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On the Road to Greenhouse Gas Emissions Trading

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SUMMARY

In the lead-up to the sixth Conference of the Parties, countries potentially affected by the 1997 Kyoto Protocol to the 1992 United Nations Framework Convention on Climate Change are actively negotiating the rules and conditions for trading in greenhouse gas emissions. Integral to this discussion is a determination of the legal nature of the emission trading instruments.

*The Australian Greenhouse Office views the two forms of emissions trading instruments, carbon credits and emission permits, as identical for the purposes of trading. However, review of the common law and existing emission trading programmes suggests that the legal status of such instruments is very different. Carbon credits, which may be seen as a *profit à prendre*, may constitute a form of property, whereas emission permits, as a mere licence, may not involve such an interest.*

The legal nature of the emissions trading instruments will affect their transferability, severability, security, and ultimately their value.

INTRODUCTION

The Intergovernmental Panel on Climate Change recently issued its draft third report on the predicted effect of greenhouse gas emissions. The report is a sobering read.¹ In the lead-up to the sixth Conference of the Parties to the 1997 Kyoto Protocol (the Protocol) intense negotiations are underway to grapple with this challenge.²

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¹ Copies of the draft report may be requested from the Australian Greenhouse Office. See, www.greenhouse.gov.au/international/ipcc/.

² The sixth Conference of the Parties will be held in the Hague, Netherlands, from 13 to 24 November 2000.

The rules for emissions trading are a major issue in the negotiations. As the Protocol requires 39 countries limit their emission of greenhouse gases,³ and as greenhouse gases are produced in almost every human endeavour, emissions trading is seen as offering a more economical means of achieving greenhouse reductions than direct government intervention.⁴

The Protocol provides for emissions trading amongst countries listed in Annex 1 to the 1992 United Nations Framework Convention on Climate Change (the Convention) (known as Joint Implementation), amongst countries listed in Annex B to the Protocol (known simply as emissions trading) and between developed and developing countries (known as the Clean Development Mechanism). Whilst countries continue to negotiate the trading rules, actual trading has already begun and there is an urgent need to understand the legal nature of the instruments being traded.⁵

Emissions trading instruments have been variously described as a contractual promise, a chose in action, a licence and a profit à prendre.⁶ At this stage, it is unclear whether they will constitute a form of property, a mere government backed permission or some combination thereof. This is an important question, for as the Australian Greenhouse Office has pointed out:

“The property status of permits is often raised as an issue for the design of an emissions trading system ... Intuitively, if permits are to be tradeable then rights of permit ownership need to be established so that they can be transferred from one party to another as a result of transactions with the marketplace.”⁷

Greenhouse Gas Emissions

Our starting point lies in understanding the physical processes giving rise to emission trading instruments.

³ Greenhouse gases include carbon dioxide, methane, nitrous oxides, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride.

⁴ Tim Treadgold argues that companies may move their operations from countries faced with greenhouse gas emission limits to countries without such limits. He calls this “carbon leakage”. See, T Treadgold, “Environment: Industries threaten to flee a costly carbon-tax regime”, *Business Review Weekly*, vol 21, no 37, 24 September 1999.

⁵ For example, Tokyo Electric Power Company recently signed a carbon credit deal with State Forests of New South Wales potentially worth up to \$130 million. See, “Japan power firm pays to plant Australian trees”, *Environment News*, 17 February 2000, www.planetark.com.au/dailynewsstory.

⁶ See, for example, J Taberner, “Climate Change and the Kyoto Protocol: Practical Domestic Legal Issues” in [1998] *AMPLA Yearbook* at 490 and, s 88AB of the New South Wales *Conveyancing Act 1919*.

⁷ Australian Greenhouse Office, “National emissions trading: designing the market: Discussion paper 4” at 29. See also the Interim Report of the Standing Committee on Environment, Recreation and the Arts, “Inquiry into the regulatory arrangements for trading in greenhouse gas emissions”, 17 August 1998, which states that in respect of the legal nature of

Greenhouse gases are emitted at virtually every stage of a production process in all sectors of the economy.⁸ This is a direct result of relying on the development and use of carbon compounds such as oil and gas, wood, and coal. Short of a complete switch from using these compounds, greenhouse gas emissions will continue.

Traditionally, the principal greenhouse gas, carbon dioxide (CO₂) has been emitted into the atmosphere almost without thought. Few regulatory requirements restrict its emission, and rarely because of its greenhouse effect. Until the discovery of the greenhouse problem, CO₂ was generally regarded as a virtually harmless gas completely assimilated in the atmosphere.

