

### How will NZUs be allocated?

NZUs will be allocated through a combination of sale (by auction) and free allocation (gifting). The level of free NZU allocation to participants will be determined sector by sector, according to the likely impact of emissions pricing and the sector's ability to pass on emission costs to consumers.

Free allocation of emission units will preserve the incentive for firms (or other emitters) to reduce their greenhouse gas emissions, but will protect firms' profits, helping them to offset some of the impacts of an emissions trading scheme.

The government will give landowners the option to receive emission units for Kyoto-eligible afforestation, provided they also take on the associated liabilities for future emissions from harvesting or deforestation. The government's proposals for applying these principles to particular sectors are presented in further detail in the document 'The Framework for a New Zealand Emissions Trading Scheme'.

### How will the emissions trading scheme be administered?

The scheme will be administered through an electronic registry, which will record:

- > the holders of emission units and the amount of emission units they hold
- > transfers of emission units between holders
- > participants' reported emissions
- > emission units surrendered for compliance purposes.

### How will obligations under the emissions trading scheme be enforced?

An administering agency with audit and inspection powers will verify that participants have correctly complied with their obligations under the scheme. Participants' surrender and reporting obligations will be enforced through penalties and inspections.

The scheme will operate with a 'self-assessment' system like that used in the New Zealand tax system. Participants will take the actions they are required to under the scheme, and the administering agency will verify their compliance (either itself or through an agent).

Participants will face binding consequences for non-compliance with their obligations under the scheme. These will include penalties, and participants will still need to surrender the units they owe.

### Will participants be encouraged to find innovative ways to meet their obligations?

An emissions trading scheme will create new incentives for participants to reduce their greenhouse gas emissions, or to finance emission reduction by other firms.

This is expected to promote innovation in energy efficiency and other emission management practices, as well as developing new technology.

The government is also considering using an offsetting mechanism that could award emission units for emission reduction activities not covered by the scheme. For example, this option could apply to firms with emissions below the minimum threshold for participating in the scheme, with emissions exempted (eg, wastewater management), or with emission reductions that are not fully counted under standard means of measurement.

### Where to go for more information

For more information on the government's climate change work, including the 'The Framework for a New Zealand Emissions Trading Scheme' and a series of emissions trading factsheets, visit [www.climatechange.govt.nz](http://www.climatechange.govt.nz)

The New Zealand government has decided to use an emissions trading scheme for greenhouse gas emissions as part of its response to climate change. Emissions trading will help reduce emissions, encourage and support global action on climate change, and help put New Zealand on a path to sustainability. This factsheet explains some of the main design features of the proposed emissions trading scheme.

## Emissions trading scheme: major design features



The emissions trading scheme has been designed to support efforts to reduce greenhouse gas emissions while maintaining economic flexibility, equity and environmental integrity at least cost in the long term.

Most of the main design features of the emissions trading scheme have been agreed 'in principle' by the government. This means that the government is persuaded by the merits of the approach chosen and will need compelling reasons before changing its decision. These design features are summarised below.

There is also a range of other design features that the government will engage with stakeholders on before making decisions. These features are discussed in the document 'The Framework for a New Zealand Emissions Trading Scheme' and in other emissions trading factsheets.

### What activities are covered by the emissions trading scheme?

It is desirable to include as many industry sectors as possible in the emissions trading scheme to ensure equity of treatment between sectors. Also, the broader the coverage of the scheme, the more opportunities there are to realise least-cost emission reduction options.

Once fully implemented, the scheme will apply to all greenhouse gases specified in the Kyoto Protocol (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulphur hexafluoride).

It will also apply to all parts of the economy that emit these gases, including electricity generation and industrial heat and power, transport, industrial processes, forestry, agriculture, and waste.

There will be a small number of exceptions for activities that involve minimal volumes of emissions (for example, emissions from wastewater management).

### How will the emissions trading scheme be implemented?

The emissions trading scheme will be introduced gradually over a period of five years, starting in 2008.

Sectors of the economy will be brought into the scheme in stages, taking into account their preparedness, administrative issues, and the price effects of the scheme in the economy.

