

# Regulatory Impact Statement

## New Zealand Emissions Trading Scheme: Draft Fishing Allocation Plan

### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry for the Environment. It provides an analysis of options to address what rules should be included in the Draft Fishing Allocation Plan developed under the Climate Change Response Act 2002 (the Act) as part of the New Zealand Emissions Trading Scheme (NZ ETS).

Allocation to fishing quota owners is largely established by the provisions of the Act. The Draft Fishing Allocation Plan can specify matters such as tests and thresholds for eligibility and the type of information eligible persons must provide.

The purpose of the allocation is to provide partial compensation for a decrease in quota value arising from the impact of the liquid fossil fuels sector's entry into the NZ ETS and the effect rising fuel prices will have on quota value.

This Regulatory Impact Statement discusses the allocation of NZUs and possible tradeoffs between an equitable allocation of these property rights and administrative costs. Officials have evaluated options for an eligibility threshold against the criteria of equity and cost-effectiveness.

Setting a threshold, even a low threshold like 5,000kg, has the ability to reduce the number of eligible people significantly (from 1500 to 900) while still allocating 99.5 per cent of the quantum of NZUs. This would ease the administrative burden and associated costs to the government (from \$340,000 at a rate of \$240 per application). However, this approach (under options 2, 3 or 4) is likely to be perceived as inequitably favouring large quota owners over the smaller quota owners who would be made ineligible (including iwi with settlement quota), and who would reasonably expect to be entitled as a quota owner under the Act. Given that the Crown will be consulting with all quota owners on the draft fishing allocation plan, those made ineligible will be likely to raise their concerns. For these reasons, setting a threshold is not recommended.

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\_\_\_\_\_ Date: \_\_\_\_\_

## Status quo and problem definition

The fishing sector contributes approximately \$1.1 billion in annual exports. The New Zealand Seafood Industry Council estimates that the fishing sector (including aquaculture), employs directly and indirectly 20,000 Full Time Equivalents. Quota owners hold the property rights associated with commercial fishing – they either fish directly, or sell or contract Annual Catch Entitlements (ACEs), primarily to fishing vessel operators.

The purpose of an allocation of New Zealand units (NZUs<sup>1</sup>) to fishing quota owners is to provide partial compensation for a reduction in quota value as a result of the liquid fossil fuels sector entering the NZ ETS on 1 July 2010 (given that the fishing sector is an intensive user of fuel).

The status quo is that there is no fishing allocation plan. However, there is an expectation under the Climate Change Response Act 2002 (the Act) that one will be prepared. Not preparing a fishing allocation plan would be against the intent of the Act and contrary to the effective operation of the NZ ETS.

Allocation to the fishing sector is largely established by the Act. Section 74 specifies:

- a total of 700,000 NZUs for allocation under the fishing allocation plan<sup>2</sup>
- the category of persons who may be eligible to receive an allocation (persons who were shown on the quota register kept under Part 8 of the Fisheries Act 1996 as owners of quota on 24 September 2009)
- a formula<sup>3</sup> for calculating how many NZUs each eligible person may receive.

Section 74 also provides for the fishing allocation plan to specify any tests or thresholds that people must meet to be eligible for an allocation of NZUs, the data and information that eligible people must supply with their application; the records that the person must retain and the length of time they must retain records; and any other necessary administrative matters.

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<sup>1</sup> The New Zealand unit (NZU) is the primary unit of trade in the NZ ETS. NZUs are issued and allocated by the government. One NZU corresponds to one emission unit, although from July 2010 to December 2010 participants can surrender 1 unit for every 2 tonnes of emissions.

<sup>2</sup> The quantum of 700,000 NZUs represents 90 per cent of the sector's 2005 emissions multiplied by 2.5 years and reflects the 'progressive obligation' (surrender of 1 unit for every 2 tonnes of emissions) that applies in the transition period (the 2.5 years from July 2010 to December 2012).

