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Australia's Clean Energy Act: A New Measure in the Global Carbon Market

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AUSTRALIA'S CLEAN ENERGY ACT: A NEW MEASURE IN THE GLOBAL CARBON MARKET

Dr. Bruno Zeller & Dr. Michael Longo[†]

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I. Introduction

The compromise reached at Durban on December 11, 2011 (“Durban Compromise”) on a climate action roadmap committed states to negotiating a legal agreement by 2015, which would prospectively come into force in 2020. It represents a limited success on the international stage. The agreement will oblige major greenhouse gas emitters such as China, India and the USA to agree to legally binding greenhouse gas emission targets in the future via a new protocol, another legal instrument, or an agreed outcome with legal force. In the interim, the Kyoto commitments will be extended for at least another five years.

Notwithstanding this apparent success, there are inevitable doubts and uncertainties about the nature and scope of any future agreement. This reality should not, however, diminish the responsibility of individual states to develop and then link their carbon schemes to achieve desired environmental outcomes pending a concerted international effort. Ideological cleavages, narrowly construed interpretations of the national interest, and the usual political maneuvering between states have acted to impede a binding global bargain on numerous occasions.

However, key regional and national players have largely kept the momentum for climate action going through domestic (or regional) action and limited trans-boundary linkages. Europe has led the way. Others have followed. The Durban Compromise, if successful, will likely bring all major emitters into a global network of carbon mitigation schemes. It will be instructive to assess how states at the forefront of climate action are situating themselves on the path to carbon reduction. States and interest groups have lessons to learn and pitfalls to avoid as they embark on the task of formulating and implementing carbon reduction schemes which seek to balance the needs of the community, business and the environment.

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Australia's Clean Energy Act: A New Measure

Despite the absence of an informed debate in Australia on the most effective, equitable and efficient means of mitigating climate change and reservations from many interest groups on the policy choices ultimately made, the Australian experience can prove enlightening. Australia became the latest participant in the world of emissions trading—following the European Union and New Zealand—in passing the *Clean Energy Act 2011* (the “Act”). The Act may not represent the optimum solution, but it does nonetheless present valuable lessons for other states (or regions within a state), including China,¹ South Korea,² Japan³ and the United States,⁴ where similar legislation.

II. The Australian Legislation

The *Clean Energy Act* passed the Australian Senate on November 8, 2011 following a tumultuous period in Australian politics.⁵ The Act came into force on July 1, 2012. Despite intense interest in the political maneuverings surrounding the legislation and the compensation package attending it, there was surprisingly little public debate on which carbon reduction method was best suited for Australia. While academics debated the merits of a carbon tax over an emissions trading scheme⁶ and called for a genuine debate,⁷ the debate rarely spilled over into the public sphere. Of particular concern is that there was little discussion of how the carbon tax and emissions trading scheme would affect the competitiveness of Australian businesses or of its impact on related trade policies.

It is instructive to follow the path from the *Clean Energy Bill* (the “Bill”) to the Act as passed. By providing an analysis of the commentary to the exposure draft and associated provisions, it is hoped this article will be of assistance to policy makers in other countries contemplating the introduction of carbon mitigation legislation.

On July 10, 2011, the Gillard Government released its anticipated proposals⁸ to reduce carbon through a carbon tax. The Bill, together with the associated

¹ China will be piloting an emissions trading scheme in six regions starting in 2013.

² South Korea's emissions trading scheme is planned for 2015.

³ Japan's emissions trading legislation is currently on hold.

⁴ While the US had abandoned its planned national scheme, California's emissions trading scheme will commence in 2013 and the RGGI, a climate action initiative encompassing ten northern US states, is already in existence.

⁵ Clean Energy Act (Act No. 131/2011) (Austl.).

⁶ See, e.g., John Sheehan, *Carbon Taxation Versus Emissions Trading Schemes?*, 15 DEAKIN L. REV. 99 (2009); Lidia Xynas, *Climate Change Mitigation: Carbon Tax – Is It the Better Answer for Australia?*, 26 AUSTRAL. TAX FORUM 340 (2011); Wayne Gumley & Natalie Stoianoff, *Carbon Pricing Options for a Post-Kyoto Response to Climate Change in Australia*, 39 FED. L. REV. 132, 132-59 (2011).

⁷ Sheehan, *supra* note 6; *Call for Genuine Debate on Which Carbon Reduction Path Best Suits Australia*, DEAKIN UNIV. NEWSROOM (Sep. 27, 2010), <http://www.deakin.edu.au/news/2010/27092010carbontax.php>.

