Chapter 13

Legal aspects

13.1 This chapter examines the legal issues that were raised in the course of the inquiry.

Contractual impediments to carbon cost pass-through

13.2 A number of stakeholders raised issues in relation to contractual impediments to carbon cost pass-through.

13.3 The Australian Pipeline Industry Association (APIA) expressed concern over the lack of a mechanism to enable carbon cost pass-through in respect of existing contracts.[1] APIA submitted that such a mechanism was necessary because many of its members were parties to long-term contracts that did not make provision for the structural changes, and hence increased costs to its members, arising from the introduction of the CPRS.[2]

13.4 APIA observed that many of its members would be liable entities under the CPRS as they produced CO_2-e emissions over the threshold of 25 000 tonnes annually. This was due to the amount of natural gas used to transport gas through extensive networks of pipelines by means of compression.[3]

13.5 Alternatives to this method of gas transportation were, in APIA's view, capital intensive and not necessarily an economic alternative to purchase of permits under the proposed CPRS.[4]

13.6 The APIA submission outlined the impediments to passing through carbon costs:

> Many long−term contracts, and some recent contracts, in the gas transmission industry predate the fundamental policy shift reflected in the CPRS. Whilst the wording of these contracts in relation to change of law clauses or pass through of tax changes depends upon the particular contracts, many do not allow for costs associated with carbon constraints to be passed through to customers. These contracts can extend up to 15 or 20 years, which means affected gas transmission companies will bear this cost, with no compensation, for many years to come.[5]

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1 Australian Pipeline Industry Association, *Submission 6,* p. 1.

2 Australian Pipeline Industry Association, *Submission 6*, p. 1.

3 Australian Pipeline Industry Association, *Submission 6*, p. 2.

4 Australian Pipeline Industry Association, *Submission 6*, p. 2.

5 Australian Pipeline Industry Association, *Submission 6*, p. 3.

13.7 In submissions on the government's policy papers, and to the committee, APIA proposed that the draft legislation be amended to include provisions requiring that 'the CPRS…be treated as a tax for the purpose of allocating costs under contractual obligations'.[6]

13.8 Santos Limited (SL) also raised the issue of carbon cost pass-through, in relation to its existing long-term contracts of supply of gas such as methane.[7] Like APIA, Santos defined this issue as essentially a contractual problem. Mr Gregg Rowley, Group Executive, Clean Energy, advised:

> Those long-term contracts often go back years in terms of when they were signed. The idea of an ETS, or carbon trading system, was not agreed on at that stage, so, unfortunately, in not all but a number of those long-term contracts, the wording is not right to allow the passing of those carbon costs through the system.[8]

13.9 The Santos submission proposes the following solution to remedy this perceived oversight in the design of the CPRS:

> Santos strongly believes that a statutory pass-through provision, acting for a transitional period, needs to be inserted in the CPRS Bill to reinforce the key design of the CPRS that the costs of the scheme are passed through to the end users. To provide certainty for business on this matter the scope of the statutory pass-through provision should apply specifically to contracts where the:
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> • issue of carbon cost pass-through was not explicitly and effectively dealt with in the contract
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> • contract was entered into before 3rd June 2007
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> • contract is for a supply that has an associated carbon cost and occurs after the commencement of the CPRS; and
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> • contract is non-reviewable for carbon costs.[9]

13.10 Appearing before the committee, Santos disagreed with the response provided by the government in the White Paper, which rejected this approach on the grounds of constitutional issues, difficulty in assessing respective liabilities between parties to a contract and the potential for such pass-through clauses to act as disincentives for emissions abatement.[10]

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6 Australian Pipeline Industry Association, *Submission 6*, p. 1.

7 The extracted methane contains CO_2, which is separated out and vented, thus attracting liability under the proposed CPRS.

8 *Proof Committee Hansard*, 24 March 2009, p 23.

9 Santos Limited, *Submission 81*, p. 2.

10 Mr Gregg Rowley, *Proof Committee Hansard*, 24 March 2009, p 23.

13.11 The Australian Coal Australian Association (ACA) submission highlighted carbon cost pass-through as an issue for coal mines supplying thermal coal for the domestic market, again due to long-term contracts inadequately drafted to deal with the issue of carbon cost pass-through. ACA recommended that the coal industry therefore be allowed access to EITE assistance. This issue is addressed in Chapter 6.

