



**Submission to:** The Environment Committee  
New Zealand Parliament

**On:** The Climate Change Response (Emissions Trading Reform)  
Amendment Bill and Supplementary Order Paper No 413

**By:** The Interim Climate Change Committee

## A. Introduction

1. The Interim Climate Change Committee (ICCC) was established as a precursor to the Climate Change Commission.
2. Until its Terms of Reference<sup>1</sup> expired on 24 December 2019, the ICCC was a Ministerial Advisory Committee comprised of:
  - Chair: Dr David Prentice
  - Deputy Chair: Lisa Tumahai
  - Dr Keith Turner
  - Dr Jan Wright
  - Dr Harry Clark
3. Short descriptions of each ICCC member are attached in Appendix A. The ICCC also included Dr Suzi Kerr, as a special advisor, up until 30 April 2019.
4. The ICCC approved lodging this submission prior to expiry of its Terms of Reference on 24 December 2019.

### A.1 Our mandate

5. The ICCC's work was directed through Terms of Reference set by the Minister for Climate Change.
6. The original Terms of Reference required the ICCC to prepare two reports. These reports: **Action on agricultural emissions**, and **Accelerated electrification** were handed over to Minister Shaw on 30 April 2019. Both reports were released by the Government on 16 July 2019, along with the Government's response to the recommendations made by the ICCC.

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<sup>1</sup> The current Terms of Reference are available at: <https://www.iccc.mfe.govt.nz/who-we-are/terms-of-reference/>

7. The Terms of Reference were updated in March 2019 with the addition of a requirement to deliver “*evidence and analysis of plausible pathways to, and any elements of, the 2050 emissions reduction target(s), to support the advice required of the Climate Change Commission (the Commission) shortly after its establishment.*”
8. In May 2019 the ICCC wrote to the Minister to advise how it would approach delivering on the updated Terms of Reference. This letter noted that the ICCC would focus on putting the Commission in the best possible position to start its work when established, and that it would provide input into climate change consultations and policy development, where it overlaps with the ICCC’s role. The Minister responded to affirm the approach.<sup>2</sup>
9. The Terms of Reference were extended until 24 December 2019. This timing was intended to allow the ICCC to cover the transition of the Zero Carbon Bill into legislation and the establishment of the Climate Change Commission.
10. In this context, the ICCC began the work required to prepare emissions budgets and emissions reduction plans, as required by Part 1B Subpart 3 of the Climate Change Response Act 2002 (the CCR Act).

## A.2 Our submission

11. In making this submission, we hope to provide insight on the provisions of the Climate Change Response (Emissions Trading Reform) Amendment Bill 2019 (186-1) based on our experience over the past 18 months.
12. The ICCC’s role since its establishment has been to provide independent, expert advice. From May 2019, we have been focused on laying the groundwork for the Climate Change Commission. This means that we have an appreciation of the practical aspects of the Commission’s work, and are wish to ensure that tasks and functions proposed for the Commission are appropriate.
13. As part of our initial phase of work, we were asked to consider “how surrender obligations could best be arranged if agricultural methane and nitrous oxide emissions enter into the New Zealand Emissions Trading Scheme (NZ ETS)”. In our agriculture inquiry, we carefully examined the policy issues encountered in designing policies to reduce agricultural emissions, including bringing agricultural emissions into the NZ ETS but also other options.
14. For these reasons, our submission focuses primarily on the content of the Supplementary Order Paper 2019 (413) Climate Change Response (Emissions Trading Reform) Amendment Bill 2019 (186-1) (referred to as SOP413). The amendments in SOP 413 result to a large extent from the Government’s response to the ICCC’s report, **Action on agricultural emissions**. These amendments relate to the agricultural activities listed on Subparts 1 to 4 of Part 5 of Schedule 3 of the CCR Act and add provisions to support the formal agreement between the Government and the agriculture sector.

