

The Chair

Cabinet

## **Review of operation of Negotiated Greenhouse Agreement policy**

### **Proposal**

1. This paper recommends a series of amendments to the Government's Negotiated Greenhouse Agreement (NGA) policy to improve the policy, and by doing so, enable completion of the majority of NGA agreements by mid-2006.

### **Executive summary**

2. As directed by Cabinet, officials have undertaken a review of the operation of NGA policy. The main conclusions of the NGA review were that the time required to complete an NGA is significantly greater than foreseen and there is a significant risk that NGA agreements will not be completed by the time the carbon tax is introduced.
3. The proposed policy improvements set out in this paper will enable the NGA process to be streamlined, reducing the time and cost to both the Government and applicants, rather than fundamentally changing the NGA policy objectives. Policy improvements include:
  - Establishing a standard end date for all NGA agreements
  - Determining the NGA participant's emissions intensity targets
  - Clarifying the treatment of fuel switching.
  - Clarifying the scope of relief from the carbon tax.
  - Clarifying world's best practice identification and assessment.
4. While streamlining the NGA process is likely to result in more NGA applications, the recommendations set out in this paper are unlikely to fundamentally affect the estimated value of relief provided to NGAs as:
  - The recommendations do not materially alter the likely outcomes under the NGA policy.
  - The competitiveness-at-risk assessment criteria are not being altered (which could substantially broaden eligibility).
  - The majority of the estimated value of relief is attributable to a small number of large industrial energy users. These parties are already in the NGA process.
5. Together, these policy improvements should assist in achieving completion of the majority of NGA agreements by mid-2006.

## Background

6. A key component of the Government's climate change policy package is NGAs for firms or industries that, as a result of a carbon tax<sup>1</sup>, face significant risk to their competitiveness relative to producers in countries with less stringent climate change policies [CAB Min (03) 13/4]. Under a NGA, participants<sup>2</sup> will receive full or partial exemption (i.e. relief) from the carbon tax in exchange for moving towards world's best practice (WBP) in emissions performance.
7. At the time the policy was finalised, there was considerable uncertainty surrounding key aspects of climate change policy and how workable several aspects of the policy would be in practice. Accordingly, Cabinet [CAB Min (03) 13/4] directed officials to report back to Cabinet on:
  - (i) How frequently firms or industries should be allowed to reapply for eligibility, or renegotiation of a NGA.
  - (ii) Consideration of experience with NGAs to date.
  - (iii) Applicability of the proposed NGA eligibility criteria and processes.
  - (iv) Recommended improvements to the NGA policy.

## Stakeholder consultation

8. In November 2004, feedback on the NGA process was sought from NGA applicants, NGOs and various industry organisations. The consistent thrust of the feedback was concerns around the time, cost and complexity of undertaking a NGA.
9. In response to the stakeholders' and officials' concerns on the lack of NGA progress, officials developed proposals to clarify NGA policy, simplify, and streamline the process. In February and March 2005, further stakeholder consultation was undertaken where officials outlined the proposals contained in this paper. Submissions have been received from 19 stakeholders, including most of the firms that have to date applied for a NGA. These submissions have been considered and are incorporated in this paper.

## Discussion

10. Sections A to C of this paper address the items (i) to (iii) that officials were directed to report back on.
11. Item (iv), recommended improvements to the NGA policy, is addressed in Section D of this paper. Stakeholder feedback on the proposed policy improvements is included in this section.

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<sup>1</sup> For the purposes of this paper, the "carbon tax" has replaced references to the "emissions charge."

<sup>2</sup> NGA participants include individual firms and co-operatives and may extend to industry-wide organisations.

## **A Frequency of reapplication for NGA eligibility and renegotiation of a NGA**

12. NGA policy provides that firms deemed ineligible for a NGA or only offered a partial exemption be eligible to reapply if they can demonstrate that due to changing circumstances they should now be eligible, or eligible for a greater exemption.
13. Officials have interpreted the “renegotiation of a NGA” to refer to the NGA participant’s eligibility to seek a greater exemption from the carbon tax.
14. Officials note that as a consequence of this policy there may be a risk that frequent reapplications would increase administrative cost to the Government. However, the administrative cost to the Government is not considered to be prohibitive. In addition, officials also recommend improving the eligibility process to ensure the process is simple and low cost.
15. Stakeholders supported that there be no restrictions to a firm’s ability to reapply for NGA eligibility or renegotiation of a NGA.
16. Officials therefore consider that the current policy with respect to reapplication for NGA eligibility and eligibility for a greater exemption is appropriate.

### Recommendation

Agree to retain the current policy with respect to reapplication for NGA eligibility and eligibility for a greater exemption.

## **B Experience with NGAs to date**

17. The Crown has entered into NGAs with two firms and has received applications for a NGA from a further 12 firms<sup>3</sup>. The Crown is currently in negotiations with four of these firms. The Crown has also received an indication of interest in a NGA from a further 14 firms and industry groups.
18. To date, NGAs have taken longer to complete and the negotiations have been more complex and costly than originally envisaged. The main conclusions of officials’ review of experience with NGAs to date are that:
  - Some policy ambiguity has resulted in complex eligibility assessments.
  - The eligibility process has not been simple or low cost as it has required considerable financial information to be submitted.
  - Considerable information is required in the WBP study. In addition, data for international comparisons are often limited.
  - There have been difficulties finding appropriate WBP consultants. For most industries limited experience exists either within the industry or among consultants to carry out benchmarking studies.

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<sup>3</sup> These 14 firms represent the core of New Zealand’s large industrial energy users facing international competition and consume approximately 55% of the electricity used by New Zealand industries.

- Asymmetrical knowledge and information about a NGA participant's operations has made it difficult for the Crown and the NGA participant to agree the NGA participant's Target Pathway to 2012.
  - Negotiation of the NGA participant's terms and conditions has proven to be a complicated, highly detailed, and time-consuming process.
19. Stakeholders have reported that the complexity, cost and time taken to negotiate a NGA are imposing a barrier to entry for some firms. NGA participants have also raised the issue of the significant cost of the NGA eligibility and negotiation processes. The Crown's costs of negotiating a NGA have also increased significantly to between \$100,000 and \$200,000 per NGA – double the amount originally estimated.
20. Officials consider that completing NGAs by mid-2006 will be beneficial in ensuring that sufficient time is given to NGA participants to enable early adoption of mitigation actions and facilitate long-term investment decisions. Based on progress to date and the expressions of interest received, this is unlikely to be achieved under the current NGA policy and process.

### **C Applicability of the NGA eligibility criteria and process**

21. A principle underlying the implementation of NGA policy is that the eligibility assessment processes should be simple and low cost to reduce barriers to at-risk firms accessing NGAs.

