



December 2008

Climate Change update

When we last updated you on the new Government's proposed approach to New Zealand's domestic implementation of its climate change obligations under international law, it appeared as if a radical revision was possible. National's support agreement with ACT included ACT's terms of reference for a Select Committee inquiry which suggested that climate change science would itself be reviewed.

One month on, the range of potential changes to New Zealand's approach does not look as radical. However, the process that the Government has announced could lead to some fundamental changes. It also creates opportunities for sector participants to lobby more effectively than they were able to achieve under the previous Government.

Emissions Trading Scheme under scrutiny

On 11 December 2008 Parliament issued the terms of reference for a select committee to conduct a review of the ETS. The committee has been tasked to:

- hear views from trade and diplomatic experts on the international relations aspects of this issue
- consider the prospects for an international agreement on climate change post Kyoto 1, and the form such an agreement might take
- require a high quality, quantified regulatory impact analysis to be produced to identify the net benefits or costs to New Zealand of any policy action, including international relations and commercial benefits and costs
- identify the central/benchmark projections which are being used as the motivation for international agreements to combat climate change; and consider the uncertainties and risks surrounding these projections
- consider the impact on the New Zealand economy and New Zealand households of any climate change policies, having regard to the weak state of the economy, the need to safeguard New Zealand's international competitiveness, the position of trade-exposed industries, and the actions of competing countries

- examine the relative merits of a mitigation or adaptation approach to climate change for New Zealand
- consider the case for increasing resources devoted to New Zealand-specific climate change research
- examine the relative merits of an emissions trading scheme or a tax on carbon or energy as a New Zealand response to climate change
- consider the need for any additional regulatory interventions to combat climate change if a price mechanism (an ETS or a tax) is introduced
- consider the timing of introduction of any New Zealand measures, with particular reference to the outcome of the December 2009 Copenhagen meeting, the position of the United States, and the timetable for decisions and their implementation by the Australian government

No Stopping the ETS – well for the moment anyway

Prime Minister John Key expects a response from the committee and draft legislation to amend the existing ETS legislation before 30 September 2009. However, in the interim the ETS will remain as law. This will prevent opportunistic deforestation. It means that obligations on forests owners that were effective from 1 January 2008 remain. Penalties can apply for non-compliance with reporting requirements and liabilities to pay for deforestation. As foresters don't have an obligation to pay for emissions (unless they deforest) John Key does not see them as a significant part of the scheme. 2010 is the deadline that he is focused on – it is at that time that the first participants (other than forestry) will be liable to pay for their emissions. By that stage Key expects a revised scheme to be in place.

Remember the Carbon Tax?

Despite the history of the colloquially known "fart tax", it has returned to the political agenda as fears have increased about the impact of the ETS on New Zealand's economy, particularly in these hard times.

The story of the carbon tax has similar overtones to the review situation today. After tax reviews in 2001, the government announced in 2002 its intention to introduce a carbon tax as part of its preferred policy package designed to address climate change. The proposal was to introduce the tax in April 2007, initially set at NZ\$15 per tonne of carbon dioxide emissions until 2012. The proposal allowed for fluctuation in the level of tax in the event of substantial and sustained deviations in the international price of carbon, yet restricted the ceiling for the tax for the initial period to NZ\$25 per tonne. These figures are now looking pretty attractive to those affected.

That proposal was for a tax to address all emissions from fossil-fuel based energy supply and use and industrial processes, as well as fugitive energy emissions of carbon dioxide, methane and nitrous oxide. A similar scope may well be contemplated today. (Note that this did not include agriculture, being in line with the international approach to this issue by the present government.)

The demise of the carbon tax followed a "full review" of New Zealand's climate change policy in June 2005. This occurred after revised projections of New Zealand's greenhouse gas emissions showed emissions had grown significantly more than was forecast. That review reported back in November 2005 that the carbon tax model was no longer a cost effective platform for achieving emissions reductions in New Zealand. Consequently the government announced it would not proceed with the carbon tax.

