

## ETS consultations: Industrial allocations and market governance

**The Government has recently released two public consultations relating to the Emission Trading Scheme (ETS): one that relates to the future industrial allocation and one that relates to improving the governance framework.**

### Industrial Allocation

The Government is reviewing its policy around industrial allocation (also known as free allocations) in the ETS. It has released the "Reforming industrial allocation in the New Zealand Emissions Trading Scheme" consultation document and is seeking feedback from the public on different options that will inform proposed regulatory changes to industrial allocation.

Last year, the Government introduced a gradual phase-down of industrial allocations to encourage emissions-intensive and trade exposed (EITE) firms to reduce their carbon emissions, so this consultation signals that the Government still has concerns with the industrial allocation framework. See our previous publication [here](#) for details of the phase-down.

Industrial allocation is the provision of free emission units (New Zealand units or NZUs) to industries considered to be EITE. Industrial allocation was designed to mitigate the risk of emission leakage by reducing the costs of complying with the ETS for industries and reducing the risk of emission price competitiveness.

The Government has identified that the current levels of industrial allocation in the ETS are likely to be unsustainable in New Zealand's future emission budgets and in the context of its other climate objectives.

The purpose of the consultation document and review is to:

- assess New Zealand's industrial allocation policy;
- ensure it manages any ongoing risk of emission leakage; and
- ensure consistency with New Zealand's climate change commitments.

In the Government's view, industrial allocation should continue to address emission leakage, but it needs to be consistent with New Zealand's broader climate change objectives and commitments. The main concern the Government has highlighted is over-allocation, and wants to address this because:

- it is inconsistent with the policy intent of industrial allocation;
- it mutes the incentive to reduce emissions;
- it is an additional cost to the Government; and
- it leads to windfall gains for EITE firms.

It plans to address the over-allocation by revisiting the calculation and eligibility settings prescribed in the Climate Change Response Act 2002. The options for improvement have been grouped into three categories:

- options to reform how industrial allocation is calculated;
- options to reform eligibility for industrial allocation; and
- other options to reform industrial allocation.

### Options to reform how industrial allocation is calculated

The baseline to calculate industrial allocation is based on historical data from the financial years 2006/07, 2007/08 and 2008/09. Although this gives certainty to industries about their future allocations,

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## ETS consultations: Industrial allocations and market governance (Continued)

and can promote investment in lowering emission intensity, it has also caused over-allocation. The Government believes that updating the baselines with more recent data would better reflect the emissions intensities of industrial activities in the calculations, and is seeking feedback on the following baseline options:

- status quo – no change to allocative baselines;
- one off update of baselines (with no planned reassessments in the future);
- update baselines every year;
- update baselines every five years; and
- update baselines every ten years.

The Government is also seeking public feedback on which financial years should be used as the new baselines, given that the years 2019/2020 and 2020/2021 were impacted by COVID-19.

### Options to reform eligibility for industrial allocation

Similar to allocative baselines, eligibility based on emissions intensity (the emissions intensity test) is assessed using historical base years, which is leading to over-allocations. The Government is also seeking feedback on whether to update the historical base years (in the same manner as above) for the purposes of the emissions intensity test.

The Government is also looking into other options for reassessing eligibility, including;

- developing New Zealand specific thresholds based on domestic industries, rather than using the existing thresholds which were taken from the Australian Carbon Pollution Reduction Scheme;
- changing the emissions intensity test to use a New Zealand electricity allocation factor instead of using the current Australian electricity allocation factor; and

- introducing a more calibrated trade exposure test.

### Other options to reform industrial allocation

The Government is also looking into other reforms to improve the industrial allocation framework in the ETS, including:

- clarity on how new industrial activities seek eligibility for industrial allocations; and
- new mandatory and voluntary data reporting obligations.

The deadline for submissions is Friday 17 September. Click [here](#) for a copy of the consultation document and information about how to make a submission.

### Developing a governance framework in the ETS

The Government is also considering changes to the market governance framework for the ETS and has released the "Designing a governance framework for the New Zealand Emissions Trading Scheme" consultation document. The Government is seeking feedback from the public on seven key risks identified in the existing ETS framework.

The Government has highlighted that the ETS is "patchy" and there is no regulator overseeing the market. Without addressing these issues, there is a risk of undermining New Zealand's climate change goals.

The Government has broken down the key seven risks identified in the ETS into three broader themes, and is consulting on a range of options to improve the ETS framework.

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## ETS consultations: Industrial allocations and market governance (Continued)

### Theme A: Governance advice

#### Risks:

- 1) Inadequate, false or misleading advice to ETS users. For example, land buyers are unaware they are buying NZ ETS registered land with reporting, compliance and NZU surrender obligations with financial implications.
- 2) Conflicts of interest involving the New Zealand Emissions Trading Register. Examples include advisers putting their own interests ahead of their clients' and not disclosing emission unit holdings.

#### Options:

- Education campaign to improve knowledge and understanding of the ETS.
- Sector guidelines for NZU advisers to set the benchmark of the expected level of service from advisers, and to promote quality advice.
- Code of conduct, licensing and registration of advisors to help raise the standard of advice, and better protect users.

### Theme B: Governance of trading

#### Risks:

- 3) Potential lack of oversight and monitoring of trade in the secondary market.
- 4) Credit and counter-party risks. Examples of this include where users default on payments for NZUs or default on the obligation to transfer the NZUs as part of trades.

#### Options:

- Voluntary reporting of trades for greater transparency
- Mandatory reporting requiring ETS to disclose the number of NZUs they are holding or borrowing.

- Exchange-based trading requiring users to register and meet conduct obligations.

### Theme C: Governance of market conduct

#### Risks:

- 5) Insider trading and information asymmetry. For example, where an ETS user had confidential information that a large emitter planned to shut down or substantively reduce their emissions, and then used that information to trade NZUs to make a profit following its release.
- 6) Manipulation of NZU price.
- 7) Money laundering and financing of terrorism.

#### Options:

- Position and purchase limits restricting the number of NZUs a user can hold at any one time and restricting the maximum number of NZUs a user can buy at primary NZU auctions.
- Price reporting to a regulator for all NZU traders.
- Full transaction detail reporting to a regulator.

The Government is also considering appointing a market regulator to oversee the operation of the ETS and its users.

The deadline for submissions is Friday 17 September. Click [here](#) for a copy of the consultation document and information about how to make a submission.

### Want to know more?

If you would like further information or want to discuss the Government's proposals, please contact Anderson Lloyd's specialist [Carbon Trading and ETS Team](#).