Upon the domestic imposition of the Kyoto Protocol limits, companies operating facilities that emit greenhouse gases (such as powerplants, aluminium refineries, and gas refineries) will suddenly find their operations becoming significantly more expensive.⁹ In order to continue operations, an emitter will have to either:

- restrict operations;
- invest in technology to reduce greenhouse gas emissions;
- invest in technology to sequester greenhouse gas emissions;
- obtain emission allowances from emitters who have already invested in greenhouse gas reduction technology or are planning to curtail or shut down their operations and are willing to sell such allowances;
- buy emission permits from companies who have discovered an emission reduction offset and are willing to on sell those rights; or
- buy carbon credits generated from sequestration efforts.

Current estimates put the price of an emission trading instrument at anywhere from US\$5 to US\$100 per tonne of carbon.¹⁰

emissions permits, "The Commonwealth Government also commented that its experience in other trading schemes, such as those for fisheries, water quotas, and salinity, had demonstrated the need for clearly defined permits" (p 8).

⁸ In Australia, greenhouse emissions principally arise in the agricultural, transportation, industrial, stationary energy and land clearing sectors. Commonwealth of Australia, "The National Greenhouse Strategy", 1998 at 98. The report notes that while Australia produces only approximately 1.4% of the world's emissions, on a per capita basis, Australia ranks third amongst industrialised countries in emissions.

⁹ As Australia's Protocol limit is an average annual emission level between 2008-2012 of 108% of 1990 emission levels and as Australia's emissions in 1998 were already 19% above 1990 levels, it is assumed that domestic imposition of Kyoto limits will result in emission reductions. See, L Taylor, "Cabinet burning midnight oil over gas", *Australian Financial Review*, 26 May 2000 at 23.

¹⁰ N Hordern, "Carbon costs are the unknown factor in the gas emissions debate", *Australian Financial Review*, 26 May 2000 at 22.

The Greenhouse Gas Emission Reduction Trading Pilot

The Canadian Greenhouse Gas Emission Reduction Trading Pilot programme, begun in 1998, illustrates the above responses.¹¹

On 23 March 2000, British Columbia Hydro announced it would purchase up to 33,400 tonnes of greenhouse gas emission reductions from Norseman Engineering Ltd. Norseman collects a portion of the methane gas generated from a landfill in Surrey, British Columbia. Norseman delivers the gas to a wallboard plant owned by Georgia Pacific Ltd. With the installation of larger burners in the wallboard plant, paid for by Norseman, a greater amount of methane will be captured from the landfill and burnt in the plant rather than being emitted into the atmosphere. This decreased emission of methane constitutes the emission reduction sold to British Columbia Hydro.

In another example, Ontario Hydro was matched with CHI Canada Inc to buy 840,000 tonnes of greenhouse gas emission reductions. CHI Canada had built and installed a 15 megawatt hydroelectric facility. The facility replaced an oil-fired powerplant. With the reduction in use of the oil-fired plant, substantial greenhouse emissions were avoided, thereby creating the emission reductions.

In a third example, the Saskatchewan Power Company bought 22,000,000 tonnes of carbon credits from the Saskatchewan Department of Environment and Resource Management. These credits were generated by the Department planting five million white spruce seedlings, and setting aside 178,000 hectares of forest which would otherwise have been logged. Saskatchewan Power bought both the carbon that will be sequestered by the white spruce, and the carbon that would have been released if the forest was cut.

From the above it is clear that a range of actions may give rise to an "emission reduction". The issue is how that reduction is characterised in law.

The Emission Trading Instrument

Pursuant to Art 3.10 of the Protocol, the instrument to be traded between countries listed in Annex 1 to the Convention (Art 6, Joint Implementation), and the instrument to be traded between countries listed in Annex B to the Protocol (Art 17, Emissions Trading) is called an

¹¹ See, Memorandum of Understanding, October 13, 1993, Greenhouse Gas Emission Reduction Trading Pilot signed between BC Ministry of Environment, Lands and Parks, BC Ministry of Energy and Mines, Natural Resources Canada, Environment Canada, Alberta Department of Energy, Manitoba Energy and Mines, Saskatchewan Energy and Mines, and Nova Scotia Natural Resources. An outline of the programme may be found at <http://www.gert.org>.

“emission reduction unit”. The instrument to be traded between developed and developing countries under Art 12 (Clean Development Mechanism) of the Protocol is called a “certified emission reduction”. Neither of these terms is further defined in the Protocol.

Pursuant to Art 3.3 of the Protocol, countries may also use “verifiable changes in carbon stocks” resulting from “afforestation, reforestation and deforestation since 1990” to meet the Kyoto commitments. The definition of these various terms is still under debate, but essentially Art 3.3 allows countries to use carbon sequestration as a method for meeting the Kyoto obligations.

