



December 2007

Climate Change Update

The Climate Change (Emissions Trading and Renewable Preference) Bill

The Government's highly anticipated draft legislation establishing the New Zealand Emissions Trading Scheme ("the ETS") was introduced on 4 December 2007. In addition to addressing the legislative framework for the ETS, the *Climate Change (Emissions Trading and Renewable Preference) Bill* also proposes to legislate the Government's preference for new renewable electricity generation. The Bill is divided into two parts to deal with these two issues.

The ETS

Part 1 of the Bill implements a scheme which builds upon the Government's announcement in September. It does this by amending the *Climate Change Response Act 2002*. The core obligation of participants covered by the ETS is to surrender one emission unit for each tonne of greenhouse gas emissions for which the participant is responsible. It remains the world's first proposed multi-sectored, multi-greenhouse gas trading scheme.

Mandatory Registration

To ensure certainty, the Bill describes all activities that give rise to obligations under the ETS, even where those obligations are not scheduled to arise in a sector for many years. Persons carrying out these activities are deemed to be "participants" and are obliged to

register as such. These activities identify the point of obligation for participants – sometimes it is placed on a producer or a purchaser of goods – and require careful examination.

For the agricultural sector, the Bill has defined points of obligation at both the processor level and the farmer level and has drafted them as alternatives. The Bill provides that obligations will lie at the processor level and will come into force on 1 January 2013, unless the alternative is brought into force by an Order in Council. This is in line with the Government's stated preference that obligations should fall at the processor level. It is interesting to note that the Government is forecasting that there are likely to be less than 200 participants in the ETS, not including those in the forestry sector. This figure is obviously based on the assumption that farmers are unlikely to become participants in the scheme.

Six sectors that emit greenhouse gases have been targeted, with entry by these sectors (and their subcategories of activities) into the ETS being staggered.

- Forestry (pre-1990 forests) – 1 January 2008
- Liquid fossil fuels (transport) – 1 January 2009
- Stationary energy – 1 January 2010
- Industrial processes – 1 January 2010 (except for the importation of sulphur hexafluoride, which is from 1 January 2013)
- Agriculture – 1 January 2013
- Waste – 1 January 2013

Voluntary Registration

The Bill also contains descriptions of activities (grouped by sector) that can qualify for registration if a person wishes to opt in. Provided the definition of activity is satisfied then registration as a voluntary participant in the ETS commences on the following dates:

- Forestry (post-1989 forests) – 1 January 2008
- Removal activities – 1 January 2010
- Transport (major jet fuel purchasers) – 1 January 2008
- Stationary energy (major coal and natural gas purchasers) – 1 January 2009

If a person were to opt in then there are also provisions for that person to opt out.

The Government had signalled its intention for owners of post-1989 forests to have the option of joining the ETS and receiving credits for carbon sequestered in forests. Interesting though, is that the Bill also gives those who undertake "removal activities" the option to join the ETS and have the ability to earn credits. The inclusion of this group in the ETS incentivises the exploration of alternative greenhouse gas storage.

Exemptions

Under the draft legislation the relevant Minister has the power to exempt any person who would otherwise be a participant from the ETS in respect of all or some of their obligations. Various criteria have been set out detailing the circumstances in which an exemption can be made. In addition, firms that had concluded a Negotiated Greenhouse Agreement with the Government may seek exemptions. Prior to making a decision the Minister may seek submissions from parties whose interests may be affected. However, if the Minister chooses not to take this consultative route then it will not invalidate the decision made. This is bound to become a political issue when enacted and during the progress of this Bill through the House of Representatives.

Participant Obligations

As stated above, the core obligation on participants is to surrender one emission unit for each tonne of greenhouse gas emissions. Participants must have an account to hold emission units, monitor their emissions and removals, report annually on any emissions or removals, and retain records showing their emissions and removals for seven years.

