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Parliamentary Commissioner for the Environment
Te Kaitiaki Taiao a Te Whare Pāremata

20 YEARS
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Charles Chauvel MP
Chair Finance and Expenditure Committee
Parliament Buildings
WELLINGTON

Dear Charles

Response to advice from officials on the PCE recommendations concerning the environmental effects of the ETS

I understand that the committee has received a report from the Emissions Trading Group responding to my two recommendations on the environmental effects of the Emissions Trading Scheme (ETS). This letter presents my position with regard to the report from the officials.

My first recommendation was that:
the committee consider adding a new sub-section to clause 28 of the bill to enable regulations to provide for discrimination between New Zealand units (NZUs) that produce significant environmental benefits beyond greenhouse gas reduction and other New Zealand units.

In their report to the committee, the officials have recommended that the Climate Change bill require the provision of sufficient documentation of the ownership and source of NZUs created by post-1989 forest owners (see paragraph 11 of the report).

I understand that such information would enable the identification of afforestation activities supportive of biodiversity and other environmental benefits and their discrimination from other types of activities (see paragraph 6 of the report). Paragraph 11 of the report recommends an amendment to the bill to enable this.

Although I have not seen the proposed modification to the bill, I am satisfied that such an amendment could adequately address the substance of this recommendation to the committee.

My second recommendation was that:
a clause be added to the bill that makes the ability of participants to gain carbon credits under the ETS contingent on their compliance with all relevant environmental legislation while undertaking the registered Schedule 4 activity.

This recommendation addresses my concern that a Kyoto forest owner may earn carbon credits despite not being a "fit and proper person" from an environmental perspective – for instance, by contravening a local plan rule or a provision of the Resource Management Act 1991 (RMA).

The intent of the recommendation is to create a tool to strengthen the environmental integrity of the ETS, while addressing the potential risk to indigenous biodiversity created by the ETS. It does not intend to establish a regime to regulate biodiversity criteria and performance standards under the ETS.

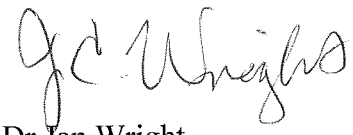
My recommendation could be implemented by requiring Schedule 4 participants to the ETS to provide, as part of their application for registration (clause 57) and of their annual emission returns (clause 65), a statement that they have complied with the RMA and all other relevant environmental legislation while undertaking the registered Schedule 4 activity. (The statement could also apply to other legislation, but that is beyond the scope of my advice.) The requirement to produce a statement could be linked to the existing offences and penalties provisions in the bill regarding false declarations and the provision of false or misleading information.

My office has discussed the possibility to mandate such a statement with the officials and I understand that the officials have recommended against an amendment to the bill.

I have considered the advice provided by the officials to the committee in their report to the committee.

However, my position remains that there is value in amending the bill specifically to require that Schedule 4 participants to the ETS declare their compliance with environmental legislation as part of their registration to the ETS and annual emissions returns.

Yours sincerely



Dr Jan Wright
Parliamentary Commissioner for the Environment

Encl: *Emissions Trading Group report to the finance and expenditure committee on the Climate Change Bill.* Report no.41 dated 3 June 2008, received on 5 June 2008.

EMISSIONS TRADING GROUP REPORT TO THE FINANCE AND EXPENDITURE COMMITTEE ON THE CLIMATE CHANGE BILL

Request

1. On 21 May 2008, the Finance and Expenditure Committee requested:

   Advisers (PCE/ETG/PCO) to discuss and report back on recommendations for Part 1 of the Bill (Emissions Trading). [Incorporating discussion of proposals for how to incorporate consideration of biodiversity protections for post-1989 afforestation into the Act.]

Response

Background on the PCE's Recommendations

2. With regard to the conservation of biodiversity under the NZ ETS, the Parliamentary Commissioner for the Environment (PCE) made two recommendations in its advice to the Finance and Expenditure Committee:

   - Recommendation 4: That the committee consider adding a new sub-section to clause 28 enabling regulations to provide for discrimination between New Zealand units that produce significant environmental benefits beyond greenhouse gas reduction and other New Zealand units.

   - Recommendation 5: That a clause be added to the Bill that makes the ability of participants to gain carbon credits contingent on their compliance with all relevant environmental legislation.

3. This advice builds from the PCE's review of the Cawthron-led 'Scoping Report for an Environmental Assessment of the NZ Emissions Trading Scheme and Closely Related Measures.' The key excerpt from this advice is presented in Annex I. In particular, the PCE recommends:

   > "The development of such additional measures [for the protection of high value indigenous biodiversity] should take into account the relevant existing strategies and provisions for protecting indigenous biodiversity[1] and the reasons that may have hindered their satisfactory implementation to date[2]. Care should also be taken not to increase the statutory responsibilities of local and regional councils, without providing adequate support."

