

Departmental Disclosure Statement

Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill

The departmental disclosure statement for a government Bill seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill.

It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

This disclosure statement was prepared by the Ministry for Primary Industries and the Ministry for the Environment.

The Ministry for Primary Industries and the Ministry for the Environment certify that, to the best of their knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

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Part One: General Policy Statement

This Bill amends provisions in the Climate Change Response Act 2002 relating to the New Zealand Emissions Trading Scheme (**ETS**). The amendments concern:

- the penalty that applies when small forestry participants fail to surrender or
- repay units by the due date; and
- industrial allocation.

Amendment to the penalty for small forestry participants

This Bill updates the penalty for participants with low volume liabilities of less than 25,000 units on average per year from forestry activities (**small forestry participants**) occurring from 1 January 2025, who fail to surrender or repay New Zealand Units (**units**) by the due date (the **proposed penalty**).

The Climate Change Response (Emissions Trading Reform) Amendment Act 2020 introduced a strengthened penalties and compliance regime that came into force for most ETS participants, account holders and other eligible persons on 1 January 2021. This included a stricter penalty (the **"3 to 1" penalty**) that applies to ETS participants who fail to surrender or repay units by the due date.

The "3 to 1" penalty is an absolute liability penalty set at 3 times the price of carbon (as set in regulations) for each unpaid unit with no discretion to be reduced. The application of the "3 to 1" penalty was deferred for small forestry participants due to concerns that it could cause serious financial hardship if they were to incur it and be unable to pay it; potentially putting their personal assets (such as their home or farm) at risk. That risk persists and may be exacerbated by the rising price of carbon.

The proposed penalty introduced by this Bill aims to mitigate the risk of serious financial hardship to these participants. It is a strict liability penalty, meaning the Environmental Protection Authority (the **EPA**) may waive the final penalty if the participant can prove total absence of fault, and is calculated as follows:

- 0.5 x the price of carbon (as set in regulations) per unpaid unit: where the unpaid liability relates to post-1989 forest land registered in the NZ ETS; or
- 0.25 x the price of carbon (as set in regulations) per unpaid unit: where the unpaid liability relates to deforestation of pre-1990 forest land.

Participation in the ETS is voluntary for owners of post-1989 forest land. Owners of pre-1990 forest land become mandatory participants in the ETS if they deforest (ie, change the land use or do not re-establish forest) all or some of their pre-1990 forest land. The proposed penalty takes this distinction into account.

The proposed penalty introduced by this Bill will apply from 1 January 2025. This ensures adequate time to implement an education programme for participants on what the new penalty will mean in practice, before it takes effect.

Amendments to industrial allocation

Industrial allocation refers to the provision of free emission units to firms that undertake emissions intensive and trade exposed activities to help them meet some of their emissions costs. It recognises that emissions pricing may affect the international competitiveness of

some firms leading to their closure in New Zealand. Loss of jobs and economic activities within the New Zealand market would be the result. In addition, this may lead to firms relocating their business to countries with weaker or no climate policies, which would result in an increase of global emissions (known as emissions leakage).

However, the current industrial allocation settings are leading to substantial over-allocation, attributed to out-of-date allocative baselines and eligibility test outcomes. This means industries receive support beyond their actual emissions costs. There is an immediate need for change of the settings as over-allocation is a significant cost to the Crown and undermines New Zealand's climate goals.

Updating allocative baselines to address over-allocation

The Bill provides for an update of all allocative baselines (the emission cost intensities of production) based on data from new base years. Further, the Minister of Climate Change will be able to review activity-specific allocative baselines (after 5 years at the earliest) and update them if there is evidence that allocations exceed emissions costs. A review of all allocative baselines will be required every ten years following their most recent review to determine if they need updating.

Reassessing eligibility to ensure appropriate levels of support to at-risk industries

The Bill enables a reassessment of the eligibility for industrial allocation using new base years to ensure existing activities receive an appropriate level of assistance. The emissions intensity thresholds, used to determine eligibility, will be updated to account for the increase in the emissions price. This will better reflect the increased costs to emitting business, and therefore the risk of emissions leakage.

This reassessment may lead to existing activities either moving up or down an eligibility category. Activities moving down an eligibility category would have 2 years from the date of publication of the amendment regulations before changes take effect. This is a change from the current 5-year delay.

New base years for updating allocative baselines and reassessing eligibility

The firms undertaking eligible activities will be required to provide emissions, production, and revenue data for the financial years between 2016/17 and 2020/21. However, the Bill provides the option to nominate the exclusion of emissions, production, and revenue data from one of either 2019/2020 or 2020/2021 financial year from calculations. This is to smooth out any distortions resulting from COVID-19 and the COVID-19 response.