The government's proposal is for sectors to enter the scheme as outlined in the table below.

#### Proposed timeframe for sectors to enter the trading emissions scheme

Sector	Commencement of obligations	End of initial compliance period
Forestry (includes deforestation of pre-1990 forest land and afforestation post-1989)	1 January 2008	31 December 2009 (first compliance period is two years)
Liquid fossil fuels (mainly transport)	1 January 2009	31 December 2009
Stationary energy (includes coal, gas and geothermal)	1 January 2010	31 December 2010
Industrial processes (non energy) emissions	1 January 2010	31 December 2010
Agriculture (includes pastoral and arable farming and horticulture)	1 January 2013	31 December 2013
Waste	1 January 2013	31 December 2013

In addition to staging the implementation of the emissions trading scheme, the government will provide short-term help for some sectors in the form of free emission units, as well as assistance for low and modest income households.

This will help businesses and households to make the necessary changes to reduce their greenhouse gas emissions and provide a gradual period of adjustment to emissions pricing.

### Who will participate in the emissions trading scheme?

Businesses will participate in the scheme in three different ways.

1. Some will have a legal obligation to acquire and give up emission units to cover their direct greenhouse gas emissions or the emissions associated with their products. This is called a 'unit obligation'. These participants will generally be 'upstream' operators, for example, fossil fuel producers or importers bringing in products to New Zealand with an emissions component.
2. Some will receive free emission units that can be used to meet their own obligations or to sell to other firms, for example, landowners with forestry holdings.
3. Some will not have unit obligations but will trade emission units in the same way that stockbrokers or real estate agents trade in their respective markets (secondary market traders). They will develop specialist expertise in linking those who can reduce their emissions (thereby freeing up emission units for trading) with those wishing to buy these units.

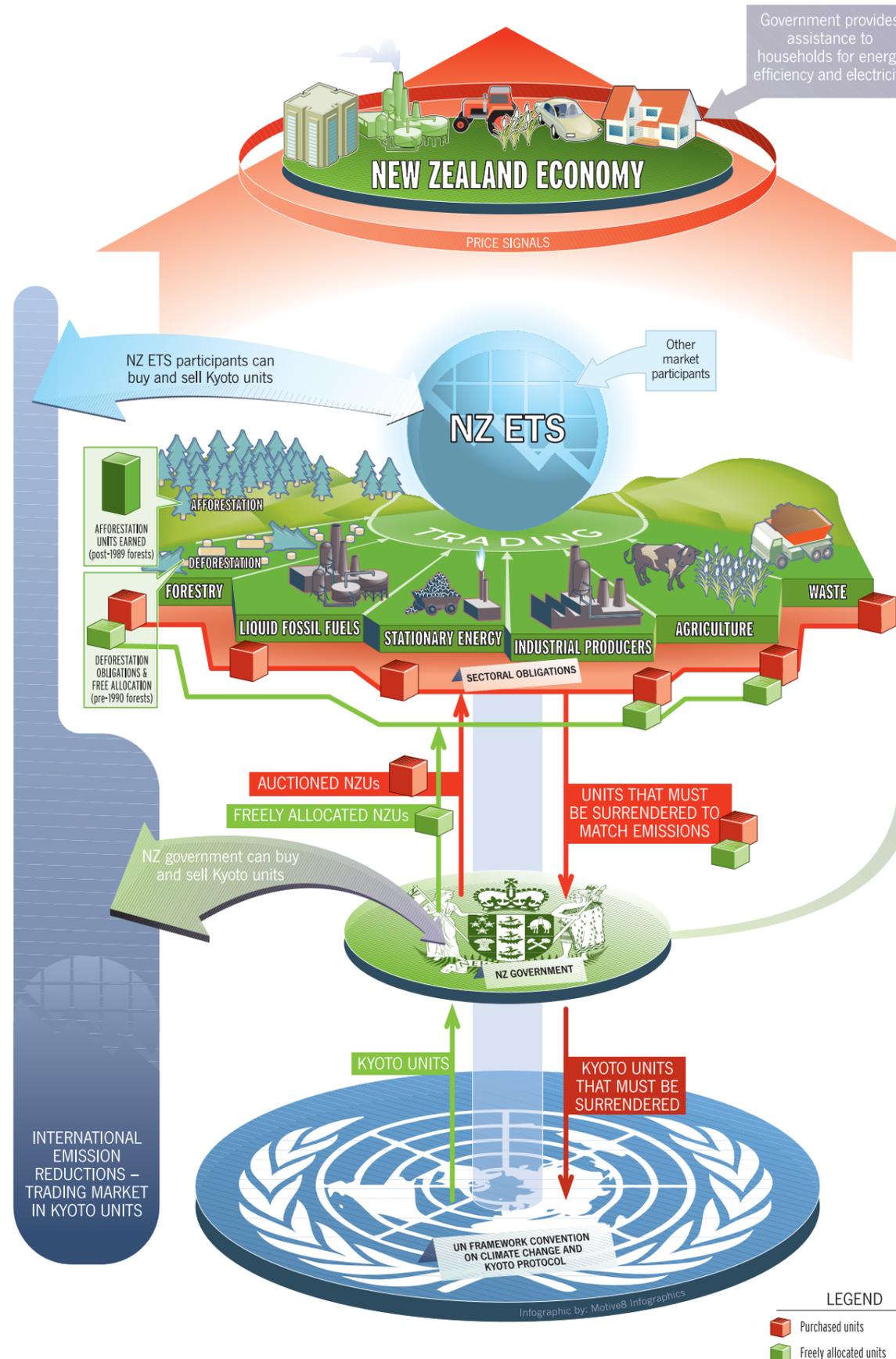
### What is an 'emission unit'?