4. Officials met with staff from the PCE to discuss these recommendations. Officials have considered the outcome of those discussions and conducted further analysis. Officials have prepared the advice in this paper in response.

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1 These include the Resource Management Act 1991, the New Zealand Biodiversity Strategy, the National Priorities for Protecting Rare and Threatened Native Biodiversity on Private Land, and covenants on private land.

2 Some of those reasons are presented in the 2004 report "A snapshot of councils' efforts to address biodiversity on private land" published by the Ministry for the Environment.

Analysis

5. As noted in Chapter H of the departmental report, the ETS should be designed to support New Zealand's sustainable development objectives but is not the appropriate vehicle for remedying a range of environmental problems that are far broader than the NZ ETS. The management of biodiversity and land use in New Zealand needs to be addressed in a comprehensive policy framework that takes into consideration the range of factors driving biodiversity loss. The primary vehicle for addressing this issue is the RMA.

6. There is no UNFCCC or Kyoto Protocol requirement for New Zealand to discriminate between different types of afforestation units issued in New Zealand. However, some buyers in the marketplace may place a premium on units from afforestation that supports biodiversity, or conversely to avoid buying units that do not support biodiversity. From both an environmental and economic standpoint, there is value in allowing the creation of market signals that create incentives to reward landowners that undertake afforestation activities supportive of biodiversity and other environmental benefits. To help create these incentives, buyers and sellers would need to be able to discriminate between afforestation units generated from different types of activity.

7. There are two key questions to address:

   (a) In the Bill as drafted and given the Registry design, will it be possible for market players to trace specific NZUs (and associated NZ AAUs) to specific land areas and land-use activities?
   (b) Should biodiversity (and other environmental) criteria and certification schemes for post-1989 afforestation be driven by the government or the market?

Traceability of Units

8. The information provided to the administering chief executive by post-1989 forest owners, coupled with the unit Registry functions, will enable a high degree of traceability by the Crown on issuance and transfer of NZUs (including information on the sectoral activity associated with the first transfer of an NZU from the Crown). The outstanding issue is the policy question as to whether the New Zealand government will publicly disclose this information and make it readily available to forest owners wishing to market their NZUs.

9. Those undertaking removal activities that earn NZUs, such as post-1989 forest sink creation with biodiversity benefits, will receive a notice from the Registry when the NZUs are transferred to them. The notice should provide sufficient documentation that a third-party verifier can certify the serial numbers of the units sourced from the activity (ie, the landowner will be able to prove the provenance of the units). It is expected that the market and private-sector actors (including NGOs) will determine what activity attributes should be certified and command a premium.

10. This information does not necessarily need to "travel" with the unit beyond the first point of sale. The incentive for appropriate afforestation activity will be driven by the unit price at the first point of sale.

11. Officials recommend that the Bill be amended to require the provision of sufficient documentation of the ownership and source of NZUs/NZ AAUs to post-1989 forest owners to enable third-party certifiers to link NZUs/NZ AAUs to specific post-1989 forest.

Biodiversity (and Other Environmental) Criteria and Certification Schemes

12. The development of biodiversity (and broader environmental) criteria for application to afforestation at the landowner level under a government regulatory framework would be a very complex exercise and could impede the implementation of the NZ ETS. Challenges would include making the counterfactual case of what the biodiversity outcome would be without the afforestation, classifying afforestation that involved a mix of indigenous and exotic species in a common area, ensuring fairness in the application of such criteria across landowners, auditing and verifying that management plans were met, meeting expectations of the market (for example some buyers may look for a commitment to consultation with local communities and/or indigenous people), and addressing the potential leakage and impermanence of biodiversity benefits.

13. Requiring government certification of biodiversity and other environmental impacts of afforestation at the landowner level before issuing NZUs could add significantly to the transaction costs for all landowners participating in the NZ ETS, and create a disincentive to participate in the scheme.

14. As long as the government enables the flow of sufficient information about the source and ownership of NZUs, there will be distinct advantages to having biodiversity (and other environmental and social) criteria and certification schemes be driven by the marketplace rather than government. The market will not demand uniform consensus on what constitutes environmentally beneficial afforestation activity, enabling a range of beneficial activities to be marketed on their true merits and verified independently. Existing forest sustainability certification schemes and environmental standards for carbon credits could be a useful starting point for those landowners seeking to market the environmental benefits of their afforestation activity. Market demand could catalyse development of further afforestation certification schemes that meet the needs of buyers and sellers in the carbon market.