Changing the approach to assessing eligibility for new activities

The Bill is introducing a renewed approach of assessing eligibility for new activities, also acknowledging that new activities may not have sufficient actual emissions, production, or revenue data needed to determine the level of assistance and allocative baselines once eligible.

The main features of the new approach are as follows:

- the current emissions intensity and trade exposure tests are retained for determining the eligibility of a new activity, to enable government to determine an appropriate level of assistance for a new activity;

- in addition, the Minister of Climate Change is required to consider criteria before recommending a new activity to be added, similar to section 84C(3) in relation to increases in phase-out rates;
- applicants without data from the specified financial years are required to provide projected emissions, production, and revenue data for the emissions intensity test and to calculate an initial allocative baseline;
- where eligibility has been initially derived from any forecasts, the Minister of Climate Change sets the level of assistance in line with that of moderately emissions-intensive activities;
- any level of assistance is subject to the relevant phase-out rate (currently 0.01 per year);
- applicants that provided projected data will be required to submit actual operational data from a period defined by the Minister of Climate Change to determine a final eligibility assessment and allocative baseline(s); and
- a washup is calculated following the reassessment using actual data to correct the initial allocations derived from projections.

Enabling easier access to allocative baselines

The Bill simplifies the process to update allocative baselines, using previously submitted data to reflect changes to NZ ETS emissions factors, the electricity allocation factor, or NZ ETS exemption thresholds. These changes do not require consultation as they are merely technical adjustments, reflecting changes occurring in the NZ ETS and electricity market.

Enabling easier access to data

Upon request, the Environmental Protection Authority will be required to share information, submitted in industrial allocation applications, with the Ministry for the Environment or the Climate Change Commission. This will enable better access to this data and aid the monitoring of industrial allocation policy.

Setting up a new electricity allocation factor methodology

The Bill introduces a high-level framework for calculating the electricity allocation factor (**EAF**) used in allocative baselines. In particular:

- the EAF will be calculated by the Electricity Authority from an electricity market model that is publicly and freely available;
- the EAF set in regulations for a particular year is the average of the yearly ETS impact on the price of electricity from the last 3 years, which will reduce volatility and provide allocation recipients with a level of certainty; and
- the Minister of Climate Change will be able to set modelling assumptions in regulations that are required to be used when calculating the EAF - after consultation with those significantly affected.

Part Two: Background Material and Policy Information

Published reviews or evaluations

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?	YES
<p>Industrial allocation</p> <ul style="list-style-type: none"> • <i>Potential for emissions leakage from selected industries in the ETS, Resource Economics, January 2021,</i> https://environment.govt.nz/assets/publications/potential_for_emissions_leakage_from_selected_industries_in_the_ets.pdf • <i>Industrial Allocation Policy Review: Issues paper, Ministry for the Environment, April 2021,</i> https://environment.govt.nz/assets/publications/industrial_allocation_policy_review_issue_paper.pdf • <i>Future options for Industrial Free Allocation in the NZ ETS, Motu, September 2021,</i> https://www.motu.nz/our-research/environment-and-resources/emission-mitigation/emissions-trading/future-options-industrial-free-allocation-nz-ets/ • <i>Reforming industrial allocation in the New Zealand Emissions Trading Scheme – Consultation document, Ministry for the Environment, July 2021,</i> https://consult.environment.govt.nz/climate/reforming-industrial-allocation-in-the-nz-ets/supporting_documents/IA%20review%20consultation%20document%20%20FINAL.PDF <p>Amendment to the penalty for small forestry participants</p> <ul style="list-style-type: none"> • <i>Consultation document: Changing the surrender/repayment penalty for small forestry participants in the New Zealand Emissions Trading Scheme, Te Uru Rākau – New Zealand Forest Service, August 2022,</i> https://www.mpi.govt.nz/dmsdocument/52387-Changing-the-surrenderrepayment-penalty-for-small-forestry-participants-in-the-New-Zealand-Emissions-Trading-Scheme • <i>Summary of Submissions: Changing the surrender/repayment penalty for small forestry participants in the New Zealand Emissions Trading Scheme, November 2022,</i> https://www.mpi.govt.nz/dmsdocument/54133-Changing-the-surrender-repayment-penalty-for-small-forestry-participants-in-the-New-Zealand-Emissions-Trading-Scheme • <i>Approval of policy changes to the Climate Change Response (Emissions Trading Reform) Amendment Bill, Ministry for the Environment, 14 May 2020,</i> https://environment.govt.nz/assets/publications/Approval-of-policy-changes-to-the-Climate-Change-Response-ETR-Amendment-Bill.pdf 	

