

# **New Zealand's Emissions Trading Scheme: An In-depth Examination of the Legislative History**

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## INTRODUCTION

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The science surrounding climate change is essentially beyond question,<sup>1</sup> and will not be the focus of this dissertation. The solution is clear: in order to limit the effects that climate change will have, substantial and sustained reductions of Greenhouse Gas (GHG) emissions are required.<sup>2</sup>

This imperative raises the question of how New Zealand (NZ) has responded to this need to reduce GHG emissions. NZ's primary policy response has been an Emissions Trading Scheme (ETS). The specific focus of this dissertation is to provide an evaluation of this ETS throughout its legislative history. This evaluation will occur against the backdrop that NZ's ETS has not adequately reduced GHG emissions nor has it provided an adequate incentive for those reductions to be made.<sup>3</sup> To conduct this evaluation, the ETS will be examined at numerous points of significance throughout its history. The intention at each of these points is to dissect the decision making process in order to ascertain: what decision was made, why the decision was made, what the decision was intended to achieve, and finally, what the result was. The outcome of this process will then be linked back and compared to the aforementioned backdrop.

In addition to the backdrop, another point of importance that will develop throughout the dissertation and that will frequently be referred to is the apparent disjunct between the expressed intentions and objectives underlying the legislation and the provisions as enacted in the legislation.

Before proceeding further it is important to note a few preliminary matters. Firstly, the dissertation is not aimed at making *personal* normative statements that suggest how the NZ ETS should operate or how it should be structured. Possible normative statements of this nature may become clear as the evaluation unfolds, but they are not the focus. Rather, the dissertation focuses intently on the normative statements that were made by those involved in the legislative process of the ETS.

Secondly, NZ has a highly unique emissions profile. As at 2015, the agricultural sector was the source of approximately half (47.9%) of NZ's GHG emissions,<sup>4</sup> this is significantly higher than other developed countries.<sup>5</sup> In addition to this, throughout its history the NZ ETS

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<sup>1</sup> See generally – Intergovernmental Panel on Climate Change *Climate Change 2013 The Physical Science Basis* (Cambridge University Press, Cambridge, United Kingdom, 2013) for a comprehensive overview of the science of climate change.

<sup>2</sup> Above n 1, at 19.

<sup>3</sup> Ministry for the Environment *New Zealand's Greenhouse Gas Inventory 1990-2015* (May 2017) at 38.

<sup>4</sup> Above n 3, at 39.

<sup>5</sup> See generally - United Nations Framework Convention on Climate Change "GHG Profiles – Annex I"

has *intended* to encompass all sectors and all gases, NZ is a world leader in this regard. Therefore, given this unique emissions profile, and the unique emissions and sectorial coverage addressed by the NZ ETS, the ability to make comparisons to international ETSs' is limited and will be used sparingly in the dissertation.

Finally, it is useful to stress why this topic has been chosen and why it is of importance that the ETS be examined in this way. A clear reason why this examination is important is that the ETS is NZ's principal policy response to climate change.<sup>6</sup> A further reason is that the ETS was a relatively novel mechanism for NZ, therefore evaluating its performance by comparison to other similar mechanisms used previously in NZ is not feasible. An evaluation of the ETS thus becomes important as it allows for a comparison to be made internally, between what the ETS was intended to achieve and what it actually did achieve. In addition to this, the ETS has been governed almost exclusively by the executive, with reduced opportunities for public participation when compared to other areas of environmental law.<sup>7</sup> Therefore, this evaluation is also important to the extent that it plays an educative, informative and accountability role.

In terms of the structure, chapter one will begin with the legislation that implemented the first ETS in NZ: the Climate Change Response (Emissions Trading) Amendment Act 2008. Chapter two will focus on the changes to the ETS that were implemented by the Climate Change Response (Moderated Emissions Trading) Amendment Act 2009. Chapter three will then address the additional changes that were made via the Climate Change Response (Emissions Trading and Other Matters) Amendment Act 2012. Chapter four will examine key developments in the ETS that occurred post-2012. The process of examination at each juncture will largely involve a close examination of policy reports and parliamentary materials in order to ascertain what the legislation in question was intended to achieve. The legislation itself will then be inspected to assess the extent to which it aligned with those intentions. That will then lead to the final chapter, chapter five, which will provide an overall conclusion to the dissertation.

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<di.unfccc.int/ghg\_profile\_annex1> for summaries by country of GHG emissions profiles.

<sup>6</sup> Ministry for the Environment "About the New Zealand Emissions Trading Scheme" <www.mfe.govt.nz>.

<sup>7</sup> Ceri Warnock "Human Rights and the Environment" in Margaret Beddgood and Kris Gledhill *Human Rights in New Zealand* (forthcoming Thomson Reuters, Wellington, 2018).

## CHAPTER ONE: The Creation of New Zealand's Emissions Trading Scheme

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NZ signed an international climate change agreement in 1992 known as the United Nations Framework Convention on Climate Change (UNFCCC), with it being ratified in 1993.<sup>8</sup> This agreement constituted a formal acceptance that anthropogenic actions are the cause of climate change, with this stated in the preamble. The objective of this agreement was stated as being to stabilise “greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.”<sup>9</sup> NZ was classified as an Annex I country and as a result was committed to adopting national policies with regards to the mitigation of climate change, this was to involve limiting “anthropogenic emissions of greenhouse gases”.<sup>10</sup> However, the UNFCCC merely *encouraged* mitigation action but did not provide binding obligations. As a result, the UNFCCC then led to NZ ratifying a further agreement in 2002 known as the Kyoto Protocol, with it coming into force in 2005.<sup>11</sup> The Kyoto Protocol committed Annex I parties to binding GHG emissions reduction targets, with the first commitment period to take place from 2008 to 2012.<sup>12</sup> NZ’s commitment under the Kyoto Protocol and this first commitment period was to reduce GHG emissions levels to 1990 levels,<sup>13</sup> with a view to reducing all emissions from Annex I countries to 5 percent below 1990 levels.<sup>14</sup> NZ was allocated an amount of *permissible* emissions equal to their 1990 level of emissions.<sup>15</sup> In order for NZ to achieve its goal and fulfil its obligations, total emissions at the end of the commitment period must not exceed this allocation.<sup>16</sup>

As a result of these two agreements, it was necessary for NZ to produce a policy response in order to fulfil these obligations. The response chosen was an ETS. NZ implemented its first ETS in 2008 in the form of the Climate Change Response (Emissions Trading) Amendment Act (‘2008 Act’).<sup>17</sup>

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<sup>8</sup> United Nations Framework Convention on Climate Change; see also – United Nations Framework Convention on Climate Change “Status of Ratification of the Convention” <[www.unfccc.int](http://www.unfccc.int)> for the entry and ratification dates of various countries.

<sup>9</sup> Article 2.

<sup>10</sup> Article 4(2)(a).

<sup>11</sup> United Nations Framework Convention on Climate Change “Status of Ratification of the Kyoto Protocol” <[www.unfccc.int](http://www.unfccc.int)>.

<sup>12</sup> United Nations Framework Convention on Climate Change “Kyoto Protocol” <[www.unfccc.int](http://www.unfccc.int)> at Article 3(1).

<sup>13</sup> Kyoto Protocol to the United Nations Framework Convention on Climate Change, Annex B.

<sup>14</sup> Above n 10, at Article 3(1).

<sup>15</sup> Above n 10, at Article 3(7)

<sup>16</sup> United Nations Framework Convention on Climate Change “Kyoto Protocol Reference Manual - On Account of Emissions and Assigned Amount” (2008) <[www.unfccc.int](http://www.unfccc.int)> at 2.1.

<sup>17</sup> Climate Change Response (Emissions Trading) Amendment Act 2008.

## *I. What Were the Objectives and Intentions of the Initial ETS?*

Close inspection of policy reports and parliamentary materials reveals numerous important objectives that the ETS was intended to achieve when it was first introduced. As mentioned, international obligations led to the creation of the ETS and therefore a clear objective was to comply with these international obligations.<sup>18</sup> Another clear objective was to reduce net GHG emissions levels<sup>19</sup>, several other objectives develop from this and therefore it has been described as the underlying objective of the ETS.<sup>20</sup> To cause these emissions reductions, the ETS was designed to create a *fundamental change in behaviour*.<sup>21</sup> The price signal created by the ETS was to be integrated into the decision-making process of producers and consumers in order to incentivise an economic shift towards the “using and investing in goods and services with lower greenhouse gas emissions.”<sup>22</sup>

In addition to the above, the environmental integrity of the ETS was to be maximised in order to prevent trade risks at both the political level and the global consumer level.<sup>23</sup> There is a growing market for goods and services that are the result of low greenhouse gas emissions processes, and a movement away from environmentally damaging products.<sup>24</sup> Therefore, if NZ’s ETS did not have a high level of environmental integrity then resistance may have been received from trading partners that demand clean trade. In contrast to preventing trade risks, responding to the challenge of reducing emissions was also seen as an opportunity to benefit from new market opportunities as they emerge.<sup>25</sup> The rationale is that the ETS will incentivise a change in behaviour, causing NZ to innovate and create world leading technology for reducing GHG emissions, this technology will put the NZ economy in a strong position to benefit from the markets that emerge as the world shifts towards sustainability.

In terms of the coverage of the ETS, there was a clear and strong emphasis on the intention for NZ’s ETS to encompass all sectors and all gases, a feat not achieved by any other ETS in the world at the time.<sup>26</sup> The justification was that excluding sectors from the ETS would unfairly mean that the emissions costs of those sectors would need to be paid by other

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<sup>18</sup> Climate Change (Emissions Trading and Renewable Preference) Bill 2007 (187-2) (Bills Digest) at 2.

<sup>19</sup> Above n 18, at 1; Ministry for the Environment *The Framework for a New Zealand Emissions Trading Scheme* (September 2007) at 1 and 5. Note – ‘net emissions’ includes removals of emissions from the land-use, land-use change and forestry sector.

<sup>20</sup> (11 December 2007) 644 NZPD 13789, per Hon Trevor Mallard.

<sup>21</sup> Above n 20, per Jeanette Fitzsimons.

<sup>22</sup> Ministry for the Environment *The Framework for a New Zealand Emissions Trading Scheme* (September 2007) at 10.

<sup>23</sup> Above n 22, at 1.

<sup>24</sup> Above n 22, at 1.

<sup>25</sup> Above n 22, at 2.

