

8 Institutional arrangements

This Chapter sets out broad proposals for institutional arrangements for the governance structure of the NETS. If the Commonwealth chooses to implement the scheme in conjunction with the State and Territory Governments, then it is possible that existing institutions could undertake these roles. In the absence of Commonwealth involvement, the State and Territory Governments would need to establish new institutions. The Chapter does not attempt to set out the minutiae of scheme institutional arrangements; such details will be progressively developed by governments as the scheme's design is progressed.

8.1 Institutions required to implement emissions trading

New governance arrangements will be required to implement a NETS and support its ongoing operation and administration, its registry system, and its reporting, compliance monitoring and enforcement regime.

In designing the NETS, the clear preference of all State and Territory Governments and stakeholders is for the Commonwealth Government to be involved. Therefore, the preferred options in this Chapter are based on Commonwealth Government participation and the use of existing institutional arrangements. These institutions could be, for example, those created for energy market governance in Australia (that is, the Ministerial Council on Energy, the Australian Energy Market Commission, and the Australian Energy Regulator). However, other options may also be possible (for example, the National Environment Protection Council and other policy and regulatory agencies).

In the event that the Commonwealth Government chooses not to participate in the NETS, State and Territory Governments could establish a new, separate Ministerial Forum, Scheme Developer and Scheme Regulator to govern the scheme. Although there are clear advantages to Commonwealth involvement, operation of a scheme remains feasible without Commonwealth involvement at commencement.

8.2 Intergovernmental agreement

To work effectively, the NETS would require a consistent legislative framework and approach to implementation across jurisdictions. Stakeholders were unanimous in their view that scheme rules, institutions and implementation should be nationally consistent.

An intergovernmental agreement is seen as the best way to progress this. In broad terms, the intergovernmental agreement would need to cover issues such as:

- the legislative structure to give effect to a NETS and the obligations of liable parties
- the roles, responsibilities and governance arrangements for new institutions created under the agreement

- arrangements for Ministerial oversight
- funding and other financial arrangements, such as agreement on how auction revenues are distributed
- review provisions.

Intergovernmental agreements of this type are common in Australia where cross-jurisdictional arrangements are to be put in place. Well-known examples are the intergovernmental agreements on the environment, on national competition policy arrangements, and on the management of the Murray-Darling Basin.

8.3 Legislation

Legislation would be required to establish the basic framework of the scheme. For example, legislation would need to cover issues such as:

- emissions monitoring, reporting and verification
- establishing an obligation to surrender permits or offset credits in respect of greenhouse gas emissions
- setting out the functions and powers of relevant institutions
- the ability to impose penalties for non-compliance on liable parties
- the ability to impose penalties for non-compliance with conditions of accreditation for offset creators.

With Commonwealth Government participation in the scheme, primary legislation could be enacted by the Commonwealth Government, with complementary legislation and/or a referral of powers by the State and Territory Governments if needed. In the absence of Commonwealth participation, the State and Territory Governments would still be able to implement nationally consistent legislation based on the approaches used in previous areas of joint effort⁸⁴ that have not involved the Commonwealth.

Beyond the initial establishing legislation, the scheme would need regulations and rules to deal with matters of finer detail. These regulations and rules would be developed through extensive consultation.

⁸⁴ For example, the *Uniform Consumer Credit Code*, Mutual Recognition Legislation, and the *National Electricity Law*.

8.3.1 Option 1: Commonwealth legislation with complementary legislation by State and Territory Governments as needed

The preferred approach is for the Commonwealth to enact legislation to create the scheme on a basis agreed with the State and Territory Governments, with complementary legislation passed by the State and Territory Governments as required.⁸⁵ The advantages of this approach include:

- the legislative change process would be simplified.
- Policy, regulatory and administrative functions may be able to be conferred on an existing policy agency and regulator.

8.3.2 Option 2: Template legislation passed in one State, with other States legislating the application of the template and future changes to that template

If the Commonwealth did not choose to participate in the implementation of the scheme, a viable alternative option would be for one State to pass template legislation, with other State and Territory Governments applying that template legislation through their own Acts of Parliament. This is the normal approach taken by the State and Territory Governments for issues in which the Commonwealth is not involved. The advantages of this approach include:

- It is a relatively straightforward way to obtain consistent nationwide legislation without the involvement of the Commonwealth.
- Because any changes to the template legislation would need to be approved by the legislation's governing body (which presumably would include representatives of the other jurisdictions), the scope for 'individualising' the legislation is reduced.
- national institutions could be created with powers conferred by each State and Territory.