Together, Arts 3.3, 3.10 and 12 provide the international basis for tradeable emission instruments.

In analysing the Protocol, the Australian Greenhouse Office (AGO) has arrived at five possible sources for emission trading instruments:

1. assigned amount units – which would be issued by Australia’s Commonwealth government from its emission commitment under the Kyoto Protocol;
2. carbon credits – which would be issued by Australia’s Commonwealth government to owners of the rights to sequestered carbon subject to verification and auditing standards acceptable to the government;
3. assigned amount units issued by another country from its Kyoto Protocol emission commitment, and acquired by entities operating in Australia through international emissions trading;
4. emission reduction units issued by Australia, or another country, from its Kyoto Protocol emission commitment or from sequestration projects, and acquired by entities operating in Australia through Joint Implementation (JI) projects; and
5. certified emissions reductions issued under the auspices of the Clean Development Mechanism (CDM), reflecting sequestration or emission reduction projects in various non-Annex B countries.”

The AGO has stated:

“While an instrument could be issued outside Australia as an assigned amount unit, an emission reduction unit through JI or a certified emission reduction through CDM, it is proposed that once it entered the Australian system it would be treated as an emission permit – as this would minimise the costs of trading. Thus, there would not be different instruments circulating in the Australian emission trading system – there would be one instrument, the emission permit, which would have originated from one of five possible sources.”¹²

¹² Op cit n 7, AGO at 43.

The AGO proposes that for every tonne of greenhouse gas emitted, a permit would provide a "one-off authority to emit". In other words, for every tonne of greenhouse gas emitted, one permit would have to be acquitted to the Commonwealth Government.¹³

The AGO defines an "emission" as, "the release of [greenhouse] gases from industrial processes and vehicles as well as by living organisms".¹⁴

It defines "permits" as, "a licence or equivalent control document issued by government authorising the permit holder to emit a defined quantity of greenhouse gas".¹⁵ This is similar in nature to licences and permits currently issued by governments for other types of air emissions.

The AGO defines carbon credits as an instrument that would, "authorise the emissions of a specified mass of CO₂ equivalent gas over a specified time," and goes on to state: "In this respect they [carbon credits] are identical to emission permits."¹⁶

It is clear that the AGO is of the view that a single emission trading instrument will encompass both carbon credits and emission reduction units. As carbon credits would arise from the "Kyoto forests" located within Australia, they would be additional to the permits issued out of Australia's assigned amount under the Kyoto Protocol (108 percent of 1990 emissions).¹⁷

Deeming all emission trading instruments to be emission permits regardless of their source (domestic or international), nature (Joint Implementation or Clean Development Mechanism projects), or type (carbon credits or certified and uncertified emission reduction units), makes emissions trading appear simple. Buyers and sellers merely trade a tonne of emission reduction whatever its source. However, whilst deeming all emission trading instruments to be identical may be convenient, it is not clear that given their varied sources, natures and types the instruments are identical in law. Aside from the different sources and the varied nature of the instruments, there may be a fundamental legal difference between emission trading instruments backed by carbon credits and instruments backed by emission reduction units (certified or uncertified).¹⁸

¹³ Ibid at 43, 51 and 52.

¹⁴ Ibid at 51.

¹⁵ Ibid at 52.

¹⁶ Australian Greenhouse Office, "National emissions trading: crediting the carbon: Discussion paper 3" at 52.

¹⁷ Op cit n 7, AGO at 44.

¹⁸ Debate continues over the rules in regard to the recognition of emission reductions in

Carbon Credits

Carbon credits result from the process of gathering carbon dioxide from the atmosphere and sequestering the gas for a period of time in a carbon “sink”. A sink may take various forms including plants (such as trees), underground rock formations, or coral reefs. Article 3.3 of the Kyoto Protocol contemplates trees as the primary sink mechanism.

Some Australian State governments, eager to encourage the planting of trees, have been quick to capitalise on Art 3.3. In 1998, New South Wales enacted legislation to create a carbon sequestration right pursuant to which a person could hold the right separately from either the right to the trees (a general forestry right) or the ownership of the land upon which the trees were located. The legislation provided that the carbon sequestration right could itself be registered on title. This legislatively created right is deemed to carry the same attributes as a common law property right.¹⁹

Under the New South Wales legislation a carbon sequestration right is defined as,

“a right conferred on a person by agreement or otherwise to the legal, commercial or other benefit (whether present or future) of carbon sequestration by any existing or future tree or forest on the land after 1990”.²⁰