⁸ AUSTRAL. GOV'T, SECURING A CLEAN ENERGY FUTURE: THE AUSTRALIAN GOVERNMENT'S CLIMATE CHANGE PLAN (2011), available at <http://www.cleanenergyfuture.gov.au/wp-content/uploads/2012/06/CleanEnergyPlan-20120628-3.pdf>.

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commentaries, was released on July 28 for public comment⁹ and introduced into Parliament on September 13 despite claims that the government had not done enough to secure community support for the scheme. The government's intention is to reduce "carbon pollution by 5 per cent from 2000 levels by 2020 irrespective of what other countries do."¹⁰

The essential question for any policymaker is whether any policy—and in this case the Clean Energy Act—will achieve its desired result. The exposure draft spelled out the objects of the mechanisms as follows:

To give effect to Australia's international obligations on addressing climate change under the Climate Change Convention and the Kyoto Protocol;

To support the development of an effective global response to climate change; and

To take action directed towards meeting Australia's long term target of reducing net greenhouse gas emissions to 80 per cent below 2000 levels by 2050 and take that action in a flexible and cost effective way.¹¹

A carbon reduction scheme must seek to reduce carbon as flexibly and efficiently as possible, taking into account the unique features of the domestic economy and hence the national interest. Considering that the Act envisages the introduction of a substantial tax on carbon (\$AUD23 per tonne) to be followed by an internationally linked emissions trading system—which will forever change the Australian economic landscape—it was imperative that policymakers carefully assessed the extent to which international legal commitments and the state of the global economy would affect Australia's interests. Such a far-reaching, momentous change warrants a careful approach.

Recent debate in Australia on a carbon tax has been fractured and excessively politicised to the extent that real doubts have emerged as to the Act's value. At the height of the political contestation, there appeared to be a widely-held belief in the community that the Bill was a premature and ill-fitting proposal, having significant and poorly studied flow-on effects in the economy which no amount of adjustments or compensation could remedy. Public perceptions aside, it is the view of the authors that the *Clean Energy Act* fails to give adequate consideration to how Free Trade Agreements and Bilateral Investment Treaties will affect domestic outcomes of the Carbon Price Scheme. It is argued that the timing of its introduction is sub-optimal in light of ongoing EU and US financial and economic problems as well as the scheme's potential to generate economic jolts domestically by virtue of the size of the tax. Whether the timing was so inauspicious as to warrant a postponement of the scheme was a matter for deliberation and decision. Instead, it was hardly discussed.

⁹ *Commentary on Provisions*, AUSTRALIAN GOV'T DEP'T OF CLIMATE CHANGE & ENERGY EFFICIENCY (July 28, 2011), available at <http://www.climatechange.gov.au/government/submissions/closed-consultations/clean-energy-legislative-package/clean-energy-bill-2011/commentary.aspx>.

¹⁰ *Id.* at 11.

¹¹ *Id.* at 27.

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It has been argued that "Australia is best-placed when it plays in as many leagues as it can simultaneously."¹² However, the Act may have the effect of reducing the competitiveness of key emission-intensive, trade-exposed industries and thereby jeopardise Australia's capacity to play competitively in certain leagues. While the Carbon Price package includes a program worth \$AUD9.2 billion of industry assistance and adjustment in the first three years to support jobs and competitiveness in industries affected by the introduction of a carbon price,¹³ the tax still has the capacity to affect the balance of trade as consumers may opt for cheaper imported goods. It is apparent that under the Act, importers will not be subject to the carbon tax, which has the effect of making imports cheaper and eroding the competitiveness of Australian exporters and manufacturers. The Act therefore raises questions as to how Australia will fare if it prices carbon at \$AUD23 a tonne, rising by 2.5% per annum in real terms, when many of its important trading partners have not priced carbon at all.

While this article questions the path set by the Act for its poor timing and its potentially less than positive effects on the economy, it is strongly supportive of measures to decrease the carbon footprint. Though the climate science may be beyond challenge, the government's modeling on emissions and targets is not always so. Nevertheless, it is not in dispute that "[t]aking into account existing climate change policies, Australia's emissions are expected to be around 22 per cent higher than 2000 levels in 2020."¹⁴ Australia has adopted binding obligations in respect of emissions reductions that require serious and effective climate action.

However, well-intended policy does not excuse imprudent policy formulation or implementation. It has been argued elsewhere that a targeted, bottom-up approach¹⁵ can, if properly supported and implemented, make incremental and substantial contributions to the reduction of carbon emissions while simultaneously reducing risks to the Australian economy.¹⁶ A smaller carbon tax with less focus on compensation and more focus on investment in renewable energy with complementary policies covering energy efficiency would perhaps have offered a more modest and effective alternative to the grand scheme that Australia has opted for.