13.12 Griffin Energy (GE), a group with interests in the WA electricity generation and supply industry, was also concerned about contractual impediments to carbon cost pass through.

Committee comment

13.13 The committee observes that the issues raised in submissions and hearings on this issue have been identified and considered in detail in the consultations on the Green Paper and White Paper. The government declined to take the approaches recommended by stakeholders on the basis that renegotiation of contracts or new market entrants was a more likely and reliable means by which defective contracts could be remedied. In contrast, the approaches suggested could be complex, ineffective and carry a real risk of: exposing the government to claims for just terms compensation by virtue of section 51 (xxx1) of the Constitution.

13.14 The committee heard no evidence to convince it that the government's previously expressed position should be reconsidered.

13.15 The committee notes also that equity issues arise where it is proposed to intervene in contracts negotiated in recent years, which either failed to consider the potential for a carbon price or that were technically defective in creating terms to deal with the possibility. The committee considers it very likely that a significant number of the contracts in question failed to anticipate the introduction of emissions trading, and hence a carbon price, at a time when this was at the very least a reasonable prospect. It would be inappropriate for the government to intervene in order to make good any such failure.

13.16 Finally, the committee notes that the government has undertaken to monitor the progress of commercial contract negotiation and formation now that stakeholders are aware of the scheme design and intent with regard to carbon cost pass through. The CPRS White Paper states:

> Based on current information, the Government will take no action with respect to contractual impediments other than as discussed in Chapter 7 in relation to the ability of firms to transfer obligations under certain circumstances. In 2009 the Government will continue to monitor the nature of contractual issues, including the scope for, and progress of, commercial negotiations, once stakeholders have had an opportunity to assess the exposure draft of the legislation.

> The legislation will not contain any provisions designed to override contracts to allow for pass-through of carbon costs.[11]

Regulation-making under the CPRS

13.17 A number of witnesses were concerned about the scheme's reliance on regulations. Mr Ralph Hillman, Executive Director, Australian Coal Association (ACA), advised:

> The ACA…[is concerned that the] legislation does not address the principal policy elements of the proposed CPRS, leaving most of the important policy objectives and instruments to the explanatory memorandum and regulation.[12]

13.18 The Australian Petroleum Production and Exploration Association (APPEA) shared this concern over the potential scope of the regulations, and expressed support for a discrete inquiry into the issue.[13]

13.19 More particularly, Ms Aileen Murrell, Assistant Director, Chamber of Minerals and Energy of Western Australia, submitted:

> …key sections of the draft legislation, such as part 8 relating to the Emissions-Intensive Trade-Exposed Assistance Program, contained little detail, leaving a substantial amount to be set out in the regulations not planned for release until June 2009.[14]

13.20 Mr Rowley, representing Santos, also raised this issue in relation to EITE assistance, cap limits and scheme coverage. Mr Rowley noted the importance of 'due time, consideration and consultation' in the formulation of the regulations.[15]

13.21 In response to the criticisms outlined, Mr Barry Sterland, Acting Deputy Secretary, Department of Climate Change (DCC) provided a comprehensive assurance of the range of consultations to be undertaken in formulating the CPRS regulations:

> There is consultation, as I said, on the detail of the emissions-intensive trade-exposed. There will be consultation on some elements of the auction legislative instrument early and that consultation will be ongoing through the year. There will be a number of tranches of regulation later in the year, but by and large they are fulfilling and translating the policy that has been clearly enunciated in the white paper. The normal technical interchange that happens in any legislative program will happen. There will be consultation. There will exposure drafts, by and large, of things of interest. We will take

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11 *White Paper*, Vol. 1, p. lxxxv.

12 Mr Ralph Hillman, *Proof Committee Hansard*, 25 March 2009, p 107.

13 *Proof Committee Hansard*, 24 March 2009, p. 10.

14 Ms Aileen Murrell, Chamber of Minerals and Energy of Western Australia, *Proof Committee Hansard*, 23 March 2009, p 2.

15 *Proof Committee Hansard*, 24 March 2009, p. 24.