#### **Eligibility criteria**

22. To be eligible, a NGA participant's international competitiveness must be considered to be at-risk as a result of the carbon tax. The current eligibility criteria are:
- Is the firm's output internationally traded and are the climate change policies of competitor countries less stringent?
  - What is the impact of a \$25 per tonne of CO<sub>2</sub> charge (i.e., carbon tax) on the competitiveness of domestic output? Either:
    - a. Will the charge significantly increase costs (due to more than 20% of the NGA participant's expenses being energy and emissions related)? or
    - b. Will the charge reduce profitability (earnings before interest and tax) by more than 10%? or
    - c. Will the charge move the firm significantly below the appropriate industry weighted average cost of capital?
  - Net national benefit of the NGA.
23. In agreeing the eligibility criteria, Cabinet considered that the above principle would result in more eligible at-risk firms being able to apply for and receive NGAs but would also likely result in some not-at-risk firms receiving NGAs.

24. To date the NGA applications received have been from large industrial energy users facing international competition, and the majority of these applicants have easily met the eligibility criteria. Officials consider that the three financial tests have generally proven to be adequate proxies for assessing the impact of the carbon tax. However, there have been insufficient borderline applications to assess whether the threshold levels of these financial tests are appropriate in ensuring at-risk firms receive eligibility.
25. Cabinet also agreed that industry-wide eligibility applications can be received. Officials have received expressions of interest in NGAs from a number of industry groups. However, to date no industry-wide applications have been received and officials have yet to determine the applicability of the NGA policy relating to industry-wide NGA agreements. Stakeholder submissions indicated continued interest in the availability of industry-wide applications.
26. The majority of submissions received did not raise concerns regarding the NGA eligibility criteria. Submitters confirmed that the criteria should enable firms that are competitiveness-at-risk as a result of the carbon tax to seek a NGA.
27. Officials note that a technical amendment is required in respect of paragraph 22 test (c) above, which currently assesses the impact of the charge relative to the appropriate industry weighted average cost of capital. Information on industry weighted average cost of capital is not readily available and is difficult to obtain. Officials therefore propose that this test be amended to “Will the charge move the firm significantly below the firm’s weighted average cost of capital?” This amendment will result in the test being more meaningful without reducing its rigour.

### **Eligibility process**

28. With regards to the eligibility process, officials’ experience is that firms’ NGA applications are not always complete, and that in some instances issues of policy interpretation have complicated the process. These factors have contributed to protracted and/or costly assessments of eligibility. This was also confirmed by submissions received during the review of the operation of NGA policy.
29. Recommendations aimed at improving these issues are covered in section D of this paper.

### **Recommendations**

Note that, whilst to date there is limited information to assess the applicability of the eligibility criteria, there is no evidence to suggest that the NGA eligibility criteria are inappropriate.

Agree that the competitiveness-at-risk criterion “Will the charge move the firm significantly below the appropriate industry weighted average cost of capital?” be replaced with “Will the charge move the firm significantly below the firm’s weighted average cost of capital?”

## **D Recommended improvements to NGA policy**

30. There are several areas where the NGA policy should be improved, either by providing further clarification or amending the original policy. This will enable the NGA process to be streamlined, reducing the time and cost to both the Government and to applicants of completing the determination of NGA eligibility and the negotiation of the NGA, and will assist with the aim of achieving completion of NGA agreements by mid-2006.
31. Proposed policy improvements discussed in this section include:
- Establishing a standard end date for all NGAs.
  - Determining the NGA participant's emissions intensity targets.
  - Clarifying the treatment of fuel switching.
  - Clarifying the scope of relief from the carbon tax.
  - Removing the principle of "hold harmless."
  - Clarifying world's best practice identification and assessment.

### **Establishing a standard end date for all NGAs**

32. NGA policy does not explicitly specify the end date of NGAs. The two completed NGAs have the following end dates:
- The NGA with the New Zealand Refining Company (NZRC) has a term to 2022 with a full review in 2012 of the NGA participant's competitiveness-at-risk status, definition of WBP and Target Pathway.
  - The NGA with OceanaGold has a term to 2012 with the following proviso<sup>4</sup>:
    - That if between 2010 and 2012 OceanaGold requests, and if the Crown's policy at the time is to continue to offer NGAs after 2012, then the Crown will meet with OceanaGold to discuss whether it is eligible for a NGA under that policy.
    - That if the Crown should enter into a NGA with another firm before 2010 with a longer term, the Crown will be required to negotiate with OceanaGold to similarly extend the term of the OceanaGold NGA.
33. During consultation officials proposed that the end date of all NGAs be 31 December 2012. This has caused considerable concern with the majority of current and prospective NGA participants. Submissions on this issue reflected the following themes:
- Capital investments are long term and therefore a NGA participant requires certainty that there will not be Government-imposed climate

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<sup>4</sup> Officials note that this information has not been publicly released to date under the Official Information Act.

change policies that reduce the NGA participant's international competitiveness during the economic life of these investments.

- The ability to secure a NGA to only 2012 may be a factor that will discourage future re-investment in the business operations covered by the NGA and may slow the transition to a less emissions-intensive economy.
  - The NGA end date should be negotiable on a case-by-case basis, left silent, or subject to extension beyond 2012 if certain criteria are met.
  - The continuation of a NGA term beyond 2012 should be guided by a firm's individual circumstances, the national interest, the fundamental purpose of a NGA, and/or the nature of the Government's climate change policy post 2012.
  - A review of each NGA should be conducted in 2012 to confirm a NGA participant's competitiveness-at-risk status and to provide for the Crown and the NGA participant to negotiate a new Target Pathway.
34. New Zealand's international climate change obligations post 31 December 2012 (the end of the first commitment period of the Kyoto Protocol) are currently unknown. Whilst I acknowledge the concerns raised by NGA stakeholders, a standard end date for NGAs of 31 December 2012 best preserves the Government's options for its post-2012 climate change policies. Therefore I recommend that the end date for NGA agreements be no later than 31 December 2012 until such time as the Government decides otherwise, which may occur in conjunction with the development of the Government's future climate change policies.

