

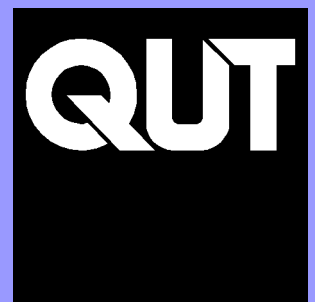


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## EDITORIAL

Environmental law is as much concerned with the detailed minutiae of the system as with the overarching relationships among its components. In this edition of the *Queensland Environmental Practice Reporter* we have examples of both.

Madonna Parker examines in some detail the complex elements of the laws governing gas pipelines that cross international and national boundaries. Michael Raine similarly examines how Australia is responding to its responsibilities for the discharge of greenhouse gases. In each case, the implementation of legal rules has major commercial – and no doubt political – implications. The way in which gas pipelines and greenhouse gases are managed is clearly a matter of interest to the commercial sector.

The costs associated with environmental litigation are equally a matter of interest not only to the commercial sector but also to the public at large. This is particularly so in relation to “public interest” litigation. Anthony O’Dwyer and Roland Davies provide an up-to-date commentary on this important matter.

*Douglas Fisher*  
*Editor*





# DECISIONS OF COURTS AND OF TRIBUNALS

## 1. The Planning and Environment Court

by Michael Walton and Ben Job

### **Grabbe v Maroochy Shire Council** (Robertson DCJ – 6 May 2005)

*Application for declaration and deletion of condition of approval – whether material change of use on adjoining land – whether abandonment of agricultural use – whether conditions still reasonably required and/or an unreasonable imposition of use of land – s 3.5.33 Integrated Planning Act 1997*

**Facts:** This was an application for declarations and orders that a condition of an existing reconfiguration approval should be deleted.

The applicant was the owner of land, which adjoined land, which had previously been used for macadamia nut farming. At the time of reconfiguration approval for the subject land, a condition had been imposed requiring the applicant to enter into a lease with the respondent and to provide a vegetated buffer to protect the subject land from agricultural spray drift from the adjoining land. The condition contemplated the surrender of the lease on a material change of use occurring on the adjoining land.

In these proceedings, the applicants submitted that the condition should be deleted because a material change of use had occurred, the agricultural use had been abandoned, and the condition ought to be cancelled pursuant to s.3.5.33 of the IPA. The respondent contended that the application was too early, as the evidence did not establish that the adjoining land was no longer used for agricultural purposes.

**Decision:** The Court held, in ordering that the condition be deleted, that:

1. It was probable that the adjoining land would be developed as residential lots within a few years.
2. There had been a material change of use of the adjoining land, and the agricultural use on the adjoining land had been abandoned from a practical point of view.
3. The condition in question no longer satisfied the requirements of s 3.5.30 as it was no longer required and represented an unreasonable imposition on the intended use of the land for residential purposes.

### **Stevens & Ors v Brisbane City Council & Anor** (Robin QC DCJ – 1 June 2005)

*Submitter appeal – material change of use for multi-unit dwelling – gross floor area – setback – traffic – words and phrases “gross floor area”*

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Telephone: (07) 3349 2324

**Facts:** This was a submitter appeal against the approval of a development application for a material change of use to facilitate the development of a multi-unit dwelling. The subject land was situated at Moray Street, New Farm and comprised Lot 1 (1108m<sup>2</sup>) and Lot 2 (1120m<sup>2</sup>). Lot 1 contained a large house called “Moana” which was included on the respondent’s Heritage Register.

The issues in the Appeal involved the calculation of gross floor area of the proposal, setbacks, and traffic issues. The gross floor area issue involved a consideration of what constituted the “site” and whether the site was properly the amalgamation of Lots 1 and 2 as proposed by the development application. The gross floor area issue involved a consideration of whether lobbies in the multi-unit dwellings were excluded from GFA, whether external stairs providing access from the basement carpark should be excluded and whether an appropriate part of each level or “storey” consumed by stairs ought to be included.

The traffic issues involved impacts of the proposed development on a rear lane.

**Decision:** The Court held, in allowing the appeal and requiring conditions to be reviewed, that:

1. It was open for a developer to concentrate development in one part of a site; that the site may have been produced by an amalgamation ought not to affect the matter
2. The importance of preserving “Moana” was such as to justify some leeway or indulgence in calculating its GFA.
3. To be a “lobby”, an area must have some aspect of being available to the public or of being available for common use by more than a single person or a single household. The express purpose of restricting GFA was to control building size and bulk. Any lobby included within a “dwelling” must be included in GFA.
4. External stairs included in GFA, must, by the definition, be “in the building”.
5. For stairs that had to be counted, the Court preferred the view which was conformable with lift wells being brought to account for each level rather than counted once only.
6. The absence of a front setback contributed to an impression that the building was greater in bulk and scale than would be gained if it had some setback.
7. Although there were continuing improvements to the traffic-related problems associated with the proposal, they did not go to the extent of persuading the Court that the proposal was acceptable. The sound planning decision was to preserve and use and, if necessary, enhance the Moray Street access. One making Bowman Lane the sole access for new development of the scale proposed was not acceptable.
8. The site presented unusual challenges. Preservation of “Moana” was important, and also ensuring that, so far as possible, new development does not detract from the contribution that house made to New Farm.
9. Citizens of the City, and near neighbours of a development site in particular, are entitled to expect that things will not be made significantly worse for them by the granting of relaxations by the Council. The Council and the Court ought to consider impartially proposals for relaxation. There ought to be none here in respect of the GFA acceptable solutions (except as indicated), this largely because of the artificiality of the site area brought into the calculation.
10. It may be that a proposal would be acceptable which permitted Bowman Lane access to the extent that it could be available to the amount of traffic that would be generated by the amount of “rear” development that might have been expected on Lot 1.

### **Smerdon v Maroochy Shire Council** (Nase DCJ – 6 June 2005)

*Application to strike out issues – appeal against deemed refusal of application for operational works – previous development permit and preliminary approval for parts of reconfiguration application – ss 3.5.19(c) and 4.1.47(2) Integrated Planning Act 1997*

**Facts:** A declaration was sought that issues notified by the respondent were irrelevant, or in the alternative an order was sought striking out issues which had been notified.

The appeal was against the respondent's deemed refusal of an application for operational works approval. Previously, the respondent had, in respect of an application for a development permit to reconfigure land into 48 lots, granted a development permit for 25 of the lots, and a preliminary approval for the balance 23 lots. The preliminary approval was granted because of concerns associated with the proximity of the land to a quarry, and a condition of the preliminary approval prohibited subdivision whilst the quarry continued to operate.

In these proceedings the respondent had indicated that it had changed its mind about the development permit for the reconfiguration, and that it would put in issue the development permit.

The present dispute arose out of further issues notified by the respondent. The issues included that the grant of the operational works approval would be premature pending resolution of that earlier appeal in which the Court would be asked to examine and determine the extent to which any of the original 48 lots ought to have been the subject of a development permit or a preliminary approval, and the conditions which ought to apply in respect of that application.

**Decision:** The Court held, that:

1. All of the issues raised were strictly irrelevant to a consideration of the merits of the operational works application.
2. The issue whether the appellant should be authorised to commence development of the 25 lots was an issue which should be resolved within an application under s.4.1.47(2) of the IPA. Without authorisation under that section, no development could be undertaken.
3. The appropriate course was to give a further direction in relation to the disputed issues by which the disputed issues in the appeal be identified as those grounds set out in the Notice of Appeal.

### **Daniels v Brisbane City Council & Ors (Robin QC DCJ – 8 June 2005)**

*Appeal against refusal – material change of use for use of backyard shed for home based hobby (storing and maintaining motor vehicles) – proper characterisation of the use – words and phrases “hobby”, “warehouse”*

**Facts:** These appeals concerned applications for material changes of use of the appellant's land for the storage and maintenance of motor vehicles. That use had a long history of complaint by neighbours, and prosecutions by the respondent.

The appellant contended that his “hobby” activity was part and parcel of residential use.

**Decision:** The Court held, that:

1. The appellant made it clear he did not intend to be restricted in the ways his town planner envisaged. Further, he had a proven track record of unreliability. It would irresponsible of the Court to disregard those matters.
2. The Court was concerned with development applications for a material change of use, and not with any application to authorise the building of a shed or sheds. Conditions associated with the sheds could only be imposed if there was an approval of a material change of use.
3. An estoppel was created by previous convictions of the appellant for the unlawful use of the subject land as a “storage yard” which, given that that definition, and the new definition of “warehouse” were indistinguishable, established that a use of “warehouse” was being carried out on the land, just as a use of “storage yard” by reference to the superseded planning scheme was. If that was incorrect, there was no escaping the conclusion that the definition of “warehouse” was satisfied.

4. The contention that the appellants past and proposed activities amounted to a home-based hobby could not be accepted.
5. The “hobby” had had dreadful impacts on visual amenity.
6. The proposal was undoubtedly within “*any other material change of use*” for purposes of City Plan 2000 and was there “*inappropriate development*”.
7. Inconsistency with the proposal with current ideas about sound planning for residential areas could hardly be denied.
8. The appellant’s proposals were clearly in conflict with the relevant planning provisions and there were no planning grounds to recommend it.

### **Shannon & Ors v Dalby Town Council & Ors** (Wilson SC DCJ – 15 June 2005)

*Previous decision – adjournment for conditions – proposed conditions*

**Facts:** These proceedings involved an appeal against the respondent’s approval of a development application for a grain ethanol refinery. The appeal had been heard in July 2004 and Reasons for Judgment given.

The respondents had presented a proposed form of final order dismissing the appeal and approving the application subject to conditions contained in Annexures. The appellants sought changes and additions to a number of the draft conditions.

**Decision:** The Court held, that:

1. The appellants’ recent submissions involved some attempt to re-open issues about which there was detailed evidence from experts at the trial and which were addressed in the Reasons, and the subject of concluded findings.
2. Draft conditions accorded with the findings at trial and were consonant with conclusions reached in the Reasons, and were otherwise satisfactory and appropriate.

### **Butler v Kingaroy Shire Council** (Rackemann DCJ – 16 June 2005)

*Application for extension of time to serve Notice of Appeal – whether sufficient grounds for extension – s.4.1.55 Integrated Planning Act 1997*

**Facts:** In these proceedings, the appellant sought an order pursuant to s.4.1.55 of the IPA extending the appeal period up to and including the day upon which the Notice of Appeal was filed.

The appeal was against the respondent’s decision of 26 August 2004 to approve in part, rather than in its entirety, a development application for a material change of use.

The applicant’s failure to institute an appeal within the appeal period was explained by reliance upon his planning consultant who instead sought to make recommendations to the assessment manager pursuant to s.3.5.17 of the IPA with a view to obtaining a negotiated decision notice. It was common ground at the hearing that such a process was not available in the circumstances. Although it was accepted that the appeal period had been suspended for a time, the Appeal had been filed 6 months late.

It had not been until 27 January 2005 that the respondent first asserted that it was unable to issue a negotiated decision notice. Subsequent correspondence ensued including a letter from the respondent dated 6 April 2005 which confirmed its position that it was unable to issue a negotiated decision notice, and drew specific attention to s.3.5.17(1). Following receipt of that correspondence, the appeal was filed on 27 April 2005 and the subject application had been filed the following day.



**Decision:** The Court held, in granting the extension, that:

1. There were a number of factors which weighed in favour of the exercise of discretion, in particular, the failure to file the appeal in time had been explained by the actions of the applicant's consultant in seeking to evoke the s.3.5.17 process; the applicant relied upon his consultant town planner and later his solicitor, and any errors on their part should not necessarily be visited upon the applicant; the respondent did not take issue with the course adopted until well after the expiration of the appeal period; the representations put the respondent on notice, at an early time, that the applicant did not accept the partial refusal of the application and held at continuing interest in pursuing the proposed development; no specific prejudice would arise to the respondent or any third party from permitting the extension; although it was not possible to assess the merits of the appeal, there appeared to be a genuine controversy between the parties; and delay and expense would be occasioned were the applicant required to lodge a fresh application.
2. The fact that the Notice of Appeal was filed about 6 months out of time must be seen in the context of the circumstances, including the correspondence which was passing between the parties, which did not conclude until Council's letter of 6 April 2005.
3. Further, as to interested parties other than the respondent, there were no submitters in respect of the development application and the concurrence agency did not become a party to the Appeal.

## **2. The Court of Appeal**

*by Michael Walton and Ben Job*

### **Woolworths Limited v Townsville City Council & Ors (Court of Appeal, Brisbane – 10 June 2005)**

*Court of Appeal – appeal against declarations – whether activities a “showroom” or “shop”*

**Facts:** These matters involved applications for leave to appeal from a decision of the Planning and Environment Court. The issue between the parties was one of law, whether the activity carried on by each applicant was a “showroom” and therefore a lawful use.

The Court had invited the parties to assume that leave had been granted, and to address the Court on the merits.

The Court had regard to definitions contained in the Planning Scheme of “major shopping development”, “shop”, “shopping centre” and “showroom”. The latter was defined as:

*“... a use requiring a large floor area where the gross floor area to be used for that purpose is not less than 400m<sup>2</sup>, for the display or offering for sale by retail of goods being one or more of the following uses, or other uses of like nature requiring large floor spaces as determined by Council:*

- (a) floor coverings and wall tiles;*
- (b) furniture;*
- (c) domestic appliances being washing machines, dishwashers, clothes dryers, refrigerators, hot water systems, air-conditioning systems and the like;*
- (d) domestic fittings and electric appliances;*
- (e) building and construction materials;*
- (f) sporting goods;*

*where more than three (3) showrooms exist in one or more than one building and function as an integrated unit, they become a shopping centre ...”.*

The applicants submitted that the use of the premises in question by each applicant was covered by the definition of “*showroom*”. It was submitted that having regard to the context, and the general purpose and policy of the scheme, construing “*showroom*” in a way which embraced the activity in question was consistent with the language of the scheme and achieved consistency and fairness when considered against the background of the scheme viewed as a whole. It was submitted that such an approach avoided conflict between various definitions and provisions found in the scheme.

The applicants focused on the “*second limb*” of the definition which referred to “*uses of a like nature*” requiring large floor space as determined by Council, and to the fact that the definition of “*shop*” limited that use to premises with a floor area of less than 600m<sup>2</sup>. It submitted that many retail outlets required, or in fact, occupied large floor areas and such retail outlets did not display or offer for sale only goods within the broad product description identified in items (a) to (f) of the “*showroom*” definition.

