CO ² emissions charge. Instead, it proposes a sustained research effort to find out how the agricultural sector can reduce its emissions. Much of the funding will come from the sector, and if the sector is unwilling to work with the Government to invest in research, it will impose a research levy. |
| 4. Others | These are sectors where factors such as a lack of cost-effective abatement options (synthetic gases sector) and/or emission measurement difficulties (the waste sector e.g. landfills) affect their ability to cope with the cost of emissions in the short-term. | The Government proposes to manage the synthetic gases sector by a mixture of regulation and industry agreement . In the pre-commitment period, the Waste Strategy should create incentives in the waste sector but its success will be reviewed in 2005. The possibility of a levy on waste will be examined at that time. |

It is clear, therefore, that the extent of an entity's obligations is very largely dependent on which category it is deemed to fall into. Categorisation will be a key area on which to lobby. Other areas that would merit consideration for purposes of submissions to the Government include:

- the extent to which competitiveness-at-risk firms should be shielded;
- whether the \$25 cap is set at the appropriate level;
- how revenue from the emission charges should be recycled through the economy; and
- how agricultural sector funding for research should operate (including who should get rights in any intellectual property that is developed and could be sold overseas).

For a full copy of the Government's Preferred Policy Package consultation document, which includes more detail on the policies set out above, see www.climatechange.govt.nz.

3 PRE-COMMITMENT PERIOD INVOLVEMENT

While the Government favours early action on emissions reduction, any emissions charge would not come into effect until 2008. In light of this tension, the Government is looking at ways to incentivise firms to become involved in emissions reduction in the pre-Commitment period. By doing this, it is hoped that management will focus on abatement opportunities within firms and that investment up to 2007 will reflect the future cost of emissions. Two interesting aspects of the policy package proposed by the Government deserve mention.

Negotiated Greenhouse Agreements

A competitiveness-at-risk firm might consider getting involved in NGAs in the pre-commitment period because some of the options the Government is considering include:

- making access to NGAs (and therefore shielding from emission charges) conditional upon having completed an NGA by the end of 2004-2005;
- using an NGA to negotiate an emissions baseline with the Government that would apply up to any agreed future date (say 2012 or 2017).

Affected firms should, therefore, be starting to consider what the characteristics of their particular situation are, and what their abatement opportunities are, in preparation for negotiations with the Government.

Projects

In sectors where there is an absence of price signals, it is not considered likely that significant early reductions will occur. Therefore, the Government is considering using emission-reducing projects (e.g. efficiency upgrades or forest planting) in those sectors to achieve significant levels of early abatement. Those who undertake emission-reduction projects, and who have received recognition by the Government under its contestable framework for project support, will be rewarded with funding or emission units. As noted above, the criteria that will apply to the approval of projects will avoid supporting those efforts to reduce emissions that would have occurred anyway.

The opportunity to reap rewards from projects could begin, potentially, as early as next year. Work should be started now on determining, and getting involved in setting, the criteria that the Government will apply in considering whether or not to support a particular project – as well as on identifying what those projects might be.

4 WHAT ABOUT EMISSIONS TRADING?

While the concept of private sector emissions trading is not developed under the Preferred Policy Package, the policy specifically leaves open the option for the introduction of emissions trading if conditions permit.

Parts of the policy already contemplate the possibility that private sector actors could obtain emission units, for example, under NGAs. Emissions trading, on the other hand, would see firms take on and manage an emission obligation directly. It would involve the devolution by the Crown of some of its rights and obligations under the Protocol.

Further information on emissions trading issues (*The Point of Obligation and Allocation*) can be found on <http://www.bellgully.com/resources/resource.00218.asp>, or are available in hardcopy.

With emissions trading comes the potential for individual firms to reduce their costs or add value through trading emission units, either domestically or internationally. The ability to trade emission units is seen as one of the strengths of the flexible compliance mechanisms available under the Protocol. It encourages those with low abatement costs to reduce their emissions and to sell their emission units to those with higher abatement costs. Overall, this process results in a saving on the total cost of abatement.

Again, further legislation will be required to allow for private sector entities to engage in emissions trading. Because the Government has signalled that it will only introduce emissions trading if conditions permit, the scheme is not likely to be implemented until part-way through the first commitment period or beyond. Moreover, the legislation will involve complex matters of policy and regulation. This is a further area where making submissions to the Government will be important.

5 RELATIONSHIP BETWEEN THE PREFERRED POLICY PACKAGE AND THE BILL

The Bill allows the Government to ratify the Protocol. It does not impose any obligations on businesses or individuals. As mentioned above, the contents of the Bill do no more than provide the mechanisms by which the Government could, by itself, enable New Zealand to comply with its obligations under the Protocol.

The Preferred Policy Package, on the other hand, does signal that certain actors within the economy will be required to take some responsibility for the creation of CO² emissions – for example, through the payment of emission charges. To implement these policies, further legislation, over and above the Bill that is currently in front of Parliament, will need to be introduced. It is likely that the final policies will come into law through an amendment to the Bill, possibly introduced next year.

The following presents a short timetable of climate change policy milestones to watch out for, although with the intervention of the election there is necessarily quite a bit of uncertainty around those dates.

| Pre-commitment Period | | |
|--------------------------------|-------------------|--|
| 2002 | June | Submissions on policy closed. |
| | August/September | Government's final decisions on climate change policy and ratification. |
| | August/September | Rio + 10 World Summit – proposed ratification by New Zealand likely to be held up by early election. |
| | September/October | Enactment of Climate Change Response Act 2002. |
| 2003 | | Possible second climate change Bill, putting in place any required legislative measures for domestic policy. |
| 2003 – 2007 | | Implementation of pre-commitment period policies. |
| First Commitment Period | | |
| 2008 – 2012 | | Implementation of first commitment period policies. Possible regulatory enhancements to the climate change legal framework to enable domestic emissions trading. |

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