Relevant international treaties

2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?	NO
<p>The Bill is amending the Climate Change Response Act 2002 that includes giving effect to New Zealand’s obligations under the Paris Agreement and the United Nations Framework Convention on Climate Change. The amendments in this Bill are consistent with that purpose but do not directly seek to give effect to New Zealand’s obligations under these international treaties.</p>	

Regulatory impact analysis

2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?	YES
<p><i>Industrial allocation</i></p> <p><i>Regulatory Impact Statement: Reform of industrial allocation policy in the NZ ETS, August 2022,</i> https://www.treasury.govt.nz/publications/risa/regulatory-impact-statement-reform-industrial-allocation-policy-nz-ets</p> <p>This regulatory impact statement has been revised to reflect the proposed approach for assessing eligibility for new activities: https://www.treasury.govt.nz/publications/risa/updated-regulatory-impact-statement-reform-industrial-allocation-policy-nz-ets-address-current-over-allocation.</p> <p><i>Amendment to the penalty for small forestry participants</i></p> <p><i>Interim Regulatory Impact Statement: Consultation on options to amend the surrender/repayment penalty for small forestry participants in the New Zealand Emissions Trading Scheme, Te Uru Rākau – New Zealand Forest Service, July 2022,</i> https://www.mpi.govt.nz/dmsdocument/52462-Interim-regulatory-impact-statement-Consultation-on-options-to-amend-the-surrenderrepayment-penalty-for-small-forestry-participants-in-the-New-Zealand-ETS</p> <p>This interim regulatory impact statement has been updated to incorporate the final proposal for the new penalty:</p> <p><i>Regulatory Impact Statement: Changing the surrender/repayment penalty for small forestry participants in the New Zealand Emissions Trading Scheme, Te Uru Rākau – New Zealand Forest Service, November 2022,</i> https://www.mpi.govt.nz/dmsdocument/54463</p>	
2.3.1. If so, did the RIA Team in the Treasury provide an independent opinion on the quality of any of these regulatory impact statements?	YES

Industrial allocation

The Ministry for the Environment’s Regulatory Impact Analysis Panel determined that the regulatory impact statement makes a good case for change. The underlying analysis is robust, complete, and shows adequate consultation with affected parties. However, the analysis section does not communicate in a way that is easily understandable by decision makers or the public and could be shortened and simplified.

The Ministry’s panel reviewed the updated regulatory impact statement. The previous assessment remained unchanged.

The Treasury’s Regulatory Impact Analysis team determined that the proposal regarding implementation of the revised electricity allocation factor is exempt from the requirement to provide a regulatory impact statement on the grounds that it has been addressed by existing impact analysis [ENV-32-MIN-0041] and published on the Ministry for the Environment website.

Amendment to the penalty for small forestry participants

The Ministry for Primary Industries’ Quality Assurance Panel determined that:

- The interim regulatory impact statement meets the quality assurance criteria. It is clear, concise and complete, clearly outlining the limitations of the analysis and is convincing within those limits. Adequate targeted stakeholder consultation was undertaken, given that it supports a public consultation document.
- The final regulatory impact statement partially meets the quality assurance criteria. It is clear and concise, setting out the limitations of the assessment undertaken and providing clear recommendations. The proposals have benefited from public engagement and options developed and refined in response to that engagement. However, it does not fully show how the status quo penalty disproportionately affects small forestry participants compared to larger participants. Given the limitations, it is unlikely that this document could make this clear.

2.3.2. Are there aspects of the policy to be given effect by this Bill that were not addressed by, or that now vary materially from, the policy options analysed in these regulatory impact statements?	YES
<p>There are aspects of the proposed penalty for small forestry participants to be given effect by this Bill that were not addressed by the analysis in the Interim and Final Regulatory Impact Statements. These are minor additions to the Act to clarify how the regulator will apply the penalty when participants file emissions returns:</p> <ul style="list-style-type: none">• covering part-years;• containing incorrect information requiring amendments after a penalty has already been applied; and/or• covering activities occurring both before and after the new penalty is introduced on 1 January 2025.	