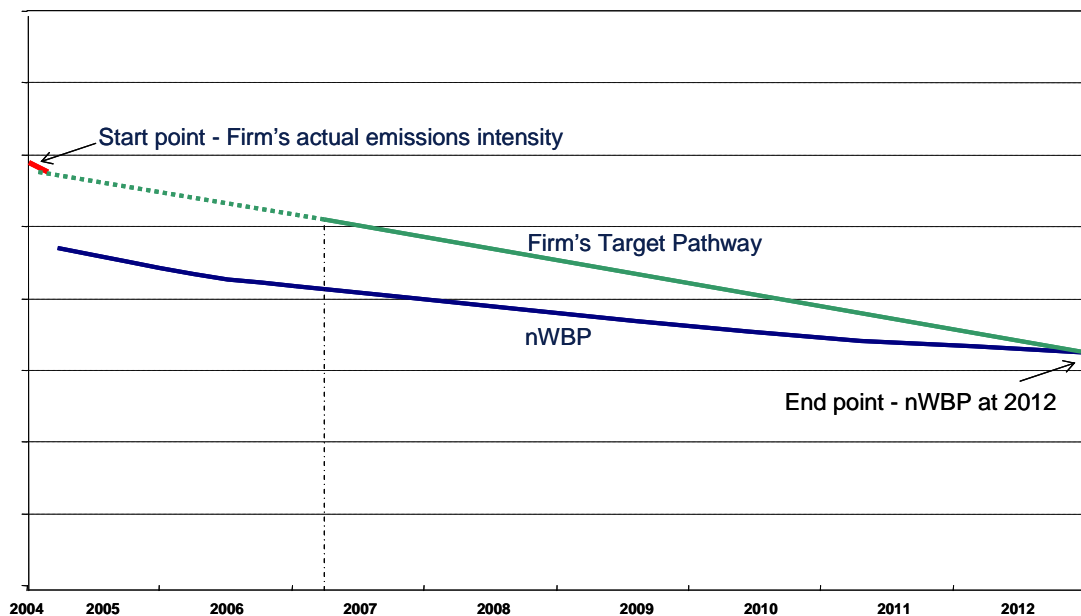
#### Recommendation

Agree that the end date for NGAs be no later than 31 December 2012 until such time as the Government decides otherwise, which may occur in conjunction with the development of the Government's future climate change policies.

#### **Determining the NGA participant's emissions intensity targets**

35. NGA policy provides that the negotiation of emissions intensity targets will, where possible, be based on WBP (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement.
36. There is a natural information asymmetry between the NGA participant and the Crown. In negotiating a NGA participant's emissions intensity targets, the Crown needs to be satisfied that the targets are sufficiently stringent. This has required officials to develop an in-depth understanding of a NGA participant's business and operations, which has contributed to the complex and lengthy negotiations.
37. To simplify the determination of a NGA participant's Target Pathway, I propose using an objective process rather than negotiating a Target Pathway.

38. During consultation with industry, officials discussed five possible Target Pathways. After considering stakeholder comments, I propose that the Target Pathway be a straight line between the following points:
- A start point defined as a NGA participant's actual average emissions intensity for the 2004 calendar year, or as agreed by the Crown and the NGA participant if:
    - the NGA participant's performance in 2004 is atypical; or
    - the business activity was not in operation for a full calendar year ending 31 December 2004.
  - An end point defined as the normalised world's best practice emissions intensity (nWBP)<sup>5</sup> at 31 December 2012.
39. The Target Pathway will take effect from the date the carbon tax takes effect. This Target Pathway determination is represented in the following graph.



40. Under the proposed approach, a NGA participant's performance relative to the Target Pathway for the purpose of determining entitlement to relief will be measured in each calendar year from the date the carbon tax takes effect until 31 December 2012. NGA participants will have no obligation to improve their emissions performance prior to the introduction of the carbon tax. A NGA participant's performance in each year will be its average performance from 1 January through to 31 December in that year. At agreed milestone dates, the NGA participant's performance will require independent verification.
41. Officials consulted with stakeholders on multiple proposals for setting the Target Pathway; some were more lenient and some were more stringent than the proposed Target Pathway. Submissions on this issue reflected the following themes:

<sup>5</sup> Normalised WBP in emissions intensity is a combination of WBP in energy intensity, the NGA participant's fuel mix and WBP in process emissions (if any). This concept is discussed in more detail in paragraphs 75 to 84.

- A NGA participant's ability to meet nWBP over time depends on participant-specific variables such as capital investment cycles and regulatory requirements. Any exposure to the carbon tax from an overly stringent Target Pathway could significantly affect a NGA participant's international competitiveness.
  - Some stakeholders supported moving away from the current method of Target Pathway negotiation and relying more heavily on the WBP study. However, others advocated that the Target Pathway should remain subject to negotiation as under the current policy.
  - Many stakeholders advocated that full relief should be based on a Target Pathway moving *toward* nWBP by 2012 according to the NGA participant's circumstances, instead of reaching nWBP before a specified date (e.g., 2007, 2009, or 2012). Others suggested that the Target Pathway should reach nWBP no earlier than 2012, or at a later date after 2012.
  - Some stakeholders supported a straight-line approach to simplify the Target Pathway, whereas others supported a stepped-line approach to reflect a NGA participant's circumstances.
  - Stakeholders broadly agreed that the start point of the Target Pathway should be the NGA participant's actual emissions, not a more stringent level, and should reflect a representative year or years.
  - Some stakeholders contended that a NGA participant should not bear liabilities for its emissions performance prior to the commencement of the carbon tax.
  - Some stakeholders supported defining the Target Pathway as a band around nWBP instead of a line to reflect the uncertainty in forecasting nWBP.
42. Following consideration of stakeholder submissions and officials' consultations across agencies, I consider that the proposed approach to determining the Target Pathway balances the interests of both the Crown and NGA participants and that it is consistent with the intent of the NGA policy.
43. The proposed approach will place much more emphasis on the WBP process. To improve transparency and accountability in the WBP process officials propose that on signing the NGA agreement, the end points of all Target Pathways used to determine the NGA participant's Target Pathway will be made public.
44. The public release of the Target Pathway end points was strongly opposed by stakeholders during consultation, as stakeholders considered this would result in substantial commercial risk. Whilst I acknowledge the concerns raised by stakeholders, I consider the transparency and accountability as paramount.

### Recommendations

Agree that the existing policy that “emission intensity targets will, where possible, be based on WBP (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement” be replaced by:

Emissions intensity targets (the Target Pathway) will be a straight line between the following points:

- a. A start point defined as a NGA participant’s actual average emissions intensity for the 2004 calendar year, or as agreed by the Crown and the NGA participant if:
  - i. the NGA participant’s performance in 2004 is atypical; or
  - ii. the business activity was not in operation for a full calendar year ending 31 December 2004.
- b. An end point defined as the normalised WBP emissions intensity (nWBP) at 31 December 2012.

Agree that the Target Pathway will take effect from the date the carbon tax takes effect.

Agree that on signing the NGA agreement, the end points of all Target Pathways used to determine the NGA participant’s Target Pathway will be made public.

### **Clarifying the treatment of fuel switching**

45. The potential for fuel switching improvements cannot be factored into the determination of WBP because of differences in fuel supply and cost across different countries. Under the current policy, fuel switching has previously been addressed during the negotiation of a NGA participant’s Target Pathway. Under the proposed approach to determine the Target Pathway on the basis of the WBP report, a separate process is needed to account for the effects of fuel switching on a NGA participant’s performance relative to its Target Pathway.
46. In considering how fuel switching should be addressed, officials were guided by the following:
  - NGA participants should have an incentive to move to less carbon-intensive fuels.
  - NGA participants should have a disincentive to move to more carbon-intensive fuels.
  - The policy should provide certainty of treatment and be simple to administer.
47. The potential for any fuel switch that will impact on the NGA only relates to the fuel mix associated with the NGA participant’s processes that are included in the scope of the NGA.
48. Officials propose that all electricity generation facilities (including co-generation) owned or operated by NGA participants, or located on a participant’s site, be excluded from the scope of the NGA. Officials note that the generation of electricity in New Zealand is unlikely to meet NGA eligibility

criteria and be eligible for inclusion in an NGA as it is not subject to international competition.