<sup>26</sup> Above n 18, at 1; Above n 22, at 4 and 31; Above n 20, per Hon Trevor Mallard.



members of the economy.<sup>27</sup> Encompassing all sectors would provide fairness and certainty, it reflects an equitable approach to coverage.

An obvious objective of the ETS was to achieve the aforementioned objectives at least cost.<sup>28</sup> A cost of particular concern was ‘emissions leakage’.<sup>29</sup> Emissions leakage can be defined as “the shift in emissions (and other environmental impacts) from one country to another associated with economic activity being displaced from one country to another”.<sup>30</sup> Essentially, the increased costs of climate policies in one country (i.e. produced by an ETS) cause businesses to shift their operations to countries with lower cost climate policies. The costs are twofold, there is an economic loss as businesses leave the economy, and there is an environmental loss as those businesses now have less incentive to reduce their emissions.

### *1. Summary*

The ETS was intended to cause a fundamental change in behaviour, an economy-wide shift that would lead to a reduction in GHG emissions levels. This would allow NZ to meet its international obligations under the Kyoto Protocol and reduce its net GHG emissions level. In terms of trade, the ETS would act as a double edged sword by preserving the environmental integrity of NZ’s exports whilst also positioning NZ to benefit from emerging markets in low-emissions technology. The ETS was to be a first of its kind by encompassing all sectors and all gases, and this was to be achieved at least cost with minimal leakage. Finally, the ETS was to be flexible such that it could persist in the event that international agreements change or fail.

## *II. The ‘2008 Act’*

The legislation of the ETS as initially enacted in the ‘2008 Act’ will now be examined in order to assess the extent to which it aligns with the above objectives/intentions, and also to enable a comparison between the provisions of the legislation and the backdrop underlying the dissertation.

The purpose of the ‘2008 Act’ is stated as being to:<sup>31</sup>

Enable New Zealand to meet its international obligations under the Convention and the Protocol... [and to] provide for the implementation, operation, and administration of a greenhouse gas emissions trading scheme in New Zealand that supports and encourages global efforts to reduce greenhouse gas emissions by assisting New Zealand to meet its

<sup>27</sup> (2 September 2008) 649 NZPD 18124, per Hon David Parker; Above n 20, per Hon Jim Anderton.

<sup>28</sup> Above n 18, at 2; Above n 20, per Hon Trevor Mallard; (28 August 2008) 649 NZPD 18075, per Hon David Parker; (10 September 2008) 650 NZPD 18724, per Hon David Parker; Climate Change (Emissions Trading and Renewable Preference) Bill 2007 (187-2) (Finance and Expenditure Committee Report) at 1; Above n 22, at 14.

<sup>29</sup> Dr Suzi Kerr *Review of Proposed New Zealand Emissions Trading System* (Motu Economic and Public Policy Research, 4 November 2007) at 3.1; Above n 20, per Hon Dr Nick Smith - discussing the issue of allocation plans with regards to leakage; (10 September 2008) 650 NZPD 18724, per Eric Roy.

<sup>30</sup> Above n 22, at 126.

<sup>31</sup> Climate Change Response (Emissions Trading) Amendment Act 2008, s 5.

international obligations under the Convention and the Protocol, and by reducing New Zealand's net emissions below business-as-usual levels.

There is a clear emphasis in this purpose on complying with international obligations and reducing NZ's net emissions. However, it is important to note that those two goals are independent of each other,<sup>32</sup> such that the ETS was intended to persist even if international agreements such as the Kyoto Protocol cease.<sup>33</sup> The section was designed to reflect the intention that the "NZ ETS signal New Zealand's commitment to reducing its carbon emissions irrespective of its international obligations."<sup>34</sup> Therefore the '2008 Act' provides for an unequivocal goal of reducing NZ's net GHG emissions, regardless of the status of international agreements. The following will now examine the extent to which this goal was reflected in the provisions of the '2008 Act'.

### A. *Sectorial Coverage*

The forestry sector was included as a participant in the ETS.<sup>35</sup> Forestry is a sector of significant importance when it comes to reducing GHG emissions. This is because as trees grow they absorb carbon dioxide from the atmosphere. These removals are recognised under the Kyoto Protocol and emission units can be earned via this process.<sup>36</sup> These units can then be used to contribute to compliance with Kyoto obligations by offsetting emissions. In turn, when these trees are removed (deforestation), there is a *possibility* that the carbon will be released back into the atmosphere (depending on the method of removal).<sup>37</sup> Therefore the forestry sector also has the ability to increase emissions levels. However, the provisions relating to forestry are extensive and complex. These provisions and the changes made to this sector throughout the history of the ETS are beyond the scope of this dissertation and will not be addressed as the examination progresses.

As mentioned earlier, the agricultural sector is the largest emitter of GHG's in the NZ economy, accounting for approximately 46.6% of emissions when the ETS was implemented in 2008<sup>38</sup>. How did the '2008 Act' address this sector and incentivise emissions reductions? Section 54 establishes that the agricultural sector is to be a participant in the ETS.<sup>39</sup> However, the agricultural sector was not required to surrender emissions units until 2013, meaning that the sector did not have any emissions liabilities for the entirety of the first Kyoto commitment period.<sup>40</sup> In addition to this, once required to surrender emissions units in 2013, the

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<sup>32</sup> Climate Change (Emissions Trading and Renewable Preference) Bill 2007 (187-2) (Finance and Expenditure Committee Report) at 8.

<sup>33</sup> Above n 32, at 8.

<sup>34</sup> Above n 32, at 8.

<sup>35</sup> Section 54(1).

<sup>36</sup> Article 3.3.

<sup>37</sup> See – Ministry for the Environment "Forestry in the Emissions Trading Scheme" <[www.mfe.govt.nz](http://www.mfe.govt.nz)> and Above n 22, at 72-73 for an outline of the role forestry plays with regards to GHG emissions.

<sup>38</sup> Ministry for the Environment *New Zealand's Greenhouse Gas Inventory 1990-2008* (April 2010) at 23.

<sup>39</sup> Section 54(1)(b)

<sup>40</sup> Above n 32, at 6.

agricultural sector was to receive free allocation of emissions units from 2013-2019 equal to 90% of the sector's 2005 level of emissions.<sup>41</sup> Following this, the free allocation of units was to be phased out at a linear rate of 8% from 2019-2029, with the intention that it reach zero by 2030.<sup>42</sup> The political and legal disjunct is profound here. The ETS was intended to encompass all sectors and all gases, with the aim of incentivising behavioural change and reducing net GHG emissions levels. Yet in the case of NZ's largest emitting sector, a five year period of zero emissions liabilities was provided, followed by a six year period of heavy subsidisation, with full emissions liabilities not required until 2030, over 20 years after the '2008 Act' was created. Not only is there a disjunct, but the consequence of this disjunct is that these provisions also heavily weaken the price signal of the ETS, and therefore weaken the ability of the scheme to incentivise behavioural change and emissions reductions.

The industrial processes and synthetic gases sector was included as a participant in the scheme<sup>43</sup> and accounted for approximately 5.7% of total emissions in 2008.<sup>44</sup> However, in a similar fashion to the agricultural sector, the surrender of emissions units for industrial processes and synthetic gases was not required until 2010 and 2013 respectively.<sup>45</sup> This sector was also given the opportunity to receive heavy subsidisation up to a maximum of 90% of the sector's 2005 level of emissions.<sup>46</sup> As with agriculture, this free allocation is available until 2019 with a linear phase out from 2019-2029.<sup>47</sup> There is a caveat on this subsidy, in order to obtain the free allocation it must be established that the relevant producer involved in the sector is "trade exposed".<sup>48</sup> The satisfaction of this threshold is a matter of Ministerial discretion, with the key factors to consider being: whether the producer competes with firms that operate overseas, whether the producer faces higher costs of emissions than those competitors, and whether the producer is unable to pass-on some or all of the costs due to that competition.<sup>49</sup> Despite this caveat, there is evidence that significant free allocation has been permitted with regards to industrial processes.<sup>50</sup> The ability of these provisions to incentivise a change in behaviour and emissions reductions can also be questioned. Producers of synthetic gases were to suffer no emissions liabilities for the entirety of the first Kyoto commitment period. Whilst firms involved in industrial processes did not suffer emissions liabilities until 2010 with evidence of large subsidisation from 2010 onwards.

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<sup>41</sup> Section 76(2)(b)

<sup>42</sup> Section 76(2)(c).

<sup>43</sup> Section 54(1)(b) – Industrial processes include, but are not limited to, the production of; iron, steel and aluminium. Synthetic gases refer to hydro fluorocarbons, per fluorocarbons and sulphur hexafluoride.

<sup>44</sup> Above n 38, at 23.

<sup>45</sup> Above n 32, at 5.

<sup>46</sup> Section 73(2)(b).

<sup>47</sup> Section 73(2)(c).

<sup>48</sup> Section 73(2)(a)(i).

<sup>49</sup> Section 73(2)(d).

<sup>50</sup> See generally – Environmental Protection Authority "Industrial Allocations Decisions" <[www.epa.govt.nz](http://www.epa.govt.nz)> - for records of the allocations that were given from 2010-2016.

The waste sector was included as a participant in the scheme,<sup>51</sup> and accounted for approximately 2.2% of total emissions in 2008.<sup>52</sup> However, this sector was not required to surrender emissions units until 2013 and therefore also suffered no liabilities for the entirety of the first Kyoto commitment period.<sup>53</sup>

The Liquid fossil fuels sector was included as a participant in the scheme and did not receive free allocation of units.<sup>54</sup> However, this sector was not required to surrender emission units until 2011<sup>55</sup>, with the first Kyoto commitment period ending in 2012.

The stationary energy sector was also included as a participant in the scheme and did not receive free allocation of units.<sup>56</sup> This sector was not required to surrender emission units until 2010.<sup>57</sup>

Recall that NZ's goal under the first commitment period of the Kyoto Protocol was to reduce GHG emission levels to 1990 levels. From 1990-2008 total GHG emissions increased by 22.8% and net GHG emissions increased by 63.2%.<sup>58</sup> Therefore not only would the ETS need to halt this growth in emissions, it would also need to create substantial reductions. However as is shown above, numerous sectors were excluded for either the whole or the majority of the first commitment period. This emphasises the political and legal disjunct, an ambitious goal was set, yet the sectorial provisions implemented did not reflect this ambition.