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<sup>2</sup> Both letters are available at : <https://www.iccc.mfe.govt.nz/our-news/updates-from-the-chair/iccc-work-programme-from-1-may-2019/>

## B. Reforms to the New Zealand Emissions Trading Scheme

15. We strongly support the aims of the reforms contained in the Climate Change Response (Emissions Trading Reform) Amendment Bill (the ETR Bill) - improving certainty for businesses, making the NZ ETS more accessible, and improving its administration.
16. Fit-for-purpose emissions pricing is a critical component of the suite of climate policies that will be needed to enable New Zealand to meet its emission reduction targets. Other policies will also be necessary, particularly where non-price market failures exist, but emission pricing provides the foundation for an effective and efficient policy package. There is extensive evidence that emissions trading and other market-based measures help allocate financial resources efficiently and achieve reductions at lower cost than other approaches.
17. In reforming the architecture of the NZ ETS, we consider that the following outcomes should be sought:
  - coherence with the framework provided by the Zero Carbon Bill and now included in the CCR Act (specifically, part 1B of the CCR Act on emissions reduction)
  - predictable and coordinated processes for adjusting NZ ETS settings
  - sufficient predictability of future unit supply volumes and prices, to build confidence and drive low-emissions investment in line with the 2050 target and emissions budgets
  - an effective framework and process to enable future pricing of biogenic agricultural emissions
  - strong safeguards for market integrity
  - cross-party support for the core NZ ETS architecture and decision-making processes.
18. We welcome that the Bill introduces a decision-making framework to enable the supply of units in the NZ ETS to be capped.
19. The effectiveness of this framework will depend on finding an appropriate balance of rules to provide predictability and flexibility to adapt to changing circumstances. In particular this should be carefully considered in relation to the proposed changes to 30GB of the CCR Act on regulations about overall limits and price control settings for units.
20. The Government will have considerable scope to adjust existing price control and unit supply settings under 30GB (4) of the CCR Act. The list of considerations that may affect these settings (in new section 30GC) is also very broad. There is a risk that this could unduly increase uncertainty about future unit supply and prices. Options to manage this risk could include narrowing the parameters (rationale and/or scale) of the adjustments that can be made, or for the Government of the day to create and publish policy guidance about how it intends to exercise this function.

## B.1 Commission's role to advise on industrial allocation

21. The ETR Bill proposes new roles for the Climate Change Commission; to advise on overall limits on units, price control settings, and phase-out rates for industrial allocation. On the latter, it is proposed that the Commission advise on both:
  - a. slowing the general phase-out rate of industrial allocation (new section 84A of the CCR Act) and
  - b. increasing the phase-out rate for specific eligible industrial activities (new section 84B of the CCR Act).
22. We support the intent of ensuring that industrial allocation remains commensurate with actual emissions leakage risks and compatible with the 2050 target and emissions budgets.
23. The provisions for slowing the phase-out rate can only be applied to all eligible activities. This "all or nothing" approach may not prove suitable. For example, if the default phase-out rate was too fast for only one activity, it would not be possible for the Commission to slow down the phase-out rate only for that activity – the phase-out rate would have to slow for all.
24. The provisions on increasing the phase-out rate in new section 84B of the CCR Act recognise that leakage risk may vary across sectors. We think that sector-specific considerations will also be relevant to slowing the phase-out rate, and that new section 84A of the CCR Act should therefore allow for slowing the phase-out rate for specific activities. This will give the Commission better ability to tailor its recommendations to the most appropriate course of action.
25. In respect of advising on the phase-out rate for specific eligible industrial activities, we consider that it will be important for the Commission to have the ability to determine the scope and phasing of this work. The scope of this advice is potentially very large. There are 26 activities eligible for industrial allocation. It will be necessary to assess a range of complex issues including emissions leakage risk and potentially gathering extensive evidence to judge whether phase-out rates should change.
26. Time to undertake the work will also be constrained, given that any regulations setting increases to phase-out rates must be in place before the start of an emissions budget period in order to apply to that period. Consultation requirements must also be satisfied, and the Commission will need to provide its advice allowing sufficient time for the Minister to consider it before recommending regulations.
27. There is no information in the Bill as to whether this role will be undertaken under a new function to be added to section 5J of the CCR Act, or under section 5K of the CCR Act which allows the Minister for Climate Change to request that the Commission prepare specific reports. Under 5K of the CCR Act, the Minister must consult the Commission about the terms of reference for the requested report, including for example on its scope.
28. Whichever approach is used, it would be helpful for there to be clarity that the Commission can prioritise in undertaking this work, taking into account the time and resources available to do it.

