

# OVERVIEW OF POLICY AND REGULATORY EMISSIONS TRADING FRAMEWORKS IN AUSTRALIA

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*The election of the Australian Labor Party to Government on 24 November 2007, the subsequent and immediate ratification of the Kyoto Protocol, the setting of a longer-term target to reduce emissions by 60% by 2050 and plans to commence an Emissions Trading Scheme by 2010 and significantly increase the share of renewable energy in our national generation mix to 20% by 2020 represent a new era in climate change policy for Australia. As the detail of these policies develop over the coming months and years, careful thought will need to be given to designing our national emissions trading scheme. This article will provide an overview of the new policy and regulatory frameworks, focusing on the proposed frameworks for emissions trading in Australia.*

## 1. INTRODUCTION

The election of the Australian Labor Party to Government on 24 November 2007 has resulted in a significant shift in Australian climate change policy. The Rudd Government immediately ratified the Kyoto Protocol and has reaffirmed its intention to introduce a National Emissions Trading Scheme to commence in 2010.<sup>1</sup> It has also set a longer-term target to reduce emissions by 60% by 2050<sup>2</sup> and has announced plans to increase the share of renewable energy in our national generation mix to 20% by 2020. This bundle of measures represents a full turnaround of the position adopted by the previous Government and places Australia as a global leader alongside the European Union in terms of climate change policy development. It also signals a clear commitment on the part of the Government to ensure levels of anthropogenic emissions of greenhouse gas emissions are in accordance with those safe levels recommended by the Intergovernmental Panel on Climate Change. However, much of the detail will not be known until later this year and it is such detail that will ultimately determine the price of carbon, the impact that this will have on the Australian economy and our ability to limit and reduce national levels of greenhouse emissions.

This article will examine the new climate policy framework for Australia but with specific focus on the existing and proposed frameworks for emissions trading in Australia. It will begin with the proposed National Emissions Trading Scheme (NETS) and Australian Emissions Trading Scheme (AETS), which scheme designs were partly developed prior to the Federal election and are now likely to be drawn upon for a national emissions trading scheme under the new Federal Labor Government. Following this, the article will consider the newly implemented mandatory greenhouse and energy reporting scheme which will provide the data to underpin the national emissions trading scheme, and analyse the NSW Greenhouse Gas Reduction Scheme (GGAS) and the Commonwealth Government's Greenhouse Friendly program, both of which are already in operation. The article will conclude by briefly considering Professor Ross Garnaut's recently

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<sup>1</sup> Australian Labor Party, "Labor's Five Tests for an Effective Emissions Trading Scheme", <http://www.alp.org.au/media/0507/msCCloo301.php> (30 May 2007).

<sup>2</sup> Australian Labor Party, "Labor's Greenhouse Reduction Target - 60% by 2050 Backed By the Science", <http://www.alp.org.au/media/0507/msCC020.php> (2 May 2007).

released interim report on the costs of climate change to the Australian economy and the Garnaut Review's subsequent report on emissions trading scheme design, released on 20 March 2008.

## 2. A HISTORICAL PERSPECTIVE

During the mid-1980s, climate change began to emerge as a real issue on the Australian political and policy landscape. Global negotiations around a treaty were underway and the media focussed increasingly on the problem. The then Australian Government (under Labor Governments led by Bob Hawke and Paul Keating) adopted an ambitious climate policy aimed at stabilising national greenhouse gas emissions at 1988 levels by the year 2000 (the Interim Planning Target) and then reducing emissions by a further 20 percent by 2005 (the Toronto target). These goals were reflected, by December 1992, in the National Greenhouse Response Strategy (NGRS), which set out a range of voluntary low- and no-cost measures to achieve emission reduction targets.<sup>3</sup> At this time, Australia was enthusiastically and cooperatively involved in the *United Nations Framework Convention on Climate Change* (UNFCCC) negotiations, advocating mandatory emission reduction targets, and was the eighth sovereign state to ratify the Convention.

By 1994, it had become clear that NGRS was failing to achieve its aspirational targets.<sup>4</sup> The energy, mining and transport sectors successfully lobbied the Government not to implement a carbon tax (on the basis of its potentially damaging effects to Australia's resource-intensive economy)<sup>5</sup> and the program was ultimately replaced by a new package of measures, *Greenhouse 21*. The new policy, which also set out voluntary, non-binding targets, similarly failed to achieve the intended reductions.<sup>6</sup>

In March 1996, a Liberal (conservative) Government led by John Howard replaced the Labor Government. The Liberal Government transferred responsibility for climate negotiations from the Commonwealth Environment Department to the Department of Foreign Affairs and Trade. In doing so national policy also shifted from one of leading a multi-lateral approach to climate change to one based protecting our "national interest" (in general, support for fossil fuel energy use and exports and the development of energy-intensive manufacturing industries such as aluminium and magnesium smelting).<sup>7</sup> This position was consolidated in August 1997 with the release of the White Paper, *In the National Interest*, emphasising the importance of protecting national economic growth and downplaying support for multilateral climate change action, and reemphasised in November 1997 in the Prime Ministerial Statement *Safeguarding the Future*.

*Safeguarding the Future* set out Australia's negotiating objectives at COP 3 in Kyoto. On the basis of the UNFCCC's reference to "common but differentiated responsibilities" (a phrase intended to differentiate the responsibilities of developed and developing countries), Australia argued for differentiated targets between Annex B (developed) countries. Under the threat of defecting from the multilateral process altogether, Australia negotiated a relatively lenient target of

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<sup>3</sup> Commonwealth Government of Australia, National Greenhouse Response Strategy (Canberra: AGPS, 1992).

<sup>4</sup> National Greenhouse Advisory Panel, Report on the National Greenhouse Response Strategy (Canberra: Environment Australia, 1996).

<sup>5</sup> Peter Christoff, "Market-Based Instruments: The Australian Experience", in R Eckersley (ed), *Markets, the State and the Environment: Towards Integration* (Macmillan, Sydney, 1995), pp 157–193

<sup>6</sup> Peter Christoff, "Policy Autism or Double-Edged Dismissiveness? Australia's Climate Policy Under the Howard Government" (2005) 17 (No 1) *Global Change, Peace & Security*.

<sup>7</sup> Ibid.

108% of 1990 emissions by the end of the first commitment period in 2012, making it one of the few States to negotiate a target of increased emissions over the baseline year. In late 1997, then-Prime Minister John Howard joined the US Republican Senators in calling for binding targets on developing countries, despite the principle of common but differentiated responsibility being enshrined in the UNFCCC. Although this was not ultimately adopted, Australia did extract the concession of the “Australia clause”, whereby countries for which land-use change (ie deforestation) represented a net source in 1990 were permitted to add these emissions to their initial assigned amount, significantly easing the burden on Australia of meeting its first commitment period goal.

Despite growing global support for multilateral climate change agreement, in 1998 Cabinet moved further from Kyoto, declaring that it would not ratify the Protocol unless the US did so. When President Bush announced his opposition to the Protocol, stating that the US would not ratify, Foreign Minister Alexander Downer announced that Australia would follow suit, despite general agreement within the Government that Australia’s negotiated target was a good outcome for Australia. Nonetheless, some in Government continued to push for ratification and the introduction for emissions trading. In 2000 and 2002, successive Environment Ministers (Robert Hill and David Kemp) publicly expressed support for the Kyoto Protocol, and Senator Hill advocated (without success) for the introduction of a national emissions trading scheme. Detailed analysis of the design of an emissions trading scheme was undertaken and the then Australian Greenhouse Office published a series of reports on scheme design. A further proposal by Minister Kemp for a national emissions trading scheme in 2004 was again rejected by Cabinet. In July 2004, John Howard ruled out altogether the introduction of an emissions trading scheme.