This right is deemed to be a forest right, which in turn is deemed to be a profit à prendre.²¹ The profit which is *taken* from the land is the “legal, commercial or other benefit (whether present or future) of carbon sequestration by any existing or future tree or forest on the land that is the subject of the carbon sequestration right”.²²

This rather complex method of separating the carbon right from the forestry right, and at the same time deeming the carbon right to be an incorporeal property right, has resulted in New South Wales enticing companies to “buy” carbon credits and thereby pay for the planting of trees in that State.²³

Similarly, the West Australian State Government considers carbon sequestration rights as a profit à prendre under its *Conservation and Land Management Act 1984* (WA). Section 34B(4) states that the right

various countries. For a discussion of international compliance issues, see Malleons Stephen Jaques' submission to the Department of Foreign Affairs and Trade, “Compliance Mechanisms under the Kyoto Protocol”, May 2000.

¹⁹ See the *Carbon Rights Legislation Amendment Act 1998* (NSW) which amended the *Conveyancing Act 1919* (NSW) and the *Forestry Act 1916* (NSW).

²⁰ Section 87A of the *Conveyancing Act 1919* (NSW).

²¹ *Ibid* s 88AB(1).

²² *Ibid* s 88AB(2).

²³ *Op cit* n 5.

to establish, maintain and harvest, or maintain and harvest, or harvest a crop of trees (which is further defined to include forest produce from the crop) is a profit à prendre. Forest produce includes trees and “parts of trees” which the Government considers includes carbon. Section 34B(4) goes on to state that the right “has all the attributes of a profit à prendre including, but not limited to, assignability”.

Other States are not far behind. Queensland, South Australia and Victoria are all exploring legislative schemes to enshrine carbon sequestration. Victoria is examining its existing *Forestry Rights Act 1996* (Vic) to determine if it already provides such rights.²⁴

Under law, a profit à prendre is the right to take produce from another’s land.²⁵ For a right to become a profit, the subject matter of the profit must be part of the land itself. For example, the right to remove sand from land is a profit, but the right to collect sand and objects blown onto the land is not.²⁶ The right to take animals which are on land at any one time is capable of being a profit,²⁷ but the right to take air, water and light is not capable of forming the subject matter of a profit. As wandering things, air, water and light are necessarily common and incapable of ownership.²⁸

In *Australian Softwood Forests Pty Ltd v Attorney General (NSW)*,²⁹ the High Court discussed whether an obligation under a contract to care for and cut trees was capable of being a profit à prendre. Mason J noted that

“all the instances given in text books and legal dictionaries of profit à prendre are of ‘rights’ to take something. There are no cases where an obligation to take something off another person’s land has been considered to be a profit à prendre”.³⁰

However, he determined that “this does not negate the possibility that a grower’s rights amount to an interest in the nature of a profit à prendre”.³¹

²⁴ Section 5 of the *Forestry Rights Act 1996* (Vic) provides that an owner of land may enter into an agreement with a person to “(a) grant to that person a right to (i) plant, maintain and harvest forest property on that land; or (ii) maintain and harvest forest property on that land or derived from forest property planted on that land; and (b) to vest the ownership of the forest property in that person...” Forest property includes all parts of trees and the products of trees whether or not those products have become separated from those trees prior to harvesting. Whilst these provisions are obviously aimed at the planting and harvesting of forest plantations, the question is whether they may extend to provide carbon sequestration rights. Unlike Western Australia or New South Wales, a Victorian forest property right is deemed not to be an interest in land (s 11).

²⁵ Mason J in *Australian Softwood Forests Pty Ltd v Attorney-General (NSW)* (1981) 36 ALR 257 at 263 stated: “A profit à prendre is generally described as a right to take something off another person’s land ... or to take something out of the soil, including [a] portion of the soil itself.”

²⁶ *Blewett v Tregonning* (1835) 111 ER 524.

²⁷ *Peech v Best* [1931] 1 KGB 1.

²⁸ *Race v Ward* (1855) 119 ER 259; *Manning v Wasdale* (1836) 111 ER 1353.

²⁹ (1981) 36 ALR 257.

³⁰ At 264-265.

³¹ *Ibid.*

For the purpose of classifying a sequestration right as a profit à prendre, it is arguable that the carbon, forming part of the tree, forms the subject matter of the land. As it is attached and not wandering, it is properly the subject of a profit.

This classification is not without problems. As Mason J noted, a traditional profit à prendre is the right to take something away from the land. This would not seem to extend to the right to place something upon the land. Nor does it traditionally encompass the right to ensure something remains on the land. Carbon sequestration, on the other hand, is a process of sequestering carbon on the land, or at the very least, stopping carbon from leaving the land. In effect, the right to plant trees, or to stop the harvest of trees.

