

Regulatory Impact Statement

New Zealand Emissions Trading Scheme Implementation: Emissions Rulings Fees and Charges

Agency Disclosure Statement

- 1 This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.
- 2 It provides an analysis of options for the prescribing of fees for applications for an emissions ruling under the New Zealand Emissions Trading Scheme.
- 3 Consideration was given to:
 - (a) Whether rulings are a private good;
 - (b) Issues of administrative and collection efficiency (whether the costs of managing a fee charging regime are out of proportion to the sums involved);
 - (c) Ensuring the process to calculate and set fees is appropriate in relation to the expected volume of emissions ruling applications and quantum of fee revenue;
 - (d) Public submissions; and
 - (e) Treasury and Auditor-General guidelines.
- 4 A model for calculating fees was developed based on:
 - (a) Estimating the volume of emissions rulings expected to be received; and
 - (b) Identifying resources used, and the direct and indirect costs, associated in providing an emissions ruling service.
- 5 As applying for an emissions ruling is voluntary, none of the options impose additional costs on businesses that do not wish to apply for a ruling.
- 6 None of the options impair private property rights, market competition, or the incentives on businesses to innovate and invest; or override fundamental common law principles.

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Status quo and problem definition

Background

- 1 The Climate Change Response Act 2002 (the “Act”) is the governing legislation for the New Zealand Emissions Trading Scheme (the “ETS”).
- 2 Under the Act, a person may apply to the Chief Executive of MED for an emissions ruling in respect of certain matters.
- 3 Emissions rulings can only be made under the Act when they are requested, and are binding on the Government in respect of the applicant.
- 4 Emissions rulings are conceptually similar to the binding private tax rulings provided by Inland Revenue.
- 5 MED is responsible for administering emissions rulings and coordinating associated operational processes across other agencies and external parties as required. In the case of emissions rulings relating to forestry and agriculture, MED obtains specialist advice from the Ministry of Agriculture and Forestry (MAF). External and internal costs will be incurred in providing the emissions rulings service. Some emissions ruling applications are expected to be very complex and may require legal advice from Crown Law and technical advice from experts external to the core Crown.
- 6 Sections 107(2) and 167 of the Act anticipate the introduction of regulations to set fees and charges to recover the costs of considering emissions rulings.
- 7 At present, there are no regulations in place to recover costs of considering emissions rulings. No specific appropriation has been made to MED for the provision of the emissions ruling service. Costs related to emissions rulings are met from the general Emissions Trading Scheme (ETS) administration appropriation. As emissions rulings are a private good, it is considered appropriate that the Crown fully recovers the costs associated with them.

Likely costs involved

- 8 Cost modelling was carried out in order to determine the likely internal costs of providing the emissions rulings service. A model for calculating MED and MAF’s internal costs was developed based on:
 - (a) Identifying services to be provided;
 - (b) Identifying resources used in providing the emissions ruling service;
 - (c) Estimating the volume of emissions rulings expected to be provided in a given period; and
 - (d) Estimating the volume and cost of resources required to produce emissions rulings in the given period.
- 9 In addition, consideration was given to:
 - (a) The direct and indirect costs associated with providing the emissions ruling service;
 - (b) How to appropriately deal with capital expenditure, fixed assets and depreciation;
 - (c) Issues of administrative and collection efficiency (the transaction costs in managing a fee charging regime should not be out of proportion to the sums involved);

- (d) Ensuring the process to calculate and set fees is appropriate in relation to the expected volume of emissions ruling applications and quantum of fee revenue;
 - (e) Public submissions received on a discussion document; and
 - (f) Treasury Guidelines, and the Auditor-General's publication Good Practice Guide: Charging Fees for Public Sector Goods and Services (June 2008).
- 10 All sectors will join the Emissions Trading Scheme by 31 December 2012 (the end of the first commitment period). Accordingly, it is assumed that the majority of applications for emissions rulings are likely to be received by 30 June 2013. Accordingly, modelling for cost recovery has been developed over a three year period to 30 June 2013 (rather than the typical 5 year modelling period).
- 11 Based on estimates of volumes and modelling assumptions, the components of the internal costs identified for recovery through an application fee and hourly charge are set out in Table 1:

Table 1: Internal costs associated with making emissions rulings	
Cost Types	Forecast Expenditure (\$) To June 2013
Labour	242,250
Materials	0
Overheads	122,500
Other costs	0
Total recoverable costs	364,750