**Decision:** The Court held, that:

1. One could not avoid the consequences of a town planning scheme by extending the meaning of a use defined therein beyond what is its proper meaning in the context.
2. Considering the scheme as a whole, and given the definitions of the various “uses” contained therein, it was clear that a “*showroom*” must be something other than a “*shop*” having a floor area of more than 600m<sup>2</sup>.
3. Given the wording of the definition of “*showroom*”, the learned Judge at first instance was correct when he said that “*the nature of the goods sold is a material factor*” in distinguishing a “*showroom*” from a “*shop*”. A “*showroom*” use was to be contrasted with a use for a “*shop*” and, given the terms of the definition, that distinction must be because the former refers to a specialised retail outlet dealing in goods which need a large area for display.
4. A “*showroom*” was a specialised retail outlet offering for sale goods appropriate for that specialised use. In other words, the goods in question must be of a bulky nature, or have some other feature, which requires a reasonably large floor area for their display.
5. The making of a declaration that the second respondent had started assessable development “*being another use under column 4*” of the Planning Scheme arguably went beyond what was litigated and what was necessary for the decision on the issues raised at first instance. That declaration should be set aside.
6. The stop order made at the first instance should be replaced with an order requiring the applicants to stop the display or sale of goods other than those listed in the definition of “*showroom*” in the Planning Scheme without a development permit authorising it to do so.

***Michael Walton and Ben Job***



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# PROFESSIONAL COMMENTARY AND CRITIQUE

## 1. IPA Costs Powers Extended

by Anthony O'Dwyer and Roland Davies

The recovery of costs against parties running unmeritorious cases in the Planning and Environment Court is more likely following a decision in the Land Appeal Court. The decision in *Chrismel Pty Ltd v Department of Natural Resources & Mines*<sup>1</sup> has the potential to expand the approach taken by the Planning and Environment Court in relation to costs orders.

### Costs under the Integrated Planning Act

Obtaining an order for costs in the Planning and Environment Court is a difficult task due to the operation of s. 4.1.23 (1) of the *Integrated Planning Act 1997* (Qld) (IPA) which provides:

*Each party to a proceeding in the court must bear the party's own costs for the proceeding.*

In *Mudie v Gainriver Pty Ltd (No 2)* the Court of Appeal recognised that the policy behind parties bearing their own costs:

*...is to ensure that citizens are not discouraged from appealing or applying to the Planning and Environment Court because of fear that a crippling costs order might be made against them. The provision no doubt also recognises the public interest character of some applications to the Planning and Environment Court.*<sup>2</sup>

Section 4.1.23(2) of the Act prescribes certain circumstances where the court may make an order for costs. This section empowers the court to compensate a party that is disadvantaged by the "unmeritorious conduct of another party".

### Discharging a Party's Responsibilities in the Proceedings

Section 4.1.23(2)(i) of the Act provides that the court may award costs if:

*an applicant, submitter, referral agency, assessment manager or local government does not properly discharge its responsibilities in the proceedings.*

The Planning and Environment Court has to date construed this section narrowly. The court has restricted the application of s. 4.1.23(2)(i) to circumstances involving either a default in compliance with a statutory obligation relating to the appeal or a default in compliance with procedural requirements.

<sup>1</sup> [2005] QLAC 0031.

<sup>2</sup> [2003] 2 Qd R 271 at 283



In *Shaw v Brisbane City Council & Anor*<sup>3</sup> the court construed the expression “responsibilities in the proceedings” to mean “responsibilities that are imposed on the parties named to do what the Act specifically requires of them when they become involved (in those capacities) in proceedings which the Act governs”.

The narrow construction of s. 4.1.23(2)(i) continued in *Browning & Sargeant v Cairns City Council & Bernstrom*<sup>4</sup> where the court considered that “responsibilities in the proceedings is confined to procedural requirements arising out of the Integrated Planning Act and the Rules thereof, and itself obeying any Court orders made as part of a proceeding”.

### Chrimel v Department of Natural Resources & Mines

In *Chrimel v Department of Natural Resources & Mines* the Land Appeal Court considered the effect and application of s. 4.1.23(2)(i) of IPA when considering an analogous provision in the *Water Act 2000* (Qld) (*Water Act*).

The Appellant originally appealed to the Land Court against the decision of the Respondent to refuse the Appellant’s application for a water licence to draw water from the Brisbane River for irrigation purposes. The Respondent refused the Appellant’s licence application on the basis of a 1988 cabinet minute<sup>5</sup> which purportedly limited the water available for licences in the area. The Appellant contended in its appeal that the Respondent had failed to consider the criteria for deciding applications of the nature of the Appellant’s application prescribed in s. 210 of the *Water Act*.

The Respondent conceded in written submissions filed on the eve of the Land Court hearing that it “did not exercise, or otherwise commence to exercise, the requirements imposed... under s. 210 of the [*Water Act*]” and that there had been a “failure to decide the appellant’s application at all”.

At the Land Court hearing the Appellant made an application for costs in accordance with s. 882 of the *Water Act*. The relevant provisions are:

*882(3) Each party to the appeal must bear the party’s own costs for the appeal.*

*882(4) However, the court may order costs for the appeal... as it considers appropriate in the following circumstances—*

*(g) a party to the appeal does not properly discharge its responsibilities in the appeal.*

The Land Court held that s 882(4)(g) of the *Water Act* and s. 4.1.23(2)(i) of IPA were sufficiently analogous as to “not allow for any meaningful distinction in interpretation”.<sup>6</sup>

In dismissing the Appellant’s application for costs the Land Court cited the Planning and Environment Court cases discussed above and refused to ascribe a broader interpretation to the expression “discharging its responsibilities in the appeal”.

The Appellant successfully appealed to the Land Appeal Court against the Land Court’s decision not to award costs. The Land Appeal Court held that the Respondent’s conduct in maintaining a position that “was unsustainable in law”<sup>7</sup> following the filing of the Notice of Appeal led to the conclusion that it had not discharged its responsibilities in the appeal. The Land Appeal Court accepted that the Respondent adopted the role of a model litigant however this was not expanded upon.<sup>8</sup>

The Land Appeal Court acknowledged that the “responsibilities” of a party extend to more than just compliance with procedural requirements in stating: “Section 4.1.23(i) of the IPA and s 882(4)(g) of the [*Water Act*]... are directed at the nature of a party’s conduct in the appeal”.<sup>9</sup> The Court referred to the Explanatory Notes to s 4.1.23(2)(i) in suggesting that the section should be given a “wide ambit”. The Explanatory Notes to s 4.1.23(2)(i) provide:

*This ground applies to a wider variety of participants than the previous ground, and goes beyond the requirement to take an active part in proceedings. For example, an assessment manager may take an active part in proceedings, but present evidence that is poorly researched or not relevant to the issue at appeal.*<sup>10</sup>

<sup>3</sup> [2000] QPELR 57 at 58. See also *Oakden Investments Pty Ltd v Pine Rivers Shire Council* [2002] QPEC 075 where the decision in *Shaw* was cited with the comment that “No further elaboration is required”.

<sup>4</sup> [2002] QPELR 577 at 583. See also *Evans v Townsville City Council* [2000] QPELR 337 where a council failing to comply with s 4.1.40 of IPA was ordered to pay the appellant’s costs occasioned by that failure.

<sup>5</sup> Whilst the Respondent expressly relied on the cabinet minute, it refused to disclose the document.

<sup>6</sup> *Chrimel Pty Ltd v Department of Natural Resources & Mines* [2005] QLC 0012 at para [27].

<sup>7</sup> *Ibid* at para [55] and [57].

<sup>8</sup> The Appellant argued that the Respondent was required to act in accordance with the standards of a model litigant as required of all three tiers of Government (*Scott v Handley* [1999] FCA 404 at para [43] and [44]). The Appellant contended that the model litigant principle was a relevant consideration when determining the extent of the Respondent’s responsibilities in the appeal.

<sup>9</sup> *Chrimel v Department of Natural Resources & Mines* [2005] QLC 0012 at para [48].

<sup>10</sup> Explanatory Notes to the Integrated Planning Bill 1997 (Qld), p140.

The Land Appeal Court declined to follow *Browning*<sup>11</sup> in stating “we do not see any basis for construing s. 882(4)(g) of the Act so as to confine its application to circumstances where there has been a default in compliance with procedural requirements”.<sup>12</sup>

In seeking to broaden the scope of the expression “discharge its responsibilities” the Land Appeal Court asked “can a party be said to fail to properly discharge its responsibilities in an appeal when it resists an appeal on grounds that are plainly baseless and completely unsustainable? In our view, s. 882(4)(g) is capable of encompassing such a situation”.<sup>13</sup>

The Land Appeal Court also indicated that the scope of unmeritorious conduct to which s. 882(4)(g) may extend includes “the presentation of irrelevant evidence or the raising of plainly unarguable matters”.<sup>14</sup>

### Implication of *Chrismel* Decision for Planning and Environment Court

The *Chrismel* case has potentially expanded the circumstances in which a party may be regarded as not having discharged its responsibilities under s 4.1.23(2)(i) of IPA. It is conceivable that the conduct of parties who resist appeals on grounds that are “baseless” or “unsustainable” is conduct falling short of discharging that party’s responsibilities in the appeal.

It is likely that the mere failure of a party to “recognise any weakness in one’s case and to respond accordingly by not pursuing the matter further”<sup>15</sup> would not constitute unmeritorious conduct sufficient to attract the application of s. 4.1.23(2)(i) unless that weakness was plainly destructive of that party’s case.

The importance of the Land Appeal Court’s approach is that there is no need to show an ulterior or improper purpose for participating in the appeal or any breach of procedures or specific statutory obligations to take advantage of the costs provisions in s. 4.1.23(2)(i) of IPA.

**Anthony O’Dwyer and Roland Davies**

<sup>11</sup> *Browning & Sargeant v Cairns City Council & Bernstrom* [2002] QPELR 577.

<sup>12</sup> *Chrismel v Department of Natural Resources & Mines* [2005] QLC 0012 at para [49].

<sup>13</sup> *Ibid* at para [51].

<sup>14</sup> *Ibid* at para [50].

<sup>15</sup> *Ibid* at para [51].

## 2. Commercial Risks Associated with Cross-border and Offshore Pipelines related to the PNG Gas Project

by *Madonna Parker*



### Introduction

Cross-border trade of gas is not a new concept for today, however for Australia and Papua New Guinea it presents some new considerations and challenges when pulling together an infrastructure project. The PNG Gas Project will deliver natural gas from the highlands in Papua New Guinea to Cape York. The journey will see the hydrocarbons travel through a multitude of jurisdictional limits. This encompasses a range of possible laws which may apply to the gas during the transport phase and will include laws of Papua New Guinea, laws applying in Australia and some international law. The concept will have major implications for the Australian gas market and since its planning phase has already triggered an increase in competitive forces for gas by the increased exploration and production of coal seam methane gas resources. This is mainly due to the use of CSM as an alternative fuel source for electricity generation.

The following discussion will be limited to an analysis of the offshore legal implications for the project infrastructure with a particular consideration of the rules surrounding unutilised capacity and how this may affect the upstream and downstream markets. Finally, comments will be made about the ways in which the risks encountered by the project proponents may be mitigated through the use of bilateral or multilateral treaties.

### The Project

The following gives a brief overview of the proposed infrastructure and detail of the PNG Gas Project. The project sponsors embarked on a long-term project to transport gas from exploration fields in PNG to Queensland in about 1997. It was recognised the natural resources available in Papua New Guinea (PNG) would provide an economic stimulus in terms of employment, investment opportunities by taking further advantage of the gas reserves which will in turn provide a substantial contribution to the petroleum industry, to the PNG economy and the local people. The project will involve the development of a number of petroleum fields in the remote Southern highlands of PNG, and the delivery of large volumes of natural gas to customers in eastern Australia. The gas reserves are considered to be extremely large and would represent a significant volume of gas in terms of total consumption in eastern Australia. The gas will be delivered to Australia by a dry gas pipeline consisting of approximately 3,200 kilometres.

The project components include:

- the onshore production facilities, including wells, treatment facility and gathering facilities, within PNG;
- pipelines connecting the gas fields to the main processing facility for the transportation of hydrocarbons and liquids;
- the transportation of dry gas through pipelines from the main processing facility to the shoreline of PNG;
- the transporting of gas by way of a submarine gas pipeline from the PNG shoreline to the PNG-Australian border pipeline; and
- the Australian pipeline – from the PNG-Australian border into Queensland<sup>1</sup>

The pipeline will be laid on the seabed or buried, as bottom conditions and other considerations dictate. It will run 403 kilometres from the marine facility through the Gulf of Papua into Torres Strait, across the PNG-Australian border, to landfall on Cape York in Queensland.<sup>2</sup> The terminus of the pipe is in Queensland, however there are plans for the interconnection with the present network to occur.

<sup>1</sup> Papua New Guinea Department of Petroleum and Energy, "The PNG Gas Project: Project Brief", October 2002, available at <<http://www.petroleum.gov.pg/DPE%20Downloads.htm>> (accessed 10 September 2005).

<sup>2</sup> Ibid at 5

To embark upon the project, the upstream gas production joint venture ('the project sponsors') was created for the extraction of gas, operation of pipelines and processing facility to the PNG-Australia border. It was planned the Australian pipeline would be built and operated by a different joint venture from the PNG-Australia border through the Torres Strait for the delivery of gas.<sup>3</sup> The likely route of the pipeline once it reaches Cape York has yet to be completely resolved, however it will expand the Queensland gas market and provide a means for the southern States to interconnect, thereby creating further interconnection of Eastern Australia.

As a cross-border pipeline, certain factors will influence the structure of the project as there is potential for several producers, all of which may not be known or defined at the time of the project development and a range of potential end-use customers. The pipeline will cross the seabed jurisdictional border between Australia and PNG in the Torres Strait. The source of gas and the producers are located in PNG and end-use customers in Queensland or the southern States of East Australia. The proposed structure for the pipeline will have the owners perform a transport function for the benefit of the producers joint venture. The transport function will involve transferring the hydrocarbons between producers and consumers for a tariff. The producers will enter into long-term gas sales contracts relying upon the transport through the pipeline.

### Cross-border Gas Trade

The construction of the pipeline will create the first cross-border pipeline into Australia. The uniqueness of the PNG-Australian pipeline with the cross-border issues and international implications does not allow for a clear comparison or similar approach to the current issues of developed transmission pipelines in Australia - even previous experience in cross State border pipeline developments provides limited relevancy and guidance to this context.

The growing importance of cross-border energy trade is apparent by the multitude of trans-border energy trade experiences that are planned or have been successfully completed internationally. The importance of cross-border gas trade has been recognised in Europe, for example Turkey is allowing an alternate gateway or transit transmission pipelines for cross-border gas trade which will enhance the security of gas supply to Europe. Turkey is geographically located relatively close to the abundant gas sources in the Middle East countries. Similarly the availability of gas reserves in Bolivia, Argentina and Brazil has enabled the development of a cross-border gas trade in the Southern Cone of Latin America. Evidently the European Union saw cross border issues as a key political issue and sought the establishment of the Energy Charter Treaty to govern cross jurisdictional energy infrastructure.