49. The reason for excluding electricity generation is to limit the likelihood of a perverse outcome (an increase in total emissions associated with electricity generation, despite a reduction by the NGA participant's emissions associated with electricity generation). Excluding electricity generation from the NGA exposes all generators to the price incentive of the carbon tax. A NGA participant's emissions intensity performance would be independent of the source of the electricity it uses, but any increase in the amount of electricity it uses will be accounted for in the NGA at the marginal electricity grid emission factor. Under this approach, the NGA participant's net emissions will be increased if co-generation associated with the firm is closed down.
50. Under the proposed policy, NGA participants with co-generation would receive the same rebate in respect of the electricity from their co-generation as they would for electricity from the grid. The NGA participant would also receive a rebate in respect of the increased cost of the heat from their co-generation.
51. This proposed policy was developed after the last stakeholder consultation and therefore has not been consulted with stakeholders. However, it appears to be the most appropriate policy for providing consistent incentives for fuel switching across all electricity generators (including co-generation). Therefore I propose that:
  - Subject to consultation, electricity generation, including co-generation, be excluded from the scope of NGAs.
  - The Minister of Finance and the Convenor of the Ministerial Group on Climate Change be authorised to confirm this policy following consultation with stakeholders.

***NGA participant's fuel mix becomes less carbon intensive***

52. During consultation with stakeholders two options for handling the scenario of a firm moving to less carbon intensive fuels were discussed. The preferred option was that a NGA participant will receive the benefit of improved emissions performance from the NGA participant's voluntary change to a less carbon intensive fuel or fuel mix (e.g. changing from coal to natural gas or biofuel). This approach was supported by stakeholders. The second option presented was that NGA participants would not be able to take advantage of a move to less carbon intensive fuels through their NGA target but would only be able to receive emission units for such activity through the Projects to Reduce Emissions programme.
53. In light of concerns about inconsistency with other climate change policies, and the risk of firms receiving emission units for what might be a business-as-usual shift to a less carbon intensive fuel, officials propose that if a NGA participant is contemplating a fuel switch, the Target Pathway will be recalculated to reflect that fuel switch so the NGA participant does not receive the benefit of that fuel switch, unless the fuel switch represents less than 10 percent of its total emissions or the fuel switch passes the Crown's additionality test. That additionality test will be consistent with other climate change policies.

Therefore when the emission reductions that result from the fuel switch represent less than 10% of the firm's total emissions, then the firm will be able to utilise the emission reductions in meeting its Target Pathway. These circumstances would be reflected in no recalculation of the Target Pathway.

*NGA participant's fuel mix becomes more carbon intensive*

54. Under the proposed Target Pathway approach, a NGA participant will be exposed to the carbon tax if, as a result of a change to a more carbon intensive fuel, its emissions intensity is above the Target Pathway.
55. Stakeholder submissions strongly advocated that NGA participants should not be penalised if they were compelled to switch to a more carbon-intensive fuel due to security of supply or other economic factors. Stakeholders contended that there is a reasonable probability of such an event occurring and they supported the use of an automatic upward adjustment to the Target Pathway if the fuel switch meets specific criteria relating to cause and materiality.
56. To the extent that the impact of the fuel switch is material and due to circumstances beyond the control of the NGA participant, officials acknowledge the concerns raised. Officials consider this issue can be appropriately addressed and propose that the Target Pathway be recalculated to reflect the higher intensity fuel mix if the NGA participant can demonstrate to the Crown's satisfaction that the switch to the more carbon intensive fuel meets the following criteria:
  - Is outside the NGA participant's control; and
  - Has a significant impact on the NGA participant's competitiveness-at-risk status.

## Recommendations

Note that stakeholders have not been consulted on the exclusion of electricity generation, including co-generation from the scope of NGAs.

Agree that, subject to consultation, electricity generation, including co-generation, be excluded from the scope of NGAs.

Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be authorised to confirm the decision on the above recommendation following consultation with stakeholders.

Agree that, for a switch to a less carbon intensive fuel, a NGA participant's Target Pathway be recalculated to reflect the fuel switch (so the NGA participant will not receive the benefit of the fuel switch), unless the NGA participant can demonstrate to the Crown's satisfaction that the fuel switch meets the following criteria:

- (i) Represents less than 10 percent of the NGA participant's total emissions; or
- (ii) Represents 10 percent or more of the NGA participant's total emissions and the fuel switch project has passed the Crown's additionality test.

Agree that, for a switch to a more carbon intensive fuel, a NGA participant's Target Pathway not be recalculated to reflect the fuel switch (so the NGA participant will be exposed to the carbon tax), unless the NGA participant can demonstrate to the Crown's satisfaction that the fuel switch meets the following criteria:

- (i) Is outside the NGA participant's control; and
- (ii) Has a significant impact on the NGA participant's competitiveness-at-risk status.

Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be responsible for defining the above criteria and the process for their application.

## **Clarifying the scope of relief from the carbon tax**

57. NGA policy provides that the coverage of an exemption (i.e., relief from the carbon tax) be consistent with the coverage of the at-risk assessment including direct and indirect (e.g., electricity) inputs if they are material and reasonable quantifiable.
58. To provide clarity and streamline the determination of eligibility, officials propose providing more definitive criteria for the scope of relief from the carbon tax under a NGA.
59. Stakeholder submissions strongly advocated that the scope of relief should include all direct and indirect costs of the carbon tax that are material and quantifiable, since these costs will impact on NGA participants' international competitiveness. Stakeholders strongly supported relief for indirect costs of the carbon tax that are passed on to a NGA participant by its contractors, provided such costs are material and quantifiable.

60. Officials propose that only the following financial impacts of the carbon tax be included within the scope of relief in a NGA if they are material, quantifiable, and verifiable:
- (i) Direct financial impacts – any carbon tax that is paid directly by the NGA participant (i.e., when the NGA participant is the point of obligation for payment of the carbon tax).
  - (ii) Indirect financial impacts – any carbon tax that is passed on to the NGA participant in the price paid for a product or service:
    - from the purchase of electricity by the NGA participant;
    - where the use of the product (e.g., fossil fuels, geothermal fluid and geothermal steam) by the NGA participant results in emissions; and
    - from the use of contractors by the NGA participant, if:
      - The service provided by the contractor relates to the NGA participant’s primary production processes (as defined in the NGA);
      - The emissions of the individual contractor for the service to the NGA participant are not less than 5% of the NGA participant’s annual emissions included in the NGA (a test of materiality); and
      - The emissions and the financial impacts of the carbon tax attributed to the individual contractor providing the service to the NGA participant are quantifiable and verifiable.
61. The above materiality threshold proposed by officials in respect of contractors has not been discussed with stakeholders. However, during consultation, stakeholders recognized that materiality was required.
62. Officials note that, with the exception of electricity, the proposed approach would exclude second-round price increases<sup>6</sup> from the scope of relief from the carbon tax in a NGA. This may have a significant impact on some NGA participants.