- 12 Recoverable internal costs are significantly reduced from the cost estimate of \$2,772,000 in the Interim RIS attached to the Cabinet Paper seeking approval to release the discussion document [EGI (09) 237]. The reduction is the result of a significant reduction in the estimated volumes of applications from approximately 1,700 to 100.
- 13 The new volume estimates are influenced by:
- (a) an amendment to the Act providing that the Chief Executive may not make a ruling if the information submitted with the application raises question of fact that the Chief Executive would need to determine in order to make the ruling;
 - (b) the number of rulings applications subsequently received;
 - (c) the number of post-1989 forestry owners who have opted into the ETS to date;
 - (d) The subsequent exemption of certain classes of people from the ETS by Order in Council; and
 - (e) Further development of policy options to exempt other classes of people from the ETS.

- 14 As a result of reduced volume assumptions it is considered that the cost of materials and administrative and managerial support for emissions rulings can be absorbed within the general ETS administrative appropriation.

Objectives

- 15 The objectives of the proposal are to:
- (a) fund the cost of considering rulings applications;
 - (b) provide applicants some certainty around the costs, and timeframe for obtaining an emissions ruling;
 - (c) require the Chief Executive to take, to the extent that is reasonably practicable, every effort to minimise the fees and charges for which an applicant is liable.

Regulatory Impact Analysis

Internal Costs

- 16 The following three options in relation to internal costs have been considered;

Option A - no fee

- 17 Option A provides for no costs to applicants and requires no administration of a fee system. However this option would require the Crown to forego an estimated \$115,000, to \$130,000 per annum in recovery of internal costs. No fee will encourage more applications on everyday straightforward matters. If the ETS team received an increased volume of applications for straightforward matters, then resources would have to be diverted from other ETS administrative functions to process them.

Option B - a fixed, one-off, application fee

- 18 Option B provides up-front certainty for an applicant of the total cost of an emissions ruling, and the fee is simple to administer and collect. However there is no recovery for the costs of external advice. Complex applications will take longer to consider than more straightforward applications. With a one-off fee there is a risk of under or over recovery of direct costs. The fiscal risk is borne by the Crown if a flat fee is set too low compared with the actual work involved. An applicant will be charged too much if a flat fee is set too high compared with the actual work involved.
- 19 Applications for matters that are less complex or applications that are clear and complete will subsidise applications on matters that are more complex or applications that are ambiguous and incomplete. This cross-subsidisation between applicants is not considered justifiable.

Option C - the preferred option - a fixed one-off application fee plus a fixed hourly rate

- 20 Applicants receive the private benefit of certainty about how the Chief Executive will apply the Act in relation to their situation. Therefore it is considered appropriate that the costs associated with making the ruling are borne by the applicant. If no fees were charged for emissions rulings, taxpayers in general would effectively fund the private benefit received by the applicant.

- 21 Having an hourly fee component reduces the risk of under and over recovery of direct costs. An hourly rate coupled with time and costs estimates assist applicants to make a cost-benefit analysis of whether or not to make an application.

External costs

- 22 Two options have been considered in relation to the external costs incurred by MED or MAF in obtaining external advice in relation to an emissions rulings:

Option (i) - no recovery of these costs, or

Option (ii) – the preferred option - full recovery of these costs.

- 23 For reasons similar to those discussed in relation to option C, it is considered appropriate that the Crown fully recover the potentially substantial costs of external advice.
- 24 Options C and (ii) are applied by Inland Revenue to applications for private tax rulings and is likely to be familiar to corporate applicants.

Preferred option

- 25 As with binding tax rulings, it is considered appropriate that the Government recovers the cost of considering an emissions ruling. Consequently, the preferred options are options C and (ii).

- 26 It is proposed to prescribe through regulations the following basis for fees and charges:

- (a) a flat rate initial application fee; and
- (b) an hourly charge at a flat rate (fixed) for each hour (or part hour) beyond the first 4 hours spent in consideration of an emissions ruling application; and
- (c) full reimbursement of the costs and reasonable expenses in relation to external advice obtained by the Chief Executive in relation to a particular emissions ruling.

