

EMISSIONS TRADING — HAS AUSTRALIA FOUND THE RIGHT BALANCE?

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Of the many aspects of the Carbon Pollution Reduction Scheme Bill 2009 ('Bill'), this paper will investigate whether the emissions trading aspect is compatible with relevant international instruments. The compatibility of the Bill with the European Union regulations and, by necessity, with the requirements embedded within the Kyoto Protocol will also be explored. Without access to the international market the economic impact of the Emissions Trading Scheme ('ETS') will be significant, as the Australian market is small and, hence, prices will be inflated in comparison with the open international market.

I INTRODUCTION

A The Australian Trading System

Australia has responded to the challenge of reducing greenhouse gases by signing the Kyoto protocol. The instrument of ratification was signed on 3 December 2007¹ with the ratification coming into effect on 11 March 2008.² As a result, the draft of the Carbon Pollution Reduction Scheme Bill 2009 (Cth) (the 'Bill') was released on 10 March 2009.³ In addition, the Minister for Climate Change and Water, Senator Penny Wong, authorised circulation of the *Exposure Draft: Carbon Pollution Reduction Scheme Bill (2009): Commentary* ('Commentary')⁴ to assist in the understanding of the Bill. The Commentary states:

Different levels of scheme caps will have different economic implications, including on likely carbon prices and/or the flow of funds outside Australia to purchase eligible international units. In addition, judgements about the

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1 Australian Government, *Kyoto Protocol* (2009) Department of Climate Change <<http://www.climatechange.gov.au/en/government/initiatives/kyoto.aspx>> at 28 November 2009.

2 United Nations Framework Convention on Climate Change ('UNFCCC') *Australia: Ratification Status* (2009) UNFCCC Parties and Observer States <<http://maindb.unfccc.int/public/country.pl?country=AU>> at 30 September 2009.

3 Australian Government, *CPRS Legislation* (2009) Department of Climate Change <<http://www.climatechange.gov.au/government/initiatives/cprs/cprs-progress/legislation.aspx>> at 28 November 2009.

4 Penny Wong, *Exposure Draft: Carbon Pollution Reduction Scheme Bill 2009: Commentary* (2009) <http://www.aph.gov.au/Senate/committee/economics_ctte/cprs_09/commentary_cprs_bill.pdf> at 28 June 2010.

appropriate level of the cap will take into account the carbon price and economic impacts arising from observing the actual operation of the cap in previous years.⁵

This statement accurately reflects the problems of the economic impact the Bill could have on the Australian economy. It is one thing to state an aspirational goal, but it is an entirely different thing to evaluate the strengths and weaknesses of a proposed legislative framework. This is made particularly difficult without having had the opportunity to observe the actual operation of the cap and trade system in Australia, nor even of a pilot scheme with government participation.

The Australian carbon price was initially set at A\$40 per ton,⁶ a price level above any international market price. The Bill also proposes to introduce an auction system.⁷ Of interest therefore are the results of the first auction of emission units held in the US on 25 September 2008 under the auspices of the Regional Greenhouse Gas Initiative ('RGGI'),⁸ which shows that 59 separate entities submitted bids to purchase four times the available supply of allowances.⁹ The bids range from a minimum of US\$1.86 to a maximum of US\$12.00 with an average mean of US\$2.77. In its *Carbon Review*, the Australia and New Zealand Bank ('ANZ') notes that the commodity prices have decreased, trading at around A\$10.90 in April 2009.¹⁰ The conclusion is that the prices are volatile and that they are likely to drop further considering the issue of a high volume of free permits.

Even if the operations of other countries were considered, it would only give an indication as to what is an appropriate system. The point is, that of all the aspects of a regulatory framework, the real test is: '[d]oes it work, keeping in mind the intended audience?'. A test has never been seriously attempted by the Australian Government and, furthermore, it is generally understood that economic modelling regarding cost implications by various interest groups has not delivered consistent outcomes.

Not surprisingly, two months after the release of the Bill, major concessions were granted to relevant industry groups by the government. These concessions included increasing the conditional reduction target to 25 per cent below 2000 levels by 2020¹¹ and lowering the set carbon price per unit for Australian Emission

5 Ibid [2.19].

6 Australian Government, *Carbon Pollution Reduction Scheme: Australia's Low Carbon Pollution Future: White Paper* (2008) xxxi ('White Paper').

7 See generally, *Carbon Pollution Reduction Scheme Bill 2009* (Cth) pt 4 div 2 sub-div C.

8 Regional Greenhouse Gas Initiative, *RGGI States Release Post-Settlement Auction Report on the Nation's First Carbon Dioxide Emissions Auction* (2009) <http://www.rggi.org/docs/Auction_1_PostSettlement_Release_MM_Report.pdf> at 28 November 2009.

9 Ibid. See specifically, Memorandum from Potomac Economics to RGGI Inc, 16 October 2008 <http://www.potomaceconomics.com/uploads/documents/Auction_One_Assessment.pdf> at 18 June 2009.

10 Julie Toth and Astarini Suyono, *ANZ Carbon Review* (2009) ANZ 5 <<http://www.anz.com/documents/economics/ANZ%20Carbon%20Review%20May%2009.pdf>> at 18 June 2009.

11 Australian Government, *Fact Sheet: Strengthening Australia's 2020 Carbon Pollution Target* (2009) Department of Climate Change <http://whitepaper.climatechange.gov.au/whitepaper/measures/pubs/fs_Carbon_Pollution_Target.pdf> at 28 November 2009. The government has stated that this target is conditional on the international community reaching an agreement to stabilise the emission of greenhouse gases at '450 parts per million CO₂-equivalent or lower' by mid century.

Units ('AEUs') to A\$10.¹² Furthermore, the price of A\$10 is fixed for the first year and AEUs cannot be banked in the first year.¹³

Despite the assurances of the government, concerns regarding shortfalls and inconsistencies are still being raised by industry and academics alike. This is not surprising as the Bill heralds the beginning of a new structural adjustment. As was pointed out, 'we need to restructure our economies as we change the things we produce and the way we produce them'.¹⁴

At a community level, it is accepted that a reduction of greenhouse gasses is a priority. Doing nothing is simply not an option, as the effects of climate change are already noted by academics, scientists and governments. From a business point of view, it is also generally accepted that in doing so, painful structural adjustments are needed.¹⁵ Business cannot absorb the costs of restructuring alone, nor can it pass on all the costs to the end users. In response, the government has indicated that structural adjustment packages are to be allocated.¹⁶ Indeed it is understood within industry at large that 'changes in policy occur on a regular basis [necessitating] some form of structural adjustment'.¹⁷ Simshauser added that the structural adjustment needed from the Carbon Pollution Reduction Scheme has been rarely experienced with such intensity.¹⁸

The Australian Power Market believes that 'a range of approximately [A]\$12–\$15 billion in wealth transfers [is needed] when an ETS case is compared to business as usual on an asset base of [A]\$53 billion'.¹⁹ The suggestion is that about a 30 per cent increase in costs is expected and few in this particular industry believe that an adjustment package will be anywhere near those figures.²⁰ The Minister for Climate Change, Senator Penny Wong, in her address to the G20 Workshop, said that the commitment included 'the provision of [A]\$500 million through the National Low Emissions Coal Fund, and the development of a new legal framework for carbon capture and storage'.²¹ Further provision for the promotion of clean energy and complementary program in the 2009–10 Budget. The government

12 Mallesons Stephen Jaques, *Australian Government Tables Emission Trading Legislation – 14 May 2009* (2009) <<http://www.mallesons.com/publications/2009/May/9914497W.htm>> at 28 November 2009.