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<sup>6</sup> Second-round price increases relate to an increase in the price of a product or service that could be attributed to the carbon tax or other climate change policies, but that does not result from payment of the carbon tax itself (i.e., no one has paid the carbon tax on the product or service at any stage in the supply chain). An example is an increase in the price of wood waste due to increased demand for wood waste as a biofuel.

### Recommendation

Agree that only the following financial impacts of the carbon tax be included within the scope of relief in a NGA if they are material, quantifiable, and verifiable:

- (i) Direct financial impacts – any carbon tax that is paid directly by the NGA participant (i.e., when the NGA participant is the point of obligation for payment of the carbon tax).
- (ii) Indirect financial impacts – any carbon tax that is passed on to the NGA participant in the price paid for a product or service:
  - from the purchase of electricity by the NGA participant;
  - where the use of the product by the NGA participant results in emissions; and
  - from the use of contractors by the NGA participant, if:
    - The service provided by the contractor relates to the NGA participant’s primary production processes (as defined in the NGA);
    - The emissions of the individual contractor for the service to the NGA participant are not less than 5% of the NGA participant’s annual emissions included in the NGA; and
    - The emissions and the financial impacts of the carbon tax attributed to the individual contractor providing the service to the NGA participant are quantifiable and verifiable.

Note that with the exception of electricity, the above proposed approach would exclude second-round price increases from the scope of relief from the carbon tax in a NGA.

### **Removing the principle of “hold harmless”**

- 63. NGA policy provides that exemption commitments given prior to the detailed design of the carbon tax be based on the principle of a commitment to hold the NGA participant “harmless” from the material and reasonably quantifiable impacts of the carbon tax (or part thereof).
- 64. In consultation, stakeholders frequently cited the “hold harmless” principle as a fundamental element of the NGA policy. Some stakeholders supported retaining the “hold harmless” principle in the Crown’s relief commitments, either indefinitely or until the design of the carbon tax is complete.
- 65. However, officials consider that this principle is no longer appropriate. As a consequence of the proposed policy improvements discussed in this paper, NGA participants may no longer be “held harmless” from all material and reasonably quantifiable impacts of the carbon tax.
- 66. Officials therefore propose that the principle of holding the NGA participant “harmless” from the material and reasonably quantifiable effects of the carbon tax no longer applies.

### Recommendation

Agree that NGA policy no longer includes a commitment by the Crown to hold the NGA participant “harmless” from the material and reasonably quantifiable impacts of the carbon tax (or part thereof).

### **World’s best practice identification and assessment**

67. NGA policy sets out the process for negotiating agreements including a requirement that parties jointly appoint an advisor on WBP. In addition, the policy provides for the Crown to make a contribution to any joint third-party costs incurred as part of the negotiation of a NGA (to recognise the joint benefits of this work and to establish a duty of care to the Crown).
68. Both stakeholders and officials recognise that the proposed change to the determination of the Target Pathway may result in the NGA participant being more cautious in selecting the WBP advisor and agreeing to the WBP scope and the methodologies for determining WBP. This may create bottlenecks during the WBP process and delay the completion of NGAs.
69. Officials propose a more streamlined approach to the WBP study that requires the NGA participant to appoint and pay for the WBP advisor to undertake a WBP study, and the Crown to appoint and pay for its own advisor to validate that the WBP methodology and determination of WBP are fair and reasonable.
70. The appointment of Crown advisors will enable a greater number of WBP studies to be managed by appropriately qualified and industry-experienced consultants, ensure transparency, and reduce the risk of bottlenecks occurring during the WBP process.
71. This approach will also eliminate most joint third-party costs and offset the Crown’s contribution requirement against the additional Crown costs for the appointment of its advisors. The NGA participant and the Crown will enter into an agreement that will govern the relationship and requirements of the parties and the use of the WBP report.
72. As the NGA participant will be solely responsible for the WBP study and the Crown will be responsible for review of the study by its own advisor, officials consider that a Crown contribution towards the costs of the WBP study is no longer appropriate.
73. In addition, the proposed approach to objectively determine the NGA participant’s Target Pathway will reduce the Crown’s need to develop such an in-depth understanding of a NGA participant’s business and operations. This will simplify the WBP study and will reduce its time and cost.
74. Stakeholder submissions varied on this issue. Some advocated retaining the joint appointment of a WBP consultant whilst others supported the approach proposed above. Stakeholders supported the joint determination by the Crown and the NGA participant of terms of reference for the WBP advisor and the Crown’s advisor. Some stakeholders noted the high cost of a WBP study, and

advocated that the Crown should contribute to the cost of the WBP consultant on a more equitable basis.

### *Normalising world's best practice*

75. NGA policy provides that unless specifically modified, emission intensity targets will, where possible, be based on WBP (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement.
76. To ensure consistency across NGA agreements, officials consider that an appropriate level of stringency for normalised world's best practice (nWBP) be set. Officials propose that:
  - NWBP be the top 10 percentile point of the data set of the world-wide range of like-for-like practice.
  - If there is an inadequate data set to identify the top decile, nWBP be an equivalent level of stringency based on the WBP advisor's best judgment and the available data set.
77. Stakeholder submissions supported this proposal.
78. Officials propose that during normalisation, WBP should be modified for appropriate technical factors but not for factors reflecting technical and economic feasibility in the New Zealand context. Experience to date has highlighted the difficulty in objectively assessing and quantifying these types of factors. Removing this requirement will further streamline the determination of WBP and the setting of the NGA participant's Target Pathway.
79. Officials consider a WBP study that selects a data set of like-for-like process technologies and normalises the data set (nWBP) for appropriate technical factors (e.g. feedstock, scale, product mix, etc.) will represent a fair comparison and will result in a more objective and streamlined outcome.
80. The WBP advisor will be able to exercise best judgment regarding the WBP methodology and the technical factors to be taken into consideration in determining nWBP. Stakeholders supported this approach.
81. Stakeholder submissions expressed strong concerns about excluding from nWBP consideration of economic feasibility in the New Zealand context. Stakeholders noted that some normalisation factors contain both technical and economic components, and that New Zealand market conditions will influence their ability to achieve nWBP while remaining internationally competitive.
82. Officials consider that the proposed approach of comparing like-for-like technologies together with the WBP advisor's ability to normalise for technical factors should eliminate the need for consideration of New Zealand-specific factors.

### *Calculating emissions intensity targets*

83. Normalised WBP in emissions intensity in 2012 is a combination of WBP in energy intensity, the NGA participant's fuel mix and WBP in process emissions (if any).

84. A NGA participant's fuel mix will vary over time. Assessment of a NGA participant's future fuel mix creates a level of complexity and uncertainty. To keep the process simple, officials propose applying the NGA participant's actual average fuel mix at the start point as defined in paragraph 38 as the assumed fuel mix when calculating nWBP emissions intensity at 31 December 2012.

