

Emissions Trading Reform

Climate Change Response (Emissions Trading Reform) Amendment Act

In June 2020, the Climate Change Response (Emissions Trading Reform) Amendment Act (CCRETRA) received Royal Assent, introducing updates to New Zealand's Climate Change Response Act 2002.

The changes introduced with CCRETRA are designed to improve certainty for businesses, make the New Zealand Emissions Trading Scheme more accessible, and improve its administration.



New Zealand Emissions Trading Scheme (ETS)

Under the Paris Agreement, New Zealand has set a target to reduce greenhouse gas emissions by 30 percent from 2005 levels by 2030.

To achieve this, the Government introduced the New Zealand Emissions Trading Scheme (ETS) as a key policy tool to reduce greenhouse gas emissions, meet climate change targets and transition to a low emissions economy.

The ETS puts a price on greenhouse gases to provide a financial incentive to businesses and landowners to reduce emissions and plant forests that absorb carbon dioxide. The main unit of trade in the ETS is the New Zealand Unit (NZU). One NZU represents one tonne of carbon dioxide.

New Zealand has several greenhouse gas emissions reduction targets, which are set in legislation to help achieve a 2050 domestic target of:

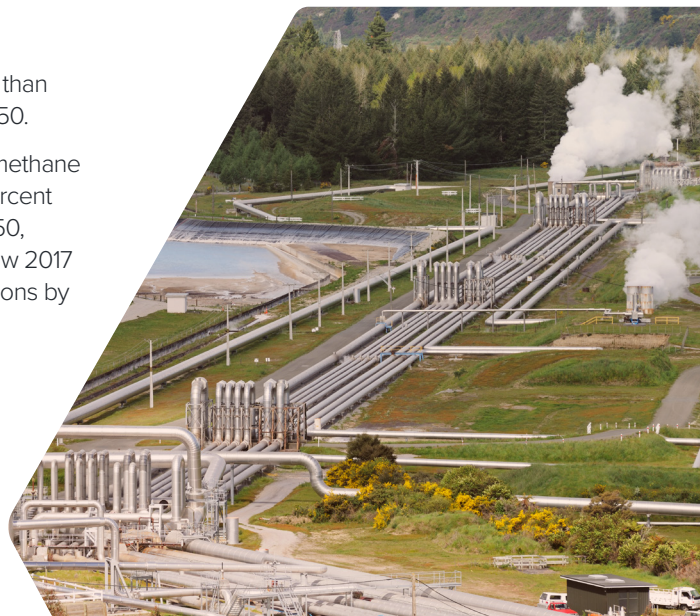
- Net zero emissions of all greenhouse gases other than biogenic methane by 2050.
- A reduction of biogenic methane emissions by 24 to 47 percent below 2017 levels by 2050, including 10 percent below 2017 biogenic methane emissions by 2030.



CCRETRA impacts for business

Most changes introduced by CCRETRA will come into force this year followed by more changes on 1 January for the years 2021, 2023 and 2024. As a result, businesses may face additional costs while others like foresters will receive emissions units from the carbon absorbed by their trees. Therefore, it is essential businesses understand these changes now so they can prepare where necessary. The key changes that will result from the Bill include:

- Cap on the ETS units.
- Auctioning of ETS units.
- Forestry reforms and Permanent Forest Sink Initiative.
- Phasing out industrial allocations from 2021.
- Agriculture.
- New price controls and replacing the fixed price option.
- Fixed price option remains during transition to auctioning and increases to \$35.





