

# Legal issues arising with the linking of international emissions trading schemes

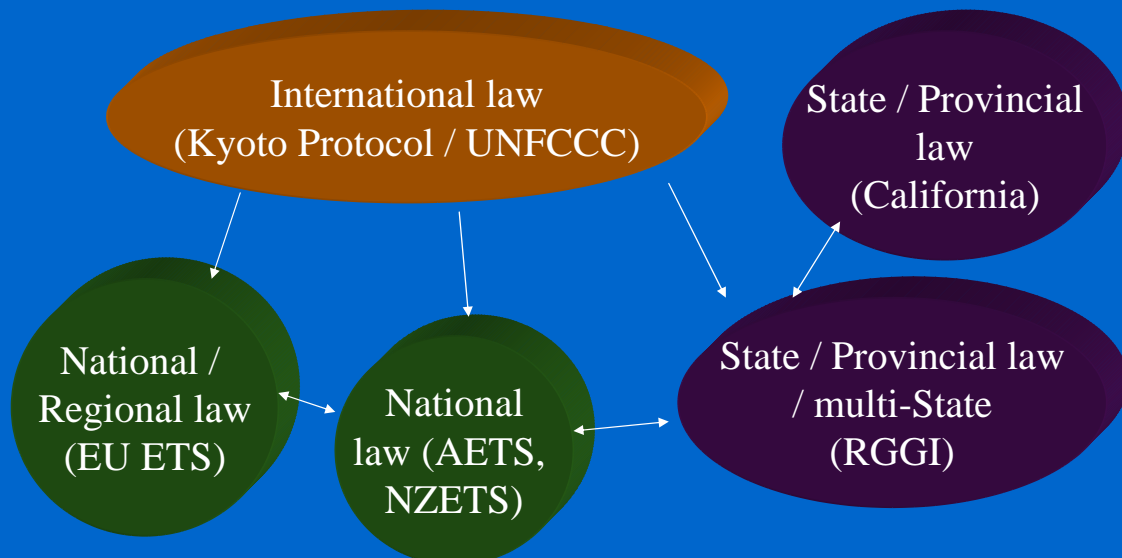
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CEEM 3<sup>rd</sup> Annual Conference

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## Different legal jurisdictions

- Examples of jurisdictional linkages



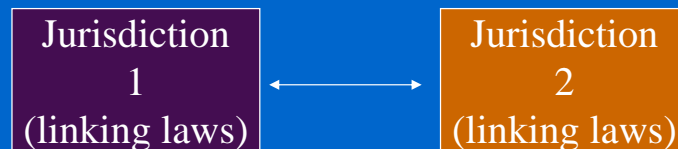
## Direction of linking

- Unilateral



- In time Jurisdiction 1 might need regulation to take account of impact of unilateral linking in Jurisdiction 2 on the market in Jurisdiction 1 (e.g. voluntary surrender laws in MRET)