**29. We recommend that the Environment Committee considers:**

- a. adjusting proposed new section 84A of the CCR Act to enable the general phase-out rate to be reduced for specific activities, rather than only for all participants**
- b. clarifying that the Commission has discretion to determine the scope and phasing of advice on increasing phase-out rates for specific activities under proposed new section 84B of the CCR Act.**

## C. Pricing agricultural emissions

30. We are pleased that the Government is pursuing our key recommendation to price livestock emissions at farm-level, and that it is working towards implementing this from 2025, the date that we considered would be an ambitious but feasible goal. We also welcome that a clear decision has been made to price emissions from nitrogen fertiliser at processor level through the NZ ETS, unless there are clear, evidence-based benefits to support moving the obligation to farm-level.
31. We respect the decision that the Government has made to partner with farming sector leaders to implement a joint action plan for pricing farm-level emissions from 2025, as an alternative to covering these emissions through the NZ ETS as soon as practicable.
32. Our concern now is for this process to be strongly supported by the legislative provisions that apply to it. This will help ensure that a robust and fit-for-purpose farm-level emissions pricing scheme is in place as soon as practicable.

### C.1 Farm-level emissions pricing and primary sector commitments

33. The new Schedule 5 to the CCR Act proposed in SOP 413 contains primary sector climate change commitments, which are a key element of working towards a farm-level emissions pricing scheme.
34. In general, the type of commitments in Schedule 5 are appropriate. The commitments would benefit, however, from improved clarity and focus. This is for two reasons. First, these commitments should practically contribute to progress on the path towards the farm-level pricing system. Secondly, well-defined objectives and responsibilities – what must be done, by when and by whom – will better enable the Commission to assess progress, as proposed in new section 220 of the CCR Act.
35. Given the Government’s proposal to price nitrogen fertiliser at processor level, it is clear that the farm-level pricing system should be focused on farms that have livestock. The commitments in Schedule 5 should also therefore relate to farms with livestock, so that effort is directed most productively. This would not prevent consideration of the reporting of other emissions sources and sinks on the land used for livestock farming.
36. The farm emissions reporting pursued as part of the Schedule 5 commitments should be aligned with the emissions reporting method to be eventually used in the regulatory emissions pricing

system. Lack of continuity risks creating confusion which would undermine the awareness raising benefits of the early farm emissions reporting activities.

37. There should also be alignment between the farm emissions reporting and the emissions calculations in the farm plan element of the primary sector commitments. The farm plans will need to include emissions information to assist de farmers to manage their greenhouse gas emissions. Inconsistency between this and other emissions reporting would send unhelpful signals to farmers.
38. As outlined in our *Action on agricultural emissions* report<sup>3</sup>, for emissions reporting in a farm-level pricing system it would be entirely acceptable to begin by using a simple emissions calculation method requiring very limited farm data, with the aim of moving to a more complex method over time. One way to do this would be to start with a complex model for calculating emissions, populated mainly with default values. More farm specific data could be progressively included over time to improve the accuracy of the emissions estimates. Audit processes and requirements would need to be considered in determining which farm data can be included.
39. **We recommend that the Environment Committee considers amending proposed Schedule 5 to the CCR Act so that the primary sector commitments clearly relate to farms with livestock, and to highlight the importance of alignment and continuity between early emissions reporting efforts, emissions information in farm plans, and the eventual emissions reporting to be used in the alternative farm-level emissions pricing system.**