13 Toth and Suyono, above n 10.

14 Martin Parkinson, 'The Economics of Climate Change and its Policy Implications' (Speech delivered at G-20 Workshop on the Economic and Financial Implications of Climate Change, Sydney, 13 February 2009) 1.

15 Andrea Hasan and Leigh Funston, *The Introduction of Australia's Emissions Trading Scheme: Level of Understanding among CEOs/Senior Executives* (2008) Australian Institute of Management <<http://www.aim.com.au/research/AIM%20Emissions%20Trading%20Scheme%20Survey.pdf>> at 24 June 2009.

16 See generally, Carbon Pollution Reduction Scheme Bill 2009 (Cth) pt 8.

17 Paul Simshauser, 'On Emission Permit Auction vs. Allocation and the Structural Adjustment of Incumbent Power Generators in Australia' (2008) 21(10) *The Electricity Journal* 30, 40–1.

18 *Ibid.*

19 *Ibid* 9–10.

20 *Ibid* 10.

21 See Penny Wong, 'Official Dinner Keynote Address' (Speech delivered at the G-20 Workshop on the Economic and Financial Implications of Climate Change, Sydney, 13 February 2009).

committed a further A\$3.5 billion through its Clean Energy Initiative.²² This includes the Carbon Capture and Storage Flagship projects which will promote innovative developments in ‘low emission coal technologies’.²³

The power industry arguably would be one of the worst affected industries, but the fact remains that adjustments are needed and they can be painful in some circumstances. The problem so far is perceived to be the lack of direction offered by the Bill. Senator Fielding noted that he is ‘concerned that the government doesn’t really know what it wants to do’.²⁴ The Bill was introduced in its present form into the Senate on 15 June and in a doorstep interview, Senator Penny Wong made it clear that the Bill needs to be passed in its present form because it is in the national interest.²⁵

B International Linkages and Competitiveness

What ought to be obvious is that, purely from an efficiency perspective, and to keep compliance costs to a minimum, any trading scheme must be compatible with the prevailing international view. The cost factor is always a significant consideration for business. Being competitive in the international market depends on a cost structure which is at least in line with other competitors. In addition, it can be confidently stated that EU and Chinese governments will assist their industry to be competitive through tariffs, subsidies or tax concessions. To level the playing field, Australia must look to introduce internal as well as external effective border measures. These measures are not new and several countries including Australia have flagged the introduction of a tax associated with imports to complement climate change policies.²⁶ It is obvious that these measures must take into consideration Australia’s international trade commitments as well as the political implications which would flow from the imposition of a tax, specifically with developing nations.

Any international trade in carbon credits has two aspects which need to be compatible. Firstly, there has to be a secure and standardised system of registering permits and secondly, the allowable units which can be traded must be in conformity with the global registration systems. It would be of no value to have a domestic system of trade which is not compatible with an international one. The reasons are many but are best encapsulated in the following comment from the Australian Industry Group’s Chief Executive:

22 Australian Government, *Budget Measures 2009–10: Budget Paper No 2: Part 2 Expense Measures: Resources, Energy and Tourism* (2009) The Treasury <http://www.ato.gov.au/budget/2009-10/content/bp2/html/bp2_expense-22.htm> at 28 November 2009.

23 Ibid.

24 John Breusch, ‘Rudd’s Bid to Win Business Support’, *The Australian Financial Review* (Sydney) 5 May 2009, 6.

25 Interview with Penny Wong (Doorstop Interview, Canberra, 15 June 2009) <<http://www.climatechange.gov.au/~media/Files/minister/wong/2009/transcripts/June/tr20090615.ashx>> at 28 November 2009.

26 *Carbon Scheme Vote Putt Off Until August* (2009) ABC News (Online) 25 June 2009 <<http://www.abc.net.au/news/stories/2009/06/25/2608273.htm>> at 20 August 2009.

Robust measures to ensure the competitiveness of trade-exposed industries are critical while costs of greenhouse gas emissions imposed on domestic industries are not also imposed on businesses in the countries with which we compete.²⁷

This observation is critical in the development of any domestic legislative framework. It would be economically unsound — to say the least — to devise a carbon reduction scheme which does not allow Australian industry full access to the international trading markets and hence remain competitive. Industries are quick to respond to business opportunities offered by overseas governments. As an example, '[o]n March 23 2009, China's Ministry of Finance and State Administration of Taxation jointly issued a Notice on the Policy of Enterprise Income Tax for China Clean Development Mechanism Fund ("CCDMF") and China Clean Development Mechanism ("CCDM").²⁸ In brief, the proceeds from the sales of certified emissions reductions ('CER') attract a reduction of up to 65 per cent of the sales price of the CER. Furthermore, any enterprise that invests in Clean Development Mechanism ('CDM') projects in China will be exempt from an enterprise income tax for three years.²⁹ It does not take much imagination to realise that such an incentive will encourage relocation of companies and that China will have a decisive influence in the trade of global carbon credits specifically in CDM units. This is supported by the fact that 73 per cent of the total volumes of CDM projects are located in China.³⁰

It is argued that before a greenhouse abatement scheme is implemented, it ought to have the mechanical aspects such as registration and trade well bedded down. It would also be anticipated that these regulations pertaining to registration and trade in carbon permits are easily understood and are compatible with the major players. It is obvious that international trade in carbon credits can only progress if the registration process is commonly accepted and therefore instils the necessary confidence in the authenticity of the carbon credits.

Also, the tradable instruments must be accepted by potential buyers and sellers as truly being of a tradable nature, that is, readily passed on. Whether the carbon credits should be classed as financial instruments³¹ or goods is an issue which is not discussed in this paper. It is sufficient to note that the lessons regarding financial instruments triggering the Global Financial Crisis should not be forgotten.