The features of the gas market in Queensland show a lack of inter-basin competition due to the limited access to gas in the Queensland region, consequently the available resources are on a slow decline in the area. The presence of a natural gas pipeline exploiting the resources in PNG will enhance the available gas resources. The growing demand for gas resources in industry provides a rationale for increased co-operation in building a pipeline connecting the PNG resources to East Australia. To promote greater usage of gas the Queensland Government has created energy policy to encourage the use of gas in electricity generation with an aim to develop further gas infrastructure in Queensland including the Australian Pipeline. Given these factors, it is anticipated the Australian pipeline will better secure the continued supply of gas to meet the future energy needs of the region.

From an Australian perspective, the benefit of initiating the cross border trade of gas will facilitate the further development of the Australian gas market. The implementation of the project will achieve increased inter-basin competition with the expansion of the gas pipeline infrastructure and attain further interconnectivity of the national gas market. This project will further promote the objectives of the National Competition Council (NCC) in developing the National Gas Code which aimed to remove the barriers to interstate trade and seek to develop a more robust and interconnected national market for gas.

This development will open the opportunity of supply from the present gas fields controlled by the project sponsors but may also make possible further exploration and production potential. The interconnection between PNG and East Australia may influence further commercial development thereby increasing customer options. Also, further exploration

<sup>3</sup> The operation and development of the Australian pipeline was the subject of a competitive tender process by the operation of s 70A of the *Petroleum Act 1923* (Qld).

and gas development projects in PNG may appear more attractive and commercially lucrative to investors. This could only have greater benefits to the Australian gas market by presenting additional competitive pressures. This, of course, is dependent upon the availability of third party access to the Australian pipeline for utilisation by any future exploration party. With such opportunities the likelihood of attracting large exploration activities through large multinational companies is increased by the presence of a cross border pipeline as an incentive to enter the market. This will only see a further stimulation of the PNG economy and foster further good relations with a close border relation.

Some key risks with this cross-border trade project include:

1. Sovereignty in respect of trans-border project infrastructure located in that State's territorial sea;
2. Sovereign laws applicable to the pipeline affecting the market in PNG and downstream market in Australia;
3. Security of supply; and
4. Enforceability of project agreements.

Firstly, the issue of sovereignty of infrastructure located in the State's territorial sea. Due to the nature and the level of complexity of the legal and jurisdictional issues for interstate pipelines, the risks associated raise issues of a political, financial and a technical nature. It is important to recognise the role of governments is essential to facilitate cross border gas trade. The key responsibility of government is to establish clear, transparent and predictable regulatory frameworks for private investments within their country for all aspects of the project, particularly gas production, trade and transit, consumption, and the development of energy policy.

The PNG submarine pipeline commences in PNG and travels to the PNG-Australia border, where the Australian pipeline starts. The PNG pipeline and Australian pipeline will be controlled or owned by different parties. The ownership structure is split at the border indicating there is a break in the chain where the jurisdiction of the pipeline will move from one nation to another. By implication, it appears the project sponsors anticipate there will be at least two sets of domestic law applying to the submarine pipeline.

For half its journey, the Australian pipeline will be a sub-sea pipeline in the Australian territorial sea and Queensland territorial waters. International law is relevant because the area between the coastline of PNG and Australia is the Torres Strait, which has international recognition as a "Strait" in the United Nations Convention of the Law of the Sea (UNCLOS).<sup>4</sup> UNCLOS is the basic building block for international maritime law, including coverage of extraction of natural resources and the delimitation of international boundaries. Given its wide acceptance, there is now a strong argument that the provisions of the convention forms part of customary international law.<sup>5</sup> In any event, international law provides limited regulatory guidance for an international gas pipeline transport. It distinguishes between submarine and terrestrial pipelines, providing no status for onshore pipelines, on the other hand the UNCLOS provides some legal foundation for the construction, operation and protection of submarine pipelines.

Under the Law of the Sea, the construction of offshore pipelines is free and it covers the laying of submarine pipelines. Coastal States have the right to explore and exploit natural resources on their continental shelves as distinct from the construction of submarine pipelines, however there is no express jurisdictional authority to lay the pipe. Further there is no right of the Coastal State to impede the laying or maintenance of submarine pipelines except for instances where, the pipelines projected in an area where a Coastal State intends to carry out petroleum activities. Consequently, the freedom of transit prevails over sovereignty for construction of offshore transit pipelines.<sup>6</sup> This however, does not imply Coastal States have no power to exercise some control over the construction of submarine pipelines, they remain subject to laws relating to the marine environment by international and local standards. Consequently, international law would prevent a State interfering with the construction of a submarine pipeline in the Torres Strait without reliance upon a purpose for which they are expressly permitted to control.

Despite UNCLOS governing delimitation of international maritime boundaries, it is not completely clear as to its strict application. Experience tells us, nations generally seek to take an expansive view to territorial claims and inevitably disputes arise. In this instance,



<sup>4</sup> UNCLOS 10 December 1982, entered into force 16 November 1994, provides that States may exercise over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources.

<sup>5</sup> By virtue of UNCLOS being so broadly ratified, the practice mandated by the Convention satisfy the criteria of customary international law.

<sup>6</sup> M Roggenkamp, "Transit of Network-bound Energy: the European Experience" in *The Energy Charter Treaty : an east-west gateway for investment and trade*, Thomas W Walde (ed), Kluwer Law International, 1996, pp 499-519, at 557.

the international boundary located in the Torres Strait of PNG and Australia is clearly defined in the Treaty between the Australian and the Independent State of Papua New Guinea (the Treaty) concerning matters of sovereignty and maritime boundaries. It is the framework by which Australia and PNG seek to manage the border region cooperatively, in the interest of preserving the lifestyle and environment of Torres Strait traditional inhabitants.<sup>7</sup>

The primary function of the Treaty is to establish the maritime boundary between the countries given the closeness of the shorelines. In terms of energy related purposes, the Treaty establishes various rights between the parties by defining the Seabed Jurisdictional Line<sup>8</sup>, and designates a Torres Strait Protected Zone<sup>9</sup>. The Treaty appears to be an effective measure in the proper management of the unique Torres Strait region with governments committed to co-operation with respect to the common treaty area, however there is some literature suggesting it is unworkable in terms of ocean management policy<sup>10</sup>. In terms of the present analysis, the Treaty does not provide assistance in resolving the sovereign risk issues associated with the project nor assist with long term security of supply for the Australian market.

The Treaty provides for the joint production of off-shore petroleum in the Protected Zone but does not account for transmission pipelines originating in PNG. Nevertheless, the Treaty effectively resolves any border issues as it clearly defines the maritime boundary allowing the parties to ascertain the PNG-Australian border from where the Australian pipeline will begin its journey into Australia. As noted previously, a further risk relates to the sovereign laws applicable to the pipeline which may affect the market in PNG and downstream market in Australia. The jurisdiction governing the Australian pipeline is a fundamental issue for project sponsors and the pipeline owner. This influences activities relating to the transport of the gas to the Australian pipeline and once it has reached the border how it may be regulated and by whom.

There are two ways to deal with the PNG to Queensland pipeline from an international perspective, as a separate system of pipelines with each section subject to the laws of the occupier (territorial state). Alternatively, it may be viewed as a complete transport system to be dealt with in a unified way. A more unified approach will make way for consistent pricing, regulatory and legal rules for the resolution of commercial or contractual disputes. As a general rule, States could ensure consistent legal rules at a national level although there is still risk with respect to inconsistent application. To structure the pipeline as a single jurisdictional unit is achievable by intergovernmental agreement creating the legal foundation for the interstate pipeline which would include a system of commercial and intergovernmental agreements<sup>11</sup>. The purpose of having the pipeline viewed as a legal and factual unit will fashion a legal framework structured to suit the specific project and will better ensure an uninterrupted flow of energy.

In this instance, the structure of the PNG-Queensland pipeline is deliberate in that the Australian pipeline will be entirely within the confines of the Australian and Queensland jurisdictions suggesting there is no mechanism at present for a unified approach. The concerns associated with the application of separate regulatory systems is the potential for an inconsistent regulatory approach for the same infrastructure, the possible need to duplicate approvals for the pipeline in both jurisdictions with the resultant effect of increasing compliance costs for both parties. It also casts doubts as to the enforceability by investor's of the project arrangements and may impact the ability of those parties to resolve potential disputes with relative ease. Hence, these issues must be addressed in a government context and will be a key investment consideration to a prospective investor.

The jurisdiction of the pipeline will determine the applicable laws which will govern the construction and operation of the infrastructure, and define the types of regulatory permits. The Australian Pipeline being wholly located in Australia will require the owners to comply with the requirements for the petroleum regime in Queensland and other applicable national laws including obtaining all necessary regulatory approvals.

A trans-border project may observe that laws applying to the upstream facilities and the pipeline infrastructure within the same jurisdictional limits may have a detrimental effect on the downstream pipeline. For example, there may be difficulties with interruption in the flow of gas, difficulties with the security of supply, congestion related issues (production capacity of the upstream facility), actions preventing further exploration or limits upon extraction of resources, or export/tax issues. Any discriminatory laws affecting upstream infrastructure will have a massive bearing on the commercial viability of such a project. For this reason,

<sup>7</sup> David Hallett, "Torres Strait Treaty and You: the Practical Operation of the Torres Strait Treaty" Paper presented to the Australian Defence Force Academy Seminar on "Torres Strait: Policing the Open Border", 24 February 1998, Australia, Department of Foreign Affairs, [www.dfat.gov.au/geo/torres\\_strait/adfa\\_paper.html](http://www.dfat.gov.au/geo/torres_strait/adfa_paper.html) (accessed 12 September 2005)

<sup>8</sup> The Seabed Jurisdictional Line is the main boundary between Australia and Papua New Guinea

<sup>9</sup> The Protected Zone is an area within the Torres Strait recognised by Australia and PNG as worthy of special attention due to the traditional way of life of Torres Strait Islanders and the coastal people of PNG. The Protected Zone recognises the importance of preserving and protecting the land, sea and air of the Torres Strait as well as native plant and animal life.

<sup>10</sup> DM Schug, "International maritime boundaries and indigenous people: The case of the Torres Strait" *Marine Policy*, Vol 20(3) 209 at 217.

<sup>11</sup> Framework Agreement between the United Kingdom and Norway relating to the laying, operation and jurisdiction of interconnecting submarine pipelines. Blanche Sas, "Legal and Contractual Issue Relating to Interstate Gas Pipelines in Emerging Nations", [2002] IELTR 70 at 71.

the ideal governing structure is a single set of legal and regulatory rules treating the infrastructure as a whole unit. Of course, practically such an outcome may be difficult to achieve given the reluctance of governments to forego control of important infrastructure.

### *Security of Supply*

Security of supply was not much of an issue in the past where the consuming country was adequately guaranteed supply through the use of integrated gas companies. Since disaggregation and liberalisation of the energy market, the resultant effect is a greater number of stakeholders are involved in single energy project which creates complexity, particularly if there are conflicting interests. As costs in this type of project are substantial and can only be recouped over long-term periods of time, uncertainty about secure supply is a project preventative risk. To mitigate this risk it is important the relationship between the producing and the consuming country is sound.

From the perspective of the project sponsors (producers), the use of take or pay contracts will hedge against the high risk inherent to trans-border gas contracts. In this case, such a contract will also guarantee transport revenue for the pipeline owner. A difficulty with this structure is the pipeline owner has only its gas transportation agreement with the project proponents as recourse and presumably the issue of security of supply is resolved by mutual agreement. Despite the presence of contractual obligations, it is possible there may be interference with the flow of energy before the gas reaches the Australian pipeline. Provisions in contracts can manage risk of such an event, however what cannot be predicted is the restriction of flow due to an exercise of sovereign power in the originating State. Such sovereign risks will ultimately have an effect on the security of supply for the project.

### *Enforceability*

And finally, the enforceability of the project arrangements must be addressed in the governmental arrangements. With a high sunk cost of a pipeline, water tight contracts will be a key factor relevant to an investing participant. For example, in Australia the ability of Parliament to modify contractual arrangements through the passing of subsequent legislation – there is a danger for any investing participant that its bilateral arrangement (the basis of its investment security) with the government may be altered.<sup>12</sup>

In essence the viability of a cross border project may be compromised by two key issues both relating to sovereignty:

- **Jurisdictional elements**

The PNG to Queensland pipeline qualifies with cross border pipeline status, because it passes through the Commonwealth territorial sea and beyond into Queensland territorial waters. Accordingly, the route of the whole project pipeline moves through multiple legislative jurisdictions including PNG National, PNG Provincial, the Commonwealth of Australia and Queensland. Having said this, the jurisdiction of the Australian pipeline is not in contention, although it is interesting to consider the relationship between international law, the laws of the Commonwealth and of Queensland which apply to the Australian pipeline.

### *International Law*

The maritime areas between Australia and PNG, that is the Torres Strait has international relevance. Lying on a major sea route between the Pacific and the Indian Oceans, at an international level, the Torres Strait qualifies as an international strait for the purposes of Chapter III of the 1982 United Nations Convention on the Law of the Sea<sup>13</sup>. The UNCLOS imposes direct obligations upon Australia for the use of the marine area - specifically to permit innocent passage by all vessels. Pursuant to various Acts passed relying on Section 51(xxxviii) of the Constitution<sup>14</sup>, Queensland has unfettered jurisdiction and effective title of those waters and seabed to a distance of 3 nautical miles. The Commonwealth retains jurisdiction over the territorial sea beyond 3 nautical miles, except in the northern portion of the Strait where the Torres Strait Treaty did not extend it that far. The management of the coastal areas and the territorial sea within 3 nautical miles is within the legislative competence of the Parliament of Queensland.<sup>15</sup>



<sup>12</sup> The Courts have also held, the executive cannot contractually fetter the statutory power of the government: *Cudgen Rutile (No. 2) Ltd v. Chalk* [1975] AC 520.

<sup>13</sup> United Nations Convention on the Law of the Sea, done at Montego Bay 10 December 1982, entered into force on 16 November 1994, Australian Treaty Series 1994 No. 31

<sup>14</sup> The Commonwealth Constitution, Section 51(xxxviii) The acquisition, with the consent of a State, of any railways of the State on terms arranged between the Commonwealth and the State.

<sup>15</sup> *Petroleum (Submerged Lands) Act (Qld) 1982*

International law provides the basis for a Coastal State like Australia having sovereign rights over the continental shelf beyond the limits of Australia's territorial waters for the purposes of exploring and exploiting natural resources.<sup>16</sup> To reinforce this fundamental international legal right Australia enacted the *Seas and Submerged Lands Act 1973* (Cth) which declares sovereignty in respect of the territorial sea of Australia, the airspace over it, and its seabed and subsoil is vested in the Crown in the right of the Commonwealth.