Extent of impact analysis available

2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?	YES
<p>The regulatory impact statement for the reform of industrial allocation has been revised to reflect the proposed approach for assessing eligibility for new activities.</p>	

2.5. For the policy to be given effect by this Bill, is there analysis available on:	
(a) the size of the potential costs and benefits?	YES
(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?	YES
<p><i>Industrial allocation</i></p> <p>It is estimated that over-allocation resulting from out-of-date allocative baselines is around 800,000 units or \$60 million based on a unit price of \$75. The 2020 data collection exercise indicated that updating allocative baselines for four activities would reduce industrial allocation by around 180,000 units per annum. Extrapolating the findings, the impact of updating baselines with recent data could reduce allocations to industry (7.7 million units in 2020) by about 800,000 units.</p> <p>Updating allocative baselines will result in a benefit to the Crown in the form of a direct cost reduction, and an equivalent cost to industrial allocation recipients in the form of reduced allocation. Some firms may receive substantially less industrial allocation due to updated allocative baselines.</p> <p><i>Amendment to the penalty for small forestry participants</i></p> <p>In developing this policy, it was identified that the ‘three to one’ penalty (that would otherwise apply to small forestry participants in the absence of this Bill) could impose significant costs on small forestry participants.</p> <p>The analysis of these costs was undertaken at a general level due to limited detailed information being available, time constraints, and limitations on comparing previously applicable penalties. Notwithstanding this, analysis identified that the ‘three to one’ penalty could put small forestry participants at risk of serious financial hardship if they were to incur it. This is because of the significant size and stringency of the penalty and the nature of the assets owned by these participants, meaning their farm or home could be at risk.</p> <p>This Bill ultimately reduces the potential cost to these participants, by introducing a revised, more proportionate penalty.</p> <p>For example, at \$75 per unit, if a unit liability of 5,000 units (worth \$375,000) was not met on time:</p> <ul style="list-style-type: none"> • the resulting ‘three to one’ penalty would be \$1,125,000; whereas • the resulting revised penalty would be \$187,500 (for post-1989 participants), \$93,750 (for pre-1990 participants), or \$0 (if the participant could prove total absence of fault). <p>The revised penalty aims to reduce costs on participants who incur it, while still encouraging compliance. This is important to mitigate potential costs to the Crown which arise when unit liabilities are not met.</p>	

2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be impacted by:	
(a) the level of effective compliance or non-compliance with applicable obligations or standards?	YES
(b) the nature and level of regulator effort put into encouraging or securing compliance?	YES

Industrial allocation

Although industrial allocation is voluntary, the information provided to inform eligibility and the amount of allocation must be correct. Already existing penalties apply when providing incorrect information (see sections 134, 134B and 134D of the Act).

Amendment to the penalty for small forestry participants

In the absence of this Bill, the 'three to one' penalty would apply to small forestry participants in relation to activities occurring from 1 January 2025. The Bill does not introduce any new obligations.

The potential costs or benefits could be impacted by regulatory effort put into encouraging compliance. This is because participants can avoid the penalty in this Bill by ensuring they meet their liabilities on time, or if they cannot meet their liabilities on time through no fault of their own (e.g., due to circumstances beyond their control), ensuring that this is adequately proven to the regulator within an appropriate timeframe.

Generally, small forestry participants are less likely to be aware of their NZ ETS obligations due to their lower sophistication and less frequent interaction with the scheme than larger-scale participants. Therefore, effective guidance, education and outreach targeted at these participants and other stakeholders has the potential to improve compliance, lessening costs and increasing benefits.

This is a key reason why the revised penalty will not take effect until 1 January 2025; to allow sufficient time to develop and deliver this education, which will help small forestry participants (and prospective participants) to understand their obligations and the penalties involved if they fail to meet them.

Part Three: Testing of Legislative Content

Consistency with New Zealand's international obligations

3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?

The policy to be given effect by this Bill is limited in scope and does not amend sections of the Climate Change Response Act 2002 that affect New Zealand's international obligations under climate change treaties.

The Ministry of Foreign Affairs and Trade have been included in agency consultation on the policy provisions in this Bill.

Further, the proposed penalty is not expected to affect New Zealand's ability to link with international carbon markets in future if it wishes to do so.

Consistency with the government's Treaty of Waitangi obligations

3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?

Industrial allocation

The Ministry for the Environment has assessed the Bill, and considers that the limited scope and mostly technical nature of the Bill means that it is not inconsistent with the principles of the Treaty of Waitangi.

The Bill amends section 3A of the Climate Change Response Act 2002 (recognising and respecting the Crown's responsibility to give effect to the principles of the Treaty of Waitangi) to require consultation for regulations setting assumptions for the electricity allocation factor modelling.

Amendment to the penalty for small forestry participants

Māori have significant interests and opportunities in forestry and the NZ ETS. In particular, small forestry participants are often individual persons such as small farm foresters or small Māori trusts. Therefore, a key objective of the revised penalty is to help protect Māori rights and interests and their ability to manage their land in line with their land-use aspirations.