Considering that the EU has the only legislated and operating trading scheme,³² it is of value to compare the EU scheme with the proposed Australian one. Linkage in itself may pose advantages but on the other hand may also have significant impacts

27 Breusch, above n 24.

28 William Zheng, Sheppard Mullin Richter & Hampton LLP, *China Introduces Tax Incentives for Clean Development Mechanism Projects* (2009) The Sheppard Mullin China Law Update <<http://www.lexology.com/library/detail.aspx?g=645a0d25-287c-4fed-8319-2c993255af45>> at 5 January 2010.

29 Ibid.

30 Karan Capoor and Phillippe Ambrosi, *The World Bank: State and Trends of the Carbon Market 2008* (May 2008) 27.

31 Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 (Cth) sch 1 pt 1 div 1 s 6.

32 Lenore Taylor, 'The EU Out on a Limb With Carbon Scheme', *The Australian* (Sydney) 28 May 2009, 5.

on the Australian scheme. Some of the obvious problems are that a linkage of the two schemes may have a significant impact on the Australian permit price considering that the EU market is four to five times larger.³³ Furthermore, the coverage of the EU scheme is narrower than the Australian one. For example, it does not include forestry or agriculture, which Australia may include at a later stage.³⁴

This paper restricts itself to an examination of the compatibility of the Australian registry with EU regulations and an analysis of the object of trade, namely the various emission units. If the register and the surrendered emission units do not match up, trade will simply not develop. Therefore, it is crucial to the success of the Bill that Australian legislation is specifically synchronised with international developments. This is of importance given the fact that Australia is not a pivotal player.

It is already obvious that the ‘flipside’ of trade, namely dispute resolution regulations, have been left out of the Bill. As mandatory arbitrations have not been included into the Bill, it must be assumed that international private laws will determine the applicable legal system where disputes can be resolved. Of course, this observation does not extend to contracts executed on a derivatives exchange or any direct contractual arrangements, but only to the legislative framework dealing with trading aspects and Australia’s international commitments.

In summary, it is argued that a sound internationally compatible trading platform is the foundation on which governments and business can build and change domestic legislation and regulations where necessary to assist the international competitiveness of Australian industry. The Commentary to the Bill does set out the most important criterion, namely that ‘the Australian Carbon Pollution Reduction Scheme creates a link between this scheme and the international market for Kyoto units’.³⁵ The question is: how liberal or restrictive is the link between the Australian and EU systems?

II TRANSACTION LOGS

The EU, pursuant to the *Commission Regulation No 2216/2004*,³⁶ developed a standardised and secure system of registries, taking into account the importance of a worldwide connecting system. The preamble noted:

The Community independent transaction log will perform automated checks on all processes in the Community registries system concerning allowances, verified emissions, accounts and Kyoto units, and the UNFCCC

33 See Frank Jotzo and Regina Betz, *Linking the Australian Emissions Trading Scheme* (2009) Australian National University [16] <http://www.crawford.anu.edu.au/research_units/erh/pdf/EERH_RR14.pdf> at 5 January 2010.

34 Ibid [17].

35 Wong, *Commentary*, above n 4, [2.5].

36 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1.

independent transaction log will perform automated checks on processes concerning Kyoto units to ensure that there are no irregularities. Processes that fail these checks will be terminated to ensure that transactions in the Community registries system comply with the requirements of Directive 2003/87/EC and the requirements elaborated pursuant to the UNFCCC and the Kyoto Protocol.³⁷

Article 1 further elaborates on the technical requirements of the transaction logs but specifically notes that there must exist an efficient communication system between the interdependent logs of the EU and *United Nations Framework Convention on Climate Change* ('UNFCCC').³⁸

The implication for an Australian scheme is apparent. The minimum requirement is compliance with the system as proposed by the UNFCCC and the EU, otherwise international trade of Australian permits is not possible, or at best difficult. At a cursory glance, compliance is not obvious, as Part 7 of the Bill merely includes legislation in relation to a national Registry of Emissions unit.³⁹ Section 145 (3) states that 'the Registry is to be maintained by electronic means' and subsection (4) notes

The purposes of the Registry are as follows:

- (a) to be a registry for Australian emissions units:
- (b) to be Australia's national registry for Kyoto units.⁴⁰

Whilst the EU Regulation uses language which is decisive and clear, the Bill is devoid of detail. The Commentary does mention 'that the Registry must be maintained by electronic means in the form of a standardized electronic database', and refers to s 145 (3) and (4). The Bill does refer in the definitional section to the existence of the international independent transaction log which is established, operated and maintained by the Secretariat of UNFCCC,⁴¹ and it can be assumed that the Australian Registry is compatible with the international transaction log. It would have created greater certainty if this information had been included in s 145 (4) (c) in order to clarify the relationship between the Australian registry and the UNFCCC log.

It must be assumed that at some stage further legislation and regulations need to be passed to fill these gaps if the legislation is to become compatible with an international trading system. Furthermore, art 6(3) of the EU directive points to the fact that the Commission 'may instruct the Central Administrator to temporarily suspend the communication link between a registry and the Community independent transaction log'.⁴²

37 Ibid 4; see generally *United Nations Framework Convention on Climate Change*, opened for signature 9 May 1992, 1771 UNTS 107 (entered into force 21 March 1994) ('UNFCCC').

38 Ibid 5.

39 Carbon Pollution Reduction Scheme Bill 2009 (Cth) pt 7.

40 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 145.

41 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 5.

42 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, 7.

It appears most likely that the same procedure would also be applied to any non-EU register which wishes to interlock with the EU Community independent transaction log. This is important, as art 10(3) describes the sequence and the units of registrations.⁴³ In particular, art 7 clearly states that the registration is only completed ‘through the exchange of data via the UNFCCC independent transaction log and thereon to the Community independent transaction log’.⁴⁴ The EU Directive in essence elevated the UNFCCC as the overarching controller and conduit of registration of allowances, verified emissions, accounts, automatic national allocation plan table changes and Kyoto units.⁴⁵

The Bill on the other hand does not specify any method by which a transfer can be affected. Section 112(1) does allow a transfer of Kyoto units to a foreign account, however s 112(2) also indicates that regulations can be made for the purpose of either restricting or preventing a transfer to a foreign account or from a foreign account to a Registry account.⁴⁶ It is therefore possible that regulations can be introduced to isolate the Kyoto units to domestic trade only. However, of interest are ss 109 and 110, where it appears that a person can give notice to the Authority to ‘transfer the units from the relevant Registry account ... to a foreign account kept by another person’.⁴⁷

Taking EU Directive 2216/2004 into consideration, it appears that the Australian Authority will follow the procedure laid down in the EU directive and perform all relevant steps to transfer — for the purpose of this paper — units from an EU account via the UNFCCC transaction log into the Australian log and then into the relevant ‘personal’ registry account. However there is no clear indication contained within the legislation as to whether the flow as described above will be executed. It appears logical that the Authority should perform these tasks, and at a cost which will be determined in the future. The effect of this process is that business needs to factor in not only the cost to purchase the permits but also the various registration and transfer costs, which include the administrative time and processes allocated to this task by individual businesses.

