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Climate change focus

Government outlines its climate change solutions

The Government has now confirmed that an emissions trading scheme, as opposed to the previously proposed carbon tax, will be its central platform for implementing New Zealand's commitments under the *Kyoto Protocol* and more generally reducing New Zealand's greenhouse gas emissions.

The most important feature of the proposed scheme is that it will encompass all sectors and all gases. It is proposed that the scheme will be phased in from 1 January 2008, beginning with the forestry industry, and including all other sectors over a five year period, with agriculture and waste coming on line in 2013.

In conjunction with the emissions trading scheme, the Government also announced a range of other initiatives aimed at reducing New Zealand's greenhouse gas emissions and improving New Zealand progress towards a more sustainable nation.

The bottom line is that business and households will – to varying degrees – face increased costs. Fuel companies and electricity generators will definitely have to pay for their allocations under the emissions trading scheme. And agriculture gets a longer timeframe to come on line, as well as the possibility of significant free allocations. The key will be to appreciate and understand the proposed framework and its implications.

New Zealand's unique challenge

As opposed to all other developed countries, New Zealand has a unique (and somewhat unusual) greenhouse gas emissions profile:

- Approximately 49% of emissions result from agriculture, in contrast to an average of 12% in other developed

countries. (In our nearest neighbour, Australia, agriculture contributes just under 20% of its emissions).

- The energy sector contributes 43% of emissions, which is low relative to other countries. However, emissions from transport (currently 19% of emissions) are forecast to increase steadily.
- New Zealand has significant emissions from deforestation, with emissions predicted to rise sharply between 2020 and 2030.

What are the Government's solutions?

The Government has clearly positioned sustainability and climate change as being one of its key policy platforms going forward. (In fact, it has gone so far as describing climate change as the single greatest challenge facing the human race and comparing it to the challenge of averting nuclear war last century).

The Government's recently announced package includes:

- Establishment of an emissions trading scheme (discussed below).
- A goal to increase renewable electricity generation in New Zealand.
- Measures to encourage forestry and environmentally-friendly land use, including the provision of financial incentives to the New Zealand forestry industry to encourage the planting of trees.
- Research into how New Zealand will remain a world leader in agricultural emission reduction research.
- Improvement of fuel and energy efficiency in buildings, homes and businesses.

- A goal to reduce emissions from the transport sector, and to be one of the first nations to widely introduce electric vehicles.
- A goal to make the public sector carbon neutral.

To achieve these objectives, the government has adopted a number of aspirational targets for New Zealand. For example, by:

- 2020, New Zealand will have a net increase in forest area of 250,000 hectares;
- 2025:
 - 90% of New Zealand's electricity generation will be from renewable sources;
 - the electricity sector will be carbon neutral;
- 2030, the energy sector (including coal, natural gas and geothermal) will be carbon neutral;
- 2040:
 - New Zealand's per capita transport gas emissions will be reduced by half;
 - the total energy sector will be carbon neutral.

How will the emissions trading scheme work?

Much like the European model, the emissions trading scheme will be a 'cap and trade' scheme whereby the amount of greenhouse gases that can be emitted will be capped and those going over the cap will be required to either reduce their emissions or buy 'carbon credits' off entities whose emissions are lower than the cap. The idea is that by putting a price on greenhouse gas emissions, producers, consumers and investors will be influenced to reduce emissions and invest in environmentally friendly alternatives.

The scheme will apply to all parts of the economy that emit greenhouse gases (namely, carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride), including electricity generation, transport, industrial processes, forestry, agriculture and waste. There will be a range of exceptions, principally relating to those activities that involve minimal emissions, but precise details have yet to emerge.

The core design features of the scheme include:

- Participants being obliged to hold emission units reflective of the emission levels for which they are responsible and required to surrender one emission unit to cover each metric tonne of eligible emissions.
- Participants facing binding consequences for non-compliance, including penalties and 'make-good' provisions.

- Primary domestic unit of trade will be the New Zealand Unit (NZU), with each NZU being equal to a tonne of emissions. (The price of an NZU will, of course, be closely tied to the international price of carbon. The Government has indicated that the price could be around NZ\$15, but this is far from clear, with higher prices possible).
- Allowing sales to, and purchases from, international trading markets, ensuring market liquidity and price stabilisation.

In addition to those participants with an obligation to hold emission units there is also scope for entities or individuals to:

- Engage in trading emission units to take advantage of market opportunities; and
- Earn emission units for activities resulting in a reduction of total greenhouse gases being released (e.g. through forestry activities).

How will emission units be allocated?

Allocation of emission units will be a significant focal point. At this stage, allocation will take place by way of sales (most likely auction) and free allocation. The Government's thinking on this is, however, far from clear. At a minimum, the following underlying principles will apply:

- Broad equity of treatment between and within sectors.
- Avoidance of long-term regrets in designing and implementing short-run policies.
- Assistance for transition by being relatively generous in the first commitment period (2008-2012).
- No assistance for firms whose profits will be largely unaffected by introduction of the trading scheme.
- A favouring of assistance by way of free allocations.
- A move to zero assistance over time for overall efficiency, equity and administrative reasons.

The Government has also observed that it intends to be fair and generous in its initial allocations. In terms of those sectors that might be eligible for free allocations, the Government has specifically ruled out fuel companies and electricity generators. But it has indicated that some big emitters – facing competition from overseas entities not yet being confronted by emissions pricing – should receive generous levels of free allocations: up to 90% of their 2005 stationary energy and process emissions. At the same time, and even though it has not actually decided whether any direct obligations will be imposed on individual farmers (as opposed to processing companies), the Government has indicated that farmers will likely benefit from free allocation of emissions units, based on 90% of their 2005 emissions.

How exactly the Government will balance such concessions with its World Trade Organization and other international obligations is a moot point.

The method of allocation will differ widely from sector to sector, with significantly more details yet to emerge. In addition, there are a lot more aspects of the scheme that have yet to be fully addressed, including the tax treatment of NZUs, credits, liabilities etc.

When will the scheme be implemented?

The proposed emissions trading scheme will be introduced across the economy through a staged approach, so that by the start of 2013 all sectors (including forestry, transport, stationary energy, industrial processes, agricultural and wastes) will be included. The Government has identified the following as the commencement dates and initial compliance periods for each sector:

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, natural gas and geothermal)	1 January 2010	31 December 2010
Industrial process (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

New legislation will be required to introduce the emissions trading scheme and ensure that the obligations under the scheme can be effectively enforced. The Government has indicated that the requisite legislation will be introduced into Parliament before the end of the year and the main opposition party, National, has already indicated that it generally supports the framework.

It will be vitally important for all interested and affected parties to ensure that their views are conveyed in the lead up to, and during the forthcoming legislative process. At the same time, adjustments will need to start being made to some operations to ensure alignment with the proposed scheme.

How do I find out more?

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 sustainability and climate change issues, including how your interests can most effectively be managed, advanced and addressed under the recently announced package of initiatives, as well as associated initiatives, e.g. Waste Minimisation (Solids) Bill, the Energy Strategy etc.



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