Meanwhile, the Labor Party reiterated during its unsuccessful 2001 and 2004 election campaigns its support for ratification of the Kyoto Protocol, and the NSW and Victorian State Labor Governments under Bob Carr and Steve Bracks moved to implement measures to limit and reduce emissions. The NSW State Labor Government established the NSW Greenhouse Gas Abatement Scheme (GGAS), now called the Greenhouse Gas Reduction Scheme, the first mandatory greenhouse gas emissions trading scheme in the world. Several State Governments followed suit with mandatory renewable energy targets and Queensland’s 13% Gas Scheme.

In 2004, the Labor Premiers and First Ministers of the States and Territories established the National Emissions Trading Taskforce (NETT) to develop detailed design propositions for a national emissions trading scheme (NETS). The latest report on the design of the NETS was released in August 2006 (although other reports on subsidiary issues and consultations have also been released since).<sup>8</sup> Since at the time the NETT was established, the Howard Government’s stated position was that it would not implement any form of emissions trading scheme, the Labor State and Territory Governments charged the NETT with developing a scheme which could be implemented at a State level. However, it was always the stated preference of the States and Territories that the scheme be implemented at a Federal level if this was ultimately possible.

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<sup>8</sup> National Emissions Trading Taskforce, *Discussion Paper: Possible Design for a National Greenhouse Gas Emissions Trading Scheme*, [http://www.emissionstrading.nsw.gov.au/key\\_documents/discussion\\_paper](http://www.emissionstrading.nsw.gov.au/key_documents/discussion_paper) (August 2006). See also <http://www.emissionstrading.net.au>.

The scheme designed by the NETT was to be implemented through mirror legislation, implemented by a lead State and then enacted in each participating State.<sup>9</sup> This is the arrangement adopted for the National Electricity Market (NEM), where the *National Electricity (South Australia) Act 1996* (SA) sets out in its Schedule the National Electricity Law, and each NEM State has enacted an “Application Act” providing that the National Electricity Law in force for the time being applies as a law of that State.

During this period a growing awareness by the public on climate change started to occur largely as a result of the drought, privately sponsored public advertising campaigns, visits by Al Gore and Sir Nicholas Stern to Australia, the release of a number of business round table reports on climate change and a Government Opposition running hard on the issue. On 4 December 2006, the Australian Labor Party elected Kevin Rudd as leader, and he quickly reaffirmed climate change as a priority issue and a point of differentiation to the Government.

In responding to this momentum and with a Federal election no more than a year away, in December 2006, the then-Prime Minister John Howard announced to the Business Council of Australia that his Government would now investigate emissions trading as a means to address climate change, a reversal of the policy advanced for the previous 11 years.<sup>10</sup> The Prime Minister’s Task Group on Emissions Trading (Task Group) was soon thereafter established, and was charged with advising on “the nature and design of a workable global emissions trading system in which Australia would be able to participate... and [any] additional steps that might be taken, in Australia, consistent with the goal of establishing such a system”. The Task Group interpreted this broad mandate as an invitation to develop design propositions for a national emissions trading scheme, in parallel to the NETT process. The Task Group released its final report in May 2007.<sup>11</sup>

During this period, on 31 March 2007 Kevin Rudd held a National Climate Change Summit in Canberra, inviting key leaders in the field to debate the future of national climate change policy. A key issue at the Summit and in the broader political debate was and continues to be what impact both climate change and an emissions trading regime would have on the Australian economy. While the Government left this issue to the Prime Minister’s Task Group, immediately after the Summit, the Labor Party commissioned Professor Ross Garnaut of the Australian National University to conduct an Australian version of the Stern Review Report on the Economics of Climate Change.<sup>12</sup> The full terms of reference for the so-called Garnaut Review<sup>13</sup> are as follows:

“To report to the Governments of the eight States and Territories of Australia, and if invited to do so, to the Prime Minister of Australia, on:

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<sup>9</sup> National Emissions Trading Scheme, *Discussion Paper: Possible Design for a National Greenhouse Gas Emissions Trading Scheme*, Ch 8, “Institutional Arrangements” (p 148), [http://www.emissionstrading.nsw.gov.au/\\_data/assets/pdf\\_file/0020/1973/Discussion\\_Paper\\_-\\_Ch\\_8\\_-\\_Institutional\\_arrangements.pdf](http://www.emissionstrading.nsw.gov.au/_data/assets/pdf_file/0020/1973/Discussion_Paper_-_Ch_8_-_Institutional_arrangements.pdf) (August 2006).

<sup>10</sup> *Prime Minister’s Address to the BCA 2006 Annual Dinner*, <http://www.bca.com.au/Content.aspx?ContentID=100889>, 13 November 2006.

<sup>11</sup> This report is no longer available online.

<sup>12</sup> [http://www.hm-treasury.gov.uk/independent\\_reviews/stern\\_review\\_economics\\_climate\\_change/stern\\_review\\_report.cfm](http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm)

<sup>13</sup> Garnaut Review Terms of Reference, [http://www.garnautreview.org.au/CA25734E0016A131/WebObj/GarnautClimateChangeReviewTermsofReference2007/\\$File/Garnaut%20Climate%20Change%20Review%20Terms%20of%20Reference%202007.pdf](http://www.garnautreview.org.au/CA25734E0016A131/WebObj/GarnautClimateChangeReviewTermsofReference2007/$File/Garnaut%20Climate%20Change%20Review%20Terms%20of%20Reference%202007.pdf) (30 April 2007).

1. The likely effect of human induced climate change on Australia's economy, environment, and water resources in the absence of effective national and international efforts to substantially cut greenhouse gas emissions;
2. The possible ameliorating effects of international policy reform on climate change, and the costs and benefits of various international and Australian policy interventions on Australian economic activity;
3. The role that Australia can play in the development and implementation of effective international policies on climate change; and
4. In the light of 1 to 3, recommend medium to long-term policy options for Australia, and the time path for their implementation which, taking the costs and benefits of domestic and international policies on climate change into account, will produce the best possible outcomes for Australia. In making these recommendations, the Review will consider policies that: mitigate climate change, reduce the costs of adjustment to climate change (including through the acceleration of technological change in supply and use of energy), and reduce any adverse effects of climate change and mitigating policy responses on Australian incomes.

This Review should take into account the following core factors:

- The regional, sectoral and distributional implications of climate change and policies to mitigate climate change;
- The economic and strategic opportunities for Australia from playing a leading role in our region's shift to a more carbon-efficient economy, including the potential for Australia to become a regional hub for the technologies and industries associated with global movement to low carbon emissions; and
- The costs and benefits of Australia taking significant action to mitigate climate change ahead of competitor nations; and
- The weight of scientific opinion that developed countries need to reduce their greenhouse gas emissions by 60 percent by 2050 against 2000 emission levels, if global greenhouse gas concentrations in the atmosphere are to be stabilised to between 450 and 550ppm by mid century. Consult with key stakeholders to understand views and inform analysis.

A draft Report is to be distributed for comment by June 30 2008. The final Report is to be completed and published by September 30 2008. Interim draft reports on particular issues may be released before that time for public discussion. The Report will embody the independent judgments of its author."