- Bilateral



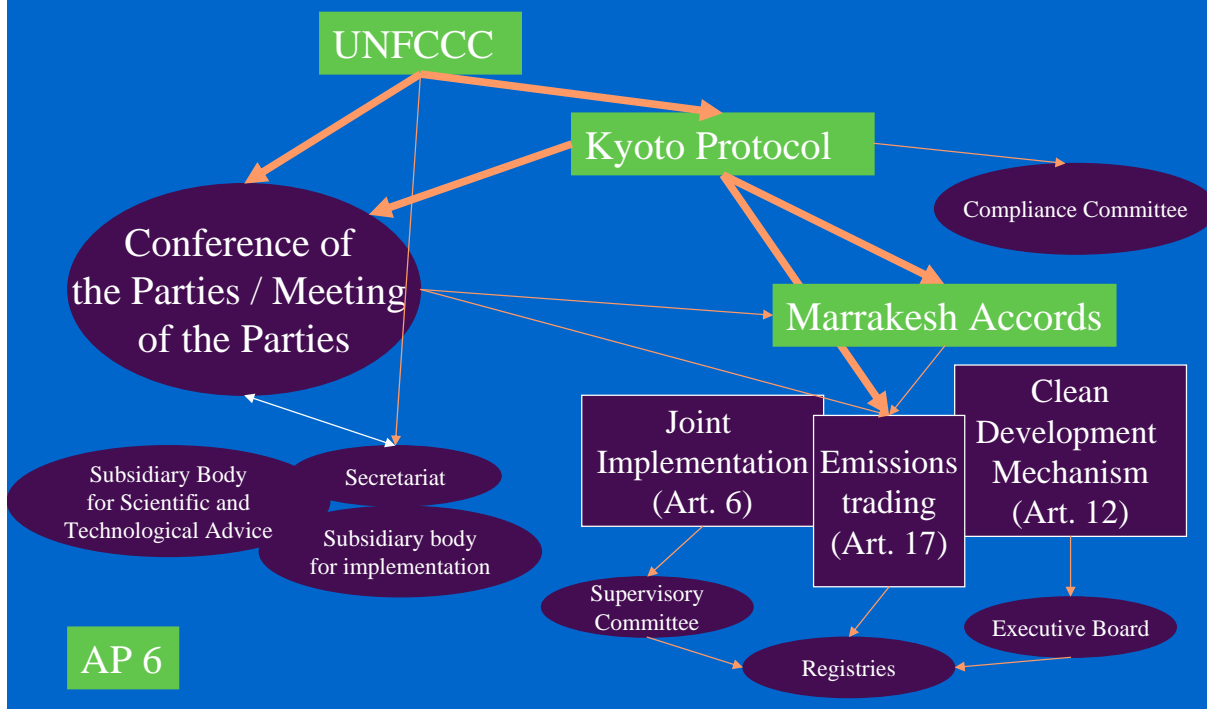
## Legal nature of carbon

- Permit / allowance
  - AAU, AETS Permit, EUA
  - Legal nature and effect could differ
    - Statutory entitlement to emit greenhouse gases
    - Exception from prohibition on greenhouse gas emissions
    - Certificate reflecting component of capped emissions (part of a broader obligation)
  - Property? Real or personal? Chose in action? Statutory right? Statutory instrument?
- Offset
  - CER, AETS Offset
  - Legal nature and effect could differ
    - Statutory credit for reduction in emissions
    - Statutory entitlement to have less actual emissions recognised in return for having reduced emissions elsewhere
    - Statutory entitlement to emit greenhouse gases in return for having reduced emissions elsewhere
  - Property? Real or personal? Chose in action? Statutory right? Statutory instrument?

# Legal nature of carbon

- Offset from covered sector
  - ERU, AETS Early Action Credit
  - Usually created from a permit or allowance (or in exchange for or instead of)
  - Same possibilities arise as for other types of carbon
- Few commodities are so intangible or lack uniform legal standards
  - Law is familiar with rights without tangible form or “incorporeal”
    - Intellectual property, debts, for example
  - Compare with:
    - Wheat, oil or gold → physical form
    - Shares or funds → central registries
  - Registries in individual countries for Kyoto Protocol (functioning once ITL fully operative beyond NZ and Japan)

# International Institutional Framework



## Legal recognition across jurisdictions

- Linking like with like → science, economics and policy (later speakers)
- Linking legal instruments across two jurisdictions:
  - International law acts on nation states not individual natural or corporate persons or even domestic law unless a nation so provides
  - Constitutional law within a nation can limit capacity for extraterritorial operation of legislation, legislation interacting with international law or law on certain subject matter
  - Directly recognise / import “instrument” into Jurisdiction
    - E.g. international law instrument is recognised as such and in the same way in domestic law
    - Extraterritorial operation of law
    - Registries interact → laws must be able to support this
    - Laws interact → so must be legal capacity to do so
  - Directly recognise / import carbon into jurisdiction but without maintaining the same legal “instrument”
    - E.g. CERs becoming a creature of domestic law in a domestic registry → character of international law instrument lost in nations where international law does not directly apply?
    - Still interaction between registries and laws to effect import
    - Can depend on way international law recognised in domestic law
  - Require surrender of legal form of instrument in one registry with that in another (e.g. surrender CERs internationally and recognise as CERs domestically OR recognise as offsets)