A further point which has not been clarified is whether Australia is actually compliant with international requirements. The commentary to the Bill does acknowledge this fact and states that ‘[i]f Australia does not satisfy the set of eligibility requirements no transfers of Kyoto units will be allowed’.⁴⁸ The eligibility requirements for Australia, an Annex I country, to trade under the Kyoto Protocol are set out in art 6.⁴⁹ One of the commitments is listed in art 3, which in brief notes that Australia needs to reduce its ‘overall emission of [GHG] gases by at least 5 per cent below 1990 levels in the commitment period 2008 to

43 Ibid 8.

44 Ibid 7.

45 Ibid.

46 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 112.

47 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 109(1)(c).

48 Wong, *Commentary*, above n 4, [2.73].

49 *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 16 March 1998, 2303 UNTS 148, art 6 (entered into force 16 February 2005).

2012', and that it has 'made demonstrable progress in achieving its commitments under this protocol'.⁵⁰ However, no guarantee is given that at this stage the eligibility requirements are satisfied.

In contrast, EU Regulation 2216/2004 gives clear indications as to how the process will work. Arguably, it would instil greater confidence in the Bill if this crucial aspect of the trading system had been positively noted. It is quite obvious that if Australia fails to be compliant, trade would be restricted to the domestic market only and higher cost implications would follow. A further point must be added. The EU Regulation also makes note of the CDM registry, which is established, operated and maintained by the executive board of the CDM pursuant to art 12 of the Kyoto Protocol.⁵¹ The Bill, on the other hand, does not make a clear mention of the fact that two central registries are maintained by different international bodies

III TRADABLE UNITS

In order to give effect to the Bill, the Australian and EU systems of emission units and associated gateways will be discussed and compared. This is important as only the EU is currently operating an emission reduction scheme. The Commentary to the Bill correctly notes that 'determining the emissions units that can be used for surrender is fundamental to the operation of the scheme'.⁵² As a surrender of units is fundamental, it is also imperative that the Australian scheme is compatible with international registries and units. In other words there needs to be a seamless exchange of units and every register must be able to handle a through flow of all units as described by international models. Any other scheme in Australia would weaken economic competitiveness.

Several criteria are outlined in the Commentary, namely that the emission units are tradable and that Australia must fulfil its obligation under the Kyoto protocol by retiring Kyoto units.⁵³ However the commentary also makes it clear that, at least initially, not all Kyoto units will be able to be surrendered.⁵⁴ The legislation left room to prescribe additional units which can be issued in accordance with the Kyoto Protocol.⁵⁵ In addition, the government will not allow the Australian emission units to be exported. The problem is that at the current proposed cost of A\$10 per tonne, nobody would be able to sell the units, as the current price on most derivative markets is or could be well below the Australian mark. Furthermore,

50 *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 16 March 1998, 2303 UNTS 148, art 3 (entered into force 16 February 2005).

51 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, 5.

52 Wong, *Commentary*, above n 4, [2.3].

53 *Ibid* [2.4].

54 *Ibid* [2.51].

55 *Ibid* [2.27].

unless the final Bill, which will be accepted by Parliament if it passes through the Senate, makes it compulsory to purchase domestic units and only accepts primarily Australian Emissions Units for the purpose of surrender, industry will not buy domestic emission units unless they are issued free of charge, which is anticipated. The structure of the auction system arguably supports the above argument, as the ascending clock auction will be employed. The system is explained in the white paper as follows:

the auctioneer announces the current price. Bidders indicate the number of permits they are prepared to purchase at that price. If demand exceeds supply, the auctioneer raises the price in the next round and bidders resubmit their bids. This process continues until the number offered is equal to or greater than demand. Bidders then pay the price from the previous round.⁵⁶

The obvious problem is that companies will purchase where the costs are lowest. Hence, absent legislative restrictions to the contrary, the auction system will form part of a profit induced mechanism. In other words, companies will know where the market is lowest and will purchase in that market and not necessarily in the domestic auction system. This means that in the initial years an outflow of funds is inevitable, which of course means that the Authority would arguably have problems balancing their accounts.

The Bill in s 82 mentions three types of units: the Australian emission units, Kyoto units and non-Kyoto international emissions units. However, the scheme makes a distinction between ‘eligible emission units’ and other units which are not allowed to be surrendered within the Australian Scheme. Section 5 merely defines an eligible emission unit as ‘an Australian emissions unit or an eligible international emissions unit’.⁵⁷

However, under the Bill it is clear that some Kyoto Units can not be used for compliance purposes. Assigned Amount Units (‘AAUs’) will not be able to be used for compliance purposes.⁵⁸ AAUs are of particular importance, as they represent a country’s allocation under the Kyoto Protocol regarding the amount of emissions that an Annex 1 country can produce during a given commitment period.⁵⁹ Furthermore, ‘temporary and long term certified emissions reductions’ as a result of forestry based projects cannot be used for compliance purposes either.⁶⁰ Simply put, more detail would have been useful in understanding the scheme in a global context.

56 Australian Government, *White Paper*, above n 6, ch 9, 23.

57 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 5.

58 Wong, *Commentary*, above n 4, [2.51].

59 Australian Government, *White Paper*, above n 6, *Appendix C: Implementing the Kyoto Protocol*, C-6.

60 Australian Government, *International Linking* (2009) Department of Climate Change <http://climatechange.gov.au/emissionstrading/legislation/pubs/international_linking.pdf> at 28 November 2009 (Copy on file with author).

A Australian Units

The Australian emission units ('AEUs') are issued on behalf of the Commonwealth pursuant to s 83 and are identified by a unique number.⁶¹ The last four identification numbers relate to the year of issue.⁶² However, because of Australia's unique system where a financial year is different to a calendar year, the Bill has introduced the term of 'vintage year'.

As an example, where a number identifies 2011, the eligible financial year would be 30 June 2011, but from an international point of view the eligible year ends on 30 December 2011. As the AEUs have no expiry date,⁶³ this distinction of vintage years appears to be of little if any utility, especially considering that the units can be banked and additional units can be borrowed.⁶⁴ The issue is: how will imported units with no identification of a vintage year affect the surrendering provisions?