### ***B. The Method of the ETS***

The NZ ETS was *intended* to operate as a 'cap-and-trade' system. Under a cap-and-trade system, the government sets a limit on the level of emissions that is permissible (i.e. a cap) during a certain compliance period.<sup>59</sup> The regulator then creates and issues tradeable economic instruments known as emission units (or permits), with the number of units available corresponding to the level of the cap.<sup>60</sup> Each permit represents a set quantity of GHG emissions. At the end of the compliance period, participants are required to surrender sufficient units to cover their actual emissions. If a participant's emissions exceed their quantity of emission units, they must purchase additional units to offset their emissions. Similarly, if a participant's emissions are less than their quantity of emission units, either due to emissions reductions or other methods (e.g. carbon sequestration), then they may sell these spare permits. This creates a market in which emission units can be traded. The rationale is

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<sup>51</sup> Section 54(1)(b).

<sup>52</sup> Above n 38, at 24.

<sup>53</sup> Above n 22, at 31.

<sup>54</sup> Section 54(1)(a).

<sup>55</sup> Above n 32, at 4.

<sup>56</sup> Section 54(1)(a).

<sup>57</sup> Above n 32, at 4.

<sup>58</sup> Above n 38, at 18.

<sup>59</sup> Alastair Cameron (ed) *Climate Change Law and Policy in New Zealand* (LexisNexis NZ, Wellington, 2011) at 146; Toni E Moyes "Greenhouse Gas Emissions Trading in New Zealand: Trailblazing Cap and Trade" (2008) 35 *Ecology LQ* 911 at 922.

<sup>60</sup> P Salmon and D Grinlinton *Environmental Law in New Zealand* (Thomson Reuters, Wellington, 2015) at 800.

that as the level of permissible emissions (the cap) is reduced incrementally over time, there will be an increasing financial incentive to shift behaviour towards reducing GHG emission levels.

However, the NZ ETS as implemented in the ‘2008 Act’ did not quite align with the requirements of a cap-and-trade system. Despite the explicit intention to reduce GHG emissions levels, the ETS did not implement a domestic cap on emissions. The ETS was to instead operate within the cap on emissions established by the Kyoto Protocol.<sup>61</sup> The rationale was that all emissions reductions have a global benefit, no matter where they occur.<sup>62</sup> This Kyoto Protocol cap refers to the allocation of Assigned Amount Units (AAUs). AAUs are the emission units that are assigned to NZ under the Kyoto Protocol. AAUs can act as a cap such that NZ is required to surrender emissions units equivalent to the quantity of AAUs owned. However, the design of the NZ ETS prevents AAUs from acting in this way. The domestic unit of trade in the NZ ETS, the New Zealand Unit (NZU), are created via Ministerial discretion<sup>63</sup> and there was no express requirement<sup>64</sup> that the number of NZUs created equal the allocated amount of AAUs. In addition, participants in the scheme were able to use other international units to meet their obligations (see below). As a result, there was no national cap on the scheme. This arrangement has been described as a flexible cap, constrained by international prices for GHG emissions, with no limit on permitted emissions levels in NZ.<sup>64</sup>

Nonetheless, the purpose statement in section 5 of the ‘2008 Act’ refers to reducing NZ’s net emissions below “business-as-usual” levels.<sup>65</sup> However there is no statutory requirement that this objective be achieved. In addition to this, business-as-usual levels is defined as being the level of GHG emissions that would have been emitted if the ETS was not implemented.<sup>66</sup> It was previously shown that emission levels had been consistently increasing above the Kyoto target in the absence of an ETS. Thus even if the non-mandatory business-as-usual reductions were adhered to, significant additional reductions to the level of GHG emissions would likely be required to achieve the goal envisaged in the Kyoto Protocol.

### ***C. International Linkage***

Article 17 of the Kyoto Protocol allows for the trading of various emission units between participating parties.<sup>67</sup> The Kyoto units that may be traded include: assigned amount units

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<sup>61</sup> Above n 22, at 47.

<sup>62</sup> Above n 22, at 47.

<sup>63</sup> Climate Change Response (Emissions Trading) Amendment Act 2008, s 69(1)

<sup>64</sup> Toni E Moyes “Greenhouse Gas Emissions Trading in New Zealand: Trailblazing Cap and Trade” (2008) 35 Ecology LQ 911 at 913.

<sup>65</sup> Section 5(1)(b).

<sup>66</sup> Section 5(2).

<sup>67</sup> Kyoto Protocol to the United Nations Framework Convention on Climate Change, art 17.

(AAUs), removal units (RMUs), emission reduction units (ERUs) and certified emission reduction units (CERs).<sup>68</sup> Each of these units will be explained in turn.

AAUs represent the initial allowance of emissions that is assigned to a country under the Kyoto Protocol.<sup>69</sup> RMUs are generated by domestic emissions removals from land use, land-use change and forestry (LULUCF).<sup>70</sup> ERUs involve an Annex 1 country implementing a project in another Annex 1 country that results in “a reduction of emissions by sources, or an enhancement of removals by sinks”.<sup>71</sup> Any reduction in emissions that is achieved by the country implementing that project can then be converted into ERUs that may be used towards meeting their Kyoto target. ERUs are converted from the AAUs and RMUs of the country in which the project was implemented, therefore the total assigned amount of Annex I parties is not affected, it is merely redistributed.

CERs are obtained via clean development mechanisms (CDMs). A CDM involves Annex 1 Kyoto participants implementing projects that reduce emissions (or absorb carbon through afforestation or reforestation) in non-Annex 1 countries.<sup>72</sup> If a CDM results in an emissions reduction that is subsequently certified, the Annex 1 participant responsible will receive CERs which can then be used to contribute to their obligations under the Protocol.<sup>73</sup> It is important to note that CERs earned via CDMs create *additional units*, as opposed to a redistribution of AAUs, therefore possessing the ability to dilute the overall limit on emission units set by the Kyoto Protocol.

The NZ ETS in the ‘2008 Act’ was linked to this international market of emissions units. The ‘2008 Act’ creates this international link by defining the units that can be surrendered as “a Kyoto unit, a New Zealand unit, or an approved overseas unit.”<sup>74</sup> Kyoto units are then stated to include:<sup>75</sup>

All of the unit types specified in, or in accordance with, the Protocol (namely, assigned amount units, certified emission reduction units, emission reduction units, Long-term certified emission reduction units, removal units, and temporary certified emission reduction units).

International linkage was intended to ensure that participants in the ETS have access to the largest pool of Kyoto compliant units possible in order to minimise the compliance costs of

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<sup>68</sup> Article 3.

<sup>69</sup> Article 3(7).

<sup>70</sup> United Nations Framework Convention on Climate Change “Glossary of Climate Change Acronyms and Terms” <[www.unfccc.int](http://www.unfccc.int)>.

<sup>71</sup> Article 6(1)(b).

<sup>72</sup> United Nations Framework Convention on Climate Change “Kyoto Mechanisms – Background” <[www.unfccc.int](http://www.unfccc.int)>.

<sup>73</sup> Article 12(3)(b).

<sup>74</sup> Section 6(23).

<sup>75</sup> Section 6(2).

the scheme.<sup>76</sup> However the executive was cautious not to preclude future linking opportunities with countries by including units that other systems did not include.<sup>77</sup> Of particular concern was the integrity of AAU's from Eastern European countries.<sup>78</sup> As a result the '2008 Act' places a constraint on the surrendering of certain units. Section 18CB states that any imported AAU's must meet certain requirements or conditions of regulation before they may be surrendered.<sup>79</sup> This allows all AAUs to be screened in order to preserve the integrity of the units surrendered.

However, it must be noted that the '2008 Act' does not place any restriction on the *quantity* of international units that may be traded. This is in contrast to the ETS that was operating in the European Union (EU scheme) at the time, which provided a discretion for Member States to place a restriction on the number of units that can enter the system. Therefore participants in the NZ ETS were largely not restricted in their ability to purchase Kyoto units to fulfill their obligations. In essence, this acts as a way in which participants can fulfill their obligations without reducing their levels of GHGs emitted. Instead, participants can maintain or even increase their level of emissions and merely purchase units to match those emissions. As mentioned, the price signal of the ETS was intended to incentivise behavioural change and emissions reductions. Therefore the price of these international units then becomes relevant. The cheaper these units are, the more the impact of a price signal is diminished and the easier it is for participants to comply with their obligations without changing their behaviour.

## 2. '2008 Act' Conclusion

It is incontrovertible that the ETS in the '2008 Act' was *intended* to incentivise a change in behaviour and a subsequent reduction in *domestic* GHG emissions levels. However in terms of liabilities for emissions, the largest GHG emitting sector of the NZ economy was fully excluded for the first commitment period, whilst numerous other sectors were excluded for significant portions of this period. Heavy subsidisation was then provided to these sectors once they were eventually included in the scheme. In addition to this, no cap was introduced on domestic emissions. When combined with the international linkage of the scheme, this lack of an emissions cap meant that participating parties had the ability to fulfill their obligations without achieving emissions reductions and therefore without changing their behaviour.

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<sup>76</sup> Above n 32, at 11.

<sup>77</sup> Above n 32, at 11.

<sup>78</sup> (2 September 2008) 649 NZPD 18124 per Jeanette Fitzsimons; (11 December 2007) 644 NZPD 13789 per Hon Dr Nick Smith – the concern was that these AAU's may not constitute the reduction in GHG emissions that they represent.

<sup>79</sup> Section 18CB.

The price signal of the ETS was intended to cause this change in behaviour and reduction in emissions levels. Yet the causes of approximately half of NZ's GHG emissions faced either: no price signal, a delayed price signal or a heavily subsidised price signal. Those that were subject to the price signal had their incentive to change behaviour reduced by the ability to purchase international Kyoto units to fulfill their obligations. Overall, the ETS as enacted in the '2008 Act' did not adequately reduce emissions nor did it provide an adequate incentive for those reductions to be made.



**CHAPTER TWO:  
The Climate Change Response (Moderated Emissions Trading)  
Amendment Act 2009**

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The NZ ETS as it existed in the ‘2008 Act’ was amended in 2009 by the Climate Change Response (Moderated Emissions Trading) Amendment Act (2009 Act).