Examination of voluntary schemes such as the Regional Greenhouse Gas Initiative (RGGI) in the United States reveals that carbon is currently priced well below the price proposed by the Gillard government. In the auction on September

¹² Greg Sheridan, *Now Is Australia's Time: World Bank Chief Robert Zoellick*, THE AUSTRALIAN, Aug. 13, 2011, at 23.

¹³ CCH PARLIAMENT AUSTRALIA, CARBON PRICING SUMMARY REPORT, 4 (2011), <http://www.cch.com.au/DocLibrary/Order-form-Carbon-pricing-summary-report-July11.pdf>.

¹⁴ *Id.*

¹⁵ By bottom-up is meant an industry driven approach. See Bruno Zeller, *Carbon Reduction Schemes and the Energy Sector: A Bottom Up Approach*, 28(5) ENVTL. & PLAN. L.J. 332 (2011).

¹⁶ See Bruno Zeller & Michael Longo, *Carbon Reduction Legislation in Australia — What Next?*, 8 MACQUARIE J. BUS. L. 182 (2011). The bottom-up approach would see the introduction of an initially small tax on all fossil fuel users with receipts invested in a range of energy projects with a low carbon footprint.

7, 2011, the price was \$US1.89 per ton. More telling is the fact that 42,189,685 permits were offered but only 7,487,000 were sold with total proceeds of \$US14,150,430, down from the month before.¹⁷ This is perhaps a consequence of the decline in economic output, which sees companies sitting on excess carbon permits and not needing to purchase new ones.¹⁸ This is equally the case in Europe.¹⁹

The distance between the proposed carbon price and market realities bring into question the ability of market forces to achieve the sort of emission reductions required to stabilize global warming. Unsurprisingly, in the present politically-charged environment, a carbon price of \$AUD23—well above the EU and US price—is also being touted as overkill, economically irresponsible and difficult to justify with regard to its potentially negative effects.

It may be observed that the whole process leading to the release of the Bill and associated supporting Bills²⁰ exemplified political “deal making,” which raises doubt whether the Act is based on sound economic, social and environmental reasons at all. In keeping with the politically charged, media-driven debate, it was argued by Tom Dusevic of *The Australian* that Prime Minister Gillard “kept the [Multi Party Climate Change Committee] on track.”²¹ Dusevic further noted that there is “firm evidence how the Prime Minister governs; a creature of process, the queen of consensus is a deal maker first and last.”²² Paul Kelly, also of *The Australian*, went even further by noting that:

This is Julia Gillard's finest achievement as a political fixer. She has become a carbon pricer, a tax reformer and a renewable energy champion rolled into one. Gillard is carrying the parliament but faces the unlikely task of persuading the nation at an election. The package is a triumph for Labour-Green shared values. That is its tactical strength and its core defect.²³

While it is accepted that politics is rarely far removed from the legislative process, it is especially apparent that politics has played an instrumental and de-

¹⁷ The RGGI states distribute most CO₂ allowances through quarterly, regional CO₂ allowance auctions. For price updates *See Auction Results*, REGIONAL GREENHOUSE GAS INITIATIVE, http://www.rggi.org/market/co2_auctions/results (last visited Mar. 11, 2013).

¹⁸ Adam Morton, *The Heat Is On*, THE AGE, Sep. 13, 2011, at 11.

¹⁹ It is apparent that the economic crisis following the Global Financial Crisis largely contributed to a drop in total EU-27 GHG emissions in 2009 compared to 2008. According to the European Environment Agency, total EU-27 emissions were estimated to be 6.9% below 2008 levels. *See Deep emission cuts give the EU a head start under the Kyoto Protocol*, EUROPEAN ENV'T AGENCY (Oct. 12, 2010), <http://www.eea.europa.eu/pressroom/newsreleases/deep-emission-cuts-give-the>.

²⁰ *See e.g.*, Australian Energy Market Amendment (National Energy Retail Law) Bill 2011; Australian National Registry of Emissions Units Bill 2011; Australian Renewable Energy Agency Bill 2011.

²¹ Tom Dusevic, *How the Queen of Consensus and Her Team Kept the Negotiations on Track as Conflicting Political Demands Threatened to Derail a Delicate Process*, THE AUSTRALIAN, July 11, 2011, at 8.

