Climate Change Response (Extension of Penalty Transition for Forestry Activities with Low Volume Emissions Liabilities) Amendment Bill

175—1

Report of the Environment Committee

November 2022

Contents

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Chairperson

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Recommendation

The Environment Committee has examined the Climate Change Response (Extension of Penalty Transition for Forestry Activities with Low Volume Emissions Liabilities) Amendment Bill, and recommends that the bill proceed.

Introduction

The bill would amend the Climate Change Response Act 2002 (the Act) to extend a transitional arrangement put in place by the Climate Change Response (Emissions Trading Reform) Amendment Act 2020.

The transitional arrangement that is being extended prevents small forestry participants from being subject to the "surrender or repayment" penalty—also known as the "three to one" penalty—as part of the New Zealand Emissions Trading Scheme (NZ ETS). It does this by ensuring the former "excess emissions" penalty continues to apply to small forestry participants[1] if they fail to surrender or repay "New Zealand units" (units) by the due date.

The penalty applies when a person fails to surrender or repay units by the due date. When the penalty was strengthened in 2020, there were concerns that it could significantly impact small forestry participants, causing serious financial hardship in some cases.

These concerns persist, and so the bill seeks to extend the transitional arrangement from the end of 2022 to the end of 2024. This would allow more time for a new, more proportionate penalty to be developed, and for participants to be educated on the new penalty before it is implemented in 2025.

Background information

Forestry in the New Zealand Emissions Trading Scheme

The NZ ETS is the main tool for reducing New Zealand's greenhouse gas emissions. The NZ ETS creates an obligation on emitters who are participants in the scheme to surrender units according to their level of emissions. Units can be acquired in several different ways, such as through government-run auctions, sales on a secondary market, and free allocation to industries.

[1] Forestry liabilities of less than 25,000 units on average per year are considered small forestry participants. For forestry participants, these liabilities usually arise when forests are harvested, deforested, or deregistered from the NZ ETS, and sometimes arise if units need to be paid back (for example, if they are over-claimed).

New Zealand is one of the only countries to have forestry included in its emissions trading scheme. For NZ ETS purposes, forests are split into two classes, depending on when they were established. The split reflects the emissions baseline date of 1 January 1990 that New Zealand's international climate obligations are based on. The two classes are as follows:

- Pre-1990 forests are considered part of New Zealand's baseline carbon storage. Therefore, owners of pre-1990 forests cannot register their forests in the NZ ETS to earn units. However, if the land is deforested (such as through land use change), the owners become mandatory participants in the NZ ETS.
- Post-1989 forests are considered to be new carbon sinks—additional to New Zealand's baseline carbon storage. Owners can voluntarily register their forest in the NZ ETS to earn units as the forest grows.

Forestry participants—whether mandatory or voluntary—are required to submit emissions returns. Each return reports on the carbon stock in the forest. A notice is then issued to the forest owner by the relevant government agency setting out how many units the owner must surrender for the emissions (if any).

Penalty for failing to surrender or repay units by due date

The Climate Change Response (Emissions Trading Reform) Amendment Act 2020 created a revised penalties and compliance system for most participants in the NZ ETS.

The revised system included a strengthened penalty from 1 January 2021 that applies to NZ ETS participants and other unit holders who fail to surrender or repay units to the Crown by the due date—the "three to one" penalty.

The "three to one" penalty is provided for in section 134 of the Act. The penalty is set at three times the price of carbon (as set in regulations) for each unpaid unit. It is absolute in nature, meaning there is no discretion for the regulator to waive or reduce it.

This "three to one" penalty replaced the former "excess emissions" penalty for NZ ETS activities occurring prior to January 2021 (with the exception being the arrangement for small forestry participants). Generally speaking, the calculation for the "excess emissions" penalty resulted in a lower penalty amount compared to the "three to one" penalty, and there was discretion for the regulator to waive or reduce the penalty in certain circumstances.

Transitional arrangement for small forestry participants

When forests are harvested, deforested, or deregistered, the participant must report this in an emissions return. Generally, the units that are due must be paid within 60 working days of a notice being issued by the regulator. If the units are not paid on time, the "three to one" penalty would apply. However, the 2020 amendments deferred the application of the "three to one" penalty for small forestry participants to 1 January 2023. The transitional arrangement is set out in clause 17 of Schedule 1AA of the Climate Change Response Act.

