



White Paper

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Energy law and emissions trading

Abstract

This paper presents the national energy law and emissions trading under the proposed Carbon Pollution Reduction Scheme Bill. The impact on the energy sector of the Carbon Pollution Reduction Scheme will be examined. The paper takes a policy and economic approach to the national energy law and the proposed emissions trading scheme. The author's expertise is legal policy development and economic assessment and analysis and this is applied in the publication, Australian Energy Law and Economics Newsletter, published monthly. The newness of the draft Carbon Pollution Reduction Scheme legislation and the current political debate means that a broad approach is taken in relation to the law. As the draft legislation becomes law a more certain focus can be given to the statutory provisions setting up the Carbon Pollution Reduction Scheme and ancillary changes to other laws.

The paper identifies areas of opportunity for legal practitioners to expand their practice. The discussion on the national energy law and the impact of the Carbon Pollution Reduction Scheme on the energy sector provides a useful guide for practitioners.

Introduction to energy law

Energy law in Australia is emerging as a national law and away from jurisdiction based law. The formation of the National Electricity Market in 1989 has seen the focus of legal control move away from State specific legislation to a national scheme law. To complete the national market, issues of ownership of electricity assets and geography need to be overcome.

Like gas pipelines the electricity assets such as generators and transmission and distribution assets need to be privatised and be overseen for their competitive operations. While electricity assets remain in government ownership private investment is deterred. There is significant investment risks associated with government owned assets.

Australia's geography currently prevents the national market covering the whole country. Western Australia and the Northern Territory are outside the National Electricity Market and with natural gas they are outside the emerging National Energy Market. However, from a regulatory point of view there are activities occurring to link Western Australia and the Northern Territory as a western market still separate from the national market although the regulatory regimes are similar.

Opportunities for legal practitioners in the energy sector are many and they depend on the knowledge of the practitioner in this area of law. It is not essential to understand the engineering of energy but it can assist when dealing with persons in the sector. Despite this, practitioners can assist clients in energy by providing advice and drafting legal documents and using current law and agreements among the States and Territories to define terms and provide strong legal relations between parties. As the national market matures the involvement of the financial market with the commodity energy markets provide a broader range of opportunities for legal practitioners. Further, the pending emissions trading scheme establishes another commodity market driven by derivative products. State energy law is incorporating carbon emissions matters and these need to be examined in addition to Commonwealth law. These opportunities are identified in the second part of this paper.

Legal practitioners can find opportunities in State and Territory law in addition to national laws. The focus of this paper is on national scheme laws with minor reference made to State law.

Overview of energy law and markets

Energy law has evolved from State and Territory based legislation to a national scheme law based on South Australian legislation and applied in other jurisdictions. This law applies to the National Energy Market that is based on the national electricity market and the gas market.

The South Australian law is:

National Electricity (South Australia) Act 1996 and National Electricity (South Australia) Regulations¹

National Gas (South Australia) Act 2008 and National Gas (South Australia) Regulations²

The Commonwealth law is:

Australian Energy Market Act 2004³.

Also, there are rules that are very detailed:

National Electricity Rules (as amended)⁴

National Gas Rules 2008⁵.

These rules are amended regularly so it is advisable to use an electronic copy only.

The National Electricity Law and the National Gas Law are schedules to the South Australian Acts (the lead legislation). They can be found in the application Acts of New South Wales, Victoria, Queensland, Tasmania and

¹ This legislation can be found on the Parliament of South Australia website at [http://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ELECTRICITY%20\(SOUTH%20AUSTRALIA\)%20ACT%201996.aspx](http://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ELECTRICITY%20(SOUTH%20AUSTRALIA)%20ACT%201996.aspx).

² This legislation can be found on the Parliament of South Australia website at [http://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20GAS%20\(SOUTH%20AUSTRALIA\)%20ACT%202008.aspx](http://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20GAS%20(SOUTH%20AUSTRALIA)%20ACT%202008.aspx).

³ This legislation can be found at [http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/23531AFCBEAC447ACA2572BF0020CC79/\\$file/AusEnergyMarketAct2004.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/23531AFCBEAC447ACA2572BF0020CC79/$file/AusEnergyMarketAct2004.pdf).

⁴ View at: <http://www.aemc.gov.au/rules.php>.

⁵ View at: <http://www.aemc.gov.au/gas.php>.

the Australian Capital Territory. These jurisdictions with South Australia make up the National Energy Market⁶. Western Australia and the Northern Territory are outside the national market but they have similar regulatory regimes. The relevant laws in Western Australia and the Northern Territory are:

Electricity Industry Act 2004 (WA)

Gas Pipelines Access (Western Australia) Act 1998

Electricity Reform Act (NT)

Gas Pipelines Access (Northern Territory) Act 1998

Each jurisdiction of the national market has legislation governing the electricity sector such as the New South Wales *Electricity Supply Act 1995*⁷. This legislation deals with operational activities of electricity suppliers such as customer contracts, supply matters, marketing, pricing, powers and duties, reductions of greenhouse gas emissions and abatement certificates, safety, offences and enforcement, small retail customer dispute resolution involving the Energy & Water Ombudsman NSW (EWON)⁸. Structural issues for the electricity sector in New South Wales involve legislation⁹.

The electricity sector's functional structure comprises:

Generation (power stations for generation of electricity)

Transmission (networks transporting electricity from generators to distribution networks)

Distribution (move electricity from transmission networks to residential customers and businesses)

Retail (main interface between electricity supply and customers).

The gas sector has emerged from a relatively small base compared with electricity. It emerged from a typically single supply source for customers using a single transmission pipeline. The gas sector relies on long term contracts although spot markets are emerging. The Report by ACIL Tasman Pty Ltd, "Australia's Natural Gas Markets: The Emergence of Competition?" in Australian Energy Regulator, *State of the Energy Market 2008*¹⁰ describes the state of Australia's natural gas industry:

"The Australian natural gas industry has grown considerably over the past decade, and the structure and operation of the industry has changed as a result of privatisation, corporate activity and regulatory reform."

The gas sector's functional structure comprises:

Upstream (exploration, development, production and processing of raw gas to produce sales gas that meets established quality specifications)

Midstream (transportation of sales gas from upstream producers to downstream customers through high and mid-pressure transmission pipeline systems)

⁶ The National Energy Market is made up of the convergence of the National Electricity Market and the National Gas Market. The recent report by the Australian Energy Market Commission (AEMC), *Review of Energy Market Frameworks in light of Climate Change Policies: 1st Interim Report (23 December 2008)* describes the National Electricity Market as:

"The NEM is an energy-only market through which wholesale electricity is traded in the eastern and southern states of Australia. It commenced operation on 13 December 1998. The scope of the NEM is defined by the interconnected transmission network that covers more than 4 000 km and runs from Port Douglas in Queensland to Port Lincoln in South Australia, and across to Tasmania via a sea-bed cable from Victoria. The market consists of five regions which are based on jurisdictional regions: Queensland, New South Wales, Victoria, South Australia and Tasmania."

The National Gas Market is described as:

"Australia's natural gas market is characterised by the eastern interconnected gas network and the separate Northern Territory and Western Australia markets. The eastern interconnected gas network includes: New South Wales, the Australian Capital Territory, Victoria, South Australia, Tasmania and will include Queensland when a pipeline known as the QSN link is complete. This is due to be commissioned in January 2009. Western Australia and the Northern Territory are not connected with other jurisdictions, and thus operate their own separate market schemes.

An overview of the National Energy Market can be seen in Tunstall I, "Energy law and emissions trading", paper presented at the New South Wales State Legal Conference, August 2008 which can be viewed at www.iantunstall.com.

⁷ This Act can be found on the Parliamentary Council website at

<http://www.legislation.nsw.gov.au/scanview/inforce/s/1/?TITLE=%22Electricity%20Supply%20Act%201995%20No%2094%22&nohits=y>.

⁸ See <http://www.ewon.com.au/>.

⁹ The current energy reform program can be viewed at <http://www.nsw.gov.au/energy/index.aspx?id=7b28878d-9099-4e82-acb6-e6a96bf36c4b>.

¹⁰ View at: <http://www.aer.gov.au/content/index.phtml/itemId/723410>. This report is a useful analysis of the energy sector in Australia.

Downstream (wholesale supply of gas to major industrial and power generation facilities, low pressure pipeline distribution, retail supply of gas to smaller industrial, commercial and household customers).

Energy's regulatory framework for the national market

The regulatory framework for energy in Australia is still emerging into a national scheme. The enacting of the National Electricity Law and the National Gas Law provides the basis for a national regulatory framework for a national energy market. However, due to geographical constraints, Western Australia and the Northern Territory are outside the national scheme.

National Electricity Law

Part 2 of the *National Electricity (South Australia) Act 1996* provides for the National Electricity (South Australia) Law, the National Electricity (South Australia) Regulations and the National Electricity Rules. The National Electricity Law is a Schedule to the Act. Similar provisions apply for other States except Western Australia, and the Northern Territory.

National Gas Law

Part 2 of the *National Gas (South Australia) Act 2008* provides for the National Gas (South Australia) Law, the National Gas (South Australia) Regulations and the National Gas Rules. The National Gas Law is a Schedule to the Act. Similar provisions apply for other States except Western Australia, and the Northern Territory.

Consistency between Laws

The National Electricity Law and the National Gas Law govern different sectors of the National Energy Market. However, there are consistent regulatory arrangements between the two Laws. A table is given in Annexure 1 showing these consistent arrangements.

Regulators

The regulatory framework comprises:

Trade Practices Act 1974 s 44AE for the Australian Energy Regulator

*Australian Energy Market Commission Establishment Act 2004 (South Australia)*¹¹

*Australian Energy Market Commission Establishment Regulations 2005 (South Australia)*¹²

The legislation for electricity and gas confer powers on the Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC). AEMC is the rule maker and AER monitors compliance and take prosecution action for breaches of the energy law. AER has issued *Compliance and Enforcement: Statement of Approach* (August 2007) to explain "the AER's approach to enforcement, including its approach to monitoring compliance, how it responds when breaches are identified and the criteria it uses in deciding whether to take enforcement action."¹³ AER has other roles include hearing disputes in relation to access by third parties to infrastructure such as electricity transmission lines and covered pipelines for the transport of natural gas.