²² *Id.*

²³ Paul Kelly, *ALP-Green Values Triumph in Julia's Finest Political Fix*, THE AUSTRALIAN, July 11, 2011, at 1.

cisive part in the policy processes of climate change in Australia. The political machinations of climate change policy have been evident in the life of the 43rd Parliament no less than the previous Parliament, which saw the acrimonious dumping of Prime Minister Rudd in favour of Gillard after a string of policy failings including the shelving of Rudd's emission trading scheme. This has regrettably entrenched a view of climate change policy as inherently political and open to grandstanding. The Australian Government Productivity Commission's Annual Report for 2009/10 stated that "good public policy combines evidence-based analysis with a good process, one that is systematic, inclusive and transparent."²⁴ Arguably, energy and climate change policy in Australia have not met these standards. As Helen Sullivan notes:

Unfortunately lay knowledge may be marginalised in public policymaking because it is considered to be of less value than other sources of knowledge such as professional expertise or political wisdom. This reflects the power relationships that exist between politicians, professionals and particular service users or communities. Frameworks of evidence-based policymaking can exacerbate this marginalisation as the emphasis on "robust" evidence tends to privilege a particular kind of evidence, collected in a particular kind of way, and can lead to the dismissal of lay knowledge as "anecdotal" and so not relevant.²⁵

Perhaps not surprisingly, current climate action has been buried under the weight of the compensation package (without which, it is thought, a carbon tax would be impossible to sell). Indeed the Commentary notes that "over 50% percent of the carbon price revenue will be spent on households," mainly as tax relief.²⁶ The Commentary notes further that "40% of revenue from the mechanism [will be used] to help business and support jobs."²⁷ Such comments beg the question: why tax 500 firms \$AUD23 per tonne of carbon pollution if most of the revenue is to be redirected into support packages instead of being invested in the development of clean energy? The Commentary makes it clear that the government believes that business will drive the carbon reduction, as the price on carbon will have two effects:

It creates a powerful incentive for all business to cut their pollution by investing in clean technology or finding more efficient ways of operating. A price on carbon will also create economic incentives to reduce pollution in the cheapest possible ways, rather than relying on more costly approaches such as government regulation and direct subsidies.²⁸

²⁴ Posting of Helen Sullivan, CentreEvents@artsit.unimelb.edu.au (Oct. 24, 2011) (on file with author).

²⁵ *Id.*

²⁶ *Commentary on Provisions, supra* note 9, at 13.

²⁷ *Id.* at 14.

²⁸ *Commentary on Provisions, supra* note 9, at 11.

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The carbon tax strategy is premised on the assumption that businesses will adopt carbon reduction techniques as long as the cost of doing so is less than the tax that is otherwise payable.²⁹ It must be noted, however, that business has already found efficient ways to contribute to the reduction of carbon by simply cutting out waste and improving operations in a cost effective way.³⁰

The Act arguably contributes little to the understandings of business of the actual means by which to reduce carbon, as business tends to take a long-term view and pursue solutions, which may not necessarily be contemplated by the Act. Furthermore, the legislative scheme encompasses administrative and compliance costs which, arguably, do not facilitate the stated objective of encouraging business to invest in efficient ways to reduce greenhouse gases.

Undoubtedly, governments around the world have been reluctant to introduce carbon taxes because new taxes are typically viewed as unpopular. For this reason many governments resort to increasing taxes on gasoline or introducing a variety of administrative requirements such as automobile mileage standards, standards on bio-fuels and production technology standards including minimum renewable fuel inputs for electricity generation.³¹ The experience of the successful introduction of a Goods and Services Tax³² by the previous Howard government may have lead the current government into believing that negative community attitudes on tax can be reversed by strong evidence of need and effective campaigning. While the task is usually harder than at first appears, in reality the minority labour government's need for support from the Australian Greens meant that carbon tax policy became a political imperative for the government. Nonetheless, it is apparent that the government has thus far failed to educate the public on the need for the tax and its multiple effects. It remains to be seen whether negative public sentiment will interfere with the Act's implementation.

The higher costs of production attending a carbon tax will, where possible, be charged to consumers. Basic economic theory informs us that consumers would respond to the tax-induced cost increase of emissions intensive products by reducing their consumption of those goods and services in favour of cheaper products.³³ However, the vast sums of money to be spent on the compensation package suggests that while business will still pass the tax on to consumers—potentially necessitating changes to the tax system—consumers may not be encouraged to change their consumption choices. Only when business is finally convinced that investing in changed production techniques is financially more attractive than paying the carbon tax, will innovation in clean energy facilitate a change.

This already drawn-out process is further extended by the artifice of widespread compensation of polluting industries, which, though thought necessary, is

²⁹ Martin Feldstein, *Cap-and-Trade Protectionism?*, THE INT'L ECON., Summer 2009, at 42.

³⁰ As seen specifically in the Swiss efforts to reduce greenhouse gases through the bottom up approach. See e.g., Zeller & Longo, *supra* note 16.

³¹ Feldstein, *supra* note 29, at 43.

³² *A New Tax System (Goods and Services Tax) Act 1999* (Act 55/1999) (Austl.).