- 27 An hourly rate for considering emissions rulings was calculated by dividing the total recoverable costs over the 3-year period by the total productive work hours available over the 3-year period:

Hourly Rate	
Total productive work hours available over 3 years	3,535
Total recoverable costs over 3 years	\$364,750
Hourly rate	\$103.18
GST @12.5%	\$12.90
Total hourly rate	\$116.08
Rounded hourly rate	\$115.00

- 28 Rounding the hourly rate down to a tidier \$115.00, it is therefore proposed that fees and charges are set to recover the actual and reasonable costs of providing the emissions rulings service as set out in Table 2 below:

Table 2: Fee Schedule for Emissions Rulings	
Application filing fee (per application) (4 hours x \$115.00)	\$408.88
GST	\$51.12
Total	\$460.00
Hourly Rate (for considering and processing applications over and above 4 hours)	\$102.22
GST	12.78
Total	\$115.00
External costs and disbursements	Actual and reasonable costs fully recovered from applicant

- 29 By way of comparison, the hourly rate for an Inland Revenue private ruling is \$155 (including GST).
- 30 It is further proposed that the regulations provide that the Chief Executive will ensure, to the extent that is reasonably practicable, that every effort will be made to minimise the fees for which an applicant is liable.

Estimate of cost and time

- 31 It is proposed that:
- (a) the Chief Executive provide the applicant with an estimate of the fees that will be payable (if any) in excess of the initial application fee; and
 - (b) if the Chief Executive believes that a provided estimate is incorrect, then the Chief Executive must as soon as practicable revise that estimate and notify the applicant of the revised estimate; and
 - (c) if the Chief Executive believes that it will take longer than four weeks to issue a emissions ruling then the Chief Executive will provide the applicant with the date that the Chief Executive estimates the ruling will be issued by; and
 - (d) if the Chief Executive believes that a provided estimate is incorrect, then the Chief Executive must as soon as practicable revise that estimate and notify the applicant of the revised estimate.

Waiver

- 32 It is also proposed that the Chief Executive may in exceptional circumstances, at his discretion, grant, in whole or in part, a waiver, exemption, or refund, of any fees payable by an applicant.

- 33 A case where the Chief Executive might consider using such a discretion is where an application has taken a substantially longer time to consider than an earlier ruling of a similar nature.

Sensitivities and Risks

- 34 Because demand for emissions rulings is driven by applicants it is difficult to predict how many applications will actually be received and hence what fees will actually be paid to cover the fixed costs of the service.
- 35 Analysis has shown that fees are moderately sensitive to changes in labour cost assumptions, annual corporate overhead and changes in the productivity rates of staff. The costs of the emissions ruling service, and hence the hourly rate, are therefore largely fixed due to the employment of a minimum number of staff and their related overheads.
- 36 The charging approach proposed seeks to ensure each applicant meets the actual costs related to their application. To remove risk of cross-subsidisation, a fixed application fee plus a fixed hourly charge has been adopted.
- 37 Operationally, MAF/MED face a risk of 'resourcing up' to provide a service (and incurring largely fixed costs) for which actual demand proves to be low. This gives rise to a further risk of under recovery of costs through fees and charges. Such an under-recovery creates a fiscal risk for the Crown and MED/MAF would need to ensure appropriations are in place to cover such an under recovery.
- 38 Conversely, if MED/MAF do not resource up (in order to prudently minimise costs) actual demand for the service may exceed MED/MAF's capacity to meet demand. This gives rise to a risk that a statutory service is poorly provided.

Consultation

- 39 The release of a discussion document, Proposals for Cost Recovery: Emissions Ruling Service for public consultation was approved by Cabinet [CAB Min (09) 42/7]. Nine submissions were received and considered.
- 40 Key feedback and responses to the feedback is as follows;
- A - For 1 to 2 years there should be no fees, or only 25% cost recovery, because the Act is new, and complex.*
- 41 The age and complexity of the Act may be reasons for providing an emissions rulings service. However it is not considered that these factors provide a sufficient basis to deviate from the general principle that recipients, rather than taxpayers, pay for private goods such as emissions rulings.
- 42 Costs recoverable for the Chief Executive include the costs of a rulings analyst applying the law to the facts provided by the applicant on the matter the applicant seeks a binding ruling on.
- 43 Costs incurred by a Chief Executive as a result of considering the Act generally, as part of his administrative responsibilities, before or during the consideration of an emission ruling are not recoverable through emissions rulings fees.

B – There should be no fee, or a waived fee, if a matter on which a ruling is sought is unclear because of bad drafting.

