



Cabinet Economic Development Committee

Minute of Decision

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New Zealand Emissions Trading Scheme: Design Details and Complementary Measures

Portfolios **Forestry / Climate Change**

On 8 May 2019, the Cabinet Economic Development Committee:

Background

1 **noted** that on 25 March 2019, the Cabinet Business Committee:

1.1 agreed that:

1.1.1 averaging accounting will be the compulsory accounting method for all forests registered in the New Zealand Emissions Trading Scheme (NZ ETS) after 31 December 2020;

1.1.2 existing NZ ETS forestry participants with post-1989 forests registered in the NZ ETS after 31 December 2018 will have the ability to use the averaging accounting approach;

1.2 noted that the Minister of Forestry and the Minister for Climate Change intended to report back in May 2019 with further detail on the design of averaging for newly established and existing post-1989 forestry as part of a package of improvements to the incentives for forestry in the NZ ETS;

[CBC-19-MIN-0008]

2 **noted** that the paper under DEV-19-SUB-0113 provides the extra design detail referred to in paragraph 1.1.1 above;

3 **noted** that due to Budget 2019 implications, an additional paper will be submitted to Cabinet in June 2019 seeking decisions on the eligibility for existing post-1989 registered before 2019 to use averaging accounting (paragraphs 1.1.2 above);

4 **noted** that in December 2018 and March 2019, Cabinet also agreed to:

4.1 the introduction of a new permanent post-1989 forest activity;

4.2 a range of operational improvements to the forestry elements of the NZ ETS, including in relation to offsetting, tree weed exemptions, and the treatment of land owned by multiple Māori owners;

[ENV-18-MIN-0047 and DEV-19-MIN-0043]

Averaging accounting

- 5 **noted** that averaging accounting is a method to determine the long-term amount of carbon that is stored in a forest over multiple growth and harvest cycles;
- 6 **agreed** that:
- 6.1 under averaging, participants with newly registered forests receive a sum of New Zealand Units (NZUs) during the first rotation up until the point at which the forest is assumed to have stored its long-term average carbon stock;
- 6.2 this is will be expressed as an ‘average age’ for each forest type;
- 7 **agreed** that the ‘average age’ be calculated and applied in the regulations and that, in principle, it will be based off:
- 7.1 the type of forest; and
- 7.2 the age at which the forest is harvested (assessed over multiple rotations) within prescribed ‘period rotation bands’;
- 8 **noted** that the above concept of ‘period rotation bands’ means that all forests of the same type, harvested within a defined range of ages, will have the same ‘average age’ applied to their forest (for example, radiata pine harvested between ages 25 and 30 could all have the average age of 18);
- 9 **noted** that the actual carbon stock of the forest at the time it reaches its ‘average age’ is referred to as the ‘average age carbon stock’;

Detailed methodologies and rules in regulations

- 10 **noted** that in practice, participants can register forests in the NZ ETS that have all the same characteristics, or with a mix (such as species, age, rotation length), which is all within one carbon accounting area (the area to which unit entitlements are calculated);
- 11 **noted** that the high level design of averaging accounting has been mostly based around how a forest with the same characteristics within one carbon accounting area will interact with the NZ ETS;
- 12 **noted** that while the design principles outlined in the paper under DEV-19-SUB-0113 will apply to all post-1989 forests subject to averaging accounting in the NZ ETS, officials are still developing the most practical ways in which all of these proposals will be implemented for the different types of forests;
- 13 **noted** that, therefore, a considerable amount of supporting detail around aspects such as measurement methodologies, reporting requirements, application processes and unit flows are needed to fully give effect to the decisions relating to the paper under DEV-19-SUB-0113;
- 14 **noted** that officials propose that these details be included in regulations, rather than the Act itself;
- 15 **noted** that:
- 15.1 the Minister of Forestry and the Minister for Climate Change intend to seek Cabinet’s approval to consult on the proposed regulations to accompany the Bill by August 2019;

- 15.2 this will mean that the relevant select committee will have access to the draft regulations when it is considering the draft Bill arising from these proposals;

Section A: Design details for averaging accounting

Determining the 'average age'

