[In Confidence]

Office of the Minister of Forestry
Office of the Minister for Climate Change
Chair, Cabinet Economic Development Committee

**Improving the Emissions Trading Scheme for forestry participants – Part Two: Decisions for operational improvements and permanent forests**

## Proposal

1. We are seeking policy approval for the second set of operational improvements for forestry in the New Zealand Emissions Trading Scheme (ETS). These require changes to the Climate Change Response Act 2002 (CCRA).

## Executive Summary.

2. The 2015/16 ETS review identified a range of issues relevant to ETS forestry participants, including issues that make it difficult for forest owners to understand and comply with the scheme. These issues are barriers to participation.

3. Public consultation on improvements was concluded in September 2018. Cabinet agreed to a first set of improvements in December 2018 (Cab 18 Min-0606 refers). A second set of decisions were deferred as they link to other policy areas and processes (e.g. improving the penalties and compliance framework). This paper addresses those linked decisions

4. The paper seeks agreement to six significant operational improvements and six minor and technical improvements to the ETS. These changes complete the suite of operational improvements to the ETS for forestry. The six significant operational proposals are:
   i) Enabling the use of better land information in determining ETS eligibility and status, and improving the emission ruling process;
   ii) Preventing units being issued to a grant funded forest during the term of its grant agreement (post-1989 forest land);
   iii) Re-aligning mandatory emission return periods with international reporting periods (affecting post-1989 forestry participants);
   iv) Allowing persistent non-compliant voluntary post-1989 participants to be deregistered;
   v) Improving and enabling enforcement of the transmission of interest[1] process; and
   vi) Introducing penalties for breaching the permanence conditions for permanent post-1989 forests.

1 This is the process the CCRA prescribes for transferring registered post-1989 forest land between parties, commonly when buying and selling land.

5. We also propose six minor and technical improvements to the ETS for forestry, located in Appendix One. These changes give effect to previous decisions, provide clarity, remove redundancy in the CCRA, and ensure that we can make use of any future improvements to processes and IT systems to simplify reporting for forest owners.

6. Together these changes will:
   i) set the foundation for land owners to make better-informed decisions around establishing forests on their land;
   ii) improve the environmental integrity of forestry settings within the ETS;
   iii) enhance the outcomes of introducing a permanent post-1989 forest activity into the ETS, as agreed by Cabinet in December 2018 (Cab 18 Min-0606 refers); and
   iv) complement wider changes to forestry settings for which we expect to bring proposals to Cabinet in April 2019, including the introduction of averaging. However, the proposals in this paper are not contingent on those decisions.

**Background**

7. The ETS was introduced in 2008 as New Zealand's primary tool to assist in meeting our international emission reductions targets. Forestry was the first sector to be included in the ETS.

8. There are around 2,100 forestry participants in the ETS, out of 2,400 participants in total. In addition to having the largest number of participants of any sector, forestry participants are diverse, with different forests (in size, species, and growth rate) and management intentions.

9. The ETS contains two key classifications of forest land:
   i) Post-1989 forest land (primarily newly established forest after 31 December 1989) which may be native or exotic forest. These forests can be voluntarily registered in the ETS. If registered, the forests can earn New Zealand Units (NZUs) for forest growth and NZUs are surrendered for carbon stock loss.
   ii) Pre-1990 forest land (land which was forest at 31 December 1989 and exotic forest at 31 December 2007). This land does not have to account for changes in carbon stock, but NZUs must be surrendered if the land is deforested.

10. The ETS 2015/16 review (the review) identified improvements to the ETS that were needed to incentivise forest establishment and reduce operational complexity. The forest package has been developed to deliver these improvements for participants.

11. In December 2018, Cabinet agreed to a first set of forestry related improvements, including introducing a new permanent post-1989 forest activity into the ETS (Cab 18 Min-0606) which will greatly reduce barriers to establishing permanent forests. In addition, Cabinet agreed to a first set of operational changes to improve the way the ETS works for forestry participants.

12. The package of proposals in this paper completes the operational changes required to improve the ETS for forestry. We expect to bring a final package of substantive policy proposals on forestry settings in the ETS to Cabinet in April 2019. Table One summarises the Cabinet papers comprising the total package of proposals for forestry.

*Table One: Summary of delivered and planned Cabinet papers seeking decisions on the ETS for forestry*

| Cabinet paper in December 2018 | |
|---|---|
| Improving the Emissions Trading Scheme for forestry participants Part One<br><br>**[Decided on by Cabinet in December 2018]** | Decisions to:<br>a. Establish a new permanent forest activity in the ETS.<br><br>b. Introduce a package of operational changes to improve the way the ETS works for forestry participants. |
| Cabinet papers in 2019 | |
| **Improving the Emissions Trading Scheme for forestry participants Part Two**<br><br>**[This Cabinet paper at DEV on 20 March]** | **Decisions to make:**<br>**a. Further operational changes to improve the way the ETS works for forestry participants.**<br><br>**b. Minor and technical changes to improve the ETS for forestry participants.** |
| Decisions to introduce averaging<br><br>**[Second forestry Cabinet paper at DEV on 20 March]** | Decisions to confirm:<br>a. That forests, first registered in the ETS after 31 December 2020, must use averaging accounting.<br><br>s9(2)(f)(iv) [redacted] |
| Operational details of averaging, decisions on harvested wood products and residual issues<br><br>s9(2)(f)(iv) [redacted] | Decisions on:<br>a. s9(2)(f)(iv) [redacted] |

| | |
|---|---|
| | s9(2)(f)(iv) [redacted] |

13. Alongside these decisions, the Minister for Climate Change is proposing amendments to the CCRA through a series of papers, as set out in an overview paper *Amendments to the Climate Change Response Act 2002: tranche two*. We expect all amendments to the CCRA agreed by Cabinet since December 2018 to be developed into a single Bill, and introduced to the House in mid-2019. However, the proposals in this paper are not contingent on those decisions.

*We are proposing six significant proposals to improve understanding of the ETS for land owners and provide new compliance tools.*

14. The six significant changes finalise details of the permanent post-1989 forest activity, and complete the suite of operational improvements to the ETS for forestry. This section explains these proposals in detail.

*Enabling the use of better land information in determining ETS eligibility and land status and improving the emission ruling process*

15. Land and forest owners need to know how the ETS classifies their land to make informed investment decisions, such as whether to purchase land, deforest, or establish new forest.

