

Don't let ETS become a nightmare

BY STUART ORME*



THE EMISSIONS

Trading Scheme (ETS) is here to stay. It brings important legal implications to consider when providing advice to your clients, especially surrounding the

transfer of land ownership, whether it is by sale/purchase, or succession arrangement.

You could either save your clients a lot of money and hassle, or unwittingly allow them to fall into the dark depths of an ETS nightmare.

This article outlines the potential booby traps and how you can help your clients avoid them.

Overview

The ETS is governed by the Climate Change Response Act 2002 (CCRA). It identifies two classes of land: post-1989 and pre-1990 forest land.

Post-1989 forest land

This is land that was established in forest after 31 December 1989. Land that was in forest before this date, but was subsequently deforested between 1 January 1990 and 31 December 2007 (ie, the land use was changed to something other than forestry) is also eligible if it has since been re-established as forest. Post-1989 forest land can be exotic or indigenous species, providing it meets the forest land requirements.

It is completely **voluntary** for a post-1989 forest landowner to join the ETS. If the landowner chooses to become a participant, they can earn New Zealand Units (NZUs) as their forest grows, and they also have to surrender NZUs (in part or full) if their forest is harvested or destroyed.

When post-1989 forest land is registered in the ETS, a notice is lodged on the land title records. This notice provides a flag to prospective purchasers that the land is affected by the ETS.

Pre-1990 forest land

This is land that was already in forest on 31 December 1989 and remained in predominantly exotic forest on 31 December 2007.

Pre-1990 forest landowners are bound by the obligations that the CCRA enforces upon them, which are that the land must be used to grow forest in perpetuity. Harvesting pre-1990 forest is allowed but the land must be re-established back into forest within four years of harvest. If the land is converted to non-forest, then a deforestation obligation is created.

Pre-1990 forest landowners do not receive NZUs as their forest grows, but they were given the opportunity to apply for a one-off allocation of NZUs or an exemption to the deforestation rules of the ETS.

When a successful application for an allocation or an exemption for pre-1990 forest land is made, a notice is lodged on the land title records that the land is pre-1990 forest land (and hence affected by the deforestation provisions of the ETS) or is exempt from the ETS. Pre-1990 notices do not show the exact areas affected. The notice simply flags to prospective purchasers that the some part of the land is affected.

Deforestation: potential risk

Deforestation obligations apply to owners of pre-1990 forest land regardless of whether there is a notice on the title or whether an allocation has been received or not. Importantly, the absence of a notice on land title records is not evidence that the land or part of it is not pre-1990 forest land.

Understanding if deforested land exists on properties for sale or on properties purchased since 2008 should be part of any due diligence process applied before any sale and purchase agreement is entered into.

The following is a case study showing what may occur if 20ha of pre-1990 forest in the lower North Island is deforested:

- In 2009 a landowner fells a 20 ha stand of 30-year-old pine trees and does not replant.

- The farm is sold in 2011 to a new owner who continues to farm the land that has not been replanted.
- In 2012 the new owner is likely to receive a deforestation notice from MPI for immediate surrender of 17,140 NZUs, or in lieu of NZUs surrender a payment of \$428,500 (based on \$25/NZU) to the Crown.
- In addition to the above, the Crown may also impose a fine of \$30/NZU for not voluntarily advising MPI of the deforestation, which in this case would amount to \$514,200.
- Total potential cost to the new owner = \$942,700.

The CCRA does allow for an appeal. To date if there is voluntarily disclosure, or if extenuating circumstances apply, there has sometimes been movement on the amount this cost has settled at.

Offsetting as an alternative

In 2013, "offsetting" will be introduced to allow an owner of pre-1990 forest land to deforest. Offsetting is where new forest can be planted elsewhere in lieu of the deforested land.

The exact details of offsetting are still emerging. However, the rules regarding deforestation will still apply to pre-1990 forest land deforested up until at least the end of 2012.