The AEUs, pursuant to s 88, can either be issued as a result of an auction or pursuant to s 89 for a fixed charge. Alternatively an AEU may also be issued free of charge as part of an emission-intensive trade-exposed assistance program. Section 93 explains that the issue of AEU 'equals the national scheme cap for that vintage year'.⁶⁵ It is doubtful whether the authority will be able to sell all the proposed AEUs for the reasons discussed above. However, there is no debate that all the free AEUs will be taken up, which raises the question: who bears the cost of issuing the AEUs? It can confidently be argued that the uptake of A\$10 AEUs will be limited, and will be less than the issue of the free units. Furthermore, as units are issued 'equal to the cap', any imports of international units will increase the volume of available units, leading to a price fall of Australian AEUs. Already approximately 11 brokers are operating in Australia,⁶⁶ which means that every business will be able to access international units via brokers. Furthermore, AEUs which have been issued free of charge can still be sold by the Authority if they have not been transferred.⁶⁷ It is not clear whether the free units can or will be sold into the derivatives market and repurchased when there is a price differential.

B Kyoto Units

In s 105, the Bill provides that Australia can issue assigned amount units, which are defined as a unit 'issued in accordance with the relevant provisions of the Kyoto rules. It is immaterial whether the unit was issued in or out of Australia'.⁶⁸ The

61 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 83–4.

62 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 85.

63 Wong, *Commentary*, above n 4, [2.34].

64 *Ibid.*

65 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 93.

66 Graeme Anderson, 'Farming Carbon — An Update' (2008) 43 *Victorian Landcare* 16.

67 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 101.

68 Carbon Pollution Reduction Scheme Bill 2009 s 5.

proposed legislation does not make a clear distinction between a Kyoto unit and the AEU. The Commentary notes though that the Kyoto Protocol only provides for an ‘overarching framework with relevant decisions made by the Meeting of the Kyoto Parties providing the detail’.⁶⁹ This may be true but it has not deterred other parties such as the EU to progress past the initial framework.

Of interest is the distinction to be found within the Bill between the provisions relating ‘to holding and transferring Kyoto units and those relating to surrendering of eligible international units’.⁷⁰ Some units such as assigned amount units are not eligible to be surrendered but are able to be held and transferred in the Australian Registry⁷¹ This is puzzling as the Bill in s 5 defines Kyoto units as meaning:

An assigned amount unit,⁷² or a certified emission reduction⁷³ or an emission reduction unit⁷⁴ or a removal unit⁷⁵ or prescribed unit issued in accordance with the Kyoto Protocol.⁷⁶

The Bill also provides that regulations can be made to ‘prevent, restrict or limit the transfer of Kyoto units’⁷⁷ between accounts. It appears that s 112(2) is inconsistent with the functioning of an international registry. Article 63, for example, dealing with the retirement of Kyoto units in the European scheme notes that ‘the registry administrator shall transfer any quantity and types of Kyoto units’.⁷⁸ However, under the EU scheme not all Kyoto units can be used for compliance purposes. Besides the European Union allowance units, (‘EUAs’), only CERs and ERUs can be used.⁷⁹ Furthermore art 25 of the Directive 2003/87/EC⁸⁰ clarifies the relationship with other trading schemes. This article states:

69 Wong, *Commentary*, above n 4, [2.50].

70 Ibid [2.51].

71 Ibid.

72 These units are issued by an ‘Annex 1’ country on the basis of assigned amounts pursuant to art 3.7 and 3.8 of the *Kyoto Protocol: Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 16 March 1998, 2303 UNTS 148, art 3.7, 3.8 (entered into force 16 February 2005).

73 These units are the result of clean development mechanism projects pursuant to art 12 of the *Kyoto Protocol*.

74 Joint Implementation (‘JI’) projects within another ‘Annex 1’ country generate emission reduction units pursuant to art 6 of the *Kyoto Protocol*.

75 Issued by an ‘Annex 1’ country in relation to land use and change under art 3.4 and 3.3 of the *Kyoto Protocol*.

76 Carbon Pollution Reduction Scheme Bill 2009 (Cth) s 5.

77 Carbon Pollution Reductions Scheme Bill 2009 (Cth) s 112 (2).

78 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, 19.

79 Department of Energy and Climate Change, Environment Agency, *A Guide to Using Kyoto Units in the European Union Emissions Trading Scheme (EU ETS)* (2008) 6 <http://www.environment-agency.gov.uk/static/documents/Business/2008-11-12_Guide_to_Allowances_and_Kyoto_Units.pdf> at 14 March 2010.

80 *Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 Establishing a Scheme for Greenhouse Gas Emission Allowance Trading within the Community and Amending Council Directive 96/61/EC* [2003] OJ L 275/32, 39.

Article 25

Links with other greenhouse gas emissions trading schemes

1. Agreements should be concluded with third countries listed in Annex B to the Kyoto Protocol which have ratified the Protocol to provide for the mutual recognition of allowances between the Community scheme and other greenhouse gas emissions trading schemes in accordance with the rules set out in Article 300 of the Treaty.
2. Where an agreement referred to in paragraph 1 has been concluded, the Commission shall draw up any necessary provisions relating to the mutual recognition of allowances under that agreement in accordance with the procedure referred to in Article 23(2).

However, the point is, if a unit is included in the interdependent logs of the EU and UNFCCC, Australian limitations will be contrary to the stated aim of the Bill which purports to be ‘internationally friendly’. Senator Wong also pointed out that the government has ‘chosen a market-based approach’,⁸¹ which arguably is not completely reflected in the Bill as a ‘market’ in a globalised world is international in character.

It can be argued that if a unit is included in any independent log, and specifically in the independent log managed by the UNFCCC, any contrary view found in the Bill is counterproductive and only leads to confusion. Furthermore, any global corporation will find legitimate ways and means to overcome any restrictions as products on the derivatives market are globally traded. Additionally, inter- and intra-company transfers of units would be difficult to control. Hence the distinction within the Bill between eligible and non-eligible international Kyoto units appears to be artificial and at first glance defies logic.⁸²

In addition, it does not appear that the current Bill is easy to understand and easy to implement. The only clear matter is the fact that the Bill only mentions a registry and not several registries. It can be assumed that all Kyoto units must be recorded in the same registry. If that were the case, why then distinguish between different types of units? It is only of utility if the five named types of Kyoto units would attract either a different trading price, differing values for offsets, or are traded on different markets. It must be understood that CDMs are different as they are recorded in a specially dedicated log. That does not mean that the differing types of Kyoto units should not have different labels, as it clearly indicates their origin and allows the trader to make a decision as to which product they prefer. Therefore, it is of little utility — unless clearly demonstrated — that the transfer of Kyoto units distinguishes between domestic and international transfers and outgoing and incoming transfers, as found in Division 3 of the Bill. It only adds to the complexity of trading in carbon credits.

81 Wong, ‘Keynote Address’, above n 21.

82 Whether the effect of the ‘controlling corporation’ provisions within the Bill staves off this eventuality needs to be seen.