## C.2 Commission's role to advise on assistance to agricultural participants

40. SOP 413 includes new proposed roles for the Commission as follows:
  - a. reporting on progress towards meeting farm-level obligations by 30 June 2022 (proposed section 220 of the CCR Act), and
  - b. advising on what, if any, assistance (i.e. an allocation of units or emissions,) should be given to the participants in the alternative farm-level pricing system (proposed section 215(4)(a) of the CCR Act)<sup>4</sup>.
41. In terms of the progress report, we welcome the way provisions in proposed s220 give the Commission scope to assess progress as it best sees fit.
42. On assistance to agricultural participants (also known as agricultural allocation), the advice to be requested from the Commission is not clearly defined. There is unhelpful ambiguity in s215(4)(a) around who will lead the detailed work required to develop the method for assistance; it should be made clear that this is not in the scope of the Commission's role.
43. The ICCC has already made recommendations on agricultural allocation methods in the *Action on agricultural emissions* report. We recommended that the appropriate method in respect of farm-level obligations for livestock emissions would be a hybrid of output-based and land-based

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<sup>3</sup> See *Action on agricultural emissions* [Technical Appendix 2: Calculating Emissions](#)

<sup>4</sup> The timing for this advice is not clearly specified, but it is likely that a report would have to be delivered in early 2022, given Ministers must release their report, having taken the Commission's advice into account, by 31 Dec 2022.

allocation methods. As far as we are aware, the Government has not formally considered or responded to that advice.

44. The land-based allocation method requires substantial further work to develop, and this work needs to start as soon as possible. A delay in starting this work would put the 2025 start date for the farm-level emissions pricing system at risk. It would also lead to a longer period of regulatory uncertainty that could discourage farmers from taking actions to reduce emissions. For example, farmers might delay implementing a mitigation action out of fears that doing so would materially reduce the allocation volume they will receive when the emissions pricing system starts.
45. There is an operational component to developing allocation methods that does not sit well with the Commission's role. Any allocation system will need to mesh with other systems, e.g. for emissions reporting used in the pricing scheme. Developing the land-based method would also benefit from drawing on the range of specialised skills and knowledge available across government agencies. As an independent body, there are limits to how the Commission can collaborate with government agencies to make use of this expertise and incorporate operational perspectives.
46. Furthermore the Commission will be fully focused on emissions budget advice until early 2021 and is already managing risks to meeting that statutory deadline. After that, it will be taking on substantial new work tasks related to advice on NZ ETS settings and industrial allocation. It will not have capacity to take on work related to agricultural allocation methods unless substantial additional resources are provided.
47. We do, however, agree that it would be beneficial for the Commission to have a role in providing independent review of the method/s to be used for agricultural allocation in the alternative emissions pricing system. In this way, the Commission could appropriately play a role in supporting the robustness and integrity of the system.
48. **We recommend that the Environment Committee provides clarity that the Commission will review any methods proposed for providing assistance to participants in the alternative farm-level pricing system, by amending proposed section 215 (4)(a) of the CCR Act in SOP 413 to state:**

***“(4) Before preparing the report, the Ministers must-***

***(a) Request a report from the Climate Change Commission under section 5K about what level of assistance, if any, should be given to participants and that it reviews progress on the development of the method or methods for providing assistance to participants;***  
***...”***

### C.3 Treatment of emissions from nitrogen fertiliser

49. SOP 413 contains provisions for a regulation-making power for the Minister for Climate Change to impose surrender obligations for livestock emissions on agricultural processors, if progress towards milestones is considered insufficient.
50. We support this “backstop” to the Government-agriculture sector joint action plan on pricing farm-level emissions from 2025. This approach allays some of the concerns we outlined in our

**Action on agricultural emissions** report that a Government-sector agreement would lack accountability and lead to continued regulatory uncertainty.