## Different rules

- Rules consistent enough across jurisdictions to maintain integrity of each scheme
- In Task Group report referred to as “appropriate” opportunities for linking:
  - be designed to enhance the scope for links, both formal and informal, with as many different systems as possible.
  - basic approach should be to promote links where there is assurance of the integrity of the partner system and the linking mechanism
- Example: different penalty regimes
  - Weakest system can act as a cap
    - If one scheme has buy out and other doesn't then shift carbon to meet toughest scheme and pay penalty under the easiest one.
  - Effective forum shopping

## Applying a legal “filter” to imported carbon

- EU ETS → restrictions on volumes of CERs and ERUs that may be used (supplementary limits) and sources from which may come
- RGGI → cap on use of domestic and international offsets → overall limit of 50% of projected avoided emissions needed to meet cap

## Federal to international

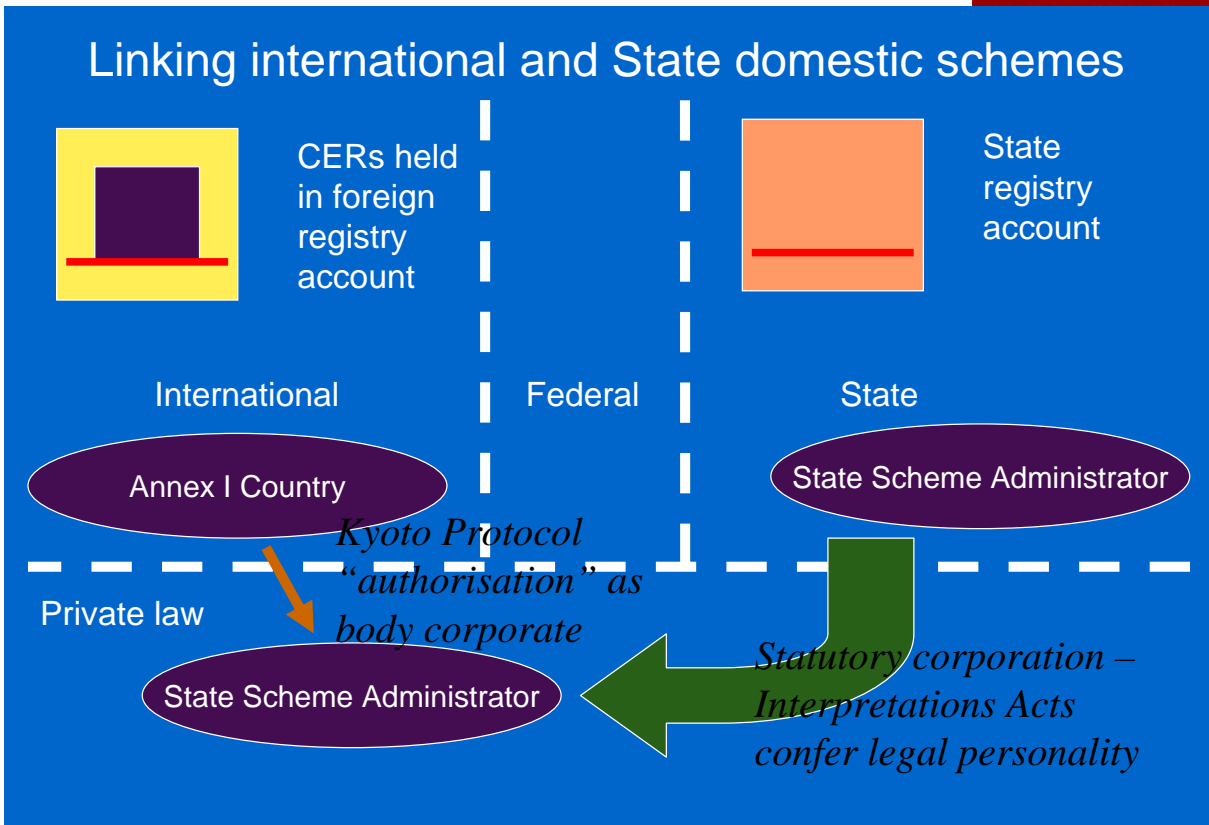
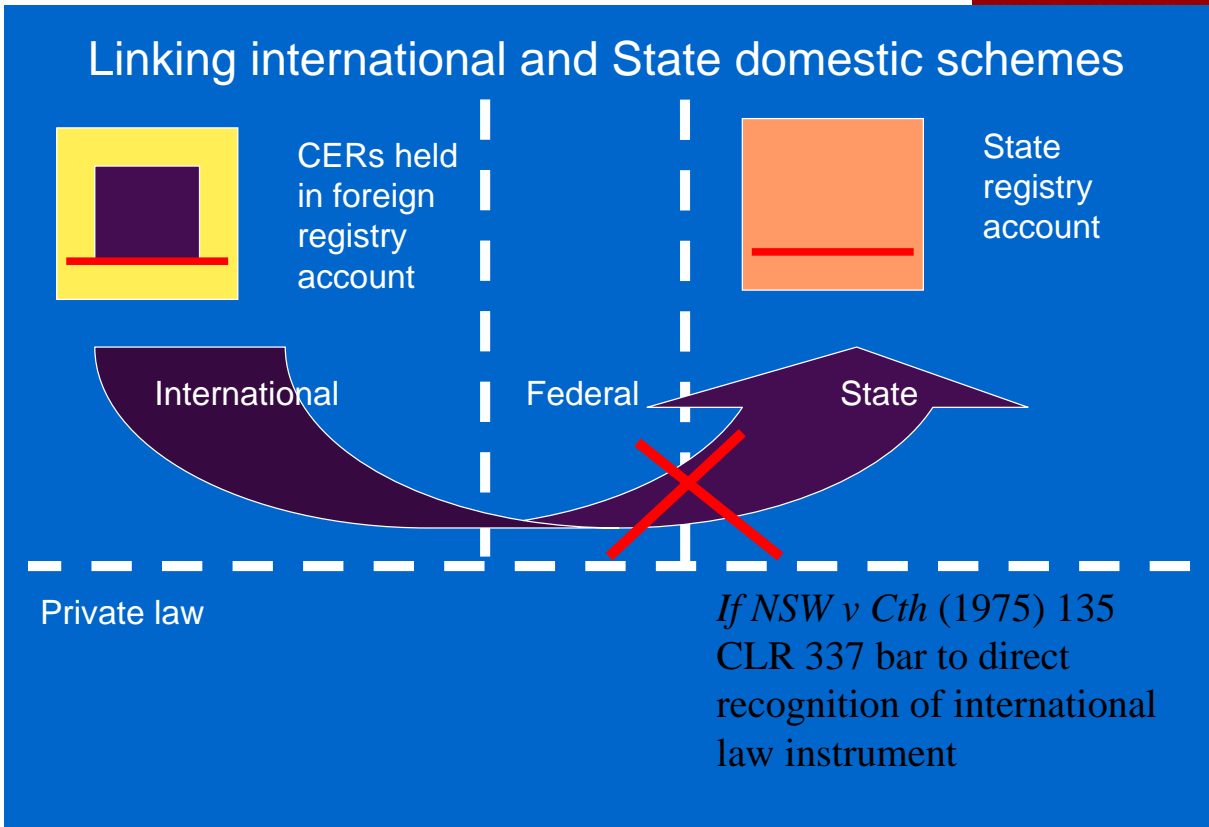
- Australian context: the external affairs power
- *Victoria v Commonwealth* (Industrial Relations Act Case) (1996) 187 CLR 416
  - Law must be reasonably capable of being considered as appropriate and adapted to implementing a treaty to which Australia is a party
  - *Deficiency in implementation of a supporting Convention is not necessarily fatal to the validity of a law; but a law will be held invalid if the deficiency is so substantial as to deny the law the character of a measure implementing the Convention or it is a deficiency which, when coupled with other provisions of the law, make it substantially inconsistent with the Convention.*
- Little doubt Commonwealth would have power to link
- UNFCCC - All parties (Art 4(1)(b)): *Formulate, implement, publish and regularly update national and, where appropriate, regional programmes containing measures to mitigate climate change by addressing anthropogenic emissions by sources and removals by sinks of all greenhouse gases not controlled by the Montreal Protocol, and measures to facilitate adequate adaptation to climate change*
- UNFCCC - Developed countries (Art2(a)): *Each of these Parties shall adopt national policies and take corresponding measures on the mitigation of climate change, by limiting its anthropogenic emissions of greenhouse gases and protecting and enhancing its greenhouse gas sinks and reservoirs*

