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Submission to the

Joint Standing Committee on Treaties

relating to

Ratification of the Kyoto Protocol

1. **It is submitted that for the purpose of providing significant support in meeting our international obligations under the Kyoto Protocol an immediate initiative should be undertaken to obtain uniform or at least compatible legislation in each of the States and Territories for the creation of the basic property upon which Greenhouse Emission Trading will subsequently rely in respect of a range of matters set out below. The legislation envisaged neither anticipates nor pre-empts future Commonwealth Government policy nor can it be seen as doing so.**

   1.1 Australia has a critical reliance on Carbon Sinks ("sinks") to comply with its Kyoto obligations. This reflects a national reliance on coal in the production of static energy. It also reflects the requirements of primary production and that as a developing nation, land-clearing requirements have been and continue it is argued, to be considerable.

   1.2 In the result and before considering either abatement measures or the possibility of baseline adjustment (referred to in sub-paragraph 1.3), it appears Australia's CO_2 equivalent emissions may exceed its Kyoto obligations by 100 million tonnes or more in the first compliance period.

   1.3 The conclusion appears inescapable notwithstanding the suggestion that research may yet reveal a higher baseline figure than imagined. Either the required quantity of sinks are grown or Australia faces the prospect of either defaulting or purchasing Emission Permits externally (assuming their availability) to cover the deficit. The potential cost would be significant. It is clearly not economically possible for commercial plantations alone to grow the required sinks. A substantial quantity must be produced by thousands of landowners growing coupes for environmental purposes.

   1.4 Australia at Kyoto, secured for itself the best terms possible. Our Annexe B obligation included a substantial increase over the 1990 emissions baseline. The undesirability of pressing for a similar result in the second or any subsequent commitment period, after failing to achieve our first commitment, requires no elaboration.

   1.5 In order to be considered as sinks on 1 January 2008 trees need to be at least 5 years old. The collection of provenance for seed and the growing of seedlings takes at least another year. Trees grown under dry farming conditions are planted in spring. The last date for planting Kyoto forests in readiness for the first year of the commitment period is therefore spring 2002 which necessitates a vast increase in seedling production in 2001.

   1.6 Present government policy is that nothing be done which anticipates or pre-empts future policy (ie 'no regrets'). The policy is understandable, as is the need to maintain it pending:

      1.6.1 clarification of requirements under the Kyoto Protocol; and

1.6.2 ratification and implementation of the Kyoto Protocol as an international treaty.

1.7 In addition, the legal view, which argues that the Commonwealth may incur legal liability to investors who claim they were induced by Commonwealth action to invest in sinks, in the event that, for any reason, Greenhouse Emission Trading fails to eventuate, appears on first consideration to be an obstacle. In reality, however, it presents an obstacle capable of removal.

1.8 Many investors, including large industries, international investors and those commencing new industrial developments causing emissions above the 'trigger level' imposed by existing legislation, are prepared to participate in the planting of trees without the certainty of government's clear mandate. This submission argues they must not be handicapped because it is they who may assist in removing the shortfall.

1.9 These investors:

1.9.1 do not regard tree growing as core business; and

1.9.2 are willing to make appropriate legal arrangements for the growing of sinks with those who are willing and able to carry out this function; but

both parties to such arrangements lack any guidance as to how the rights to Emission Permits in respect of those sinks can be <u>securely</u> established under present State/Territory law.

1.10 Current State and Territory legislation

1.10.1 where it exists, exists only in a rudimentary and unsatisfactory form;

1.10.2 exists only in some States and not in any Territory; and

1.10.3 is not designed to complement what is likely to be eventual Commonwealth legislation.

1.11 This firm pioneered the argument that Emission Permits (Carbon Credits) arising from sinks cannot be created in a vacuum. It is a fundamental legal requirement that Carbon Rights must firstly exist in the sinks and that those Carbon Rights must be:

1.11.1 legally separated from the sinks and from the land containing the sinks; and

1.11.2 capable of ownership separately from the sinks and from the land.