51. However, this backstop appears to only apply to livestock emissions. We consider that the same mechanism should be available to bring forward obligations for fertiliser emissions.
52. Emissions from nitrogen fertiliser are a relatively small proportion of New Zealand's total greenhouse gas emissions from agriculture – but they have grown rapidly. Most nitrogen fertiliser used in New Zealand is urea applied to dairy pasture, and its use has increased by about 650 per cent since 1990. Increasing use of nitrogen fertiliser has caused the associated emissions to grow from 230.3 kilotonnes (kt) of carbon dioxide equivalents (CO<sub>2</sub>-e) in 1990 (0.7 per cent of total agricultural emissions) to 1,365.6 kt CO<sub>2</sub>-e in 2017 (3.5 per cent of agricultural emissions).<sup>5</sup>
53. We see no compelling reason to treat nitrogen fertiliser emissions differently from livestock emissions in the “backstop” arrangements to bring surrender obligations forward, should progress towards the farm-level pricing system prove insufficient. While nitrogen fertiliser emissions are significantly smaller than emissions from livestock, their growth means they should not be disregarded.
- 54. We recommend that the Environment Committee extends the regulation-making power in SOP 413 that allows surrender obligations to be brought forward for activities listed in subpart 3 of Part 5 of Schedule 3 (i.e. for livestock emissions) to also apply to activities listed in subpart 1 of Part 5 of Schedule 3 (i.e. for nitrogen fertiliser emissions).**

#### C.4 Agricultural allocation in the NZ ETS

55. A result of SOP 413 will be that the provisions will be retained in the CCR Act for agricultural allocation in the NZ ETS to be provided using an output-based method. This is in line with the IPCC's recommendations for agricultural allocation if the point of obligation is at processor level.
56. The Government clearly intends to develop an alternative pricing system to the NZ ETS to price livestock emissions at farm level, in which case new legislation will need to be prepared outlining the method/s and rules for any assistance provided agricultural participants. However, we note that the ability to shift the NZ ETS obligation from processor-level to farm-level by Order In Council will continue to exist in the Act in sections 2A(8) and (9). If this option were to be used, the Act would require the output-based allocation method to be used at farm level.
57. As outlined on pages 88-89 of the IPCC's **Action on agricultural emissions** report, there are some important downsides to the use of output-based allocation at farm-level. These include that it could encourage some farmers to intensify, which may conflict with other environmental objectives such as water quality.
- 58. We recommend that the Environment Committee consider enabling changes to the method for agricultural allocation in the NZ ETS, in case the option to move the NZ ETS point of obligation from processor to farm-level by Order in Council in sections 2A(8) and (9) is ever used.**

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<sup>5</sup> Ministry for the Environment (2019). New Zealand's Greenhouse Gas Inventory 1990-2017.

## C.5 Allocative baselines for agricultural activities

59. SOP 413 proposes to amend section 161G(3) of the CCR Act so that the Minister must have regard to the most recent annual inventory report before allocative baseline or baselines for agricultural activities are set in regulations; and to amend section 161G(6) of the CCR Act so that those regulations are reviewed at least one in every 5-year period.

60. We would like to highlight the recommendation from our **Action on agricultural emissions** report that the Government set livestock-related allocative baselines (also termed allocation factors) so that they reduce in line with expected improvements in emissions intensity. We quote below the relevant text from pages 97 – 98 of the report:

*“The emissions intensity of agricultural production in New Zealand has fallen at a rate of about 1% per year over the last 25 years and further reductions are expected in the near term. If the agricultural allocation factors do not take this into account, in a few years the amount of allocation provided to agriculture would be 100% of actual agricultural emissions. This would be over-allocation.*

*To avoid this situation, the Committee proposes that the livestock-related allocation factors for both processors and farmers be set to decline in line with anticipated business as usual improvements in emissions intensity.*