The regulators operate consistently with the objectives of the National Electricity Law and the National Gas Law. The role of AER is expressed in the *State of the Energy Market 2007* as:

"The AER will play a number of roles in the evolving energy market environment. As the national regulator for electricity networks and gas pipelines the AER will look to apply a consistent and transparent approach that is conducive to efficient prices and investment, and reliable service delivery. The AER will also regulate aspects of the retail market, as agreed by the jurisdiction. It will continue to monitor the wholesale electricity market and investigate breaches of the rules and will help the ACCC assess the implications of merger activity for competition."

¹¹ View at:

<http://www.legislation.sa.gov.au/LZ/C/A/AUSTRALIAN%20ENERGY%20MARKET%20COMMISSION%20ESTABLISHMENT%20ACT%202004.aspx>.

¹² View at:

<http://www.legislation.sa.gov.au/LZ/C/R/AUSTRALIAN%20ENERGY%20MARKET%20COMMISSION%20ESTABLISHMENT%20REGULATIONS%202005.aspx>.

¹³ View at:

<http://www.aer.gov.au/content/item.phtml?itemId=714582&nodeId=86ee130ebf5c5789a62af56779c6a4db&fn=Compliance%20and%20enforcement%20statement%20of%20approach.pdf>.

The inaugural chairman¹⁴ of AEMC recently described the role of AEMC as:

“The AEMC is an independent statutory body, comprising three Commissioners and supported by a staff of forty people. We are based in Sydney and have a national role. Our formal statutory role spans two key functions. First, we are the Rule maker for the National Electricity Market (NEM) and for aspects of the rules for gas markets. Second, we are responsible for market development. We undertake this latter role in a variety of ways. The most significant ... is our role to review issues and provide advice to the main policy-making body, the Ministerial Council on Energy (MCE).”

AEMC is currently assessing the impact of climate change policies on the energy sector in its role for providing MCE with policy advice.

Market operator

The National Electricity Market Management Company (NEMMCO) is the operator of the national market for electricity. NEMMCO is owned by the governments of the participating States and Territory. The administration of the National Electricity Market includes billing and collection of funds for all trades in the market. NEMMCO settles payments due to market participants who are generators of electricity. Payments are made using funds received from other market participants such as electricity retailers. The *State of the Energy Market 2008* describes NEMMCO's role:

“NEMMCO coordinates a central dispatch to manage the wholesale spot market. The process matches generator supply offers to demand in real time. NEMMCO issues instructions to each generator to produce the required quantity of electricity that will meet demand at all times at the lowest available cost, while maintaining the technical security of the power system. NEMMCO does not own any physical network or generation assets.”

NEMMCO will be replaced by the Australian Energy Market Operator (AEMO) on 1 July 2009. It will be the operator for electricity and gas for the national market. Existing functions performed by NEMMCO and other market operators such as VENCORP¹⁵ will be transferred to AEMO. As a transitional measure the Ministerial Council on Energy (MCE) incorporated the Australian Energy Market Operator (Transitional) Limited ACN 132 770 104 as a public company limited by guarantee. It is responsible for **the transitional arrangements for managing activities for the transfer of existing electricity and gas market operation functions other than Western Australia and the Northern Territory. Key tasks are:**

- AEMO Implementation Plan agreed by the MCE on 13 December 2007 (including the National Transmission Planner)
- working with the management of the existing Australian energy market operators on practical issues such as the transfer of staff and business processes
- liaising with the Gas Market Leaders Group on the development and ultimate assumption of the function of operating the Short-Term Trading Market and the Gas Statement of Opportunities
- determining the composition and detailed arrangements for the Market Operations Advisory Panels
- liaising with the AEMO Implementation Steering Committee (ISC) and reporting on progress as required by the ISC.

Objective for national energy law

The objective of the national energy market is to promote efficient investment in energy and the efficient use of energy services. The benchmark for these efficiencies is the long-term interests of consumers of energy. The elements of the benchmark are:

- price
- quality

¹⁴ Tamblyn J, “The Reform Journey Continues: Energy Markets And Climate Change Policies”, A paper presented at the Committee for Economic Development of Australia (CEDA) CEDA Energy Forum, 19 February 2009, Melbourne Australia. The paper can be viewed at <http://www.aemc.gov.au/pdfs/media/Speeches/CEDA%20Conference%20Paper%20JT%20190209.pdf>.

¹⁵ Victorian Energy Networks Corporation established under the *Gas Industry Act 1994* (Vic) and operates under the *Gas Industry Act 2001* (s 158).

- reliability and security of supply.

An overall benchmark for the energy sector in measuring the efficiencies is the “reliability, safety and security of the national electricity system”. This objective is expressed in the National Electricity Law and the National Gas Law.

The National Electricity Law, s. 16 requires the Australian Energy Regulator to perform or exercise its economic regulatory function or power “in a manner that will or is likely to contribute to the achievement of the national electricity objective”. A similar provision is contained in the National Gas Law, s 28. Also, the Australian Energy Market Commission is required by the *Australian Energy Market Commission Establishment Act 2004 (SA)*, s 8 to “have regard to any relevant objectives set out in National Energy Laws” in the performance of its functions. The Inaugural Chairman of AEMC said in relation to rules for electricity that “AEMC can only make a Rule where it is satisfied that it meets the National Electricity Objective. This objective also guides all of our work on electricity market development.”¹⁶

The objective of the national energy law is essentially economic and has its origin in early discussions that were identified in Council of Australian Governments (COAG) Energy Market Review, *Towards A Truly National And Efficient Energy Market*, 2002 (Parer Report) where it says (p 64):

“COAG detailed the following principles to support the energy policy objectives:

- recognise the importance of competitive and sustainable energy markets
- continually improve Australia’s national energy markets
- enhance the security and reliability of energy supply
- stimulate sustained energy efficiency improvements
- encourage the development of less carbon-intensive sources and technologies
- recognise and enhance Australia’s competitiveness in world energy markets
- provide transparency and clarity in government decision making to achieve confidence in current and future investment decisions
- consider the social and economic impacts on regional and remote areas
- facilitate effective inter-jurisdictional cooperation and productive international collaboration on energy matters.”

The Standing Committee of Officials of the Ministerial Council on Energy, *Electricity amendments and further amendments to the electricity and gas rule-change process*, January 2007, says:

“A common objective for both the NEL and NGL will provide a uniform guiding principle in relation to all aspects of the regime where discretions are required to be exercised or interpretations to be made. Administrative bodies (including Ministers) will have to ensure that their regulatory decisions are consistent with the objectives of the NEL and NGL, and the AEMC will have to test any future Rule changes against the objectives of the NEL or NGL (as applicable) when making Rules. Courts and other review bodies will also be guided in their application of both regimes by the common objective.”

Also, the Report to the Council of Australia Governments, *Reform of Energy Markets*, by the Ministerial Council on Energy (11 December 2003)¹⁷ says:

“Effective economic regulation is a key to successful market reform. The regulation of network access (prices and standards) seeks to balance energy users’ short-term interests in price benefits with their long-term interests in a reliable supply, service enhancements and timely investment in new capacity. The making of market and regulatory rules aims to provide reasonable stability to market participants, while ensuring that the rules can evolve to meet challenges that will inevitably arise. The enforcement of those rules maintains an important discipline on market conduct.”

The objective of energy law needs efficient regulatory measures and authorities to oversee the pursuit of the objectives. The outcome of the reforms is the regulatory measures discussed earlier.

¹⁶ Tambllyn J, “The Reform Journey Continues: Energy Markets And Climate Change Policies”, A paper presented at the Committee for Economic Development of Australia (CEDA) CEDA Energy Forum, 19 February 2009, Melbourne Australia.

¹⁷ View at http://www.ret.gov.au/Documents/mce/_documents/MCE-Dec03RpttoCOAG2003121117144320040729131023.pdf.

Interpreting the objective

As an economic concept the objective of the national energy market expressed in the National Electricity Law and the National Gas Law needs to be interpreted within its economic context. This is discussed in the Second Reading Speech to the National Electricity (South Australia) (New National Electricity Law) Amendment Bill:

“The market objective is an economic concept and should be interpreted as such. For example, investment in and use of electricity services will be efficient when services are supplied in the long run at least cost, resources including infrastructure are used to deliver the greatest possible benefit and there is innovation and investment in response to changes in consumer needs and productive opportunities.

The long term interests of consumers of electricity requires the economic welfare of consumers, over the long term, to be maximised. If the National Electricity Market is efficient in an economic sense the long term economic interests of consumers in respect of price, quality, reliability, safety and security of electricity services will be maximised.”

The national energy market objective is now the focus of regulatory supervision. Participating jurisdictions have applied the legislation of the lead legislature, making the objective national.

Legal practitioners need to look at the legislation with the objective in mind to make sure its intention is reflected in advice on other parts of the national energy law. An understanding of the economic principles underlying the legal expression of the objective will assist. So too will a knowledge of the economic structure and infrastructure of both electricity and gas sectors. The structure and infrastructure has influenced the drafting of the national energy law and to a large extent dominates the law. Hence, the objective being an economic one. This is to cause the reading of the law to be consistent with economic principles. The requirement to focus on the long term interests of consumers is essentially similar to the “customer first” principle.

The Second Reading Speech to the National Electricity (South Australia) (New National Electricity Law) Amendment Bill makes the comment:

“Applying an objective of economic efficiency recognises that, in a general sense, the national electricity market should be competitive, that any person wishing to enter the market should not be treated more nor less favourably than other energy sources or technologies.”

Interpreting the provisions of the national energy law

The interpretation of the provisions of the national energy law should occur in a similar manner to interpreting the national energy law objective. Knowledge of the electricity sector, its infrastructure, size, market dominance and the supply of electricity to customers is essential. Also, the nature of electricity supply as a utility requiring government ownership and operation needs to be understood in the context of the purpose and direction of the National Electricity Market. Similarly, knowledge of the natural gas industry and emerging technologies to extract gas from coal seams, together with ownership, market power and the transport of gas to industry and consumers, is helpful. Further, the impact of the pricing of carbon under the proposed Carbon Pollution Reduction Scheme law is another area that needs the legal practitioner to have knowledge. These factors are evident in the national energy law which has its origins in State and Territory laws.