> submissions or feedback, and that will be incorporated in the regulations that are made. Ultimately, there is obviously potential for scrutiny in the parliament. So there are a significant amount of regulations to be made, but they are not surprising in their area, they have been well canvassed to date and there will be ongoing consultation on all elements of them.[16]

13.22 Responding to the concerns about the reliance on regulations, Mr Sterland observed that the White Paper and exposure draft of the Bill provided sufficient information and guidance on the likely detail of regulations:

> The policy in the white paper is very clear, for example, about the way in which emissions-intensive trade-exposed industries are going to be treated. The regulations will implement that, so there is a very extensive process underway to translate that policy through to the regulations. But it is about translating the policy into the regulations, not changing it or bringing in new considerations. There are a substantial amount of regulations, to be sure, and they are outlined quite transparently in both the exposure draft and the white paper itself, which makes very clear the areas where regulations will be important: scheme caps, EITS and a whole range of determinations.[17]

Committee comment

13.23 The Committee notes that the commentary on the exposure draft of the Bill provides a direct justification for relying on regulations to define critical elements of the EITE assistance program:

> The technical aspects of precisely defining emissions-intensive trade-exposed activities and relevant production units, and the need for flexibility to include new activities, make the program appropriate to locate within regulations rather than the bill itself.[18]

13.24 More generally, the committee acknowledges that the Bill requires the making of numerous regulations across all parts of the proposed legislative scheme; elements of the scheme will also be specified in the *National Greenhouse and Energy Reporting Regulations 2008*. The areas of the CPRS which are to be the subject of regulations include, for example, EITE assistance, national targets and scheme caps and gateways, thresholds for ascertaining liability of entities, values for calculating greenhouse gas emissions from certain processes, accounting rules and estimation methodology for greenhouse gas removals in relation to reforestation, and additions or changes to classes already specified in the CPRS legislation (such as types of 'eligible international emissions unit').

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16 *Proof Committee Hansard,* 30 March 2009, p. 39-40.

17 *Proof Committee Hansard,* 30 March 2009, p. 39.

18 Department of Climate Change, *Carbon Pollution Reduction Scheme Bill 2009 Commentary*, p. 126-7.

13.25 However, the committee received no convincing evidence that the extent of regulation making is inappropriate to the administrative or regulatory requirements of the scheme. Indeed, the committee notes that extensive regulations are made under other Commonwealth legislation, such as that dealing with environment protection and biodiversity conservation.

13.26 In terms of consultation and the final scope and substance of the regulations, it is relevant to note that the Commonwealth *Legislative Instruments Act 2003* ensures that in Australia there is a comprehensive regime for the proper making and management of Commonwealth legislative instruments. The objects of this Act include:

- encouraging rule−makers to undertake appropriate consultation before making legislative instruments;
- encouraging high standards in the drafting of legislative instruments to promote their legal effectiveness, their clarity and their intelligibility to anticipated users;
- improving public access to legislative instruments;
- establishing improved mechanisms for parliamentary scrutiny of legislative instruments; and
- establishing mechanisms to ensure that legislative instruments are periodically reviewed and, if they no longer have a continuing purpose, repealed.[19]

13.27 The committee received evidence indicating that the development of the regulations is proceeding in accordance with legislative requirements and best practice, particularly with regard to consultation,[20] as indicated by the evidence of the DCC.

13.28 In the committee's view, the CPRS appropriately sets out both mandatory and discretionary elements that must or may be dealt with by the regulations. The regulations are not to be prescriptive of substantive aspects or general principles of the CPRS, but are appropriately limited to technical matters as well as issues of administration and detail, some of which may be subject to regular or even frequent change. Given the relatively limited experience of emissions trading both in Australia and throughout the world, the committee notes that there is a strong justification for the CPRS to have the scope and flexibility to change in response to changes in our understanding of regulatory best practice or relevant science. Further, regulations enable the executive to more easily adjust the scheme in the interests of supporting the

19 *Legislative Instruments Act 2003*, section 3.

20 See Dr Peter Burn, Associate Director Public Policy, Australian Industry Group, *Proof Committee Hansard*, 27 March 2009, p. 85; and Mr Lee White, General Manager, Institute of Chartered Accountants, *Proof Committee Hansard*, 27 March 2009, p. 55.

development of an effective global response to climate change, which is a central object of the CPRS legislation.[21]

13.29 Notwithstanding the need for flexibility, the making of regulations under the CPRS is adequately constrained by legislative requirements or mandatory considerations contained in the CPRS legislation. This should serve to provide further certainty in relation to the making of regulations.

Senator Annette Hurley

Chair

21 *Proof Committee Hansard,* 27 March 2009, p. 39.