Don't get caught out

When a post-1989 ETS participant (transferor) transfers, by way of sale, assignment, or by operation of law, an interest in all or part of the forest land, the ETS participation automatically transfers to the new ETS participant (transferee).

The transferor and transferee must notify MPI of the transfer within 20 working days by completing a "Transfer of Participation" form. Regardless of whether the transfer form is completed, if someone acquires post-1989 land that is ETS registered, they will automatically inherit the obligations registered against that land unless the previous participant withdraws the land from the ETS before the land transfer.

A not-so-well-known but very established fact regarding post-1989 forest land registered into the ETS

is that if the participant sells their property (or changes the names on the title by more than 40%) then they must make a Mandatory Emissions Return (MER) within 20 working days of the date of the transfer. Failure to do so would be in breach of the CCRA. This return confirms the transferor's obligations and entitlements up to the date of transfer.

What to look for on behalf of your client

If your client is looking to purchase land for future registration as post-1989 forest land in the ETS, then it is important to investigate the history of the land to confirm it is eligible. Historical photos, satellite imagery and farm records can help determine the status of the land as at 31 December 1989.

If the land is already registered in the ETS, important considerations are:

- If the forest land is not withdrawn from the ETS before the date of transfer, the new owner will automatically become the new participant in the ETS and be responsible for any subsequent surrender obligations.
- It is prudent to request information from MAF such as prior emissions returns and the unit balance for the forest land. Requests can be made by calling 0800 CLIMATE (254 628).
- If the vendor withdraws the land from the ETS before settlement of the sale, they will be responsible for any surrender obligations, so there will be no responsibility transferred to the new owner. Once the land is withdrawn, the notice that the land is affected by the post-1989 provisions of the ETS is removed from the land title.

My experience to date shows that

although the ETS registration will be noted on the title and although the CCRA is clear on the responsibilities of each party, due diligence practice is not as good as it could be. There may be parties in breach of the CCRA that will eventually be caught up with in 2013 – possibly when the Mandatory Emissions Return is not filed by a new landowner who does not realise they're in the ETS.

If you are affected by the above, I advise you to be proactive in remedying any oversight as soon as possible. It is an offence not to (knowingly or without reasonable excuse) provide any required emissions returns, notifications, information or documents, and fines may apply.

Post-1989 land transfer case study

A client approaches you having purchased a property at the beginning of this year, which they later find already has post-1989 forest land registered into the ETS. They request an explanation of:

- what obligations they may have inherited (if any);
- what, if any, responsibilities they now have; and
- what are the implications of not fulfilling those responsibilities.

The answers you could provide to your client:

- They have inherited the surrender obligations to Ministry of Primary Industries (MPI) for any credits the previous owner claimed and any future surrender obligations that may arise.
- They are required to do a Mandatory Emissions Return (MER) between 1 January and 31 March 2013 for the 2008 to 2012 commitment period.

- If they do not do a MER, MPI will eventually contact them requesting it. Because they will have committed an offence by not completing the return on time, penalties may apply, including a fine of up to \$8,000 (it is likely that this will be the first time many parties in this situation will discover they are obligated and also in default of the CCRA).
- At the date of land transfer, the previous owner had 20 working days to affect a Mandatory Emissions Return and Transfer of Participation to the new owner who has automatically become the new ETS participant through purchasing post-1989 registered land. If the previous owner has not submitted a Mandatory Emissions Return as above, they are in default of the CCRA and their responsibilities.

Summary

The effects and implications of the CCRA are only just beginning to emerge. The ETS should always be investigated and considered when providing professional advice to clients, whether it be embracing its opportunities or mitigating its risks. [LT](#)

**Stuart Orme is a Registered Forestry Consultant and ETS adviser to New Zealand lawyers. He is from Woodnet, a Wairarapa-based independent forest advisory and management company providing a wide range of services to land and forest owners and the professionals who support them. See www.woodnet.co.nz.*

Reference: Some information in the above article has been obtained from Forest Land Transactions in the Emissions Trading Scheme, published by MAF, May 2011. This guide can be obtained from www.mpi.govt.nz.



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