## Linking international and State domestic schemes

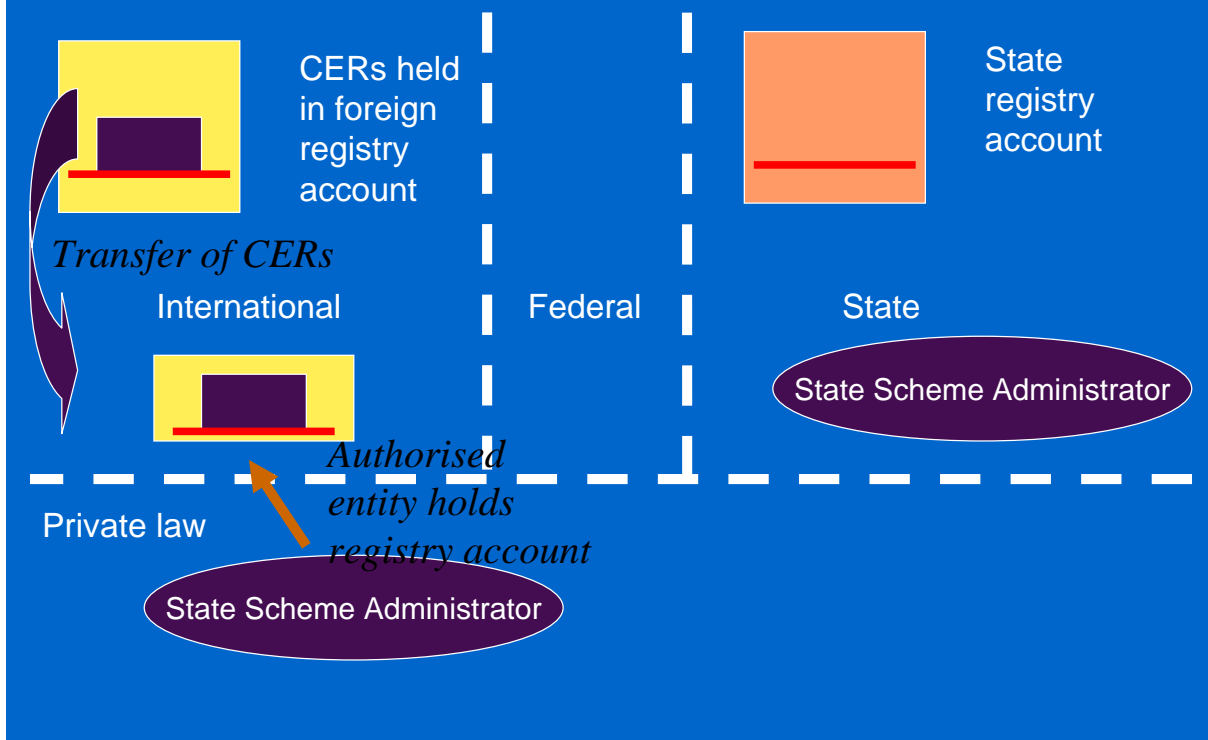
- Can Certified Emissions Reductions be directly recognised or owned in State law or only Federal law?
- Barwick CJ in the context of the international law of territorial waters (*NSW v Cth* (1975) 135 CLR 337 at 361) considered (the majority adopting a similar position):
  - “The rights of which [the conventions in question] speak are conferred on the nation state, which unquestionably is Australia and not the and not the constituent States whether regarded individually or collectively... Only the nation state could shoulder and perform these obligations which in their nature and origins are obligations between nation states”
  - The notion of territorial waters was one which “derives entirely from international law” and which his Honour considered it had “no place in the domestic or municipal law of a country”, so that only legislatures with plenary power to make extraterritorial laws concerning treaties could do this. The States could not do this because they can only legislate extra-territorially for the peace, order and good government of their territories.
- Need for territorial connection in State lawmaking vs plenary extraterritorial powers of the Federal legislature affirmed in *Polyukhovich v Commonwealth* (1991) 172 CLR 501
- By analogy it might be argued that the notion of an international offset corresponding to a reduction in emissions in a developing country is entirely a creature of international law, which has no place in State law.
- However, if the CER is being used to offset emissions generated within State boundaries so that a domestic economy has time to transition to a lower-carbon future, should State laws be able to establish the necessary connection to recognise an international law commodity?
- Bankes and Lucas: in Canadian context considered that even though emissions trading scheme might extend beyond the boundaries of a province, the objective is not trade of itself, but is specifically tailored rights for the purpose of facilitating effective and efficient provincial source GHG emissions