In the months that followed climate change became an increasingly important election issue and both the Government and the Labor Opposition now endorsed the introduction of an emissions trading scheme. However, the Labor Party continued, unlike the Government, to support both ratification of Kyoto Protocol and a substantial increase in our renewable energy target. Labor also over the last six months of 2007 released a raft of other climate change policies. On 24 November 2007 the Labor Party was elected to Government.

Prime Minister Rudd ratified the Kyoto Protocol on his first day in office, and the Australian delegation to COP/MOP 3 announced this ratification on behalf of the Australian Government on the opening day of the Bali conference. This was followed on Wednesday 6 February 2008 by a statement by the new Minister for Climate Change, Senator Wong, when addressing business

leaders at an Ai Group lunch, setting out high-level principles for the domestic climate change strategy to be put in place by the Rudd Government.<sup>14</sup> Her speech, “Climate Change – A Responsibility Agenda”, contained the announcement that the new Federal Government would implement a cap-and-trade emissions trading scheme with the following design features:

- A trajectory designed to minimise the economic impacts of transition (presumably less stringent caps early on, becoming more stringent over time);
- Broad sectoral coverage (over 70% of national emissions), consulting with agriculture and forestry on prospects for their inclusion as the scheme design develops;
- Potential for international linkages;
- Compensation for emissions-intensive, trade-exposed industries and other strongly affected industries;
- Measures to assist low-income households to adjust to the impact of carbon price;
- Commencement by 2010, with scheme design finalised by the end of 2008; and
- Complementary policies, including the already-announced Clean Energy Target.

However, the Federal Labor Government has resisted committing to binding targets in advance of receiving the final report from the Garnaut Review on the costs of climate change for the Australian economy. Although commissioned at a time when Federal Labor was in Opposition, with the election of the Labor Party to Government, the Garnaut Review has now become the primary analysis for determining the way in which future Australian climate policy, and in particular the design of an Australian emissions trading scheme, is to be developed. Professor Garnaut released an interim report on 21 February 2008,<sup>15</sup> which is discussed later in this article; his final report is not to be released until later this year.

On Monday 17 March, Senator Wong announced a detailed timetable for the introduction of an emissions trading scheme, with the following stages:<sup>16</sup>

<b>March to June 2008</b>	Preliminary consultations on technical issues with industry and non-government groups
<b>July 2008</b>	Public release of a Green Paper on emissions trading design, drawing on preliminary consultations
<b>December 2008</b>	Public release of exposure draft legislation
<b>March - Mid 2009</b>	Bill considered by Parliament
<b>2009</b>	Consultation on emissions trading regulations
<b>3rd quarter 2009</b>	Act enters into force, regulator established
<b>2010</b>	Emissions trading scheme will commence

<sup>14</sup> Senator Penny Wong, *Climate Change – A Responsibility Agenda*, <http://www.environment.gov.au/minister/wong/2008/pubs/tr20080206.pdf> (6 February 2008).

<sup>15</sup> Garnaut Climate Change Review, *Interim Report to the Commonwealth, States and Territory Governments of Australia*, <http://www.theaustralian.news.com.au/files/garnaut.pdf> (February 2008).

<sup>16</sup> Media release, “Government Announces Detailed Timetable on Emissions Trading”, 17 March 2008.

### 3. MANDATORY REPORTING OF EMISSIONS AND ENERGY USAGE

The development of Australian climate policy and any emissions trading scheme requires an understanding of what Australia's emissions actually are. The design of emissions targets and caps is therefore necessarily underpinned by the mandatory national greenhouse and energy reporting scheme, intended to provide the necessary data for cap-setting and permit allocation under the scheme.

The Federal Government passed the enabling legislation for the reporting scheme, *National Greenhouse and Energy Reporting Act 2007*, in providing for a national greenhouse and energy reporting scheme (NGERS). The Act will be implemented on 1 July 2008 and will require corporate groups which are large energy users or producers and/or emitters to report their energy use and greenhouse emissions to a regulator. The key data to be provided through the NGERS will be:

- fuel and energy produced/consumed (by fuel type and by equipment type);
- emissions of each of the six Kyoto Protocol greenhouse gas classes (where methodologies permit separate estimation of each gas class); and
- total emissions of all six classes of greenhouse gases (in carbon dioxide-equivalent).

The type of emissions that will be reported include direct emissions from onsite combustion or industrial processes (Scope 1) and indirect emission from electricity usage (Scope 3). Companies will be able to “opt in” to report on imputed emissions from purchased materials, transport and purchased fuels, and use of sold products (Scope 3). Under an emissions trading scheme, however, emissions permits would only need to be surrendered in respect of Scope 1 emissions (except for petroleum and gas producers, where upstream liability would mean that permits would need to be surrendered in respect of Scope 3 emissions – that is, emissions embodied in sold fuels). Non-compliance with reporting obligations under NGERS will result in a penalty being imposed on companies, as well as specific penalties for Chief Executives Officers of non-compliant corporations in certain circumstances.

The NGERS intends to “cover the field” in the area of emissions and energy reporting, and will apply to the exclusion of all State and Territory laws providing for this. As a result, the mandatory reporting scheme may also force the phase-out of State-based energy or emissions reporting schemes such as the NSW Energy Savings Action Plan scheme under the *Energy and Utilities Administration Act 1987* (NSW).

NGERS will require mandatory reporting for corporations only if their emissions or energy usage exceeds a certain amount. There are both facility-level and company-level thresholds, which are:

- A company-level threshold to be phased in during the first three years following the commencement of the legislation, set at:
  - 125kt of CO<sub>2</sub>-e of emissions or 500TJ of energy produced or consumed in the year commencing 1 July 2008;
  - 87.5kt of CO<sub>2</sub>-e emissions or 350TJ of energy in the year commencing 1 July 2009; and
  - 50kt of CO<sub>2</sub>-e emissions or 200TJ of energy in the year commencing 1 July 2010; and
- A facility-level threshold of 25kt of CO<sub>2</sub>-e emissions or 100TJ of energy annually from the year commencing 1 July 2008.



Companies triggering any of the above thresholds would be required to report on company-wide emissions and energy usage.

Responsibility for reporting will be assigned to the corporation at the top of a corporate hierarchy. In this way, the “controlling corporation” would be responsible for registering and reporting energy use and greenhouse gas emissions from corporations within its corporate group. A “controlling corporation” is defined as a constitutional corporation that does not have a holding company in Australia. This includes foreign corporations, trading, or financial corporations, and statutory corporations that operate energy generation facilities in the States and Territories. The “corporate group” would include the controlling corporation or one of its subsidiaries and any partnerships or joint ventures (including unincorporated joint ventures) for which the controlling corporation or its subsidiaries have been identified as responsible for reporting under the scheme.

It is proposed that companies liable to report will be required to submit data that is disaggregated to the facility level, except where there are a number of small sites where aggregation is possible and cost-effective. A facility is defined as “an activity, or series of activities (including ancillary activities) that involve the production of greenhouse gas emissions, the production of energy or the consumption of energy and that:

- form a single undertaking or enterprise and meet the requirements of the regulations; or
- are declared by the Greenhouse and Energy Data Officer to be a facility.”

Activities undertaken in Australia’s exclusive economic zone (other than oil or gas extraction activities) are excluded from the definition.

