

Regulatory Impact Statement

Proposed options to include fugitive coal seam methane in allocative baselines in the New Zealand Emissions Trading Scheme

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry for the Environment.

It provides an analysis of options for a change to regulations under the Climate Change Response Act 2002 (CCRA) to include fugitive coal seam methane (FCSM) emissions as an eligible emission source for the purpose of industrial allocation to eligible activities that use coal. This regulation change is required to implement the decisions made by Parliament in November 2012 through the Climate Change (Emissions Trading and Other Matters) Amendment Act, which was accompanied by a Regulatory Impact Statement (RIS).

The range of options considered in this document reflect, and are consistent with, decisions already made by Parliament. This RIS focuses on three options for implementing Parliament's decision. These options do not include a status quo option as this would contravene Parliament's original decision. The analysis contained in this RIS examines the most desirable method of including FCSM emissions as an eligible emissions source. The appropriateness of such inclusion has already been explored in a previous RIS. The main point of difference between the options is in how broadly the additional allocation is distributed across eligible coal users.

All options examined would benefit entitled businesses by granting additional New Zealand Units (NZUs) to cover the costs associated with FCSM emissions in the New Zealand Emissions Trading Scheme (ETS). The costs to Government of implementing these options have been considered by Cabinet [Cab Min (12) 23/10 refers] and agreed to by Parliament. Some uncertainty exists in regard to costs as the level of allocation is adjusted to reflect the (imperfectly known) origin of the coal. However, consultation and analysis reveal that this uncertainty does not constitute a significant risk to Government. The overall impact of this decision is to increase allocative baselines by a small amount, resulting in a small increase of allocated units to eligible coal users.

The analysis conducted incorporates feedback provided by affected parties through a consultation process, including coal users and suppliers. There are some limitations associated with the analysis due to only five submitters responding; however, as the consultation period and notification were substantial, it can be assumed that the lack of submissions equates to a lack of disagreement from stakeholders with the Government's preferred option. The analysis has been informed by feedback received and concerns raised by submitters have been considered; therefore policy decisions can be implemented based on the outcomes contained in this analysis.

The preferred option would not impair private property rights or the incentive to innovate and invest for businesses. No fundamental common law principles are overruled. Minor market competition issues may arise, regardless of the choice of option; however these are considered to be insignificant.

Malcolm McKee, Acting Director, Climate and Risk

Signature

Date

Context/Background

1. Industrial allocation provides assistance to the parts of the economy most heavily affected by the ETS. It does this by granting NZUs to businesses whose activities are considered emission intensive and trade exposed. Level of allocation is primarily determined through a baseline calculation expressed in terms of emissions per unit of output.
2. FCSM emissions occur when a small amount of methane is released directly into the atmosphere in the process of mining, and from freshly mined coal. Emissions of FCSM are reported by coal miners in their ETS emission returns.
3. Coal used in New Zealand is obtained from three sources: underground-mines, surface-mines, and imports. FCSM emissions represent a significant cost in the case of coal that is mined underground, which has an emissions factor of 0.343 or 0.484 tonnes of CO₂ equivalent (tCO₂e) per tonne mined. Surface mined coal has a significantly lower emission factor of 0.022 tCO₂e, while imported coal does not face domestic New Zealand ETS costs for FCSM¹.
4. The majority of coal mined in New Zealand is surface mined coal, accounting for approximately 4 million tonnes in 2011, while underground mined coal accounted for only approximately 0.9 million tonnes of coal mined. Imported coal only accounts for 0.17 million tonnes used in New Zealand. Allocative baselines were originally formulated based on coal use from 2006-2009, during which time more imported coal was used than is currently. The majority of this was used in electricity generation at the Huntly power station².
5. New Zealand used a total of 2.8 million tonnes of coal in 2011, and the largest domestic users were the Huntly power station (0.7 million tonnes) and the Glenbrook Steel Mill (0.8 million tonnes)³.