## Linking international and State domestic schemes

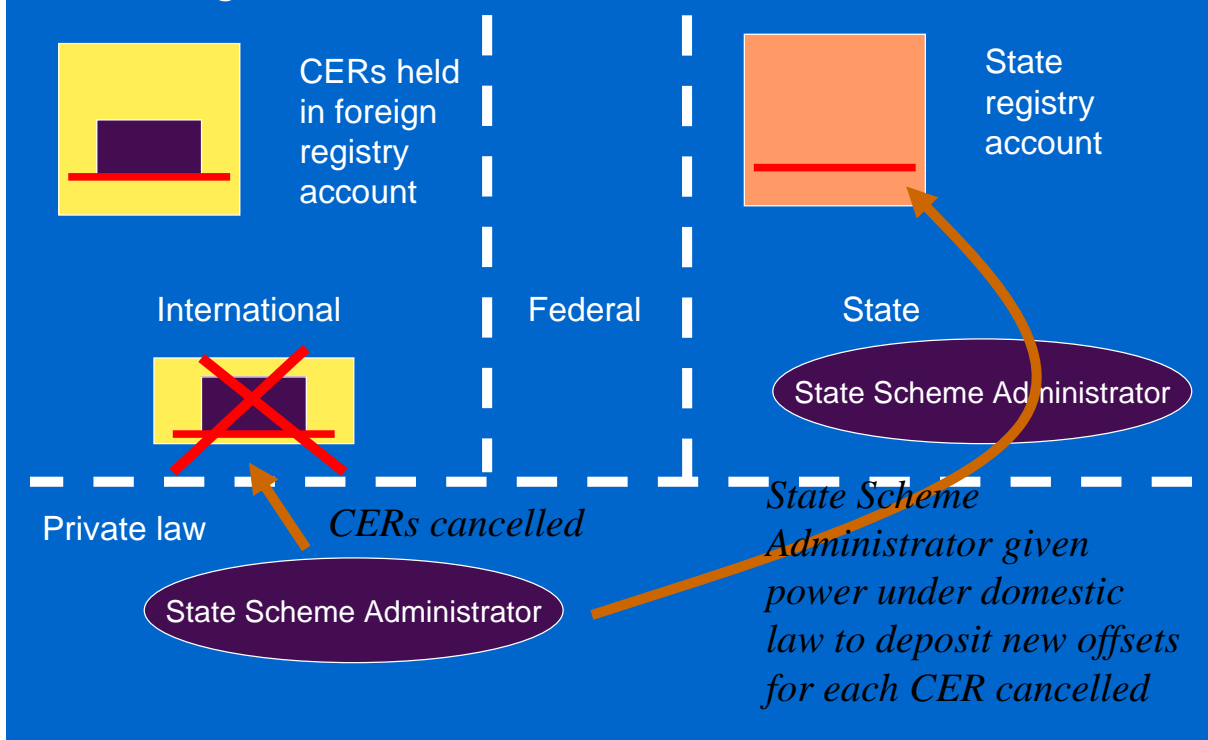
- No framework in the Kyoto Protocol for entities other than Parties to operate a national registry in which CERs are held.
- Australian or US States cannot be Parties because they have no capacity to enter into relations with nation States: *Montevideo Convention on Rights and Duties of States* 1933 Article I(d) with *NSW v Cth* (1975) 135 CLR 337 at 361 Barwick CJ