16. However, the EPA[2] determines the eligibility of land (and the activities on that land) for the ETS after deforestation or forest establishment, when investment decisions have already been made. This is because at the time of registration the ETS requires the participant to be undertaking the activity[3] and simply planning to undertake an activity is insufficient to apply to register in the ETS[4]. Effectively this means that the participant will attempt to register an area of forest, and then the EPA determines which parts meet the post-1989 forest definition.

17. Determining land status requires expert interpretation of historical aerial and satellite imagery (which has a much lower resolution than current satellite imagery). Te Uru Rākau also carries out field visits and undertakes destructive sampling to assess eligibility, but this assessment is not required or useful in every application. Te Uru Rākau also cannot carry out that level of assessment for all potential participants.

2 Ministry for Primary Industries carries out most of the forestry related administrative functions under the Climate Change Response Act 2002 under statutory delegation from the Environmental Protection Authority and a memorandum of understanding.
3 Either deforesting pre-1990 forest land or owning, having a lease or forestry right over, post-1989 forest land, or being party to a Crown conservation contract.
4 Note participants may apply for an 'Emissions ruling' prior to deforestation or forest establishment, but this process is costly and has its own issues (addressed in paragraphs 22 and 23).

18. This process is due to the CCRA's definition of 'forest land' being taken from the rules that form part of our international agreements. This is important as it allows New Zealand to count the carbon sequestered in post-1989 forests towards our emissions reduction target (which is a purpose of the CCRA).

19. NZUs issued to participants in the ETS come at a fiscal cost to the Crown, and any significant departure from the international rules would carry a reputational risk when it comes time to reconcile our domestic actions, and emissions, with our emissions reduction target[5].

20. This means the ETS is set up to be conservative around assessing eligibility. Areas of land are typically rejected as post-1989 forest land due to a lack of detailed mapping data and evidence. Currently, there is no national map with the detail in high enough resolution to be consistent with the Act.

21. The untimely nature of ETS eligibility decisions is frustrating to applicants, who see it as complicated, lengthy and lacking transparency. It is likely that the decision will reject some of the land they had assumed they would receive carbon income for. Participants have the ability to request a review of the decision. To date there have been 50 reviews of decisions at a cost to the Crown of around $20,000 each. There is also potential for decisions to be appealed via court action, though there have been none relating to registering land to date[6].

22. Between 2013 and 2018 an average of 20 per cent of land for which applications were made for registration as post-1989 land, was rejected. This rejected forest land is unable to earn NZUs, and the owner will have incurred costs to establish the forest (e.g. planting costs).

23. The ETS does allow a person to seek an *emissions ruling* from the EPA on the eligibility of their actual or proposed activity in connection with land, prior to deforestation or forest establishment. This ruling allows the applicant to apply to the EPA, and have them rule on whether the applicant is, or will be, undertaking an activity. The ruling is based on certain assumptions and conditions which need to remain unchanged for the ruling to have effect e.g. a participant plants a forest. This ability to seek a ruling is part of wider provision in the Act that applies to all sectors.

24. We are proposing a two part solution to the issues around determining land status and informing decision making:
    i) Create the ability to publish a map (or similar tool) which identifies land status, and other information relevant, for the ETS, and use this map for ETS applications and eligibility assessments; and
    ii) Improve the process around emissions rulings so it works better for forest and other land owners prior to forest establishment.

5 Under the Kyoto Protocol, the international target also carried fiscal risk for the Crown as we were expected to purchase international units for this deficit. This was recorded as part of the Crown Accounts.
6 There has been one appeal on a penalty ruling.

*Publishing an ETS map or similar tools to provide the public with, and enable the better use of, land information*

25. We propose to create the ability to publicise and use tools or a map to determine how the ETS classifies different areas of land. Using tools or a map in this way will require provisions in the legislation to:
    i) Allow electronic tools, maps or other information to be defined through regulations ('the mapping instrument');
    ii) Empower the proactive classification of land into the mapping instrument; and
    iii) Enable the mapping instrument to be used to meet the information requirements of the EPA when an applicant is applying to register into the ETS by registering it as undertaking an activity. The applicant still needs to provide other information needed for registration, e.g. mapping information of the forest, and evidence that it will meet the definition of a forest[7].

26. The Regulations will define the mapping instrument, the types of land status classifications and prescribe the decision-making process and any conditions. This includes consultation requirements with people who appear likely to be substantially affected by the decisions.

27. We intend that current application processes will remain available and the map will work alongside the improved emissions rulings process (below), and the review and appeal mechanisms. If a participant disagrees with the status found on the map, or new information becomes available, an emissions ruling can be requested prior to investment, or they can follow the current application, review and appeal mechanisms.

28. Delivering a map, or tool, that is fit for purpose will require additional work before it goes public. We expect officials to report back to us on options for developing the map, s9(2)(f)(iv) , but we must first provide the enabling function in the legislation and now is the time to do so as drafting of the Climate Change Response Amendment Bill has already started.

29. The development of a map to determine land status under the ETS was supported by 85 per cent of submissions during the ETS review consultation. Ten per cent of respondents disagreed, mainly focusing on concerns about commercial sensitivity if the map contained more information than land status (e.g. information on the carbon stocks associated with the forest).

7 For example 5m tall at maturity.

*Improving the emissions rulings process for land and forests*

30. The emissions ruling process is set out in a provision in the Act that applies to all sectors. It was developed to allow persons to find out if they were undertaking an ETS activity or that they would be in the future if their planned actions went ahead. For some activities this is relatively simple (e.g. importing coal) however, for forestry there are challenges to using the emissions ruling process.

31. Forestry-specific issues with the emissions ruling process are that it:
    i) can be interpreted in such a way that should even 1 hectare of the proposed post-1989 not being eligible for registration, the whole area subject to the ruling is rejected;
    ii) does not explicitly allow an emissions ruling to be made on part of the definition of the activity, and only comes into effect if the full definition is met (e.g. it would be valuable for a land owner to know that an area of land qualifies as post-1989 forest land, should it become forest land in the future (i.e. forest species at least 5 meters tall at maturity));
    iii) is based solely on the evidence provided by the applicant. Should the applicant not have sufficient evidence to satisfy the EPA on land status, the ruling will determine that the land to be ineligible for the activity. This may be despite Te Uru Rākau having access to information (e.g. satellite imagery) which would assist addressing the question being asked, or assist in finding in the participants favour; and
    iv) does not adequately apply to land classifications that are not directly associated with forestry activities, e.g. tree weeds status.