The relevant Acts and Regulations for electricity and gas are reasonably easy to read and comprehend. They provide reasonable direct provisions that are function based. The real danger for legal interpretation is the National Electricity Rules and the National Gas Rules. These are very prescriptive as legal instruments. The National Electricity Rules and further amendments to the Rules can be viewed on the website of the Australian Energy Market Commission website at <http://www.aemc.gov.au/rules.php>. The Australian Energy Market Commission is responsible for making further amendments to the Rules under a process of consultation. Similarly, the National Gas Rules can be viewed at <http://www.aemc.gov.au/gas.php>.

National energy law

The national energy law deals with participation in the national market by electricity and gas participants. It provides the regulatory framework and prescribes the functions and powers of the regulators and market operator. The process for legal proceedings by the Australian Energy Regulator to enforce the law is also prescribed. The law also provides for the making of rules and prescriptions¹⁸ for matters covered in more detail by the rules. The Australian Energy Market Commission is responsible for making rules and this action amends the National Electricity Rules and the National Gas Rules. The list of provisions referred to in Annexure 1 show more broadly these prescriptions.

¹⁸ National Electricity Law, Sch 1 and National Gas Law, Sch 1.

Interpreting the provisions of the national energy law requires the legal practitioner to understand public authorities' law particularly for interpreting the provisions dealing with functions and powers. Provisions dealing with legal proceedings are interpreted according to the rules and requirements of courts and tribunals. These provisions of the national energy law do not intended to operate outside the rules of court. Further assistance is available under Schedule 2 of the National Electricity Law and Schedule 2 of the National Gas Law.

The national energy law is new and needs to be tested over time. Legal practitioners need to watch for amendments to the law in the South Australian Parliament for lead legislation and then application laws in other jurisdictions.

National energy rules

Interpretation of the rules presents a challenge to legal practitioners coming into this area of law. It is necessary to understand the rule making processes under the national energy law and the role of the Australian Energy Market Commission in the process. The rules are presented as subordinate legislation and they are drafted as regulatory prescriptions. They deal with the various aspects of the process to generate or source energy, transport the energy and delivery to customers.

The rules are framed in a manner that shows the nature and structure of electricity supply and gas supply. For example, in relation to gas, there is a need to ring-fence a related business activity. Section 139 of the National Gas Law prohibits a covered pipeline from carrying on a related business. The restriction covers marketing and related staff and accounting records. This means that gas distribution must be separate from gas retail sales businesses. The basis for the section 139 prohibition is to provide for third party access to the pipeline in a non-discriminatory manner. Transmission pipelines tend to be natural monopolies as it is usually not economic to build another pipeline in the midstream industry. This is brings midstream gas services into the access regime that is regulated (or covered) by the National Gas Law¹⁹.

Also, the National Gas Law provides for the Natural Gas Services Bulletin Board to facilitate trade in gas over the relevant pipeline system through by providing system and market information that is readily available to all users, potential users and other interested parties²⁰. It collects and publishes information in relation to major natural gas transmission pipelines in Australia.

You will see from Annexure 1 that a common feature of both the National Electricity Law and the National Gas Law is access to infrastructure such as transmissions lines for electricity and covered pipelines for natural gas. Third party access involves disputes. The processes for dealing and resolving these disputes are detailed in Part 10 of the National Electricity Law and Chapter 6 of the National as Law. They involve notification of a dispute, hearing a dispute, a determination of the dispute, variations to the access determination, and compliance. These are areas of law where the legal practitioner can greatly assist the process. This is particularly so as the hearing of the dispute is conducted in private. Advice on the handling of information for the hearing including confidential information is important for a determination that gives the best economic outcome in the circumstances (in view of the national energy law objective). The hearing process involves the giving of evidence, answering questions and avoiding intimidation. Issues of costs are also determined where the Australian Energy Regulator makes an order "that a party pay all or a specified part of the costs of another party in a dispute hearing."²¹

Complexity in the rules

The complexity in the rules in their former state has come under scrutiny by the courts. This can be seen in the High Court decision in *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* [2007] HCA 44. This case involved the rules under the former *National Third Party Access Code for Natural Gas Pipeline Systems*²² supervised by the Australian Competition and Consumer Commission. The issues involved not only gas law under the Code but also administrative law. The terms used under the Code for access arrangements such as the initial capital base of existing pipelines is used in determining the rewards and disciplines normally provided in a competitive market. Gleeson CJ, Heydon and Crennan JJ said that the "Code as a whole provides for a regulatory regime of a kind which is 'a surrogate for the rewards and disciplines normally provided by a competitive market'. Competitive pressures in a market stimulate efficiency of production and resource allocation, they stimulate efficient investment decisions and they minimise costs."

¹⁹ The National Gas Law replaced the access arrangements required under the former National Third Party Access Code for Natural Gas Pipelines Systems known as the "National Code".

²⁰ The Bulletin Board can be accessed at <http://www.gasbb.com.au/>.

²¹ National Electricity Law, s 147(2) and National Gas Law, s 206(2). See the circumstances in which the Australian Energy Regulator can consider making an order for costs at s 147(3) and s 206(3).

²² The Code was greed to by the Council of Australian Governments on 7 November 1997 and subject to later amendments. The Code can be downloaded at <http://www.coderegistrar.sa.gov.au/attachments/code.pdf>.

Their Honours also said that the parties did not dispute “the fact that the regulatory process set out in the legislation was directed to eliminating monopoly pricing whilst nevertheless providing a rate of return to pipeline owners, commensurate with a competitive market.” The intention of the rules under the Code is to reduce uncertainty to not deter investment. Later in the judgment their Honours said that the “greater the degree of uncertainty and unpredictability in the regulatory process, the greater will be the perceived risk of investment.”

The complexity in the rules involves the difficulty experienced by regulators in setting prices that would normally be determined in a competitive market. Their Honours Referred to a statement made by the Australian Competition Tribunal where it was observed:

“The setting of a tariff for a monopoly service provider, whether for gas, electricity or other services, is a difficult matter that has vexed regulators, service providers, producers and consumers in various parts of the world. ...[A] corpus of economic theory has developed and, as will be seen, its existence is taken for granted by the form of the Code.”

The construction of the rules played a significant part in the case. The relevant provision under investigation for setting the initial capital base for a reference tariff to be determined mandated a process. The process contains factors that need to be considered sequentially and not be treated as an independent factor within the process.

Their Honours reflected on the complexity in the rules by referring to the “complicated nature” on the process under the provision investigated. They said that “the task of establishing a rate of return on investment, for regulatory purposes, commensurate with prevailing market conditions for funds and the risk involved would be rendered a much less certain process than it is already. Such a result could distort future investment decisions about essential infrastructure.”

Gummow and Hayne JJ considered the administrative law issues of the appeal, in particular, the unreasonableness of decisions by the regulator. This is another area of legal exploration that needs to be done by legal practitioners when advising on the regulatory implications of the rules.

Legal practitioners need to keep in mind the complexity in the rules and the breadth of the laws that they contain. This means that there are many and possible alternative ways in which a matter can be challenged and appealed. Further consideration of the national energy rules can be seen in the decisions of the Australian Competition Tribunal.

Introduction to Carbon Pollution Reduction Scheme law

The *Carbon Pollution Reduction Scheme Bill 2009* has been released as an exposure draft. This Bill is accompanied by other Bills to implement the Commonwealth Government's policy to deal with climate change in Australia:

Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009

Australian Climate Change Regulatory Authority Bill 2009

Carbon Pollution Reduction Scheme (Charges – General) Bill 2009

Carbon Pollution Reduction Scheme (Charges – Excise) Bill 2009

Carbon Pollution Reduction Scheme (Charges – Customs) Bill 2009.

All Bills have commentaries to assist the reading of the Bills²³.

Carbon Pollution Reduction Scheme Bill

The full title of the Commentary to the Carbon Pollution Reduction Scheme Bill is:

“A Bill for an Act to reduce pollution caused by emissions of carbon dioxide and other greenhouse gases, and for other purposes”

An extract of the Scheme in brief from the Commentary is shown in Annexure 2.

The Carbon Pollution Reduction Scheme Bill Commentary says about this Bill:

“The Carbon Pollution Reduction Scheme Bill 2009 is the main bill. It contains the detailed provisions relating to the emissions trading scheme. These include:

- entities and emissions that are covered by the scheme
- liable entities' obligation to surrender emissions units corresponding to their emissions
- limits on the number of emissions units that will be issued
- the nature of Australian emissions units
- allocation of Australian emissions units
- assistance in relation to emissions-intensive trade-exposed activities and coal-fired electricity generators voluntary inclusion of reforestation activities under the Scheme
- the National Registry of Emissions Units
- monitoring and enforcement.”

The Commentary to the Bill says that the Bill establishes “a national emissions trading scheme, the Carbon Pollution Reduction Scheme”. A broad description of the Scheme is given in the Commentary:

“The quantity of greenhouse gas emissions for which liable entities are responsible will be monitored, reported and audited.

At the end of each year, each liable entity will need to surrender an eligible emissions unit for every tonne of greenhouse gas emissions that they are responsible for in that year.

Eligible emissions units include Australian emissions units issued by the Australian Climate Change Regulatory Authority (the Authority) and eligible international emissions units. The number of Australian emissions units issued by the Authority in each year will be limited by a scheme cap.

Liable entities will compete to purchase the number of units that they require, either at auctions arranged by the Authority or on the secondary trading market. Those that value the units most highly will be prepared to pay most for them. For many liable entities, it will be cheaper to reduce emissions than to buy units.

²³ The Bills and Commentaries are available on the Department of Climate Change website at <http://www.climatechange.gov.au/emissionstrading/legislation/index.html>.

Certain categories of entities will receive an administrative allocation of Australian emissions units, as a transitional assistance measure. Those entities will be able to use the units to comply with obligations under the Scheme or sell them.”

The objects of the Bill are expressed in clause 3 of the Bill as:

“(1) This section sets out the objects of this Act.

Climate Change Convention and Kyoto Protocol

(2) The first object of this Act is to give effect to Australia’s obligations under:

- (a) the Climate Change Convention; and
- (b) the Kyoto Protocol.

Global response to climate change

(3) The second object of this Act is to support the development of an effective global response to climate change.

Long-term targets

(4) The third object of this Act is:

- (a) to take action directed towards meeting Australia’s targets of:
 - (i) reducing greenhouse gas emissions to 60% below 2000 levels by 2050; and
 - (ii) reducing greenhouse gas emissions to between 5% and 15% below 2000 levels by 2020; and
- (b) to do so in a flexible and cost-effective way.”