Cap on ETS units

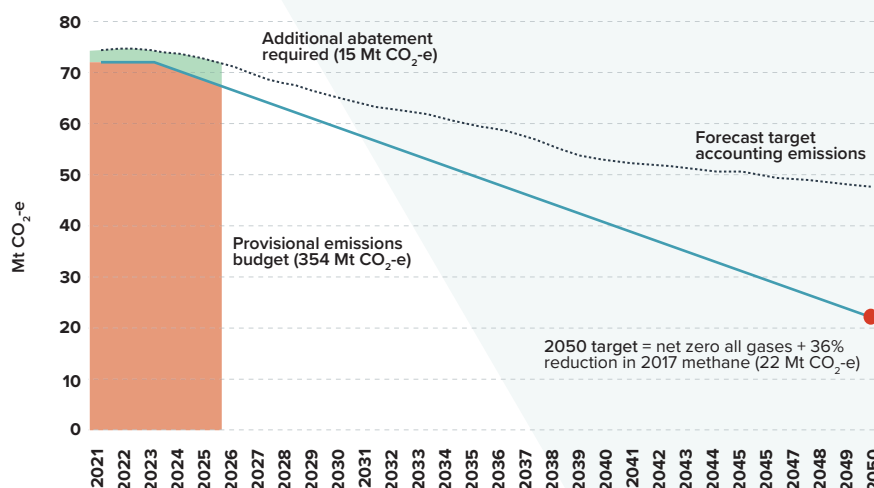
Historically, the New Zealand ETS has not had a cap on the number of units available within the scheme, which meant the ETS pricing wasn't compatible with the scheme's objectives. Now, with the changes from CCRETRA, a cap will be set on emissions covered by the scheme.

The cap requires an emissions budget to be in place and it will decline over time as New Zealand's emissions budget reduces in line with its targets.

Each emissions budget covers a period of five years, essentially operating as stepping stones to keep New Zealand on track to meeting its long-term emissions reduction targets. The Government has set a provisional emissions budget and cap for New Zealand's total volume of net emissions for the period 2021-2025 of 354 million tonnes CO₂ equivalent.



Provisional emissions budget trajectory towards 2050 Zero Carbon Act target



The graph shows the five-year provisional emissions budget for 2021 to 2025 of 354 Mt CO₂-e under the straight-line trajectory from 2021 towards the 2050 combined gas target (which includes 22 Mt CO₂-e reduction in methane). It also shows forecast target accounting emissions to 2050 and the required abatement to meet the provisional emissions budget of 15 Mt CO₂-e¹.

¹ Source: <https://www.mfe.govt.nz/reforming-nzets-emissions-reduction-targets-and-emissions-budgets>



Auctioning

The Government will sell New Zealand emissions units through a process called auctioning, which will be scheduled quarterly.

Under CCRETRA, the Government is required to set limits on the supply of units into the scheme on a five-year rolling basis in line with the emissions budgets. This process sets an overall cap on units supplied into the New Zealand ETS. As part of this process, the Government has established price control measures to prevent unacceptably high or low unit prices in the ETS, which we discuss in more detail further on.

An auction calendar was published for the upcoming year in September 2020 and provides the volume of NZUs available to be sold at each quarterly auction. An auction notice will be published at least 30 days ahead of each auction and all bidders will be required to register. Auctions will be open for participation to all New Zealand Emissions Trading Register account holders.

The total volume of NZUs available for 2021 is 19 million, which is spread evenly across the year. If NZUs remain unsold at the end of an auction they will roll-over to the next auction if it is in the same calendar year.

Auction schedule for 2021 is:

17 March	4.75 million NZUs
23 June	4.75 million NZUs
1 September	4.75 million NZUs
1 December	4.75 million NZUs

The auctioning platform will have a sealed bid, single-round, uniformly priced format.

Bidders submit a single bid at their preferred price. All bids are then ranked in order from highest to lowest price and the clearing price for the auction is set to be the lowest successful bid price.

Uniform price means that all bidders then pay this clearing price regardless of what price was on their original bid. Bids are successful if they are awarded units from the auction.

Payment by the successful bidder must be made and cleared before NZUs won in the auction are transferred to the bidder's account. Once an auction is complete, successful bidders will be informed and a report of relevant information will be published to the market.

Regulations setting the rules for auctioning are expected to be published later in 2020.



Forestry reforms and Permanent Forest Sink initiative

The Permanent Forest Sink Initiative (PFSI) was one of the Government's sustainable forestry programmes. It enabled landowners to receive units through the creation of permanent forests.