***III. What Were the Objectives and Intentions of the ‘2009 Act’?***

A key objective of the ‘2009 Act’ was to minimise the possible effects of ‘leakage’ by providing support for trade-exposed emissions intensive industry.<sup>80</sup> Recall that leakage in this context involves businesses shifting from one economy to another as a result of the increased cost of climate policies in the original economy. The ‘2009 Act’ was to provide a workable and affordable ETS<sup>81</sup> in order to ensure that “the NZ economy and kiwi jobs are not put at risk”.<sup>82</sup> This concern regarding leakage was reflected in the explanatory note to the Bill for the ‘2009 Act’ which stated that the objectives of the Bill were to “reduce [the] competitive impacts of the NZ ETS” and to “provide a smoother transition for participants into the NZ ETS”.<sup>83</sup>

The ‘2009 Act’ was also intended to incentivise efficiency. This objective is linked to the aforementioned objective such that ‘leakage’ was to be minimised by incentivising more efficient production domestically.<sup>84</sup> Another objective was to create a more appropriate balance between NZ’s environmental responsibilities and NZ’s economic opportunities and realities.<sup>85</sup>

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<sup>80</sup> (24 September 2009) 657 NZPD 6854 per Hon Dr Nick Smith (Minister for Climate Change Issues); Ministry for the Environment “Departmental Report on the Climate Change Response (Moderated Emissions Trading) Amendment Bill Stage 1” (October 2009) at 10; Ministry for the Environment “Regulatory Impact Statement: Climate Change Response (Moderated Emissions Trading) Amendment Bill” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 6.

<sup>81</sup> (24 November 2009) 659 NZPD 7901 per Hon Dr Nick Smith (Minister for Climate Change Issues).

<sup>82</sup> Above n 81, per Hekia Parata.

<sup>83</sup> Climate Change Response (Moderated Emissions Trading) Amendment Bill 2009 (85-1) (Explanatory Note).

<sup>84</sup> (24 September 2009) 657 NZPD 6854 per Hon Dr Nick Smith (Minister for Climate Change Issues); (24 September 2009) 657 NZPD 6854 per Craig Foss; (24 September 2009) 657 NZPD 6854 per Dr Paul Hutchison; Above n 81; (24 November 2009) 659 NZPD 8039 per Hon Dr Nick Smith (Minister for Climate Change Issues).

<sup>85</sup> (24 September 2009) 657 NZPD 6854 per Dr Paul Hutchison.

Of particular importance was the desire to align the NZ ETS with Australia.<sup>86</sup> The explanatory note to the Bill outlined this clearly in stating that an objective of the ‘2009 Act’ was to:<sup>87</sup>

Maximise the degree of harmonisation with the Australian Carbon Pollution Reduction Scheme, in particular to reduce trans-Tasman competitiveness risks.

The rationale for the objective of aligning with Australia revolved around its significance as a trading partner and the ability for economic activity to move between the two countries with relative ease.<sup>88</sup> For example, at the time Australia accounted for approximately 23% of NZ’s exports.<sup>89</sup> The fear was that if the proposed Australian scheme provided greater assistance to emissions intensive trade-exposed industries than the NZ scheme, then NZ firms may be at a competitive disadvantage.<sup>90</sup> The aim was to align the assistance of the schemes in order to reduce these possible trans-Tasman competitiveness distortions.<sup>91</sup> This appears to be a more specific form of the general ‘leakage’ objective, focusing on Australia.

A point of significance is that the Australian scheme with which NZ intended to align, the Australian Carbon Pollution Reduction Scheme, was not in force at the time and there was no guarantee that this scheme would come into force. This scheme was eventually abandoned by the Australian executive.

### 3. *Summary*

The amendments proposed in the ‘2009 Act’ were heavily aimed at minimising the effects of leakage. This concern was especially prevalent with regards to Australia, the aim was to align the assistance provided in the NZ ETS with that of the proposed scheme in Australia. Leakage was to be further reduced by incentivising efficiency in domestic production. The overall goal was to achieve a more appropriate balance between NZ’s environmental responsibilities and NZ’s economic opportunities and realities.

It is important to note that Parliamentary debates and policy reports *largely* did not focus on the impact that the proposed amendments may have on the ETS’s ability to incentivise reductions in domestic GHG emissions. However, there was no express evidence to suggest that this objective from the ‘2008 Act’ of reducing domestic GHG

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<sup>86</sup> Above n 81, per Hon Dr Nick Smith (Minister for Climate Change Issues); (24 November 2009) 659 NZPD 7967 per Hon Dr Nick Smith (Minister for Climate Change Issues); (24 November 2009) 659 NZPD 8039 per Hon Dr Nick Smith (Minister for Climate Change Issues); (24 November 2009) 659 NZPD 8039 per Hekia Parata; (24 November 2009) 659 NZPD 8039 per Nicky Wagner.

<sup>87</sup> Above n 83.

<sup>88</sup> Ministry for the Environment *Departmental Report on the Climate Change Response (Moderated Emissions Trading) Amendment Bill Stage 1* (October 2009) at 10.

<sup>89</sup> Ministry for the Environment *Departmental Report on the Climate Change Response (Moderated Emissions Trading) Amendment Bill Stage 2* (November 2009) at 11.

<sup>90</sup> Ministry for the Environment “Regulatory Impact Statement: Climate Change Response (Moderated Emissions Trading) Amendment Bill” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 6.

<sup>91</sup> Above n 89, at 11.

emissions was removed. On the contrary, the few statements that were made with regards to reducing domestic emissions suggest that this objective was to persist alongside the new objectives. For example, it was stated that the ‘2009 Act’ “will provide incentives for industry to *reduce emissions* without encouraging an exodus overseas of industry and its skilled staff.”<sup>92</sup> This suggests that the objective of reducing GHG emissions was to work hand-in-hand with the objective of minimising ‘leakage’. Further, the ‘2009 Act’ was described as providing “a substantive framework to curb emissions”.<sup>93</sup> As such the objective of complying with international obligations and reducing GHG emissions levels was to persist in the ‘2009 Act’, additional evidence will be provided in the next section to affirm this point.

#### **IV. The ‘2009 Act’**

The legislation of the ETS as enacted in the ‘2009 Act’ will now be examined in order to assess the extent to which it aligns with the above objectives/intentions, and also to enable a comparison between the provisions of the legislation and the backdrop underlying the dissertation.

The purpose of the ‘2009 Act’ is stated as being to:

Enable New Zealand to meet its international obligations under the Convention and the Protocol... [and to] provide for the implementation, operation and administration of a greenhouse gas emissions trading scheme in New Zealand that supports and encourages global efforts to reduce the emission of greenhouse gases by – assisting New Zealand to meet its international obligations under the Convention and the Protocol; and reducing New Zealand’s net emissions of those gases to below business-as-usual levels.

This stated purpose is virtually identical to that of the ‘2008 Act’, besides minor alterations to the wording and structure. Parliament had an opportunity to alter the meaning of the purpose section but chose not to do so, therefore it can be assumed that the evaluation of the purpose statement from the ‘2008 Act’ can be carried over to the ‘2009 Act’. Recall, the section clearly outlines that the primary goals of the ETS are to comply with international obligations and reduce NZ’s net emission of GHG’s. As with the ‘2008 Act’, this purpose statement reflects an intention to reduce GHG emissions *irrespective* and *independent* of NZ’s international obligations. The following will now focus on the provisions of the ‘2009 Act’.

#### **D. Allocation**

One of the most significant changes to the ETS involved the allocation of emissions units to the agricultural and industrial sectors, specifically a shift from allocating on an historical emissions basis towards allocating on an intensity basis.<sup>94</sup> The rationale for this change was

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<sup>92</sup> (24 November 2009) 659 NZPD 7901 per Hon Dr Nick Smith (Minister for Climate Change Issues).

<sup>93</sup> (24 November 2009) 659 NZPD 8039 per Hekia Parata.

<sup>94</sup> Above n 88, at 9.

that it would: prevent leakage,<sup>95</sup> incentivise emissions-intensive industry to become more efficient,<sup>96</sup> and would mimic the approach in the proposed Australian scheme.<sup>97</sup>

Recall, under the ‘2008 Act’ emissions units were allocated to the industrial and agricultural sectors based on their 2005 level of emissions (i.e. an historical basis), with the maximum possible allocation being 90% of that 2005 level. Sections 81 and 85 of the ‘2009 Act’ implemented a change in this allocation method and provided a formula for calculating allocation levels.<sup>98</sup> The formula involves the multiplication of an assistance level with the output produced for the year, the formula itself is complex and beyond the necessary scope of this dissertation. The key point for present purposes is that the allocation in the ‘2009 Act’ is a function of production and an assistance level, with the assistance level set on a carbon intensity basis as opposed to an historical basis.<sup>99</sup>

Allocation for the industrial sector was separated into moderately emissions-intensive activity and highly emissions-intensive activity. The assistance level was initially set at 60% for moderately emissions-intensive activity, 90% for highly emissions-intensive activity,<sup>100</sup> and 90% for the agricultural sector.<sup>101</sup>

### ***E. Phase Out***

A further amendment that was made with regards to allocation involved the phase-out rate. Recall that the ‘2008 Act’ provided for a linear phase out of unit allocations in the agricultural and industrial sectors of 8% from 2019-2029 with the intention of there being zero allocation by 2030. The ‘2009 Act’ changes the timing and degree of this phase-out. Phase-out of allocations was to begin in 2012 for the industrial sector and 2015 for the agricultural sector, with the new phase-out rate set at 1.3% of the previous year’s allocation.<sup>102</sup>

As was outlined in Chapter One, the ETS intended to use a price signal to create behavioural change that would lead to a reduction in GHG emissions. To create this price signal the ETS was to operate in the manner of a ‘cap and trade’ system i.e. trading occurs under a cap and that cap is reduced over time. By definition, a cap is required for this to be effective. The ‘2008 Act’ did not implement a cap on emissions levels, nor a cap on the number of NZUs that could be created, however it did implement a cap on the amount of emissions units that could be freely allocated. This meant that those who emitted more than their allocation would

<sup>95</sup> Above n 93, per Hon Dr Nick Smith (Minister for Climate Change Issues).

<sup>96</sup> Above n 93, per Hon Dr Nick Smith (Minister for Climate Change Issues); (24 September 2009) 657 NZPD 6854 per Dr Paul Hutchison; Above n 90, at 7.

<sup>97</sup> Above n 93, per Hon Dr Nick Smith (Minister for Climate Change Issues); Above n 93, per Nicky Wagner; Above n 90, at 12; Above n 88, at 18; Above n 89, at 11.

<sup>98</sup> Sections 81 and 85.

<sup>99</sup> Sections 81 and 85. See also – Ministry for the Environment *Industrial allocation update* (September 2009) for an overview of the changes to the allocation method.