Clause 9(1) of the Bill says that the “Act binds the Crown in each of its capacities.” The Crown is not “liable to a pecuniary penalty are to be prosecuted for an offence.” (cl 9(2)) except for a penalty under sections 133 (penalty for emissions unit shortfall to surrender), 135 (late payment penalty), 287 (non-compliance with relinquishment requirements) or 288 (late penalty payment) (c 9(4)). However, this protection “does not apply to an authority of the Crown.” (cl 9(3))

The Act will extend to Australia’s external Territories (cl 10).

The exposure draft of the Bill comes after a number of reports and studies emanating from the Intergovernmental Panel on Climate Change Fourth assessment reports by the three Working Groups and contained in the Synthesis report (2007)²⁴. Also, the lessons drawn from the Stern Review²⁵ in Britain for the economic impact and consequences of climate change gave a basis for an Australian economic study.

The report, R Garnaut, *The Garnaut Climate Change Review: Final report* (September 2008), provided the view that “emissions are tracking at the upper bounds of the scenarios modelled by the IPCC in the Fourth Assessment Report.”²⁶ The Commentary to the Carbon Pollution Reduction Scheme Bill says (p 7):

“Analysis presented in the Garnaut Final Report builds a strong case for responding to climate change with mitigation action. The Garnaut Final Report observes that ‘the overall cost to the Australian economy is manageable and in the order of one tenth of 1% of annual economic growth’ and concludes that ‘the costs of well-designed mitigation, substantial as they are, would not end economic growth in Australia, its developing country neighbours or the global economy; unmitigated climate change probably would’.

The Garnaut Final Report also predicts that, in a world of unmitigated climate change, real wages will be 12% lower by 2100 than in a world without climate change. This is due to the reduced demand for labour in the second half of the century as a result of climate change.”

The Commentary also says that the Government accepts the key findings of the Garnaut report being:

- emissions consistent with stabilising concentrations of greenhouse gases at around 450 parts per million or lower would be in Australia’s interests

²⁴ Details of the Working Groups reports can be obtained at <http://www.ipcc.ch/#> and the Synthesis report can be downloaded at <http://www.ipcc.ch/ipccreports/ar4-syr.htm>.

²⁵ See <http://www.occ.gov.uk/activities/stern.htm>.

²⁶ Commentary to the Carbon Pollution Reduction Scheme Bill, at 5.

- achieving global commitment to emissions reductions of this order appears unlikely in the next commitment period
- the most prospective pathway to this goal is to embark on global action that reduces the risks of dangerous climate change and builds confidence that deep cuts in emissions are compatible with continuing economic growth and improved living standards.

In addition the Australian Treasury, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation*, 2008, was released²⁷. This report is based on "economic models to analyse the macroeconomic, sectoral and household impacts of Australia reducing its greenhouse gas emissions under different targets and trajectories. Because responding to climate change is a global challenge, this report evaluates the impacts on Australia in the context of global action to reduce emissions." The report describes (at p 4) the impact of achieving emissions targets on the Australian economy:

"Achieving greenhouse gas emissions reduction targets will lead to significant changes in the structure of the Australian economy. Continued strong economic growth is likely. These changes will arise domestically, primarily through transforming the way energy is produced, distributed and consumed, as well as from international factors, such as through trade, as Australia's trading partners respond to their own emission constraints.

Decarbonising the Australian economy will lead to adjustment costs for some individuals, industries and regions. It will create benefits for some individuals, industries and regions, and lead to new industries and employment opportunities. It will affect almost every Australian in some way."

The Treasury report recognises that stabilising carbon emissions is an economic problem as many types of economic activity leads to the emissions of greenhouse gases. The report also recognises that economic benefits are delivered from the burning of fossil fuels contributing to rising living standards. However, the report states:

"Continued growth in greenhouse gases emissions from human activities increases the risk of dangerous, human-driven interference with the Earth's climate. To respond to these risks, the international community needs to agree to limit the right of nations to release greenhouse gases into the atmosphere."

The Treasury modeling and analysis is based on assumptions:

"This report assumes that Australia links its emissions trading scheme into the world trading scheme. Australia is a small economy representing around 1.5 per cent of the world's emissions; consequently, the buying and selling of Australian emission permits is unlikely to materially affect the world emission price. If the number of international permits that can be used within Australia is not limited, the global emission price will drive the emission price in Australia."

Knowledge of the underlying economics is important to appreciate the policy for the proposed law. Policy for the proposed law was identified in *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future* (December 2008) (White Paper)²⁸.

The White Paper says there is a need for action on climate change:

"The Carbon Pollution Reduction Scheme as set out in this White Paper is the foundation of the Australian Government's whole of economy strategy to tackle climate change.

Implementing the Scheme represents the biggest structural economic reform since the opening up of Australia's economy in the 1980s and 1990s.

For the first time, the Scheme will make industries pay for the carbon pollution they generate and there will be a limit on Australia's contribution to global carbon pollution."

The White Paper recognises the current financial crisis and says:

²⁷ View at: <http://www.treasury.gov.au/lowpollutionfuture/>. The report says (at p 4) that the Treasury "established a climate change modelling unit to analyse the possible macroeconomic, sectoral and distributional impacts of greenhouse gas emission reduction targets and trajectories on the Australian economy." Also, the "Treasury's modelling program is extensive and includes model development, engagement with domestic and international experts, and consultation with stakeholders across industry, community organisations and government agencies. The result, an integrated modelling analysis of the global, national, industry, household, technological and environmental dimensions of greenhouse gas mitigation, is the most comprehensive exercise of its kind in Australia to date."

²⁸ View the White Paper at <http://www.climatechange.gov.au/whitepaper/index.html>.

“The world is currently experiencing a financial and economic crisis that has created a climate of uncertainty. Despite the challenges we face today, the global financial crisis has not diminished the risks of climate change, or the need to take decisive and responsible action now.”

However, the financial crisis is bringing a more measured response by the Government:

“The global financial crisis, does however, highlight the need for a prudent and balanced approach to delivering the Carbon Pollution Reduction Scheme.”

The White Paper provides the policy basis for the three pillars of the government’s climate change strategy that are the objects of the Carbon Pollution Reduction Scheme Bill. The policy of the Scheme is based in the advice obtained from the Garnaut report, hence an economic basis:

“The Government’s intention is to commence the Carbon Pollution Reduction Scheme on 1 July 2010. The Scheme will be Australia’s primary policy tool to drive reductions in emissions of greenhouse gases. Greenhouse gas emissions are a form of pollution—carbon pollution. The consequent economic cost is not currently reflected in the costs of business or the price of goods and services—because firms face no cost from increasing emissions, the level of emissions is too great. Unless businesses and individuals bear the full responsibility for their consumption and production decisions, the level of carbon pollution will remain too high.

The Carbon Pollution Reduction Scheme is designed to redress this market failure. Emissions trading is simply a mechanism to achieve an objective. That objective is to reduce carbon pollution, and to do so efficiently, by placing a cap on emissions.”

The Government sees the task of addressing the market failure as “a significant economic reform”. This is an understatement in view of the magnitude of the task. It is not only an economic reform but a major revolution in the way Australians (and the rest of the world) live, play, do business and everything else. It is akin to the industrial revolution of the nineteenth century. It is hoped that the magnificent discoveries, inventions and technologies that transformed the developed world at the time will arise again to deal with the current market failure²⁹. The economics underlying the end of the depression in the 1930s by the mid to late 1930s with the equipping of national economies for war are likely to be played out with the current financial crisis. Equipping the Australian economy to direct resources to deal with carbon emissions should have a similar effect in economic terms. A new economic way of life should emerge in a reduced carbon emissions world where people live in a manner that assumes an environment based on renewable energies and more energy efficient activities. The White Paper says that “in the face of international economic turmoil, Australian businesses need more certainty about their future operating environment, not less. Delaying this significant economic reform would serve no one’s interests. Moreover, the current financial crisis has not reduced the threat of climate change, nor the benefits of action. It remains in Australia’s best interests to take decisive and meaningful action on climate change.”

Cap and trade emissions trading scheme

A carbon price will be determined under a cap and trade emissions trading scheme to apply nationally. This will limit the quantity of greenhouse gas emissions. The effect of a carbon price is to make the right to emit greenhouse gases scarce so it is rationed through the pricing system. A financial incentive is available to invest in low emissions technologies, processes and systems. The White Paper says investment in technological solutions to reduce greenhouse gas emissions “has the potential to deliver high financial returns to those sectors with a high cost of abatement. These sectors have a strong incentive to reduce their exposure to a carbon liability.”

The commitment to reduce carbon emissions is the cost to the community. The White Paper says that other mechanisms not involving the market trading system “will impose higher costs on the community because they would not make use of the incentives created by the market mechanism to draw out all low-cost opportunities to reduce emissions.”

The mechanisms of the cap and trade emissions trading scheme is explained in the White Paper:

“Emitters of greenhouse gases need to acquire a permit for every tonne of greenhouse gas that they emit.

The quantity of emissions produced by firms will be monitored, reported and audited.

²⁹ It is hoped that this scenario can be played out in Britain where it is observed that the reduction in the manufacturing sector with increasing job opportunities in the services sector has meant that the decline in manufacturing provides difficulties for the British economy where the government has commenced increasing the money supply. Developing new technologies would restore the imbalance as employment of labour declines in the services sector.

At the end of each year, each liable entity will need to surrender a permit for every tonne of emissions that they produced in that year.

The number of permits issued by the Government in each year will be limited.

Firms will compete to purchase the number of permits that they require. Firms that value the permits most highly will be prepared to pay most for them, either at auction or on a secondary trading market. For some firms, it will be cheaper to reduce emissions than to buy permits.

Certain categories of firms will receive an administrative allocation of permits, as a transitional assistance measure. Those firms could use the permits or sell them.

A major feature of placing a cap on carbon is the expected behavioural changes. The White Paper uses the example of increasing electricity prices that "will provide an incentive for consumers to conserve energy in their homes." Also, it says that the "implications of the Scheme will be significant." The example is again a behavioural change:

"Placing a limit, and hence a price, on emissions has the potential to change the things we produce, the way we produce them, and the things we buy."