- 16 **agreed** that a forest will receive one unit for each tonne of removals up until it reaches its average age (as determined in regulations) on its first rotation;
- 17 **agreed** that once a forest under the averaging approach has reached its average age:
- 17.1 the participant will no longer be eligible to earn any further units as the forest continues to grow, unless the area of forest reaches an age higher than the usual rotation period band;
- 17.2 the participant will no longer be required to surrender any units on harvest for the current or any subsequent rotation, so long as any harvest activity occurs within the usual rotation period band for their forest;
- 18 **agreed** that if a participant deforests at any point, they will be required to surrender the same amount of units as is currently required for post-1989 participants using the stock change methodology (including the application of section 190, which caps the amount of units that a participant can be required to surrender at their unit balance for the relevant area);

Calculating the 'average age carbon stock'

- 19 **noted** that current rules in the NZ ETS require the carbon stock for forests under 100ha to be calculated using look-up tables in regulations, and forests over 100ha using the participant specific Field Measurement Approach;
- 20 **agreed** that the same threshold for determining whether participants are required to use the Field Measurement Approach or the lookup tables in the regulations apply to all post-1989 forest land, regardless of whether it is using the averaging accounting approach or the existing carbon stock change approach;
- 21 **agreed** that up to and including the year in which a forest reaches its average age on its first rotation, emissions and removals for post-1989 forests under the averaging approach be calculated using the same methodology as post-1989 forests operating under the stock change accounting approach (with the exception of some specific exceptions, such as temporary adverse events noted in the paragraphs set out below);
- 22 **noted** that one of the implications of paragraph 21 above is that where a participant registers their forest in the NZ ETS many years after the date that their forest was established, they will only be eligible to earn units back to the start of the Mandatory Emissions Return Period in which they registered;

Calculation of emissions and removals for forests harvested in the usual rotation period band

- 23 **noted** that while the average age of a forest is based in part on its typical age at harvest, the actual age of harvest may vary, especially over multiple rotations;
- 24 **noted** that the usual rotation period bands specified in regulations will be set so as to capture the significant majority of all 'normal' commercial variation in rotation lengths;

25 **noted** that, for example, under standard commercial practice:

25.1 75 percent of all plantation forests of radiata pine in New Zealand are typically harvested within two years (plus or minus) of the usual rotation period of 28 years;

25.2 95 percent are harvested within four years of that usual period;

Calculation of emissions and removals for participants who extend or reduce the length of their rotations

26 **agreed** that:

26.1 where a participant harvests an area of forest earlier than the relevant usual rotation period band, they will be required to surrender units down to their new average age;

26.2 where a participant grows an area of forest later than the relevant usual rotation band, they will be eligible to earn additional units up to their new average age;

27 **agreed** that:

27.1 where a participant harvests either earlier or later than the relevant usual rotation period band, the rotation period band they harvested in will become the new rotation period band for that area of forest;

27.2 for subsequent rotations, the participant will be eligible to earn, or required to surrender, units if they harvest earlier or later than this new rotation period band;

Participant changes in forest type

28 **agreed** that participants whose forests are subject to the averaging accounting approach will have the right to change their forest type at any stage, such as by planting a different species after harvest;

29 **agreed** that where a change in forest type occurs, a new average age and usual rotation period will be applied for the new forest type;

30 **agreed** that after changing forest type, the participant will be eligible to earn, or liable to surrender, an amount of units equal to the difference between the average carbon stock for the old and new forest types;

Government changes in forest type, average age, rotation period band and look-up yield tables

31 **noted** that in the future, the government is likely to update the information used to calculate the carbon storage of post-1989 forests using averaging accounting, including:

31.1 forest type;

31.2 average age;

31.3 rotation period band;

31.4 look-up yield tables;

32 **agreed** that if any of the information referred to in paragraph 31 above is updated in regulations, then:

32.1 a participant with a forest that has reached its average age, will not be eligible to earn, nor required to surrender, units to reconcile with the new calculation;

32.2 a participant with a forest that has not reached its average age (on the first rotation) will now earn units in relation to the new calculation;

33 **agreed** that if a participant's entitlement is changed through a change in regulation, then this new entitlement applies from the beginning of the mandatory emissions return period in which the regulations came into force;

Transmission of interest on lands or forests

34 **noted** that in addition to allowing post-1989 forest land to be bought and sold, the NZ ETS allows for a variety of other forms of legal interest in a post-1989 forest (such as those granted through a lease or forestry right) to also be transferred between parties independently of ownership of the underlying land (collectively, these are referred to as 'transmissions of interest');