However, as noted, the New South Wales legislation avoids this problem by deeming the right to sequester carbon a right to the benefit of the sequestering. It is that benefit which is being “taken” from the land. The benefit may extend to one tree or to the plantation depending on the agreement between the parties.

In addition, the West Australian Government argues that sequestered carbon is a forest product, a “part of” a tree, and thereby deems it a profit à prendre. As forest produce, sequestered carbon may be assigned like any other property.

At the moment, the legal characterisation of a carbon credit in Australia, while still uncertain in the absence of a court decision on point, appears to tilt in favour of a profit à prendre. New South Wales and Western Australia both consider carbon credits to be property rights. The High Court appears prepared to entertain extending the ambit of the notion of a profit à prendre in appropriate circumstances. As pointed out by Young J in *Ellison v Vukicevic*³² the profit à prendre concept is a flexible one and the courts must continually adapt to new technologies and concepts. This all suggests that carbon credits may be seen as a property right when and if they come before the courts.

Emission Permits

The AGO states that an emission permit is a “licence or equivalent control document issued by government and authorising a permit holder to emit a defined quantity of greenhouse gas”.³³ This is consistent with the regulatory approach that has been used by Australian States for the past 30 years in controlling air emissions. An emitter is not allowed to emit otherwise than pursuant to an authorisation. To emit without authorisation is to pollute.

³² (1986) 7 NSWLR at 104.

³³ Op cit n 7, AGO at 52.

Under the Protocol, Annex B countries will issue permits allowing greenhouse gas emissions up to the level of their Kyoto obligations. Companies and individuals wishing to emit greenhouse gases will require government authorisation and will only be allowed to emit to the limits provided in that authorisation. As noted earlier, an emitter will have to acquit one permit to the Commonwealth Government for each tonne of greenhouse gas to be emitted.³⁴ The question becomes, as an authorisation, does the instrument include property rights?

This question was addressed in the United States Environmental Protection Agency's sulphur dioxide programme.

The Acid Rain Programme

In 1992, the United States Environmental Protection Agency (EPA) instituted the Acid Rain Programme to deal with emissions of sulphur dioxide and nitrogen oxides. Pursuant to Title IV of the *Clean Air Act*, the programme aimed to reduce annual sulphur dioxide emissions by 10 million tons below 1980 levels.³⁵

The programme began in 1995 with application to 445 coal burning units at over 100 electric utility plants across the Eastern and mid-Western states. In the first year of the programme, sulphur dioxide emissions were reduced by almost 40 percent below target levels. Beginning in 2000, Phase II will involve 2000 coal burning units.

The programme introduced an allowance trading system. Each allowance provides for the emission of one ton of sulphur dioxide per year. Allowances were allocated on the basis of a plant's historic fuel consumption and specific emissions rates. In Phase I, the total number of allowances allocated to any one plant was calculated at 2.5 pounds of sulphur dioxide emission per million British thermal unit multiplied by the plant's average thermal unit generation from 1985 to 1987. In phase II, the allowance will be calculated at 1.2 pounds of sulphur dioxide per million British thermal unit.

The allowances may be bought, sold or banked. Thus, an upgraded facility with excess allowances may sell those allowances to an emitter that can't meet its allocation. As no new allowances are being issued, new plants must purchase allowances from the existing pool.

³⁴ There is ongoing debate over the method by which these permits will be allocated (auctioning or administrative allocation). The Australian Greenhouse Office, "National emissions trading: designing the market: Discussion paper 4" touches on this debate at 22 and 29; the AGO has also commissioned studies in this area, see, The Allen Consulting Group, "Allocation of Permits Under a National Emissions Trading System: Issue Paper", January 2000.

³⁵ Title IV, *Clean Air Act Amendments* 1990.

Any person may acquire allowances and participate in the trading system. Most trades occur directly between parties; however, once a year the EPA runs an auction in order to set a market price.

Companies report their emissions to the EPA annually and are responsible for the cost of installing monitoring systems. The EPA in turn reconciles the allowances a company has used. Each company is granted a 30-day grace period in which to purchase any extra emission allowances it requires. If a company emits more sulphur dioxide than allowed by the allowances it holds, it must pay a penalty of \$2,500 per ton of excess sulphur dioxide, and surrender one allowance for every allowance exceeded.