Organisational boundaries will be used to identify the entity that is responsible for reporting emissions produced and energy used or produced by a particular facility. These are commonly established by using either the operational control, financial control or equity share approach, as defined in the *World Business Council for Sustainable Development and World Resource Institute’s Greenhouse Gas Protocol* (GHG Protocol).

“Operational control” will be used to determine the organisational boundary for reporting. Under this approach, liability for a facility is attributed to a company if it, or one of its subsidiaries, has full authority to introduce and implement operating policies, health and safety policies or environmental policies at the facility. In the event that two or more companies have such authority, the authority to introduce operational and environmental policies will take precedence. According to the GHG Protocol, this approach is consistent with the existing reporting practice of many companies that already report on emissions from their facilities.

NGERS is a significant step towards an Australian national trading scheme as the information reported under NGERS will inform emissions liabilities and caps and depending upon the approach adopted to permit allocation, the number of permits that will be allocated to each eligible firm. Previous experience under Phase 1 of the EU ETS demonstrates the importance of using robust data to ensure correct allocation of allowances.

#### **4. A NATIONAL EMISSIONS TRADING SCHEME FOR AUSTRALIA**

##### **4.1 Introduction**

Under the Kyoto Protocol, Australia is now required to keep annual emissions to within 108% of 1990 levels between 2008 and 2012. While on track to meet this target based on the Government’s



most recent reports,<sup>17</sup> the central policy measure to manage Australian emissions is the introduction of an emissions trading regime.

Designing an emissions trading scheme is a detailed and complex exercise, that involves consideration of a wide range of economic, political, social and environmental factors. While both the former Liberal Government under John Howard and the new Labor Government under Kevin Rudd (as well as the States and Territories under NETT) had committed to implementing an emissions trading scheme, the development of the detailed design of such a system had not, at the time of the election, been undertaken. The analysis which was carried out, while in many ways substantial and incorporating a range of economic modelling, remained focused on identifying the issues and options for scheme design. The actual decisions on what options to pursue remained unanswered. Only now is the Department of Climate Change actually undertaking this task in accordance with the timetable set out by Senator Penny Wong.

It should be noted that it has always been the expectation that the Labor Party, once in Government, would implement a “tougher” scheme design with a more aggressive emissions target. Nonetheless, it is anticipated that given the level of work and consultation that has already occurred the Government will draw heavily upon the work undertaken by the NETT and the Task Group and the design proposals put forward by the Garnaut Review. As such the following section of this article will compare design features developed by the NETT and the Task Group, addressing the Labor Government’s design proposals where they have been announced. There is of course no guarantee the design will resemble any model already proposed.

## 4.2 Scheme Design Features

As the Australian emissions trading scheme evolves there are a number of key design features that need to be worked through. Those most fundamental include:

- the model to be adopted;
- the caps to be set;
- permit allocation;
- compensation for affected industries;
- scheme design;
- scheme coverage;
- penalties;
- offsets;
- linking; and
- transitional measures for existing schemes.

However, in addressing these issues the ultimate objective is to ensure emissions are reduced and done so in the most efficient manner. As Garnaut has noted:

“In developing the ETS design, the singular objective should be to provide a transactional space that enables the transmission of permits to economic agents for whom they represent the greatest economic value. A number of guiding principles can be applied in order to achieve this objective, including scarcity, tradability, credibility, simplicity and integration.

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<sup>17</sup> Tracking the Kyoto Target Report <http://www.greenhouse.gov.au/projections>.

These principles define a solid framework within which an effective market can be designed.”<sup>18</sup>

#### ***4.2.1 Cap-and-trade model***

Both the NETT and the Task Group recommended the implementation of a cap-and-trade model for an Australian emissions trading scheme. This model is consistent with the schemes under development around the world and is likely to better facilitate the development of linkages with such schemes, especially those under the Kyoto Protocol and the European Union’s Emissions Trading Scheme (EU ETS). A cap-and-trade model has been formally endorsed by the Labor Government, and was one of the party’s “five tests for an effective emissions trading scheme” announced prior to the election in November 2007.

Under a cap-and-trade model, the scheme will establish a cap on the total volume of emissions that can be emitted across the economy, which will in turn determine the number of emissions allowances issued or auctioned to companies under the scheme. Emission allowances essentially represent permits to emit one tonne of carbon dioxide equivalent (CO<sub>2</sub>-e). If a company does not have a quantity of allowances equivalent to the greenhouse gases emitted in a compliance period, it will be liable to pay a penalty for each tonne of CO<sub>2</sub>-e by which they exceed their holding of allowances (and potentially replace the permits in a subsequent compliance period, as discussed below). However, to avoid paying the penalty the company can instead purchase additional allowances from other companies in the scheme who have reduced their emissions and therefore have excess allowances.

#### ***4.2.2 Caps***

As noted, scheme cap determines the quantity of greenhouse gases that can be emitted in the covered sectors before a penalty is incurred. Both the NETT and the Task Group proposed a system of caps and indicative “gateways”, to maintain flexibility to respond to changing science while promoting investor confidence by providing indications of likely emissions trajectories on which basis predictions about future carbon prices and investments in various technologies and infrastructure could be made. Both groups also indicated that to minimise economic disruptions, a less stringent cap would be implemented in the early years, which “ramps up” as infrastructure is replaced and alternatives to fossil fuels become commercialised and affordable.

Under both schemes, caps for overall emissions would be set until 2020 and then gradually increased to ensure substantial cuts in greenhouse gas emissions. Gateways would then supplement annual caps by providing the upper and lower bounds for emissions caps for the period 2020-2030 to ensure investor uncertainty is mitigated. Both annual caps and gateways would be updated at five yearly scheme reviews.

As already discussed, the Labor Government has stated that it will not set caps for the emissions trading scheme in advance of receiving Professor Ross Garnaut’s final report. Ultimately, setting the cap will involve balancing the need to respond to the urgency of climate science, to allow for the national economy to transition as smoothly as possible to a carbon-constrained environment and to take into account the realities of the energy market, which is characterised by lumpy, long-term investments (power generation facilities, may last for 40 years, or even longer). The cap-setting process will consider in particular the extent to which new investment will be required in generation facilities and the cost and availability of low-emission technologies, in an effort to

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<sup>18</sup> Garnaut Climate Change Review, *The Emissions Trading Scheme Discussion Paper*. 20 March 2007, <http://www.garnautreview.org.au>.

direct this new investment into the lowest-carbon technology while not imposing an undue burden on the economy.

#### **4.2.3 Permit allocation**

Allocation rules determine how permits are divided up amongst industry. The rules may include free allocation, based on historical emissions (which may be updated at the start of each new phase in the scheme) or on industry best practice, or alternatively, may be auctioned. The approach that is chosen for permit allocation will have important efficiency and equity implications.

The NETT and the Task Group both proposed a system of annual permits giving the holder the right to emit one tonne of carbon dioxide equivalent (CO<sub>2</sub>-e) in a year. These contrast with long-term permits giving the holder the right to emit one tonne of CO<sub>2</sub>-e each year over a longer period (eg 10 or 20 years). While long-term permits have the potential to create additional certainty for investors (as they have a secure right to emit for as long as the permit is valid), they are not used in other schemes and therefore may create some technical difficulties for linking. It is possible to have a mix of annual and long-term permits, but this may unnecessarily complicate the scheme design, and as noted, the long-term permits may not be easily tradeable. A decision on this issue has not yet been announced by the Labor Government, but in light of these considerations it is likely that the Government will opt for a system of annual permits.