Part of consultation on the revised penalty was directly targeted at Māori with an interest in forestry. Nine of the 25 submissions received were from people or organisations that indicated they represented the interests of Māori. In general, those submitters indicated broad support for the introduction of a revised penalty and for robust education on what it will mean in practice before it takes effect.

Consistency with the New Zealand Bill of Rights Act 1990

3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?

YES

The Bill is consistent with the New Zealand Bill of Rights Act 1990. Advice provided to the Attorney-General by the Ministry of Justice is generally expected to be available on the Ministry of Justice's website at introduction of a bill, and can be accessed at <https://www.justice.govt.nz/justice-sector-policy/constitutional-issues-and-human-rights/bill-of-rights-compliance-reports/advice/>

Offences, penalties and court jurisdictions

3.4. Does this Bill create, amend, or remove:	
(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?	YES
(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?	NO
<p>This Bill amends the Climate Change Response Act 2002 to introduce a revised penalty for small forestry participants with liabilities from forestry activities occurring from 1 January 2025. The revised penalty will be applied on a strict liability basis, and is set at:</p> <ul style="list-style-type: none"> • 0.5 x the price of carbon for each unpaid unit for post-1989 forestry participants; and • 0.25 x the price of carbon for each unpaid unit for pre-1990 forestry participants. <p>The price of carbon is in dollars, set each year in the Climate Change (Synthetic Greenhouse Gas Levies) Amendment Regulations 2021, made under section 30W of the Climate Change Response Act 2002. It is based on the average market price of carbon from previous years.</p> <p>The revised penalty may be avoided where a total absence of fault applies.</p>	

3.4.1. Was the Ministry of Justice consulted about these provisions?	YES
<p>The Ministry for Primary Industries has had ongoing engagement with the Ministry of Justice on the new penalty for small forestry participants pre-NZBORA vetting and consulted with the Ministry of Justice on the Bill and the relevant Cabinet paper. The Ministry of Justice did not raise any concerns with the proposal.</p>	

Privacy issues

3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?	NO
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External consultation

3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?	YES
<p><i>Industrial allocation</i></p> <p>Public consultation took place between July and September 2021 and sought feedback on options to address over-allocation and technical issues with industrial allocation policy. Officials developed these proposals with support from a Technical Advisory Group which provided independent expertise on industrial allocation.</p> <p>Targeted engagement on the policies to be given effect by this Bill was undertaken with stakeholders, including a technical advisory group which provided independent expertise on industrial allocation.</p> <p><i>Amendment to the penalty for small forestry participants</i></p> <p>Public consultation took place in August 2022 and sought feedback on two options for the revised penalty for small forestry participants (a strict liability penalty and a discretionary penalty). Both options included deferring implementation of a revised penalty until 1 January 2025 to allow time to educate participants on what it will mean in practice.</p> <p>Consultation included two online webinars targeted at NZ ETS forestry participants and other stakeholders, as well as Māori with an interest in forestry.</p>	

Other testing of proposals

3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill's provisions are workable and complete?	NO
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Part Four: Significant Legislative Features

Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	NO
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Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	NO
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Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	NO
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Strict liability or reversal of the usual burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	NO
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	NO
No – although the Bill does create a strict liability penalty (not an offence) for small forestry participants who fail to meet unit liabilities arising from forestry activities occurring from 1 January 2025, and ensures the standard common law defence of “total absence of fault” removes all liability. In doing so, the Bill will ensure that the ‘three to one’ penalty (which is an absolute liability penalty) does not apply to this group of NZ ETS participants.	

Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	NO
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Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person’s rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	YES
<p>The settings of industrial allocation will be amended, including criteria to determine eligibility of an activity for industrial allocation. This is likely to have an impact on a firm’s eligibility as they may not meet the threshold of eligibility anymore. However, the Bill does not create but merely amends decision-making powers in relation to the industrial allocation settings.</p> <p>The decision-making powers of the Minister of Climate Change will be amended in relation to eligibility, reviewing allocative baselines and setting an electricity allocation factor.</p> <p>Amended industrial allocation settings may have a fiscal impact on industrial allocation recipients.</p>	

Powers to make delegated legislation

4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?	NO
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4.8. Does this Bill create or amend any other powers to make delegated legislation?	YES
The regulation-making power in section 161A to determine industrial allocation settings is amended. New section 161FA(6) contains a new regulation-making power for the EAF modelling assumptions.	

Any other unusual provisions or features

4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?	NO
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