Policy decision being implemented

6. The CCRA allows provision of an allocation of New Zealand Units (NZUs) to emissions intensive trade exposed (EITE) businesses to help maintain their market competitiveness relative to those not facing an emission price. The allocation for eligible EITE activities is determined according to their emissions intensity and an allocative baseline which is specified for each activity in the Climate Change (Eligible Industrial Activities) Regulations 2010.
7. The Climate Change (Emissions Trading and Other Matters) Amendment Act was passed by Parliament in November 2012. It amended the CCRA to make a number of changes to the ETS.
8. These changes included enabling FCSM emissions to be included in the list of emissions sources to be counted towards the eligibility for, and level of, allocation for activities that used coal. It was decided at this time that a regulation change to the Climate Change

¹ Emissions factors based on updated UNFCCC figures

² Energy Data File 2012, Ministry for Economic Development

³ See 2

(Eligible Industrial Activities) Regulations 2010 was required to implement this decision by Parliament. This RIS covers options for the implementation of this original decision.

Background to the original policy decision

9. During the consultation by the 2011 ETS Review panel and subsequently on the Amendment Act, some submitters commented that FCSM emissions should be included as an eligible emission source for industrial allocation purposes because their businesses face ETS costs as a result of FCSM emissions.
10. According to these submitters, excluding FCSM emissions results in a lower level of allocation for their activities. On this basis, it was considered that industrial allocation might not adequately mitigate the impact of the ETS on the international competitiveness of businesses facing ETS costs associated with FCSM emissions.
11. After considering this information, Parliament decided that the inclusion of FCSM as an eligible emissions source for determining allocative baselines for coal users (rather than coal miners) was warranted. FCSM was added to the list of emissions sources eligible for allocation for coal users by the Amendment Act. The fiscal impact of this issue was quantified at this time, and is set out in table one, below.

Table one: Net fiscal impact of fugitive coal seam methane allocation (\$ million)

\$ million	increase/(decrease) in operating balance					Total across the forecast period
	2011/12	2012/13	2013/14	2014/15	2015/16 & Outyears	
Adding fugitive coal seam methane to the list of emissions sources eligible for allocation for coal users	-	(0.692)	(0.692)	(0.692)	(0.692)	(2.767)

Source: Cab MIN (12) 23/10

12. Note that these figures are based on a carbon price of \$6.00 (NZU spot price as at 31 May 2012). Some uncertainty exists in regards to costs because the ETS is a market based instrument, and prices can fluctuate. The current carbon price used by the Crown to value NZUs is \$3.00, while the current NZU market spot price is \$2.10 (as valued by Westpac on 9 August 2013). Use of these prices would significantly reduce the costs of this proposed change; however, a higher or lower carbon price would not change the preferred policy option.
13. As the level of allocation is adjusted to reflect FCSM from coal use, the fiscal costs to Government may increase slightly. The most recent Ministry for Business, Innovation, and Employment figures suggest that coal production in New Zealand declined 7% between 2010 and 2011, while coal use declined 4.5% between 2007 and 2011. Levels of allocation (and fiscal costs to the Crown) are output based and linked to the level of output of the good in question.

Status quo

14. This RIS covers one regulation change to the Schedule to the Climate Change (Eligible Industrial Activities) Regulations (2010). The change increases the allocative baselines for eligible activities that use coal, as the Act now recognises ETS costs for FCSM emissions.
15. Through the Amendment Act, the status quo is that FCSM can be considered as an eligible emissions source for allocative baselines. Prior to the Amendment Act decision, FCSM emissions were not considered eligible, despite the fact that coal miners are required under the ETS to surrender units in respect of any coal seam gas associated with mining.

Problem definition

16. Parliament considered that industrial allocation might not adequately mitigate the impact of the ETS on the international competitiveness of businesses facing ETS costs associated with FCSM emissions.
17. Regulations are now required to determine how Parliament's decision to include FCSM emission as an eligible emissions source for the purpose of industrial allocation will be implemented. This RIS covers options for the implementation of Parliament's decision, and does not cover the costs and benefits of the original policy decision which has already been made. Action is necessary to give effect to Parliament's decision, therefore doing nothing is not a viable option.