### Commonwealth

The Petroleum (Submerged Lands) legislation<sup>17</sup> enables the allocation of some of these fundamental Commonwealth rights to be exercised by the State jurisdictions. The *Petroleum (Submerged Lands) Act 1967* (Cth) (PSLA-Cth) establishes a management regime for exploration and exploitation of offshore petroleum resources outside the coastal waters of State and Territories. Pursuant to government agreements, an offshore petroleum package which established the operation of the scheme outside the three mile territorial baseline would continue to be regulated by the Commonwealth, with day to day administration to be undertaken by the States via a joint authority arrangement comprising State and Federal Ministers. The regulatory framework of the PSLA-Cth enables the granting of petroleum licenses to participate in exploration or exploitation of natural resources including the grant of an offshore pipeline licence. It was recognised during the early development stages of the pipeline that the *Petroleum (Submerged Lands) Act 1982* (Qld) lacked scope for the grant of a petroleum pipeline licence for areas which were seaward from the State coastline at mean low water and landward of the inner limit of the territorial sea of Australia, nor did it allow for a pipeline which originated outside the Australian jurisdiction. Consequently, as part of the changes in law to facilitate regulatory aspects of the PNG Gas Project, the Queensland Parliament extended the coverage of the PSLA (Qld) to grant of licenses for pipelines originating outside Queensland and allowing for the conveyance of petroleum recovered outside of Australia.

### Queensland

In 1997,<sup>18</sup> the Queensland Parliament made amendments to the *Petroleum Act 1923* (Qld),<sup>19</sup> to formalise and clarify the selection process undertaken by the project sponsors for the proposed PNG to Queensland pipeline to make certain the process fell within the scope of s 70A of the *Petroleum Act 1923*. This was reinforced by the inclusion of s 153 of the *Petroleum Act 1923*. Section 153 of the *Petroleum Act 1923* relates to the proposed parts of the pipeline that are in Queensland or seaward of the State coastline. The provision is intended to facilitate the grant of the Queensland offshore pipeline licence under the *Petroleum Act 1923* and for the approval of access principles for the Queensland parts of the pipeline both onshore and offshore under the same Act. The effect of this section will allow the Minister to agree access principles provided the selection process to develop the pipeline is a competitive selection process. Essentially, the Minister is able to agree in the application process for the pipeline licence about access principles, conditions of the licence and other matters if satisfied the selection process was competitive.<sup>20</sup>

The establishment of this regulatory process was a significant step toward the management of regulatory risk associated with the project. One of the aims of the competitive selection process was to have interested parties compete for a commercially driven set of access and pricing principles so as to avoid potential adverse regulatory interference. However, due to significant changes in the nature of the project since commencement of project planning, the assessment of the Australian Competition and Consumer Commission (ACCC) has been delayed pending financial close and additional information from the project proponents.<sup>21</sup>

### National Gas Code

When the project was a fresh idea, the National Competition Council had not introduced the National Access Regime for Gas Pipelines. All jurisdictions in Australia signed the Council of Australian Governments (CoAG) Natural Gas pipelines Access Agreement in 1997. The national access regime consists of a National Pipelines Third Party Access Code (the Code) and the Gas Pipelines Access Law (the Law) which gives effect to the Code. The

<sup>16</sup> These rights are defined in the Convention on the Continental Shelf signed at Geneva on 29 April 1958

<sup>17</sup> *Petroleum (Submerged Lands) Act 1967* (Cth) and *Petroleum (Submerged Lands) Act 1982* (Qld)

<sup>18</sup> Petroleum and Gas Legislation Amendment Bill 1997, Explanatory Notes.

<sup>19</sup> This Act was largely repealed by the *Petroleum and Gas (Production and Safety) Act 2004* (Qld)

<sup>20</sup> Additional amendments were made to the *Petroleum (Submerged Lands) Act 1982* (Qld) to allow the *Petroleum Act 1923* to apply to the proposed pipeline in Queensland offshore territory. Additionally, the *Petroleum (Submerged Lands) Act 1982* (Qld) needs to be amended to ensure that petroleum pipelines originating from outside Australian come within the scope of the Act and the Commonwealth Act was previously amended along the same lines.

<sup>21</sup> Final Recommendation, National Competition Council, Queensland Access Regime for Gas Pipeline Service, Application for Certification under Section 44M of *Trade Practices Act 1974*, November 2002 at 92



Law and Code specifically seek to establish a transparent regulatory decision making process for determining the terms and conditions of access to both transmission and distribution pipelines independent of Ministers, including provisions for regulators' decisions to be appealable. The approach taken to implement the national access regime ensures uniformity and integrity across all States and Territories, and Federal legislation completes the regime's coverage by applying it to interstate pipelines and to offshore installations. Prior to implementation of the regime, it was generally accepted that cost-effective regulation was necessary, which balances the interests of the service provider and end users, and encourages investment in new gas pipeline infrastructure necessary for the development of a competitive national gas market. The regulatory process adopted aims to provide a fair return to network owners while eliminating opportunities for monopoly pricing.

The purpose of the National Gas Code, is slightly undermined by the derogations available through different State jurisdictions. Recently, the Productivity Commission undertook at Review of the Gas Access Regime due to concerns about the application of the regulatory approach and the relevance of the principles in a more developed market.

***Queensland Gas Access Regime (Access principles for PNG-Queensland pipeline)***

The Queensland regime set out in the *Gas Pipelines Access (Queensland) Act 1998* (Qld) applies to spare and developable capacity in Queensland natural gas pipelines covered under the Third Party Access Code for Natural Gas Pipeline Systems (National Gas Code). The regime does not apply to foundation contracts or any other pre-existing contractual arrangements. In terms of the offshore waters, the *Gas Pipelines Access (Commonwealth) Act 1998* (Cth) ensures the Queensland regime will apply to those waters – it mirrors the national regime.

The *Gas Pipelines Access (Queensland) Act 1998* establishes derogations affecting major transmission pipelines in Queensland. The derogations modify or replace certain features of the Queensland regime for the derogated pipeline. Section 59 is a derogation applying to access principles for the proposed pipeline. The principles were to be developed through a competitive tendering process which was progressed through the *Petroleum Act 1923* (Qld). Measures were put in place to ensure the competitive tendering process was consistent with the National Gas Code. Section 59 requires the access principles for the pipeline to be agreed by the ACCC who will advise the Queensland Minister as to the appropriateness of the principles.

However, for the derogations to be effective the National Competition Council must certify the regime. The NCC has yet to certify the Queensland regime. Hence, it has not been approved as a consistent national regulatory approach.

Although indicative tariffs and access arrangements were published by the project proponents in November 1998, final approval of the tariff and arrangements by the Queensland Minister and the ACCC was planned to be sought closer to financial close.<sup>22</sup> As financial close has been delayed, it can only be assumed approval was delayed and did not meet the deadline specified in s 59. Given the derogation has time-lapsed and considering the statement in the Final Recommendation by the National Competition Council, it is assumed the access principles were not approved by the ACCC within the set time limits.<sup>23</sup>

The competitive tender process was for the purpose of identifying a pipeline consortium to build, own and operate the Australian section of the PNG-Queensland gas pipeline; and to establish access arrangements and tariffs for that pipeline. The derogation in s 59 was important because it validates the outcomes of the competitive tender process. Absent the derogation, the selection of the final consortium would have no secure basis and the ultimate validity of the tariffs and access arrangements would have been uncertain amounting to an unacceptable risk for the parties involved including project sponsors, prospective gas customers and the pipeline consortium. Hence, the risk protocols undertaken by the project sponsors was somewhat thwarted.

The submission to the Productivity Commission by ExxonMobil summarises the difficulties encountered by the project sponsors and the consortium with respect to the competitive tender process and certainty of access principles:

*[I]t is ExxonMobil's experience that these processes [the Gas Access Regime and Draft Greenfields Guideline for Natural Gas Transmission Pipelines]..present difficulties for pipeline development. In the case of the tender process approval, it*

<sup>22</sup> Project Sponsors' Submission to National Competition Council, 21 May 1999 available at [www.ncc.gov.au/publication.asp?publicationID=72&sectorID=5](http://www.ncc.gov.au/publication.asp?publicationID=72&sectorID=5) (accessed 12 September 2005).  
<sup>23</sup> Ibid at 92.

*is extremely time consuming with public consultation managed by the ACCC regarding the tender process proposed to be used. ....The tender process effectively fixes the pipeline route and markets with little flexibility in these arrangements. However, ongoing project development as real market opportunities are firmed up may require the pipeline design to be re-optimised regarding capacity and potentially its route. Without this re-optimisation including the flexibility to alter pipeline route, there is likelihood that the pipeline will be inefficient and the ability for the new gas resource to provide competition will be affected. An example of this can be seen in the development of the Highlands Gas Project (formerly PNG) where a number of new market opportunities have presented themselves during project development since the original pipeline tender process was reviewed. The most efficient supply of gas to these market opportunities may require redesign of the pipeline route and capacity. Under the current non-flexible tender processes some redesign options may not be accommodated. This leads to an uncertain basis under which the project is being developed.<sup>24</sup>*

This suggests the access principles presented to the ACCC in November 1998 have been largely superseded due to inflexible regulatory arrangements. Consequently, regulatory certainty was not achieved by the project sponsors despite major efforts to conform to the necessary government policy.

The Utility Regulators' Forum<sup>25</sup> considers some service providers may perceive benefits in securing certainty about the application of the regulatory framework to Greenfield assets at the outset of a proposed project. As discussed, this was the approach taken by the project sponsors at the initiation of the project. Given the current regulatory regime in Australia the only manner to achieve this certainty is by directly approaching the ACCC to obtain regulatory approval of the process. Essentially, there are two regulatory alternatives for a Greenfield development project. A project proponent has the ability to use a competitive tender process under the National Gas Code to determine certain elements of the new pipeline's access arrangements. If carried out according to tender guidelines (as set by the Regulator) the competitive tender associated with the process will produce optimal tariffs as a competitive outcome. Alternatively, the proponents have the option of progressing without a competitive process and submitting access arrangements as voluntary coverage under the National Gas Code or under Part IIIA, *Trade Practices Act 1974* (Cth). Otherwise, once a pipeline is established it may be obliged through forced coverage to allow third party access to incremental capacity on an open non-discriminatory basis.

Cognisant of this regulatory risk and subsequent introduction of the National Gas Code, the project sponsors, early in the project development stages, embarked upon a path to reach regulatory certainty with this changing regulatory structure. Due to unforeseen difficulties with progressing the project, the gains made initially with respect to regulatory approvals, seem to have left the project in no better position.

Many submissions to the Review of the Gas Access Regime by the Productivity Commission sought recommendations such that Greenfield transmission pipeline developments, like the Australian Pipeline, should be afforded an exemption from regulation for a period of 20 years to provide better regulatory certainty for project investors. Such an outcome would have benefits for the project sponsors, pipeline owner and foundation customers.<sup>26</sup>

### Access arrangements

The objective of third party access rights is to establish a competitive market in natural gas. Third party access is the mechanism by which natural gas suppliers and customers are given the right to have their gas transported through pipelines that they do not own or control. With all the objectives of competition, the practice of third party access can be fettered by capacity constraints, obviously for third party access to succeed there must be available capacity within the pipeline.

The support for regulation of certain pipelines to create third party access rights stems from the nature of a pipeline asset. A pipeline which transports gas is a natural monopoly, by having innate characteristics which can result in low competition such as high entry costs for infrastructure, operational costs are low compared to high capital costs, unit costs decline as capacity expands and there are economies derived from several activities conducted together. Economic theory translates this to mean that new entrants have little

<sup>24</sup> Submission of ExxonMobil to Productivity Commission's Review of Gas Access Regime (July 2003), August 2003, <http://www.pc.gov.au/inquiry/gas/subs/subdr078.rtf> (accessed 12 September 2005)

<sup>25</sup> *Network*, A publication of the Utility Regulators Forum, Issue 12, 31 March 2003, p 2, <<http://www.accc.gov.au/content/index.phtml/itemId/373731/fromItemId/3737>> (accessed 12 September 2005).

<sup>26</sup> Productivity Commission, Submissions to the Review of Gas Access Regime, <http://www.pc.gov.au/inquiry/gas/index.html> (access 20 September 2005).

hope of competing on costs. Such characteristics give the providers of those services considerable market power, not to mention the absurdity of the concept of having two under-utilised pipelines covering the same territory, which amounts to unproductive use of resources. The mechanism of third party access (regulation) is used to replicate competitive pressures.

It is apparent by the statements made by the project sponsors in supporting material for the PNG Gas Project,<sup>27</sup> that excess capacity may be available for utilisation by third parties depending on the volumes of gas contracted to foundation customers.<sup>28</sup> To further support the application, Frontier Economics in their report stated, "The opportunities of third parties to utilise the Australian pipeline include domestic coal seam methane producers, thus allowing those producers access to a broader market; and other gas producers in PNG increasing the diversity of suppliers into the Australian market."<sup>29</sup> This appears to indicate the parties plan to build greater capacity than necessary to supply its foundation customers and are therefore happy to negotiate access to excess capacity.

### Capacity allocation

A critical consideration when planning a gas transmission pipeline development, is in determining whether additional capacity will be available for use by third parties. The economics of constructing a pipeline depends on the ability of the owner to utilise excess ullage, if some ullage remains unutilised the pipeline as a revenue-generating asset will be impaired. Over-sizing a pipeline by allowing for excess transport capacity will inevitably increase the cost of construction. The decision as to whether to oversize a pipeline for use as a commercial asset is largely a commercial and economic issue for the pipeline owner, subject also to regulatory considerations. This question is not easily resolved as it requires some foresight into the future development of gas reserves. Future development will depend upon the maturity of the natural gas market and if it is in the early stages of development, this will affect exploration interest at the supply side.

It is apparent the jurisdiction for which a trans-border pipeline is bound will govern how access arrangements apply to any excess capacity. This is particularly relevant in the context of the international energy market where gas reserves are abundant in concentrated areas and must be transported to those countries which are not as resource rich. Issues have arisen in an international context, about determining access arrangements for pipelines that cross one or more national boundaries. This has given rise to questions about the relevant laws which should apply to the pipeline, those of the country of origin (where the gas is injected) or those of the destination country (servicing the end customer).

### Australia

As noted above, the Australian pipeline will be governed by the laws applicable in Queensland and therefore fall within the ambit of both the National Gas Code or Part IIIA of the Trade Practices Act 1974 if declared to be covered. In order to recommend coverage, an application is made to the relevant Government Minister on advice from the National Competition Council (NCC), the NCC must be satisfied of all the following:

- That access to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline,
- That it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline,
- That access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety, and
- That access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

The Code provides for reference tariffs which act as the benchmark for maximum prices for standard network services. Pipeline operators are free to negotiate alternative tariffs and services, but the reference tariff is the default to apply in the event of dispute. The overarching requirement for reference tariffs to be approved by the relevant regulator is that they reflect the efficient cost of providing the reference service.