35 **agreed** that where a transmission of interest occurs in relation to an area of post-1989 forest that is operating under the stock change approach, but the land is eligible to transition to the averaging approach, the transmission will not alter the right of any new owner to opt to transition to the averaging approach in the future;

36 **agreed** that where a transmission of interest occurs in relation to an area of post-1989 forest that is operating under the averaging approach:

36.1 if a previous participant has opted to transition from the stock change accounting approach to the averaging accounting approach, that decision will continue to bind any future owner;

36.2 if a previous participant operating under the averaging accounting approach has utilised any of the flexibility mechanisms that exist, such as opting for a longer than normal rotation length, then any future rights and obligations arising from those decisions will transfer to any future owner of an interest in that land;

37 **noted** that rules governing the transmission of interest will be the same for post-1989 forest under averaging as other post-1989 forests;

Forests entering the ETS after their first rotation

38 **noted** that this section relates to an application to enter an area of post-1989 forest into the NZ ETS, and operate under the averaging accounting approach, when the land is on its second, or subsequent rotation;

39 **agreed** that:

39.1 an area of post-1989 forest land registered in the NZ ETS on its second, or subsequent, rotation will be unable to earn any units up to the relevant average age;

39.2 that forest will, from an operational perspective, be considered to be a post-1989 forest that has already reached its average age;

40 **agreed** that notwithstanding paragraph 39 above, a post-1989 forest registered on its second rotation will still be eligible to earn additional units, or required to surrender units, if actions are taken that result in its average age, or average age carbon stock changing relative to the level in the rotation that the forest was registered in (such as a result of an increased rotation length or change in the forest type);

Transitioning between different types of accounting approach for post-1989 forest land

- 41 **noted** that with the introduction of the averaging accounting approach, and permanent forest accounting approach, owners of an interest in post-1989 forest land will now have the option in some instances to choose to change the accounting approach that their forest is subject to in the future;
- 42 **noted** that on 25 March 2019, the Cabinet Business Committee agreed that all forests registered in 2019 and 2020 will have the option to use the averaging accounting method [CBC-19-MIN-0008];
- 43 **noted** that a decision about the ability of post-1989 forests registered before 2019 to choose to use the averaging accounting method has not yet been taken;
- 44 **agreed** that:
- 44.1 regardless of final decisions around which forests can opt to shift to the averaging accounting method, this should be a one-way option;
- 44.2 once an area of forest has been shifted from the stock change accounting approach to averaging accounting, that decision cannot be reversed in the future;
- 45 **agreed** that a regulatory power be established to provide the Minister for Climate Change the right to impose an end-date on to this ability to transition between the stock change and averaging accounting approaches at some point in the future;
- 46 **noted** that requirements around consultation requirements and a minimum notice period before the Minister can exercise the power referred to in paragraph 45 above will be specified in regulations;
- 47 **agreed** that any transfer between accounting approaches will occur at the carbon accounting area level;
- 48 **agreed** that when participants transition forests between accounting approaches, measures will be put in place to ensure they will not be able to receive units for sequestration already reflected in the unit balance for that forest (i.e. double-crediting);

Reporting obligations

- 49 **noted** that rules guiding the reporting obligations of participants operating under the averaging accounting approach will be specified in regulations;
- 50 **agreed** that those obligations should adhere to the following high level principles:
- 50.1 before the average age is reached, post-1989 forests under averaging should face the same reporting obligations as post-1989 forests under the stock change approach;
- 50.2 after they have reached their average age, post-1989 forests under averaging will still be required to report at regular intervals, but may be required to provide significantly less information. In particular, in many instances participants will no longer be required to measure or report carbon stock changes once the forest has reached its average age;

Avoiding the risk of a 'deforestation loophole'

- 51 **noted** that there is a potential risk that a post-1989 forestry participant who might not otherwise receive a benefit from averaging accounting might choose to deforest, replant their land and then register in the NZ ETS under averaging accounting in order to earn additional NZUs;
- 52 **noted** that where this occurred it, would come at a cost to the Crown, but provide no additional environmental benefit;
- 53 **agreed** to delegate a decision on the best options to address this potential loophole to the Minister of Forestry and the Minister for Climate Change, along with any other relevant Ministers;