³³ *Id.* at 42-3.

ultimately self-defeating. It is accepted that subsidies can have a distortive effect and are costly and complex if not properly administered. The Productivity Commission has warned that the government ought to “scrap renewable energy subsidies,”³⁴ while Reserve Bank board member, Warwick McKibbin, has warned that “the plan would drive up the cost of cutting emissions.”³⁵ The Commission currently estimates that the subsidies to wind farms and solar panels run at up to \$AUD1000 a tonne.³⁶ The argument is that subsidies ought to be reduced to a more sustainable level in order to keep the price of electricity down. This has happened in Australia where states have reduced the subsidy to a level which makes the installation of solar panels too expensive. The outcome is that the only manufacturer of solar panels in Australia was forced to close business and locate overseas.

While the payment of subsidies in respect of, say, solar panels will at least result in emission reductions, a carbon tax levied on a business which is then passed on to consumers will have no effect on the reduction of carbon. Indeed, it can be argued that it will have a detrimental effect as the resulting compliance costs will increase indirectly the carbon output through the creation of a new level of bureaucracy associated with increased energy needs just to drive the mechanism.

Furthermore, charges will be imposed for the creation of an emission unit, the effect of which is that complying industries will pay for the auction of carbon units, adding further to the costs of compliance.³⁷ These factors do not by themselves make these carbon mitigation measures untenable. However, they emphasise the need for coherence in climate action and giving proper consideration to likely causes and effects.

Additionally, new governance arrangements will be implemented and the Productivity Commission's functions will be expanded. A new Clean Energy Regulator (the “Regulator”) will be established to administer the carbon pricing mechanism and the Climate Change Authority (the “Authority”) will advise on pollution caps, on meeting targets and reviewing the carbon price mechanism. New commissions will be created to give financial support for innovations in clean energy technology. These new commissions are the Clean Energy Finance Corporation (CEFC), with a budget of \$AUD10 billion, and the Australian Renewable Energy Agency (ARENA), with a budget of \$AUD3.2 billion.³⁸ At first glance the administrative overlay appears to be quite excessive and this raises the

³⁴ Siobhain Ryan, *Warnings Ignored as Renewables Get Billions*, THE AUSTRALIAN, July 11, 2011, at 1, available at <http://www.theaustralian.com.au/national-affairs/carbon-tax/biggest-single-investment-ever-made-in-renewable-energy/story-fn99tjf2-1226091910294>.

³⁵ *Id.*

³⁶ *Id.* at 9.

³⁷ *Commentary on Provisions, supra* note 9, at 104.

³⁸ See e.g., *Expert Review*, CLEAN ENERGY FIN. CORP., <http://www.cefcexpertreview.gov.au/content/Content.aspx?doc=thecfec.htm> (last visited Apr. 29, 2013); *Australian Renewable Energy Act*, AUSTRALIAN GOV'T DEP'T OF RES., ENERGY & TOURISM, <http://www.ret.gov.au/energy/clean/arena/Pages/arena.aspx> (last visited Apr. 29, 2013).

question whether the plethora of authorities can deliver expected outcomes. Cuéllar makes the general comment that the law

. . . Take[s] shape through administrative decisions and legal interpretation rooted in agency practices. When choosing these practices, agencies seldom escape the influence of their external context. . . . This makes it difficult to see how the behavior of agencies can be explained without paying serious attention to . . . the strategic behaviour of people with agendas inside and outside the organisation. . . .³⁹

If organisations ultimately shape laws and their implementation, the question is whether the model of “agendas”—within and between the organisations—is the best possible design to implement an already “politically burdened” legislation. It is argued that the dangers of not achieving the goal due to bureaucratic roadblocks outweigh the purpose of the Act. A simpler structure and system would be far more appropriate given the current unstable political and economic landscape in Australia and globally.

III. Outline of the Act

The Act came into operation on July 1, 2012. The full introduction will move through two stages. For the first three years the tax will be fixed at \$AUD23 per tonne with an adjustment of 2.5% every year.⁴⁰ In 2015, it will develop into a cap and trade system.⁴¹ Perusal of the cap and trade section of the Act suggests that aspects of the previous Rudd Bill have been resurrected. Despite the fact that the government originally let the Rudd Bill lapse due to its unpopularity, it has now resurfaced in a new context. Inevitably, the question arises whether the dual system of a fixed price for three years to be followed by a price set by the market from July 2015 overcomes the defects of the previous Rudd emissions trading system (“ETS”).