The PFSI and the ETS were reviewed between 2015 and 2018. In December 2018, the Government announced it would discontinue the PFSI, and introduce a new permanent post-1989 forest activity into the New Zealand ETS to replace it.

Other forest reforms are:

- Post-1989, forests registered from 1 January 2023 must use averaging accounting. Averaging accounting reduces ETS forestry complexity (no harvesting calculations are required) and compliance (reduced reporting and monitoring requirements).
- The Fixed Price Option (FPO) has changed from \$25 to \$35 for emissions from the start of 2020.
- For emissions which occurred up to 31 December 2019, participants will continue to have access to the FPO at \$25 for those emissions.
- Post-1989 forestry participants who submit a net emissions return which covers multiple years will have access to the FPO on a pro-rata basis for the number of years in the emissions return. (E.g. if a Voluntary Emissions Return (VER) is submitted in 2021 and is the first VER since 2018, up to two thirds of the surrender obligation can be met at \$25 for the years 2018 and 2019, and up to one third at \$35 for 2020).
- Creating a new permanent forestry activity in the New Zealand ETS from 1 January 2023.
- Exempting post-1989 forests from the requirement to surrender New Zealand Units to cover emissions from temporary adverse events (such as fire or wind throw).
- Allowing some types of post-1989 forestry participants to offset their deforestation liability by planting a forest elsewhere.





Phasing out industrial allocations from 2021

Industrial allocation is where the Government gives New Zealand units to some businesses to recognise the impact the ETS could have on their international competitiveness because of emission costs.

With the changes under CCRETRA, the Government will phase-out industrial allocation from 2021 through two complementary approaches.

1. A general phase-out rate will apply equally for all industrial activities.
2. A legislated process which can set decreased or increased phase-out rates for one or more activities.

The general phase-out starts at an annual rate of one percent for both moderately emissions-intensive activities (0.6) and highly emissions-intensive activities (0.9) for the period 2021-2030.



Agriculture

Currently, farmers and producers are not required to surrender emissions units for the biological emissions produced by agricultural activity. From 2025, CCRETRA will introduce pricing of methane and nitrous oxide emissions from livestock and fertiliser and will be priced at farm level for livestock and at processor level for fertiliser.

Government is working with the agricultural sector, and kiwi Maori via the He Waka Eke Noa – Primary Sector Climate Action Partnership to determine what the farm level pricing mechanism could look like and whether agricultural emitters will receive a 95% discount or free allocation of emissions units.



New price controls and replacing the fixed price option

The new price controls are a feature of the ETS unit auctioning rules, replacing the fixed price option with a cost containment reserve. The new rules feature an auction floor price which is the minimum price a unit can be sold at auction. A cost containment reserve is triggered when the auction price gets above a predetermined price. These price controls are designed to prevent unacceptably high or low auction prices, which could end up being passed on to businesses and households.