<sup>27</sup> Submission to the ACCC in support of an Application for Authorisation. See ACCC website at <http://www.accc.gov.au/content/index.phtml/itemId/571032> (accessed 20 September 2005)

<sup>28</sup> The Project Participants actively seek further foundation customers to provide for financial security and support the viability of the proposal. To build infrastructure without locking in foundation customers will put the participants in a poorer bargaining position whilst negotiating sales once the capital investment is sunk and the essential capacity will be known at this point: "Implications of emerging patterns in energy markets for the PNG Joint Venture" *Frontier Economics* 18 November 2004, p8 para 26. (Supporting Information for Application for Authorisation may be viewed at <http://www.accc.gov.au/content/index.phtml/itemId/571032>)

<sup>29</sup> Ibid p41, para 136-7.

There is another principal scheme for third party access through the *Trade Practices Act 1974*, for access to essential services in Part IIIA. The criteria for coverage of a pipeline under the National Gas Code are similar, but not identical to those listed under Part IIIA. In addition, Part IIIA requires that relevant pipeline be of national significance.

As noted above, how the Australian pipeline will be covered is not clear, if it is covered at all.

### ***Papua New Guinea***

The Australian pipeline relies on the integrity and available capacity consistent with that open at the Australian end of the infrastructure. Therefore the PNG side of the pipeline should match capacity. Because of this, the laws of PNG will affect all parts of the proposed project.

The *Independent Consumer and Competition Commission Act 2002* (PNG) (ICCC Act), which establishes the Independent Consumer and Competition Commission (ICCC), introduced competition laws for the first time as well as a new regime for the regulation of utilities (for prices and service standards). The primary objective<sup>30</sup> of the legislation is to enhance the welfare of the people of Papua New Guinea through the promotion of competition and the promotion of economic efficiency in industry structure, investment and conduct.

In enacting the ICCC Act, Papua New Guinea has taken a step forward in attempting to address impediments to competition and free trade. The laws are based on the competition laws applying in Australia and New Zealand. This is important as there is scope for a consistent approach in interpretation of competition laws. Being similar to the Australian and New Zealand structures,<sup>31</sup> the PNG Government and Courts may utilise precedents set in Australia when interpreting the legislation.

The Act further provides the Minister may declare particular entities and goods and services to be regulated. The sectors which have been declared are electricity services, telecommunications, ports and harbours, postal services and compulsory third party motor vehicle insurance. The limited scope of the PNG gas market and its weak coverage in the residential/ commercial sector suggests the reason for the absence of gas infrastructure from the declaration. However, the mere presence of an ability of the PNG Government to declare certain services creates a small risk that once the energy market develops then gas infrastructure may become subject to economic regulation. However, the absence of a declaration covering gas services suggests commercial outcomes will prevail in the short term to medium term. Accordingly, if approached by prospective users of the pipeline the present regulatory framework will not inhibit the project sponsors from negotiating third party access for the PNG parts of the pipeline. The presence of competition provisions, in particular laws targeting conduct which may substantially lessen competition or conduct that amounts to the taking advantage of market power will provide some form of protection for consumers from the possible exertion of monopoly powers by gas infrastructure owners in the future.

### ***Interaction between Papua New Guinea and Australian laws***

The interaction between Australian and PNG laws will not present major risks of uncertain regulatory outcomes however the absence of laws applying specifically to gas infrastructure and the lack of precedent in PNG presents some uncertainty. Given the benefits to the PNG economy provided by the prospect of cross border gas trade at this point the PNG Government may be encouraging and flexible in any regulatory approach (given the Minister is the party with the power to declare services). It is predictable and possibly inevitable this proposition will not alleviate concerns of the project participants and they will seek some formal acknowledgement to provide greater certainty.

With an access framework in Australia and lack of one in PNG, a possible implication will relate to costs. It may cost more to transport in Australia due to regulatory compliance costs than the costs for PNG side of the border. Also, if access is granted to the PNG part of the pipeline upon commercial terms and no laws prevent the denial of access on this basis, the commercial arrangements may restrict or limit the gas flow into Australia.

In summary, in terms of third party access there is no risk in the short to medium term of

<sup>30</sup> Section 6, ICCC Act 2002  
<sup>31</sup> Several of the laws mirror those found in the *Trade Practices Act 1974* (Cth). The competition provisions commenced on 10 May 2003 and are closely aligned to the competition law of Australia and New Zealand competition principles.

regulatory inconsistency amongst the two jurisdictions. The only adverse outcome is if parties are denied access to utilise the PNG pipeline, despite the regulatory structure for access in the Australian pipeline, the use of the Australian pipeline will be limited to the capacity granted for the PNG parts of the project. The project proponents would need to account for this in their commercial contracts. However, this could be a way of managing regulatory risk with respect to adverse tariff and access principle determinations from within Australia in the future. This exemplifies the point that it is important access is provided to third parties at an economically efficient manner and does not inhibit upstream developments.

***Forms of investment security available to project proponents***

As the PNG Gas project is the first trans-border gas trade project between Papua New Guinea and Australia or for that matter a first for Australia, there are no international treaties to which Australia has ratified to assist with the political and regulatory issues such a project may encounter.

Specific issues have been raised throughout this paper surrounding sovereign risk, jurisdiction and regulatory application. There are various ways these issues may be managed or mechanisms which have been implemented in other jurisdictions to work through these types of issues to ensure the project comes to fruition. The cross-border nature of many energy trade projects is a consequence of natural phenomena, however access to these resources in more developed areas is becoming essential to modern society's existence.

In any cross-border infrastructure project, the means to guard against issues of sovereign risk and political instability can be through intergovernmental agreements by way of a bilateral or an multilateral international treaty such as the Energy Charter Treaty.<sup>32</sup> Historically, there have been a growing number of bilateral and multilateral agreements specifically dealing with interstate and transit petroleum infrastructure. The primary objective of such agreements was for the promotion, construction and operation of interstate pipelines. These agreements have developed significantly and instead of being targeted project agreements<sup>33</sup>, the general form has evolved into a general set of principles and obligations applying to interstate pipelines as a whole for application to multiple projects. The recognition of the growing importance of transport issues has sparked further international development of more elaborate regulatory frameworks applying to interstate pipelines including, for example, the Energy Charter Treaty.

- *Bilateral intergovernmental agreements*

Bilateral agreements remain the main instruments used at an international level for encouraging significant investment.<sup>34</sup> Essentially, an intergovernmental agreement would provide the legal framework for which the project agreements could be based. Such an agreement would help facilitate the establishment of a single unit or entity to which a consistent regulatory approach could be applied and may provide a better way to avoid inconsistent regulatory application across the borders. A significant problem with intergovernmental agreements is the inability of private individuals to enforce them, as they do not have standing in the International Court. In the present context this may not be a problem, however as it relates to offshore investment, which is critically reliant upon unrestricted flow of energy from another jurisdiction, this uncertainty does import some risk to discourage investment. Hence, intergovernmental agreements should be supplemented and implemented through the domestic laws of each country together with the project agreements.

In circumstances where an intergovernmental agreement is unachievable, if the project developers are determined to persevere then it is advisable the project is structured with individual pipeline systems confined to the different jurisdictions with the sale and purchase of gas at the border.

- *Energy Charter Treaty*

The Energy Charter Treaty (ECT) is a unique agreement establishing a multilateral legal framework specifically targeted toward cross-border energy co-operation. Despite covering a wide spectrum of legal rights and obligations for energy trade, its principal provisions regulate energy investment, trade and the transit of energy goods through States that are

<sup>32</sup> The Energy Charter Treaty was signed in 1994 and entered into force in 1998. Australia signed this treaty although did not go as far as ratifying. An Agreement of this nature was signed by the United States and Canada concerning transit pipelines in 1977.

<sup>33</sup> C Flynn, "A Broad Framework for the Exploration of South China Sea Hydrocarbon deposits in the context of the Trans-ASEAN Gas Pipeline" [2004] *Melbourne Journal of International Law* 66 at 95

parties to the treaty. The ECT has evolved from the bilateral investment treaties common within European States from the early 20<sup>th</sup> century. Europe opted for the development of a multilateral agreements after recognising it had a strong strategic interest in ensuring long-term security of energy supplies from external producer countries. Given the projected increase in reliance on energy imports over the coming decades, it planned the development of the ECT.<sup>35</sup>

By providing a stable, comprehensive and non-discriminatory legal foundation for cross-border energy relations, the ECT reduces political risks associated with economic benefits in transitional economies.

*It creates an economic alliance between countries with different cultural, economic and legal backgrounds, but all united in their commitment to achieve the following common goals:*

- *To provide open energy markets, and to secure and diversify energy supply;*
- *To stimulate cross-border investment and trade in the energy sector;*
- *To assist countries in economic transition in the development of their energy strategies and of an appropriate institutional and legal framework for energy, and in the improvement and modernisation of their energy industries.*<sup>36</sup>

The ECT confirms the principle of national sovereignty over energy resources.<sup>37</sup> Furthermore, Member countries remain free to conduct their national energy policies and exploit their natural resources, provided that they exercise their sovereign rights in accordance with treaty obligations. A useful example of this is that the ECT does not touch upon issues such as the structure of domestic energy markets, the legal structure of energy companies, or third party access rights. It is interesting to explore a few issues addressed in the ECT which are of particular relevance to the present discussion. The areas include provisions relating to freedom of energy transit and investment protection.

## 1. Transit arrangements

Article 7 facilitates transit consistent with the principle of freedom of transit without distinction as to origin, destination or ownership. The term “transit” can be defined as applying to the transport of goods from a country, through at least one other country, to a third country. Typically, in a cross border transaction two sets of rules define the relationship, those in international agreements between the States involved and in customary international law; and secondly, rules contained in private commercial contracts between market participants, including governments and state owned companies. Under Article 7, States commit to taking all necessary measures to facilitate transit of energy; to promote the modernisation, development and operation of inter-regional transport facilities, as well as the development of international and cross-border interconnection facilities; and finally to co-operate in order to mitigate the effects of interruptions in energy supply.

The increasing importance of transit issues in Western Europe became apparent with issues relating to the refusal of certain German energy companies to transport gas to Austria for a Norwegian company.<sup>38</sup> Due to the monopoly position held by various transmission companies it was apparent those companies had the ability to restrict or block the through transport of gas and electricity as well as blocking import and export of energy. In order to liberalise the transport of energy, the EU produced the Gas Transit Directive and the Electricity Transit Directive. By comparison with the ECT, the definition for transit in both directives is “special” as it moves away from the classical meaning used in previous international conventions.

The usage of “transit” in the ECT and the Directives is different. The Directive allows for a broader scope as it only anticipates the crossing of one intra-community border as long as the origin or destination is situated within the EU Community. Consequently, the Directive applies to cross-frontier transit instead of ‘through transit’ as limited in the ECT which implies the crossing of two borders and requires the involvement of three parties. In any event, the obligations for transit in the directive remain largely the same as the ECT.

One of the key risks identified earlier security of supply is addressed in Article 7(6). It provides transit countries must not interrupt or reduce existing energy flows, even if they have a dispute with any other country concerning this transit. Such a provision presents

<sup>35</sup> Speech of Dr Ria Kemper, Secretary General of the Energy Charter Secretariat, “Energy Day in Croatia”, 26 November 2004.

<sup>36</sup> *The Energy Charter Treaty: A Reader’s Guide*, available from ‘Quicklinks’ at [www.encharter.org](http://www.encharter.org) (accessed 20 September 2005)

<sup>37</sup> Article 18, *Energy Charter Treaty*; full text of the treaty available at: [www.encharter.org](http://www.encharter.org) (accessed 20 September 2005).

<sup>38</sup> M Roggenkamp, “Transit of Network-bound Energy: the European Experience” in *The Energy Charter Treaty: an east-west gateway for investment and trade*, Thomas W Walde (ed), Kluwer Law International, 1996, pp 499-519

a protective mechanism for the investing party. Due to the parameters of the transit concept, the reference to transit in Article 7(6) applies to reduction or interruption by the transiting State and will not equally apply where the interruption is due to the actions of the originating contracting party. This is arguably a deficiency in the application of the ECT. It is almost absurd to include provisions governing secure transit when the originating party or the receiving party may undertake acts to frustrate energy flows. Presumably the expansion of the transit concept, would only increase the uncertainty relating to the operation of the ECT, however this example is not an unforeseen circumstance. It is noted that the transit provisions are designed for “special purposes”, and it may be implied the remaining provisions of the ECT assist with the rights and obligations of the originating and receiving countries.

Although the ECT is absolutely clear that mandatory third party access is not required under the Treaty, negotiated access under the transit provisions is implied.<sup>39</sup> In these instances, the individual countries must rely on competition principles to provide grounds for achieving wider access. For example, the Gas Directive<sup>40</sup> would be relied upon by EU parties to seek third party access.

Given the limited scope of what is included in “Transit” (that is, it anticipates the crossing of three borders), the ECT would not assist to achieve better security of supply and co-operation in the PNG Gas project. Consequently, the relevance of ECT in this instance is limited. A type of legal obligation such as the Gas Directive would also be of limited use between Australia and PNG given the different policy objectives of the two countries and the Gas Directive prepared by the EU provides for consistency of policy and principle.

## 2. Investment Protection

The investment provisions are the cornerstone of the ECT as it grants a number of fundamental rights to foreign investors in the host country. Foreign investors are protected against important political risks such as discrimination, expropriation and nationalisation, breach of individual investment contracts, damages due to the war and similar events. The provisions for dispute resolution reinforce these rights. By reducing political risk for foreign investors faced in the host country, the ECT aims to boost investor confidence with a view to increase investment flows.

The ECT distinguishes between pre-investment and post-investment and as a result there is disparity in the application of the investment provision. Essentially, the legally binding obligation to grant non-discriminatory treatment only applies once an investment is made - that is, post-establishment. However there is no binding obligation to afford an investor non-discriminatory treatment in the negotiation pre-establishment phase. The hole created by this should be addressed and closed because it is of key importance to investors to obtain licences or concessions to begin operations - which is pre-investment. Without protections at the pre-investment stage there is room for discrimination in tender processes and sale of State assets. Accordingly, the provisions do not actively encourage foreign investment which may have beneficial consequences for all Member States.

Finally, the application of Article 10(1) recognises the sanctity of contract between contracting parties and investors. The significance of this provision is if the government fails to adhere to the investor agreement this may amount to a breach of the ECT, giving the investor and its home country the right to pursue the dispute settlement provisions of the ECT.<sup>41</sup> The treaty further provides for a private investor to compel a State to engage in arbitration in relation to a dispute.

The presence of such provisions would provide a level of comfort to investors in the present discussion, particularly with the ability of parties to seek settlement of disputes through the arbitration mechanism. Although, it is conceivable the failure of the ECT to provide protection pre-investment may have a negative influence on the decisions of foreign investors.