Moreover, the metamorphosis from a carbon tax system—a compliance regime—into a new, fundamentally different ETS will impose further compliance costs on industry. This raises a related point; it may be premature to lock in legislation on the establishment of a trading system. A trading system requires a cap, which cannot be predicted at this stage as it depends on the effects of the carbon tax. This point seems to be acknowledged by the government in the Commentary to the Act: “business will reduce their pollution when it is cheaper to do so than pay the [tax].”⁴² The government assumes wrongly that because of the tax, “the market will create incentives to cut carbon pollution.”⁴³ The only incentive to cut pollution by the market is the profit motive. Of course, it is also the

³⁹ Mariano-Florentino Cuéllar, *Refugee Security and the Organizational Logic of Legal Mandates*, 37 *GEO. J. INT'L L.* 583, 689-90 (2006).

⁴⁰ *Commentary on Provisions*, *supra* note 9, at 12.

⁴¹ *Id.* at 27.

⁴² *Commentary on Provisions*, *supra* note 9, at 27.

⁴³ *Id.*

case that legislation has a powerful effect on compliance by virtue of the threat of prosecution for non-compliance.

A potential problem with the Act is that over half of the revenue generated by it will be ploughed back into the economy in benefits, which are only necessitated because of the carbon tax. In addition, under the cap and trade system the government will issue a fixed number of carbon units every year, some of which will be sold and others allocated to key industries without charge. The point is that as long as industry can pass the extra costs onto consumers—and due to tax incentives the purchasing power of the economy will not have decreased appreciably—there will be no real incentive to reduce carbon until competition forces action such as consumers switching to imported goods. The government has realised that industry has a real option to relocate and it intends to minimise carbon leakage through the introduction of the Jobs and Competitiveness Program.⁴⁴

In effect, industry will be subsidised through free carbon units or money allocated through the various programs. It is acknowledged that subsidies and other adjustments may be required as the effects on the Australian economy can be detrimental, especially as no other country in the Asian region has yet introduced a similar carbon reduction scheme.⁴⁵

Before the proliferation of free trade agreements (FTAs), the rules of origin, which were linked to customs duties, cushioned the effect of imports on the domestic market. However, the definition of rules of origin and the application of import duties have been changed pursuant to FTAs, and arguably not to Australia's benefit. From this point of view, carbon leakage is an economy-wide risk, with the possible exception of the energy sector. However, carbon leakage is still a possibility in this sector—not in the physical sense—but through the reluctance of companies to invest in the energy sector in Australia. The Clean Development Mechanism (CDM) and Joint Implementation (JI) programs under the Kyoto Protocol have created attractive investment opportunities in developing countries which are superior to those currently on offer in Australia.

This article therefore argues that the political compromises made in drafting the legislation have produced a potentially incoherent scheme and a degree of uncertainty. With or without the Act, Australia can work towards a smaller carbon footprint by encouraging innovative and grassroots developments including localised developments that have been successfully implemented in other parts of the world, most notably Europe and the US.⁴⁶ These grassroots developments represent low-cost, low-risk, economically-sound approaches to the carbon problem. Innovative projects in themselves can be important drivers of competition and can encourage industry to develop experimental technologies. Public investment in renewable energy can accelerate the process. There are advantages for Australia in strategically positioning itself in the Asia-Pacific region through the

⁴⁴ *Id.* at 32.

⁴⁵ South Korea is developing a scheme which is due to commence in 2015; Japan has put its legislation on hold; China is piloting six trading schemes in parts of China, though a national scheme is probably some way off. See Morton, *supra* note 18.

⁴⁶ See generally, Zeller & Longo, *supra* note 16.

development of innovative localised projects with export potential.⁴⁷ Indeed, the potential to sell self-contained innovative projects—especially in the use of waste to generate electricity—to developing countries can create a significant export opportunity for Australia, a lucrative spin-off.

IV. Liable Entities and Covered Emissions

The Act covers a broad range of industries affecting around sixty percent of Australia's emissions. However, the statement that treasury modeling shows “a broad-based carbon price will encourage pollution reductions across all sectors of the economy,”⁴⁸ cannot be accepted on face value. It is difficult to imagine that the transport industry would be in a position to reduce the carbon output with or without a carbon tax or equivalent carbon price.

It might be far-fetched, for instance, to argue that an owner-driver transporting goods from Melbourne to Sydney has any option but to use diesel, irrespective of the price. A reduction of carbon emissions in this instance is not a credible outcome as demonstrated by the following hypothetical example: A national transport company has trained its drivers to drive in the most efficient way. Where legislation allows, the company has switched to night deliveries. If greater efficiencies were possible, the company would certainly have implemented changes to achieve operational improvements because they affect its bottom line. One fact appears certain: a carbon tax or equivalent price on petrol would merely raise transport costs. Those additional costs would be passed on and/or would drive transporters—especially owner-drivers—out of the industry. The likely outcome is that consumers switch to cheaper imported goods as those imported goods do not incorporate a carbon tax or the domestic transport costs at their place of manufacture. This point is further strengthened by the “virtual absence of the transport sector from [CDM projects].”⁴⁹ Arguably, if industry were able to include transport in CDM projects, it would have done so.