Objectives and Approach to options assessment

18. The objectives of the proposed regulation are to:
 1. Give effect to the Amendment Act decision to include FCSM emissions as an eligible emissions source for determining industrial allocation for coal users and meet the 'Code of good regulatory practice';
 2. Mitigate the impact on the international competitiveness of businesses facing ETS costs associated with FCSM emissions. This is the rationale of the original policy decision. This will be measured by the number of coal users that benefit from the proposed regulation.
19. A code of good regulatory practice has been developed by the Ministry of Business, Innovation, and Employment in order to create effective regulations. The code has been used as a source for criteria to measure whether the option meets objective one, to give effect to the Amendment Act decision. The criteria are as follows:
 - Efficiency - adopt and maintain only regulations for which the costs on society are justified by the benefits to society.
 - Effectiveness - regulation should be designed to achieve the desired policy objectives.
 - Transparency - the regulation making process should be clear.
 - Clarity - regulatory processes and requirements should be as understandable and accessible as practicable.

- Equity - regulation should be fair and treat those affected equally.

The following criteria have also been included:

- Environmental integrity - the environmental integrity of the ETS should be maintained. This was added by the Ministry for the Environment to consider the effect of these options on the environment.
- Implementation simplicity - regulation should be feasible and able to be implemented easily for the benefit of both Government and stakeholders. Submitters expressed a desire to see implementation simplicity included in assessment criteria.

Potential impacts

20. When implementing policy changes into regulations several impacts may occur. These are discussed in the table below and are categorised into Environmental, Economic, Implementation, Compliance, Fiscal, Legal, Social, and Cultural.

Options

21. When developing regulations to implement Parliament's decision to enable FCSM emissions as an emission source eligible for industrial allocation, an appropriate methodology must be designed.

22. The Government consulted on two options to account for FCSM in allocative baselines for coal users:

- **Option one:** Coal users will receive an increase to their allocative baselines based on the type of coal that they use. For instance, underground mined coal will receive an increase of approximately 0.484 or 0.343 tCO₂e per tonne of coal, depending on whether the coal is bituminous or sub-bituminous coal. Surface mined coal will receive 0.022 tCO₂e per tonne of coal.
- **Option two:** All eligible coal users will receive the same amount of increase regardless of the origin or type of coal used. FCSM emissions would be averaged across all types of coal (underground, surface and imported) to create the allocative baselines increase. A preliminary estimate places the increase as approximately 0.1462 tCO₂e per tonne of coal.

23. Through submissions it became clear that the treatment of imported coal warranted consideration. Two submitters were concerned that imported coal would be preferred by coal users in New Zealand as imported coal does not face any domestic ETS costs in respect of FCSM emissions but may be provided with an increase in allocation associated with these emissions. To accommodate these concerns we have considered a third option.

- **Option three:** Allocative baselines of users of domestic underground and surface-mined coal would be increased. FCSM emissions would be averaged across domestic underground and surface mined coal to create the allocative baselines increase. The actual increase under this approach has been preliminarily estimated as being very similar to that from option two (i.e. approximately 0.1462 tCO₂e per tonne of coal) because of minimal importing of coal during the period of interest. Users of imported coal would receive no increase for the coal that they import.

24. In all calculations the coal used in the generation of electricity has been excluded. This is because the activity of electricity generation is not eligible for industrial allocation within the ETS and use of this coal would distort the results of the calculations.
25. The choice of option has potential implications for allocation recipients. However, this is generally insignificant for most coal users. Detailed analysis of each option is provided in the table below.