The disadvantages of this approach include:

- The scope for Parliamentary oversight of the legislation may be limited, although this could be avoided by obtaining agreement in principle prior to the template legislation being passed in the 'home' state.

⁸⁵ Other models involving the Commonwealth are possible. For example, South Australia remains the lead legislator for the NEM, with the Commonwealth having adopted the South Australian law.

- A State or Territory could repeal or vary the legislation applying the template legislation at any time, potentially undermining the national application of the scheme. (However, in the presence of an intergovernmental agreement, this would be unlikely.)

The preferred option is for the Commonwealth Government to pass legislation to enact the scheme, with complementary legislation passed by State and Territory Governments as required.

An alternative approach, if the Commonwealth chooses not to participate in the scheme, is for one State to pass template legislation which would then be legislatively adopted by the other State and Territory Governments.

8.4 Institutional arrangements

This section describes the institutions needed to govern and administer the scheme. Stakeholders who commented on institutional arrangements generally identified the need for a Scheme Regulator and registry. Some stakeholders emphasised the need to separate regulatory and policy functions. For example, the Australian Financial Markets Association drew attention to:

... the experience of developing a National Electricity Market out of what was essentially a set of State based electricity sectors. Despite various difficulties, overall the NEM development institutions have proved functional, and present a working model.

In particular, the importance of separating roles of implementation/operation from the roles of oversight/rule changes, and the roles of the States in the regulatory arrangements are worth closely examining. (submission 51, p.11)

A smaller number commented on the need for overarching governance arrangements. Hydro Tasmania wrote:

The key institutions required to administer a NETS [include] a governance body, made up of jurisdictional representatives, with responsibility for establishment of the Scheme rules and future enhancements. (submission 31, p.5)

Stakeholders also suggested a need for scheme performance reporting and auditing, dispute resolution, and administration of appeals.

The institutions proposed for the national scheme are described below.

8.4.1 Ministerial oversight by Ministerial Council or Forum

Given the initial focus of the scheme on stationary energy, the preferred approach would be to have an existing Ministerial Council, such as the Ministerial Council on Energy, provide appropriate Ministerial oversight. The Ministerial Council would oversee the implementation and ongoing administration of the NETS, providing for national consistency and an efficient and effective scheme.

The Ministerial Council would have responsibility for:

- the policy framework for a NETS, including decisions on setting the cap and future gateways, scheme coverage and any future expansions, approval of permit allocation methodology, eligible offset projects and management of transitional arrangements
- policy oversight and future strategic directions for a NETS (including possible linking to other international schemes)
- governance and institutional arrangements for a NETS, including oversight of regulatory and policy bodies
- the legislative and regulatory framework within which the NETS operated, and agreement on any changes to that framework.

An alternative approach, in the absence of Commonwealth participation, is for State and Territory Governments to establish a Ministerial Forum on Emissions Trading. The Ministerial Forum would have representation from all State and Territory Governments and would fulfil the role that would otherwise have been carried out by a Ministerial Council that involved the Commonwealth.

In such a case, each State and Territory would nominate a Minister as its principal Member of the Ministerial Forum. A number of issues, such as who would chair the Council, voting rights and decision-making processes, would need to be addressed. Any amendments to the intergovernmental agreement on emissions trading, legislation or regulations could be decided on by unanimous agreement of all parties. Any administrative matters could be decided by a majority of members.

The Ministerial Council or Forum may have to be established quite soon after the scheme is legislated, in order to deal with issues arising during the transition period prior to the possible commencement of the scheme (i.e., 2007-2009).

It is proposed that a Ministerial Council (for example, the Ministerial Council on Energy) or Ministerial Forum oversee the NETS.

8.4.2 Scheme Developer

The Ministerial Council would be required to make decisions on the ongoing development of the scheme. Advice on such developments could be provided by the Australian Public Service (if the Commonwealth were participating in the Scheme) and State and Territory public services. However, a number of policy functions need strong coordination. It may be desirable to assign scheme development functions to a separate body, perhaps one currently tasked with supporting the Ministerial Council, such as the Australian Energy Market Commission.