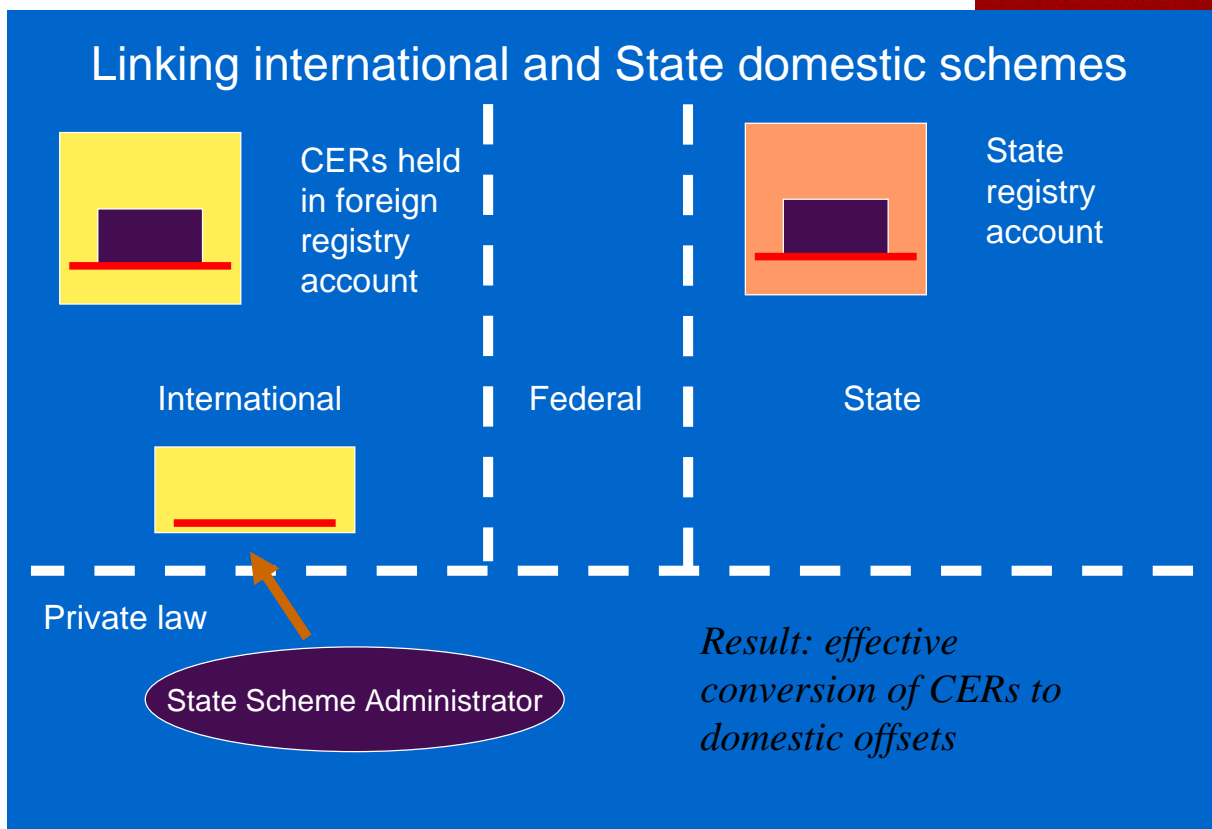
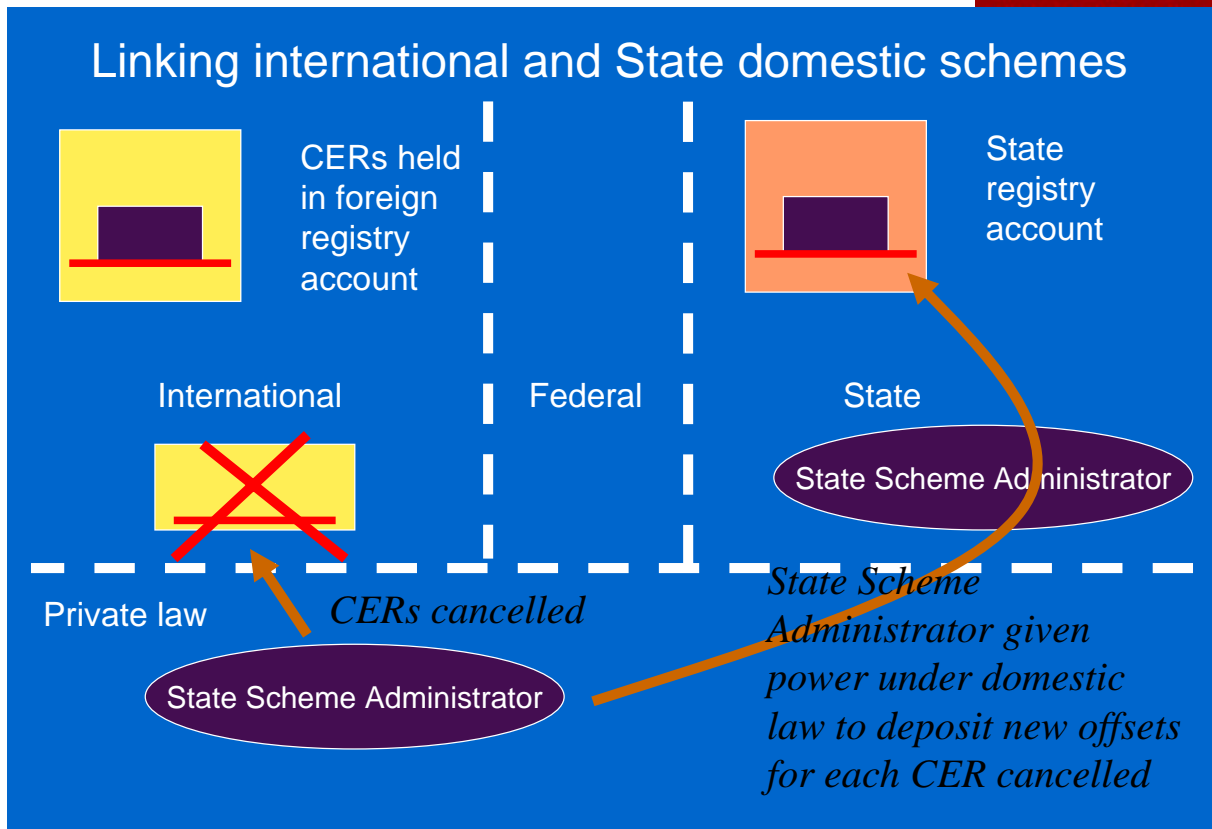
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## Same, but separate, linked State schemes?