<sup>3</sup> The formula in section 74 of the Act is:  $P = A \times (B + C) / (D + E)$ :

P is the quota owner's allocation entitlement under the fishing allocation plan

A is 700,000 units

B is the total quota weight equivalent (expressed in kilograms) of stocks, other than Foveaux Strait dredge oysters, owned by the eligible person on the close of 24 September 2009

C is the total quota weight equivalent (expressed as a number of oysters) of Foveaux Strait dredge oyster stock owned by the eligible person on the close of 24 September 2009 divided by 9.8

D is the sum of the total allowable commercial catch (expressed in kilograms) of stocks, other than Foveaux Strait dredge oysters (excluding any quota shown in the quota register kept under Part 8 of the Fisheries Act 1996 as being owned by the Crown), on the close of 24 September 2009

E is the sum of the total allowable commercial catch (expressed as a number of oysters) of the Foveaux Strait dredge oyster stock divided by 9.8 (excluding any quota shown in the quota register kept under Part 8 of the Fisheries Act 1996 as being owned by the Crown) on the close of 24 September 2009.

Under section 70 of the Act, the Minister for Climate Change Issues must recommend to the Governor-General that a fishing allocation plan be issued, although the Act does not specify a date by when the fishing allocation plan must be issued or when eligible people must receive NZUs.

Section 76 of the Act specifies that before making a recommendation to the Governor-General on the draft fishing allocation plan the Minister or chief executive (of the Ministry for the Environment) must consult people likely to have an interest in the plan and release the draft fishing allocation plan for submissions. Section 3A requires the Minister (or chief executive) to fulfil obligations under the Treaty of Waitangi to consult with representatives of iwi and Maori likely to be affected by the plan.

Sections 77 to 79 of the Act set out the processes around the Minister making determinations about how many NZUs applicants are entitled to receive. NZUs are transferred in accordance with final determinations.

In summary, the problem with the status quo is that there is no fishing allocation plan and one is required under the Act for the effective operation of the NZ ETS.

## Objectives

The primary objective is to provide partial compensation for a reduction in quota value as a result of the liquid fossil fuels sector entering the NZ ETS on 1 July 2010 by issuing a fishing allocation plan, as required under the Act.

The options have been assessed against the following criteria:

- Equity – providing fair treatment of all quota owners regardless of the volume of quota owned
- Cost effectiveness – minimising costs to participants associated with applying for an allocation and minimising administrative costs to the government

## Regulatory impact analysis

Overall, the fishing allocation plan will have a positive impact upon eligible fishing quota owners who will receive an allocation of NZUs to provide partial compensation for a reduction in quota value as a result of the liquid fossil fuels sector entering the NZ ETS on 1 July 2010 – although arguably this impact is already established by section 74 of the Act<sup>4</sup>.

At a price of \$25 per NZU, revenue from the sale of all 700,000 NZUs would have a total value of \$17.5 million.

In order to receive NZUs, a quota owner must complete a number of steps.

The first three steps below are prescribed under the Climate Change (Unit Register) Regulations 2008. Consequently there is no scope to amend these steps for the fishing

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<sup>4</sup> The Act only provides for an allocation of NZUs; it does not provide compensation to be distributed to fishing quota owners in the form of money – consequently this option has not been considered in this RIS as it is not permitted under the Act.

sector as they apply generically to any person that wishes to become a user and open a holding account in the New Zealand Emission Unit Register (Registry)<sup>5</sup>.

The following steps (1-5) apply to all of the options considered under this RIS as they are required by section 76 of the Act.

1. register as a user of the Registry – this online application for each individual that wishes to use the Registry online system is a prerequisite for opening a holding account
2. apply to open a unit holding account in the Registry – an online application to open an account and submission of a signed declaration form<sup>6</sup>
3. nominate primary representative(s) – account holders must authorise a primary representative (up to 5) to operate a holding account and submit a declaration that is signed by all account holders
4. apply to receive an allocation of NZUs – eligible quota owners must fill out an application form and send this with a signed declaration to the Ministry for the Environment by the date specified (a minimum of 20 working days from when they are invited to apply)
5. supply further information to support their application if requested – applicants must supply any further information relating to their application as requested by the Chief Executive of the Ministry for the Environment or the Minister for Climate Change Issues within 10 working days.

If people do not complete all these steps they will not be eligible to receive units. Although officials can assist people by making the process for application as straightforward as possible, and making information and assistance accessible, the decision to apply (and complete the steps above), will ultimately rest with the person or organisation. Some people may simply choose not to apply. This has no effect on the amount of allocation others may receive as that is determined by the formula specified in the Act.