A further point needs to be added in relation to the international transfer of units which is addressed in s 129 under the heading ‘How eligible emissions units are surrendered’. The Commentary notes that the government retains the right to exclude certain types of Kyoto units from being transferred into the registry in order to ensure the environmental integrity of the scheme and to ensure that the scheme is not ‘open to a “flood” of compromised units’.⁸³ The problem with this section is, as the EU regulation correctly points out:

The UNFCCC⁸⁴ independent transaction log will perform automated checks on process concerning Kyoto units to ensure that there are no irregularities. Processes that fail these checks will be terminated to ensure that transactions in the Community registries system comply with the requirements of the Directive 2003/87/EC and the requirements elaborated pursuant to the UNFCCC and the Kyoto Protocol.⁸⁵

Simply put, if the UNFCCC transaction log refuses entry of a unit, all national registers would follow suit. Therefore it is puzzling to note that Australia reserves the right for unilateral decisions of refusal. It can only lead to conflict and additional costs if the situation arises where the UNFCCC log is at odds with the Australian registry or vice versa. Simplicity of a system would dictate that as long as a unit is registered in the UNFCCC log it should be accepted in all national registries. Besides what principles would the authority use to declare a unit as being compromised?

It must also be understood that carbon units are not only a cost but — as they are proprietary rights — also a value. This leads to a suggestion that it would be easier and more cost effective not to buy a Kyoto unit but to engage in ‘carbon cost pass through’. The quantity of carbon emitted as a result of producing the goods is passed on by the seller as part of a contract in a supply chain as a discount to the buyer. The discount would be the total cost when the carbon units are surrendered in the buyer’s country. In other words, an EU buyer would procure an allowance and then surrender it through the EU log. It stands to reason that if the greenhouse gas emissions are proprietary rights, not only the unit but the actual emission is tradable. A contractual arrangement would be sufficient as long as it is not in conflict with the Bill or EU regulations, which it does not appear to be. The simple advantage is that strategic ‘carbon cost pass through’ will overcome any problems of whether any units could be compromised or could not be surrendered in Australia. Cost effectiveness would also be a feature.

83 Wong, *Commentary*, above n 4, [2.82].

84 *United Nations Framework Convention on Climate Change*, opened for signature 9 May 1992, 1771 UNTS 107 (entered into force 21 March 1994).

85 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, Preamble.

C Non-Kyoto International Emissions Units

The Bill describes these units in s 5 as meaning:

A prescribed unit issued in accordance with an international agreement (other than the Kyoto Protocol) or a prescribed unit issued outside Australia under the law of a foreign country.

The Commentary notes that a unit ‘would only be prescribed as a non-Kyoto international emission unit where the intention is to add to the types of international units that can be used for surrender’.⁸⁶ Several questions come immediately to mind. Firstly, if only units that appear in the UNFCCC transaction log can be universally traded, why run the risk of allowing a unit to be included into the Australian registry which subsequently may prove to be unsaleable? The only advantage is that such a unit may at least be able to be surrendered possibly in Australia only.

Secondly, it is not clear what situation could possibly arise which would make it necessary to create another type of a unit, as already five Kyoto units are described in the Protocol. Furthermore, any dealings with non-Kyoto countries would most likely result in CMD-type units, which are registered in a different log. It can be argued that for the sake of a label, the simplicity and ease of understanding of the Bill has been diminished, and the utility of such a possible event must be questioned.

D EU Tradable Units

The EU Regulation 2216/2004 clearly describes the units which can be traded on the open market through the independent transacting log. Article 7(3) lists the following types: allowances, verified emissions accounts, Kyoto units and automatic national allocation plan table changes.⁸⁷

In essence, the tradable units as described in the EU regulations are similar, if not the same, as the ones described in the Bill. This is not surprising, as the types of units and their descriptions are based on the Kyoto Protocol, and both the European Community and Australia are signatories to the treaty.⁸⁸ However, the significant difference is the way the registries or the transaction logs deal with the various types of units. The EU does not appear to register ERUs and CERs within

⁸⁶ Wong, *Commentary*, above n 4, [2.95].

⁸⁷ *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, 7.

⁸⁸ *United Nations Framework Convention on Climate Change*, opened for signature 9 May 1992, 1771 UNTS 107 (entered into force 21 March 1994). Australia became a signatory on 3 December 2007 and the European Commission became a signatory on the 29 April 1998 and ratified the instrument on the 31 May 2002.

its transaction log, but art 11(a), adopted by Directive 2004/101/EC,⁸⁹ allows the operators to use CERs and ERUs to be exchanged for AAUs. There is, however, a cap in place as a particular percentage of allocations of ‘allowances ... to be specified by each Member State in its national allocation plan for that period’.⁹⁰

This appears to be a better solution than the one advocated by the Bill. The problem as to the recognition of ERUs, which are the result of Joint Implementation (‘JI’) projects, and CERs resulting from CDM projects has become a purely domestic one.

The problem with these units is that double counting is possible. Specifically in JI projects an investor may wish to transfer the units to his base company in another state. Hence the:

[Transformation] of an on-going JI project into an installation subject to allowance trading may result in legal and contractual difficulties for both the investor and the host country that have made a bilateral arrangement for the acquisition and transfer of ERUs.⁹¹

The problem is not only restricted to ERUs but also to CERs. As mentioned above, the Chinese government allows significant benefits accruing to CDM projects. The problem is that inconsistencies between registers can lead to disputes. The EU has somewhat resolved this issue by the exchange of units into allowances, hence any dispute is kept within a member state and is subject to local laws. It is not helpful to argue that ‘we and the EU have different design features in our schemes reflecting our different industrial structures and comparative advantages’.⁹² If a global system and international connections are priority design features of a scheme, it must be at least compatible with international trade in carbon credits. If it is not, it will disadvantage Australia, and not the EU, as only Australia is a minor player.

E Mutual Recognition of Tradable Units

A further problem appears to be the transfer of allowances and Kyoto units by accounts holders pursuant to art 49(2).⁹³ Transfers of allowances into or out of the EU log is only allowed:

89 *Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 Amending Directive 2003/87/EC Establishing a Scheme for Greenhouse Gas Emission Allowance Trading within the Community, in Respect of the Kyoto Protocol’s Project Mechanisms* [2004] OJ L 338/18.

90 *Ibid* 20.

91 Proposal for a Directive of the European Parliament and of the Council amending the Directive establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol’s project mechanisms, COD 2003/0173, [SEC(2003) 785], Explanatory Memorandum, [3.2].