*32.* We propose improving the emissions ruling process specifically for forestry, to better accommodate the range of questions being asked by the land based sectors, address any questions around forest land under the ETS, and allow an appropriate process for using information not supplied by the person requesting the emissions ruling. This is specifically to:
    i) Clarify that the EPA may make a ruling in respect to parts of an area that is subject to a ruling application; and
    *ii)* Enable the EPA to make rulings:
        *a.* based on assumptions of future events;
        b. enable the EPA to make rulings on other ETS forestry related matters, which are not directly related to undertaking an activity; and
        *c.* based on all available information, including information it holds, subject to disclosing the information to the applicant.

33. Improving the emissions rulings process will have two benefits:
    i) It will be useful to provide clarity of ETS land status while the map is developed (for an area of land); and
    ii) Once the map is developed, the improved emissions ruling process will enable participants or applicants to query the status of land where they disagree with the map, before making an investment decision.

***Preventing units being issued to a grant funded forest during the term of its grant agreement (post-1989 forest land)***

34. As part of the One Billion Trees grant funding programme the decision was made that pine forests would not be able to receive New Zealand Units in the ETS for 6 years after forest establishment. This period has been publicised as part of the One Billion Trees announcements.

35. However, the CCRA requires participants to submit a mandatory emissions return at the end of every mandatory emissions return period (every five years) which determines the number of NZUs the participant must surrender or is entitled to receive.

36. This means that in order to comply with the CCRA, a participant with a grant-funded forest registered in the ETS will most likely be required to claim units for some of this six year period, effectively double claiming (the NZUs and the grant) and breaching the conditions of the grant.

37. Enforcing the 6 year stand down period through the grant contract (e.g. a penalty clause) will be difficult because there may be a significant delay between the conclusion of the contract and the issuance of units (up to 4 years). Furthermore any action (to repossess units or grants) would require civil action.

38. To address this incompatibility of forestry rules, we propose to make two changes:
    i) Amend sections of the CCRA which relate to emission returns for post-1989 forestry to ensure that participants are unable to double claim for NZUs during the grant funded stand down period; and
    ii) Provide the ability to create regulations defining which grant funded forests are unable to claim NZUs (in the ETS) and for how long this applies.

39. This proposal was not consulted on as decisions on the One Billion Trees programme were made after the ETS consultation material was developed. No forest owner will be worse off as a result of the change.

*Re-aligning mandatory emission return periods with international reporting periods (affecting post-1989 forestry participants).*

40. Each post-1989 and permanent post-1989 forest participants in the ETS, must make a mandatory emissions return at the end of every Mandatory Emissions Return Period (MERP). This mandatory emissions return determines the total number of NZUs the forest participant is entitled to receive or surrender to the Crown.

41. The content of the mandatory emissions return is defined in regulations. Submitting a mandatory emissions return imposes costs on the participant, e.g. all participants of more than 100ha of registered forest are required to undertake the field measurement approach, which costs at least $10,000, at least once per MERP.

42. The MERP ensures that the Crown has the best information on ETS forests, and an accurate assessment of the number of units held by the participant and the Crown (as we will report internationally).

43. Originally the timing of the MERP in the ETS was set to align with the end of New Zealand's contemporaneous commitment period which set New Zealand target under the Kyoto Protocol (2008-2012). This alignment was lost in 2013 when New Zealand chose not to take a 2013-2020 commitment under the Kyoto Protocol's second commitment period.

44. The current MERPs (2018-2022, then 2023-2027) do not align with New Zealand's reporting for our international target under the Paris Agreement (either for emissions budget for 2021-2030 or the biennial reports). At the end of each MERP, post-1989 foresters are required to account for their emissions and removals, and the EPA to transfer any extra units they have earned during that time. Different international commitment periods and MERPs will make it more difficult to manage unit supply decisions over this period as the large unit flows to and from post-1989 forestry participants will occur part way through the period the international target applies to.

45. The solution to this misalignment is to have a one-off 3 year 'mini-MERP' from 2023-2025, before resuming their standard 5-yearly periods. While this change will result on costs to participants who harvest their forests, we believe these are manageable due to at least 6 years notice prior to the units being due in 2026.

46. We intend to design the operational aspects of the mini-MERP to minimise cost to participants, for example allow participants with more than 100 hectares of registered forest to use their existing yield table, rather than undergo costly (over $10,000) re-measurement. This will not have a significant impact on NZU allocations at the national level.

47. This timing also allows the development of Te Uru Rākau's computer system which underpins the ETS for forestry to be substantially improved, which is expected to offer additional opportunity to simplify reporting for participants.

48. There was good support of a mini-MERP in the consultation, 74% agreed with only 6% disagreeing. Those who disagreed or were uncertain did not support the option of a mini-MERP from 2018 to 2020 as it would not allow time for participants to plan for their harvesting obligations. By holding the mini-MERP to 2023-2025 we aim to mitigate those concerns.

### *Allowing persistent non-compliant voluntary participants to be deregistered*

49. To ensure the integrity of the ETS it is important that voluntary (post-1989 forestry) participants in the ETS fulfil their obligations under the scheme. There is work underway to revise the wider penalty and compliance framework[8] across all ETS sectors to encourage compliance. The forestry sector has unique features, however, that require additional (or alternative) tools to deal with persistently non-compliant participants, notably:
    i. Post-1989 forestry participants are only obliged to report every 5 years; whereas other sectors typically report annually. This provides fewer opportunities for regulators to identify non-compliance and results in a long window of time when participants can remain non-compliant without any regulatory action;
    ii. The long period between mandatory reporting means that there are few options to escalate through the penalty framework in the CCRA, and the escalation will only happen several years after the first offense.
    iii. Post-1989 forestry participants are, by far, the primary participants that take part in the ETS for pecuniary gain through carbon removal[9]. Even when participants are non-compliant they still receive NZUs, for forest growth and these may be significantly higher value than the penalties in (ii) above.
    iv. Forestry participants make up about 90 percent of all participants in the scheme so the burden on regulators of managing non-compliance is greater than other sectors.