15. <u>In summary, the Bill and the Registry should be sufficient in their current form to enable the market to create incentives for afforestation activities under the ETS that generate biodiversity and other environmental benefits. Officials recommend that the role of government should be enabling and facilitative rather than regulatory in this area.</u>

Role of the Resource Management Act 1991 (RMA)

16. The compliance scheme under the RMA is the appropriate vehicle for addressing any violation of resource consents or other RMA rules by landowners. However, the PCE expressed concern that RMA penalties may not provide a sufficient deterrent against conducting afforestation activities that violate RMA rules, and landowners should not be rewarded by receiving NZUs resulting from such activities.

17. One possible option discussed with the PCE would be to include in the participant registration process for post-1989 afforestation a requirement for individual landowners to provide a statement that their afforestation activity is in compliance with relevant resource consent requirements and/or other relevant environmental rules. The provision of such a statement could be made a condition for registration. If landowners provided a false statement, they would automatically be subject to the offences and penalties under the NZ ETS, which are significant.

18. There are implementation challenges around this approach. This approach is not being applied with regard to compliance of other ETS sectors with other parts of the CCRA or other legislation. It would probably not be workable for such a declaration to be made retrospectively (ie, for afforestation activity dating back as far as 1990). Requiring

landowners to reaffirm any declaration before receiving units could further increase administrative complexity, especially in the area of auditing and verification, and would likely not be necessary since the key risks would likely be addressed through the formulation of any initial declaration. It would also create boundary issues for the enforcement of RMA requirements, which officials believe need to remain with local authorities.

19. Officials have also considered how enforcement provisions under the RMA might treat NZUs awarded to landowners who had violated RMA rules.

20. Under the RMA, regional and district councils enforce compliance with their regional or district plan rules. Some councils may have rules that specify that the clearance of native forest is a prohibited activity under the plan. This will not always be the case. The NZ ETS provides a new incentive to clear land and the councils will need to make a decision about whether their rules need amending to keep up with it (or if the councils support losing some native forest in certain places). Nonetheless, where a rule in a plan does prohibit the clearing of native forest, and a person does so regardless, the person will be subject to enforcement action.

21. Enforcement action may consist of a prosecution. If found guilty of an offence, a person is liable for up to two years imprisonment or a $200,000 fine, and where the offence is a continuing offence, up to $10,000 for each day the offence continues. These are very stringent penalties in themselves. In deciding what level of penalty to set, a Court can (and often will) consider any pecuniary gain procured through the commission of an offence.

22. Enforcement action may also consist of a Court order to take restorative action where an area has been damaged in contravention of a rule in a plan. There are cases where developers have cut down protected trees and the Court has ordered replacement with similar species. In theory, such an order may limit the person's ability to access NZUs under the ETS.

23. Enforcement action could consist of both restorative action and penalties. The courts have ordered restoration of an area and set higher penalties because of pecuniary gain procured through commission of an offence.

24. In summary, the RMA contains a comprehensive enforcement regime where a person clears native forest in contravention of a rule in a plan. Unlawfully clearing native forest in order to receive NZUs under the ETS could result in the imposition of higher penalties under the RMA because of the pecuniary gain element. The person in breach may also be required to restore the land, limiting the person's ability to access NZUs under the ETS. This provides a fairly strong incentive to comply with any rules in plans prohibiting or limiting the clearing of native forest.

Consideration of the Forest Accord

25. A further option that was raised in submissions, but not specifically by the PCE, was to link NZ ETS post-1989 afforestation activity to compliance with the Forest Accord, either via direct provisions in the Bill or via a requirement in the Bill that landowners be in compliance with the Forest Accord.

26. Officials consider that there are significant reasons not to pursue this option. For example, Māori did not sign the Forest Accord because Māori own large areas of land under pasture and scrub in various stages of regeneration which they could clear for development. Their asset would be substantially devalued by a proposal to include Forest Accord provisions in the NZ ETS and this may essentially lock Māori into a low-return option for these lands. As such it would significantly affect Māori development and is likely to be highly controversial, potentially leading to contemporary Treaty claims. It would also cause significant administrative problems.

27. However, applying the same process discussed above with regard to traceability of units, post-1989 forest landowners that do adhere to the Forest Accord provisions would have the capability and opportunity to market their units on this basis and realise a further benefit from their participation in the Forest Accord.