The primary domestic unit of trade will be a New Zealand Unit (NZU) issued by the Crown. Once the scheme is fully implemented, all participants with unit obligations will be required to 'spend' one NZU to cover each metric tonne of eligible greenhouse gas emissions within a compliance period (usually a calendar year).

Any person will be able to hold and trade NZUs, and it will be possible to carry over NZUs for use in future compliance periods.

### How do New Zealand Units relate to the Kyoto Protocol?

Each NZU will be fully comparable with one international 'Kyoto unit'. The price of the NZU will be determined in the trading market, and will tend to match the international price of emission units.



Subject to some restrictions, participants liable for emissions will be able to use both NZUs and Kyoto units to fulfil their unit obligations. Participants will also be able to sell NZUs internationally by exchanging them for Kyoto units, within the limits on international sales as set by the Kyoto Protocol.

### What are the advantages of allowing international trading in emission units?

Allowing international trading means scheme participants can quickly buy or sell emission units without causing a significant movement in their price.

International trading also gives New Zealand businesses access to least-cost ways to reduce emissions overseas. It will also support the effective use of Kyoto Protocol mechanisms such as the Clean Development Mechanism (CDM), which is an important tool for reducing greenhouse gas emissions and assisting sustainable development in developing countries.

This means that a New Zealand business with limited low-cost ways of reducing its own emissions can fulfil its emissions trading scheme obligation by buying emission reductions from overseas. This has the effect of limiting the cost to that company of reducing its emissions.

International experience suggests that, for many developed economies, the costs of compliance with Kyoto Protocol targets would be much higher than if those countries achieved the targets by domestic emission reductions alone.

Allowing international trading means that emission prices in New Zealand will align with international prices. This, in turn, helps to ensure the level of price exposure in the New Zealand economy is not too far ahead of, or too far behind, prices determined by international efforts to reduce greenhouse gas emissions.

### How many emission units will be issued?

The emissions trading scheme will operate within the cap on emissions as established by the Kyoto Protocol during its first commitment period (2008–2012). There will be no cap on the emissions that occur within New Zealand. However, domestic emissions that exceed New Zealand's allocation under the Kyoto Protocol must be matched by emission units that have been purchased internationally from within the Kyoto cap on emissions.

After the first commitment period of the Kyoto Protocol expires in 2012, the emissions trading scheme would be expected to operate within whatever international cap on emissions is set beyond that point. If no international cap has been agreed, the government will most likely need to establish a domestic cap on emissions at that point. The scheme is therefore designed to be adaptable to changes in international agreements.

