



# Australian Government

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## Department of Climate Change

### EMISSIONS TRADING STAKEHOLDER CONSULTATION

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## AGENDA PAPER: CHARACTERISTICS OF TRADABLE COMPLIANCE UNITS IN THE EMISSIONS TRADING SCHEME

*This paper does not necessarily represent the views of the Australian Government or any Government Minister. It is a working paper prepared by the Emissions Trading Division of the Department of Climate Change. The views contained in this paper are preliminary only and are subject to change. The aim is to promote discussion. **Submissions at not sought at this time.***

### 1. Introduction

This paper addresses the characteristics of tradable compliance units under the emissions trading scheme (referred to as 'Australian emissions units'). It draws together characteristics mentioned in previous roundtable papers and discusses some issues of relevance to the nature of the unit, such as whether it should be property and whether it should be a financial product.

### 2. What is an Australian emissions unit?

The Australian emissions unit is the basic unit of compliance and trade in the scheme. Its characteristics therefore have significant implications for liable entities, other participants in the emissions market and Government. There are two basic regulatory options.

One option is to characterise the unit as a licence. The major argument put for this option is that it provides greater flexibility (or alternatively, that creating property rights creates a disincentive for governments to reduce the cap). Further, it is argued that making units property would unfairly transfer from industry to taxpayers the risks of setting caps that may need to be tightened later and that compensation should not be payable if licences were extinguished in this situation. The disadvantage of this option is that the market may fail to develop because of a lack of certainty.

The other alternative is for the unit to be defined in a way that provides a high level of legal and financial certainty. Such an approach would maximise market confidence in the unit for both compliance and trading purposes. While it may reduce flexibility, this can be achieved and managed through the way in which the scheme cap is set.

The unit would need to have the following characteristics:

- It would be an entitlement, issued by the Commonwealth, composed of various 'rights' and obligations contained in the emissions trading legislation;
- It would be personal property;

- Each unit would represent one metric tonne of carbon dioxide equivalent of greenhouse gas emissions;
- Each unit would only be surrendered under the scheme once;
- A unit could be held and traded by any legal or natural person;
- There would be no restriction on foreign ownership of units, apart from any that might apply under a law other than the emissions trading legislation;
- The legislation would provide that the executive government cannot extinguish units under the emissions trading legislation (unless there has been misrepresentation or fraud by the holder against the Commonwealth in the creation or issue of the units) without compensation;
- It would be transferable on purchase or the death of the holder. Detailed requirements would be set out in the emissions trading legislation;
- It would entitle the holder to rights only if he or she appears on the registry established for the emissions trading scheme. Legal title would be transferred only by entry in the registry;
- The creation of equitable interests in units would be permitted, as would taking security over them;
- Each unit would have a unique identification number<sup>1</sup> and be marked with the first year in which it would become valid for acquittal purposes (its 'vintage').<sup>2</sup> It would not have an expiry date;
- For administrative simplicity the Regulator would issue only one type of unit. However, other types of units may be used to meet compliance requirements, as discussed in the paper on *International Linking*; and
- The unit would be uncertificated, i.e. represented as an electronic book entry in the registry, rather than by a certificate, in order to reduce unnecessary administration and inefficiency involved in handling certificates.

### **3 Should the Australian emissions units be financial product?**

Services provided in relation emissions units, such as advising a person to buy them, will be similar to services provided in relation to financial products such as shares and debentures. In order to ensure the ongoing credibility of the emissions trading scheme, consideration needs to be given to the regulation of financial services and other conduct relating to emissions units. The options are to create a new regulatory regime or to use the existing regulatory infrastructure provided in Chapter 7 of the *Corporations Act 2001* (the Corporations Act), which addresses the regulation of formal financial markets, market misconduct and financial advice. A new regime could be more easily tailored to the distinctive features of the emissions trading scheme and emissions units, but would require additional legislation and resources to implement and enforce. Adapting the existing regulatory system applying to financial markets and services is more likely to achieve regulatory consistency in the treatment of similar conduct and reduce

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<sup>1</sup> This is explained in the paper entitled *Establishing a National Registry for Australia*.

<sup>2</sup> The issue of vintages is referred to in the paper on *Banking, borrowing and safety valve*.

competitive distortions. The efficiencies gained by drawing on existing infrastructure would likely achieve savings in administrative costs.

***Stakeholders are invited to comment on:***

- 1. Whether the characteristics outlined in Section 2 above are appropriate; and*
- 2. Whether it is appropriate that the units be treated as financial products under Chapter 7 of the Corporations Act 2001.*