<sup>100</sup> Sections 81(a)(i) and 81(b)(i).

<sup>101</sup> Section 85(2)(a).

<sup>102</sup> Sections 81(a)(ii) and 85(2)(b).

face the cost of those extra emissions, i.e. there was a marginal cost to increasing emissions. By changing the method of allocation to an intensity basis the '2009 Act' has essentially removed the allocation cap, it creates an uncapped 'cap and trade' system.

In addition, emission units are allocated on a production basis. This means that an increase in production, and therefore an increase in emissions, will actually increase the units allocated. If an emitter can increase their production whilst maintaining their efficiency, then they will not face a marginal cost of increased emissions. Therefore not only has the '2009 Act' removed the price signal of an allocation cap, it has also diminished the marginal cost of increasing emissions.

The introduction of a phase-out rate for allocated units has been brought forward several years, however the rate has dropped dramatically from 8% to 1.3%. The new phase-out rate is not applied linearly, as a result the quantity of allocation that is phased out decreases each year. The consequence is that allocation will not be fully phased out until significantly later than the 2030 estimate from the '2008 Act'.

It is important to note that if a party increases their production in a year by 1.3% then they will receive an allocation of units that will offset the yearly phase-out of allocation.

Extending from this, if a party increases their production in excess of 1.3% in a year, they will increase their overall allocation. It is thus possible to make the argument that these provisions in the '2009 Act' are in fact providing an *incentive to increase emissions*.

Overall, in terms of reducing GHG emissions and incentivising those reductions to be made, the allocation in the '2008 Act' was deemed to be too generous and the phase-out period deemed to be too long. The '2009 Act' has then removed the cap on allocated units and dramatically reduced the phase-out rate. In doing so the '2009 Act' has weakened an already weak price signal and has increased the subsidies to emitters, thereby further discouraging a change in behaviour. Importantly, the '2009 Act' also allows emitters the possibility of benefiting (via extra allocations) from an *increase* in their emissions.

#### ***F. Price Cap and 1-for-2***

The provisions of the '2008 Act' provided that one emission unit was to be surrendered for every one tonne of emissions.<sup>103</sup> However, section 222A of the '2009 Act' implemented a transitional provision that required the liquid fossil fuels, stationary energy, and industrial processes sectors to only surrender one emission unit for every *two tonnes* of emissions (1-for-2).<sup>104</sup> Section 222B of the '2009 Act' implemented a corresponding provision with regards to removal activities i.e. one emission unit is received for every two tonnes of emissions removed.<sup>105</sup> In addition to this, section 222C of the '2009 Act' set a price cap of

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<sup>103</sup> Section 63(1).

<sup>104</sup> Section 222A.

<sup>105</sup> Section 222B.

\$25 per emission unit.<sup>106</sup> The rationale behind these changes was that they would “ease the introduction of the scheme by simultaneously reducing the price of carbon within the scheme by half, and protecting participants against unexpected increases in the price of carbon.”<sup>107</sup> It was believed that these amendments would not make a “material change” to the level of GHG emissions abatement due to their *transitional nature*, and that the awareness of a future price of carbon would still incentivise investment in emissions reduction technology and practices.<sup>108</sup>

As has been mentioned, the price signal of the ETS was intended to be its principal method of incentivising behavioural change and reducing GHG emissions. The transitional provision that allows for the surrender of one unit for every two tonnes of emissions effectively halves this price signal, thereby significantly reducing the ability of the ETS to incentivise behavioural change and reduce emissions. Moreover, the price signal has been capped at \$25 per tonne. When combined with the ‘1-for-2’ provision, this assures that an emitter from the relevant sectors will not pay more than \$12.50 per tonne of emissions. The price cap was designed to avoid unexpected increases in the price of carbon, however this price cap is arguably set too low and instead acts as an additional subsidy, effectively creating a cap on the price signals ability to incentivise emissions reductions.

### ***G. Agriculture***

Section 78 of the ‘2009 Act’ delays the start date for the surrender of emissions unit obligations for the agricultural sector.<sup>109</sup> The start date is delayed from 2013 to 2015, an additional two year period of no requirements to surrender emissions units. The reasons for this decision are not clear, however there is evidence to suggest that the amendment was made in order to align with the proposed Australian scheme and also to cushion the transition of this sector into the scheme.<sup>110</sup>

Under the ‘2008 Act’, the introduction of agriculture was already set to occur five years after the introduction of the scheme, and one year after the end of the first Kyoto commitment period. This five year period of no unit liabilities and therefore no price signal has now been extended to seven years. In addition to this, the highly lenient intensity based allocation would then apply from 2015 onwards. This amendment has further diminished the incentive in the agricultural sector to change behaviour.

### ***H. Targets***

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<sup>106</sup> Section 222C.

<sup>107</sup> Above n 88, at 19.

<sup>108</sup> Above n 89, at 6; above n 90, at 20.

<sup>109</sup> Section 78.

<sup>110</sup> (24 September 2009) 657 NZPD 6854 per Dr Paul Hutchison; (24 November 2009) 659 NZPD 8039 per Hekia Parata; above n 88 at 20; above n 90 at 17.

Section 225 of the ‘2009 Act’ allows for the Minister responsible for the administration of the Act to recommend a non-binding emissions reduction target.<sup>111</sup> Two targets were set. The first target was to reduce NZ’s net emissions to 50% of the 1990 level of emissions by 2050<sup>112</sup>. The second target was an interim goal of reducing NZ’s net emissions to 10-20% below the 1990 level of emissions by 2020.<sup>113</sup> The purpose behind setting these targets was to give a clear and credible statement about NZ’s long-term contribution to addressing climate change, as well as providing certainty as to where climate change policy is heading in the future.<sup>114</sup> This further supports the point addressed earlier that a key goal of NZ’s ETS was to reduce GHG emission levels. This point also emphasises the disjunct, as the provisions enacted contradict this expressed intention of reducing GHG emissions.

### *I. Notable Criticism*

It is important to note that the amendments implemented by the ‘2009 Act’ were subject to significant criticism from numerous reputable organisations leading up to the enactment. With regards to the change to an intensity basis for allocation, the Parliamentary Commissioner for the Environment stated that this would increase emissions and remove the price signal to emissions-intensive sectors, where NZ needs a price signal the most.<sup>115</sup> The Environmental Defence Society asserted that intensity based allocation “defeats the purpose of an emissions trading scheme” and would result in minimal incentives for businesses to reduce their emissions.<sup>116</sup> Similarly, the New Zealand Climate Change Research Institute stated that intensity based allocation “potentially raises global emissions” and “weakens the incentives of New Zealand’s exposed industries to adjust” to lower emissions behaviour.<sup>117</sup> The independent expert advisor to the Select Committee, Dr Suzi Kerr, argued that the allocations in the ‘2008 Act’ were already too high and that the amendments would exacerbate this problem.<sup>118</sup>

One of the principal justifications for the amendments in the ‘2009 Act’ was to align the NZ ETS with the proposed scheme in Australia. However, many of the aforementioned organisations advised that linking with Australia was neither justified nor desirable.<sup>119</sup>

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<sup>111</sup> Section 225(1).

<sup>112</sup> Above n 90, at 18. – Note that this wasn’t implemented until 2011.

<sup>113</sup> Emissions Trading Scheme Review Committee “Review of the Emissions Trading Scheme and related matters” (31 August 2009) <www.mfe.govt.nz> at 36.

<sup>114</sup> Above n 88 at 22; above n 90 at 18.

<sup>115</sup> Parliamentary Commissioner for the Environment “Submission on the Climate Change Response (Moderated Emissions Trading) Amendment Bill” at 3.

<sup>116</sup> Environmental Defence Society Incorporated “Submission on the Climate Change Response (Moderated Emissions Trading) Amendment Bill” at 2.

<sup>117</sup> New Zealand Climate Change Research Institute “Submission on the Climate Change Response (Moderated Emissions Trading Amendment Bill” at 5.

<sup>118</sup> Suzi Kerr “Climate Change Response (Moderated Emissions Trading) Amendment Bill – Final comments in response to committee queries from Dr Suzi Kerr, Independent Specialist Adviser” at 1.

<sup>119</sup> Above n 118 at 1; above n 115 at 6; above n 90 at 2-3.

The Select Committee reviewing the Bill for the ‘2009 Act’ was unable to reach agreement as to whether the amendments should be passed and also could not agree as to which amendments may benefit the ETS.<sup>120</sup> This reflects a significant divide amongst policy makers as to whether the amendments should be implemented and also raises the question as to whether legislation of such significance should be passed with such a lack of unanimity.

Perhaps the most significant criticism came from Treasury’s Regulatory Impact Analysis Team whilst reviewing the regulatory impact statement (RIS) for the ‘2009 Act’. The Treasury stated that:<sup>121</sup>

The level of analysis presented is not commensurate with the significance of the proposals, which represent major design changes to the Emissions Trading Scheme, and that the RIS does not provide an adequate basis for decision-making.

This statement is telling. The RIS is arguably the key document in terms of outlining the changes implemented by the ‘2009 Act’ and the rationale behind those changes. Yet a review of this document by the Treasury advised that it was insufficient and that decisions could not be made based on it.

#### **4. ‘2009 Act’ Conclusion**

The main objective underlying the amendments in the ‘2009 Act’ were to reduce leakage, align with Australia, and incentivise efficient production. The ‘2009 Act’ largely aligns with these objectives. Many of the amendments reduce the price signal of the ETS and therefore are likely to reduce the effect of leakage. The change to an intensity basis for allocation and the delaying of agriculture into the scheme align with Australia. However in achieving these objectives, the ‘2009 Act’ adversely affects the ability of the ETS to achieve its primary objective: incentivising behavioural change in order to reduce GHG emissions levels. The amendments retained this objective in the purpose statement of the scheme and targets were introduced that specified desired levels of emissions reduction, making it incontrovertible that this objective remained. However there was then a disjunct, a lack of legal transparency, as the majority of the amendments that were made significantly weakened the price signal of the ETS and therefore weakened the ability of the ETS to incentivise behavioural change.

A report published by the Ministry for the Environment assessed how NZ’s level of GHG emissions would progress under the provisions of the ‘2009 Act’. The report stated that under these provisions, NZ’s net emissions were projected to rise to *90% above the net emissions level in 1990*. The target set was to achieve a reduction in emissions equivalent to *10-20% below 1990 levels by 2020*. These figures could not make it any clearer, the ETS as enacted in the ‘2009 Act’ was not sufficient for

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<sup>120</sup> Climate Change Response (Moderated Emissions Trading) Amendment Bill 2009 (85-1) (Finance and Expenditure Committee report) at 2.