Corporations are affected by the cap on the price of carbon depending on the value of the carbon pollution permit and the cost to reduce carbon emissions. Where the costs are below the price of the carbon pollution permit then permits held by the corporation could be sold in the market or kept by the corporation in the event of later cost increase that takes the corporation's costs above the permit price. Corporations with costs above the carbon price cap would use up their permits by surrendering them and buy permits where their holdings are insufficient. The national scheme cap is covered under Part 2 of the Carbon Pollution Reduction Scheme Bill. The Commentary says:

"At the end of each year, each liable entity will need to surrender an eligible emissions unit for every tonne of greenhouse gas emissions that they are responsible for in that year."

The eligible emissions unit is the term to be used in the legislation for carbon pollution permit as used in the White Paper.

Law of carbon pollution permits

Carbon pollution permits are tradeable in the emission trading scheme. They have legal status as explained in the White Paper:

"Carbon pollution permits will be created as personal property, and the legislation implementing the Scheme will not provide any power to extinguish these permits without compensation (except in the case of misrepresentation or fraud). When combined with the issuance of future years' permits, this should help create confidence in the longer term durability of the Scheme."

A carbon pollution permit is called an "eligible emissions unit" in the Carbon Pollution Reduction Scheme Bill (cl 5). An eligible emissions unit is defined as:

- "(a) an Australian emissions unit; or
- (b) an eligible international emissions unit."

There are definitions of an Australian emissions unit and an eligible international emissions unit (cl 5). There is a statutory expression for the legal nature of the Australian emissions unit given in proposed section 94:

"An Australian emissions unit is personal property and, subject to sections ^96 and ^97, is transmissible by assignment, by will and by devolution by operation of law."

It is a commodity like any commodity traded in other markets such as equities and futures contracts traded in the financial markets. Its legal status would be similar to these other commodities in view of Australian emissions units being traded in the market under the Carbon Pollution Reduction Scheme. Proposed section 83 says that the Australian Climate Change Regulatory Authority "may, on behalf of the Commonwealth, issue units, to be known as Australian emissions units." This is the only "definition" of an Australian emissions unit in the Bill. It is identified by an identification number (cl 84). The issue of an Australian emissions unit is entered into an account of the National Registry of Emissions Units (cl 5, 87). There is a charge for each Australian emissions unit issued as detailed in the table in proposed section 89.

The Commentary to the Carbon Pollution Reduction Scheme Bill says (at 17):

"The Australian Climate Change Regulatory Authority will issue Australian emissions units up to the national scheme cap each year. These units will be issued:

- following purchase through an auction (see Chapter 3)
- in relation to emissions-intensive trade-exposed activities (see Chapter 4)
- in relation to coal-fired electricity generators (see Chapter 5).

In addition, units will be issued:

- on application, for the first 5 years of the scheme, at a fixed charge (see Chapter 3)
- for reforestation (see Chapter 6)
- for the destruction of synthetic greenhouse gas (see Chapter 7).

Chapter 2 addresses Australian emissions units and eligible international emissions units.

The market for the trading of Australian emissions units will be orderly. Those traded in secondary markets such as the one proposed by the Australian Securities Exchange³⁰ would have express rules of exchange of units in the market.

The secondary auction market for units will have established procedures and rules that may be determined by the Minister (cl 103) for secondary market auctions of relinquished Australian emissions units and free Australian emissions units (cll 100, 101). The market for the auctioning of units will begin on 1 January 2012 (cl 103(3)). The Minister's determination of the market's operation can deal with:

- types of auction
- timing of auctions
- advertising of auctions
- participants in auctions
- fees for participants in auctions
- proxy bidding
- representatives of participants in auctions
- minimum number of Australian emissions units to which a bid may relate
- variation of bids
- total number of units with a particular vintage year that are to be offered at a particular auction under section ^99
- limits on the total number of units with a particular vintage year that may be acquired by a person as a result of a particular auction
- limits on the total number of units with a particular vintage year that may be acquired by the members of a controlling corporation's group as a result of a particular auction
- reserve prices or charges (if any)
- deposits (if any) to be lodged by participants in auctions
- refund or forfeiture of such deposits
- guarantees (if any) to be given in respect of payment obligations that are incurred by participants in auctions
- timing and methods of payment of prices or charges.

Part 4 Division 3 of the Carbon Pollution Reduction Scheme Bill deals with Kyoto units. The Commentary describes the nature of Kyoto units:

³⁰ The proposal is shown in http://www.asx.com.au/about/pdf/mr20070604_emissions_trading.pdf. Also, see the website of the ASX at http://www.asx.com.au/products/emissions_trading/index.htm.

"2.4 The Kyoto Protocol is an international agreement governing climate change, providing among other things a framework for an international cap and trade scheme. Australia has an obligation to retire emissions units referred to as Kyoto units to meet its Kyoto target. The Kyoto Protocol also establishes three 'flexibility mechanisms'. These 'flexibility mechanisms' result in the issue of Kyoto units which can be traded between Kyoto Parties and used towards meeting their emissions reduction targets. Kyoto Parties can also allow for legal entities to participate in the trade of Kyoto units."

These are emission units created under the Kyoto Protocol and recognised in Australian law under the Bill. Kyoto units can be held and transferred in the National Registry of Emissions Units. A Kyoto unit is defined in the Bill. The Commentary says:

"2.52 A Kyoto unit is defined for the purposes of the draft bill to mean an assigned amount unit, a certified emission reduction, an emission reduction unit, a removal unit or a prescribed unit issued in accordance with the Kyoto rules [**Part 1, clause 5, definition of 'Kyoto unit'**]. The last element of this definition allows for the recognition of a new type of Kyoto unit that could be adopted in the future without an amendment to the Act."

The linking of Kyoto units into the Australian trading system is described in the Commentary:

"2.5 Allowing for Kyoto units to be used for surrender in the Australian Carbon Pollution Reduction Scheme creates a link between this Scheme and the international market for Kyoto units. This allows liable entities to access lower cost abatement opportunities wherever they occur in the world and allows for emission reduction targets to be achieved in a flexible and cost-effective way, without reducing its environmental integrity."

The nature of the Kyoto unit can be an international emissions unit but it does not need to be:

"2.51 There is a distinction in the draft bill between the provisions relating to holding and transferring Kyoto units and those relating to surrender of eligible international units. While some types of Kyoto units are eligible international emissions units and can be surrendered, others such as assigned amount units and temporary and long-term certified emission reductions, are not eligible international units and therefore cannot be surrendered. Regardless, all Kyoto units will be able to be held and transferred in the Australian Registry."

There is also a non-Kyoto international emissions unit that is defined in the Bill (cl 5) which is an eligible international emissions unit (cl 5). The nature of this unit can be explored in the Bill and the Commentary.

Liable entities

The Carbon Pollution Reduction Scheme makes an entity liable where it does one of the following:

- is responsible for greenhouse gases emitted directly from a facility
- imports, produces or supplies certain upstream fuels
- imports, manufactures or supplies synthetic greenhouse gas.

A description of the relevant provisions in the Carbon Pollution Reduction Scheme is given in the Commentary:

"1.14 Significant aspects of Part 3 are:

- Division 2 of Part 3 outlines liability for greenhouse gases emitted from a facility (direct emissions)
 - Subdivision A relates to emissions from fuel combustion, industrial process and fugitive emissions, and emissions from waste sources at non-landfill facilities.
 - Subdivision B deals with emissions from landfill facilities.
- Divisions 3 and 4 of Part 3 outline liability for emissions that are not emitted from a facility
 - Division 3 deals with synthetic greenhouse gases.
 - Division 4 deals with liability for emissions from certain fuels, known as 'eligible upstream fuels'."

Liable entities are operators of facilities where direct greenhouse gas emissions are 25,000 tonnes of carbon dioxide equivalence or CO₂-e occurs in a year or more. The Bill uses the concept of a controlling corporation of a group as used in the *National Greenhouse and Energy Reporting Act 2007*. The scope of the liability provisions

apply to a facility that was under the operational control of a controlling corporation throughout an eligible financial year (cl 17(1)). The controlling corporation is “a liable entity for the eligible financial year.” (cl 17(3)).

National Greenhouse and Energy Reporting Act

Registered corporations must report according to the requirements of the *National Greenhouse and Energy Reporting Act 2007* and regulations. The reporting requirements will be assisted by an external audit process. The *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009* proposes a change to the National Greenhouse and Energy Reporting Act by replacing the Greenhouse and Energy Data Officer with the Australian Climate Change Regulatory Authority. Apart from this change the provisions of the Act are substantially unchanged.

Reporting structure

The *National Greenhouse and Energy Reporting Act 2007*, Pt 3, provides the reporting structure under its reporting framework. The *National Greenhouse and Energy Reporting Regulations 2008*, Pt 4, gives more detail on the operation of the reporting structure for registered corporations.

Reporting by registered corporations

Registered corporations under the Regulations are corporations that are registered in accordance with the Act. Before being registered, corporations are called controlling corporations. This is defined in the Act at section 7 to mean “a constitutional corporation that does not have a holding company incorporated in Australia.” A constitutional corporation is one under Commonwealth of Australia Constitution Act, s 51(xx). These are “financial corporations, and trading or financial corporations formed within the limits of the Commonwealth”. Controlling corporations incorporated in Australia can be members of a group that involves (s 8(1)):

- a controlling corporation
- subsidiaries of controlling corporation
- joint ventures
- partnerships.

There are some exceptions to these members of the group given in section 8(3), (4), and (5). Definitions for corporate entities and structures are those in the *Corporations Act 2001*.

Reporting of greenhouse gas matters involves the controlling corporation’s facilities. These are described in sections 9 and 10 involving activities of greenhouse gas emissions, energy production or the consumption of energy. The facility needs to be one of the following:

- a single undertaking or a single enterprise and meet the regulatory requirements under Subdivision 2.4.2 of the Regulations
- a declared facility made by the Greenhouse and Energy Data Officer under section 54 of the Act.

There are exceptions given in section 9(1)-(4). Where the activity (or series of activities) is within the overall control of the same corporation that is in electricity transmission electricity distribution and gas supply and the activities are taken to be part of the single undertaking or enterprise (reg 2.20). There are more requirements under the legislative framework of the Act that need to be examined for particular controlling corporations in different industry sectors.