Regulatory impact analysis

Options	Criteria and objectives discussion - = neither meets or does not meet criteria ü = meets criteria X = does not meet criteria Green= Preferred option	Impacts discussion
<p>Option one: Coal users will receive an increase to their allocative baselines based on the type of coal that they use</p>	<p>OBJECTIVE 1: Give effect to the Amendment Act decision to include FCSM emissions as an eligible emissions source for determining industrial allocation for coal users: This option meets the transparency and clarity criteria, but does not meet the implementation simplicity criteria as it is difficult to implement, therefore will not meet this objective. This option meets the effectiveness criteria but is neutral for efficiency. This option does not meet the equity criteria as it does not treat all coal users the same, therefore does not achieve this objective.</p> <p>(-) EFFICIENCY: Option scores neutrally for efficiency as costs and benefits are minimal. No difference between the options.</p> <p>(ü) EFFECTIVENESS: The option will achieve the policy objectives. No difference between the options.</p> <p>(ü) TRANSPARENCY: The regulation making process has been clear. No difference between the options.</p> <p>(ü) CLARITY: Processes and requirements have been understandable and accessible. No difference between the options.</p> <p>(X) EQUITY: Not as equitable as option two treats users of different types of coal differently.</p> <p>(X) ENVIRONMENTAL INTEGRITY: Some negative global environmental impact. No difference between the options.</p>	<p>ENVIRONMENTAL: Minimal negative global environmental impacts. Less incentive to reduce emissions, as businesses would have less incentive to switch from using coal to adopting less emissions-intensive energy sources, because allocation protects emitters from ETS costs. These impacts are the same across all options.</p> <p>ECONOMIC: One firm in New Zealand dominates underground coal consumption and would therefore receive great benefit from the implementation of this option. The majority of coal users consume surface mined coal and would therefore receive a lesser benefit under this option. Provides a lesser number of coal users with benefits from allocation than options two and three. If coal miners can recover additional FCSM costs across all coal sold, whether underground or surface mined, then this option ineffectively reflects additional FCSM costs. Unintended spillover effects may result.</p> <p>COMPLIANCE: No significant impacts.</p> <p>IMPLEMENTATION: Lack of available data on coal origin requires extra judgement and analysis from officials and undermines the feasibility of this option. Medium impact on Government.</p> <p>FISCAL: Main cost involved is the value of additional units allocated. This value has been agreed to by Parliament and is similar across all options.</p> <p>LEGAL: Potential implications in terms of New Zealand's international trade and investment obligations to the extent that this option would change the</p>

	<p>(X) IMPLEMENTATION SIMPLICITY: Not as feasible as option two as lack of available coal origin data.</p> <p>OBJECTIVE 2: Mitigate the impact on the international competitiveness of businesses facing ETS costs associated with FCSM emissions: This option will achieve this objective as the impact on international competitiveness of coal users would be mitigated, however underground mined coal users would benefit more than surface mined coal users.</p>	<p>conditions of competition between domestic and imported coal</p> <p>SOCIAL: The coal mining community is currently facing intense commercial pressure at present due to reduced demand. The options presented would not materially affect these pressures or any commercial decisions.</p> <p>CULTURAL: No significant impacts.</p>
<p>Option two: all eligible coal users will receive the same amount of increase regardless of the origin or type of coal used</p>	<p>OBJECTIVE 1: Give effect to the Amendment Act decision to include FCSM emissions as an eligible emissions source for determining industrial allocation for coal users: This option meets the transparency, clarity and implementation simplicity criteria, therefore will meet this objective. This option meets the effectiveness and equity criteria but is neutral for efficiency, therefore does achieve this objective.</p> <p>(-) EFFICIENCY: Option scores neutrally for efficiency as costs and benefits are minimal. No difference between the options.</p> <p>(Ü) EFFECTIVENESS: The option will achieve the policy objectives. No difference between the options.</p> <p>(Ü) TRANSPARENCY: The regulation making process has been clear. No difference between the options.</p> <p>(Ü) CLARITY: Processes and requirements have been understandable and accessible. No difference between the options.</p> <p>(Ü) EQUITY: Most equitable of all the options as all coal users are treated the same.</p> <p>(X) ENVIRONMENTAL INTEGRITY: Some negative global environmental impact. No difference between the options.</p>	<p>ENVIRONMENTAL: Minimal negative global environmental impacts. Less incentive to reduce emissions, as businesses would have less incentive to switch from using coal to adopting less emissions-intensive energy sources, because allocation protects emitters from ETS costs. These impacts are the same across all options.</p> <p>ECONOMIC: If coal miners recover additional FCSM costs across all coal sold, whether underground or surface mined, then option two effectively reflects additional costs in respect of FCSM emissions, because the additional costs associated with FCSM emissions from underground mined coal are spread across all coal users. Provides a greater number of coal users with economic benefits than option one, but benefits smaller for users of domestic underground-mined coal than option one, due to the effect of averaging. Provides more coal users with economic benefits than option three, but benefits smaller for users of domestically mined coal, due to the effect of averaging. Most equitable of all the options as all coal users are treated the same regardless of the origin of the coal they use.</p> <p>IMPLEMENTATION: This option easiest to implement as based on readily available aggregate data.</p> <p>COMPLIANCE: No significant impacts.</p> <p>FISCAL: Main cost involved is the value of additional units allocated. This</p>