In general, the operator of a facility is responsible for the control of emissions and hence, for payment. It is interesting to note that the Commentary states: “The person with operational control will also generally hold the contracts for sale of the output of the facility, and will be in the best position to pass through the carbon price to customers of the facility.”⁵⁰ The purpose of the Act is arguably defeated if the effect is simply to pass on the extra costs associated with the carbon tax to customers and eventually to consumers. In such a case, it may be appropriate to question whether the existing goods and services tax—with an established compliance structure—might not instead have been deployed to fund innovation in renewable energy.

⁴⁷ Morton notes that China is now investing “far more in renewable energy than any other nation, motivated in part by its extraordinary export potential.” See Morton, *supra* note 18, at 4.

⁴⁸ *Commentary on Provisions*, *supra* note 9, at 41.

⁴⁹ Adam Millard-Ball & Leonardo Ortolano, *Constructing Carbon Offsets: The Obstacles to Quantifying Emission Reductions*, ENERGY POL'Y, Nov. 1, 2009, at 533, 545, available at <http://www.elsevier.com/locate/enpol>.

⁵⁰ *Commentary on Provisions*, *supra* note 9, at 45-6.

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It is understood that not all operators of a facility can be liable for the tax, as other points in the supply chain may be better situated to collect the tax. The treatment of natural gas retailers is a case in point and the Act has recognised this fact.⁵¹ Re-introduced from the Rudd Bill, the system of Obligation Transfer Numbers (OTNs) has the purpose of transferring the obligation to the person or entity best suited to manage the liability of paying the tax. If a tax must be levied, then the creation of OTNs is the best option. However, to tax all natural gas users is not an optimal solution.

In the short term at least, as we target dirty brown coal energy production, there will be heavy reliance on natural gas to generate electricity. Yet natural gas will be subject to the tax despite the Act's purpose to reduce the carbon footprint. This appears counterintuitive. It is accepted that once the trading system is operational, the gas-fired electricity generators might recover some costs by selling carbon credits with the extent of recovery being dependent on the ceiling set by the government. However, at the outset, the introduction of electricity generation with a smaller footprint than brown coal will be made more difficult and costly than it needs to be.

V. Pollution Caps and Emission Units

Pivotal to any carbon reduction scheme is the premise that pollution output will be reduced over time. Under the second stage of the scheme—the emissions trading system—eligible units will be traded on the market. The Act envisages that emission units will either be sold at auction or issued for free by the Federal Government to eligible industries. The pollution cap, which will be set every year, will determine the total volume of units for distribution. Affected businesses will be able to choose between reducing the carbon output domestically or purchasing emission units from overseas. There is no doubt that every business will make this calculation very carefully as competitiveness within the industry is paramount. Two criteria will affect these decisions, namely, the setting of the cap and the cost and availability of eligible emission units which can be surrendered in Australia.

The setting of the cap is problematic. The Act takes a “one size fits all” approach. Matters that need to be taken into account include, among others, Australia's international obligations under relevant agreements and the report by the relevant Authority.⁵² It appears the Government will have some limited room to move in the cap it sets, as the minister may also “have regard to twelve additional factors,”⁵³ the most significant of which allow the minister to give consideration to:

⁵¹ For example, the Act recognises the direct taxation of natural gas retailers is impractical as it can lead to double accounting. See *Commentary on Provisions*, *supra* note 9, at para 1.149 (quoting an OTN allows the OTN holder to take on liability for the emissions embodied in the natural gas they receive). The OTN holder then becomes a liable entity under the mechanism. *Id.*

⁵² *Commentary on Provisions*, *supra* note 9, at 84.

⁵³ *Id.*

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The economic and social implications associated with various levels of pollution caps, including implications of the carbon price . . . [and] the extent of actions voluntarily taken to reduce Australia's greenhouse gas emissions.⁵⁴

Such considerations would effectively drive a less formalistic approach. It is argued that a bottom-up approach affords governments the ability to test the two factors above in a more nuanced manner, that is, industry-by-industry. This can subsequently pave a path towards the eventual introduction of a carbon price and/or emissions trading scheme. Importantly, this chronology can give a government the opportunity to more effectively study the trajectory of carbon abatement and model, the likely effects that emission units in a cap and trade system would have on the economy.

