Carbon trading:

Do lawyers have a role in saving the environment?

JONATHAN WILKINSON, DEACONS

A carbon emissions trading scheme (carbon trading) is likely to be established in Australia within a few years. It will allow us to participate more effectively in the international emissions trading market. Before and after it is established, lawyers need to understand how carbon trading works, what the legal issues are, and how to advise their clients.

The Intergovernmental Panel on Climate Change (IPCC) recently reported that fossil fuel burning by humans is a major cause of global warming. At worst, we could have global temperature increases of up to 6 degrees by the end of the century. This may result in melting ice caps, sea level rises, species loss and extreme weather conditions such as drought and flooding. The effect of our actions has turned mankind into a force of nature. As a result, a new consensus is emerging about the need to act to reverse the effects of global warming.

Carbon Trading '101'

Carbon trading uses market forces to find the lowest-cost way of reducing emissions. Carbon trading schemes penalise organisations (including companies) that breach greenhouse gas emission targets by forcing them to buy carbon credits from those who have reduced their emissions. Conversely, companies with low emissions are allowed to sell their unused emissions capacity. To generate this capacity, companies must become clean and energy efficient.

Companies are allocated emissions caps under international agreements such as the Kyoto Protocol. Companies can bid at auction for credit certificates to emit carbon beyond those limits. Only Kyoto signatory countries are allowed to generate tradeable carbon credits.

These credits are used to increase environmental and investment returns. The credits are then traded on the market. Carbon credits trade like any other commodity, fostering the same deals and incentives with spot and derivatives products that underpin existing stock and other asset markets. The price of carbon would be listed and reported like any other asset.

If companies exceed their legal emission limit, they must buy credits from another company that has not reached its limit, or invest in greener technologies. "Winners" in the carbon economy are those with operational energy saving systems built into their business.

Efficient businesses benefit from their environmental credentials by being able to sell their surplus carbon. Non-efficient businesses effectively pay to pollute. Among other benefits, carbon trading aims to improve the environment by attracting people to invest where they can be assured of good renewable investments.

Shrinking emissions, growing profits

Many organisations are charting a route into the new carbon economy. A number of leading Australian

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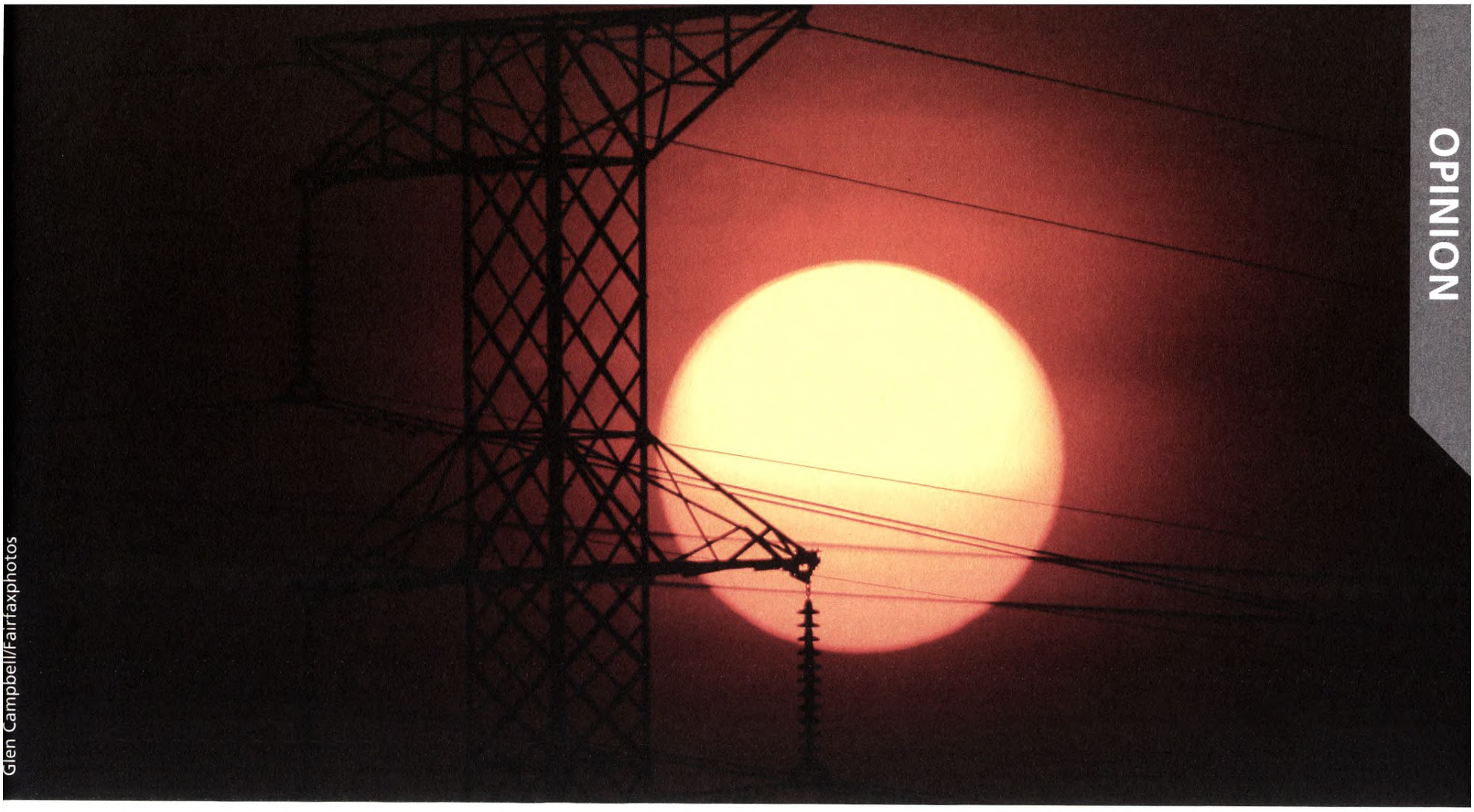