The market price of an allowance has averaged \$150 rather than the expected \$250-\$700.³⁶

In instituting the programme the guidelines make clear that the allowances are mere authorisations to emit and do not constitute property. Section 7651b(f) of *US Code Title 42* states:

“An allowance allocated under this subchapter is a limited authorisation to emit sulphur dioxide in accordance with the provision of this subchapter. Such allowance does not constitute a property right. Nothing in this subchapter or in any other provision of law shall be construed to limit the authority of the United States to terminate or limit such authorisation.”

While the allowances are available for trade, and therefore take on the appearance of property, there is no guarantee that the allowances won't be revoked by the government at any time. Such a revocation would be consistent with the general approach taken towards licences and other authorisations granted by governments.

Licences

Common law courts have generally held that licences provide no property rights and can be revoked at the will of the licensor. This was articulated in the private law context by the High Court in *Cowell v Rosehill Racecourse Co.*³⁷ In that case, a spectator at a horse race was ejected by the race course owners. The spectator argued that his entrance ticket gave him a property right and therefore the court could grant him specific performance forcing the owners to allow him back on the premises. The court held that the licence to enter did not provide a property right, and that the only remedy the spectator had available lay in breach of contract.

³⁶ B Swift, “Allowance Trading and Potential Hot Spots – Good News from the Acid Rain Program”, *Environment Reporter*, 12 May 2000 at 954.

³⁷ (1937) 56 CLR 605.

Dixon J stated the general principle that: "A licence which is not coupled with or granted in aid of an interest is revocable at law. It operates as a bare permission to do what would otherwise be an invasion of the licensor's rights."³⁸

In 1968 the High Court considered the proprietary nature of a taxi licence granted by the Transport Regulation Board of Victoria.³⁹ Barwick CJ examined the generally held view that a licence does not create any estate or interest in the property to which it relates, and compared the private law context to a grant from a public body. He stated that: "I do not find the description of the [private] licence ... appropriate to a statutory licence to which a fit and proper person has a right ..." He went on to say: "I do not think such a licence can be equated to the mere grant of a permission by a private person in respect of his own property." He therefore held that for the purposes of the *Judiciary Act 1903-1965* (Cth) a taxi licence was property.⁴⁰

More recently, the courts considered the propriety nature of a petroleum exploration permit granted to Western Mining Corporation Ltd (WMC). Subsequent to the grant of the permit, the Commonwealth passed legislation which effectively revoked the permit. The question was whether the Commonwealth had acquired property on other than just terms (s 51(xxxi) of the Constitution).

Both the Federal Court at first instance and the Full Federal Court on appeal held that acquisition on other than just terms had occurred. At first instance, Ryan J found that the exploration permit contained sufficient property-like characteristics that it should be considered to be a form of property. The permit could be transferred and dealt with for valuable consideration. The dealings were recorded in a register of titles. Furthermore, the permittee enjoyed a stable interest which was capable of constituting a valuable asset. He concluded: "It [the permit] is incorporeal but it is none the less property."⁴¹

On appeal, Black CJ took a similar position. He held that the rights attaching to the permit were clearly identifiable, they were assignable, they were stable, and they were potentially of very substantial value. The Full Federal Court dismissed the appeal.⁴²

In front of the High Court, the Commonwealth did not argue that the rights attaching to the permit were not property rights in a general sense, however it took the view that they were not property rights for the purposes of s 51(xxxi) of the Constitution. Brennan CJ, Gaudron,

³⁸ Ibid at 630.

³⁹ *Banks v Transport Regulation Board (Victoria)* (1968) 119 CLR 222.

⁴⁰ Ibid at 231-232.

⁴¹ *Western Mining Corporation Ltd v Commonwealth of Australia* (1994) 121 ALR 661 at 688.

⁴² *Commonwealth v Western Mining Corporation Ltd* (1996) 67 FCR 153 at 161-165.

McHugh and Gummow JJ found against WMC on the basis that there had been no actual acquisition of property by the Commonwealth.

In examining the matter, Brennan CJ held that the “rights of the permittee and of WMC, though created by statute, are properly to be regarded as proprietary in nature”.⁴³

However, McHugh J took a slightly different approach. He found:

“A property interest that is created by federal legislation, where no property interest previously existed, is necessarily of an inherently determinable character and is always liable to modification or extinguishment by a subsequent federal enactment.”⁴⁴

He also found, in approving an earlier High Court decision dealing with statutory entitlements (*Peeverill*),⁴⁵ that:

“*Peeverill* is a clear authority for the proposition that, where the Parliament has created a vested right of property under a head of power such as s 51(xxiiiA) of the Constitution, it retains the power to amend, revoke or extinguish that right.”⁴⁶

And finally:

“There is nothing to prevent the Commonwealth Parliament from creating a flexible scheme under which a statutory authority is established and given certain supervisory power within defined limits while at the same time the Parliament retains an overall capacity to alter or revoke rights granted under the legislation.”⁴⁷

Gummow J suggested that while the rights attaching to the permit may have been proprietary in nature, “... such property rights as were involved were not, given their nature, susceptible of such acquisition”.⁴⁸

It would therefore appear that if the permit attracted property rights, those rights would be of a limited character.