Emissions, energy production and energy consumption are identified under section 10 of the Act. These are essential for reporting purposes. The meaning of these terms is given in reg 2.5. The meaning of “emissions” is divided into “scope 1 emissions” and “scope 2 emissions”. The meaning of production refers to the “extraction or capture of energy from natural resources” and the “manufacture of energy by conversion of energy”. The meaning of “consumption” includes “losses in extraction, production and transmission” in addition to “own-use”.

Registered corporation to provide a report

A registered corporation is required to give a report to the Greenhouse and Energy Data Officer under section 19 of the Act. The report must address:

- greenhouse gas emissions
- energy production

- energy consumption.

These matters are addressed in the report for facilities “under the operational control of the corporation and entities that are members of the corporation’s group”. The report is made for each financial year (s 19(2)):

- trigger year
- end of any financial year in which the corporation is registered.

The “trigger year” relates to the corporation meeting one or more of the thresholds of section 13 “on or after 30 June 2009” (s 12(1)(a)). The corporation needs to be registered for purposes of Part 2 Division 3 of the Act which relates to the application for registration being approved by the Greenhouse and Energy Data Officer and the corporation is not deregistered.

Other rules applying to the provision of information for the report are given in section 19. The Greenhouse and Energy Data Officer can require another person to give information (s 20(1)).

The report needs to be made according to reg 4.02(3)(a), (b) and (c). Where a threshold is met for the corporation’s group for purposes of section 13(1)(a), (b) or (c) during the reporting year or for purposes of section 13(d) the corporation is required to address Part 4 Divisions 4.3 to 4.5 of the Regulations. Where the corporation does not meet a threshold during the reporting year the corporation must report under Part 4 Divisions 4.3 and 4.6 of the Regulations. Divisions 4.3 to 4.5 deal with:

- Div 4.3 General reporting requirements
- Div 4.4 Reporting greenhouse gas emissions, energy production and energy consumption
- Div 4.5 Other reporting requirements
- Division 4.6 deals with the circumstances where no thresholds are met
- Division 4.7 concerns the reporting of information by another person.

General reporting requirements

The general reporting requirements comprise basic information about the registered corporation as shown in reg 4.04. The information must contain details of status of the controlling corporation:

- holding company incorporated in Australia
- joint venture participation
- partner of partnership
- nomination as a responsible entity under the Regulations
- details of facility under the corporation’s operational control.

The general information includes:

- Australian Business Number
- head office street address
- head office postal address
- contact information of the chief executive officer (or equivalent)
- contact information for the person identified for purposes of contact.

Greenhouse gas emissions, energy production and energy consumption reporting

The reporting requirements are addressed under sub-divisions of Division 4.4 of the Regulations:

- 4.4.2 Greenhouse gas emissions from consumption of energy
- 4.4.3 Greenhouse gas emissions from particular sources
- 4.4.4 Energy production
- 4.4.5 Energy consumption.

The sources of greenhouse gas emissions under subdivision 4.4.3 are identified in the regulations as:

- coal mining source (reg 4.10)
- oil and gas source (reg 4.11)
- carbon capture and storage source (reg 4.12)
- mineral product source (reg 4.13)
- chemical product source (reg 4.14)
- metal product source (reg 4.15)
- use of commercial air conditioning and like equipment source (eg 4.16)
- waste source (reg 4.17).

Electricity producing corporations must include additional information in the report. The source of the electricity production needs to be identified as coming from one of the following (reg 4.20(1)):

- thermal generation
- geothermal generation
- solar generation
- wind generation
- water generation
- biogas generation.

The report needs to contain information on the amount of electricity produced for use in the corporation's facility and the amount of electricity produced for use outside its facility (reg 4.20(2)).

Reporting on energy consumption

Energy consumption must be reported separately in the report to identify the amount of energy consumed and the type of energy "by means of combustion" for:

- electricity production
- production of a chemical product or metal product
- transport
- other than transport involving consumption of international bunker fuel
- other purposes.

Other information relates to the reporting thresholds, criteria and methods in a Determination that for purposes of reg 1.03 is a determination made under section 10(3) of the Act. The Determination is a legislative instrument made by the Minister responsible for the Act giving "methods, or criteria for methods, by which the amounts of the emissions, reduction, removal, offsets, production or consumption are to be measured". The Determination may specify different methods or criteria for:

- different industry sectors
- circumstances for the occurrence of emissions, reduction, removal, offsets, production or consumption.

Other reporting requirements

Division 4.5 of the Regulations provides for other reporting requirements:

- reporting aggregate amounts from facilities (reg 4.25)
- reporting percentages of emissions and energy (reg 4.26)
- reporting about incidental emissions and energy (reg 4.27)
- reporting for facilities that are networks and pipelines (reg 4.28)
- reporting for facilities that are vertically integrated production processes (reg 4.29)

- reporting about contractors (reg 4.30)
- reporting a change in principal activity for facility (reg 4.31).

Division 4.6 of the Regulations requires a registered corporate group to report where they did not meet any of the thresholds of section 13 of the Act (reg 4.32). The report can be a statement that the corporate group did not meet any of the thresholds.

Division 4.7 of the Regulations provides for the reporting of information by another person (reg 4.33). Under section 20(2) of the Act a registered corporation or another person can make an application for a determination by the Greenhouse and Energy Data Officer for the other person to make the report where information is in the possession or control of another person (s 20(3)). The other person will report on section 19 information being information that would be required to be reported by the registered corporation.

The application to the Greenhouse and Energy Data Officer must be made according to the requirements of reg 4.33. The application needs to clearly identify the information that is in the possession or control of the other person (reg 4.33(1)(d)). The registered corporation can make the application in the situation where the other person refuses to give the corporation the required information to make a report (reg 4.33(1)(f)). The application is to contain written documents or a statement saying:

- the other person has refused to give the information
- any reasons for the refusal
- the other person supports or does not support the application.

Keeping records

In order to make the report under the Act a registered corporation or other person needs to keep records. The report needs to deal with greenhouse gas projects and show (s 21(1)):

- reduction of greenhouse gas emissions
- removals of greenhouse gases
- offsets of greenhouse s emissions.

The form of the report is given in section 21. To make the report records must be kept of the activities of the corporate group. The records must allow for the making of an accurate report (s 22(1)(a)). The requirements for an accurate report are detailed in section 22 (1)(c) that refer to the requirements under section 21(3) and (4). Further the records need to be sufficient for the report so that the Greenhouse and Energy Data Officer is able to “ascertain whether the corporation has complied with its obligations” under the Act (s 22(1)(b)).

Penalties of 1,000 penalty units apply in relation to false or misleading information or the making of reports that purporting to be complying with the Act. The penalties apply to the registered corporation and to a person who is required to provide the information. The penalties extend through the reporting requirements to the record keeping requirements. In the case of an individual the penalty is 200 penalty units. The records need to be accurate and kept safely for seven years “from the end of the year in which the activities take place”. The Regulations can prescribe requirements for the kinds of records that must be kept and the form of the records (s 22(4)). These penalties increase under the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009*.

Publishing information on website

The Act requires the Greenhouse and Energy Data Officer to publish certain information on the website by 28 February in a financial year (s 24(1)). The information is taken from the information contained in reports. Section 24(1) requires the publishing of totals of:

- greenhouse emissions
- energy production
- energy consumption.

The information can be published as (s 24(3)):

- disaggregated information by each member of the corporate group
- information falling within a particular range of values.

The information can only be published where the corporate group meets a threshold as shown in section 13(1)(a) for the financial year and no application has been made under section 25 to request that the information not be published (s 24(4)).

State and Territory authorities can also publish information that is disclosed to the authority (under section 27) where the information is required under a State or Territory law and there is a written agreement with the Greenhouse and Energy Data Officer (s 24(5)).

Also, the Greenhouse and Energy Data Officer can publish "information relating to the greenhouse gas projects undertaken by a registered corporation". However, this publication needs to satisfy the requirements in the Regulations (s 24(2)). Information can also be disclosed to certain authorised persons, courts and tribunals (s 26).

Reporting requirements under the Corporations Act 2001

Corporations need to prepare for the Carbon Pollution Reduction Scheme in their accounting records and financial reports. *Corporations Act 2001*, s 296 requires the corporation to comply with the accounting standards when making a financial report for the financial year. The financial reports must give a true and fair view of the corporation's financial position and performance (s 297). To assist the corporation in preparing financial reports, the Corporations Act requires the keeping of financial records to "correctly record and explain its transactions and financial position and performance" and to "enable true and fair financial statements to be prepared and audited." (s 286) The White Paper says at 7-33):

"In relation to disclosure, Australia's corporate disclosure framework currently consists of requirements for entities to report both financial and non-financial information. Under the Corporations Act, approximately 30,000 of the 1.6 million companies in Australia are required to prepare financial statements in accordance with accounting standards and a directors' report containing a range of non-financial information.

Australia's approach to the preparation of non-financial information in the directors' report is to establish general reporting principles rather than to mandate reporting on specific subjects. Such an approach helps to minimise the reporting burden on business and encourages entities to report on relevant issues."

The White Paper expresses Policy position 7.23:

"Policy position 7.23

A common reporting timeline between financial and Scheme reporting will mean that most liable entities will be able to prepare financial and emissions reports at the same time with respect to the same periods, and for this information to be communicated to the market in a consolidated fashion.

In relation to disclosure, Australia's principles-based approach to non-financial reporting currently allows for the disclosure of information on emissions in directors' reports. Strategies to clarify and further emphasise non-financial disclosures are currently being considered by the Australian Government Treasury."

The problem for corporations required to provide financial reports under the Corporations Act is that there is currently no accounting standard to assist in making reports and keeping records in relation to the Carbon Pollution Reduction Scheme. There is no international accounting standard that could be used in the absence of an Australian accounting standard. The White Papers says that there is an accounting standard that can be used:

"The Auditing and Assurance Standards Board (AUASB) already has in place a standard that can be applied to non-financial reporting, which is based on international standards. This standard is ASAE 3000 *Assurance engagements other than audits or reviews of historical financial information*. The ASAE 3000 addresses matters such as ethics, quality control, planning requirements, using the work of an expert, obtaining evidence, documentation, and preparation of assurance reports.

The AUASB has also recently issued 'Standard on Assurance Engagements ASAE 3100 *Compliance engagements*'. This standard references ASAE 3000 both in its mandatory provisions and explanatory guidance notes."