50. We propose the EPA be able to deregister persistently non-compliant forestry participants which will work to accelerate the compliance process. The test for this will be 365 days after a mandatory action (e.g. a mandatory return) was due or 90 days after the due date a participant was liable for a penalty payment under the penalty and compliance regime.

51. Deregistration of post-1989 forestry participants will require the former participant to surrender units for the full unit balance of the land, i.e. all units received since registration. This provides a strong incentive for participants to become compliant quickly, as paying the penalties is likely to be their least cost option (compared to deregistration).

52. Should they be deregistered, the former forestry participant would no longer accrue penalties and compliance costs (for new instances of non-compliance), and the Crown would not need to transfer units to them. This will reduce the compliance burden on regulators.

8 These revisions are being led by the Ministry for the Environment and are likely to be incorporated into the proposals to improve wider ETS settings, due to Cabinet in Mach 2019. For an overview of this work see the accompanying paper *Amendments to the Climate Change Response Act 2002: tranche two*.

9 There are other removal activities, but they do not have these issues, nor similar scales of unit allocations.

53. As the deregistration provisions will create an incentive for non-compliant participants to become compliant and/or pay penalties as the least cost option, we expect enforcement options created by the provisions to drive the behaviour we want, rather than use the deregistration provisions.

54. The other sectors in the ETS do not face the issues outlined in para 49. This means there is no evidence that such deregistration provisions are required for managing non-compliance in other sectors. For this reason we are proposing that the provisions only apply to the forestry sector.

55. There was good support for this proposal from consultation (71 per cent) with only 6 per cent opposing the option to deregister non-compliant participants. Some submitters commented on the need to ensure there is a low cost way to avoid deregistration and/or the importance of having it clear who has responsibility for the unit balances[10]. Our proposals do this.

*Improving and enabling enforcement of the transmission of interest process*

56. While participation in the ETS is voluntary for post-1989 forestry, if a person acquires (e.g. purchases, inherits, grants a forest lease) registered post-1989 forest land they are obliged to become an ETS participant. This ensures that the integrity of the ETS is maintained, and there are no opportunities avoid obligations around deforestation/harvest liabilities.

57. The CCRA contains rules on the around *transmissions of interest* in post-1989 forest land[11]. The *transmissions of interest* process results in a series of obligations for both the parties in the transaction. In particular, both parties are required to notify the EPA of the transmission, and the transferor is required to submit an emissions return.

58. These parts of the CCRA are a significant compliance issue, with Te Uru Rākau being aware of 106 incomplete transmission of interests from the perspective of the ETS (at time of writing). It often takes several months, or years, for non-notified transmission of interests to be detected and resolved. It is not uncommon for multiple non-compliant transmissions of interest to occur for the same piece of land (e.g. during changes to a trust). This often leads to the late discovery of the non-compliant transmissions.

59. Despite the participant for this land being non-compliant, the post-1989 forest land continues to be treated as any other area of registered land (e.g. eligible to earn units). Te Uru Rākau calculates the emissions returns during this period, which is time consuming and complex, particularly when there are multiple transmissions. When the participant does become compliant, they are responsible for the units received during this time (e.g. if they chose to deregister, or harvest the forest).

10 The unit balance is the net number of units a registered area of post-1989 forest land has received, regardless of the participant.
11 A transmission of interest includes buying or selling land, granting a forest lease or right, or changing 40% of the members of an unincorporated body, e.g. a trust.

60. Some people who are required to become a participant are refusing to do so, and Te Uru Rākau has limited options to manage these situations. While the penalty and compliance framework allows for increasing sanctions for people who refuse to become compliant, the higher levels of sanction do not occur quickly enough to encourage compliance.

61. We propose to improve the transmission of interest process for forestry participants, and enable enforcement, by creating provisions that:
    i) Enable the EPA to take all steps necessary to complete transfer (e.g. by providing a process to complete forms (relating to the ETS) on behalf of the person selling the land) and recover the costs of doing so;
    ii) Ensures the post-1989 forest land remains registered in the ETS while the transmission of interest is completed, and this land does not earn units between the transmission of interest MER (tMER) where they became the participant and any subsequent tMER[12];
    iii) Provides a deadline for those required to become participants to fulfil their obligations, being either:
        a. the last day they are required to submit a MER at the end of a MERP; or
        b. 90 working days after the discovery of the transmission of interest, after the period in paragraph a.
    iv) Should they fail to do so, they will be treated as non-compliant and the post-1989 forest land may be deregistered, this will create a civil debt; and
    v) Simplify any returns Te Uru Rākau is required to undertake when participants are non-compliant (including making it explicit that a tMER is not submitted should another transmission of interest occur).

62. The proposed approach will provide a lower cost pathway for a non-compliant participant to avoid being persistently non-compliant (i.e. by becoming compliant). As no additional units have been earned while non-compliant they will only be liable for the same number as if they deregistered immediately after the transmissions of interest.

63. This issue was not consulted on. The proposed solutions to the 'persistent non-compliant participant' (which were consulted on) were found to require a unique approach to address issues with transmissions of interest.

*Introducing civil penalties for breaching permanence conditions in new permanent post-1989 forests*

64. Permanent post-1989 forests in the ETS have a condition of their registration where the forest cannot be clear-felled for 50 years after first registration as a permanent post-1989 forest[13]. The decisions to establish the permanent post-1989 forest activity did not define the consequences of breaching this condition.

12 If the land was removed at this step there would be significant, unavoidable, costs for the new participant as they would need to surrender units for the unit balance.
13 Or 25 years, should the forest remain in the Permanent post-1989 forest activity after the initial 50 years.

65. Clear-fell for permanent post-1989 forest was defined in a way that includes harvesting, burning, or removing of trees by mechanical means or other human activity, resulting in an area greater than 1 hectare of forest land falling below 30 percent canopy cover.

66. Clear-felling of any class of forest is, however, not something which happens accidentally and requires deliberate intent, e.g. instructing harvesting crews, road construction and finding a market for the timber. Natural forest disturbance (e.g. from an adverse event) is not penalised for either the short term loss of forest (e.g. as a result of a fire) or for when the forest is unable to be re-established (e.g. a river moves).