<sup>121</sup> Above n 90, at 2 – citing the Treasury’s Regulatory Impact Analysis Team.



incentivising behavioural change and reducing GHG emissions. The amendments made contradicted the fundamental goal of the scheme and led to an increase in GHG emission levels.<sup>122</sup>

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<sup>122</sup> Above n 3.

## **CHAPTER THREE:**

### **The Climate Change Response (Emissions Trading and Other Matters) Amendment Act 2012**

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The following chapter will largely follow the same format as the previous chapters. However a minor point of difference is that the chapter will begin by examining the official review of the ETS that was conducted in 2011 before proceeding to examine the legislation. The rationale is that this will allow for an extra tier of examination i.e. a comparison between the recommendations of the review, the discernible objectives of the proposed legislation, and the provisions of the legislation itself.

#### ***V. Emissions Trading Scheme Review 2011***

The ‘2008 Act’ provided for a mandatory review of the ETS to be completed no more than 12 months before the end of the first Kyoto commitment period.<sup>123</sup> The objectives of the review were stated as being to:<sup>124</sup>

Provide the Government with recommendations on steps that can be taken to ensure the ETS after 2012... helps New Zealand deliver its ‘fair share’ of international action to reduce emissions, including meeting any international obligations... [and] delivers emission reductions in the most cost-effective manner... [and] support efforts to maximise the long-term economic resilience of the New Zealand economy at least cost.

The review panel also stated that their recommendations were made on the following basis:<sup>125</sup>

*That the essential purpose of the ETS is to reduce emissions in New Zealand by changing behaviour over the long term, and in a way that minimises the costs of that behaviour change and enables us to meet our international commitments. The panel’s view is that this purpose holds true even if there is no immediate successor to the Kyoto Protocol.*

The above quotes emphasise the fact that the key objective of reducing GHG emissions still remained in 2011 and that the review was largely tailored to help achieve that objective. With that in mind, the review arrived at the recommendations outlined below.

The review panel stressed that the government needs to “send a clear signal” regarding the future of the ETS in order to provide “certainty and confidence” with regards to the costs and obligations of the scheme so that businesses can invest and change their behaviour accordingly.<sup>126</sup> The panel recommended that “any further short-term moderation of the

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<sup>123</sup> Section 160(1).

<sup>124</sup> Emissions Trading Scheme Review Panel *Doing New Zealand’s Fair Share: Emissions Trading Scheme Review 2011* (June 2011) at 14.

<sup>125</sup> At 24.

<sup>126</sup> At 6.

carbon price should not create additional uncertainty that medium to long-term investments need to factor in a full price of carbon.”<sup>127</sup>

The panel recommended that the ‘1-for-2’ surrender obligation should be phased out over three years such that in 2015 businesses will face a one-for-one surrender obligation.<sup>128</sup> The panel believed that this phase out over a relatively short time frame was necessary to “drive long-term emissions reduction”.<sup>129</sup> With regards to the \$25 price cap, the panel recommended that this be increased by \$5 per annum from 2013 to 2017, reaching \$50 per NZU in 2017.<sup>130</sup> The reasoning was that this would incentivise long-term emissions reductions whilst also providing certainty to ETS participants.<sup>131</sup> The panel did not propose any fundamental changes to the allocation regime for industry and agriculture, but did recommend that the phase-out of allocation occur on a linear basis in order to provide more certainty.<sup>132</sup> Overall, the panel emphasised that these transitional measures “should not remain in place for a prolonged period”, and that extending them to an uncertain future date would create significant uncertainties.<sup>133</sup>

With regards to agriculture, the panel recommended that the sector should be liable to surrender emissions units in 2015 as required under the ‘2009 Act’.<sup>134</sup> A key argument against this decision that arose in submissions to the review panel was that there are insufficient abatement options available for the agricultural sector. However, the panel analysed this argument and concluded that the abatement options available are “*sufficient to enable surrender obligations to begin in 2015.*”<sup>135</sup> The panel also listed several additional reasons for why this recommendation is appropriate.<sup>136</sup>

Lastly, the panel considered whether NZ should restrict access to certain international units that have come under scrutiny, similar decisions had been made in international schemes.<sup>137</sup> The issue here involved balancing the need to preserve the integrity of the scheme with the need to minimise the cost impact of the scheme on the economy. The panel’s recommendation was that the Government should urgently consider whether certain units should be made ineligible.<sup>138</sup>

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<sup>127</sup> At 24.

<sup>128</sup> At 33.

<sup>129</sup> At 33.

<sup>130</sup> At 32.

<sup>131</sup> At 32.

<sup>132</sup> At 7.

<sup>133</sup> At 31.

<sup>134</sup> At 47.

<sup>135</sup> At 8.

<sup>136</sup> At 46-47.

<sup>137</sup> At 77.

<sup>138</sup> At 77.

Following this review, the ETS was amended in 2012 by the Climate Change Response (Emissions Trading and Other Matters) Amendment Act ('2012 Act'). The discernible intentions and objectives that underlie these amendments will now be examined.

## ***VI. What Were the Objectives and Intentions of the '2012 Act'?***

The primary objectives of the '2012 Act' were described as being to: ensure that the ETS effectively supports economic growth opportunities, ensure that the ETS is sufficiently flexible to cater for a range of international outcomes in the period 2013 to 2020, and to improve both the operation and administration of the scheme.<sup>139</sup> A phrase commonly used was that the '2012 Act' should allow NZ to do its 'fair share', as opposed to attempting to be a world leader.<sup>140</sup> However, minimal guidance was provided as to what doing our 'fair share' actually entails.

In addition to the above objectives, frequent mention was made of the intention to maintain the costs of the ETS at present levels.<sup>141</sup> In contrast to this, the review panel recommended that the incentives to change behaviour (i.e. the costs of the scheme) "should continue to increase".<sup>142</sup> The importance of this is that it shows that the political and legal disjunct is also present at this earlier tier of examination. The next section will focus on a number of key amendments that were made to the ETS in the '2012 Act'.

## ***VII. The '2012 Act'***

The legislation of the ETS as enacted in the '2012 Act' will now be examined in order to assess the extent to which it aligns with both the above objectives/intentions and the recommendations of the review panel. This overall analysis will then be compared to the backdrop underlying the dissertation.

Besides inserting an additional section relating to synthetic GHG's, the '2012 Act' did not alter the purpose statement of the ETS (see chapter two for the wording of the section). Parliament had an opportunity to amend this purpose statement, but elected not to. Therefore it can be assumed that the evaluation of the purpose statement conducted with regards to the '2008 Act', and carried over to the '2009 Act', can also be carried over to the '2012 Act'. As such, the '2012 Act' reaffirmed that the principal objectives of the ETS were to comply with

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<sup>139</sup> Climate Change Response (Emissions Trading and Other Matters) Bill 2012 (52-2) (Bills Digest) at 1-2; (23 August 2012) 683 NZPD 4723 per Hon Tim Groser (Minister for Climate Change Issues); (25 October 2012) 685 NZPD 6217 per Hon Simon Bridges (Acting Minister for Climate Change Issues); (8 November 2012) 685 NZPD 6449 per Hon Tim Groser (Minister for Climate Change Issues); Climate Change Response (Emissions Trading and Other Matters) Bill 2012 (52-2) (Finance and Expenditure Committee report) at 2.

<sup>140</sup> (23 August 2012) 683 NZPD 4723 per Hon Simon Bridges (Associate Minister for Climate Change Issues); (23 August 2012) 683 NZPD 4723 per Hon Dr Nick Smith; (23 August 2012) 683 NZPD 4723 per Todd McClay; (25 October 2012) 685 NZPD 6217 per Todd McClay; (8 November 2012) 685 NZPD 6449 per Todd McClay.

<sup>141</sup> (23 August 2012) 683 NZPD 4723 per Hon Tim Groser (Minister for Climate Change Issues) and Hon Simon Bridges (Associate Minister for Climate Change Issues) and Todd McClay; (8 November 2012) 685 NZPD 6449 per Maggie Barry.

<sup>142</sup> Above n 124, at 6.

international obligations and reduce NZ's net emission of GHG's. As was stated with regards to the previous legislation, the purpose statement was intended to reflect an intention to reduce GHG emissions *irrespective* and *independent* of NZ's international obligations. This accords with the views expressed by the review panel outlined earlier.

### ***J. The Transitional Provisions***

Section 26 of the '2012 Act' established that the ability to surrender one emission unit for every two tonnes of emissions (for eligible sectors) was to be extended indefinitely.<sup>143</sup> Similarly, section 27 indefinitely extended the provision that awarded one emission unit for every two tonnes of emissions removed.<sup>144</sup> Section 71 of the '2012 Act' extends the \$25 price cap indefinitely. The rationale behind these extensions was that there is uncertainty as to what NZ's future international obligations will be, and that the continuation of these provisions will be less influential on emissions abatement than expectations around price and the level of international action post-2015.<sup>145</sup>

These amendments dramatically emphasise the political and legal disjunct. The amendments are contrary to both the review panels' recommendations and the reasoning adopted in previous legislation. As outlined earlier, the review panel stressed the importance of providing certainty and a clear signal to participants in the scheme. However, the amendments have created significant uncertainty, participants are no longer aware of when these transitional provisions will cease and therefore are unable to ascertain what their future costs under the scheme may be. Further, the justification for their extension was based around international uncertainty. However, the review panel and the interpretation of the purpose statement both express that emissions abatement efforts should continue regardless of the situation internationally.

When these transitional provisions were initially introduced in the '2009 Act', they were justified on the basis that their temporary nature would not affect emissions abatement and that the awareness of a future price of carbon would still incentivise investment in emissions reduction technology and practices.<sup>146</sup> Yet these amendments have removed the temporary nature of the provisions and have also removed any awareness of a future price of carbon. As such, the underlying justification for these provisions no longer exists. In terms of incentivising behavioural change towards emissions reductions, these amendments have further diminished the ability of the ETS to achieve these changes by prolonging the weaknesses caused by the '2009 Act'.

### ***K. Agriculture, Allocation and International Linkage***

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<sup>143</sup> Section 26.

<sup>144</sup> Section 27.