Free permit allocation may be used as an assistance measure for adversely affected industries. It may be desirable, for example, to shield certain industries from the effects of a carbon price until major competitors are subject to equivalent carbon constraints. Allocating permits for free to trade-exposed, emissions-intensive industries (who may not have a liability under the scheme) will allow these firms to recoup some of the costs associated with the imposition of a carbon price, and thereby remain competitive in the world markets. It should be noted that free permit allocation is only one method to achieve this objective – border tax adjustments may also be considered as a means of assisting these exposed industries.

Permits under the NETT design would be given away to certain electricity generators and certain trade-exposed, emissions-intensive industries whose profits are likely to be adversely affected. The remaining permits would be auctioned, with the proceeds divided amongst the States and Territories. The Task Group similarly proposed free permit allocation, but extended this concept to any existing businesses that will suffer a disproportionate loss of value due to the introduction of a carbon price.

During the first phase of the EU ETS, almost all permits were freely allocated. However, this process became highly politicised and resulted in both an over-allocation of permits (causing the April 2005 price crash) and windfall profits for recipient entities as they still passed the “market cost” of free permits through to the consumer despite having received free permits. As a result of this experience, the European Commission will move to full auctioning in Phase 3. This raises an interesting dilemma for Australia as many industries (especially those in the energy sector) are lobbying hard for, and expect to receive, a free allocation. This is particularly the case in NSW, where the electricity generators are in the process of privatisation and a requirement to purchase permits will greatly affect asset value.

Interestingly, the Garnaut Discussion Paper on Emissions Trading Scheme Design released on 20 March 2008, strongly advocates full auctioning of permits with the revenues to be used towards compensating those most affected:

“The price of permits, the increase in the price of electricity and other emissions-intensive products, and structural change in the economy in response to the restriction on emissions,

will not be affected by the method of permit allocation. Transaction costs will be lowest if they are auctioned; any free allocation of permits will involve elaborate assessment and political processes.”<sup>19</sup>

#### 4.2.4 *Compensation for trade-exposed industries*

Both the NETT and the Task Group proposed to compensate trade-exposed, emissions intensive industries via the free allocation of permits. The number of permits allocated would be tied to the likely financial effects of emissions trading on the relevant firm and would be determined in advance by an independent body (the NETT proposed a body similar to the Australian Energy Market Commission).

For firms that would suffer a loss of competitiveness due to liability for direct emissions, a number of permits, determined by reference to that firm’s permit liability at the end of the period, would be allocated to the firm for free. For firms whose costs would rise primarily as a result of higher energy prices (indirect emissions), free permits would be allocated based on the expected increase in electricity prices. These permits could then be sold to liable parties, thereby offsetting the financial impact of the electricity price increase. For a company that would fall into both categories, free permits might be allocated on both bases.

The NETT proposed that a number of permits actually allocated is likely to be based on emissions-intensity baselines.<sup>20</sup> The NETT’s Discussion Paper gives the following example (which uses energy-intensity baselines but would presumably be adjusted to emissions-intensity baselines in line with the shift described above):

*For example, say a firm uses 13 MWh of electricity to produce 1 tonne of its product. This could be set as its energy intensity baseline. The estimated size of the increase in electricity prices could be calculated as, say \$10/MWh. Subsequently, for every tonne of product produced in Australia, permits would be allocated up to the amount of the estimated impact on total energy costs. In this example, the maximum number of permits allocated to the firm would be calculated as the energy intensity baseline (13/MWh) multiplied by the change in electricity price (\$10/MWh) multiplied by the total tonnes of output, divided by the estimated permit.<sup>21</sup>*

Baselines could be set based on:

- historic emissions intensity;
- Australian industry average emissions intensity; or
- “best practice” emissions intensity.

The NETT proposed that baselines be set for the first 10 years of the Scheme based on a firm’s average emissions intensity (over the period 2002-2005), and then transitioned to an Australian best practice emissions intensity thereafter. Recalculation of baselines would be required after 10 years in any case; the shift towards “best practice” was designed to remove perverse incentives to retain emissions-intensive practices in the first phase of the Scheme.

<sup>19</sup> Garnaut Climate Change Review, *The Emissions Trading Scheme Discussion Paper*, 20 March 2007, <http://www.garnautreview.org.au>, p.6.

<sup>20</sup> The Task Group did not provide details beyond the level of free permit allocation.

<sup>21</sup> National Emissions Trading Taskforce, *Discussion Paper: Possible Design for a National Greenhouse Gas Emissions Trading Scheme*, [http://www.emissionstrading.nsw.gov.au/key\\_documents/discussion\\_paper](http://www.emissionstrading.nsw.gov.au/key_documents/discussion_paper) (August 2006). See also <http://www.emissionstrading.net.au>, page 134-5.

Permits would be allocated in one year batches, based on output levels, in arrears. This is intended to avoid incentives for firms to shut down and reopen in another country (not subject to carbon constraints), while obtaining a windfall profit from the sale of permits that are no longer required to offset costs. For the same reason, firms which close down would be required to return unused permits.

New entrants and capacity expansions in the relevant sectors would be eligible for free permit allocation, but the baselines for such plant would be set automatically at industry best practice (to incentivise the adoption of the most efficient technologies in the design and construction of new infrastructure).

Compensation measures to trade-exposed industries would cease when competitors became subject to equivalent carbon constraints.

The Federal Government has, as outlined above, now made it clear that it will make provision to compensate trade-exposed, emissions-intensive industries and adopt measures to assist low-income households to adjust to the impact of carbon price. However, the form that this will take is unclear, and the Government has certainly not indicated whether this would be through a free permit allocation, border tax adjustment or some other mechanism (including, for example, cash payments). The Garnaut Review is clear that any such compensation should be provided out of revenues generated from the auctioning of permits and presumably only after companies clearly demonstrate the precise way in which they have been affected.

#### ***4.2.5 Scheme coverage***

An important aspect of the scheme design of the national emissions trading scheme will be determining which industry sectors will be subject to emissions liabilities (that is, which sectors will be required to surrender permits corresponding to their carbon emissions in a given period). One key objective of an emissions trading scheme is to transition an economy to a carbon-constrained environment while minimising the economic costs of such transition and avoiding, where possible, damage to national industries. For this reason, an emissions trading scheme should be designed to encourage the least-cost pattern of abatement activities across all emitting sectors. To achieve this, it is generally accepted that sectoral coverage should be as broad as possible.

However, the desire for broad coverage is counterbalanced by the need to ensure administrative efficiency and workability. The administrative burdens of compliance for certain sectors may outweigh the advantage of including such sectors in the scheme. For example, imposing a liability on users of petroleum for their automobile emissions would clearly be unworkable and overly burdensome.

The NETT proposal (in the August 2006 Discussion Paper and subsequent consultations with industry) involved coverage of the energy generation sector in the first phase, expanding to the remaining stationary energy sector, all fugitives (venting, flaring etc) except open-cut coal mines, industrial processes and upstream liability on gas and petroleum producers. The Task Group proposed a similarly broad coverage, extending also to upstream liability on non-industrial coal producers and the possible inclusion of the waste sector. The Labor Government has announced its intention to opt for broad sectoral coverage (with over 70% of national emissions covered) and to consult with agriculture and forestry on prospects for their inclusion as the scheme design develops.