#### Recommendations

Agree that normalised world's best practice (nWBP) be the top 10 percentile point of the data set of the world-wide range of like-for-like practice, or if there is an inadequate data set to identify the top decile, nWBP be an equivalent level of stringency based on the WBP advisor's best judgment and the available data set.

Agree that WBP will only be modified for appropriate technical factors when determining nWBP.

Agree that the NGA negotiation process be amended by replacing the requirement that "the parties appoint a joint advisor on world's best practice" with:

- (i) The NGA participant and the Crown agree on terms of reference for the appointment of an independent advisor to the NGA participant on world's best practice;
- (ii) The NGA participant and the Crown enter into an agreement;
- (iii) The NGA participant appoints its advisor on world's best practice; and
- (iv) The Crown appoints its advisor to validate the WBP methodology and study.

Agree that the Crown make no contribution to the costs of the WBP study, and that the Crown pay for the cost of the Crown's advisor.

Agree that, to keep the negotiation process simple, the NGA participant's fuel mix for the 2004 calendar year (or other year as defined in accordance with recommendations on the start point of the Target Pathway) will be the assumed fuel mix when calculating nWBP emissions intensity at 31 December 2012.

#### **Amending the standard NGA agreement**

85. The Minister of Finance and the Convenor of the Ministerial Group on Climate Change have previously approved a standard NGA agreement, which informs NGA participants of the likely structure, content and outcomes of a NGA and assists in the legal drafting process.
86. Subsequent to the approval of the changes to the NGA policy and processes noted in this paper, officials will submit a revised NGA agreement for approval by the Minister of Finance and the Convenor of the Ministerial Group on Climate Change.
87. The revised NGA agreement will contain standard terms and conditions that are consistent across all NGAs. There are three key reasons for this approach:
- Maintaining the same fundamental terms and conditions ensures equity across all NGA participants.

- Ostensibly small changes in the terms of the agreement can have quite large impacts on the nature of the incentive and the allocation of risk between the Crown and NGA participants;
  - A variety of contractual terms would substantially increase the Crown's transaction costs and make management of the portfolio more difficult.
88. Officials intend to undertake further consultation with stakeholders on the contents of the standard NGA agreement, prior to its submission to Ministers. This was supported by stakeholders.
89. Stakeholder submissions generally supported the concept of a revised standard NGA, but many wished to retain some flexibility to adapt the standard agreement according to individual circumstances.

### Recommendations

Agree that, subsequent to the approval of the changes to NGA policy and processes proposed in this paper, the NGA agreement will contain standard terms and conditions that are consistent across all NGAs.

Note that following further consultation with stakeholders, officials will submit a revised NGA agreement for approval by the Minister of Finance and the Convenor of the Ministerial Group on Climate Change.

### **Updating the documentation on NGAs**

90. Officials note that the time and cost of the NGA eligibility process can be reduced by using a software model to collect information from applicants and to carry out components of the eligibility assessment.
91. Subsequent to the approval of the recommendations set out in this paper, the NGA guideline documentation will be revised to reflect the policy and process changes proposed in this paper. Officials consider that the guideline documentation should also include additional information such as:
- Information on the WBP study, including generic terms of reference for the WBP advisor and the Crown's validation advisor.
  - The NGA information collection model.
92. Stakeholders expressed a strong desire to be consulted during the development of further NGA guideline documentation including the terms of reference for the WBP advisor and the Crown's validation advisor.

## Recommendation

Note that following further consultation with stakeholders, officials will revise the NGA guideline documentation.

### **Transitioning firms to the revised NGA policy**

93. The recommendations set out in this paper will not affect the two NGAs that the Crown has already entered into but will have an impact for the 12 firms that have applied for an NGA to date and are either in the process of having their eligibility assessed or are in negotiations with the Crown. In addition, all future NGA applicants will be affected by these recommendations.
94. There are four firms (being Fletcher Building Ltd, Carter Holt Harvey Ltd, New Zealand Aluminium Smelters Ltd and Norske Skog Tasman Ltd) that have already invested significant resources in WBP studies under the current policy and accordingly officials consider that not all of the recommendations in this paper should apply to them.
95. Stakeholder submissions provided a range of views on the process for transitioning firms to the revised NGA policy. The NGA participants that were already engaged in WBP studies and negotiations strongly supported retaining a choice of whether to proceed with negotiations under the current or revised policy. Some stakeholders questioned the equity and competitiveness implications of having different participants, particularly those in a common industry, proceeding with negotiations under two different policies. Others suggested that all firms that had submitted NGA applications to date should have the choice of which policy to proceed under.
96. Officials consider that excluding all current NGA applicants from the recommendations in this paper is likely to hinder the timely completion of these NGAs and pose a substantial barrier to completing the majority of NGAs prior to the carbon tax taking effect.
97. I propose that the Cabinet-approved recommendations set out in this paper apply to all firms yet to conclude a NGA with the exception of the four firms that have commenced a WBP study; those four firms may elect that the current policy will apply to their NGA with respect to WBP identification and assessment and determination of emissions intensity targets. For any of those four firms that have commenced a WBP study, the Minister of Finance and the Convenor of the Ministerial Group on Climate Change will be authorised to make modifications as required to a NGA to accommodate any retention of the current policy for WBP identification and assessment and determination of emissions intensity targets.
98. I propose that, due the complexities of NGA policy, in the event that there is any discrepancy between NGA policy approved in POL Min (03) 8/8 and the proposals set out in this paper, the proposals set out in this paper shall prevail.

### Recommendations

Agree that the proposals set out above will apply to all NGA applicants with the exception of:

- the two NGAs that the Crown has already entered into;
- the four firms that have commenced a WBP study (those four firms may elect that the current policy will apply to their NGA with respect to WBP identification and assessment and determination of emissions intensity target);

Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be authorised to make modifications as required to a NGA for any of those four firms referred to above, that have commenced a WBP study to accommodate any retention of the current policy for WBP identification and assessment and determination of emissions intensity targets;

Agree that in the event there is any discrepancy between NGA policy approved in POL Min (03) 8/8 and the proposals set out in this paper, the proposals set out in this paper shall prevail.

### **Implications of NGA policy for a transition to a domestic emissions trading regime**

99. The standard NGA agreement does not address any transition to a domestic emissions trading regime. Officials note that under an emissions trading regime, points of obligation would likely remain the same as they are proposed under the carbon tax. If the Crown wished to continue with a NGA policy under emissions trading, it is likely that a simple amendment to NGAs (namely, extending the coverage of relief to impacts of emission trading as well as or in place of impacts of the carbon tax) would make most NGAs and their relief provisions compatible with a transition to emissions trading. Where the NGA participant is a point of obligation, officials would need to investigate how the transition would occur.

### **Implications for small to medium sized enterprises (SME) policy**

100. Officials note that some SME firms have explored NGAs and rejected this option because they consider the transaction costs are too high. The proposed changes to NGA policy and processes are expected to reduce the transaction costs associated with eligibility assessment and negotiating a NGA. A reduction in transaction costs is likely to attract some energy-intensive SMEs to make an application for a NGA.
101. Officials consider that additional NGA applications are not expected to materially impact the Crown's ability to complete the majority of NGA agreements before the carbon tax takes effect.