67. The need to maintain canopy cover (by not clear-felling) in permanent post-1989 forests is the key point of difference from post-1989 forests in the ETS. Large scale clear-felling of permanent post-1989 forests would undermine the environmental integrity of the ETS, and impact all permanent post-1989 participants by undermining the market premium from 'permanent' units, which underpins the value proposition for permanent post-1989 forests.

68. Any consequence (penalty), that results from deliberate clear-felling, for the participant therefore needs to find a balance that provides i) a strong disincentive to discourage clear-fell harvest, while ii) encouraging the reporting of the emissions from the inappropriate harvest and the surrender of units for these emissions.

69. We propose that the civil penalty for the 'clear-fell' of permanent forest is equal to the deemed value of all wood (or biomass) being cleared in the permanent forest as part of the clear-fell process. This will ensure that there is no financial incentive to clear-fell the forest, and no benefit if the forest is clear-felled.

70. The deemed value will be set using regulations. In setting the deemed values the Minister will need to consider the:
    i) Species or forest type being clear felled;
    ii) The market value of the wood and other products removed, and historic variation in the price;
    iii) The need to place value for forests with no market for their product;
    iv) Any need to provide a 'look up' table for the volume of the harvest or clearance (to determine the size of the penalty);
    v) Any variation in the value with age of the forest or size of the trees removed; and
    vi) Submissions provided on the proposed deemed value (as part of a submission process).

71. The use of a regulation means there will be predictability around any penalty, reduces dispute around the commercial value of the timber removed, and allows enforcement to focus on detection.

72. There are some situations where the clearing of a permanent post-1989 forest may be outside the control of the participant. For example, a permanent post-1989 forest may be on the boundary of a property, and the logging contractor working in the rotational forest next door may stray over the boundary. Because of this, we believe some ability to reduce the civil penalty is appropriate, provided the clear-fell occurred outside the control of the participant.

73. Reporting the emissions associated with the clear-fell event will be encouraged through the penalty and compliance framework being proposed (refer *Amendments to the Climate Change Response Act 2002: tranche two*). This includes significant penalties for non-surrender of units for emissions. When an inappropriate harvest occurs the participant can avoid these emissions penalties by filing a return on time.

74. To avoid the use of the clear-fell provisions to bypass the Ministerial approval process (to withdraw a forest prior to the 50 year expiring[14]), should a clear-felled forest be deforested (i.e. the forest is not re-established) two consequences will apply:
    i) the whole affected Carbon Accounting Area[15] (CAA) will be de-registered
    ii) the participant will be liable to surrender two units for each unit the CAA has received since first registration in the ETS.

75. This issue was not directly consulted on, but the need for a penalty to disincentive clear-fell harvest was presented as an assumption of the permanent post-1989 activity.

76. This proposal allows continuous cover forestry, provided at least 30% canopy cover remains. Any indigenous forest will also have to be managed according to rules under the Forests Act 1949.

*Public consultation*

77. In August, Cabinet approved public consultation on proposals for improving the ETS [ENV-18-Min-0033 refers]. From 13 August 2018 to 21 September 2018, officials from the Ministry for the Environment (MfE), the Ministry for Primary Industries (MPI) and Te Uru Rākau conducted a joint public consultation on two packages of proposed improvements to the CCRA.
    i) More than 575 people attended one of the 10 public meetings on the proposals. These attendees represented Māori and a range of sector groups including transport, electricity, energy, forestry, local government and agriculture. Individuals and stakeholders from business associations, community groups, NGOs, and academics also attended.
    ii) There were 147 submissions received relating to the forestry proposals.

14 Refer paragraph 19 and 20 ENV-18-MIN-0047

15 A Carbon Accounting Area (CAA) how the post-1989 forestry participant registers land into the ETS. A CAA is a simple way of dividing up forest land and is used for calculating carbon gains and losses. A CAA must be at least 1 hectare in size; there are no limits on the number of CAAs a participant may have,

78. Submissions were generally very supportive of the proposals we are focusing on in this paper. Both creating a new permanent forest activity in the ETS and introducing operational changes received high levels of support. Details of the responses from submissions are included in the analysis of the proposals.

*Engagement with Treaty Partners*

79. A separate Māori Leaders hui was held in Wellington and several key points were discussed. Attendees at the hui emphasized the importance of considering the impacts on Māori from these proposals with a particular focus on those living in rural communities. They stated that the Government should ensure that Māori are not disadvantaged in any way. They requested that Māori should be involved, represented and influential in all decision-making arrangements and noted that stable and enduring policies are required to support investment decisions.

80. Submissions from iwi/Māori expressed a range of views on the detailed proposals, and included similar messages to those heard at the hui regarding consideration of impact on Māori and the importance of involving Māori in decision-making. There was no specific commentary on the proposals in this paper.

*Agency Consultation*

81. This paper was drafted by Te Uru Rākau, the Ministry for Primary Industries and the Ministry for the Environment. The following agencies were consulted on this paper: The Treasury, the Ministry for Foreign Affairs and Trade, Te Puni Kōkiri, the Ministry of Justice, the Ministry of Business, Innovation and Employment, the Department of Conservation and the Environmental Protection Authority. The Department of Prime Minister and Cabinet has been provided with this paper.

82. s9(2)(f)(iv) [redacted]

## Financial Implications

83. We are not seeking approval for any new funding in this paper. Where new powers are being created, it is expected that the operation of these will be met from the Ministry for Primary Industries existing baselines.

84. s9(2)(f)(iv) This will be part of a wider discussion around the support needed to implement the Climate Change Forestry Package, once the decisions are made around averaging accounting for post-1989 forests and harvested wood products.

## Legislative Implications

85. The policy decisions from this paper will require legislative change to be progressed through amendments to be made to the Climate Change Response Act 2002 (CCRA)

## Impact Analysis

86. A Regulatory Impact Assessment for these issues, *Climate Change Response Act 2002: Forest Sector Operational Improvements (Part 2*), is presented as Appendix 2.

87. A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury, Ministry for the Environment, and the Ministry for Primary Industries has reviewed the Regulatory Impact Assessment "Climate Change Response Act 2002: Forest Sector Operational Improvements (Part 2)" produced by Te Uru Rākau and dated 8 March 2019. The Quality Assurance panel considers that this partially meets the Quality Assurance criteria.

88. The problem definition and opportunity are clear and the proposals reflect public consultation and the Ministry for Primary Industries' operational experience in implementing the ETS.