The functions of the Scheme Developer would include:

- permit allocation:
 - devising a permit allocation methodology for approval by the Ministerial Council/Forum. This is an ongoing function, particularly in relation to permit allocations for new entrant trade-exposed, energy-intensive industries and for auctioning.
 - designing (but not carrying out) permit auctions,⁸⁶ in conjunction with the Regulator.
- scheme scope:
 - conducting reviews at the request of the Ministerial Council/Forum and identifying priority areas for expansion (for example, alterations to thresholds or the inclusion of a broader range of sectors and emissions)
 - giving guidance and detailed interpretations of the rules for liability; for example, the definitions of liable parties (installations, sites, companies and application of the aggregation rule) and thresholds, which may need further interpretation.
- caps:
 - conducting reviews and making recommendations on future caps and gateways. For example, the Ministerial Council/Forum would need advice on the implications of different caps within the adopted gateways before it could extend the period over which firm caps apply.
- performance monitoring and reviews:
 - being responsible for ongoing assessment of the performance of the scheme (see Section 8.5), and for making recommendations (and conducting public consultation processes) for scheme amendments over time.

⁸⁶ Auction design is of great importance to the realisation of the objectives of auctioning permits. There will be consultations and experimental testing on the final auction design in order to ensure that the auction regime is transparent and reliable, supporting early and robust price signals and reducing the potential for market power or collusion.

These roles are similar in many respects to the role that the Australian Energy Market Commission plays in supporting the Ministerial Council on Energy. The Australian Energy Market Commission is responsible for rule making and market development.

Previously, in the NEM the lines between regulation and policy advice were blurred. The roles of the National Electricity Code Administrator included enforcement, rule making and market development. This proved to be an unsatisfactory approach. The current arrangements have much clearer lines of accountability between the Ministerial Council, the body supporting that Council, and the regulator (the Australian Energy Regulator).

Should the Commonwealth Government choose not to participate in the NETS, the State and Territory Governments could establish a separate scheme development agency to support a Ministerial Forum.

It is proposed that a central body be given responsibility for advising on a range of ongoing policy issues before the implementation of the scheme and during the scheme's operation. If the Commonwealth is involved in the implementation of the scheme, then an existing body (such as the Australian Energy Market Commission) could be tasked with that role.

If the Commonwealth chooses not to participate in the scheme, the State and Territory Governments could establish a small scheme development agency to support the Ministerial Forum.

8.4.3 Scheme Regulator

A single national regulator should be established to manage the implementation and running of the scheme. Preferably this role should be assigned to an existing body such as the Australian Energy Regulator. The Scheme Regulator could take on the following functions:

- establishing and maintaining a registry. This may include:
 - creating a registry (the development, operation and maintenance of which could be contracted out)⁸⁷
 - issuance of permits according to the methodology approved by the Ministerial Council/Forum

⁸⁷ There are currently three greenhouse-related registries operating in Australia, for MRET, GGAS and the Queensland 13% Gas Scheme. The experience of developing and operating these, as well as international standards and other established registry systems, will be taken into account when designing and developing the emissions trading scheme registry. This is likely to lower the costs of registry development considerably.

- issuance of credits for verified emission reductions created by offsets
- recording ownership changes associated with all permit transactions, including acquittal and cancellation of permits
- reflecting the holding of CDM credits in other registries that will be used for compliance in Australia
- allocation of permits under the scheme, including the running of auctions and distribution of auction revenue among jurisdictions
- registration of offset projects according to eligible project types and baseline methodologies agreed by the Ministerial Council/Forum
- accreditation of auditors to (a) verify the monitoring reports of liable entities, and (b) verify the emissions reductions achieved by offset projects
- spot checking the verified monitoring systems and monitoring reports in order to oversee the work of auditors
- compilation of verified monitoring reports in order to assess compliance
- enforcement of compliance obligations under the scheme, including issuing of penalties and publicly naming entities who do not comply with permit acquittal requirements.

Should the Commonwealth Government choose not to participate in the NETS, the State and Territory Governments could establish a separate regulator.

8.4.4 Market participants to establish other market devices

It is not proposed that a trading platform should be established by governments. The role of governments in setting institutional arrangements is to facilitate the development of an efficient and effective scheme. Governments are best able to achieve this by establishing and protecting property rights, establishing a robust registry system, and generally preventing the development of impediments to markets.

The role of governments does not extend to the formation of market devices, acting as a broker, or developing trading platforms. Formation of market devices is best left to markets. The experience of the EU ETS shows that trading platforms can be created without government intervention, so long as there is sufficient demand for their services.⁸⁸

⁸⁸ However, monitoring of scheme performance and regular reviews by the Scheme Developer would include assessing the operation of the market.