- **What is the best alternative given the factual situation?**

Justifiably, there is unanimous acknowledgement that wholehearted government support is a prerequisite for trans-border projects. This translates not only in political declarations but other measures such as framework agreements between countries, the emulation of Energy Charter Treaty in other regions of the world, and the harmonisation of legal standards.

<sup>39</sup> M Roggenkamp, “Legal implications of the ECT competition: Rules and liberalisation” in *The Energy Charter Treaty : an east-west gateway for investment and trade*, Thomas W Walde (ed), Kluwer Law International, 1996, chapter 24.

<sup>40</sup> Directive 98/30/EC of the European Parliament and of the Council of 22 July 1998 concerning common rules for the internal market in natural gas, OJ 1998 L 204/1

<sup>41</sup> Article 26(3) grants contracting parties the right to exclude international arbitration in certain cases. Australia, Canada, Hungary and Norway have opted for this solution. Pascal Laffont, “An Energy Charter Protocol on Transit” [2003] IELTR 239 at 244.

In terms of the PNG Gas Project, Australia has a strong interest in encouraging accessibility to additional gas reserves for reasons of long term security of supply. On the other hand, PNG's economy would benefit from exploitation of its rich energy resources and has an attraction to securing long term production development, refining and transportation of capacity. The corresponding interests of the two countries provide a strong rationale for international co-operation in creating a system of predictable investment and cross-border energy flows. In this instance, the application of the ECT would be beneficial to provide some certainty to investing parties and to further encourage investment in the local industry. Given the transit provisions do not apply in the present case and the lack of assistance the ECT provides to pre-investment as well as limited relevance of the treaty to the area, it would not seem appropriate for Papua New Guinea or Australia to pursue the certainty of co-operation associated with ratification of the ECT. There are other avenues for the parties to encourage and secure investment without the added need to adhere to a further international obligation.

Although, both options may be useful, given it is likely this is a one-off project between PNG and Australia and as the Energy Charter Treaty is a mechanism to assist with operationalising cross border gas trade, a targeted bilateral agreement should suffice in this case. Even with the potential for another cross-border pipeline into Australia in the future with gas available in the Timor Sea.

### **Conclusion**

Cross-border energy trade is recognised as an important factor for future development of gas markets throughout the international community. The inherent nature of energy resources means there is a disproportionate amount of resources confined to pockets in different regions creating the need for trade between the resource rich economies and the lesser rich countries. It has been identified inconsistencies across boundaries may create distortions and hamper market development at the peril of future industry growth and investment. As a result the key to successful cross border gas trade is having the right institutional and regulatory frameworks.

The PNG Gas Project can be categorised as cross-border gas trade. It was acknowledged the nature of cross-border transactions expands the scope of sovereign risk placing more risks upon project developers than a less complex project. This is in part due to the multiple jurisdictions, which generally have some claim to the infrastructure or competing claims for the territory. Amongst these competing issues there are two discerning features relating to gas pipeline transport - jurisdiction and access rights to unutilised capacity. These two key factors will have a major impact on the planned structure and the market outcome. Such issues if not managed appropriately may compromise the success of the project.

Ultimately the main concern of investors will be their ability to achieve security of supply and to ensure they have sufficiently covered their position to enforce project arrangements across all jurisdictions. Having said this, it was made clear a key responsibility of government is to establish clear, transparent and predictable regulatory frameworks for private investments within their country for all aspects of the project, particularly gas production, trade and transit, consumption, and the development of energy policy. Additionally, it was concluded that having individual jurisdictions responsible for regulation of certain parts of a single infrastructure project could make for a myriad of project approvals. This could include pipeline licences, access, cultural and native title issues and operating and project development approvals across borders. Such processes can become duplicative or inconsistent in application and have the potential to add significant compliance costs or create delays in infrastructure investment and development. Excessive compliance costs may amount to a barrier to entry for innovative new entrants and possibly erode the development or strengthening of competition. For these reasons, it is important to develop synergies in regulation and establish streamlined and integrated approval processes. However it is rare for a party to relinquish its sovereign exercise of legal powers over property within its jurisdiction.

It was concluded the best way to mitigate risks associated with cross-border trade is by implementing intergovernmental treaties to support the development projects which will have a positive long term effect on all affected markets. An intergovernmental agreement can be achieved through the use of bilateral or multilateral arrangements. The ultimate

objective of an intergovernmental agreement is to enhance the legal and financial stability, certainty and predictability in order to encourage transport of energy and the development of infrastructure investments. Such an agreement would seek to strike a balance between the sovereignty of States involved in international energy trade and the sanctity of contracts made by the investing participants. The benefits of the Energy Charter Treaty were discussed with its ability to require Member States to co-operate to further the objectives of the treaty. This was acknowledged as useful for managing multiple instances of cross-border energy trading.

In terms of the PNG Gas Project, Australia has a strong interest in encouraging accessibility to additional gas reserves for reasons of long term security of supply and equally, the economy of Papua New Guinea would benefit from exploration and production activities. The corresponding interests of the two countries provide a strong rationale for international co-operation in creating a system of predictable investment and cross-border energy flows. Given it is likely this is a one-off project between PNG and Australia and as the Energy Charter Treaty is a mechanism to assist with operationalising cross border gas trade, a targeted bilateral agreement should suffice in this case. This is provided there is a workable structure in place to allow a seamless co-ordination of rights and obligations and there exists a mandated process for independent resolution of disputes.

**Madonna Parker**



### 3. Australia and *Kyoto*: Are we really doing our share?

by Michael Raine

#### Introduction

In the last 50 years it has become apparent that the actions of human civilization are changing the environment on planet earth.<sup>1</sup> The industrialization of the world has disrupted earth's delicate atmospheric balance leading to what has been coined the "greenhouse effect". The consequences of the greenhouse effect are that the build up of certain gasses in the atmosphere, mainly carbon dioxide, nitrous oxide, methane and fluorocarbons acts to trap heat increasing the temperature of the earth.<sup>2</sup> This increase in temperature is predicted to alter the delicate balance of life on planet earth.<sup>3</sup>

In response to this climate change threat 35 industrialized countries and the European Community adopted the United Nations *Kyoto* Protocol on 16 February 2005 making a commitment to combat the effects of global warming.<sup>4</sup> The objective of the agreement was to reduce global emissions of greenhouse gases by 5%, using 1990 emissions as a base level.<sup>5</sup> The United States of America and Australia were the only two developed nations not party to the agreement<sup>6</sup>. Both governments argued that an effective climate change regime must involve all greenhouse gas emitters, including developing nations.<sup>7</sup>

This call for a "more meaningful" involvement from developing nations had been consistently argued by Australian and US governments over the negotiation period.<sup>8</sup> The basis of the argument is that developing nations are expected to overtake the emissions of developed nations this decade.<sup>9</sup> With this in mind, and even if *Kyoto* targets are reached, Australia and the US contend that total emissions on a global level will continue to rise. They also wanted to protect their domestic fossil fuel industries which would suffer because of the stricter emission conditions placed on western domestic industry. Further, they suggested that the entire system could be undermined by the transfer of emission intensive industries offshore into "pollution havens".<sup>10</sup>

#### Australia and *Kyoto*

When the United States made it clear in 2001 that they were not going to be a part of the *Kyoto* protocol Australia was quick to follow suit.<sup>11</sup> On this issue Prime Minister John Howard personally stated that Australia would be foolish to subject itself to the penalties imposed by a failure to meet emission targets without a commitment from major emitters China and the United States<sup>12</sup>. This decision not to ratify has attracted a great deal of criticism from the international community as Australia is one of the world's highest per capita emitters of greenhouse gases<sup>13</sup>. However, despite not ratifying, Prime Minister Howard has made a commitment to ensuring that Australia meets its 2012 *Kyoto* target of 108% of 1990 greenhouse emissions<sup>14</sup>. The promise of reaching *Kyoto* targets has been echoed by numerous government departments; however, commentators suggest that it is going to be difficult for Australia to achieve<sup>15</sup>.

Under article 3 of *Kyoto* each party is to have made demonstrable progress in achieving its commitments by 2005<sup>16</sup>. In light of this, this paper attempts to examine the promise given by John Howard and his coalition government to meet *Kyoto* targets. The examination will be achieved by first examining the commitments imposed on Australia under the *Kyoto* agreement in relation to greenhouse emissions. The paper then scrutinizes Commonwealth and State legislation enacted to reduce the emission of greenhouse gases. It then concludes by making a critical analysis of the legislative mechanisms in place suggesting that Australia is not on track to fulfilling its promise of meeting *Kyoto* targets.

#### The *Kyoto* Agreement

Although there is almost unanimous scientific opinion regarding global warming, how much warmer and what the consequences will be still remains in dispute.<sup>17</sup> Despite these unknown consequences, the international community has adopted the "precautionary principle" whereby action is implemented despite absolute scientific certainty.<sup>18</sup> Further, in

recognizing the overarching issue of climate change the international community has accepted that a solution to the greenhouse problem must be a global one.<sup>19</sup>

Because of the sheer size and global nature of the greenhouse problem it quickly became apparent that it was not a traditional environmental problem amenable to traditional environmental action.<sup>20</sup> The problem is further compounded by the critical role played by greenhouse pollution in the modern way of life.<sup>21</sup>

The first move by the international community towards combating the effects of climate change was the ratification of the United Nations Framework Convention on Climate Change in 1992. The convention was the first international treaty solely based on combating human interference with the atmosphere.<sup>22</sup> The ultimate objective of the convention was to achieve stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous interference with the climate system. To achieve this objective the convention set out a number of principles and broad obligations for parties to follow in their attempts to combat climate change.<sup>23</sup>

The *Kyoto* agreement, adopted in 1997, was the latest in international agreements to be ratified by the international community in an attempt to curb the effects of climate change or global warming.<sup>24</sup> The successor of the Framework Convention on Climate Change, the protocol is an agreement that stands on its own but is linked to an existing treaty.<sup>25</sup> Certainly the most onerous of international environmental agreements it imposes rigorous obligations on parties to curb emissions.<sup>26</sup> The key difference between *Kyoto* and its predecessors is that *Kyoto* contains legally binding quantitative time-bound targets for developed countries party to it.<sup>27</sup>

### **Regulation vs. Market based Initiatives – the evolution of the *Kyoto Protocol***

In establishing binding targets there was a great deal of dispute between nations as to whether *Kyoto* mechanisms were to be of a traditional punitive compliance nature or of a more modern and innovative market based nature.<sup>28</sup> Under the punitive system, member countries would be set emission targets and those who failed to reach their assigned quota would be liable to pay a pecuniary penalty. This punitive system would also require member states to implement similar domestic policies requiring domestic emitters to reduce emissions or be liable to pay penalties to government. The European Union was a particular advocate of this type of system.<sup>29</sup>

The market based system sought to promote the reduction of emissions by establishing a market for emission trading.<sup>30</sup> Under such a system nations are given emission quotas which they are required to meet. However, under the market system should the situation arise where a member nation was below their assigned quota, they may sell their excess emission allowance to other member nations.<sup>31</sup> Further, under the market based system, member nations would be required to implement a similar domestic policy whereby emitters could trade emission credits with each other and owners of emission sinks, which cleanse the air of pollution.<sup>32</sup> This move away from the traditional regulatory arrangement was motivated by western economies that looked for the 'least cost' greenhouse response.<sup>33</sup>

After intense negotiations it was decided that *Kyoto* would adopt a market based system due to its cost effectiveness. As such the protocol has largely been seen as innovative by the international community. It applies an integrative approach to curbing climate change, moving away from traditional action – penalty law and utilizes a number of economic, fiscal and technological instruments to combat climate change.<sup>34</sup> Further, the protocol recognizes the need for solutions to be economically viable and able to sustain the growth and development of economies.<sup>35</sup> In recognizing these issues *Kyoto* set different emissions targets, according to the national circumstances, economic structure and development needs of member countries.<sup>36</sup> Australia particularly benefited from the use of equity in setting *Kyoto* targets. Whereas most member nations are required to reduce their emissions by 2012, Australia was permitted an increase in emissions of 8%.<sup>37</sup>

### **The Convention**

The *Kyoto Protocol* sets out a number of political and legislative provisions to be implemented by member states. This paper focuses on area of emission reduction through legal reductions



schemes and legislative carbon seizure. Relative to these areas are articles 2, 3, 4, 6 and 10. The following is an examination of the obligations that would be imposed on Australia if it was a party to the protocol. Following this is an examination of Australian legislative mechanisms introduced to meet these obligations.

### **Article 2**

Article 2 of the convention sets out the broad spectrum of obligations that member countries are expected to implement and promote. Under the article Australia would be required to:

Implement and/or further advance national policies such as:

- I. Enhancement of energy efficiency in relevant sectors of the economy
- II. Protecting and enhancing of sinks and reservoirs of greenhouse gases
- III. Promoting sustainable forms of agriculture in light of climate change
- IV. Researching, promoting and developing the increased use of new and renewable forms of energy, carbon dioxide sequestration technologies and of advanced environmentally sound technologies
- V. Progressive reduction of market imperfections, fiscal incentives, tax and duty exemptions that run counter to the objective of the Convention and the application of market instruments
- VI. Encouraging of appropriate reforms in relevant sectors aimed at promoting policies and measures which limit or reduce emissions of greenhouse gases
- VII. Measures to limit and/or reduce emissions of greenhouse gases not controlled by the Montreal Protocol in the transport sector
- VIII. Limitation and/ or reduction of methane emissions through recovery and use in waste management, as well as in the production, transport and distribution of energy.<sup>38</sup>

These policies would be implemented in accordance with Australian national circumstances. Any such implementation would also need to be done in such a way so as to minimize adverse social and economic impacts<sup>39</sup>. Further, Australia would also be obligated to share its experiences in relation to the above objects in an effort to increase the overall effectiveness of the scheme among member parties<sup>40</sup>.

### **Article 3**

Article 3 is the cornerstone provision in the *Kyoto* agreement and imposes an obligation on member countries to reduce their green house emission.<sup>41</sup> The types of gases classed as a “greenhouse gases” are contained in Annex A and amount of emission reduction for each member party is contained in Annex B of the protocol. Annex A includes only developed industrialized countries. Developing nations have not had to commit to emission quotas for the first *Kyoto* period, 2008-2012.

The variation in emission reductions between developed nations and between developed and developing nations operates in accordance with the protocol’s equity objectives.<sup>42</sup> This ensures that restrictions will only be imposed in accordance with the respective capabilities and national circumstances of a contracting party. This has been criticized as both a major strength and weakness of the treaty.<sup>43</sup> On one hand, the treaty operates in a flexible manner and allows emission targets to be set according to the capacity of a member state. On the other, it imposes uneven obligations on parties in accordance with their state of development.