#### **4.2.6 Penalties**

Compliance with obligations under an emissions trading scheme can be encouraged by applying a penalty for non-compliance, payable in the event that a participant has an insufficient number of permits to cover its emissions at the end of a compliance period. In addition to the level of the penalty, a “make-good” provision may be included, meaning that payment of the penalty does not effectively “buy out” the non-compliant firms obligation to surrender permits, and that firm will be required to surrender a quantity of permits equivalent to the shortfall in a subsequent period to “make good” that shortfall. A scheme without a make-good provision essentially provides a price cap, as firms have no incentive to purchase allowances at prices above the penalty if they can simply pay the penalty as an alternative. However, if the penalty level is set significantly above the marginal cost of abatement, the penalty will not in fact operate as a price cap.

It is also possible to include criminal penalties. A criminal penalty (which could be imposed for example on directors of companies that were non-compliant) would have a greater deterrent effect than a civil penalty. However, most schemes around the world have adopted a civil penalty regime for non-compliance with the obligation to surrender permits. Intentionally fraudulent or other serious offences, such as intentionally deceiving the scheme administrator by under-reporting total emissions or creating false permits, may carry a criminal penalty.

Both the NETT and the Task Group proposed a civil penalty regime for permit shortfalls, with no make good provision. The Task Group went further, proposing a low penalty in the early years of the scheme to minimise economic disruptions (presumably accepting that the penalty would be paid by many firms in preference to higher cost structural adjustments, despite the fact that this would compromise the environmental integrity of the scheme). However, in light of the EU Commission’s stated position that it will not link with schemes that have a price cap, it is possible that the Labor Government will revisit this issue and either abandon the “buy out” proposal or set the penalty significantly above the marginal cost of abatement. Indeed, the Garnaut Review has recommended that the penalty *not* take the form of a “buy-out”, and that firms with a shortfall at the end of a compliance period be required to purchase replacement permits or credits. The EU ETS currently imposes a penalty of €100 for each permit not supplied, with an additional requirement to make good any shortfall.

#### **4.2.7 Offsets**

Offsets represent a reduction or removal of greenhouse gases that is intended to counterbalance an emission that takes place elsewhere in the economy. The use of offsets in an emissions trading scheme greatly decreases the costs of adjustment for covered sectors that is associated with the introduction of a carbon price. Instead of requiring an immediate shutdown of emitting facilities and the construction of new facilities using expensive new technologies, firms can satisfy a percentage of their obligations by surrendering offset credits (for example, from a forestry project) and smooth the investment transition to low-emitting technologies over a number of years. In theory, at least, the use of offsets should be environmentally equivalent to actual abatement in the covered sectors, but this will depend on whether the offset rules are sufficiently robust to ensure additionality and permanence.

One of the most important issues in designing an offset regime is determining which activities will be eligible to generate offsets. Activities such as forest sequestration, abatement initiatives in the agricultural sector (through, for example, changes to farming practices) and energy efficiency have all been used in various schemes to generate offset credits.

The design of a national emissions trading scheme may also allow credits from Clean Development Mechanism (CDM) and Joint Implementation (JI) projects to be surrendered for domestic compliance purposes. There are a number of advantages in adopting this approach: it allows the scheme to be linked to the global market, which stabilises prices in the permit market (if firms are able to surrender Certified Emission Reductions (CERs), the domestic permit price is unlikely to rise significantly higher than the prevailing CER price, thus creating a form of “safety valve”), it increases the availability of abatement and sequestration options which again lowers permit prices, and it provides an entry for the future linking of the scheme to international carbon trading regimes. With support for linking into a global market it is likely CDM will be allowed, as the NETT and Task Group proposed. However, unless we are well in excess of our target there may be limitations placed on JI. This is because the allocation of emission reduction units (ERUs) to JI projects requires them to be converted from assigned amount units (AAUs) or removal units (RMUs) (in the case of forestry projects), so any offshore sale of these credits by project developers would leave the Government with fewer of these credits with which to meet their emission reduction targets.

Both the NETT and the Task Group proposed to allow a wide range of domestic and international offsets, with no limits on the number of offsets that could be surrendered by firms to meet their compliance obligations. Potential offset projects under both designs included forestry, carbon capture and storage, industrial process emissions and methane emissions from the waste sector (subject to coverage of this sector under the Task Group proposal). Renewable energy generation was excluded under both schemes, as inclusion as an offset would lead to double counting of emission reductions (by freeing up a permit that was no longer required in the fossil fuel-fired energy generation sector and creating an offset credit in respect of the same tonne of CO<sub>2</sub>-e).

No announcement on the range of acceptable offsets under the Labor Government’s emissions trading scheme has yet been made.

#### **4.2.8 Linking**

Finally, both the Task Group and the NETT proposed that an Australian emissions trading scheme be designed in a manner that would allow linkages to overseas schemes, either through bilateral linkages or integration through the CDM and JI mechanisms. In her speech to the Ai Group, Senator Wong announced an intention to follow a similar approach to international linking. Garnaut has also supported this.

#### **4.2.9 Transition Issues – the NSW GGAS Scheme**

The implementation by the Federal Labor Government of a national emissions trading scheme will have implications for the viability of the NSW/ACT Greenhouse Gas Reduction Scheme (GGAS), the world’s first mandatory carbon trading scheme. The NSW Government has indicated the GGAS will remain in existence until 2020 or until commencement of a Commonwealth scheme.<sup>22</sup> A working group on GGAS transition issues is currently considering options for the transitioning of NGACs into the national scheme so as not to disadvantage market participants who have made good faith investments under GGAS.

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<sup>22</sup> NSW Department of Energy, Utilities and Sustainability, *Extending the NSW Greenhouse Gas Abatement Scheme – Policy Paper*, [http://www.deus.nsw.gov.au/publications/Greenhouse\\_Gas\\_Abatement\\_Scheme\\_Policy\\_Paper.pdf](http://www.deus.nsw.gov.au/publications/Greenhouse_Gas_Abatement_Scheme_Policy_Paper.pdf) (October 2006).



Unlike other major schemes around the world, GGAS uses a baseline-and-credit model, establishing annual state-wide greenhouse gas reduction targets and requiring individual electricity retailers and certain other parties who buy or sell electricity in NSW to meet mandatory benchmarks based on the size of their share of the electricity market. Parties, known as benchmark participants, are able to meet their benchmarks by creating or purchasing “greenhouse abatement certificates” (known as NGACs) that are used to offset actual emissions attributable to their electricity purchase. If these parties fail to meet their benchmarks, then a penalty is assigned. Penalties are paid to the Independent Pricing and Regulatory Tribunal of NSW (IPART) which administers the GGAS.<sup>23</sup>

The scheme uses a form of corporate accounting to calculate the emissions attributable to the electricity that the participants have purchased and project based accounting for measurement of abatement by Abatement Certificate Providers. This form of reporting differs in comparison to other schemes such as the EU ETS which uses site (or installation based) accounting as a platform and the Kyoto Protocol which combines jurisdiction-based accounting (for individual countries) and project-based accounting (for CDM and JI). Other schemes such as the Canadian ETS and the system adopted by the North Eastern States of the USA (the Regional Greenhouse Gas Initiative, or RGGI) use a combined site-based and project-based approach.

The GGAS is particularly unique in scheme design in the breadth of abatement projects permitted under the greenhouse gas benchmark rules. Despite this breadth, to date renewables such as wind, solar or geothermal have not been used to generate NGACs in GGAS. This is because it has not been viable to undertake sustainable energy generation projects at current costs (even with revenue from NGACs) and given the relative wholesale price for coal-fired electricity it is much more cost effective to generate electricity from coal and offset the required percentage of those emissions by creating or purchasing NGACs.