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companies in established industries have given provisional backing to a carbon trading scheme, arguing that even big energy users can profit from carbon trading. Many of these companies have been making headlines by pursuing initiatives under Kyoto.

Why are these players interested? Among other factors, carbon trading provides an opportunity to gain an advantage over less technologically sophisticated rivals. For example, the current carbon price for one tonne of emissions is between A$10 and A$20. If brown coal produces 1.0 to 1.4 tons of carbon dioxide per megawatt hour of electricity, compared with 0.9 tons for black coal and 0.3 to 0.4 tons for gas, it makes economic sense to retire polluting old technology and invest in cleaner energy production methods.

The international emissions market: Australia's future?

The carbon emissions trading market is among the fastest growing markets in the world. At the end of 2006 it was worth EUR22 billion (A$36 billion), doubling in value since 2005. In 2004 it was only an idea. A major influx of private and public capital has flooded into the carbon market to speculate on its price and add carbon commodities to the list of other commodities, derivatives, and securities.

Accordingly, the mainstream finance sector has moved in with its consultants, banks, insurance, hedge funds, accounting and legal industries. The International Emissions Trading Association (IETA) claims thousands of companies are involved in its activities.

International carbon funds are currently managing billions of dollars under Kyoto and the European Trading Scheme (ETS), the European Union's manifestation of Kyoto. Operational for more than two years, the ETS combines a regulatory approach with the flexibility and innovation of private markets. Spawning a massive new economy in carbon credits, it has targeted cuts at 12,000 of the EU's largest emitters, responsible for about 45 per cent of the region's emissions.

Signing up to Kyoto would allow Australian companies to link to the ETS and provide immediate economic incentives to invest in cleaner power generation. There is dispute over effective and achievable targets. But even if we created a domestic trading scheme combined with a carbon tax (such as the McKibbon-Wilcoxen model of a fixed number of tradable long-term permits) it is a step towards embedding the cost of carbon into everything we consume, and helping to reduce emissions.

Legal issues

What is the role of lawyers in this? Australian lawyers will need to become familiar with a range of issues. Currently, parties engaged in early carbon trading overseas are establishing credits through private contracts dealing with the issues of ownership, transferability and risk associated with credit certification.

However, until there is a clear Australian scheme in place many of these issues remain speculative. These might include the handling the sale of credit transactions, company mergers/demergers and credit allotments, contractual provisions guarding against uncertified credits, insurance for associated risks, whether credit generation is tied to the land or the owner of the land, and avoiding prospective legal action by lowering direct climate risk.

A major issue is whether companies will be given permits on the basis of existing emissions, or have to buy them from the government. Giving permits is a financial asset with property implications. To buy them would effectively be a tax, with associated fiscal issues. The government could use this to reduce other taxes and subsidise research and development into energy efficiency.

Conclusion

The price to pollute under carbon trading is the sum due for centuries of dumping our waste into the environment without paying maintenance. The proceeds can be used to invest in solutions to our energy problems. While we need a thriving economy to maintain our standard of living, we also need a thriving environment to maintain our economy. A carbon trading scheme with clear targets and effective global links will put a carbon value on everything we do. Among other solutions, our survival may depend on it.

Postscript: The LIV has recently sent a submission to the National Emissions Trading Taskforce. Amongst other things, the LIV fully supports a national scheme.