As expected, participants may surrender either Kyoto Units or New Zealand Units (NZUs) to meet their ETS obligations. The Bill does not limit the amount of Kyoto Units that can enter the ETS, although the Minister does have the ability to place restrictions on which classes of Kyoto Units may be brought in and registered. The Government has already decided to

exclude certain units from the ETS, for example those created from nuclear projects. This has been welcomed by some, but criticised by other domestic stakeholders, who have expressed concerns about potentially damaging the integrity of the ETS and reducing New Zealand's prospects of linking with schemes of other countries.

Allocation of New Zealand Units

The proposal for the Government to distribute NZUs either by public auction or by free allocation to certain sectors remains in the Bill. In order for units to be freely allocated the Minister must first develop an Allocation Plan. The Allocation Plan will determine who is eligible to receive a free allocation of units, and how many units each person will receive.

In developing an Allocation Plan the Minister must prepare a "statement of intention to prepare a draft Allocation Plan". The statement of intention and the draft Allocation Plan must be publicly notified; giving those affected the chance to have input and to demonstrate their eligibility and entitlement to free units. It is in this manner that the Government of the day will consult on the appropriateness of allocation in the various sectors. Once the consultation process has been completed then the Government can issue an Allocation Plan by an Order in Council. Any free units in that sector will then be allocated in accordance with that plan.

Compliance and enforcement

The Bill envisages that if participants fail to meet their obligations, they will be subject to both financial penalties and make-good provisions. The Bill creates the right to seek District Court review of enforcement decisions and appeals of law will lie with the High Court.

Transitional enforcement provisions

The Government has acknowledged that new systems will need to be developed by participants and has provided transitional arrangements in respect of penalties. In the first year that participants are required to report on their emissions, they will not be liable for any financial penalties if their annual emissions return contains errors. Participants will simply be required to surrender units to cover their shortfall.

Forestry

Although the ETS legislative process is not expected to be finalised until late in 2008, those participants in the pre-1990 forestry sector will be required (at the end of December 2009) to report on compliance from 1 January 2008 until 31 December 2009.

Owners of pre-1990 forests will receive assistance to meet their obligations in the form of freely allocated NZUs. Forestry is the only sector for which the Government has identified the actual number of units that will be available for free allocation:

55 million NZUs are available for owners of pre-1990 forests. That said, the Government has not specified its basis for distributing these units; the discussion documents had said it would pro-rata the units based on land size.

What next?

It is expected that the Bill will receive its first reading early in the new year. The Climate Change Leadership Forum and other groups established by the Government in September will continue the engagement process with stakeholders throughout 2008. We expect topics of discussion will include the type of emission units allowed into the ETS, the timing of phasing out free allocation of NZUs, and whether an intensity based approach can be included within an absolute cap of free allocation.

Once enacted, there will be an ETS framework with a range of in-principle features, but further details will be subsequently added by regulations. For example, the methodologies to be used to calculate emissions and removals.

Looking further ahead, there is provision for a review of the ETS. This will occur prior to the end of the Kyoto Protocol's first commitment period (2012) and at the end of each subsequent commitment period. The Government has acknowledged the uncertainty about any international climate change agreements post-2012. In the face of this, it boasts that the ETS has been flexibly designed to adapt to a range of possible future scenarios.

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Moratorium

Part 2 of the Bill implements a ten-year legislative moratorium on new fossil fuelled thermal baseload generation to complement the Government's policy preference for renewable electricity generation. The moratorium will apply to all fossil fuelled generation greater than 10MW in capacity. The Bill provides for exemptions in order to address concerns over security of supply.

How do I find out more?

The introduction of the Bill moves us one step closer to the implementation of the ETS and it will be interesting to track any changes that arise as it progresses through the legislative process.

The foregoing is just a snapshot of the Bill, but it captures the essence of what the Government has placed on the table. The integrated team at Minter Ellison Rudd Watts comprises exceptional lawyers with expertise in sustainability, climate change and New Zealand's business environment. They can advise on all aspects of the issues associated with this Bill, including how your interests can most effectively be managed, advanced and addressed.

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