## 5. THE GARNAUT REVIEW

As noted above, the Garnaut Review, remains a key driver in advising the Government on the future development of Australian climate change policy. In particular and again as outlined earlier, the design of an Australian emissions trading scheme is likely to be significantly influenced by the report of the Garnaut Review, due to be released in June 2008.

In February 2008, the Garnaut Review recently released an interim report, and a further report specifically on emissions trading scheme design was released on 20 March 2008.<sup>24</sup>

The Interim Report is intended “to provide a flavour of early findings from the work of the [Garnaut] Review, to share ideas on a work in progress as a basis for interaction with the Australian community and to indicate the scope of the work programme through to completion of the Review.”<sup>25</sup> Relevantly for the development of emissions trading policy for Australia, Professor Garnaut recommends that:

- Australia should play a lead role in accelerating progress towards an effective post-2012 global emissions trading architecture, by establishing ambitious targets which it commits to

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<sup>23</sup> *Electricity Supply Amendment (Greenhouse Gas Emission Reduction) Act 2002.*

<sup>24</sup> *Ibid.*

<sup>25</sup> Garnaut Climate Change Review, *Interim Report to the Commonwealth, States and Territory Governments of Australia*, <http://www.theaustralian.news.com.au/files/garnaut.pdf> (February 2008), p 4.

implementing if a global agreement is concluded (as the EU has done with its 30% by 2020 targets);

- Australia should pursue regional agreements as a means to increase ambition for a global agreement and to smooth the negotiation process. This should be complemented by unilateral initiatives, where Australia can serve as an example for strong and decisive action on emission limitations; and
- targets significantly higher than 60% by 2050 will be required by Australia as part of an effective global agreement.

The Review also explicitly endorses many of the design features proposed by the NETT and the Task Group, including broad coverage of industrial sectors, inclusion of domestic and international offsets to lower the cost of mitigation, the benefits of linkages and the need for complementary measures. The Review notes that robust institutional arrangements will be required to oversee the scheme, preferably in the form of an independent authority established to issue and monitor the use of permits and investigate and respond to non-compliance.

In its Emissions Trading Scheme Discussion Paper, the Garnaut Review has put forward a set of design propositions for an Australian emissions trading scheme, as set out below.<sup>26</sup> The Australian Labor Party has repeatedly stated (including at COP/MOP 3 in Bali) that the findings of the Garnaut Review would be central to policy development for an emissions trading scheme in Australia.

<b>Caps</b>	<p>Caps should be expressed as a trajectory of annual emissions targets over time, which define long-term budgets.</p> <p>Four trajectories should be specified upon establishment of the ETS. The first up to 2012 will be based on Australia's Kyoto commitments. The other three for the post-2012 period reflect increasing levels of ambition. Movement between them should be based on determining the comparability of Australia's response to international effort (on the basis of international policy developments and/or agreements).</p> <p>Caps will be recommended in the Garnaut Review's final report.</p>
<b>Coverage</b>	Stationary energy, industrial processes, fugitives, transport and waste from scheme outset. Agriculture and forestry to be included as soon as practicable.
<b>Point of obligation</b>	At point of emissions where practical. Where transaction costs would be too high (eg transport), upstream or downstream may be appropriate.
<b>Domestic offsets</b>	Domestic offsets should be accepted without limits, but will have a small role, given broad coverage.
<b>Permit allocation</b>	All permits auctioned at regular intervals, with the possible exception of providing free permits to trade-exposed, emissions-intensive industries

<sup>26</sup> Garnaut Climate Change Review, *Emissions Trading Scheme Discussion Paper*, [http://www.garnautreview.org.au/CA25734E0016A131/WebObj/GarnautClimateChangeReviewTermsofReference2007/\\$File/Garnaut%20Climate%20Change%20Review%20Terms%20of%20Reference%202007.pdf](http://www.garnautreview.org.au/CA25734E0016A131/WebObj/GarnautClimateChangeReviewTermsofReference2007/$File/Garnaut%20Climate%20Change%20Review%20Terms%20of%20Reference%202007.pdf) (20 March 2008).

	(TEEIs) in lieu of cash payments.
<b>Use of auction revenue</b>	<p>Cash payments to support:</p> <ul style="list-style-type: none"> <li>• TEEIs (to correct for market failures – ie distortions arising from major trading competitors not adopting emissions limits (or pricing));</li> <li>• Households, particularly low-income households;</li> <li>• Structural adjustment to support declining communities;</li> <li>• Firms to correct market failures in relation to new technologies (eg payments to emissions-intensive firms, such as coal-fired power stations, to invest in CCS research);</li> <li>• Support for public infrastructure; and</li> <li>• Cash reserves to purchase international permits/offsets to reconcile domestic emissions with international commitments.</li> </ul>
<b>Penalty</b>	<p>Penalty does not replace obligation to acquit permits; a “make-good” provision would apply. Alternatively, the use of revenue from a financial penalty could be used to purchase abatement.</p> <p>Price caps and floors not supported.</p>
<b>Banking and borrowing</b>	Unlimited hoarding allowed. Official lending of permits by the independent authority to the private sector allowed, but may be subject to limits, in terms of quantity and time, determined by the independent authority.
<b>International linking</b>	Opportunities for international linkage of the Australian ETS should be sought in a judicious and calibrated manner.
<b>Governance</b>	<p>Policy framework set directly by government.</p> <p>Scheme administered by independent authority.</p>

In the final report due in June 2008, Professor Garnaut will openly revisit certain design features proposed by the NETT and the Task Group. As a result, it is likely that at least some of the final design chosen by the Federal Labor Government will address the following issues differently from previously proposed models:

- the appropriate mechanism, timelines and triggers for determining and reviewing the abatement path (that is, whether gateways are appropriate, how reviews will be conducted and so on);
- the most appropriate point of imposition of liability (ie energy producers or consumers) to minimise transaction, compliance and administrative costs;
- whether permits should be date-stamped and/or carried over to subsequent compliance periods;
- the imposition of a “safety valve” price at which additional permits are issued without limit;

- the environmental consequences of compensating trade-exposed, emissions-intensive industries through free permit allocation;
- the appropriateness of compensation for the non-trade-exposed sector, including in relation to precedent-setting for compensation of capital and the difficulties of computation of future losses; and
- institutional design (particularly the potential for an independent regulatory body to oversee the scheme).

## 6. OTHER GOVERNMENT POLICIES

Emissions trading will remain at the centre of Australia's climate change policy over the next few years. However, the Government has a number of other policy measures to supplement emissions trading<sup>27</sup> including:

- The increase of the existing Mandatory Renewable Energy Target (MRET) from two (2%) to twenty (20%) percent by 2020.
- The inclusion of a "greenhouse trigger" of the *Environment Protection and Biodiversity Act 1999*, under which new projects of Commonwealth significance greenhouse emission above a certain threshold will require environmental impact assessment approval.
- Introduction of the *Tax Laws Amendment (2008 Measures No 1) Bill 2008* into the House of Representatives (2008 Bill) on 13 February 2008 under which taxpayers, subject to certain conditions, who carry on a business can claim an upfront tax deduction for expenditure on trees (that happen in addition to create carbon sinks).