89. The RIA is technically detailed and the presentation could have been tightened to make the content clearer and concise. Although two proposals have not been formally consulted on because the issues were identified during and after the consultation period, they have been adapted based on submissions and informal industry feedback.

90. The RIA provides a good rationale for the ability to enable a mapping tool and further work is required to decide on the appropriate mapping detail and to quantify the costs more accurately. The analysis indicates that the extent to which the potential benefits are realised is dependent on the uptake of the activity, which is uncertain.

91. The Regulatory Quality Team at the Treasury has determined that impact analysis is not required for regulatory decisions on the technical operational changes proposed in this paper[16] because they will have only minor impacts on businesses, individuals, or not-for-profit entities.

16 Refer to Appendix One.

## Human Rights

92. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## Crown-Māori Partnership

93. Māori have a significant stake in climate change action, and a significant interest in the NZ ETS. Māori have a large economy and asset base sitting largely in the primary industries, as well as Treaty-based rights and interests in natural resource use and management. It will be critical to maintain Te Ao Māori principles, including as provided by section 3A of the CCRA and a genuine Crown-Māori partnership approach.

94. It is expected that the mapping instrument will assist Māori landowners to make better informed decisions that help them increase the benefits they can realise from their forests and other lands.

95. The other proposals in this paper are designed to have no impact on ETS participants who are compliant with their ETS obligations. These are not expected to have a disproportionate impact on Māori ETS participants.

## Gender Implications

96. This paper has no gender implications.

## Disability Perspective

97. This paper has no disability implications.

## Publicity

98. A full summary of the submissions on the CCRA change proposals will be published before a Climate Change Response Act amendment bill is introduced to the house.

## Proactive Release

99. Following Cabinet consideration we intend to consider the release of this paper, and the associated RIA, with certain redactions in line with the Official Information Act 1982.

100. The timing of this will be aligned to the release of the other Cabinet papers being considered on forestry in the ETS.

## Points to note regarding the recommendations

101. These recommendations are provided in two parts. All the recommendations that can be made without detailing a long list of small changes have been included in this section.

102. The recommendations for minor operational and technical changes to the ETS are provided in an attached table for your review (refer Appendix One). This additional detail is required to support the Parliamentary Counsel Office to accurately draft the improvements.

**Recommendations**

The Minister of Forestry and the Minister for Climate Change recommend that the Committee:

1. **Note** the drafting of the Climate Change Response Act Amendment Bill, which will, amongst other amendments, introduce the permanent post-1989 forest activity into the Climate Change Response Act, is under development, and we intend that all decisions in this paper that relate to post-1989 forest land to also apply to permanent post-1989 forest land.

*Significant operational improvements:*

*Land eligibility.*

2. **Note** that knowing the Emissions Trading Scheme (ETS) status of land (e.g. whether the land is eligible to enter the ETS) is important for potential participants planning their investment in forests and forestry.

3. **Note** that the ETS settings for forestry currently make it difficult for land owners to obtain information around the ETS status of their land prior to investment, and, in the majority of cases, ETS status can only be definitively established once the forest definition is meet.

4. **Agree** to make changes to the CCRA so that:
    i. The Mapping Instrument(s) can be established in regulation and these regulations define the types of land status classifications, prescribe the land status decision-making process and any conditions, including consultation requirements with persons that appear likely to be substantially affected by the decisions;
    ii. Enable the EPA to publish decisions, in a Mapping Instrument, on land status for the ETS and other information relevant to how land is treated by the ETS;
    iii. A Mapping Instrument may be used by an applicant to satisfy information requirements used to determine ETS eligibility as part of the registration process as an alternative to the existing registration process;
    iv. The use of the existing registration process will remain an option;
    v. The Mapping Instrument(s) can be used to satisfy part of the information requirements to determine if they are undertaking an activity (For example, where the mapping instrument classifies the land as “eligible to be post-1989 forest land”, an applicant may use this decision along with evidence that the land meets the definition of “forest land” to satisfy the registration requirements);
    vi. The use of the existing provisions of the CCRA for emissions rulings, reviews of decisions and appeals remain options, and may request a review of the land status decision as part of a person’s application to register in the ETS.

**5.** **Agree** to improve the emissions ruling process for forestry by making the following changes:

i. Clarify that the EPA may make emissions rulings that can assess eligibility of any part of an area being applied for, provided this is consistent with the activity definitions in the CCRA,

ii. Make clearer that an emissions ruling made with regard to part of an activity, only comes into effect should the full activity be complied with,

iii. Extending the coverage of the emissions rulings process to include other forest land-related administrative decisions (e.g. exempt land that was formerly pre-1990 forest land);

iv. Clarify that the EPA may, in consultation with the applicant, use information it holds that was not submitted as part of assessing an application during the emissions ruling process.

*Meeting the intent of grant funded forests decisions.*

**6.** **Note** that in the decisions around the One Billion Trees programme, Cabinet agreed that grant funded *Pinus radiata* forest will not be eligible to earn NZUs within the ETS for the first six years of growth.

***7.*** **Agree** to create a regulation making power to declare which grant funded forests will be ineligible to earn NZUs and the period they will be unable to earn NZUs.

**8.** **Agree** to make amendments to the CCRA to ensure grant-funded forest is ineligible to earn units for the period it receives the grant (with reference to the regulations made in recommendation 7).

*Redefining the Mandatory Emissions Reporting Periods.*

**9.** **Note** that once every Mandatory Emissions Return Period (MERP) (every five years), all post-1989 participants must file a mandatory emissions return for their registered forest. This MERP determines the number of units participants are entitled to or owe the Crown (based on their forest carbon stock change).

**10.** **Note** the current MERP cycle (2018-2022 and then five yearly after that) is out of sync with the date of New Zealand's international reporting obligations under the Paris Agreement (2021-2030), which will make unit supply projections, and meeting our targets more difficult.

**11.** **Agree** the current MERP applies from 2018 to 2022.

**12.** **Note** there is insufficient time available to meet the legislative requirements to conclude the current MERP in 2020, as would occur if the Kyoto Protocol second commitment period comes into force at international law. Concluding the current MERP in 2020 would also have significant, negative, impacts on forestry participants (e.g. surrender obligations would be two years earlier than they are planning for).