In *National Provincial Bank Ltd v Ainsworth*,⁴⁹ Lord Wilberforce provided a general test for determining if a right was a property right. He stated:

“Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption

⁴³ *Commonwealth v WMC Resources Ltd* (1998) 196 CLR 17.

⁴⁴ *Ibid* at 51.

⁴⁵ (1994) 179 CLR 226.

⁴⁶ *Commonwealth v WMC Resources Ltd* (1998) 196 CLR 55.

⁴⁷ *Ibid* at 57.

⁴⁸ *Ibid* at 69.

⁴⁹ [1965] AC 1175.

by third parties, and have some degree of permanence or stability.”⁵⁰

An emission permit will be definable insofar as it will allow only one tonne of greenhouse gas to be emitted per permit. Because it is definable, it will also be identifiable by a third party. It will clearly be capable of assumption by third parties – indeed this will be the reason for its existence. However, there is a serious question of whether an emission permit will have the degree of permanence or stability required of a true property right. If Australia follows the United States Acid Rain Programme model, the permit will likely be issued on the basis that it could be forfeited to the government at any time without compensation.

The United States *Clean Air Act* is clear on this point: sulphur dioxide emission allotments are not property. Other Australian and New Zealand trading schemes dealing with salinity, water and fish also specifically declare that trading instruments are mere contractual rights and capable of resumption.⁵¹ In its Interim Report on greenhouse gases, the Standing Committee on Environment, Recreation and the Arts recommended that emission permits not confer property rights.⁵² It would appear that while permits may have the capability of being property, they will likely be mere authorisations, or following *WMC*, a form of property that is defeasible back to the government without compensation.

The AGO has commented that this issue requires careful consideration, and that it needs to be resolved in such a way as to provide:

“due consideration of the need for an appropriate degree of risk sharing, the desirability of encouraging stability and investor confidence within the economy, and the need for compatibility between units traded in the national and international market”.⁵³

Carbon Credits Versus Emission Permits

Several implications flow from a characterisation of carbon credits as a form of property (*profit à prendre*), and emission permits as either determinable property, or mere revocable permissions.

⁵⁰ *National Provincial Bank Ltd v Ainsworth* [1965] AC 1175 at 1248.

⁵¹ See for example the New South Wales Hunter River salinity trading scheme (s 293(6) of the *Protection of the Environment Operations Act* 1997 (NSW); the Victorian water trading scheme (ss 224 to 230 of the *Water Act* 1989 (Vic); and the New Zealand commercial fisheries programme which, while stating that individual transferable quotas are property, in fact reserves to government the power to vary the total allowable commercial catch, upon which the individual quotas are based, without compensation (*Fisheries Act* 1996).

⁵² “Inquiry into the regulatory arrangements for trading in greenhouse gas emissions – Interim Report”, 17 August 1998 at 29.

⁵³ *Op cit* n 7, AGO at 30.

Transferability

As a general characteristic, property is freely transferable. Personal property may be bought, sold and gifted. Registration may be required for the transfer of real property, but this usually occurs after the transfer. Personal and real property is fully alienable at the discretion of the owner, although certain forms might be required.

Revocable permissions, on the other hand, are only transferable upon the approval of the granting agency. As a permission, rather than a right, the holder is not an “owner” and therefore cannot freely assign the instrument. Most jurisdictions require such approval in advance of the transaction.⁵⁴ This slows the process and hinders the creation of a market for such instruments.

From this point of view, an emission trading instrument based upon the right to sequester carbon (such as New South Wales’ forestry right) would be more freely transferable than an emission trading instrument based upon an emission permit. This would have to be considered in the design of the emission trading system.⁵⁵

Severability

A second general characteristic of property is its severability. Real property may be subdivided, and personal property may be separated into constituent parts. A statutory permission is ill suited to being subdivided, and often the rules governing the authorisation expressly forbid severability.⁵⁶

For example, the West Australian *Environmental Protection Act* 1986 does not allow the holder of an air emission licence to sell part of the licence to a third party. A licence must be transferred as a whole. If the holder wishes to divide the authorisations granted in the licence and transfer one or some authorisations to a third party, then the licence holder must apply to have the licence split into separate and distinct instruments.