Based on the Ministry of Economic Development's experience with supporting participants in the forestry sector through the first three steps above, it is estimated that the total labour costs to quota owners of both receiving and selling NZUs could range from \$165 to \$1275. This is based on the administrative Registry steps plus the allocation application process taking from 3.5 to 22.5 hours, and arranging to sell the NZUs taking between 2 to 20 hours (at \$30 per hour). However, the Ministry of Fisheries advises that there are likely to be a large number of small individual quota holders for whom it would be worth taking the time to lodge an application because the comparatively small benefit will still be of significance to them.

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<sup>5</sup> Some have suggested that administrative costs could be minimised by using the quota register managed by FishServe. However, this is not an option as all transactions relating to NZUs must occur within the New Zealand Emission Unit Register (Registry), which meets stringent compliance regulations set by the International Transaction Log (ITL) of the United Nations.

<sup>6</sup> The type of organisation determines the nature of additional information that must be provided when opening a holding account. Where an account is to be operated by two or more people, all account holders must sign the declaration form. Requirements about providing information are contained in the Climate Change (Unit Register) Regulations 2008.

Costs to the government for administering fishing allocation (registering and opening holding accounts for quota owners and processing applications for allocation) are commensurate with the entitlement of quota owners to receive an allocation. Based upon experience with the forestry sector, it is estimated that total administrative costs to the government could reach approximately \$340,000 if 1400 or more quota owners applied to become Registry users, open holding accounts and applied for an allocation. This is based on an estimated average labour cost of \$240 per application. This does not include any costs associated with conducting analysis, preparing documents or Ministerial advice related to fishing allocation.

As the Act prescribes the major features of allocation to the fishing sector (quantum, eligible persons, and a formula for calculating eligible persons' entitlements), the discretion around options in the allocation plan is limited to minor matters such as the tests or thresholds to set around who can be eligible for an allocation of NZUs; the type of data or information that must be supplied with applications; records people must keep and the length of time they must keep them; as well as any other necessary administrative matters.

Given the minor nature of these discretionary questions, the costs and benefits of each option for eligible quota owners do not differ greatly (although including a threshold for eligibility would determine who actually benefits). As noted above, the administrative costs to the government increase commensurate with the number of quota owners that are eligible.

It is proposed to insert a rule to introduce a 'rounding principle' as use of the formula provided in the Act would result in partial NZUs being calculated (eg, 0.6 or 5.3). As NZUs can only be allocated as whole units, it is necessary to create a rule that specifies the principle for rounding down or up NZUs. It is proposed that NZUs are rounded down from 0.1 – 0.4 and rounded up from 0.5 – 0.9. This is consistent with rounding applied for emissions reporting, where emissions are rounded up or down to the nearest tonne (or kilolitre for liquid fossil fuels). It is useful to bear the proposed rounding principle in mind when examining the options for threshold described below.

*Options for an eligibility threshold*

To examine options for an eligibility threshold threshold, the formula set out in the Act was applied to the list of fishing quota owners to calculate the number of NZUs that would be allocated according to different quota weights. The options for the threshold have been assessed according to the objectives of equity and cost effectiveness.

| Option | Individual Transferable Quota (ITQ) weight equivalent threshold (Kg) | Minimum amount of NZUs that a quota owner would receive | Approximate \$ value range (@ \$17-25/NZU) | No. of Quota owners that would receive an allocation | Estimated administrative cost to government |
|--------|--|---|--|--|---|
| 1      | No threshold (420kg) <sup>7</sup>                                    | 1   | \$17 - \$25                                | 1408   | \$337,920                                   |
| 2      | 5,000  | 6   | \$102 - \$150                              | 896  | \$215,040                                   |
| 3      | 20,000   | 24  | \$408 - \$600                              | 432  | \$103,680                                   |
| 4      | 50,000   | 61  | \$1037 - \$1525                            | 249  | \$59,760                                    |

<sup>7</sup> This is the minimum amount of kilograms a quota owner would need to hold on 24 September 2009 to receive 1 NZU (applying the rounding principle).