Conclusion

28. As noted in Chapter H of the departmental report, the ETS should be designed to support New Zealand's sustainable development objectives but is not the appropriate vehicle for remedying a range of environmental problems that are far broader than the NZ ETS. The management of biodiversity and land use in New Zealand needs to be addressed in a comprehensive policy framework that takes into consideration the range of factors driving biodiversity loss. The primary vehicle for addressing this issue is the RMA.

29. Officials strongly recommend against establishing a regime to regulate biodiversity criteria and performance standards under the NZ ETS as the basis for issuing units for post-1989 afforestation activity. As discussed above, this would be very difficult to design, implement and administer at the landowner level, and the significant transaction costs would be a serious deterrent to participation in the ETS by all landowners. It could also conflict with the appropriate management of land use by local councils under the RMA.

30. However, officials recognise the value in having the government provide positive incentives for afforestation activity that is more supportive of biodiversity and other environmental and social objectives, and take appropriate steps to enable such incentives to be developed and reinforced in the marketplace. Officials believe that ultimately a package of measures, both inside and outside of the NZ ETS, will be needed to provide appropriate incentives for the conservation and enhancement of biodiversity in afforestation activity in New Zealand.

Annex I: Excerpt from the PCE's Review of the Scoping Report (May 2008)

Finding 5
Additional measures to ensure the protection of high value indigenous biodiversity should be considered because of the incentive to plant exotic forests and the variable quality of the biodiversity management frameworks currently offered by councils. Consideration of these measures should not delay the implementation of the ETS.

The development of such additional measures should take into account the relevant existing strategies and provisions for protecting indigenous biodiversity[3] and the reasons that may have hindered their satisfactory implementation to date[4]. Care should also be taken not to increase the statutory responsibilities of local and regional councils, without providing adequate support.

The five key response measures proposed in the Cawthron Report fall into three categories: deterrents (R1), incentives (R2), and information to support decision making (R3, R4 and R5). The report does not suggest that the risk to indigenous biodiversity created by the ETS should delay the passing of the bill or require a significant redesign of the bill. We comment on the measures below.

Information
Widely available mapping of indigenous biodiversity in New Zealand is needed. However, if the participation of post-1989 forests in the ETS is made contingent on this additional mapping, the complexity and time required may significantly affect New Zealand's ability to optimally reduce its net greenhouse gas emission in the medium term. So we suggest that the additional mapping of indigenous biodiversity continues, but not be made a requirement of the bill.

Deterrence
The legislative framework that enables enforcement action where indigenous biodiversity has been affected is already in place under the Resource Management Act 1991, and is used by a number of councils. Introducing to the bill a penalty or enforcement provision associated with damage to indigenous biodiversity would result in an additional and unnecessary layer of complexity. The existing legislative framework should be used where deterrence and enforcement relating to indigenous biodiversity issues are required.

In addition, the ability of participants to gain carbon credits under the ETS should be made contingent to them having complied with all relevant legislation while undertaking the registered schedule 4 activity.

Incentive
The ETS offers an opportunity to exclude or give preference to certain emission units[5]. 'High biodiversity value units', for which the unit holder is able to demonstrate that the creation of the unit had positive effects on indigenous biodiversity, have a number of advantages.

In an international carbon market, that is likely to become stratified (with different prices for different types of emission units), New Zealand 'high biodiversity value units' would have a high value and be widely accepted by participants in the domestic and the international carbon market. They would also contribute to the integrity of the ETS and help maintain the

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3 These include the Resource Management Act 1991, the New Zealand Biodiversity Strategy, the National Priorities for Protecting Rare and Threatened Native Biodiversity on Private Land, and covenants on private land.

4 Some of those reasons are presented in the 2004 report "A snapshot of councils' efforts to address biodiversity on private land" published by the Ministry for the Environment.

5 Such as Certified Emission Reductions from nuclear projects, which the government has decided to exclude.

clean-green image of New Zealand. The bill may therefore contribute to the protection of indigenous biodiversity and mitigate the risk to indigenous biodiversity it creates by:

- enabling the identification of high biodiversity value units; and
- providing an incentive to create high biodiversity value units.

This may be achieved by requiring that the unique identifiers of emission units under clause 30G(1)(e) of the bill enable discrimination between high biodiversity value and other emission units. Other incentives may include lower administrative costs associated with the registration or verification of high biodiversity value units.

Finding 6
Both minor changes to the bill and complementary measures should be considered to address the potential risk to indigenous biodiversity created by the ETS. These may include enabling the identification of high biodiversity value units and providing for an inventive to create high biodiversity value units.