13. **Agree** to change the MERP cycle to better match the Paris Agreement's reporting requirements:
    a. Setting a mini MERP from 2023-2025; and
    b. Establishing the next full MERP from 2026 to 2030 (and subsequent MERPs for 5 year periods after this)

14. **Agree** officials will prepare proposals for regulation changes to reduce operating costs for participants during the mini-MERP.

***15.*** **Note** the regulation changes in recommendation 14 will be submitted to Cabinet for approval prior to a round of consultation.

*Deregistering persistent non-compliant post-1989 forestry participants.*

16. **Note** that high numbers of voluntary post-1989 participants are failing to meet their obligations under the ETS (e.g. 10% have failed to submit a return due 30 June 2018), and are subject to penalties.

17. **Note** that the existing consequences of non-compliance are not proving effective for participants who are persistently non-compliant with their obligations, and they will continue to accrue penalties while being entitled to receive NZUs (so receive an income stream, even when non-compliant).

***18.*** **Agree** to empower the EPA to deregister post-1989 forestry participants who are persistently non-compliant.

***19.*** **Agree** to define persistent non-compliance as the later of:
    *a.* 365 days after a mandatory action in the ETS (e.g. a mandatory emissions return); or
    b. 90 days after the last date a payment is due under the penalty and compliance regime.

*Non-compliant participants after a transmission of interest.*

20. **Note** that when registered post-1989 forest land undergoes a transmission of interest (e.g. is sold) both the original participant (transferor) and the new participant (transferee) have obligations under the CCRA.

21. **Note** these obligations are often not complied with, particularly the transferee does not become a fully compliant participant in the ETS, and it is hard to identify this failure.

22. **Agree** to make the following changes to the transmission of interest process to improve our ability to manage this process, and encourage more rapid compliance with participant obligations:
    i) Enable the EPA to take necessary steps to complete transfers (such as completing forms on behalf of the person selling the land);

ii) Ensure the post-1989 land remains registered in the ETS, but does not receive any NZUs until the transferee becomes fully compliant with being a participant;

iii) Once a transferee becomes compliant, clarify that the transferee may claim units from the time of transmission of interest (this makes clear the status quo);

iv) Enable a transferee who is not compliant on the last date they are required to submit a MER, to be deemed non-compliant and the EPA may de-register the post-1989 forest land; and

v) Provide for the late discovery of the transmission of interest by giving the transferee 90 working days to become compliant if is it discovered after the period in recommendation 22(iv).

**23.** **Agree** to allow the recovery of costs of the EPA having to complete the transfers on behalf of participants (so there is no incentive to default on obligations and expect the EPA to undertake the actions).

*Penalty and compliance for permanent post-1989 forests.*

**24.** **Note** that as Cabinet has decided (in CAB-18-MIN-0606) that a permanent post-1989 forest is not able to be 'clear-felled' during the time it is registered as a permanent post-1989 forest, a penalty is needed for this condition of registration.

**25.** **Note** the clear-fell restriction is the key differentiation between the post-1989 and permanent post-1989 forests in the ETS, and the non-clear-fell provision will be key to units from permanent post-1989 forests commanding a market premium.

**26.** **Note** the ETS penalty and compliance framework improvements described in the paper *Amendments to the Climate Change Response Act 2002: tranche two,* does not cover a permanent post-1989 forestry participant breaching the clear-fell provisions.

**27.** **Agree** that there will be a civil pecuniary penalty for clear felling a permanent post-1989 forest equal to the deemed value of all clearance.

**28.** **Agree** that a court may, following a finding of liability, impose on the participant a penalty up to a maximum as set out in recommendation 32.

**29.** **Agree** that the court may apply discretion to reduce the clear-fell penalty if the participant had reasonable excuse for why the clear fell occurred.

**30.** **Agree** to provide a defence to liability (per recommendations 27 and 28) where the contravention is beyond the person's control and could not reasonably have been foreseen, and the person could not reasonably have taken steps to prevent it occurring.

**31.** **Agree** that the maximum penalty will be based on the deemed value, per hectare (or part) clear-felled, and the deemed value will be set using regulations.

**32.** **Agree** that when establishing those regulations the Minister may consider the:

i) Species or forest type being clear felled;

ii) The market value of the wood and other products removed from the forest, and historic variation in the price;

iii) The need to place value for forests with no market, or market price;

iv) Any need to provide a 'look up' table for the volume of the harvest;

v) Any variation in the value with the age of the forest or size of the trees;

vi) Submissions provided on the proposed deemed value (as part of a submission process); and

vii) Any other matters that the Minister considers relevant.

**33.** **Note** that if the clearance results from an adverse event (as defined in regulations) the participant will not be in breach of the non-clear-fell provision, as, by definition, the clear-fell is not caused by human activity; however, the participant is required to re-establish the forest.

**34.** **Note** that Cabinet agreed (in CAB-18-MIN-0606) that the Minister of Climate Change must approve areas of permanent post-1989 forest land to be withdrawn from the ETS prior to the 'clear-fell' period ending, and if permission is granted the participant needs to repay all units received.

**35.** **Agree** that should deforestation occur after a 'clear-fell' event (i.e. the forest is not re-established or the land is converted to a non-forest use), and Minister has not agreed to the deregistration, the Carbon Accounting Area in which the clear-fell/deforestation occurred will be deregistered and the number of units to be surrendered is twice the unit balance of the land immediately prior to the clear-fell event.

**36.** **Note** that continuous cover forestry practices are allowed so long as canopy cover remains above 30%. Any indigenous forestry will also have to be managed in accordance with rules under the Forests Act 1949.

*Other recommendations.*

**37.** **Invite** the Minister for Climate Change, in consultation with the Minister of Forestry as appropriate, to issue drafting instructions to the Parliamentary Counsel Office to give effect to the recommendations in this paper.

**38.** s9(2)(f)(iv)

39. **Authorise** the Minister for Climate Change, in consultation with the Minister of Forestry as appropriate, to further clarify and develop policy decisions relating to the amendments proposed in this paper, in a way not inconsistent with Cabinet's decisions.

40. **Agree** the Minister for Climate Change and Minister of Forestry may share this Cabinet paper, drafts of further Cabinet papers on related issues, drafting instructions to the Parliamentary Counsel Office, subsequent drafts of amendments to the Act or regulations, and related documents, with the Environmental Protection Authority, as a key agency in the proposed amendments.