	<p>(U) IMPLEMENTATION SIMPLICITY: Easiest to implement as based on readily available aggregate data.</p> <p>OBJECTIVE 2: Mitigate the impact on the international competitiveness of businesses facing ETS costs associated with FCSM emissions: This option will achieve this objective as the impact on international competitiveness of all eligible coal users would be mitigated.</p>	<p>value has been agreed to by Parliament and is similar across all options.</p> <p>LEGAL: Less risk in terms of New Zealand’s international trade and investment obligations as all coal types would be treated the same regardless of origin.</p> <p>SOCIAL: The coal mining community is currently facing intense commercial pressure at present due to reduced demand. The options presented would not materially affect these pressures or any commercial decisions.</p> <p>CULTURAL: No significant impacts.</p>
<p>Option three: Averaged across domestic underground and surface-mined coal only-imported coal not included</p>	<p>OBJECTIVE 1: Give effect to the Amendment Act decision to include FCSM emissions as an eligible emissions source for determining industrial allocation for coal users: This option meets the transparency, clarity and implementation simplicity criteria, therefore will meet this objective. This option meets the effectiveness criteria but is neutral for efficiency. This option does not meet the equity criteria as it does not treat all coal users the same, therefore does not achieve this objective.</p> <p>(-) EFFICIENCY: Option scores neutrally for efficiency as costs and benefits are minimal. No difference between the options.</p> <p>(U) EFFECTIVENESS: The option will achieve the policy objectives. No difference between the options.</p> <p>(U) TRANSPARENCY: the regulation making process has been clear. No difference between the options.</p> <p>(U) CLARITY: processes and requirements have been understandable and accessible. No difference between the options.</p> <p>(X) EQUITY: Not as equitable as option two treats users of different types of coal differently.</p> <p>(X) ENVIRONMENTAL INTEGRITY: Some negative global environmental</p>	<p>ENVIRONMENTAL: Minimal negative global environmental impacts. Less incentive to reduce emissions, as businesses would have less incentive to switch from using coal to adopting less emissions-intensive energy sources, because allocation protects emitters from ETS costs. These impacts are the same across all options.</p> <p>ECONOMIC: Risk of over allocation of units relative to option two in that imported coal with no explicit FCSM costs are ignored. Provides a lesser number coal users with benefits from allocation than option one or two.</p> <p>IMPLEMENTATION: This option easy to implement as based on readily available aggregate data; however imported coal would not be eligible for allocation and this may pose extra complications. Small impact on Government.</p> <p>COMPLIANCE: No significant impacts.</p> <p>FISCAL: Main cost involved is the value of additional units allocated. This value has been agreed to by Parliament and is similar across all options.</p> <p>LEGAL: Potential implications in terms of New Zealand’s international trade and investment obligations to the extent that this option would change the conditions of competition between domestic and imported coal.</p> <p>SOCIAL: The coal mining community is currently facing intense commercial pressure at present due to reduced demand. The options presented would</p>

	<p>impact. No difference between the options.</p> <p>(X) IMPLEMENTATION SIMPLICITY: Easier to implement than option one as aggregate coal use data available; however not as feasible to implement as option two as imported coal users must be separated.</p> <p>OBJECTIVE 2: Mitigate the impact on the international competitiveness of businesses facing ETS costs associated with FCSM emissions: This option will not achieve this objective as the impact on international competitiveness of users of imported coal would not be mitigated.</p>	<p>not materially affect these pressures or any commercial decisions.</p> <p>CULTURAL: No significant impacts.</p>
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Preferred option