The equitable principle, particularly the exclusion of developing countries has been a particular point of debate in the development of *Kyoto*. The Australian and American Governments have, throughout the development of *Kyoto*, cited the significant economic impacts the agreement would have on their relative economies.<sup>44</sup> They also argue that the agreement is unfair because major emitters, China and India, are not subject to such restrictions because they are seen as developing nations.<sup>45</sup>

As previously mentioned, Australian and US governments further argue that as developing nations are set to overtake developed nations as the largest emitters of greenhouse gases this decade, *Kyoto* is an ineffective means of stopping climate change. They suggest that

even if developed nations reduce emissions by 5%, developing nations would still increase emissions and the net result would be an increase in greenhouse gases.<sup>46</sup>

### Australia's commitment under Article 3

If Australia was a party to the agreement their quota would be 108% of 1990 emissions. This amount was negotiated by the Australian government and allowance was made by the international community for Australia's population growth and reliance on fossil fuels.<sup>47</sup> If Australia were a party to the protocol it would have to have made demonstrable progress towards achieving its assigned 108% emission cap by 2005.<sup>48</sup>

Article 3 also sets out the second revolutionary component of the protocol, the inclusion of carbon sequestration provisions. Carbon Sequestration is the process whereby carbon dioxide ("carbon") is taken up by plants and converted into biomass through photosynthesis.<sup>49</sup> Under this provision, member parties may subtract greenhouse gas removed by trees planted after 1990. To enable such a reduction the trees planted must be a human-induced effort to convert land not previously forested into forest by planting trees.<sup>50</sup>

To enable this reduction, member parties must provide data that establish tree stocks in 1990 to the Kyoto Subsidiary Body for Scientific and Technological Advice to enable an accurate reforestation estimation to be made in 2012.<sup>51</sup> Further, the reporting of any carbon sequestration reductions must be transparent and verifiable in accordance with *Kyoto* provisions.<sup>52</sup>

### The "Australia Clause"

Article 3.7 of the *Kyoto Protocol* allows parties who had greenhouse gas emissions from land-use change and forestry sources in 1990 to add these emissions to their 1990 baseline. Emissions from land-use change and forestry applies almost exclusively to Australia. Effectively this means that Australia is allowed to add 5 tonne in emissions to its 1990 base year, bringing its total base year emissions up to 26 tonnes per year. This is the highest 1990 per capita emission level in the world. Furthermore, Australia's 108% emission quota is calculated from this artificially inflated base amount making it the most generous arrangement of any developed nation privy to *Kyoto*. This clause has become known as the "Australia clause" and has widely been criticized for undermining the substantial environmental progress made by other developed nations.<sup>53</sup>

### Article 4

As another innovative provision in the *Kyoto Protocol*, Article 4 provides for the trading of unused carbon quotas. For example, if Australia were able to achieve annual emissions of 104% of 1990 levels rather than 108% by 2012, Article 4.1 would allow them to sell the excess 4% quota to another country. Should there not be a buyer for the carbon, Australia would also be able to roll over their "emission credits" into the next commitment period.<sup>54</sup>

### Article 6

Article 6 of the protocol expands on the carbon trading regime established in Article 3, allowing for carbon sequestration rights to be traded between nations.<sup>55</sup> Reporting conditions similar to the United Nations apply for trading in sequestration credits as are applied under Article 3 for acquiring sequestration credits.<sup>56</sup>

### Article 10

Article 10 imposes obligations on member parties to implement domestic regimes for the reporting and reduction of carbon credits. Similarly, obligations to implement carbon sequestration programmes are imposed on member parties. Such programmes are to be implemented in the domestic industries of energy, transport and industry sectors as well as the agriculture, forestry and waste management sectors.<sup>57</sup>



## Australian Legislative Mechanisms to Reduce Greenhouse Emissions

### The Renewable Energy (Electricity) Act 2000

Traditionally, Australia has had little motivation or need to source energy from renewable sources because of its abundant fossil fuel supplies.<sup>58</sup> Further, Australia's heavy reliance on the energy sector has made emission reductions difficult.<sup>59</sup> Energy generation has, and continues to be, Australia's single highest source of greenhouse gas emissions.<sup>60</sup>

In 2000, the Commonwealth Government implemented the *Renewable Energy (Electricity) Act 2000 (Renewable Energy Act)* as part of a national effort to decrease Australia's reliance on fossil fuels.<sup>61</sup> The objectives of the Act were to increase Australia's reliance on renewable energy sources and to reduce the emissions of greenhouse gases.<sup>62</sup> The implementation of this act was a significant step by the Australian Government because electricity use and production did, and still does, account for the largest proportion of Australia's carbon emissions.<sup>63</sup>

The Act achieves its objective of reducing Australia's reliance on fossil fuels by allowing power stations generating electricity from "renewable sources" to issue renewable energy certificates ("certificates").<sup>64</sup> The list of energy sources considered to be "renewable sources" is contained in s. 17. This list has attracted widespread criticism because it classes energy obtained from native forest wood waste and municipal waste incineration as "renewable". Critics argue that energy obtained from these sources are clearly not "renewable" or sustainable and their inclusion allows the generation of misleading figures regarding clean energy sources.<sup>65</sup>

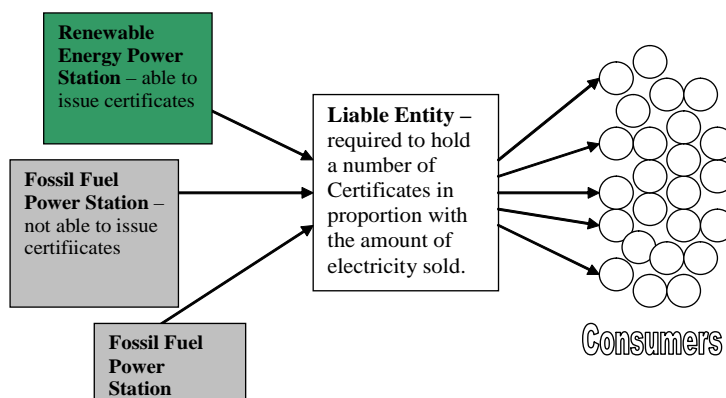
If a power station is generating energy from sources classified as renewable it must be accredited by the government to issue certificates.<sup>66</sup> The certificates issued by power stations are of value to bulk purchasers of electricity, who are required under the act to surrender a specified number of certificates every year. The number of certificates is proportional to the amount of electricity that a bulk purchaser acquires during a year. These purchases are called "liable entities" under the act. Should a liable entity supply more electricity during a year than they have certificates for they are liable to pay a fee.<sup>67</sup>

It has been suggested that the fee-based mechanism was chosen by the Commonwealth because they do not have the power to regulate electricity generation under the Australian Constitution. Critics suggest that to deal with this issue the Commonwealth uses the taxation power under s 55 to impose a tax on power suppliers who do not comply with regulations.<sup>68</sup> However, given the market based arguments voiced by the Australian Government throughout *Kyoto* negotiations it is more likely that the market-based model was used because of its cost effectiveness.

### The Operation of the Act

Under the Act a liable entity can be likened to a wholesaler of electricity. They purchase bulk electricity from various power stations and on sell it to the consumer.<sup>69</sup> The idea behind the scheme is to impose requirements on generators, the middlemen between the power station and the consumer, to purchase a proportion of their electricity sold from renewable electricity producers. The operation of the scheme may be seen in diagram A below.

**Diagram A.** Operation of the Renewable Energy Act



This system is known as a “quota system”, a market-based strategy to ensure that renewable energy constitutes a certain percentage of total energy generation or consumption.<sup>70</sup> Under the quota system the government sets an amount of electricity, or a percentage of the total electricity generated or consumed, that must be sourced from renewable energy.

The *Renewable Energy Act* has set mandatory targets of renewable energy to be met by electricity producers. The required gigawatt hours of renewable source electricity begins at required 300 GWh for 2001, building over the years to 2010 to a total of 9500 GWh.<sup>71</sup> This is a significant target and will represent 10.5%-12.5% of Australia’s total electricity generation in 2010.<sup>72</sup>

The Australian Act differs from similar legislation in the United States and United Kingdom. Under the US system, each electricity supplier/ retailer must acquire a set percentage of total electricity sales from renewable energy sources.<sup>73</sup> Under this system every supplier *must* purchase a percentage of total electricity sales from renewable sources. In contrast the Australian renewable energy legislation sets a mandatory target of electricity consumption for the whole of Australia. This fundamental difference allows for trading of certificates among electricity suppliers. Further, by requiring power suppliers to acquire certificates or pay a fee, a market for certificates is created. Should a supplier be short of certificates, rather than pay the penalty fee to the government they have the option of purchasing certificates from other suppliers who have excess certificates.<sup>74</sup>

In terms of world standards Australia’s *Renewable Energy Act* is by no means revolutionary or innovative. The United Kingdom and the United States have been using legislative, market-based and incentive systems to promote continued development of renewable energy sources for some time.<sup>75</sup> However, for Australia the legislation is a significant step in the right direction to the reduction of overall carbon emissions from the electricity generation sector, which, makes up the majority of Australia’s carbon emissions.

Commonwealth claims indicate that Australia has met the targets set under the renewable energy legislation to date, sourcing 1100 GWh of energy from renewable sources.<sup>76</sup> Further, the Commonwealth claims that it is on track to meet the its renewable energy proportion of 12% (9500 GWh) by 2010. Without such initiatives carbon emissions from electricity generation were expected to increase by 65% in 2010 and 97% by 2020.<sup>77</sup> This is the ‘do nothing’ scenario as predicted by the government. Under the current framework the Commonwealth expects emissions to rise by 46% in 2010 and by 70% in 2020.<sup>78</sup> These reductions of 19% and 27% respectively are due to a predicted increase in the use of renewable energy sources.

*Primia facie* the figures published by the Commonwealth suggest that Australia is doing its part to reduce carbon emissions. However, by the governments own figures it expects an increase of carbon emissions from the electricity sector alone to be 46% by 2010. Further, Australian emissions from the electricity industry are already some 30% higher than they were in 1990.<sup>79</sup> Given that electricity generation makes up the largest proportion of Australian carbon emissions, it is difficult to imagine how Australia could possibly meet its *Kyoto* target of 108% of 1990 emissions.

Critics argue that at the predicted rates of electricity growth between 2002 and 2020, renewable energy would supply only 9% of total generation under the *Renewable Energy Act*. This is less than the percentage of total electricity generation from renewable sources in 1997 and well below the average target for renewable energy of most other developed nations.<sup>80</sup> Critics further argue that that the low renewable energy targets are not enough to justify any significant investment in renewable energy generation or to allow Australia to develop a market in the production and export of renewable energy technology.<sup>81</sup>

To remedy these problems, critics suggest that the target should be set as a percentage of electricity production rather than an amount of GWh. They further suggest that the percentage be increased to an additional 10% generation in 2010, 20% in 2020, and should continue increasing thereafter.<sup>82</sup> It is thought that such a change would achieve the necessary reductions in carbon emissions required under *Kyoto* as well as stimulating the development of a renewable energy industry for Australia.<sup>83</sup>

Realistically it is difficult to see how the operation of the *Renewable Energy Act* can make any significant progress toward meeting Australia’s obligations under *Kyoto*. The current targets are too low for Australia to achieve significant reductions in carbon emissions or to establish a significant manufacturing or export industry in renewable energy technologies.

The level of energy sourced from renewable energy needs to be raised substantially to see real reductions in carbon emissions by the energy industry. The current regime suggests that the government is merely 'going through the motions' of trying to reduce greenhouse gases.

### *Energy Grants (Cleaner Fuels) Scheme Act 2004 (Cth)*

In 2004 the Australian government implemented the *Energy Grants (Cleaner Fuels) Scheme Act 2004 (Cth)* (EGCS Act) with the object of establishing a scheme for the provision of grants to encourage the manufacture and import of environmentally friendly fuels.<sup>84</sup> This Act is part of the government's long term strategy on reducing emissions.<sup>85</sup> The Act uses an incentive-/ market-based system to encourage an increase in the use of fuels that emit lower amounts of environmentally detrimental gases. The EGCS Act effectively exempts manufactures or importers of cleaner fuels such as bio diesel, ethanol, LNG, LPG or methanol from customs or excise duty.<sup>86</sup>

### *Operation of the Act*

To apply for a rebate of excise duty suppliers must first register with the Australian Taxation Office (ATO).<sup>87</sup> Secondly the claimant must make a self assessment of whether they are eligible for the rebate. The self-assessment of a claimant's eligibility is made in accordance with the rules of the Scheme and claiming process under the Act.<sup>88</sup> The rules of eligibility are contained in ss 5-7 of the act and work to define what a clean fuel is, who may apply for the grant (manufactures, importers, consumers or sellers<sup>89</sup>) and in which circumstances a grant will not be available (where the fuel is sold after the 'qualifying time' has expired or where the fuel is included in a blend).<sup>90</sup>

Claims may be submitted at any time within three years of fuel purchase, as long as the claimant has purchased the fuel, and used it (or intends to use it) in an activity defined as eligible under the Act.<sup>91</sup>

During 2003–2004, there were approximately 24 000 registrations for grants and the ATO received almost 450 000 claims.<sup>92</sup> Further by the end of June 2004, there were almost 194 000 claimants for grants, 91 per cent of which were micro entities.<sup>93</sup> The agriculture and road transport industries account for the most claimants, over 60 per cent and 36 per cent respectively.<sup>94</sup> Given the uptake of this initiative the act has been a positive step by the government towards the adoption of cleaner fuels and in turn the reduction in emissions. However, looking on at the success of the scheme in the overarching light of greenhouse gas emissions under *Kyoto*, the act does not have the potential to make any significant impact on Australia's total emissions.

### *The Ozone Protection and Synthetic Greenhouse Gas Management Act 1989 (Cth)*

The *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989 (Cth)* (OPGM Act) was introduced in 1989 as a response to the growing world focus on climate change and ozone depleting gases. The objectives of the Act were to achieve Australia's obligations under the Vienna Convention and the Montreal Protocol.<sup>95</sup> The Act asserted a firm commitment by Australia to do its part to slow global warming, as illustrated in the objective which commits Australia to achieving "a faster and greater reduction in the levels of production and use of ozone depleting substances" than is required by the two conventions.<sup>96</sup> The commitment is further affirmed by the inclusion of both the Vienna Convention and the Montreal Protocol in schedules 2 and 3 of the Act.

When the treaties are used in combination, the Vienna Convention and the Montreal Protocol operate in a similar fashion to the *Kyoto Protocol*. Both the Vienna/Montreal combination and *Kyoto* impose definite gas emission targets on member states. The key difference is Vienna and Montreal target the hydrobromofluorocarbons (HBFC) and hydrochlorofluorocarbons (HCFC)<sup>97</sup> and *Kyoto* targets Carbon Dioxide ("carbon").

The Act was amended in 2004 to allow for the development of uniform Australia-wide regulations.<sup>98</sup> Such regulations are to control both the import and the end use of synthetic greenhouse gases and ozone depleting substances. The government claims that the changes will reduce Australia's greenhouse gas emissions by the equivalent of nearly six million tonnes of carbon dioxide, putting Australia within striking distance of its *Kyoto* target.