<sup>145</sup> Ministry for the Environment *Departmental Report on the Climate Change Response (Emissions Trading and Other Matters) Amendment Bill* (September 2012) at 7.

<sup>146</sup> Above n 89, at 6; above n 90, at 20.

Under the ‘2009 Act’ the agricultural sector was to incur obligations for the surrender of emissions units from 2015 onwards. Section 96 of the ‘2012 Act’ delayed this entry of agriculture into the ETS indefinitely.<sup>147</sup> The agricultural sectors entry was stated as being conditional on: technologies being available to reduce emissions and international competitors taking sufficient action on their emissions in general.<sup>148</sup> The conclusion was reached that there is currently insufficient abatement methods and thus agriculture entry was delayed. The disjunct is again present with regards to this amendment. The review panel explicitly stated that abatement options are available and sufficient for agriculture to be included under the ‘2009 Act’ timeframe, and as mentioned earlier, abatement efforts were intended to persist despite international situations, in stark contrast to the two-pronged entry test established for agriculture.

Sections 34-36 suspend the phase-out of allocation for eligible industrial and agricultural activities until those participants face full surrender obligations.<sup>149</sup> However, the incurrence of full surrender obligations for these participants has been deferred indefinitely (see above), therefore these amendments have effectively postponed the phase-out of allocation indefinitely.

An issue arose with regards to the integrity of certain international units that were available under the NZ ETS and whether these units should be prohibited. The conclusion was reached that the ETS is designed to achieve emissions reductions in the most cost-effective manner, that a restriction on units is not necessary and that existing provisions in the ETS are sufficient.<sup>150</sup>

### 5. *Conclusion on the ‘2012 Act’*

The amendments in the ‘2009 Act’ have been evaluated as weak in terms of their ability to incentivise behavioural change and emissions reductions (see chapter two). The ‘2012 Act’ has now prolonged these weaknesses indefinitely. Participants from numerous sectors are eligible for significant free allocation of units, with no visible start date for when this allocation will be phased-out. The surrender obligations for numerous participants has been halved via the one-for-two provision, and this cost reducing provision also has no visible end date. International units have not been restricted, and at the time the ‘2012 Act’ was enacted, international units and NZUs were priced within a range of \$5-\$10 per unit (significantly below the \$25 price cap), which would then be *halved* by the one-for-two provision. This suggests that on top of the generous free allocation and transitional provisions, participants were also able to

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<sup>147</sup> Section 96

<sup>148</sup> Above n 145, at 39.

<sup>149</sup> Sections 34-36.

<sup>150</sup> Above n 145, at 80-81; (25 October 2012) 685 NZPD 6217 per Hon Simon Bridges (Acting Minister for Climate Change Issues). – Section 30G(1)(c) of the ‘2008 Act’ provides for a regulation making power that may restrict the surrender of certain units.

meet their obligations via purchasing cheap units. These provisions show that the price signal of the ETS has been diminished even further, to the extent that the Parliamentary Commissioner for the Environment has stated that these amendments make “a farce of our response to climate change.”<sup>151</sup>

The review panel recommended providing a clear signal regarding the future costs of the scheme and also recommended a gradual increase in these costs. The response is in stark contrast to this recommendation, the costs have been maintained and potentially reduced, whilst indefinitely extending provisions has created significant uncertainty as to the future costs of the scheme.

In addition to the above points, the cause of approximately half of NZ’s GHG emissions, the agricultural sector, was excluded from the scheme indefinitely. The entry of the agricultural sector was delayed on the basis of a lack of abatement options. However as mentioned earlier, this is in contrast to the review panels recommendation that there are sufficient abatement options available for a 2015 entry. In addition, upon entry, the agricultural sector was to receive significant free allocation and would likely benefit from the transitional provisions, thereby greatly reducing the costs the sector would face under the scheme. This suggests that the decision to delay the entry of agriculture into the scheme was unjustified. The costs imposed by the ETS were to provide a price signal that would cause behavioural change and emissions reductions. As mentioned, the review panel stressed that certainty regarding this price signal is important for its effectiveness. However, the agricultural sector has now had its entry delayed indefinitely, thereby effectively removing any impact of a price signal on the sector and creating enormous uncertainty as to when they will be subject to a price signal in the future. This amendment made in the ‘2012 Act’ is clearly inadequate for incentivising behavioural change and emissions reductions.

The political and legal disjunct was particularly prevalent in the examination of the ‘2012 Act’. The review panel emphasised that the underlying goal is to reduce GHG emissions levels. The discernible intentions/objectives underlying the ‘2012 Act’ then consisted of minimal reference to this goal. Yet the purpose statement in the ‘2012 Act’ reaffirmed the goal. Lastly, key amendments made in the ‘2012 Act’ diminished the ability of the ETS to achieve this goal. The disjunct was thus present in the ‘2012 Act’ at all three tiers of analysis.

The next chapter will address any key developments in the scheme post-2012, followed by the final chapter which will provide an overall conclusion to the dissertation.

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<sup>151</sup> Parliamentary Commissioner for the Environment “Submission to the Finance and Expenditure Select Committee on the Climate Change Response (Emissions Trading and Other Matters) Amendment Bill” at 5.

## CHAPTER FOUR: Post-2012 Developments

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The following section will not provide an examination to the same depth as the previous chapters, rather it is aimed at providing a brief overview of relevant developments that have occurred with regards to the ETS post-2012. There are three main developments that will be briefly examined: the delinking of the NZ ETS with the Kyoto Protocol, the entry into a new international agreement, and an evaluation of the ETS conducted in 2016.

### *L. Status of International Agreements*

The first Kyoto commitment period came to an end in 2012. The conclusions reached with regards to emissions reductions, for all three pieces of legislation ('2008 Act', '2009 Act' and '2012 Act'), was supported by the manner in which NZ complied with its Kyoto Protocol commitment period one obligations. NZ's total emissions were significantly greater than the level of emissions permitted by AAUs, compliance was only secured through a large number of international units and removal units from forestry, as opposed to reductions in domestic GHG emissions levels.<sup>152</sup>

In November 2012 it was announced that NZ would not be committing to a second Kyoto Protocol commitment period, and instead would be taking its post-2012 commitment under the UNFCCC.<sup>153</sup> The importance of this is that it meant NZ's commitment would no longer be legally binding internationally.<sup>154</sup> This then led to a decision in 2013 that the NZ scheme would become a domestic only scheme, with the surrender of Kyoto Protocol commitment period one units no longer accepted from June 2015.<sup>155</sup> This decision was largely the result of participants in the NZ ETS complying with their obligations via the surrender of low priced international units.<sup>156</sup> Participants were able to surrender low value Kyoto units whilst retaining NZUs received via free allocation to hedge against future liabilities. This led to a large number of banked NZUs. Given that NZ was unable to trade in a second Kyoto

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<sup>152</sup> Ministry for the Environment "New Zealand meets its target under the first commitment period of the Kyoto Protocol" <[www.mfe.govt.nz](http://www.mfe.govt.nz)>.

<sup>153</sup> Motu Economic and Public Policy Research *Evolution of the New Zealand Emissions Trading Scheme: Linking* (April 2017) at 25.

<sup>154</sup> Above n 153.

<sup>155</sup> Above n 153, at 25-26.

<sup>156</sup> Ministry for the Environment "Regulatory Impact Statement: Improving alignment of the New Zealand Emissions Trading Scheme with New Zealand's provisional 2030 emissions reduction target" <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 10; Ministry for the Environment "New Zealand Emissions Trading Scheme Evaluation 2016" <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 14.



commitment period, this was seen as a fiscal liability and thus provided further justification for the aforementioned changes.<sup>157</sup>

In December of 2015, a new international agreement was established at the 21<sup>st</sup> Conference of the Parties to the UNFCCC (the ‘Paris Agreement’). NZ ratified this agreement, with it coming into force in November of 2016.<sup>158</sup> Article 2 of the Paris Agreement stated that the aim was to strengthen the global response to climate change by:<sup>159</sup>

Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognising that this would significantly reduce the risks and impacts of climate change.

Article 3 then stated that Parties are to decide upon a nationally determined contribution (NDC) to the global response to climate change, with a view to achieving the purpose outlined in Article 2 above.<sup>160</sup> NZ submitted a NDC target of reducing GHG emissions by 30% below 2005 levels by 2030 (equivalent to 11% below 1990 levels).<sup>161</sup> This is the fourth emissions reduction target to be created. The emissions targets are as follows: an unconditional target of 5% below 1990 levels in 2013-2020, a provisional target of 10-20% below 1990 levels by 2020, a long-term target of reducing net emissions by 50% below 1990 levels by 2050, and the Paris Agreement target just mentioned. This represents an unequivocal intention to reduce domestic GHG emissions levels, and this intention has also been affirmed in a number of post-2012 government publications.<sup>162</sup>

However, the most recent report on NZ’s GHG inventory showed that from 1990-2015 NZ’s net GHG emissions had increased by 63.6%.<sup>163</sup> There is also evidence that these emissions levels were projected to continue increasing if the provisions of the ETS remained unchanged.<sup>164</sup> In response to this, a review of the ETS was conducted and the Climate Change Response (Removal of Transitional Measure) Amendment Act 2016 was

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<sup>157</sup> Ministry for the Environment “Regulatory Impact Statement: Improving alignment of the New Zealand Emissions Trading Scheme with New Zealand’s provisional 2030 emissions reduction target” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 10.

<sup>158</sup> United Nations Framework Convention on Climate Change “Paris Agreement – Status of Ratification” <[www.unfccc.int](http://www.unfccc.int)>.

<sup>159</sup> Paris Agreement to the United Nations Framework Convention on Climate Change, art 2.

<sup>160</sup> Article 3.

<sup>161</sup> Ministry for the Environment “New Zealand’s 2030 climate change target” <[www.mfe.govt.nz](http://www.mfe.govt.nz)>.

<sup>162</sup> Ministry for the Environment *New Zealand’s first biennial report under the United Nations Framework Convention on Climate Change* (December 2013) at 46; Ministry for the Environment “New Zealand Emissions Trading Scheme Review 2015/16: Discussion Document and Call for Written Submissions” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 3; Above n 157, at 8; Ministry for the Environment “New Zealand Emissions Trading Scheme Evaluation 2016” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 7.

<sup>163</sup> Ministry for the Environment *New Zealand’s Greenhouse Gas Inventory 1990-2015* (May 2017) at 38.