Finally during the election campaign, Labor announced a raft of other policy measures focused around funding climate initiatives and offering various rebates, including rebates and low interest loans for solar power, solar hot water systems, grey water piping, rainwater tanks and insulation, a \$15 million Clean Energy Export Strategy, a \$20 million Clean Energy Innovation Centre, a Green Car Innovation Fund to develop and build green cars in Australia, a \$500 million Renewable Energy Fund to develop, commercialise and deploy renewable energy in Australia, a \$240 million Clean Business Fund to help business and industry deliver energy and water efficiency projects, a \$150 million Energy Innovation Fund to keep our world leading scientists and researchers in Australia, rather than losing them overseas and a \$500 million Clean Coal Fund to fund the deployment of clean coal technologies.

## 7. THE VOLUNTARY CARBON MARKET

The trade in carbon rights and carbon permits, will in Australia, be dominated by the Australian emissions trading scheme once established. However, for those many companies not covered by the scheme, the increasing corporate objective of becoming environmentally responsible or carbon neutral has seen a continued growth in the voluntary carbon market over the last year. Currently,

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<sup>27</sup> Senator Penny Wong, *Climate Change – A Responsibility Agenda*, <http://www.environment.gov.au/minister/wong/2008/pubs/tr20080206.pdf> (6 February 2008).

the primary source of voluntary carbon credits in the Australian market is the Greenhouse Friendly program, implemented by the Howard Government.<sup>28</sup>

The Department of Climate Change is now examining the potential for developing an Australian Offset Standard, to replace Greenhouse Friendly accreditation and cover both voluntary and compliance offset credits. Further details on the standard, including the eligibility of offshore projects and projects undertaken at sub-threshold facilities in covered sectors (such as the waste sector) are likely to be revealed later this year.

The announcement by Prime Minister Rudd on 6 June 2007, when he was Opposition Leader, that Federal Labor would introduce a national standard for carbon offsets, may give some clues as to the nature of the Australian Offset Standard. Prime Minister Rudd said that an Australian Offset Standard would be implemented that would:

- require all products on the market to be accredited;
- build on existing standards to avoid duplication;
- provide a nationally consistent approach to offsetting, but take account of international developments;
- set minimum standards for offsets and include verification and validation protocols;
- require ongoing management where necessary to ensure integrity; and
- incorporate a standard means for calculating carbon neutrality and require credits to be cancelled when used to provide an offset.

This announcement followed a joint communiqué from the Council for the Australian Federation, comprising all Australian Premiers and Chief Ministers, on 9 February 2007, calling for strengthened standards and accreditation in the carbon offset industry, including a possible registry of offset products.

### **7.1 Australian Competition and Consumer Protection investigation into “green” claims**

The Australian Offset Standard may assist in overcoming one of the difficulties that has faced consumers in Australia’s largely unregulated voluntary market – that is, how to determine whether an emissions offset scheme will deliver its claimed benefits. This issue is the subject of a current investigation by Australia’s competition watchdog, the Australian Competition and Consumer Commission (ACCC).

The ACCC recently announced that it would be examining carbon neutrality claims more closely. Commissioner John Martin said that a steadily increasing number of inquiries and complaints around “green” marketing (promoting, for example, “green flights”, “green cars” or “green toilet paper”) had led the ACCC to examine how the consumer protection provisions of the *Trade Practices Act 1974* might apply.

The basis for the investigation is the confusion in the market as to the nature and credibility of different offset products and the basis for claims of “carbon neutrality” in relation to products and

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<sup>28</sup> Greenhouse Friendly provides two different services – certifying abatement certificate providers and certifying carbon neutral products and services. Once certified for a particular sector, abatement certificate providers may carry out projects which can generate Greenhouse Friendly voluntary carbon credits, which can then be sold to companies to offset the embodied emissions in their products and services. Such products and services can then be sold as “carbon neutral” with a Greenhouse Friendly certification.

services. For example, some carbon offset schemes rely on forestry programs, whereby additional trees are planted to offset a specified quantity of carbon dioxide emissions, while other offset schemes rely on emissions reductions as a result of energy efficiency or utilising energy from a source that causes fewer emissions (like wind farms or natural gas). The effectiveness of a program used to offset emissions depends heavily on the effectiveness of the methodologies used to measure the emissions reductions or captured carbon and the reliability of the arrangements that the offset provider has put in place to implement and monitor the emissions reductions or ensure the captured carbon will be maintained.

Different forestry schemes may use different methodologies to calculate the amount of carbon dioxide that trees are capable of absorbing and the amount of time for which it will be stored. Likewise, projects that reduce emissions from electricity generation, industrial processes or waste may also use different methodologies to determine the emissions avoided or reduced. More generally, different schemes utilise different methods for determining the amount of emissions generated by certain practices, such as air travel, leading to significant variations in the number of carbon offsets required to neutralise similar activities. This can create confusion for consumers.

Further, there are a range of subtle differences in the offset products offered, their price in terms of the timing and source of the emissions reductions, other environmental benefits achieved from the underlying projects, and the period over which the emissions reduction will be maintained. For example, some offset products comprise a promise to carry out a project to reduce emissions (for example, to plant trees or reduce energy consumption in the future), whereas others represent emissions reductions that have already been achieved (because the project has already been undertaken and the captured carbon or reduced emissions have already been measured and verified). In some cases the captured carbon underlying the offset product might be retained and monitored over the long-term, whereas in other cases it might not be clear how permanent the emissions sequestrations or how constant the reductions will be.

The ACCC will be increasing its green compliance activities through education initiatives involving both business and consumers, as well as targeted enforcement action. It plans to conduct a series of separate reference group meetings with, respectively, consumers, green groups and industry representatives. These reference groups will be targeted and specific, with invitees to consist of those entities that the ACCC considers to be representative of particular sectors. By the end of March, the ACCC intends to release further guidance on green marketing. This guidance will not involve the creation of any new regime, but will focus on existing legal standards under the *Trade Practices Act*.

The ACCC has already released some guidance relating to self-declared environmental claims (though not covering carbon neutrality), which aligns with the Australian/New Zealand standard AS/NZS ISO 14021 – Environmental Labels and Declarations – Self Declared Environmental Claims.

## **8. CONCLUSION**

Since the late November election of the Rudd Labor Government, climate change policy in Australia has undergone a significant reversal. Internationally Australia's ratification of the Kyoto Protocol sees Australia playing a lead role in international negotiations and domestically its aggressive policy agenda will see a domestic emissions trading regime in place by 2010. How the scheme is to be designed remains to be finally determined but it is clear that the Garnaut Review will play an important role in influencing the design of the regime.

In the longer term it is however critical that Australia plays a lead role in reaching a new global agreement on climate change. As Garnaut points out in his most recent report:

“Climate change is a global issue requiring global solutions. Australia’s efforts both internationally and domestically need to be situated in this context. Reducing the risks of dangerous climate change to acceptable levels requires a comprehensive global agreement, which will be difficult to achieve and take time to build. Emissions targets for Australia will eventually be defined through such agreement. It is not in Australia’s interests to free ride, nor to act in isolation. We should set an emissions budget and specific reduction targets prior to the emergence of a comprehensive global agreement, but comparable in adjustment effort to those accepted by other developed countries.”<sup>29</sup>

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<sup>29</sup> Garnaut Climate Change Review, *Interim Report to the Commonwealth, States and Territory Governments of Australia*, <http://www.theaustralian.news.com.au/files/garnaut.pdf> (February 2008), Executive Summary.