## **Financial implications**

### **Carbon tax revenue issues**

102. Estimation of the relief provided to NGA participants is complex with a major uncertainty relating to the extent of the pass-through of the carbon tax for electricity.  
**[Information withheld under s 9(2)(f)(iv) of the Official Information Act 1982]**
103. While streamlining the NGA process is likely to result in more NGA applications, the recommendations set out in this paper are unlikely to fundamentally affect the estimated value of relief provided to NGAs as:
- The recommendations are do not materially alter the likely outcomes under the NGA policy.
  - The competitiveness-at-risk assessment criteria are not being altered (which could substantially broaden eligibility).
  - The majority of the estimated value of relief is attributable to a small number of large industrial energy users. These parties are already in the NGA process.
104. Furthermore, the possibility of a greater number of small to medium sized enterprises seeking NGAs is unlikely to substantially alter the estimated relief provided to NGAs.

### **Other costs**

105. Officials estimate that adopting the changes recommended in this paper will result in the costs to the Crown of negotiating NGA agreements (including the costs of consultants, legal fees and negotiation costs) to reduce from between \$100,000 and \$200,000 to between \$50,000 and \$100,000 per NGA.
106. The costs to the Crown of monitoring and enforcement of NGAs cannot be reliably estimated at this time. These costs are expected to be able to be managed from within departmental baselines.

## **Consultation**

107. The following departments and Government agencies have been consulted in the development of this paper: Inland Revenue Department, New Zealand Customs Service, the Ministry of Agriculture and Forestry, the Ministry of Economic Development, the Treasury, the Ministry of Transport, the Ministry of Foreign Affairs and Trade, and the Energy Efficiency and Conservation Authority. Their feedback has been incorporated in this paper.

## **Legislative implications**

108. As advised in previous Cabinet papers on NGAs [POL (02) 210 and POL (03) 79], implementation of a carbon tax and exemptions will require

legislation. This was discussed in the paper “Climate Change: Work Programme for Carbon tax and Revenue Recycling”.

109. Since NGAs involve exemptions from revenue provisions in the carbon tax legislation, they may need to be provided for legislatively, whether case-by-case or (more likely) by empowering the Governor-General to make NGA regulations. Enforcement of NGAs may also require legislation.
110. I note that further details regarding exemption legislation will be addressed in the paper “Carbon tax: key design features and release of consultation paper on implementing the tax”, which is expected to be submitted to POL in April 2005.

### **Treaty of Waitangi Implications**

111. There are no Treaty of Waitangi implications arising from this paper.

### **Publicity**

112. It is proposed that the agreed changes to the NGA policy be announced as soon as possible and that, with appropriate withholdings, this paper and the associated Cabinet minute be made available to the public, subject to the provisions of the Official Information Act.

### **Recommendations**

It is recommended that the Committee:

#### **Background**

1. Note that in April 2003 Cabinet directed officials to report on:
  - 1.1 How frequently firms or industries should be allowed to reapply for eligibility, or renegotiation of a NGA;
  - 1.2 Consideration of experience with NGAs to date;
  - 1.3 Applicability of the proposed NGA eligibility criteria and processes;
  - 1.4 Recommended improvements to the NGA policy;[POL Min (03)8/8]
2. Note that the time required to complete a NGA is significantly greater than foreseen and there is a significant risk that NGA negotiations will not be complete by the time the carbon tax is introduced;

#### **Frequency of reapplication for NGA eligibility and eligibility for a greater exemption**

3. Note that:
  - 3.1 In April 2003 POL agreed that firms rejected for an NGA or only offered a partial exemption be eligible to reapply if they can demonstrate that due to changing circumstances they should now be eligible, or eligible for a greater exemption; the current policy [POL Min (03) 8/8]

- 3.2 Officials have interpreted the “renegotiation of a NGA” to refer to the NGA participant’s eligibility to seek a greater exemption from the carbon tax;
4. Agree to retain the current policy with respect to reapplication for NGA eligibility and eligibility for a greater exemption;

#### **Applicability of the NGA eligibility criteria and process**

5. Note that, whilst to date there is limited information to assess the applicability of the eligibility criteria, there is no evidence to suggest that the NGA eligibility criteria are inappropriate;
6. 6.1 Note that to be eligible for a NGA, a NGA participant’s international competitiveness must be considered at risk as a result of the carbon tax;
- 6.2 Note that in April 2003, POL agreed that one of the criteria for assessing that risk was:

“Will the charge move the firm significantly below the appropriate industry weighted average cost of capital?”

[paragraph 8 of POL Min (03) 8/8]
7. 7.1 Note that information on industry weighted cost of capital is not readily available and difficult to obtain;
- 7.2 Rescind the decision referred to in paragraph 6.2;
- 7.3 Replace the wording referred to in paragraph 6.2 with:

“Will the charge move the firm significantly below the firm’s weighted average cost of capital?”;

#### **Proposed policy improvements**

##### *Establishing a standard end date for all NGAs*

8. Note that NGA policy does not explicitly specify the end dates of NGAs;
9. Agree that the end date for NGAs be no later than 31 December 2012 until such time as the Government decides otherwise, which may occur in conjunction with the development of the Government’s future climate change policies;

##### *Determining the NGA participant’s emissions intensity targets*

10. Note that in April 2003 POL agreed that, “unless specifically modified in individual NGAs, emissions intensity targets will, where possible, be based on world’s best practice (WBP) (as modified to what is technically and economically feasible in the New Zealand context) as forecast over the duration of the agreement” [paragraph 19 of POL Min (03) 8/8];
11. 11.1 Note that the Crown needs to be satisfied that the emission intensity targets are sufficiently stringent, and this has required officials to develop an in-depth understanding of a NGA participant’s business and operation, which has contributed to the complex and lengthy negotiations;
- 11.2 Rescind the decision referred to in paragraph 10;

11.3 Replace the existing policy referred to in paragraph 10 with the following:

“Emissions intensity targets (the Target Pathway) will be a straight line between the following points:

- A start point defined as a NGA participant’s actual average emissions intensity for the 2004 calendar year, or as agreed by the Crown and the NGA participant if:
  - the NGA participant’s performance in 2004 is atypical; or
  - the business activity was not in operation for a full calendar year ending 31 December 2004.
- An end point defined as the normalised WBP emissions intensity (nWBP) at 31 December 2012.

Agree that the Target Pathway will take effect from the date the carbon tax takes effect”;

12. Agree that on signing the NGA agreement, the end points of all Target Pathways used to determine the NGA participant’s Target Pathway will be made public.

*Clarifying the treatment of fuel switching*

13. Note that stakeholders have not been consulted on the exclusion of electricity generation, including co-generation from the scope of NGAs;

13.1 Agree that, subject to consultation, electricity generation, including co-generation, be excluded from the scope of NGAs;

13.2 Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be authorised to confirm the decision in paragraph 13.1 following consultation with stakeholders.