<sup>164</sup> Above n 157, at 12; Ministry for the Environment *New Zealand’s sixth national communication under the United Nations Framework Convention on Climate Change and the Kyoto Protocol* (December 2013) at 16; Ministry for the Environment *New Zealand’s first biennial report under the United Nations Framework Convention on Climate Change* (December 2013) at 67.

implemented. This Act provided for the phase-out of the ‘1-for-2’ unit surrender obligation. The phase out was to begin in 2016, with a 1-for-1 unit surrender obligation incurred from 2019 onwards.<sup>165</sup> However, the ability of this amendment to enable the ETS to adequately reduce emissions can be questioned. The ETS still provided for significant free allocation on an intensity basis, with the phase-out of this allocation not to begin until 2019, once the ‘1-for-2’ provision is fully phased out. In addition to this, the largest emitting sector in the NZ economy (agriculture), was still excluded from the scheme. Therefore, it is unlikely that phasing out the ‘1-for-2’ provision would create the large emissions reductions necessary to comply with the aforementioned targets.

The political and legal disjunct is evident here. NZ has committed to an international agreement, with the contribution to that agreement focusing heavily on reducing GHG emissions levels. However, the historical emissions reduction performance of NZ’s ETS does not align with this commitment. In addition, the changes made to the ETS are unlikely to be sufficient to remedy this performance. It is therefore likely that NZ will have to comply with this commitment via other means (i.e. international or domestic offset units), a possibility that has been acknowledged in a number of government publications.<sup>166</sup>

### ***M. ETS Evaluation 2016***

The ETS was evaluated in 2016 with the intention of providing “a structured assessment of how the NZ ETS has performed to date.”<sup>167</sup> For present purposes, the evaluation is significant to the extent that it confirms a number of the conclusions that have been reached previously in the dissertation.

For example, the conclusion was reached that the provisions of the ETS encouraged compliance with obligations via the purchase of international units, as opposed to compliance through behavioural change and a reduction in GHG emissions levels. The evaluation of the scheme then confirmed this, stating that in 2014 international units (ERUs and CERs) amounted to more than 95% of the units surrendered.<sup>168</sup> The conclusion was also reached that the provisions of the ETS, throughout its legislative history, have provided an inadequate incentive for participants to change their behaviour and to reduce GHG emissions levels. Research conducted for the evaluation confirmed this, stating that:<sup>169</sup>

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<sup>165</sup> Climate Change Response (Removal of Transitional Measure) Amendment Act 2016, s 4.

<sup>166</sup> Ministry for the Environment “Phase out of the one-for-two transitional measure from the New Zealand Emissions Trading Scheme” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 18; Ministry for the Environment “New Zealand Emissions Trading Scheme Review 2015/16: Discussion Document and Call for Written Submissions” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 9; above n 161; above n 157, at 4.

<sup>167</sup> Ministry for the Environment “New Zealand Emissions Trading Scheme Evaluation 2016” <[www.mfe.govt.nz](http://www.mfe.govt.nz)> at 15.

<sup>168</sup> Above n 167, at 14.

<sup>169</sup> Above n 167, at 21.

No sector other than forestry made emissions reductions over Kyoto Protocol Commitment Period One (2008-12) (CP1) that were directly caused by NZ ETS obligations.

With regards to behavioural change it was stated that:<sup>170</sup>

Nearly all of those interviewed, across all sectors, indicated the NZ ETS had provided *no incentive* to look at how to reduce their emissions.

The general conclusion was that “the NZ ETS and carbon pricing has not yet been significantly embedded in businesses’ decisions in New Zealand”.<sup>171</sup>

The political and legal disjunct has been identified at numerous stages throughout the legislative history of the ETS. It has then been shown that a common consequence of this disjunct was a weakening of the ETS’s ability to incentivise behavioural change and GHG emissions reductions. The evaluation of the ETS conducted in 2016 has then provided evidence that supports this conclusion.

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<sup>170</sup> Above n 167, at 28.

<sup>171</sup> Above n 167, at 29.

## CHAPTER FIVE: Conclusion

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NZ committed to binding GHG emissions reduction targets via the Kyoto Protocol. In response, the NZ ETS was implemented in the '2008 Act'. This initial ETS was intended to cause a fundamental change in behaviour that would not only allow NZ to comply with its international obligations but also to reduce its domestic level of GHG emissions. These objectives of reducing emissions and complying with international obligations were enshrined in the purpose statement of the '2008 Act'. In terms of coverage, this initial ETS was to encompass all sectors and all gases, leading the world in doing so.

However, the provisions of the '2008 Act' did not align with the aforementioned goals. The largest emitting sector, agriculture, was excluded from the scheme for the entirety of the first Kyoto commitment period, with significant free allocation to be received upon entry and a relatively slow phase-out of this allocation. Other sectors such as industrial processes, synthetic gases, waste, liquid fossil fuels and stationary energy also received a delayed entry, with a number of those sectors also eligible for free allocation. These provisions do not reflect the intention to encompass all sectors and all gases. In addition to this, the initial ETS did not implement a cap on domestic emissions and allowed participants to offset their emissions via the purchase of international units.

The political and legal disjunct was clear. The price signal of the ETS was intended to be the primary driver of behavioural change and emissions reductions, and thus the primary method of fulfilling the discernible intentions and objectives of the initial ETS. Yet the price signal was delayed for numerous sectors and once in effect it was often heavily subsidised, with the option of complying with obligations through the purchase of international units as opposed to behavioural change.

The discernible objectives and intentions of the ETS as enacted in the '2009 Act' focused on minimising 'leakage' and incentivising more efficient domestic production. The scheme was also intended to align with the proposed Australian scheme in a number of ways. These objectives appeared to reflect a focus on reducing the costs of the scheme. However, the purpose statement of the '2009 Act' was virtually identical to that of the '2008 Act' and therefore maintained the overarching objectives of complying with international obligations and reducing GHG emissions levels. The political and legal disjunct was apparent even at this early stage of examination such that the discernible objectives contradict each other. Minimising leakage and aligning with Australia was to involve reducing the costs of the scheme, whilst the overarching objectives maintained in the purpose statement are to be achieved by an incremental *increase* in the costs of the scheme.

The disjunct was then further reflected in the provisions of the ‘2009 Act’. The method of allocation was changed from an historical basis to an intensity basis, with the rationale for this focusing on minimising leakage and aligning with Australia, with no mention of complying with international obligations or reducing GHG emissions levels. The ‘2009 Act’ also significantly reduced the level of phase-out of free allocation and also prolonged the duration of this phase-out. The ‘1-for-2’ provision was introduced, which effectively halved the cost of compliance for eligible participants. Lastly, the entry date of the agricultural sector was delayed until 2015. The overall result of these provisions was a clear reduction in the costs of the scheme. Free allocation had the potential to increase, the phase-out of this allocation was prolonged, and in fact participants had the ability to *increase* their free allocation whilst the phase-out process was underway by increasing their production, effectively incentivising an increase in emissions levels. It is clear that the outcome of the disjunct favours the objectives of reducing costs, at the expense of the overarching and statutory enshrined objective of reducing GHG emissions levels.

The ‘2009 Act’ also provided for a Ministerial discretion to set non-binding emissions targets. These targets were then set at relatively ambitious levels, given NZ’s previous emissions reduction performance. The setting of these targets reflects a direct intention to reduce GHG emissions levels, aligning with the purpose statement of the scheme. The purpose statement and the setting of targets are significant as they show that the lack of transparency operates at two levels in the ‘2009 Act’. There is a clear lack of transparency between the discernible objectives of the scheme and the provisions enacted, but there is also a lack of transparency internally, between the provisions of the scheme themselves.

The political and legal disjunct culminates in a three-tiered examination of the amendments that were made to the ETS by the implementation of the ‘2012 Act’. Preceding the ‘2012 Act’, a review of the ETS was conducted by the ETS review panel in 2011. The recommendations were made on the basis that the “essential purpose” of the ETS is to reduce emissions in NZ by changing behaviour, thereby reaffirming this overarching objective.<sup>172</sup> The review panel then recommended that any amendments should send a clear signal to participants in order to provide certainty and confidence as to the costs of the scheme so that they can change their behaviour accordingly. The panel recommended: a phase-out of the ‘1-for-2’ surrender obligations by 2015, an increase in the price cap by \$5 per annum until it reaches \$50 in 2017, no fundamental change to the phase-out of allocation, and maintenance of the 2015 entry date for agriculture.

The discernible objectives of the ‘2012 Act’ involve: supporting economic growth, doing our ‘fair share’ and *maintaining* the costs of the scheme at present levels. There was already a disjunct at this early tier of examination. The discernible objectives made little to no reference to reducing GHG emission levels. In addition to this, the goal of maintaining costs

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<sup>172</sup> See Chapter Three

is in direct contradiction to the review panel's recommendation that the costs of the scheme should be incrementally increased.

The provisions that were enacted in the '2012 Act' are then in stark contrast to the review panel's recommendations and are perhaps the greatest example of the political and legal disjunct. Instead of providing certainty, the '2012 Act' *indefinitely delayed*: the '1-for-2' surrender obligation, the price cap, the phase-out of allocation and the entry date for agriculture. Thereby creating significant *uncertainty* as to what the future costs of the scheme may be. Thus the disjunct was present at all three tiers in the examination of the '2012 Act'. As with the previous legislation, the result of this disjunct is that the provisions tend to oppose the overarching objective of reducing GHG emissions. The price signal was dramatically weakened by these amendments. In addition, access to international units was left largely unrestricted at a time when these units were extremely cheap, thus encouraging compliance via the purchase of these units as opposed to via behavioural change. This frequent weakening of the price signal resulted in low compliance costs and an inadequate incentive to change behaviour and reduce GHG emissions levels.

In terms of post-2012 developments, NZ has delinked with the Kyoto Protocol and has agreed to another ambitious emissions reduction target under the Paris Agreement. The disjunct was also present with regards to this examination, as the performance of the ETS does not align with the target set, and compliance with the target will likely require a re-opening of access to the international units which were recently prohibited.

The NZ ETS has changed frequently and significantly throughout its history. Although despite these changes, there is strong evidence that the scheme has always maintained the objective of reducing domestic GHG emissions levels. A political and legal disjunct, a lack of legal transparency, has hindered the ability of the scheme to achieve this objective. Provisions were enacted that oppose this objective, without a definitive acknowledgment that these provisions would do so. The result has been a frequent weakening of the price signal, causing low compliance costs and an inadequate incentive to change behaviour and reduce GHG emissions.

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