Option 1: no threshold (equivalent to 420kg after applying rounding principle) – under this option 1408 of the 1559 quota owners would be eligible. However, this option may result in a substantial number of people – 500 or more – receiving none or only from one to four NZUs. It is possible that the benefit to people that receive such a small amount of NZUs could be outweighed by the cost (in time/wages) of them applying. However, fishing quota owners are best placed to make a decision about whether they wish to access their entitlement and whether there would be a net benefit to them. Precluding smaller quota owners (including many Maori owners) would not fulfil the equity criteria. This approach would allow quota owners to apply for the minimum amount that they could reasonably expect to be entitled under the Act. A threshold is likely to be perceived as inequitably favouring large quota owners over the smaller quota owners (which could include some iwi with settlement quota). Given that the Crown will be consulting with all quota owners on the draft allocation plan, those made ineligible will be likely to raise their concerns.

Setting no threshold may reduce the risk of a challenge based on WTO subsidies disciplines as compared to a higher threshold that would concentrate the allocation benefit in the hands of a smaller number of quota holders.

Having no threshold is the most costly and complex option from an administrative point of view as 1408 quota owners could potentially open Registry accounts and be allocated NZUs. Consequently, it would be prudent to increase the time period for people to apply and provide further information by 50 per cent above the minimum required by the Act. This would give people longer to make a decision about whether to apply and complete all required administrative steps. It would also increase the government's ability to effectively manage large volumes of applications (should they be received).

Option 2: Threshold of 5,000kg – under this option, only those that owned 5,000kg or more fishing quota would receive an allocation. Similarly to option 1, it is possible that the time spent applying for an allocation and completing all necessary administrative steps would outweigh the benefit of receiving the NZUs for some people, especially where the quota owner was a company or trust. If this threshold was implemented, 99.8 per cent of the 700,000 NZUs would be transferred to 896 (57 per cent of) quota owners. The cost savings to the government relative to implementing no threshold would be \$112,880.

Option 3: Threshold of 20,000kg – under this option people that owned 20,000kg or more would receive a minimum of 24 NZUs, with an indicative value of around \$600 under the \$25 per NZU scenario. Under this option, it would be clearer who may apply given there is likely to be a clear net benefit. However, it would clearly not meet the equity criteria as it would exclude people that would benefit from receiving NZUs where the threshold was lower. Under this option, 98.9 per cent of the quantum would be transferred to only 432 (28 per cent of) quota owners. The cost savings to the government relative to implementing no threshold would be \$234,240.

Option 4: Threshold of 50,000kg – under this option people that owned 50,000kg or more would receive a minimum of approximately 61 NZUs with an indicative value of up to around \$1525. The number of people eligible would decrease to approximately 249, making fishing allocation far simpler administratively. 249 (15.9 per cent of) quota owners would receive 97.9 per cent of the quantum. The cost savings to the government relative to implementing no threshold would be \$278,160.

The thresholds used for emissions reporting and allocation in other sectors are not directly comparable given the differing purposes of allocation. In fishing, the quantum and individual amounts will be much smaller than other sectors that are participants in the NZ ETS. However, thresholds in other sectors provide context about the wider operation of the NZ

ETS. Across other sectors, the minimum threshold for incurring surrender obligations is around 2000 to 5000 tCO<sub>2</sub>-e, while the minimum amount that could be received for allocation occurs in the forestry sector, where 18 NZUs could be received for one hectare of pre-1990 forest land (as per the Draft Forestry Allocation Plan). While possible, it is not expected that people within the forestry sector would apply to receive such a small allocation. The amounts allocated to participants in the industrial sector are expected to be much higher. The threshold for applying for industrial allocation is based on the amount of emissions per million dollars of revenue; there is at present no minimum number of emissions units that could potentially be applied for in this sector.

## Consultation

Officials from the following departments have been consulted on the Draft Fishing Allocation Plan and this RIS: Ministry of Fisheries, Ministry of Economic Development, Ministry of Transport, Te Puni Kokiri, Ministry of Foreign Affairs and Trade, Inland Revenue, and The Treasury. The Department of Prime Minister and Cabinet has also been informed.

The Ministry of Economic Development prefers option 4 (a 50,000kg threshold) as it considers it is the best balance of the assessment criteria of equity and cost-effectiveness.

Representatives of the Seafood Industry Council, FishServe and Te Ohu Kaimoana have also been informed about the indicative timeframes for allocation to fishing quota owners and about options for implementing a threshold and specifying the data and information to be supplied. They will be consulted on the Draft Fishing Allocation Plan when it is released for public consultation.