- 44 No specific examples of where the Act is unclear because of bad drafting were provided. MED will not be considering whether or not the Act sufficiently reflects policy intent as part of the work undertaken in considering a ruling itself. The Ministry for the Environment (MfE) is responsible for overall administration of the Act. Any costs that might be incurred by MED in considering, and giving advice to MfE about possible issues that might exist with drafting would not be recovered through an emissions ruling fee.
- 45 The Act requires an application to specify the applicant's opinion on what the ruling on the matter should be. The prescribed emissions ruling application form requires this opinion to be expressed in the form of a draft emissions ruling. If a person believes that an opinion cannot be expressed on a matter because of perceived poor drafting then an emissions ruling application is unlikely to be the appropriate medium to raise such concerns.
- 46 MfE invited and considered public submissions on the Act, and the regulations for which emissions rulings can be sought, prior to their enactment. Any comments on perceived issues with ETS policy or the drafting of the Act can still be provided to MfE for its consideration.

C- Fees should be capped if the cost is estimated to exceed a specified threshold.

- 47 A specific cap is not considered appropriate for the same reasons that a fixed price fee is not considered appropriate at paragraph 18. Estimates, revised estimate and an obligation to minimise costs are the proposed mechanisms to provide some certainty to applicants.

D- No fee, or fees waived, if the Chief Executive publishes part or all of a ruling.

- 48 Section 117 provides that, for the purpose of providing general guidance about the application of Part 4 and 5 of the Act, a Chief Executive may, after making an emission ruling, publish information that relates to the ruling. While rulings are binding on the Chief Executive in respect of the applicant; no person can treat published information that relates to the ruling as binding on the Chief Executive (section 117).
- 49 General guidance is inherently for the public benefit. However the fact that this guidance can include information that relates to a ruling is not considered a sufficient basis for the costs of a private good (the ruling itself) being wholly, or partly, met by taxpayers.

E- Applicants should be consulted on the choice of any third-party experts.

- 50 Consistent with government requirements, any required third-party legal advice will be provided by the Crown Law Office. In selecting a technical expert the Chief Executive will consult with the applicant, and will also take into account the government's procurement guidelines and the potential expert's independence.

Conclusions and recommendations

- 51 It is recommended that regulations be prescribed that provide for:
- (a) a flat rate initial application fee of \$460 (including GST); and
 - (b) an hourly charge of \$115 (including GST) for each hour (or part hour) beyond the first 4 hours spent in consideration of an emissions ruling application; and
 - (c) full reimbursement of the costs and reasonable expenses in relation to external advice obtained by the Chief Executive in relation to a particular emissions ruling.
- 52 Such regulations are recommended because rulings are a private good and therefore it is appropriate that the Government recovers the actual and reasonable costs of providing them.
- 53 There is no specific appropriation for emissions rulings. If there was no fee, the MED ETS group would receive a greater number of applications for straightforward matters and resources would have to be diverted from other ETS administrative functions to process them.
- 54 It is also recommended that the regulations state that the Chief Executive:
- (a) must provide time estimates for rulings taking over 4 weeks, and costs estimate where hourly fees will be incurred (and provide revised estimates when necessary),
 - (b) must take, as far as practicable, all steps to minimise the fees; and
 - (c) may in exceptional circumstances, at his discretion, grant, in whole or in part, a waiver, exemption, or refund, of any fees payable by an applicant.

Implementation

- 55 The enactment of regulations prescribing a fee will be notified in the New Zealand Gazette. The fees will be also be notified on the ETS website, and in the guidance section of the Emission Rulings Application form.
- 56 The fees prescribed in the proposed regulations will be administered by the Emission Rulings team at MED. The costs of processing fees will be absorbed into MED's appropriation for the administration of the ETS.
- 57 Implementation risks will be mitigated by the administrative processes that already exist for the receiving and managing of emissions rulings.
- 58 The proposed fees will not interact with, or impact on, existing regulation and there is no scope to reduce or remove any existing regulations.
- 59 MED will seek to recover debts due arising from unpaid fees to ensure that the proposed regulation achieves its public policy objectives.

Monitoring, evaluation and review

- 60 MED/MAF will monitor, on a quarterly basis, the trend in emission rulings volumes, average standard processing times and the labour costs of providing the emissions rulings service.
- 61 MED Finance will track and report on emissions ruling fees revenue and costs.
- 62 MED will comprehensively review the fees model assumptions at least annually. Where appropriate, changes will be initiated to the actual costs incurred to deliver the service or fees charged for the service.
- 63 Officials will recommend amendment of the regulations if this is considered necessary to ensure they continue to meet their objectives.