In implementing Vienna and Montreal in the OPGM Act has used a traditional regulatory system which licenses, the manufacture, import, export, distribution and use of products that contain ozone depleting substances. This can be contrast to the *Renewable Energy Act* which uses a market-based system and was implemented in accordance with *Kyoto* principles.

The reason behind the different legislative mechanisms lies in the differences between the regulated gases. HBFC's and HCFC's, although extremely detrimental to the ozone layer, make up less than 2% of the worlds greenhouse emissions.<sup>99</sup> Carbon on the other hand makes up over 82% of greenhouse emissions.<sup>100</sup> Further, carbon is the emission produced by electricity generation and transportation, the industries that countries and economies are most dependant on.<sup>101</sup>

Given the minimal scale of emissions from HBFC's and HCFC's it is easy to see why the implementation of a world wide regulatory framework on the emission was easier to implement than reductions in carbon emissions. Further, whilst the act achieves its objectives of phasing out HBFC's and HCFC's it really does nothing to help the onset of global warming, the key objective of *Kyoto*.

### ***Environment Protection and Biodiversity Conservation Act 1999 (Cth)***

In 1999 the *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act) was introduced by the Commonwealth. The overall objective of the act was to provide for the protection of the environment, however, coupled with this objective were Australia's environmental obligations to the international community.<sup>102</sup> These obligations, which include obligations under *Kyoto* have been intertwined throughout the Act.

The provisions relating to *Kyoto* under the act is another legislative mechanism implemented to lessen carbon emissions. Unlike the other acts considered in this paper the EPBC attacks carbon emissions at the proposal stage from the angle of environmental impact. Rather than directly or indirectly limiting carbon levels through regulation the EPBC looks at proposed projects, which are defined as "actions", in light of their ecological sustainability. These "actions" must be developed through the conservation and ecologically sustainable use of natural resources.

The EPBC Act provisions are "triggered" when "actions" of "significant impact" are proposed matters of national environmental significance. This process of "triggering" is designed to ensure actions that are likely to have significant impacts on the environment are properly assessed in light of their environmental impacts rather than their economic benefits.<sup>103</sup> If an action triggers the significant impact criteria, they are required to provide an environmental impact statement the Commonwealth Environment Minister. The final approval of the action then rests in the hands of the Environment Minister rather than the relevant Resources Minister.<sup>104</sup>

The EPBC Act and its accompanying regulations do not define 'significant impact' criteria for identifying whether the impacts of a particular action are likely to be 'significant'. Rather the criteria have been set out in administrative guidelines.<sup>105</sup> The administrative guidelines set out that each action will be decided on the nature and magnitude of potential impacts and whether that action will have a significant impact on a matter of national environmental significance.<sup>106</sup>

The guidelines consider matters such as:

- all on-site and off-site impacts,
- all direct and indirect impacts,
- the frequency and duration of the action,
- the total impact which can be attributed to that action over the entire geographic area affected, and over time,
- the sensitivity of the receiving environment, and
- the degree of confidence with which the impacts of the action are known and understood.

In deciding whether an action is likely to have a significant impact on a matter of national environmental significance the Act provides that the Environmental Minister must take account of the precautionary principle. This means that the fact that a lack of scientific certainty about the potential impacts of an action will not be enough to justify a decision that the action is not likely to have a significant impact.<sup>107</sup>

It was initially expected that actions with a proposed emission over the threshold level of 0.5 million tonnes of carbon dioxide or its equivalent in any 12 month period would trigger the assessment approval process under the Act.<sup>108</sup> However, to date no such trigger has been implemented by the government in legislation or regulation<sup>109</sup>.

Whilst this legislative proposal requiring large emitters of greenhouse gases to acquire environmental impact statements is a logical and innovative approach to addressing the issue of carbon emissions, it is yet to be implemented by the Commonwealth Government. The minister may still seek impact statements for actions of significant environmental impact but there is no automatic trigger ensuring that the environmental consequences of an action are examined. This significantly reduces the use and effectiveness of the act in addressing Australia's obligation to reduce carbon emissions because the environmental benefits under the act are at the discretion of the Environment Minister rather than a mandatory measure.

### Legislative Efforts to Increase Carbon Sequestration

As previously discussed, Article 3.3 of the *Kyoto Protocol* allows for the use of carbon sequestration to offset greenhouse gas emissions. Also previously discussed, carbon sequestration is the process whereby carbon dioxide ("carbon") is taken up by plants and converted into biomass through photosynthesis. Projects to establish vegetation are referred to as carbon sinks as they act to remove carbon from the atmosphere.<sup>110</sup>

Also, previous discussed Articles 3.10 and 3.12 of *Kyoto* allows for the trading of Carbon Sequestration Rights.<sup>111</sup> A Carbon Sequestration Right (CSR) is used to describe a legal relationship between property, the vegetation on it, the carbon that is held in the vegetation and the owner of the property. Once this relationship is established CSRs may be used to offset carbon emission limitations imposed on the owner of the CSR.<sup>112</sup> Further, if an owner of CSRs has an excess of carbon sequestration credits they may trade their CSR to another party who has exceeded their authorized carbon emission limitation. This is known as a 'carbon trading' and has been seen as a revolutionary market based form of regulation of greenhouse gases.<sup>113</sup>

### Australia's Implementation of Carbon Emissions Trading

Although the Australian Greenhouse Office has canvassed a number of ideas regarding carbon trading Australia does not currently have a national market or system for the trading of carbon credits.<sup>114</sup> Despite this, New South Wales, South Australia, Western Australia, and Tasmania have all enacted legislation to recognize the ownership of carbon sequestered in sinks.<sup>115</sup> Further, all the States allow for Carbon Sequestration Rights (CSRs) to be registered on land title. This legislation is in accordance with Article 10(a) of *Kyoto* which requires signatories to formulate national and regional programmes to improve local emission factors.<sup>116</sup> *Prima facie*, Commonwealth regulation of this area is not possible due to a lack of Constitutional power to make legislation over property personal or real. However, there are ways around the constitutional power problem, using other heads of power, for example Australia's external affairs power.<sup>117</sup>

Registration means that CSRs become part of the 'bundle of rights'<sup>118</sup> attached to land making the CSRs 'run with the land' and binding future owners<sup>119</sup>. This provides legal protection of vegetation on the land even when the land is sold.

### State Carbon Trading Legislation

#### Victoria

Amendments to the *Forestry Rights Act 1996* (Vic) in 2001 provide for rights to the commercial exploitation of carbon sequestered by trees.<sup>120</sup> Under the Act an owner of land may enter into a Forest Property Agreement with another party (eg an investor) and grant to that person a forest property rights. These rights include the right to plant, maintain and

harvest “forest property” on the land.<sup>121</sup> “Forest property” includes carbon sequestered by trees.<sup>122</sup> This allows a property owner to grant a person a CSR and vest ownership of that “forest property” in the person.

Section 12 of the *Forestry Rights Act* also makes separate specific provisions for the creation of a Carbon Rights Agreement. Under such an agreement a property owner may divest their ownership of carbon sequestered by their trees to a third party separate to the trees on the land or the land itself. This agreement may be registered on the land title and gives the owner indefeasible title against unregistered interests and an enforceable right against future owners.

### ***New South Wales***

The New South Wales government has dealt with the creation and ownership of CSRs through the 1998 carbon rights amendments to the *Conveyancing Act 1919*. The key objective of the act is to recognise rights associated with carbon sequestered from the atmosphere by forests as “forestry rights” that may be the subject of certain forestry covenants.<sup>123</sup> “Forestry rights” under the Act are defined to mean a right conferred on a person, in relation to land, to the legal, commercial or other benefit of carbon sequestration.<sup>124</sup> Forestry rights may be treated as a profit a prendre<sup>125</sup> (a right to take something off another’s land). As a profit a prendre, the CSR will ‘run with the land’ and survive against the new owner.

Section 87A of the *Conveyancing Act* also provides for the creation of a “forestry covenant”, defined as a “covenant that is incidental to a forestry right”. The definition is another mechanism under which parties may create CSRs. Attached to the definition of a “forestry covenant” are a number of rights. These include:

- a) a right of access to or maintenance of trees or forests on land that is the subject of a CSR and;
- b) a condition that the ownership of any tree or trees on land that are the subject of a forestry right are to be vested in the person who owns the forestry right. This provision basically means that if a person owns the forestry right on land they own the trees on the land.

Like the early provisions, a forestry covenant will also run with the land and bind future owners.

### ***South Australia***

The South Australian government enacted the *Forest Property Act 2000* to cater specifically for the separation of land ownership rights from property ownership rights.<sup>126</sup> The Act provides that the rights to the carbon absorption properties and commercial exploitation of those properties rest with the owner of the forest. The provisions in the legislation are similar to the Victoria’s provisions and allow a land owner to enter into a “Forest Property Agreement”. Entrance into such an agreement confers a right to carbon sequestration independent of the rights of ownership of the land owner.<sup>127</sup>

Similar to provisions in other States, the South Australian legislation allows for a Forest Property Agreement to be registered on a property’s land title.<sup>128</sup> Once registered, an agreement can be enforced against future owners, preventing removal of carbon stores.<sup>129</sup>

### ***Queensland***

To deal with carbon rights the Queensland Government enacted the *Forestry and Land Title Act Amendment 2001 (Qld)*. This Act amends the *Forestry Act 1959 (Qld)*. Under Part 6B of the Act a land owner may enter an agreement with a person about a “Natural Resource Product” on the land.<sup>130</sup> A “Natural Resource Product” is defined to include all parts of a tree or vegetation, or carbon sequestration by a tree or vegetation.

Under the provisions an agreement relating to a Natural Resource Product may vest all or part of the Natural Resource Product in a person. Further, the land owner may also grant the person the right to enter the land to establish, maintain or harvest the natural resource product or carry out works or activities for the natural resource product.<sup>131</sup> Similar to the



New South Wales and South Australian frameworks, a person's rights under a Natural Resource Product agreement is classified as being a profit a prendre. Therefore, these rights can be registered on the land title and 'run with the land' binding future land owners.<sup>132</sup>

### Tasmania

In Tasmania the *Forestry Rights Registration Act 1990* provides for the registration of forestry rights on the title of land. The Act makes "forestry rights" a profit a prendre as in other States.<sup>133</sup> The Act also provides for the complete separation of carbon sequestering rights from the land and the trees contained on it.<sup>134</sup> Similar to the New South Wales provisions the Tasmanian Act makes covenants binding on all future owners and assignees of the land.

Under Article 3.3 of the *Kyoto Protocol*, net changes in greenhouse gas emissions may be reduced by the sequestration of carbon. However, achieving a long term verifiable system of atmospheric carbon is a challenging undertaking.<sup>135</sup> The complexity of the global carbon cycle and the potential for incentives for carbon sequestration to be used in a perverse manner disrupting delicate biodiversity make regulation and trade of carbon rights very difficult. Further, it has been argued that by catering for allowing the trade of carbon rights the focus has been taken off reducing carbon emissions.<sup>136</sup>

As a whole the legislative mechanisms implemented by Australian States create a clearly defined "carbon right". Whilst this allows for carbon sequestration rights to be bought and sold there is no apparent moving for anyone to sell, buy or trade in such rights. In order to stimulate such trade a second layer of legislation is required. This legislation, whether it be traditional regulatory or market based must create a reason for wanting to acquire sequestration rights. Without such a reason the creation of carbon rights is redundant because there is no need to acquire them.<sup>137</sup> Initially, Australian state governments had hoped to overcome the problem of needing to purchase carbon rights by selling the rights to overseas emitters subject to emission regulations.<sup>138</sup> However, as Australia has not signed the *Kyoto* agreement they have effectively been locked out of the global carbon trading market.<sup>139</sup>

Looking to other jurisdictions examples of the second layer of legislative mechanisms can be seen. Under the *Clean Air Act* in the United States new sources of air pollution that have not reached their national air quality standards are required to arrange offsets.<sup>140</sup> These offsets include the holding of carbon rights. Further, if the pollution problem is severe, the new source must arrange an offset greater than the expected emissions. Where the pollution is more moderate the ratio of emission to offset imposed is closer to one-to-one.<sup>141</sup>

The Australian government has no plans to implement a similar mandatory domestic emissions trading scheme.<sup>142</sup> The reluctance to implement such a taxation scheme is due to the adverse impact that it would have on the Australian economy. A recent economic forecast on the implementation of a carbon taxation scheme designed to reduce carbon emissions by 5% showed significant economic impacts.<sup>143</sup> Based on a permit price of \$15 per tonne of carbon the study forecast a reduction in real GDP of 0.24% and real GNP by 0.25. Further, it predicted an increase of unemployment by .33% or around 35,000 jobs.

### Conclusion

Although the Australian Greenhouse Office has canvassed a number of ideas regarding carbon trading in 2000 there is still no market in place for the trading of carbon.<sup>144</sup> Further, there is an apparent absence of any stimulus for the purchase of carbon rights on the horizon. This is due to the adverse economic impact of carbon taxation.<sup>145</sup>

Clearly, the operationalization of carbon rights trading by a market requires a motivation, whether it is political, legislative or market based. Overwhelming, the mechanics of the current system of owning and trading carbon rights is flawed and incapable of being an effective means of reducing Australian carbon emissions to *Kyoto* targets.

This paper concludes that given the present legislative mechanisms Australia will not meet its 2012 *Kyoto* target. Throughout this paper it can be seen that the government has implemented a number of legislative mechanisms to significantly reduce carbon emissions in Australia but have stopped short of activating them. Further, the active legislative

mechanisms examined have been shown to fall well short of capable of achieving Australia's obligations under *Kyoto*.

Further, the "legitimate expectation"<sup>146</sup> created by the government that "Australia leads the way in tackling greenhouse gas emissions"<sup>147</sup> is misleading the Australian people and the international community. None of the Acts examined in this paper are revolutionary, innovative or even capable of making any substantial change to Australia's greenhouse emissions. Overwhelmingly, it appears that the Commonwealth Government is merely 'going through the motions' of legislating to reduce greenhouse emissions. Adding insult to injury is the fact that Australia was given the most generous *Kyoto* greenhouse emission quota of any industrialized country both through the "Australia clause" and the 108% quota. In contrast countries like Germany, Denmark and the United Kingdom had reached their 2012 *Kyoto* emissions targets by the year 2000.<sup>148</sup>

Given its popularity in recent times, for strong economic management,<sup>149</sup> it appears that the Howard Government is content to put Australia's economic priorities before its national and international environmental obligations. This is an unfortunate outlook as climate change is a global problem that requires the participation of all nations. Further, the failure to implement substantial mechanisms to stabilize emissions undermines the substantial environmental progress made by other developed nations.

Michael Raine

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