14. Agree that, **for a switch to a less carbon intensive fuel**, a NGA participant’s Target Pathway be recalculated to reflect the fuel switch (so the NGA participant will not receive the benefit of the fuel switch), unless the NGA participant can demonstrate to the Crown’s satisfaction that the fuel switch meets the following criteria:

14.1 It represents less than 10 percent of the NGA participant’s total emissions;  
or

14.2 It represents 10 percent or more of the NGA participant’s total emissions and the fuel switch project has passed the Crown’s additionality test.

15. Agree that, **for a switch to a more carbon intensive fuel**, a NGA participant’s Target Pathway not be recalculated to reflect the fuel switch (so the NGA participant will be exposed to the carbon tax), unless the NGA participant can demonstrate to the Crown’s satisfaction that the fuel switch meets the following criteria:

15.1 It is outside the NGA participant’s control; and

15.2 It has a significant impact on the NGA participant’s competitiveness-at-risk status;

16. Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be responsible for defining the criteria noted in paragraph 14 and 15, and the process for their application;

*Clarifying the scope of relief from the carbon tax*

17. Agree that only the following financial impacts of the carbon tax be included within the scope of relief in a NGA if they are material, quantifiable, and verifiable:
  - 17.1 Direct financial impacts – any carbon tax that is paid directly by the NGA participant (i.e., when the NGA participant is the point of obligation for payment of the carbon tax).
  - 17.2 Indirect financial impacts – any carbon tax that is passed on to the NGA participant in the price paid for a product or service:
    - 17.2.1 From the purchase of electricity by the NGA participant;
    - 17.2.2 Where the use of the product by the NGA participant results in emissions; and
    - 17.2.3 From the use of contractors by the NGA participant, if:
      - 17.2.3.1 The service provided by the contractor relates to the NGA participant’s primary production processes (as defined in the NGA);
      - 17.2.3.2 The emissions of the individual contractor for the service to the NGA participant are not less than 5% of the NGA participant’s annual emissions included in the NGA; and
      - 17.2.3.3 The emissions and the financial impacts of the carbon tax attributed to the individual contractor providing the service to the NGA participant are quantifiable and verifiable;
18. Note that with the exception of electricity, the above proposed approach would exclude second-round price increases from the scope of relief from the carbon tax in a NGA;

*Removing the principle of “holding harmless”*

19. Agree that NGA policy no longer includes a commitment by the Crown to hold the NGA participant “harmless” from the material and reasonably quantifiable impacts of the carbon tax (or part thereof);

*World’s best practice identification and assessment*

20. Note that to ensure consistency across NGA agreements, it is proposed to set an appropriate level of stringency for normalised world’s best practice (nWBP);
21. Agree that normalised world’s best practice (nWBP) be the top 10 percentile point of the data set of the world-wide range of like-for-like practice, or if there is an inadequate data set to identify the top decile, nWBP be an equivalent level

of stringency based on the WBP advisor's best judgment and the available data set;

22. Agree that WBP will only be modified for appropriate technical factors when determining nWBP, subject to rescinding the decision referred to in paragraph 10 above (see paragraph 11.2);
23. Note that in April 2003 POL agreed that "parties appoint joint advisor on world's best practice" [paragraph 22.3 of POL Min (03) 8/8];
24. 24.1 Note that stakeholders and officials recognise that the proposed change to the determination of the Target Pathway may result in the NGA participant being more cautious in selecting the WBP advisor and agreeing to the WBP scope and methodologies for determining WBP;
- 24.2 Rescind the decision referred to in paragraph 23;
- 24.3 Replace the decision referred to in paragraph 23 with:
  - 24.3.1 The NGA participant and the Crown agree on terms of reference for the appointment of an independent advisor to the NGA participant on world's best practice;
  - 24.3.2 The NGA participant and the Crown enter into an Agreement;
  - 24.3.3 The NGA participant appoints its advisor on world's best practice; and
  - 24.3.4 The Crown appoints its advisor to validate the WBP methodology and study;
25. Agree that the Crown make no contribution to the costs of the WBP study, and that the Crown pay for the cost of the Crown's advisor;
26. Note that;
  - 26.1 The normalised WBP in emissions intensity in 2012 is a combination of WBP in energy intensity, the NGA participant's fuel mix, and WBP in process emissions (if any);
  - 26.2 A NGA participant's fuel mix will vary over time and the assessment of a NGA participant's future fuel mix creates a level of complexity and uncertainty;
27. Agree that, to keep the negotiation process simple, the NGA participant's fuel mix for the 2004 calendar year (or other year as defined in accordance with recommendations on the start point of the Target Pathway) will be the assumed fuel mix when calculating nWBP emissions intensity at 31 December 2012;

#### **Amending the standard NGA agreement**

28. Agree that subsequent to the approval of the changes to NGA policy and processes proposed above, the NGA agreement will contain standard terms and conditions that are consistent across all NGAs;
29. Note that following further consultation with stakeholders, officials will submit a revised NGA agreement for approval by the Minister of Finance and the Convenor of the Ministerial Group on Climate Change;

### **Updating the documentation on NGAs**

30. Note that following further consultation with stakeholders, officials will revise the NGA guideline documentation;

### **Transitioning NGA participants to the revised NGA policy**

31. Agree that the proposals set out above will apply to all NGA applicants with the exception of:
  - 31.1 The two NGAs that the Crown has already entered into;
  - 31.2 The four firms that have commenced a WBP study (those four firms may elect that the current policy will apply to their NGA with respect to WBP identification and assessment and determination of emissions intensity target);
32. Agree that the Minister of Finance and the Convenor of the Ministerial Group on Climate Change be authorised to make modifications as required to a NGA for any of those four firms referred to in paragraph 31.2 that have commenced a WBP study to accommodate any retention of the current policy for WBP identification and assessment and determination of emissions intensity targets;
33. Agree that in the event there is any discrepancy between NGA policy approved in POL Min (03) 8/8 and the proposals set out above, the proposals set out above shall prevail;

### **Implications for SMEs**

34. Note that some small to medium enterprises (SMEs) have explored NGAs and rejected this option because they consider the transaction costs are too high;
35. Note that the reduction in transaction costs associated with the proposed changes to NGA policy and processes may attract some energy-intensive SMEs to make an application for a NGA;

### **Financial implications**

36. Note that the proposals set out above are unlikely to substantially alter the estimated relief provided to NGAs;

### **Legislative implications**

37. Note that further details regarding exemption legislation will be addressed in the paper "Carbon tax: key design features and release of consultation paper on implementing the tax" to be submitted to the POL in April 2005;

**Publicity**

38. Agree that changes to the NGA policy be announced as soon as possible and that, with appropriate withholdings, this paper and the associated Cabinet minute be made available to the public, subject to the provisions of the Official Information Act.

Hon Pete Hodgson  
**Convenor, Ministerial Group on Climate Change**