Small forestry participants are those with low volumes of emissions liabilities—the Act identifies the participants by their low volumes of emissions liabilities for each emissions return. A low volume means a net liability of less than 25,000 units per year—representing emissions of less than 25,000 tonnes of carbon dioxide equivalent each year. This could work out as a forest of about 35 hectares or less. Small forestry participants are often individual persons such as small farm foresters, or small Māori trusts, with lower financial capabilities than well-established and large corporations. Small forestry participants are more likely to face resourcing constraints to understand and comply with their NZ ETS obligations and as a result, are more likely to be liable for unexpected unit obligations.

A key reason for the transitional arrangement was concern that the “three to one” penalty could cause serious risk of financial hardship to small forestry participants if they were to incur it and were unable to pay it. The scale of the penalty, and the lack of discretion for the regulator to reduce it, could result in a liability that was disproportionate to small forestry owners’ cash flow and the nature of the assets they own—meaning their house or farm could be at risk.

Before the “three to one” penalty commenced in 2021 for most participants, the “excess emissions” penalty applied across the NZ ETS if any person failed to surrender or repay by the due date. The transitional arrangement means the “excess emissions” penalty continues to apply to low volume forestry emissions returns if there is a failure to surrender or repay units on time.

The Government considers that the risk of serious hardship identified in 2020 persists for small forestry participants. In recognition of this, the bill would extend the transitional arrangement until the end of 2024, while a new penalty that is more proportionate for small forestry participants is developed. The new penalty that will be developed is intended to take effect from 1 January 2025 and be accompanied by educational information to facilitate the transition to a new penalty.

We were advised that the transitional arrangement for small forestry participants is not expected to affect New Zealand’s ability to link with international carbon markets in the future. This is because most international emissions trading schemes often do not include forestry, and often exclude emitters of less than 25,000 tonnes of carbon dioxide equivalent annually.

Legislative scrutiny

As part of our consideration of the bill, we have examined its consistency with principles of legislative quality. We have no issues regarding the legislation’s design to bring to the attention of the House.

Provisions in the bill

Clause 4 of the bill would amend clause 17 of Schedule 1AA of the Climate Change Response Act 2002, which sets out the transitional arrangement provision for small forestry participants.

Clauses 4(1) and 4(2) would amend clause 17 so that the period of the transitional arrangement is extended to the end of 2024. Clause 4(3) would amend clause 17 to make it clear that the transitional arrangement also applies to penalties that could otherwise arise under secondary legislation.

We support the bill proceeding

The bill was referred to us for a shortened select committee process because the transitional arrangement will expire on 31 December 2022 if this bill does not come into law before the end of the year.

We asked what consultation had been carried out before the bill was introduced about extending the period of the transitional arrangement. Our departmental advisers informed us that the intention to extend the period of the transitional arrangement to the end of 2024 had been noted in August 2022 as part of broader consultation about a new proposed penalty for small forestry participants. We were informed that no submitters proposed that the extension should not proceed.

We acknowledge the purpose of the bill and recommend that it proceed.

Appendix

Committee procedure

The bill was referred to this committee on 18 October 2022. The closing date for submissions was 26 October 2022. We received one written submission, which did not directly address the substance of the bill.

We received advice on the bill from Manatū Ahu Matua Ministry for Primary Industries and Manatū Mō Te Taiao Ministry for the Environment. Te Tari o Te Manahautū o Te Whare Māngai Office of the Clerk of the House of Representatives provided advice on the bill's legislative quality. Te Tari Tohutohu Pāremata Parliamentary Counsel Office was available to assist with legal drafting.

Committee members

Hon Eugenie Sage (Chairperson)
Rachel Brooking
Tāmati Coffey
Simon Court
Anahila Kanongata'a-Suisuiki
Hon Scott Simpson
Stuart Smith
Lemauga Lydia Sosene
Angie Warren-Clark

Advice and evidence received

The documents that we received as advice and evidence are available on the Parliament website.