Could the economic modellers of today come up with a different result? Perhaps. Either model will still involve a cost to business. Clearly the ETS presents a variable price of carbon while a carbon tax could be set at a rate fixed by the government or other delegated authority. In the past a fixed rate for all sectors of the economy and households was identified as a problem. It potentially enabled household consumption to remain largely unchanged while business sectors faced significant economic challenges. Consequently it wouldn't be surprising to us if the concept of different tax rates for different sectors is explored during the review. The ETS can be pointed to as support for this approach: using a simple emissions factor for sectors and sub-sectors (as the regulations to date have done) to calculate average emissions per unit of output is akin to a carbon tax system for each sector.

Interestingly, Energy Minister Gerry Brownlee has indicated that he favours the ETS over a carbon tax and other regulatory interventions, though he professes to have an open mind on the issue.

The Debate

Apart from considering a carbon tax we expect the debate on the ETS to focus on more flexible price signals that do not penalise growth. This will be apparent in discussions about point of obligation, free allocation of units, the desire for a fiscally neutral scheme, possibly one where the tax payer bears some of the costs for industry and agriculture. The acceptability of relocating forests will also be revisited. Instead of a scheme that leans towards promotion of carbon leakage from New Zealand to other countries there may be more recognition of mitigation potential in New Zealand and exposure to international competition. This could be reflected in approach taken towards distributing "free" units.

For example, an intensity (per unit of output) emissions reduction target could be informed by cost effective emissions reduction potential (at the various sector levels) may be explored as a potential approach.

What is no longer included in the debate is the science of climate change. Draft terms of reference for the committee were initially prepared by the ACT party. The issue of the science behind climate change that was in the first draft dropped quietly away after serious concerns were raised about New Zealand's credibility on the world stage.

International links?

The negotiations for a post 2012 climate change framework (successor to the current Kyoto Protocol First Commitment Period) were launched in December 2007 and are scheduled to be completed by December 2009. New Zealand Government's negotiators are taking a strong stance on the need to address issues for agriculture and forestry before agreeing international commitment ranges. The potential exclusion of methane emissions from reduction commitments may be considered favourably in light of food security issues, the relatively short atmospheric life of methane in the atmosphere and the current lack of mitigation tools.

National has a watchful eye on the Australian Carbon Pollution Reduction Scheme and will be looking for possible areas of alignment. Details of [Australia's climate change targets](#) were released on 15 December 2008. In some key respects, the Australian proposals are more modest than anticipated. It is not difficult to contemplate affected New Zealand sectors from arguing that we should adopt a similarly measured response.

The Minter Ellison Legal Group has been advising on the Australian proposals as details have been revealed. If you would like more information about the Australian proposals or how they are likely to interrelate to the New Zealand proposals please contact us.

Conclusion

The new Government's approach to meeting New Zealand's climate change obligations provides further opportunities for affected sectors to advocate for different substantive outcomes than under the ETS, or different transitional arrangements. A carbon tax may be the preferred transitional arrangement. However, while the Select Committee process will provide better opportunities for sector participants to be heard than the compressed timeframe allowed for the Select Committee under the previous Government, New Zealand's response to climate change clearly remains a Government priority. We are already working with clients on potential approaches, and are happy to assist clients' thinking in these areas.

contacts

Joanne Dunne - Partner

T +64 9 353 9990
M 021 610 874
E joanne.dunne@minterellison.co.nz

John Peterson - Partner

T +64 4 498 5028
M 021 895 559
E john.peterson@minterellison.co.nz

Rachel Devine - Partner

T +64 9 353 9912
M 021 521 299
E rachel.devine@minterellison.co.nz

Matthew Andrews - Partner

T +64 4 498 5126
M 021 999 106
E matthew.andrews@minterellison.co.nz

Carolyn van Leuven - Partner

T +64 4 498 5008
M 021 220 0510
E carolyn.vanleuven@minterellison.co.nz

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