92 Parkinson, above n 14, 8.

93 Proposal for a Directive of the European Parliament and of the Council amending the Directive establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol’s project mechanisms, COD 2003/0173, [SEC(2003) 785], art 49(2).

where an agreement has been concluded in accordance with Art 25(1) of Directive 2003/87/EC and such transfers are in accordance with any provisions relating to the mutual recognition of allowances under that agreement drawn up by the Commission pursuant to Art 25(2) of Directive 2003/87/EC.⁹⁴

The Bill does not make any specific mention of the necessity to require mutual recognition with the EU log or even with the log managed by the UNFCCC. The problem is that the Australian Bill has not clearly worked out the relationship of transfers in and out of national registers. Specifically it does not address the problem of allowances bought in the derivatives market. It can be assumed that the transfer will take place at a later stage similar to shares bought at the stock exchange. However it does not eliminate the problem of mutual recognition between registers. It appears that if that is the case, a potential source of disputes has been created, and the maxim of *caveat emptor* would hardly be a defence in these cases.

IV DISCUSSION

If the Bill is read from a macro point of view, it can be argued that it is in tune with international obligations and with the EU regulations. However, it still lacks the clarity of the EU regulation and Directives and is unnecessarily complicated. It also lacks the precise technical quality that the EU Directives display. The Bill seeks to cover not only reasonable possibilities, but attempts to devise solutions for non-existent problems. British Petroleum ('BP') significantly noted:

The cornerstone of a successful emissions trading program is having a robust and credible system in place to measure, and where appropriate, verify the greenhouse gas data used in the trading scheme.⁹⁵

It is argued that the Bill did not apply the lessons learned which relate to market fundamentals such as a simple system which is target specific and specifically:

[It is critical] to establish a clear set of simple trading guidelines — designed for the 90% of 'good actors' instead of focusing on the 10% of bad actors.⁹⁶

This statement sets two parameters. Firstly, governments must introduce a cap and trade system which achieves the goal of a broad compliance. Secondly, a trading system should be implemented which in essence, must be global, should be simple, and must be arguably without undue interference of governments and have strong

94 *Commission Regulation (EC) No 2216/2004 (Regulation 2216/2004) of 21 December 2004 for a Standardised and Secured System of Registries Pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No. 280/2004/EC of the European Parliament and of the Council* [2004] OJ L 386/1, 16.

95 Mark Akhurst, Jeff Morgheim and Rachel Lewis, 'Greenhouse Gas Emissions Trading in BP' (2003) 31 *Energy Policy* 657, 657–63.

96 *Ibid.*

and robust international linkages. After all the ‘big players’ are multinationals or organisations that operate in supply chains which are multinational in character.

It has been stated that the ‘Climate Change framework is cast in terms of three pillars, all with a significant economic dimension’.⁹⁷ That is indeed true, and the government intended to achieve this with an ‘innovative and market-based approach’.⁹⁸ However, the problem is that innovative and market-based approaches still ought to be situated within a compatible global system; otherwise the innovative approach may deliver negative results. Considering that the first pillar lists as the key objective: ‘to introduce an explicit long-term forward price for carbon, bringing the externality of climate change into investment and behavioural decisions’⁹⁹ a long term forward price arguably will not be achieved, as the derivatives market already quotes cheaper prices than the proposed A\$10.

It is unlikely that a derivatives market will deliver explicit long-term forward prices as there will always be a difference between spot and futures prices. Furthermore, prices under an auction system are known to be extremely volatile. Also as the government decided to declare carbon units as financial products¹⁰⁰ the lessons of the Global Financial Crisis speak against long term explicit prices given the character of the product. Therefore the Bill, and for that matter any other legislation, will simply not achieve such a goal.

The second pillar of the Bill is to take account of the risk of the adaptation to climate change, which is unavoidable.¹⁰¹ The Bill does attempt to do so by the issue of free AEU’s, as well as the attempt to create an assistance program for emission-intensive, trade-exposed industry sectors. Whether the assistance is sufficiently broad and effective needs to be road tested first. Australia cannot afford to get it wrong as it is understood that otherwise, climate change has the ‘potential to be catastrophic — threatening GDP growth, living standards, prices and industry prospects’.¹⁰²

The third pillar is ‘forging a global solution to the challenge [and] to arrive at a global solution’.¹⁰³ It is specifically this area which is of concern. The point is, how can Australia arrive at a global solution as a very small player if only the EU has a system which is operational? It can be argued that the government ought to wait at least until the end of the year after the Copenhagen Conference, the 15th Conference of the Parties (‘COP’), before any decisions are made. It is extremely doubtful, if not impossible, to believe that the US and other big players will take note of the Bill. It is already noted in this paper that compatibility with the EU system is not clear and no precise functional legislative policies have been implemented or are on the table. The Minister herself noted in her keynote

97 Parkinson, above n 14, 2.

98 Ibid.

99 Ibid.

100 Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 (Cth) sch 1 pt 1 div 1 s 6.

101 Parkinson, above n 14, 2.

102 Ibid 4.

103 Ibid 2.

address that the scheme ‘has been designed so as to link eventually with other international schemes as these schemes are implemented and mature’.¹⁰⁴ The problem to link ‘eventually’ into other systems is contrary to logic and also to the advice by Treasury.

The modelling by the Australian Treasury certainly is correct in noting that ‘changing policy involves potentially stranding assets, particularly long-lived assets like power stations or industrial plants’.¹⁰⁵

This raises the important question as to why the push to have a legislation passed is so strong when it will only come into effect in 2011, when the impact of the Bill can be assessed comparatively with other legislative frameworks once they are put into operation. It is interesting to note that New Zealand¹⁰⁶ is waiting for Australia, and Canada for the USA, to ‘make a move’. It can be argued that the higher the stakes the more careful one ought to be.

In relation to carbon leakage, the government stated that the trading scheme ‘has been designed to avoid creating incentives for carbon leakage’¹⁰⁷ — that is, the relocation of emitters to third countries, which inevitably increases global emissions.¹⁰⁸ It has been amply demonstrated that industry will relocate, and examples especially in the textile and footwear industry are abundant where industries relocated to China to reduce their costs and remain competitive in a global market.¹⁰⁹ Australia appears to be vulnerable as, unlike the governments of the EU and other countries, the Australian government is not enthusiastic to introducing tariffs or export subsidies to protect domestic industries. The EU has recognised the factor of ‘carbon leakage’ and the Commission is already preparing for such an event by identifying by 2010 possible energy intensive sectors which may be subject to carbon leakage. In anticipation, it is proposing to allocate up to 100 per cent free allocations, or an effective carbon equalisation system could be introduced.¹¹⁰ Several leading Australian businesses, for example Onesteel, Australia’s second biggest steel maker, have also expressed the view that the current design of the ETS will ‘lead to job losses and force new investments offshore’.¹¹¹ This view has not changed significantly despite the recent concessions by the government.¹¹²

104 Wong, ‘Keynote Address’, above n 21, 10.

105 Parkinson, above n 14, 5.

106 New Zealand does actually have legislation. At this stage it is anticipated to have the *Climate Change Response (Emissions Trading) Amendment Act 2008* (NZ) phased in between 2008 and 2013.