Other standards referred to in the White Paper that could be referenced are:

- ISO 14064-3:2006 *Greenhouse gases—Part 3: Specification with guidance for the validation and verification of greenhouse gas assertions*
- ISO 19011:2002(E) *Guidelines for quality and/or environmental management systems auditing*
- The International Standard on Related Services (ISRS) 4400 *Engagements to perform agreed-upon procedures regarding financial information*

- The former AUASB standard AUS 904 *Engagements to perform agreed-upon procedures*.

In addition, and in view of the nature of emissions units, AASB 7 *Financial instruments: disclosures* might be examined for relevance. Also, the issue of an Australian emissions unit for free would be a government assistance measure that needs to be accounted for in the corporations accounting records. There are also taxation issues (capital gains tax and GST) that need to be considered.

The Australian Accounting Standards Board (AASB) is adopting a "wait and see" approach to developing an Australian accounting standard³¹. It is waiting to see the standard prepared by the International Accounting Standards Board (IASB) under the project "project on emissions trading with a stated objective of developing comprehensive guidance on accounting for emissions trading schemes". AASB says:

"As an active project on the AASB's 2008/09 work program, AASB staff are closely monitoring this IASB project. However, the AASB's preferred course is to await the outcome of the IASB project, rather than develop an Australian Pronouncement. This is a stance supported in the government's Green Paper on a Carbon Pollution Reduction Scheme, which suggests that to ensure globally consistent accounting policies, the Australian Government strongly supports a development by the IASB to emission trading, rather than an Australian specific response."

The obligations on directors of corporations will need to formulate policies under corporate governance to deal with the reporting requirements under the Carbon Pollution Reduction Scheme. The corporation will need to make disclosures such as the annual directors' report under *Corporations Act 2001*, s 299. Also, there are disclosure obligations under the Australian Securities Exchange Limited's listing rules where the corporation is a listed public corporation. A useful document to assist the process of managing greenhouse gases is published by the World Resources Institute, *A Corporate Accounting and Reporting Standard*, Revised Edition³².

An insurance issue

The recent High Court decision in *CGU Insurance Limited v Porthouse* [2008] HCA 30 contains warning for corporations and other persons in relation to "known circumstances" provisions under insurance contracts. The case involved a barrister advising a client who was injured while undertaking a community service order. The barrister wrongly advised the client that the NSW Workers Compensation Act did not apply in relation to proceedings brought by the client against the State. The advice given by Mr Porthouse was confirmed by the District Court. Mr Porthouse completed an insurance proposal form between the time of the District Court's decision and a later unfavorable appeal. He did not mention the appeal. The client later claimed against Mr Porthouse.

Known circumstance was defined in the insurance contract as:

"Known Circumstance

Any fact, situation or circumstance which:

- an Insured knew before this Policy began; or
- a reasonable person in the Insured's professional position would have thought, before this Policy began,

might result in someone making an allegation against an Insured in respect of a liability, that might be covered by this Policy."

The High Court decision says that there are two issues:

"There were two main issues of construction before this Court. The first was whether, upon a proper interpretation of the phrase 'a reasonable person in the Insured's professional position', one was confined to taking into account the insured's experience and knowledge and was not permitted to take into account the insured's state of mind, as to whether '[a]ny fact, situation or circumstance known to the insured might give rise to an allegation against the insured.

The second main issue of construction concerned the correct interpretation to be given to the conditional expressions italicised below, when determining whether the hypothetical reasonable person 'would have thought [any fact, situation or circumstance known to the insured] might result in' someone making an allegation against the insured."

³¹ See http://www.aasb.gov.au/Publications/eNewsletter/Issue4_EmissionsUpdate.aspx.

³² This document can be downloaded at <http://www.ghgprotocol.org/files/ghg-protocol-revised.pdf>.

The High Court found that Mr Porthouse would be aware of the circumstances of the law including court proceedings to apply these to the facts of the case involving his client. He was expected to have known the possibility that an appeal could overturn the decision of the District Court.

The High Court decision is instructive not only for legal practitioners but also for corporations and other entities under the Carbon Pollution Reduction Scheme and the National Greenhouse and Energy Reporting Act. Where there is knowledge of the possibility of a potential claim for example where there is a possible misunderstanding of the provisions of the law under the Carbon Pollution Reduction Scheme, this needs to be identified and disclosed under an insurance contract. The state of mind of the corporation is important where, for example, there is doubt about a matter of compliance and the likelihood of a possible legal action by the regulator or other person. The objective test for the corporation³³ is that it should have been aware of the possibility of a claim or other legal action and not merely be aware of a potential claim or action. It is too late to disclose the fact when a potential claim is made by the Australian Climate Change Regulatory Authority against the corporation by way of a penalty or other legal action.

Impact of the Carbon Pollution Reduction Scheme on the energy sector

The Australian Energy Market Commission (AEMC) is doing a study on the impact of the Carbon Pollution Reduction Scheme and the enhanced 20% Renewable Energy Target on the energy sector. AEMC has issued the *1st Interim Report: Review of Energy Market Frameworks in light of Climate Change Policies* (23 December 2008)³⁴.

AEMC expects that the energy markets will achieve the required transformation that is needed under the Carbon Pollution Reduction Scheme provided costs are efficient. The Inaugural Chairman of AEMC said in a recent speech³⁵:

“while the significance of these reforms should not be understated, it could be argued that the effectiveness of the reforms in meeting their objectives has yet to be fully tested in energy markets. While there have been significant improvements in the operating efficiency of generation capacity (as might be expected given the sharpened financial incentives provided by competition), the arrangements have not been ‘stress tested’ considering the relatively benign starting position for the market. The current position is much more challenging, given the tighter supply and demand balance, increasing input costs, and the need for significant new investment if reliable supplies are to continue.”

The Inaugural Chairman also described the cost structure of the electricity industry and the anticipated impact of the Carbon Pollution Reduction Scheme policies:

“Australia’s large reserves of coal continue to underpin around two-thirds of our generation capacity. The introduction of the climate change policies which price carbon emissions and subsidise investment in renewable generation capacity represent large ‘shocks’ to the underlying economics of the industry. Our cheapest generation capacity is also our most carbon-intensive – and relatively modest carbon prices (in the range \$20 to \$30 per tonne) will begin to alter the pecking order between coal and gas substantially.”

The 1st Interim Report identifies risks to the energy sector of the climate change policies noting that these risks already exist but they will be exacerbated by these policies:

“The CPRS introduces a new, and potentially uncertain, cost into the supply chain for wholesale electricity. In addition, higher wholesale costs also mean higher prudential costs for retailers.”

The impact of the Carbon Pollution Reduction Scheme will stimulate investment in renewable sources of energy. The most likely source is wind energy. However, these sources for electricity generation are in remote geographical areas away from customers and existing transmission networks. The existing model of bilateral negotiation for new connections of electricity will not cope efficiently, according to the 1st Interim Report, “with multiple connection applications to the same area nor will it be likely to manage efficiently with the large expected volume of new connection applications. It is likely that this may result in unnecessary costs and delays.”

³³ For a discussion on the liability of the corporations separately from the liability of director see the White Paper, “Corporate Responsibility: The duties and liabilities of the corporation”, on www.iantuninstall.com.

³⁴ Details of the study and the 1st Interim Report can be viewed at <http://www.aemc.gov.au/electricity.php?r=20080822.183804>

³⁵ Tamblyn J, “The Reform Journey Continues: Energy Markets And Climate Change Policies”, A paper presented at the Committee for Economic Development of Australia (CEDA) CEDA Energy Forum, 19 February 2009, Melbourne Australia. The paper can be viewed at <http://www.aemc.gov.au/pdfs/media/Speeches/CEDA%20Conference%20Paper%20JT%20190209.pdf>.

Submissions to the 1st Interim Report closed on 20 February 2009.

Ministerial Council on Energy

The Ministerial Council on Energy is overseeing work to clarify the impact of the Carbon Pollution Reduction Scheme on the energy sector. Its Communiqué of 6 February 2009³⁶ of its meeting in Canberra gives more detail of this work program.

³⁶ View at http://www.ret.gov.au/Documents/mce/_documents/Final%20Communique%206%20February%20200920090206155233.pdf.

Annexure 1

Common elements of the National Electricity Law and the National Gas Law

The first matter to note is the difference between the subject matter being regulated. The regulatory framework for electricity differs from the regulatory framework for gas. However, the framework contains similar provisions to make the task of regulatory oversight more consistent.

NATIONAL ELECTRICITY LAW**Part 3—Functions and powers of the Australian Energy Regulator**

Division 1—General

Division 2—Search warrants

Division 3—General information gathering powers

Division 4—Regulatory information notices and general regulatory information orders

Division 5—Network service provider performance reports

Division 6—Disclosure of confidential information held by AER

Division 7—Miscellaneous matters

Part 4—Functions and powers of the Australian Energy Market Commission

Division 1—General

Division 2—Rule making functions and powers of the AEMC

Division 3—Committees, panels and working groups of the AEMC

Division 4—MCE directed reviews

Division 5—Other reviews

Division 6—Miscellaneous

Part 5A—Functions and powers of Minister of this participating jurisdiction**Part 5B—Functions and powers of Tribunal****Part 6—Proceedings under the National Electricity Law**

Division 1—General

Division 2—Proceedings by the AER in respect of this Law, the Regulations and the Rules

Division 2A—Proceedings before, and awards etc of, Dispute resolution panels

Division 3—Judicial review of decisions and

NATIONAL GAS LAW**Chapter 2—Functions and powers of gas market regulatory entities****Part 1—Functions and powers of the Australian Energy Regulator**

Division 1—General

Division 2—Search warrants

Division 3—General information gathering powers

Division 4—Regulatory information notices and general regulatory information orders

Division 5—Service provider performance reports

Division 6—Miscellaneous matters

Chapter 2—Functions and powers of gas market regulatory entities**Part 2—Functions and powers of the Australian Energy Market Commission**

