BUSINESS COUNCIL OF AUSTRALIA

Climate Change - Options for the Kyoto Protocol Compliance System

Submission to the Department of Foreign Affairs and Trade - May 2000

The Business Council of Australia is a signatory to the cross-industry AIGN submission to the Department of Foreign Affairs and Trade Discussion paper *Climate Change - Options for the Kyoto Protocol Compliance System*.

Introduction

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to comment on the compliance provision in Article 18 of the Kyoto Protocol. In addition to considering the issues in the Department of Foreign Affairs and Trade Discussion paper Climate Change - Options for the Kyoto Protocol Compliance System, the AIGN has also has taken account of the Australian Government's views on compliance in the 31 January 2000 submission to the UNFCCC.

AIGN supports the Government's views on compliance in the 31 January 2000 submission to the UNFCCC and wishes to highlight several aspects that are relevant to the consideration of the current discussion paper. These include:

 AIGN agrees that the primary objective of the compliance system should be to promote efficient and effective implementation of the Protocol. Hence, we believe that all proposals for the compliance system need to be tested against these criteria as well as ensuring that they are least cost, simple, equitable, facilitative and promote achievement of the Protocol's reduction commitments in the first and any subsequent

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commitment periods.

 AIGN agrees that the core function of the Article 18 compliance system should be to ensure Parties meet their Protocol obligations to limit their emissions as set out in Article 3.1 and Annex B. However, it is important to recognise that Article 3.1 commitments are determined in accordance with Annex B and several other provisions of Article 3 (including sinks and flexibility mechanisms.

 AIGN supports the establishment of a two-stage compliance system, with the first stage designed to facilitate staying in compliance or entering into compliance. We agree that the second stage would involve progressively stronger consequences for non-compliance, however these should still be designed to promote future compliance and minimise the risk of forcing Parties to consider withdrawing from the Protocol.

 AIGN also supports the Government's position that consequences under the general compliance system must have equal outcomes for all Parties and not involve suspending or removing privileges that would impact some Parties more than others such as limits on access to the mechanisms. Compliance procedures and consequences relating to the operation of the mechanisms (including Article 4) should be established as part of the operational rules for each of the particular mechanisms.

In addition to supporting the Government's two stage approach to the general Kyoto Protocol compliance system, AIGN believes that the system will need to primarily rely on the presumption of good faith of the Parties, backed up by customary international law and the Vienna Convention on the Law of Treaties. AIGN considers that the alternative of "more specific enforcement mechanisms, written into the text of the treaty" is not an appropriate model for the Kyoto Protocol for two main reasons:

1. The Protocol is less comprehensive than the UNFCCC and only specifies reduction obligations for Parties listed in Annex B. By the time of the first commitment period, it will cover less than half of the global emissions. Hence, unless non-Annex 1 countries take on commitments under the Protocol, even a fair and consistently

applied compliance system will not provide a "level playing field" for Australia.

2. Efforts to apply more onerous compliance provisions (than can be achieved under a system that depends on good international practice, backed up by enforcement provisions under customary international law) would significantly increase the risk of Parties either not ratifying the amendment under Article 24, or withdrawing from the Protocol under Article 27, rather than be subjected to what they would see as unfair enforcement.

The Protocol's Compliance System

AIGN generally supports the Government's views about how the compliance procedure should function as set out in section 2, and shown diagrammatically in the Attachment of the Discussion paper, however, we recommend the following clarifications:

1. the Attachment's heading should be Kyoto Protocol: Compliance Procedure - Article 3 emission commitment issues only (including Articles 3.1, 3.3, 3.4, 3.7, 3.10, 3.11, 3.12, 4, 5, 6, 7, 8, 12 & 17 that are relevant to Party's emission commitments or the reporting and review provisions that are critical to the compliance system.

2. the procedure as outlined applies throughout the commitment period. However, the procedure for the 'true-up' period needs more consideration to take account of the limited time and to determine how the compliance will be finally assessed for all Parties (not just for example, those found in non-compliance following an Article 8.3 Expert Review Team (ERT) report).

AIGN agrees that the monitoring, reporting and review provisions in Articles 5, 7 & 8 will be critical to the effective functioning of the compliance system and the mechanisms (including Article 4). AIGN also agrees that the compliance system will need to observe due process and include consideration of contributory factors, mitigating circumstances and the degree and frequency of non-compliance.

The Timing and Nature of Consequences for Non-Compliance

As already noted, AIGN supports the view that the prime purpose of the Article 18 compliance system is to ensure Parties meet their Protocol obligations. AIGN also agrees that the 'core' obligation is to meet the commitment to limit emissions. However, the Article 18 compliance system must also ensure that Parties meet their obligations for effective monitoring, reporting and expert review procedures to enable assessment of compliance with the emission obligation. Hence, AIGN believes that during the commitment period, the most probable 'consequence' that may be faced by an Annex B Party would be some form of corrective action to remedy non-compliance with effective (comprehensive, accurate and timely) monitoring, reporting or expert review procedures. On the other hand, during the 'true-up' period, the most probable 'consequence' for an Annex B party would be to address any excess of emissions above the Party's final assigned amount.

AIGN doesn't agree with the views of some Parties (including the EU) that Article 18 should directly address mechanism eligibility issues. AIGN believes that the mechanisms are simply additional means (supplementary to other domestic actions) to assist Parties to comply with their obligations. However, the eligibility rules for the mechanisms will depend on the Article 18 Compliance system ensuring that all Annex B Parties conform with the requirement for effective (comprehensive, accurate and timely) monitoring, reporting or expert review procedures.