Again, an emission trading instrument backed by the right to sequester carbon, and an emission trading instrument backed by an emission permit, would seem to be at odds on this point. Once a sequester based emission trading instrument is constituted (for example, an emission allowance of 100 tonnes of greenhouse gas based

⁵⁴ See, for example, s 64 of the *Environmental Protection Act* 1986 (WA).

⁵⁵ For example, the US Acid Rain programme provides that the allowances must be registered, but this may be done after the transfer.

⁵⁶ For example, allowances granted in the US Acid Rain programme cannot be divided into units smaller than one tonne of sulphur dioxide emission per year. Personal communication with Jeffrey Levy, USEPA, 14 February 2000.

on the planting of a certain number of trees) there seems no reason not to allow that 100 tonnes to be divided into 1 tonne allotments.

However, an emission trading instrument backed by an emission permit of the same value (an emission allowance of 100 tonnes of greenhouse gas based on a 100 tonne reduction in emissions below the limit set for a particular industrial facility) would provide an avenue to do indirectly what could not otherwise be done directly, that is, the transfer of part of a facility's licence. It may be argued that what is being offered is the credit generated by emitting less than the licence allows, not the licence itself. However, this ignores the fact that without the licence, that is, the permission, there would be nothing to offer at all. Emission permits exist as a result of statutory intervention allowing emitters to emit. Without such permits, they would be polluting. Therefore, one is offering a portion of a permission, in essence transferring a portion of a licence without formally splitting the licence.

Again, this difference in the basis for the trading instruments must be considered in the design of the trading system.

Security

However, the most important consideration in characterising the emission trading instrument is the matter of compensation if the instrument is resumed or if conditions are placed on it effectively reducing its value.

A fundamental characteristic of property is the right to hold the property "against all the world". It is the right to exclude others from accessing or using that property, including governments.

In order to meet its Kyoto target (108 percent of 1990 emission levels between 2008-2012), the Australian Government will be faced with having to limit greenhouse emissions. Australia is already approximately 20 percent beyond its target.⁵⁷ Therefore, as the AGO has pointed out, there is a potential for "unforeseen circumstances" that may necessitate "repossession or re-allocation of permits".⁵⁸ The status of these permits, and therefore whether and how much compensation would have to be paid for "repossession", will become a critical concern.

If the Australian Government resumes an emission trading instrument backed by carbon sequestration, the holder of that instrument may be able to argue that it is entitled to just compensation

⁵⁷ Op cit n 9.

⁵⁸ Op cit n 7, AGO at 30.

for the acquisition of an incorporeal property right, in this case a right to the benefit of the carbon sequestered. As this credit is generated through the efforts of private individuals, is capable of transfer, is certain and ascertainable, and is relatively unchanging, it would be difficult to argue that no compensation need be paid.

However, if the Australian Government resumes an emission trading instrument backed by an emission permit, the consequences are much less clear. Even if such an instrument is found by the courts to be a form of property, it may be a form of property that is determinable to the Government and is "liable to modification or extinguishment by a subsequent ... enactment".⁵⁹ If Australia follows the United States Acid Rain Programme model, then compensation may be explicitly excluded.

Value

Ultimately, these considerations will be reflected in the value of the emissions trading instrument. Instruments based on carbon sequestration appear to provide greater transferability, severability and security than instruments based on an emission permit. This would result in a higher value for trading instruments backed by carbon credits than trading instruments backed by emission permits.

This is an important consideration in designing Australia's emissions trading system. Although the AGO is of the view that both carbon credits and emission permits are the same for the purposes of trading, this does not appear to be the case in law. Buyers of emission trading instruments will need to know the basis for the instrument they are acquiring in order to determine its appropriate value.

CONCLUSION

Global warming is an enormous issue. Limiting our emissions of greenhouse gases has equally enormous implications for the economy and designing an approach that encourages reductions in emissions at least cost is critical. Emissions trading appears to promise a cost effective solution.⁶⁰

⁵⁹ Op cit n 44.

⁶⁰ The Federal Minister for the Environment and Heritage, the Hon Robert Hill, stated in a speech to the Australian Financial Review's Third Annual Emissions Conference (30 March 2000) that research carried out by the Australian Bureau of Agricultural and Resource Economics indicates that the cost to countries of achieving greenhouse targets is much less through an emissions trading system than through administrative policies and measures.

As the international trading rules gradually become clear, it is incumbent upon all who may wish to participate in or who will be affected by emissions trading to examine the legal aspects of the trading instruments, and to ensure that they are well positioned to understand the true value of what they may be buying or selling.

Further thought and investigation is required to fully explore the legal nature of the trading instruments, and the types of legislative and regulatory safeguards that will be required in order to make the trading system work.

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