Division 1—General

Division 2—Rule making functions and powers of the AEMC

Division 3—Committees, panels and working groups of the AEMC

Division 4—MCE directed reviews

Division 5—Other reviews

Division 6—Miscellaneous matters

Chapter 2—Functions and powers of gas market regulatory entities**Part 3—Functions and powers of Ministers of participating jurisdictions****Chapter 2—Functions and powers of gas market regulatory entities****Part 5—Functions and powers of Tribunal****Chapter 8—Proceedings under the National Gas Law****Part 1—Proceedings generally****Part 2—Proceedings for breaches of this Law, Regulations or the Rules****Part 3—Matters relating to breaches of this Law, the Regulations or the Rules****Part 4—Judicial review of decisions under this**

determinations under this Law, the

Division 3A—Merits review and other non-judicial review

Division 3B—Enforcement of access determinations

Division 4—Other civil proceedings

Division 5—Infringement notices

Division 6—Miscellaneous

Part 7—The making of the National Electricity Rules

Division 1—General

Division 2—Minister initiated National Electricity Rules

Division 3—Procedure for the making of a Rule by the AEMC

Division 4—Miscellaneous provisions relating to Rule making by the AEMC

Part 10—Access Disputes

Division 1—Interpretation and application

Division 2—Notification of access dispute

Division 3—Access determinations

Division 4—Variation of access determinations

Division 5—Compliance with access determinations

Division 6—Access dispute hearing procedure

Division 7—Joint access dispute hearings

Division 8—Miscellaneous matters

Law, the Regulations and the Rules

Part 5—Merits review and other non-judicial review

Division 1—Interpretation

Division 2—Merits review for reviewable regulatory decisions

Division 3—Tribunal review of AER information disclosure decisions under section 329

Division 4—General

Part 6—Enforcement of access determinations

Part 7—Infringement notices

Part 8—Further provision for corporate liability for breaches of this Law etc

Chapter 9—The making of the National Gas Rules

Part 1—General

Division 1—Interpretation

Division 2—Rule making tests

Part 2—Initial National Gas Rules

Part 3—Procedure for the making of a Rule by the AEMC

Part 4—Miscellaneous provisions relating to rule making by the AEMC

Chapter 6—Access disputes

Part 1—Interpretation and application

Part 2—Notification of access dispute

Part 3—Access determinations

Part 4—Variation of access determinations

Part 5—Compliance with access determinations

Part 6—Access dispute hearing procedure

Part 7—Joint access dispute hearings

Part 8—Miscellaneous matters

Extract from Carbon Pollution Reduction Scheme Bill 200 Commentary at pages 15-19.**The scheme in brief*****National targets and Scheme caps***

The Government has announced national targets which are reflected in the objects of the Scheme quoted above.

The Scheme is a 'cap and trade' scheme. It involves setting a national scheme cap for a particular year and issuing units within that cap. The scheme cap for a particular year is a quantity of greenhouse gases that have a carbon dioxide equivalence of a specified number of tonnes.

Scheme caps will be lower than the emissions path required to meet the national targets because some emissions sources are not covered by the Scheme (primarily, agricultural and deforestation emissions) and direct emissions from facilities are only covered if they exceed specified thresholds (usually 25,000 tonnes of carbon dioxide equivalence per year).

Detailed scheme cap numbers for each relevant financial year will be specified in regulations. The Government intends that these be consistent with the 2020 and 2050 targets. The Minister will be required to take all reasonable steps to ensure that regulations to specify the scheme cap numbers for the first five years of the Scheme are made before 1 July 2010. The purpose of this requirement is to provide market certainty. In a similar vein, for all subsequent financial years, the Minister is required to take all reasonable steps to ensure that regulations declaring the scheme cap number are in place at least five years before the end of the relevant year. There is provision for a default scheme cap number in the event that there is no scheme cap number for a year beginning on or after 1 July 2015.

To provide further guidance to liable entities and participants in the carbon market more generally, national scheme gateways may be prescribed for years beginning on or after 1 July 2015. A gateway is a range, comprising an upper bound and a lower bound of emissions, expressed in terms of tonnes of carbon dioxide equivalent, for a particular year. The Minister is required to take all reasonable steps to ensure that the scheme caps are within the range specified for the relevant year. The matters relevant to setting the gateways will be the same as in relation to setting national scheme caps.

The same considerations that are relevant in making decisions about national targets and the national emissions trajectory are relevant for setting caps and gateways. In making a recommendation to the Governor-General about scheme cap and scheme gateway regulations, the Minister must have regard to Australia's international obligations under the United Nations Framework Convention on Climate Change and the Kyoto Protocol, and the most recent report of the independent review commissioned under this draft bill. Other matters relevant to setting the national scheme caps and gateways are specified in the draft bill and discussed in Chapter 2 of this commentary.

The draft bill is designed to provide the maximum feasible level of certainty over future scheme caps consistent with retaining legitimate flexibility to adapt to changing international conditions.

Liable entities and covered emissions

The Scheme applies liability in two main ways. First, liability generally arises where the greenhouse gases emitted from the operation of a facility has a carbon dioxide equivalence of 25,000 tonnes or more per year. (One exception is in respect of landfill facilities, where the threshold is 10,000 tonnes for facilities within a prescribed distance of another landfill facility accepting the same classification of waste). Where the entity that has operational control of the facility is a member of a controlling corporation's group, liability attaches to the controlling corporation. The controlling corporation's group consists of a controlling corporation and its subsidiaries, if any. To avoid doubt a group may consist of the controlling corporation alone. Where the legal person with operational control of the facility is not a member of a controlling corporation's group (a non-group entity), liability attaches to that person.

Secondly, where there are large numbers of small emitters, it is more practical to cover emissions by applying liability at another point along the supply chain. For example, to avoid imposing a compliance burden on many individual suppliers or users of fossil fuels and synthetic greenhouse gases, while sending the same price signal,

the Scheme applies liability at the earliest point of the fuel supply chain within Australia, for example the importer or manufacturer of the fuel or synthetic greenhouse gas.

In some situations, entities that purchase fuel from that 'upstream' entity will be required to quote an 'obligation transfer number' and to take responsibility for emissions that would result from the combustion of the purchased fuel (referred to as 'potential emissions'). Large users of fossil fuels (other than petroleum liquid fuels) will be required to do this.

In certain other situations the purchaser will be allowed, on a voluntary basis, to obtain and quote an 'obligation transfer number', acquire the fuel, gas or other substance and take responsibility for surrendering the units to meet the Scheme obligation. This mechanism allows entities to take on liability voluntarily or to avoid liability for emissions associated with exported substances, such as export of black coal and synthetic greenhouse gases, because the emissions will occur outside Australia. This is discussed in detail in Chapter 1.

Making upstream entities liable, while providing the 'obligation transfer number' mechanism, will assist in achieving a reduction of greenhouse gas emissions in a flexible and cost-effective way.

Issue of Australian emissions units

The Australian Climate Change Regulatory Authority will issue Australian emissions units up to the national scheme cap each year. These units will be issued:

- following purchase through an auction (see Chapter 3)
- in relation to emissions-intensive trade-exposed activities (see Chapter 4)
- in relation to coal-fired electricity generators (see Chapter 5).

In addition, units will be issued:

- on application, for the first 5 years of the scheme, at a fixed charge (see Chapter 3)
- for reforestation (see Chapter 6)
- for the destruction of synthetic greenhouse gas (see Chapter 7).

Chapter 2 addresses Australian emissions units and eligible international emissions units.

Assessment and surrender

Liable entities under the Scheme will report the emissions for which they are liable through the *National Greenhouse and Energy Reporting Act 2007*. This Act will be amended to require those liable entities which are not currently reporting under that Act to do so.

Liability may arise from several sources for which the one entity is liable. For example, controlling corporation A may be responsible for the emissions from one or more facilities and as a large user of fossil fuels. The emissions from each of these sources are 'provisional emissions numbers'.

The sum of the provisional emissions numbers is reduced by any excess surrender number (ie excess units surrendered in the previous year) and increased by the 'make good' number (if the entity failed to meet its entity's emissions number).

Eligible emissions units representing this number must be surrendered by 15 December following the relevant financial year. If sufficient units are not surrendered, a penalty becomes due on 31 January and a late payment penalty will begin to accrue. The penalty is a pecuniary penalty and a 'make good' obligation. (A 'make good' obligation means that if a liable entity surrenders too few units in one year, the obligation to surrender the shortfall carries over into the following year.)

This is explained in Chapter 8.

Compliance and enforcement

The powers relating to information gathering and monitoring are described in Chapter 9. The enforcement regime is also described in that Chapter.

The National Registry

A National Registry, described in Chapter 10, will be established to track the ownership of eligible emissions units and to manage their surrender and cancellation. This includes opening of accounts, and correction and rectification.

Public information

Price-relevant information will be published regularly to enable Scheme participants to make informed decisions about the price of emissions units. In addition, information about liable entities, holders of Registry accounts and forestry projects will be available. This is described in Chapter 11.

Independent reviews

An independent expert advisory committee will be constituted periodically to conduct public reviews of the Scheme. The committee and its operations are described in Chapter 12.

Review of decisions and miscellaneous

Chapter 13 addresses merits review of decisions by the Australian Climate Change Regulatory Authority and various miscellaneous matters.

Simplified outline

The draft bill includes a simplified outline of the Scheme (at clause 4) and each Part of the bill includes a simplified outline of that Part's contents.

Date of effect and application

While the proposed Act will commence 28 days after Royal Assent, the first year in relation to which entities will be liable under the Scheme will commence on 1 July 2010. This is achieved by use of the phrase 'eligible financial year' which is defined to mean the financial year beginning on 1 July 2010 or a later financial year.

- Early commencement of the proposed Act will allow liable entities and the Authority to prepare for the Scheme and for the Authority to operate the National Registry in relation to Kyoto units. Preparation will include:
- Education and assistance for entities which are likely to be liable and their representatives
- Receipt and assessment of applications for, for example, certificates of eligibility for coal-fired generation assistance, registry accounts, obligation transfer numbers, emissions-intensive trade-exposed assistance and in relation to reforestation
- The holding of at least one auction.

Transitional provisions and consequential amendments

The transitional provisions and consequential amendments are included in the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill. There is a separate commentary for this draft bill.

Financial impact; compliance cost impact; regulation impact statement

Statement as to financial impact and compliance cost impact will be available at the time of introduction. A Regulation Impact Statement will also be available at the time of introduction.

Proposal announced

The measures are based on the positions included in the White Paper entitled *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future*, released by the Government on 15 December 2008.



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