



November 2008

Climate Change update

Businesses Facing Increased Costs to Operate

Having become law in September 2008 the Emissions Trading Scheme is now reality for New Zealand.

In 2010 and 2011 three sectors will enter New Zealand's Emissions Trading Scheme (**ETS**) which will result in significantly increasing costs to businesses in New Zealand. The effect on businesses from this may be direct or indirect.

The stationary energy and industrial processes sectors (**SEIP**) are two separate sectors that enter the ETS from 1 January 2010. The liquid fossil fuels (**LFF**) sector enters the ETS from 1 January 2011.

Indirect costs from these sectors entering the ETS include increased energy and transport costs, as well as the costs of purchasing industrial materials (such as glass, iron, steel, aluminium) produced in New Zealand. Contracts (particularly where there is a variable price relating to "carbon charges") are being examined closely to assess the appropriateness of who is exposed to passing these costs to consumers.

Participants in the stationary energy and industrial processes (**SEIP**) and liquid fossil fuel (**LFF**) sectors will have direct obligations under the ETS, those purchasing from these sectors will indirectly be affected. *Are you ready?*

ETS Developments

- The Climate Change Response (Emissions Trading) Amendment Act 2008 received Royal assent on 25 September 2008. It introduces the ETS and amends the **Climate Change Response Act 2002** (the **Act**).
- The **Climate Change (Liquid Fossil Fuels) Regulations 2008** come into force on 1 January 2009.
- The **Draft Climate Change (Stationary Energy and Industrial Processes) Regulations 2008** have been released for consultation on the **climate change** website. Submissions are due on **15 December 2008**.
- On 8 November 2008 New Zealand elected a new government. The National party-led government has promised to change the ETS, but the scale of the proposed changes is currently unknown.

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The Emissions Trading Scheme

The ETS assists New Zealand in meeting its international climate change commitments. New Zealand has committed under the Kyoto Protocol, to reducing its climate change emissions to 1990 levels and to otherwise take responsibility for emissions above that level.

The ETS is a market based mechanism. The ETS currency is the New Zealand Unit (NZU) which can be traded in New Zealand. The NZU is linked to the international Kyoto Protocol market and can generally be interchanged with Kyoto Protocol Assigned Amount Units (AAUs) as well as other Kyoto Units. The ETS has mandatory and voluntary participants for various sectors. There is no cap on a participant's level of emissions, rather participants are incentivised to avoid the cost of NZUs by reducing their level of emissions.

In the liquid fossil fuels, stationary energy and industrial processes sectors what activities are directly affected?

Liquid fossil fuels include owning "obligation fuels" as they are defined in the Climate Change (Liquid Fossil Fuels) Regulations 2008. Generally, these include (with qualifications):

- motor spirit (regular petrol and premium diesel)
- automotive diesel marine diesel
- aviation spirit
- jet fuel
- light residual fuel oil
- heavy residual fuel oil and others.

Liquefied petroleum gas in defined circumstances is not an obligation fuel.

Stationary energy involves making available for electricity and industrial heat generation and refining petroleum energy sources that may result in greenhouse gas emissions. That includes importing or mining coal or natural gas, using geothermal fluid, used oil, waste oil, used tyres or waste for electricity or industrial heat. It also includes refining which involves the use of intermediate crude oil products. It does not include emissions from industrial processes or transportation.

Industrial processes include the production of iron or steel, gold, and, in certain circumstances, aluminum, clinker or burnt lime, glass, cable. From 2011 it also includes, importing and manufacturing sulphur hexafluoride, hydro fluorocarbons and per fluorocarbons in particular circumstances.

If you are in these categories then you will be a participant in the ETS, required to monitor and report emissions and liable to surrender 1 NZU for each tonne of (anticipated) emissions from each of these activities.

You may also voluntarily join the ETS and face this liability if, in a year, you purchase from a participant 10 million litres of obligation jet fuel or 250,000 tonnes of coal, or 2 petajoules of natural gas.

Other sectors included in the ETS are forestry, waste and agriculture. All sectors included in the ETS will enter by 2013.