Extending the current power to exempt NZ ETS participants from liabilities

- 54 **noted** that the Act currently provides a general power for exemptions from NZ ETS liabilities to be granted in relation to pre-1990 forests so long as the Minister is satisfied that the environmental integrity of the NZ ETS is not negatively impacted by the exemption and the costs do not exceed the benefits;
- 55 **agreed** to extend the existing exemptions powers to include all Schedule 4 forestry activities;

Section B: Complementary policies to support the introduction of averaging accounting**Temporary adverse events**

- 56 **noted** that the Act currently exempts post-1989 participants from a deforestation liability if a natural event permanently prevents the re-establishment of forest on that land (such as due to significant erosion);
- 57 **agreed** that a similar exemption be introduced for situations where an adverse event causes a temporary loss of forest in an area of post-1989 forest land that is operating under the new averaging accounting approach;
- 58 **agreed** that this exemption against temporary adverse events be limited to situations where all of the following criteria are met:
- 58.1 the type of event is one of those listed in regulations;
- 58.2 the carbon stock loss and area exceeds a minimum threshold defined in regulations;
- 58.3 the affected area of forest land is re-established within four years;
- 59 **noted** that rules governing the application process, reporting obligations, and unit flows in relation to this new temporary adverse events provision will be specified in regulations;
- 60 **agreed** that:
- 60.1 if the affected area of forest is below its average age on its first rotation, the participant will:
- 60.1.1 cease earning units for the affected forest area; and

60.1.2 continue earning units again only after the carbon stock in the affected area has regained the level that existed immediately prior to the adverse event occurring;

60.2 in all other instances, there will be no impact on the participant's unit flows in relation to the affected area;

Offsetting

61 **noted** that the Act already includes provisions to allow owners of pre-1990 forest land to apply to shift all of the NZ ETS related rights and obligations in relation to that land to a new area of 'offsetting' land;

62 **noted** that these provisions require the new area of offsetting land to be at least as large as the original area, and be expected to store an equivalent or greater level of carbon;

63 **agreed** that the types of forest land that are eligible to use those existing offsetting provisions be widened to include post-1989 forest land that meets all of the following criteria:

63.1 it is currently subject to the averaging accounting approach under the ETS; and

63.2 it has already reached its average age; and

63.3 it is a rotational forest that has been actively established (rather than left to regenerate naturally);

Next steps

64 **noted** that the Minister of Forestry and the Minister for Climate Change intend to bring a paper to Cabinet in June 2019 that discusses whether existing foresters with post-1989 forests registered in the NZ ETS before 30 December 2018 should have the ability to transfer from stock change to averaging accounting;

65 **noted** that work is underway on options to better incentivise the domestic production of long-lived harvested wood products as a way to help meet New Zealand's climate change commitments;

66 **noted** that the Minister of Forestry and the Minister for Climate Change intend to report back to Cabinet before the end of 2019 with options to incentivise the domestic production of long-lived harvested wood products;

Consultation

67 **noted** that without sufficient funding to put in place the necessary system and operational changes, the Environmental Protection Authority will not be able to operationalise the proposals outlined in the paper under DEV-19-SUB-0113 and in related NZ ETS papers;

Legislative implications

68 **invited** the Minister of Forestry and the Minister for Climate Change to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs;

69 **authorised** the Minister of Forestry and the Minister for Climate Change, in consultation with relevant portfolio Ministers as appropriate, to make changes, consistent with the policy framework in the paper under DEV-19-SUB-0113, on any issues that arise during the drafting process;

Financial implications

- 70 **noted** that fiscal implications and budget appropriations associated with the high level decision to introduce averaging have been previously considered by Cabinet [CBC-19-MIN-0008];
- 71 **noted** that over the period 2019-2050, the total expected net fiscal impact of allowing participants to account for changes in harvesting age (as per paragraphs 23-27 above) is \$185 million, with the first costs falling in 2037.

Janine Harvey
Committee Secretary

Present:

Rt Hon Winston Peters
Hon Kelvin Davis
Hon Phil Twyford
Hon Dr Megan Woods (Chair)
Hon Chris Hipkins
Hon David Parker
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Damien O'Connor
Hon Shane Jones
Hon Kris Faafoi
Hon Willie Jackson
Hon Eugenie Sage

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