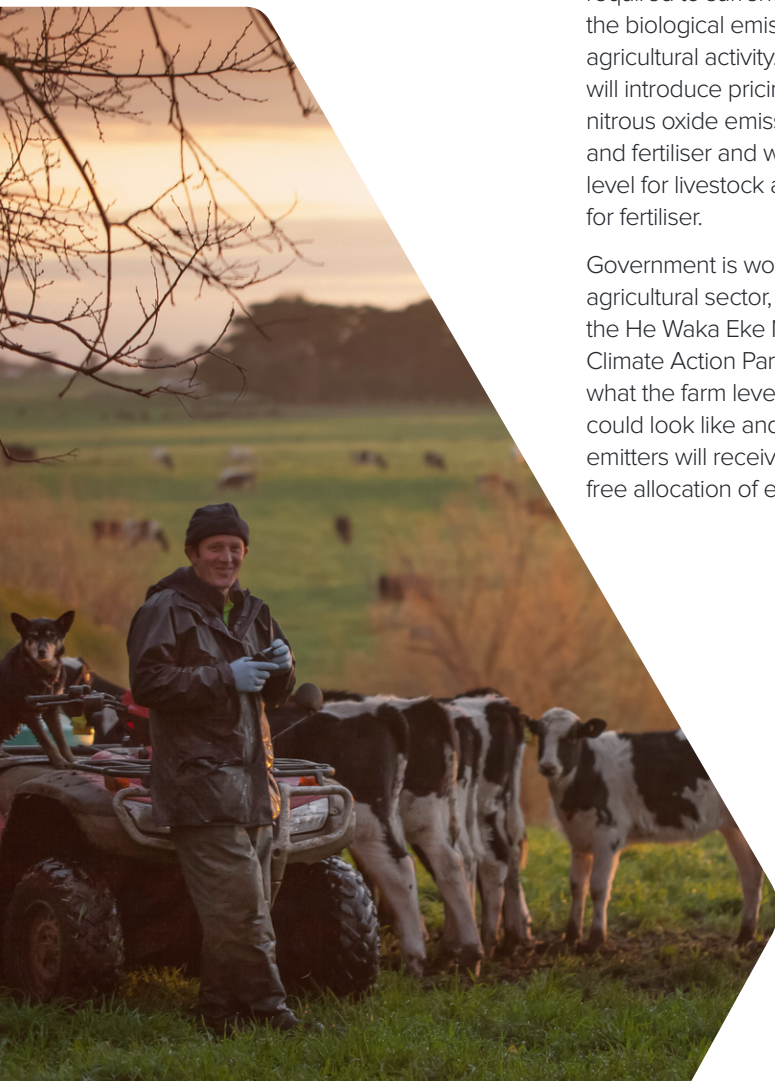
The fixed price option or FPO has been available for participants to use since the beginning of 2020 and increased from \$25 to \$35, overlapping with the start of auctioning to cover emissions in 2020.

The Government has announced the cost containment reserve will be triggered if the unit price reaches \$50 in 2021. This will release more New Zealand units into an auction to ease demand. The trigger price will increase by two percent for each subsequent year, based on forecast annual inflation.

CCRETRA will enable the price floor to be implemented through an auction reserve price. The Government has announced the minimum accepted price to bid at auction will be \$20 in 2021 and rise by two percent for each subsequent year.

Post-1989 forestry participants will also be able to use the \$35 FPO to meet net liabilities arising from multi-year emissions returns. Access to the applicable FPO price level will be determined pro-rata based on the time period covered by the return.

For example, for an emissions return that covers 2018–2020 and is filed in 2021, the \$25 FPO could be used for 2018–2019 (or 2/3 of net emissions in that return), and the \$35 FPO for 2020 (1/3 of net emissions).





Fixed price option remains during transition to auctioning and increases to \$35

During the transition to auctioning, the Government has decided to keep FPO in place and raise the price to \$35.

The availability of the \$35 FPO depends on when auctioning starts. For example:

- If the first auction occurs at any stage during 2021, the \$35 FPO will be available to cover emissions that occur within the 2020 calendar year. Participants could access the \$35 FPO all the way until the end of the 31 May 2021 surrender deadline.
- If the first auction occurs at any stage during 2022, the \$35 FPO will be available to cover emissions that occur within both the 2020 and 2021 calendar years. Participants could access the \$35 FPO all the way until the end of the 31 May 2022 surrender deadline.
- If the first auction occurs later than 2022, the same approach applies - participants can access the \$35 FPO for emissions within the previous calendar year all the way through until the 31 May surrender deadline.

Allowing the FPO to overlap with the start of auctioning gives participants certainty about the maximum costs they face until auctioning is fully established.

Government advises that raising the price to \$35 balances this certainty with the need to send a reasonable signal about the expected direction of emissions prices under the New Zealand ETS reforms.



Next steps for New Zealand businesses

The changes made in CCRETRA to New Zealand's ETS scheme are wide ranging and will see the ETS start to bite, driving the costs of emissions into our economy. Consumer pressure to prefer goods produced by low carbon technologies and processes is growing and will continue to grow.

Businesses should start to think about what this means for them, including their:

- Obligation to comply with the reporting and filing obligations.
- Need to register for emissions unit auctions.
- Ability to reduce reliance on high-carbon producing technologies.

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