In opposition, the National Party has suggested there could be improvements to the ETS. It has promised to amend some aspects of the ETS. In the past it has suggested that it would align "where possible" with the Australian ETS when it is formed, support small to medium sized enterprises in ensuring that they may obtain free allocation of units where eligible and ensure that the ETS is fiscally neutral. Regardless of the proposals, there will be further opportunities to approach the government to influence these changes to the ETS and we can advise you in doing this.

Free Allocation to Participants and Non-Participants – Allocation Plans

The expectation is that participants, particularly the SE and LFF sectors will pass through the supply chain costs of satisfying ETS obligations. For some this will reduce competitiveness. To ease the pain and to provide a "transition" while businesses adjust to these extra costs, some NZUs will be freely allocated to people who apply. The amount of NZUs will not cover a participant's entire liability to surrender NZUs.

Detailed eligibility criteria will be provided in a draft allocation plan. There will be an opportunity to comment on that plan before it becomes law. However, it is established that some sector participants and some industries indirectly affected will be eligible. Householders will be insulated (temporarily) from these increased costs in a number of ways (one-off electricity rebates, payments for the needy, a 15-year \$1b fund for energy efficiency).

However, if your business is likely to feel the impact of these increased costs then there needs to be a close assessment of the free allocation process. For those businesses that are not participants but can show that the ETS will result in them incurring higher costs than their international competitors (in NZ or abroad) which cannot be passed on, some relief may be available. These businesses are considered to be "trade exposed". Care will be needed in disseminating information about your vulnerability to competition.

There are also free units available in an Innovation Fund to facilitate deployment of innovative technology that has the potential to significantly reduce greenhouse gas emissions.

Associated persons

Where there are quantities that trigger eligibility (specifically the quantity of obligation fuel owned or coal mined or natural gas imported) there is the possibility that “associated persons” will be treated as carrying out the qualifying activities and may elect to become a participant, a person engaged in a “joint activity” or a member of a “consolidated group”.

An associated person is a defined term and encompasses entities which are related. This may be in terms of similar membership/shareholdings or control. It may also be where one entity has 25% of voting power or control of the governing body of the other entity. This needs careful consideration as liabilities will flow from being captured as an associated person and a different approach to emissions returns may be taken.

General Tax Treatment

If you will be trading and surrendering NZUs, you need to make sure you are able to pay the necessary costs. You are liable for tax obligations and need to ensure you are aware of those obligations. Generally:

- Tax payers are allowed a deduction for their accrued emissions liability.
- Any gain on the sale of emissions units will generally be taxable with a deduction for the cost of the units.
- There will be no tax consequences when a emissions unit is received from the government and surrendered in the same income year.
- Emissions units held by a person over an income year will be taxed under modified trading stock rules.
- Emission units will be zero rated for GST purposes.

For specific tax advice on climate change matters please contact the [Minter Ellison Tax team](#).

Penalties for Non compliance

There are civil penalties for non-compliance with the scheme aimed at supporting the obligations under the ETS of calculating emissions and surrendering equivalent NZUs.

Criminal offences apply when a person without good reason, knowingly or with intent to deceive, fails to collect information, register as a participant, submit an emissions return or keep information in relation to an activity.

Draft Climate Change (Stationary Energy and Industrial Processes) Regulations 2008

Public consultation is being sought on the Draft Climate Change (Stationary and Industrial Processes) Regulations

2008. The draft regulations include methodology for the monitoring and calculation of SEIP emissions. For instance, emissions calculation, point of measurement and unit of measurement (e.g. tonnes, gigajoules), setting emissions factors, unique emissions factors, the use of calorific value, opt-in, ‘ready for sale’ coal, waste, stockpile and storage adjustments. They also include methodology applying to purchases of large amounts of coal or gas from a participant.

The draft regulations set out a process for calculating emissions based on the following formula:

- Total units of production (specific to the SEIP activity).
- Plus or minus other relevant factors that may increase or decrease ETS liability.
- Multiplied by a default emissions factor for that product or activity.

There is a proposal that a process be added to the regulations to permit participants to obtain and calculate emissions by reference to a unique emissions factor. The Act enables the use of unique emissions factors where it is provided for in regulations.