26. The outcome of the above analysis shows that option two is the best option for all eligible coal users. Underground, surface, and imported coal use would be averaged to calculate the increase in allocative baselines. This option meets the desired policy objective while achieving the best result in assessment by meeting the Effectiveness, Transparency, Clarity, Equity, and Implementation simplicity criteria. This option had less compliance and fiscal costs than options one and three, and provides no risk of international trade implications due to the equitable treatment of imported coal. The economic benefits to coal users, in particular underground coal users, may be less than options one and three due to the effect of averaging, but all coal users' benefit.
27. The point of difference between the options is that if coal miners recover additional FCSM costs across **all coal sold**, whether underground or surface mined, then option one ineffectively reflects additional costs in respect of FCSM emissions. In this circumstance, because the additional costs associated with FCSM emissions from underground mined coal are spread across all coal users, then option two is more effective than option one and option three. Option three involves a risk of over allocation of units relative to option two in that imported coal with no explicit FCSM costs are ignored. This means that option one does not meet the effectiveness and equity criteria as well as option two.
28. It is not possible to exclude imported coal under the current legislated process for adjusting allocative baselines, as the allocative baseline is set by activity across the economy rather than specifically to each firm's coal purchasing decisions.
29. The overall impact is that allocative baselines would increase slightly for eligible large scale coal users. The effect on other eligible persons and activities is likely to be insignificant. Overall the fiscal costs of each option are approximately the same.
30. Of the 26 activities receiving allocation in the ETS, only 10 will have a baseline adjusted to include emissions from FCSM. A total of 95 eligible persons (i.e., entities that receive industrial allocation) are registered as receiving industrial allocation in respect of these activities. The call for data provided useful information on the origin of coal used in New Zealand. While this data is incomplete, it broadly aligns with national level data on coal use and supply.
31. The Glenbrook Steel Mill accounts for most underground-mined coal use in New Zealand. However, note that less underground mined coal is being used at the Glenbrook Steel Mill now, relative to the historic period (2006-2009) that was used to determine the baseline. Option one therefore provides a minor advantage to the Glenbrook Steel Mill.

Consultation

32. A consultation document on proposed updates to ETS allocative baselines was released on the Ministry for the Environment's climate change website. This document included information, options and consultation questions on the inclusion of FCSM emissions as an eligible emissions source for allocative baselines, and the methodology for implementing this change. Participants and Eligible Persons in the ETS were notified at the commencement of the consultation via an email sent by the EPA.
33. A four week consultation period (24 April- 17 May 2013) was conducted, and five submissions were received in response. The submissions were received from four coal users and one coal miner. Key themes raised by stakeholders are summarised below. Additionally, a 30 working day call for data period was conducted between 30 July and 10

September 2013 to gather data on coal use from Eligible Persons conducting certain activities. This data will inform the baseline increase.

Key themes from consultation

34. A total of five submitters commented on the options for FCSM. Of the five submitters, three either agreed, or agreed in principle with the implementation of the Government's preferred option. Three submitters also noted that implementation simplicity should be considered when assessing the options; this was subsequently added to the assessment criteria for this analysis.
35. Two key issues emerged through consultation regarding the implementation of the Government's preferred option.
1. **Averaging is an inappropriate method for calculating baselines:** A number of methods were proposed by submitters as alternatives to the averaging approach preferred by the Government. Some submitters proposed an emissions factor be created relating to the origin of the coal.
36. Officials consider that averaging is the best method for including FCSM emissions into allocative baselines because it is feasible to implement and administer, and treats all coal users equitably. It is unlikely that averaging the benefits of allocation for FCSM emissions will provide a sufficient incentive to switch coal suppliers as the benefits of allocation to coal users is minor.
2. **Imported coal may be favoured over domestic coal:** Submissions from two firms, one coal user and one coal supplier, were concerned that the implementation of the Government's preferred option may result in imported coal being favoured over domestic coal, which may result in economic loss for domestic coal miners due to reduced demand. The basis for their assumption is that imported coal does not face FCSM emission costs, therefore can be offered cheaper than domestically sourced coal, and suggested that allocative baselines should not include FCSM emissions for imported coal. These submissions highlight a risk that under option two (preferred option) current users of underground coal may switch to surface-mined or imported coal and no corresponding adjustment to their baseline would occur to reflect different emissions costs for the different types of coal.
37. Officials have considered this concern and understand that distributing the benefits of additional FCSM emissions across allocative baselines for all types of coal would not necessarily create an incentive to switch to imported coal. No price incentive would be created through the proposed method. Furthermore, Officials consider that the implementation of alternative option that the submitters propose would potentially create spillover issues within the coal market. That carries a risk of a potential breach of New Zealand's obligations under international agreements, and increased costs to the Government due to the complexity involved in implementing alternative methods.