In addition to the requirement under section 76 of the Act to consider submissions on the Draft Fishing Allocation Plan, section 3A requires the Minister or Chief Executive to consult with those representatives of iwi and Maori likely to be affected by the Plan.

As the Act prescribes the people who may be eligible to receive an allocation – those that owned quota as of 24 September 2009 – consultation will be targeted to this group, which is listed on the public Quota Register. In addition, those iwi that are yet to be allocated fishing quota under the Maori Fisheries Act 2004 will also be consulted. Under the Act, Te Ohu Kaimoana will hold NZUs in trust for these iwi, who will be transferred NZUs at the same time their fishing quota is transferred.

Consultation on the Draft Fishing Allocation Plan will include the following activities:

- February: Email/letter and text on websites and in industry newsletters informing quota owners, iwi yet to receive quota and other stakeholders about upcoming release of Draft Fishing Allocation Plan for submissions and consultation.
- March: follow-up email/letter notifying quota owners and iwi yet to receive quota (and other stakeholders) about the release of Draft Fishing Allocation Plan for consultation and opportunity to make submissions.
- March: participation by officials in industry events and conferences and any meetings as requested on Draft Fishing Allocation Plan and guidance on how to open Registry accounts.

To ensure that the sector is prepared and has the capability to complete the steps referred to on page 5, officials propose to undertake a significant amount of education alongside consultation on the Draft Fishing Allocation Plan. In particular, a component of any meetings

will be a segment on registering as a user and opening a holding account. Officials will also hold information stalls at industry conferences that are to be scheduled throughout April – June. Some generic guidance material is already available on the Registry website. This will be supplemented with a guidance booklet that is specifically targeted at fishing quota owners. In June, targeted assistance will be provided to any people who are yet to register as a user or open a holding account.

## Conclusions and recommendations

Setting a higher threshold like under options 3 and 4 would exclude most quota owners. Similarly, setting a threshold of 5,000kg a per option 2 still excludes over 50 per cent of quota owners and would not be fulfil the equity criteria for developing the fishing allocation plan policy.

Where no or a very low threshold is set (under options 1 and 2), it is possible that the benefit to people from receiving NZUs may be outweighed by the cost associated with applying for the NZUs. However, officials consider that fishing quota owners are best placed to make a decision about whether they see a benefit in applying. This approach would allow quota owners to apply for the minimum amount that they could reasonably expect to be entitled to under the Act.

Option 1 is not as cost-effective as the other options however officials consider that restricting the ability of quota owners that hold a smaller volume of quota would not fulfil the equity criteria. On balance, officials recommend option 1.

While having no threshold increases the uncertainty about who will apply for an allocation, it is possible that many smaller quota owners will decide not to apply given the time and costs of applying compared to the benefit. If no threshold is set, it is recommended that the government be very clear about the time it may take an applicant to apply.

To further increase the opportunity for quota owners to access their entitlement to NZUs, officials recommend that the timeframes for applying for an allocation and providing further information to support that application be extended by 50 per cent above the minimum requirements in the Act (eg, from 20 working days to 30 working days for applications; and 10 working days to 15 working days for further information).

## Implementation

The Draft Fishing Allocation Plan will reflect option 1. It is proposed that this be released for consultation on 1 March 2010. Following consideration of submissions, the Draft Fishing Allocation Plan may be revised. It is proposed that the Minister for Climate Change Issues will make a recommendation to the Governor-General to issue the Plan in early May.

It is proposed that the 700,000 NZUs be transferred in October 2010. Appropriations have been made for the creation of the 700,000 NZUs that are to be allocated to the fishing sector. These NZUs are ineligible for export to other countries' registries and need to be 'tagged' so their export is restricted<sup>8</sup>. This requires changes to the Registry software, which are scheduled to be implemented by July 2010.

As applying for an allocation of NZUs is optional, an enforcement strategy is not required.

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<sup>8</sup> NZUs allocated to the industrial processes sector will also be ineligible for export in commitment period one of the Kyoto Protocol.



## **Monitoring, evaluation and review**

As allocation to fishing quota owners is a one-off occurrence, the purpose of the allocation plan will be fulfilled once NZUs are transferred. No monitoring, evaluation or review of the allocation plan will be undertaken. However, fishing allocation will be evaluated more generally by examining the percentage of the quantum that is successfully transferred. The government proposes to transfer the NZUs by the end of October 2010.