The AIGN believes that the full use of each mechanism should be related to the Party concerned continuing to meet the eligibility requirements for that mechanism. If an eligibility problem needs to be addressed then, to the maximum extent possible , priority should be given to restricting the ability of a Party to dispose of assigned amount units while allowing continued use of the mechanisms to acquire credits or assigned amount units. Full suspension of use of a mechanism should only be invoked if the restriction on disposal of assigned amount units fails to correct the problem. This approach recognises that suspension of eligibility to acquire credits or assigned

amount units would tend to increase the risk that the Party involved will not be able to comply with their emission reduction obligation, and hence the environmental effectiveness of the Protocol would be reduced. AIGN would be pleased to comment further on the compliance procedures for the mechanisms, however the remainder of this submission will focus on the Article 18 Compliance system.

Options for Non-Compliance Consequences

As set out in the previous sections, AIGN believes that Article 18 non-compliance consequences should:

 apply equally to all Parties regardless of their degree of reliance on sinks or mechanisms (including Article 4) to assist in meeting their emission reduction obligations;

 be designed to maximise the prospect of achieving the core obligation of Annex 1 Parties to "individually or jointly" limit their emissions; and,

 be designed to ensure the effectiveness of the monitoring, reporting and review processes that will be essential to facilitate and ultimately measure achievement of the core obligation under the Protocol.

Hence, AIGN considers that the compliance system will need to have two 'strands', both starting with facilitative consequences that progress to stronger consequences as necessary to address the non-compliance problem. AIGN also believes that the credibility and effectiveness of the compliance system will be significantly enhanced by full public disclosure of all relevant compliance information (including the facilitative stage) once any appeals process has concluded.

The first 'strand' should focus on the monitoring, reporting and review processes because the integrity of these processes is fundamental to the second 'strand' of the compliance system. This also has the benefit of providing the foundation for the

eligibility and compliance procedures for sinks and mechanisms. The facilitative consequences for this first 'strand' should involve advice, assistance and the preparation of a compliance action plan by the Party concerned. If the facilitative consequences fail to address the problem, the consequences should progress to a level where the Party is required to engage what ever level of accredited third Party assistance is necessary to correct any problems and to provide a system and training to ensure the problems don't return.

The second 'strand' should focus on maximising the prospect of achieving the collective obligation of the Annex 1 Parties. Initially this should only be facilitative in terms of advice and assistance to help Parties formulate their own action plan to meet their emission restraint obligation. As the commitment period progresses, the monitoring, reporting and review process will provide a basis for increased or decreased intensity of compliance facilitation. The consequences for this strand should not move beyond high intensity facilitation unless there is clear evidence that the emission obligation is highly unlikely to be met – in most cases this will not be before the 'true-up' period.

Once the data for Parties is available in the 'true-up' period, they should have an opportunity (and be encouraged) to avoid non-compliance by purchasing any available credits. If there are simply not enough credits available at a reasonable price, the AIGN recommends the establishment of a Compliance fund managed by an independent organisation such as the World Bank. The fund would be authorised to sell future credits (only in the true-up period) at a price equal to the year 2012 average international permit price plus a reasonable surcharge. The fund could be used by the fund manager to bring forward additional CDM projects in the second commitment period. Parties not in compliance should have the option to not purchase from the compliance fund but to subtract tonnes from their second commitment period assigned amount equal to the shortfall plus the same surcharge percentage as used for the fund mechanism.

In the unlikely event of a Party refusing to avoid non-compliance by either (or both)

of these mechanisms, AIGN recommends that the ultimate sanction would be to carry out an in depth review with all details revealed publicly twice a year until the non-compliance is resolved. The provision of details about the non-compliance would apply substantial political pressure. In addition, it would assist any Party, who may consider that non-compliance by another Party damaged their interests, to seek redress of that loss under the customary international law and/or the World Trade Organisation.

AIGN does not support the other options such as:

 financial penalties (better to use a compliance fund;

 mechanism-related penalties (this would result in a compliance consequence that will not apply equally to all Parties, hence the AIGN strongly opposes this suggestion; and,

 trade measures (the AIGN is strongly opposed to any consideration of such an approach, particularly with a Protocol that will only establish obligations for less than half of the global emissions).

Methods of Application of Consequences

AIGN favours an approach that progressively increases the consequences to whatever level is necessary to have the non-compliance addressed. Hence, AIGN considers such a measured approach is not possible to administer automatically. It would require the existence of predetermined guidelines that would be applied with some discretion to meet the Article 18 requirement to take account of the "cause, type, degree and frequency" of the non-compliance. This AIGN progressive application of stronger consequences also has some of the benefits set out under section 6.4 (Combination of consequence) of the Discussion paper.

Are Mandatory Consequences required for an Effective Compliance System?

AIGN believes that the compliance system needs to be made as robust as possible without amending the Protocol for the following reasons:

1. Any requirement to amend the Protocol could effectively reopen the negotiations and should not be considered until there is a clear indication that such a renegotiation would improve the Protocol – for instance by progressively including non-Annex 1 Parties.

2. The suggestion that hard binding consequences will provide a "level playing field" is false as far as the current Protocol is concerned. It will only cover less than half the global emissions in the commitment period, leaving a very uneven playing field for Australia.

3. It should be possible to construct, through the process of COP decisions, a regime with a high level of commitment to the compliance system, which would also be supported by customary international law and the Vienna Convention on the Law of Treaties.

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