Conclusions and recommendations

38. A change to the Climate Change (Eligible Industrial Activities) Regulations (2010) Schedule is now required to increase allocative baselines for eligible activities that use coal, as the CCRA now recognises ETS costs for FCSM emissions.

39. The outcome of this RIS is to recommend the implementation of the Government's preferred option: All eligible coal users will receive the same amount of increase regardless of the origin or type of coal used, including those that use underground-mined, surface-mined, or imported coal (option two).
40. The overall result of this regulation change will be that allocative baselines would increase slightly for eligible large scale coal users, while the effect on other eligible activities will be zero.

Implementation

41. The preferred option for including FCSM emissions as an eligible emission source can be implemented through amendments to the Climate Change (Eligible Industrial Activities) Regulations 2010. As data for coal use in New Zealand has been collected through a call for data process (as outlined in the CCRA) and supplemented by national level energy statistics, calculation of the allocative baseline is straightforward. This figure will be used when calculating individual allocation amounts and the regulations will be amended by updating numbers associated with coal use.
42. Regulations will need to be drafted and gazetted prior to 30 November 2013 in order to come in to force on 1 Jan 2014, subject to Cabinet agreement. The Environmental Protection Authority (EPA) holds the responsibility for the allocation of units within the ETS. Allocation of units in 2014 will include emissions from FCSM and the EPA will allocate accordingly.
43. Regulations to set the new allocative baselines will be made under section 161A(1)(c) of the CCRA. These regulations will be notified in the Gazette, and current and potential participants will be made aware of them by the EPA and the Ministry for the Environment.
44. The operational requirements on firms are minimal for this proposal. Care has been taken to make sure requirements of firms are clearly articulated to them, require firms to provide only what is necessary, keep administrative processes to a minimum and ensure that the Ministry for the Environment and the EPA are set-up to provide help on demand. Some inconvenience on eligible persons has occurred (especially to small scale horticultural growers, many of whom do not use coal) through calling for data on coal use from 2006 to 2009. Thereafter, following the change in allocative baselines, no additional effort is required from eligible persons in respect of this change.
45. The CCRA supports a self assessment model for applicants to minimise compliance costs of allocation. However, to ensure that the objectives of these regulations are met, an enforcement strategy will be put in place to give confidence that annual allocations are correct. The enforcement strategy centres on a combination of both random and risk-based investigation. Desk-based assessment of allocation applications will be supported by targeted investigation if concerns arise. The CCRA allows the EPA to request specific records from the applicant to support their allocation application on a case-by-case basis.
46. Random audits can also be carried out by the EPA. The regulations require firms to keep records necessary to calculate their production for up to seven years and these would be the focus of audits. The compliance cost to firms of keeping this information is minimal as acceptable records for the purposes of this regulation would be records that firms would be expected to have already for business management and tax purposes (e.g. records of production, inventory and sales).

Monitoring, evaluation and review

47. The preferred option will be effective when allocative baselines are increased to reflect the additional emissions outlined in the CCRA. This will be undertaken as a routine part of the industrial allocation process at the EPA, which has its own evaluation and audit procedure.
48. The CCRA requires the Minister to conduct regular reviews of the operation and effectiveness of the ETS (Section 160). The first review occurred in 2011 and the next review will take place in 2015. Allocation for eligible activities can be reviewed as part of this process.
49. Under the CCRA, the Minister sets the terms of reference and appoints a panel to conduct any review (Section 160(6)). The Minister is required to publish the panel's report on the review. If the panel recommend any changes in relation to allocation to industry that require legislative change then the Minister must produce a report containing a response to the panel's recommendations.