107 Parkinson, above n 14, 7.

108 Proposal for a Directive of the European Parliament and the Council amending the Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading system of the Community, COD 2008/0013, [SEC (2008) 52], 7.

109 As an example see AAP, ‘Bonds latest brand to head offshore’, *The Age* <<http://www.theage.com.au/business/bonds-latest-brand-to-head-offshore-20090225-8hmt.html>> at 25 February 2009.

110 Ibid.

111 Lenore Taylor, ‘Steel Chief Sounds Jobs Alarm Over Carbon Scheme’, *The Australian* (Sydney), 18 February 2009, 5.

112 Paul Garvey, Ayesha De Krester and Alexander Symonds, ‘Opponents Vow to Step up Fight’, *The Australian Financial Review* (Sydney), 5 May 2009, 7.

One of the possible solutions is to create a system where the reverse is encouraged. Considering the efforts China is undertaking to attract industry, it is difficult to imagine that some industries will not be attracted and shift their operations to China, specifically in the field of CDMs. As pointed out above,¹¹³ China is offering a reduction of up to 65 per cent from the proceeds of the sales of CDM units and any enterprise investing in CDM projects is exempt from an enterprise income tax for three years.¹¹⁴ It is difficult to see whether a company that already receives tax cuts and other benefits should also be allowed to transfer CERs into its own registry. Arguably, a case of double counting can be made. It is therefore imperative that this area needs to be controlled by bi-lateral agreements or, alternatively rewrite existing Free Trade Agreements ('FTAs').

Carbon leakage can also be avoided if at least transitional assistance is implemented. There is no doubt that countries such as Japan, as well as the EU specifically, will introduce subsidies and tariffs to maintain a competitive industry sector. The Australian Government has at least noted that:

The challenge for central economic agencies is to design efficient and effective mechanisms; to ensure that such arrangements are not a guise for protection; and to phase out these arrangements as rapidly as possible.¹¹⁵

It is arguably a good time to reconsider protection, even if it means subsidies in one way or another. In a sense, free AEU's can be classed as subsidies, especially as they can be traded.

A The Effect of the Bill on Australia's Other International Obligations

As indicated earlier, Australia is party to a number of agreements and is also a member of several organisations such as the World Trade Organisation ('WTO'). Two points need to be noted: firstly, the potential clash with FTAs' and Bilateral Investment Treaties ('BITs'); and secondly, whether the problem of carbon leakage has been properly addressed.

In addressing the first point, the government should incorporate general principles contained in the agreements into the Bill, such as 'most favoured nation' principle,¹¹⁶ and the 'national treatment' principle.¹¹⁷ Environmental measures are a new consideration in international trade rules and the commitments of individual countries do not take into consideration the affect of climate change measures (such as ETS) on international trade. Establishing a coherent association between trade in bilateral and multilateral agreements is growing in importance. Whilst current international agreements do not include specific provisions to address

113 Zheng, above n 28.

114 Ibid.

115 Wong, 'Keynote Address', above n 21, 8.

116 Prohibits discrimination in trade between parties to a trade agreement.

117 Prohibits favourable treatment towards domestic commodities over imported ones.

environmental measures, the WTO agreement and a small number of FTAs do have indirect mechanisms which have potential use for resolving climate change challenges. However, these are not specific to climate change, and it is likely that the applicability will be decided through a dispute settlement mechanism. A closer study is essential in order to describe accurately the influence of the Bill on Australia's commitment to multinational agreements.

V CONCLUSION

This paper merely examined one small aspect of the cap and trade system, namely the registration of permits and the types of tradable units. A comparison with the current system of the EU indicates that the two systems are not the same. Whether an interlocking and smooth transfer of units between the two systems is possible is not certain. The differences may appear superficial, however the significant fact is that there is a difference. It can be argued that any difference can either lead to disputes, or business will simply find a way around the problem. This can have economic ramifications if Australia is perceived to have a comparatively more complicated register. It is not clear why the government is attempting to push the legislation through the two houses of parliament at this time, but implement it in 2011. It would be prudent to listen to the stakeholders who have genuine concerns that can be addressed immediately. It would seem logical that the purpose of any draft Bill is to listen to genuine concerns, and it is equally obvious that the government should not take self-serving suggestions into consideration.

This observation is given weight if the fact is taken into consideration that the EU started to devise a legal framework in 2003. The current EU system is the result of many amendments based on practical experiences and discussions with stakeholders. Unfortunately, the same cannot be said of the Australian legislative framework. It would make more sense to discuss the matter further and take note of academic research that is taking place at the moment. It can easily be seen that Australia is a minor player, and as the government does not have an appetite for subsidies and tariffs, Australian industry is nervous. If the government does not devise the legislative framework on a cap and trade system correctly, an Australian recovery from the financial crisis could be prolonged. It is simply not the time to add an additional cost burden on the economy in a time when the business sector is recovering from the Global Financial Crisis. It is strongly argued, that specifically in this case, Australia should sit back and watch and make a decision when the time is right. To be the leader in a field may be an advantage, but in this instance it is of little utility. It is surprising that the government is determined to have the Bill passed as soon as possible, despite the more sensible option of exploring the outcome of the Copenhagen Conference in December 2009 before committing to any targets and timetables.

It will be inevitable that disputes emanating from the cap and trade legislation will arise. Australia is not in a good position, as our legal system has little experience in this area, unlike the United States. Despite the fact that the US cap and trade

system is not yet developed, any dispute resolution mechanism concerning credits and trading will rely significantly on the precedent of the sulphur dioxide trading system (EPA) under Title IV of the *Clean Air Act 1990* (US).¹¹⁸

Lessons from the past twenty years should not be forgotten, as the general move towards international uniform laws has proven to be of advantage. Indeed, this current financial crisis has demonstrated that solutions based on domestic policies and laws do not supply the best solutions. Schwarzman commented in the *Wall Street Journal*:

As the global economy becomes more interconnected, we need better global over-sight. It is unimaginable that America's financial market could function effectively if we had to rely on 50 separate state regulators. But we are trying to do essentially that at the global level.¹¹⁹

The trade in carbon credits is a prime candidate for inclusion into the uniform international law regime. It is argued that as Australia is insignificant in the international trade of emission units, it ought to take note of developments in the EU and the United States. It is imprudent to develop 'an Australian solution' as, in the end, our economic wellbeing and competitiveness can be compromised. Can Australia afford to reduce its manufacturing and agricultural base any further?

118 *Clean Air Act* 42 USC Title IV (1990).

119 Stephen Schwarzman, 'Some Lessons of the Financial Crisis', *Wall Street Journal* (New York) 4 November 2008.

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