Submissions on the draft regulations are due on **15 December 2008**. Officials are particularly interested in receiving submissions on the following:

- The direct costs to participants in complying with the regulations – especially the costs associated with data collection and calculation of emissions.
- The setting of default emissions factors.
- Technical matters raised – particularly unprocessed gas, the steam conversion rate for geothermal energy and the relevant emissions factors for mined coal seam gas.
- Calculating liability for fugitive methane emissions resulting from coal mining, (officials are liaising with owners of coal mines to discuss these issues and are seeking to establish a small working group to address these issues).
- Drafting a New-Zealand specific default emissions factor or other method to calculate emissions from this practice.
- The accuracy of the assumption that all limestone used in gold production will lead to emissions.

This advice is general in nature. We recommend you obtain specific advice on how you may be affected by the ETS. We would be happy to assist you to understand further how to comply with your obligations under the ETS, make the most of the scheme, and if necessary make a submission on the Draft Climate Change (Stationary and Industrial Processes) Regulations 2008. Please [contact us](#).

Participant Obligations – Are you ready?

Commencement dates

SEIP - Reporting and liable to surrender NZUs commences 1 January 2010. LFF - Reporting is voluntary from 1 January 2009 and mandatory from 1 January 2010. The liability to surrender NZUs commences 1 January 2011.

Are you registered?

Participants are not required to register until their sector enters the trading scheme, although they can choose to register earlier. Generally, participants have 20 working days to register once they become a participant. SEIP users will need to register from 1 January 2010 and give notice to the Chief Executive of the Ministry of Economic Development (MED). The deadline for giving notice is 29 January 2010. Mandatory LFF participants must notify the Chief Executive of MED that they are a participant from 1 January 2010. Generally mandatory participants have 20 working days to give that notice. The deadline for giving notice will be 29 January 2010. Voluntary LFF participants may also register from 1 January 2009 online at: www.eur.govt.nz

Do you have a holding account?

At the time of registration participants must apply to open a holding account, if they don't have one already. Participants must have a holding account to receive and surrender units under the scheme. A holding account can be obtained from the [New Zealand Emissions Register](#).

Do you know how to monitor and calculate emissions and removals?

Participants must, for each year they carry out relevant activities, collect described data or information, calculate the emissions and the removals activity in accordance with the relevant regulations (see below) and if required, have calculations verified by a recognised person.

Are you aware of the record keeping requirements?

Participants must keep records of the data, information and calculations. Participants must also retain records for seven years after the end of the period to which they relate.

Do you know how to file annual emissions returns?

Data must be collected for LFF from 1 January 2009 (if voluntarily doing this) and 1 January 2010 (mandatory reporting). For SEIP the reporting period commences on 1 January 2010. Generally, annual emissions returns must be filed by 31 March for the previous calendar year. So the first returns for these sectors will be due on 31 March 2011.

Are you aware of the liability to surrender units to cover emissions?

Obligations to surrender units commence on 1 January 2010 for SEIP and 1 January 2011 for LFF. A participant is liable to surrender 1 NZU for each whole tonne of emissions covered by the scheme. After submitting their return by 31 March participants are required to surrender NZUs by 30 April of the same calendar year. The first dates for surrender of emissions units are: SEIP - 30 April 2011 and LFF - 30 April 2012. A participant must make an application to transfer the required number of NZUs from the participant's holding account to a surrender account designated by the Chief Executive.

Have you considered what the regulations mean for you?

The Climate Change (Liquid Fossil Fuels) Regulations 2008 come into force on 1 January 2009. In addition to defining "obligation fuels", the regulations have information collection requirements and set out methods for calculating emissions for obligation fuel participants in the ETS. They set out emissions factors required for the calculations. It is important to understand and apply these reporting requirements in meeting your obligations under the ETS. Similarly the Draft Climate Change (Stationary Energy and Industrial Processes) Regulations will prescribe the applicable methodology. (More details on this are provided below). You may need to make a submission on these Draft Regulations to ensure that the necessary methodology will work for your business.

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