- RGGI, for example
- Even if the States have a common scheme, each State would have its own legislation
- Is there a sufficient territorial connection for an allowance or offset generated in one State to be used in another?
- On Bankes & Lucas view, clear intention to ensure efficient source GHG emissions reductions in State, regardless of trading component.
- R. Garner puts different focus on activity in context of characterising Federal emissions trading: would be “difficult to argue” not within Federal “trade and commerce” power because of creation and trade of permits and allowances involves sale or delivery across State and international boundaries. Comments that “*inextricable intermingling between intrastate, interstate and international trading*”.
- Could it be that on tests for State legislative power and Federal legislative power that both levels of government could have power to legislate?

## De facto trade restrictions?

- If limitations placed on import or if effect of favouring one State or nation over another
- ***Castlemaine Tooheys Limited v SA (1989) 169 CLR 436***
  - Stated case for South Australia included: “*the use, return and refilling of refillable bottles generally results in a proportionate reduction in the release into the atmosphere of carbon dioxide from the burning of natural gas in the production of glass containers*”

## De facto trade restrictions?

- Majority assumed State's intention was only to legislate for energy efficiency in SA
  - “a regime was introduced which subjected the Bond brewing companies' interstate trade to serious competitive disadvantages by reason of their selling beer in non-refillable bottles, even though those bottles are manufactured outside the State and do not, as far as we know, involve the use of South Australian natural gas” → would assist in the conservation of SA energy because resources of other States would be consumed instead
- However, Court appeared to contemplate the scope for regulation of interstate trade for the purpose of energy conservation → potentially even for the purpose of national or global energy conservation:
  - Mason CJ, Brennan, Deane, Dawson AND Toohey JJ: *the legislature of a State has power to enact legislation for the well-being of the people of that State ... Accordingly, interstate trade, as well as intrastate trade, must submit to such regulation as may be necessary or appropriate and adapted either to the protection of the community from a real danger or threat to its welfare or to the enhancement of its welfare.*
  - Gaudron and McHugh JJ: *If, on the other hand, it be suggested that the focus of consideration is the general problem of energy conservation viewed from a national or a global perspective, the legislative regime for beverage containers must be viewed as likely to have an even less significant impact.*

## Environment and Environmental Markets

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