A single national regulator would be required. If the Commonwealth is involved, it is proposed that these functions be undertaken by an existing body, such as the Australian Energy Regulator.

If the Commonwealth chooses not to be involved in the implementation of the scheme, it is proposed that a new body be established by the State and Territory Governments.

It is proposed that governments leave the establishment of trading platforms and other market devices to the market.

8.5 Reviews

A number of reviews are nominated in respect of the scheme:

- scheme coverage (Chapter 2 and Section 8.4.2)
- levels of future caps and gateways (Chapter 3 and Section 8.4.2)
- penalties and possible future use of a make-good provision (Section 4.3.2)
- assistance for energy-intensive, trade-exposed firms in the face of major new international developments (Section 7.8)
- emissions intensity baselines for energy-intensive, trade-exposed firms from 2020-2029.

It is proposed that a general review of the scheme's rules be undertaken by the Scheme Developer and reported to the Ministerial Council/Forum 5 years after the commencement of the scheme (potentially in 2015 if the scheme commences in 2010). The review will cover the matters set out above, along with other matters as considered necessary by the Ministerial Council/Forum. The subject of the review would be confined to the detail of the scheme's rules, operation of institutions and the market, and related provisions, in order to maintain and enhance the scheme's effectiveness and efficiency. The review would be based on an assumption of scheme continuation and would not consider the question of the scheme's continuing operation.

The scope of the review would be set so as to avoid a type of problem that arose in relation to the review of the MRET scheme in 2003. The scope of the MRET review was sufficiently broad that observers could not be certain of the scheme's continuation. This led to a level of uncertainty that created a significant disincentive to new investment.

It is proposed that a general review of the scheme's rules, operation of institutions and functioning be finalised by 5 years after the commencement of the scheme with the objective of maintaining and enhancing scheme effectiveness and efficiency. The scope of the review would be developed so as to maintain investor confidence in the scheme.

8.6 Stakeholder involvement

Many of the functions described above, such as cap and target setting and scheme reviews, are likely to be of interest to stakeholders. It is likely that the Ministerial Council/Forum and Scheme Developer would actively seek stakeholder input to major questions of scheme design. However, there may also be a role for stakeholder input in day-to-day administration of the scheme by the Scheme Regulator. The Centre for Energy and Environmental Markets wrote:

...there is a need for separate institutions in each of the following areas:

- scheme development and design,
- scheme implementation and administration, and
- scheme review and evaluation

A formal and transparent stakeholder process for each of these institutions is important to their success. The linkages and information flows between these institutions also need to be formal and transparent as much as possible. (submission 59, p. 13)

Stakeholders' views are sought on possible mechanisms and processes by which stakeholders could participate in proposed scheme administration and policy development, such as in reviews of the scheme and setting of further caps and gateways.

Comment is sought on possible mechanisms and processes by which stakeholders could participate in scheme administration and policy development.

8.7 Conclusion

This Chapter identifies at a high level the institutions and governance functions required for a NETS to operate. This Discussion Paper does not attempt to address the significant detail that would eventually be required to establish such institutional and governance arrangements. Governments would progressively flesh out those details as the scheme's architecture was further developed.

The NETS would require an intergovernmental agreement setting out how the scheme is to be established, governed, and implemented consistently across jurisdictions.

A Ministerial Council or Forum, a Scheme Developer and a Scheme Regulator would be established in accordance with the intergovernmental agreement and legislation to give effect to the scheme. The Ministerial Council/Forum would provide the final decision-making forum, along with scheme oversight and accountability for the scheme's operations. The Scheme Developer would provide support to the Ministerial Council/Forum to ensure that the scheme's parameters and framework remain efficient, effective and appropriate to the scheme's objectives. The Scheme Regulator would be responsible for the day-to-day operation of the scheme.

Governments would thereby provide the governance institutions, rules and frameworks that would allow market participants to establish other market institutions and devices as required (such as trading platforms). Governments would not act in the market to establish such devices.

The Ministerial Council/Forum and Scheme Developer would undertake reviews of particular aspects of the scheme (such as coverage and banking provisions) and would perform a general review of the scheme rules 5 years after the commencement of the scheme and periodically thereafter. The terms and scope of the reviews would be devised with a view to maintaining investor confidence and market efficiency.