Authorised for lodgement

Hon Shane Jones
Minister of Forestry

Hon James Shaw
Minister for Climate Change

# Appendix One: Climate Change Response Act 2002 - Minor or Technical Issues

| | Title | Issue | Proposal |
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| 1 | Clarification of the treatment of post-1989 forest land deforested on boundaries of a forest | The ETS is intended to allow for minor reductions in areas around the margin of an established forest at no cost to the participant. This is done to ensure that the forest participant is not impacted from, e.g. slight differences in measurement of a forest boundary or forest establishment location as the forest owner undertakes best practice management when re-establishing the forest.<br><br>The current wording of the Act does reflect how post-1989 forest land is treated in the Act. If post-1989 forest land is deforested it must be deregistered from the ETS. However, the current drafting does not work as intended, as the land deemed to 'not be deforested', but could still stay in the ETS where it complicates emissions returns.<br><br>The intent is that post-1989 forestry participants should not have any unit surrender obligation if they deforest boundary strips of forest land, and this land is removed from the ETS. | Amend the CCRA to clarify that post-1989 forest land around the boundary, which is cleared and not maintained as a forest:<br>i. Must be deregistered from the ETS; and<br>ii. There is no requirement to submit an emission return for this change in area. |
| 2 | Incorporation by reference for forestry' regulations and standards in a section 60 exemption | There is no provision enabling exemption orders made under section 60 to reference the relevant regulations and standards that exist.<br><br>It is possible to incorporate by reference these regulations and standards (via the Legislation Act 2012). However, under that Act any update to the regulations or standards mean there needs to be a new *incorporation by reference* process. This creates an administrative burden as incorporated material changes frequently. | Make clear that a reference to the current version of material incorporated in section 60 exemption orders should be interpreted as the latest version of the incorporated material. If the incorporated material is amended or replaced, the latest version should take effect without having to amend the exemption order. |

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| 3 | Clarification of a provision relating to Unincorporated Bodies | Unincorporated Bodies are mandatory participants if they undertake deforestation of pre-1990 forest land. They are voluntary participants if they undertake a post-1989 activity and choose to register.<br><br>However, the section which requires the EPA to be advised of the name to be entered into the registry is confusing to participants as it appears voluntary, when it should be mandatory. | Clarify that, should an unincorporated body be a participant they *must* advise the EPA of the name to be in registry. |
| 4 | Remove the ability for forestry participants in the ETS to register as a consolidated group | ETS participants may form 'consolidated groups' where one member acts on behalf of the others members to meet their obligations in the ETS e.g. to submit a return or transfer units. When first designed, it was hoped that this would lead to efficiencies in operations.<br><br>However, for forestry, these operational efficiencies are not achieved as each area of forest must still have its emissions and/or removals calculated individually. In practice this means each member may as well submit their own emissions return because it is the calculations that take time and cost rather than filling out the emissions return.<br><br>There is currently only one consolidated group for forests and all but one of its members deregistered their post-1989 forest in 2012.<br><br>If consolidated groups were retained as an option, there are three significant issues:<br>i) It makes the introduction of permanent post-1989 forests and averaging more complex;<br>ii) It adds significant complexity to the future IT redevelopment, and increases the costs; and | Remove consolidated groups from forestry participation options in the ETS.<br><br>Note the ability of foresters to form consolidated groups under other legislation (e.g. for tax purposes) is not impacted by these decisions. |

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| | | iii) It requires unique treatment of these groups in the regulations, and any subsequent changes to regulations. | |
| 45 | Simplify emissions returns for participants by providing 'raw' information to Te Uru Rākau | Participants make many minor (and some major) errors in their emissions returns. This results in effort by Te Uru Rākau to correct the returns, compliance penalties, delays, and frustration for the participant.<br><br>If participants were provided with the ability to submit 'raw' forestry information (e.g. the planting year of the forest, the year a forest was harvested) Te Uru Rākau could pre-calculate the emissions returns for those forests.<br><br>This proposal has three parts:<br>i) Enable Te Uru Rākau to prescribe what 'raw' information is required;<br>ii) Enable Te Uru Rākau to define which forests are able to use this option; and<br>iii) Enable Te Uru Rākau to provide the participant with a completed return for 'endorsement' (acceptance as correct).<br><br>This will offer significant savings to the participant for two reasons:<br>i) it will reduce the compliance burden as they will no longer need to undertake the calculations for the returns; and<br>ii) it will reduce the exposure to compliance and penalty orders from an incorrect calculation (rather than gross error, e.g. not reporting the forest has been harvest). | Create the necessary provisions, and make clear we can use the information:<br>i) Regulations can be made to enable participants to submit 'raw' information to EPA as part of the emissions returns process;<br>ii) Enable Te Uru Rākau to define which forests are able to use this option;<br>iii) The EPA can prepare an emissions return on behalf of the participant;<br>iv) EPA can issue pre-calculated emissions returns to the participant; and<br>v) The return may then be declared by a participant as the needed emissions return and used to meet their obligations to submit an emissions return.<br><br>Make clear that the use of the provisions will be optional for the participant, and may be cost recovered.<br><br>Make clear that should incorrect 'raw' information be provided by the participant, and this used by EPA to prepare the return, the return will be considered an incorrect return supplied by the participant. This will result in the participant being subject to both the penalties and |

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| | | Te Uru Rākau's already (re)calculates the emissions and removals for the majority of participants as part of the compliance process. This proposal will simply move these calculations 'earlier' in the return cycle allowing timelier issuance of units to participants.<br><br>For non-forestry sectors, the EPA already uses an analogous process where the participant populates pre-developed forms. However, the diversity in the forestry sector means developing a 'single form' (to address all permutations) would be complex, so enabling the collection of 'raw' data is a step towards simpler returns. | compliance for an incorrect return and any consequential penalties around incorrect unit surrender/claims. |
| 6 | Provide clarity on what 'best practice forest management' means | The Act makes reference to best practice forest management in a number of places (particularly where the removal of forest is required).<br>This, however, is not defined and creates uncertainty for forest owners if the removal of forest is due to 'best practice forest management', and will qualify for an exemption. | Provide the ability to define "best practice forest management" by reference to relevant industry codes of practice, regulations, legislation or actions. This would be in addition to the current approach.<br><br>This definition will occur in regulation. |