1.12 It remains our contention that the same legislation which enables the creation of Carbon Rights is simultaneously capable of providing the legal means for:

1.12.1 the reduction of transaction costs to a negligible figure;

1.12.2 the removal of proposed monitoring costs;

1.12.3 the sizeable reduction of verification costs; and

1.12.4 the encouragement of a massive increase in environmental plantings.

1.13 In brief we urge that the Commonwealth be active in ensuring that all States and Territories enact appropriate legislation to provide the secure basis for Greenhouse Emission Trading that is at present conspicuously lacking. At the same time, the creation of the legislation suggested does not in any way pre-suppose or suggest future policy by the Commonwealth Government or by the Government of any State or Territory.

1.14 These outcomes must be built into State/Territory legislation <u>urgently</u>. Ideally, legislation should be identical in each case or at least be compatible as between all States and Territories and between

each of them and the Commonwealth (including whatever future Commonwealth legislation is likely to be enacted which 'creates' Emission Permits from sinks).

2. **The legislation suggested in Submission 1 must enable the production of absolutely secure Carbon Rights. Our contention is that without that absolute security, whatever trading system eventuates (which must, of necessity, be based in part of the availability of absolutely secure Carbon Rights) will fail.**

2.1 The announcement that the Sydney Futures Exchange ("SFE") will no longer proceed with its planned carbon credit market (Fin Rev 16 Aug 2000) will cause no surprise. While it is acknowledged that the SFE's stated reason for its decision is of an economic nature, other reasons suggested in the report have far greater significance and clearly impose themselves in any decision based on economic considerations. The other reasons are:

2.1.1 Unacceptably high financial risks for Brokers standing between buyers and sellers; and

2.1.2 concern with possible further requirements emanating from decisions taken at COP6.

2.2 The exposure of Brokers to financial risk arises because they issue and sell Emission Permits and must stand behind their paper. Emission Permits issued as part of Australia's entitlements require little or no verification. Emission Permits issued in respect of sequestrations by sinks are another matter. What is not generally appreciated is the great risks which are implicit in the legal issues involved. Buyers expect complete security in trading with Brokers. Government, we imagine, will not issue Emission Permits from sinks. Brokers will do this. They will be required to comply with rules regarding a range of matters including issue, verification, title, existing securities, insurance, replacement etc. and, in addition they will be audited. Failure in compliance will result in the imposition of very substantial penalties including automatic loss of the Broker's trading licence.

2.3 If the paper issued by a Broker is merely based on a <u>contract</u> with the sink owner, the Broker as a result is clearly required to give far greater security to the buyer than the Broker can possibly extract from the seller. In consequence the Broker, as the SFE undoubtedly realised, is and remains continuously at very considerable risk. That risk is not capable of being 'papered over', as has been suggested, by the Broker dealing with sink owners through an intermediary or even through several 'layers' of intermediaries. Neither is 'insurance' against the risk, either with an Insurer or by the Broker holding a substantial backup supply of carbon rights, a feasible option because of cost considerations and because neither solution serves to reduce the level of risk.

2.4 McKean & Park has:-

2.4.1 consistently warned of lack of secure ownership creating unacceptable risks; and

2.4.2 warned on numerous occasions that whatever methodology was developed for the ownership of Emission Permits and their trading needed to be sufficiently robust to accommodate changes to the requirements in the Kyoto Protocol.

2.5 There is a further problem in that the usual documentation establishing existing plantations, even in States where some legislative framework for the creation of Carbon Rights exists, does not make use of that legislation. In the result, the ownership of Carbon Rights arising from sinks in these plantations is uncertain and may well require extensive litigation to resolve. The State/Territory legislation we envisage would give an early opportunity to resolve these problems and would also substantially reduce the potential for litigation.

2.6 In summary we ask that the State/Territory legislation referred to in Submission 1 be strong and provide that basic security that will be necessary to sustain workable Greenhouse Emissions trading market. This firm has been consistent in its stance on the above issues. It maintains that the adoption of a secure foundation will substantially reduce anticipated costs and make the market far more accessible to landowners in respect of their environmental plantings.