*For example, if in year 1 the allocation factor per unit of output (for example, per tonne of milk solids) is 10 tonnes of CO<sub>2</sub>e, and the anticipated business as usual improvement is 0.5%, in year 2 it should be set at 9.95 tonnes of CO<sub>2</sub>e”*

61. For clarity, our intent in recommending this approach is that these declining baselines be set in advance. In other words, the allocative baselines should be set through regulations for several years into the future, with those baselines declining year-by-year in a way that anticipates business as usual emissions intensity improvements (informed by existing trends documented in the national inventory) so as to avoid over-allocation. These changes to the allocative baselines would not be the result of a review and updating process. The provisions in SOP 413 do not appear to allow the use of this approach.

62. We support the provisions for regularly reviewing allocative baselines, but for a different purpose to the ex-ante adjustments outlined above. Regular reviews of baselines could be used to adjust for a step change in the business as usual level of emissions intensity. For example, in the case where adoption of an emissions reducing technology or practice (such as use of a methane inhibitor or vaccine) has become so widespread and enduring that continuing to provide a reward for it through free allocation is no longer considered appropriate or fair; the technology has become standard New Zealand farming practice.

63. **We recommend that the Environment Committee considers adjusting the proposed amendments to s161G(3) of the CCR Act to allow livestock-related allocative baselines to be set in advance so that they reduce in line with expected improvements in emissions intensity, as recommended by the ICC.**

# Appendix A - ICCC members:

## **Dr David Prentice (Chair)**

Dr Prentice was most recently the CEO and Managing Director of Opus International Consultants. He is Chair of Business New Zealand's Infrastructure sub-group, a member of the Institute of Directors, a Chartered Professional Engineer and a Fellow of Engineering New Zealand.

## **Ms Lisa Tumahai (Deputy Chair)**

Ms Tumahai is Kaiwhakahaere (Chairperson) of Te Rūnanga o Ngāi Tahu. The climate change work championed by Rūnanga across tribal assets, along with protecting and advancing collective interests of Iwi provide valuable insights for the Committee. As whanau member of Ngāti Waewae, Lisa is acutely aware of the challenges climate change presents for local communities. As Kaiwhakahaere Te Rūnanga o Ngāi Tahu, Lisa oversees the operations of Ngāi Tahu Farming, providing her with an understanding of agri-business as well as bringing strong relationships across the sector. Ms Tumahai brings knowledge and experience of te reo me ona tikanga, matauranga Māori, Māori business and the Māori economy.

## **Dr Harry Clark**

Dr Clark is a New Zealand expert on agricultural greenhouse gas research, and is currently the Director of the New Zealand Agricultural Greenhouse Gas Research Centre, prior to which he headed up AgResearch's Climate, Land and Environment section. Harry also sits on a number of New Zealand and international government panels and committees and co-chairs the Livestock Research Group of the Global Research Alliance on Agricultural Greenhouse Gases.

## **Dr Jan Wright**

Dr Wright was New Zealand's third Parliamentary Commissioner for the Environment. She spent two terms as Commissioner, between 2007 and 2017, and has particular expertise in science, policy, and economics. In that role, she produced a number of reports on climate change issues, including agricultural emissions and sea level rise.

## **Dr Keith Turner**

Dr Turner has a background in energy, business and governance. He was CEO of Meridian Energy for many years, and more recently in governance roles, being Chair or Director of Fisher & Paykel Appliances, Auckland International Airport, Spark Infrastructure (Australia), South Australian Power Networks (Australia), Victoria Power Network (Australia) and Chorus. He brings a strong understanding of the energy sector to the Committee.

## **Dr Suzi Kerr (Term finished 30 April 2019)**

Dr Kerr is an internationally renowned expert in economics, climate change policy and emissions trading. As a Senior Fellow at Motu Economic and Public Policy Research, and Adjunct Professor of Public Policy at Victoria University, she is also a regular participant in climate roundtables and has authored a number of papers on climate policy and emissions trading in New Zealand. Dr Kerr is a specialist advisor to the Committee.