The problem with the premature introduction of a cap and trade system is that there are currently only two official systems in operation—in New Zealand and the EU. The New Zealand system is too young to extract any meaningful conclusions and the EU system is subject to the problem of carbon leakage, and is thus is not strictly comparable. It must be noted that emission trading, which was based on experience with US criteria pollutant trading programs, could “reduce compliance costs by increasing compliance options, making a greater spectrum of marginal abatement costs available to each Annex B Party.”⁵⁵

A further problem is that the carbon units—being personal property—are classified differently in the EU. For example, Austria classifies the units as commodities whereas others (including Australia in the system proposed under the Rudd Bill) classify them as financial products. The result is that the trading aspect is different. As the trading of financial products requires a licence, the question of how to accommodate two different classes of personal property remains unanswered. Furthermore, the Commentary notes that as tradable units they are “allocated to the most highly valued uses across the economy.”⁵⁶ However, as they are tradable, businesses will see a potential profit in “playing the market.” Accordingly, an incentive to reduce carbon might be diminished if the trading is, in effect, superior to the abatement cost.

Nonetheless, not all international units are eligible—they are judged by the Authority on the criteria of being credible. The question is whether the criteria used by the Authority mirrors the trading aspect in the EU and New Zealand as the “mechanism is linked to other international emissions trading markets.”⁵⁷ It appears, however, that the decision has already been made as the Commentary

⁵⁴ *Id.* at 85.

⁵⁵ Tyson Dyck, *Enforcing Environmental Integrity: Emissions Auditing and the Extended Arm of the Clean Development Mechanism*, 36 COLUM. J. ENVTL. L. 259, 267 (2011). It should also be noted that while this was a US initiative, the US has not yet signed the Kyoto Protocol. Though a regional scheme is in operation (the RGGI) in the North-East of the country, and California is pushing ahead with carbon pricing, nationally, the US is not on the same path.

⁵⁶ *Commentary on Provisions*, *supra* note 9, at 89.

⁵⁷ *Id.* at 92.

notes that the criteria includes “whether the units are accepted by either the European Union or New Zealand schemes.”⁵⁸

Having a unit judged as credible by an Australian authority has its own complexities, as the Authority needs to also see whether the units are traded in the EU and New Zealand. Such a combination is fraught with danger. If the Authority judges a unit not to be credible but it is nonetheless traded in both the EU and New Zealand, the confidence of traders will be tested.

It would make more sense to simply follow the criteria set out by the Kyoto Protocol, which embeds three trading mechanisms for Annex B Parties. In brief, Annex B countries can: trade their units among each other; trade JI units (which are units from new investments in Annex B countries); and trade CDM units (which are clean development projects in developing countries).⁵⁹ As the Act pronounces that one of its purposes is to fulfil the promise made under the Kyoto Protocol, it follows that it should fulfil the requirements set out in the Protocol and honour all three mechanisms established under the protocol.

VI. Trading of Units

The Act gives rise to further uncertainty. The carbon units can be traded on domestic as well as international carbon exchanges, which are kept in registries. Comparison may be drawn with financial securities kept by intermediated securities registries under the principle of trust law. As the Regulator transfers and makes entries for the units in the Registry account, the question is whether the system is a trust system similar or equivalent to that used for the transfer of securities.

Furthermore, as carbon units are traded it has to be assumed that the government is prepared to consider that the carbon trade will in all likelihood have a negative impact on the balance of trade. This assumption is based on the fact that CDM and JI units, as well as all those traded on the major EU floors, are eligible units. The fact is that currently, all these units are cheaper than currently proposed in Australia. Arguably, there is therefore a real incentive to buy carbon units from overseas, which could negatively affect the desire to reduce the carbon output. This argument is supported by the fact that for the first three years of the ETS period a price ceiling and floor will be set. Thus, “[the price] will be set at \$20 above the expected international price in 2015-16.”⁶⁰

The Act, in effect, also introduces hidden subsidies that cover costs for some industries—costs which will only have arisen as a consequence of the introduction of the Act. Arguably, they do little to realistically reduce carbon emissions. A person might not, for example, wish to surrender carbon units which were issued free of charge. The example provided in the Commentary is self-explana-

⁵⁸ *Id.* at 93.

⁵⁹ See U.N. FCCC, 3rd Sess., Dec. 1997, Kyoto Protocol to the United Nations Framework Convention on Climate Change, U.N. Doc. FCCC/CP/1997/L.7Add.1, arts. 6, 12, 16, *reprinted in* 37 I.L.M. 22 (1998).

⁶⁰ *Commentary on Provisions, supra* note 9, at 98.

tory and arguably constitutes a breach of, or is at least not in the spirit of, FTAs, BITs, and WTO regulations. It states:

- A person might receive units for the cost increase it faces from:
- Its use of electricity in an emission-intensive-trade exposed activity; or
 - From the cost increase it faces that is related to the upstream emissions from the extraction, processing and transportation of natural gas and its components used as feedstock in an emission-intensive-trade-exposed activity.

The person may wish to sell these units to receive cash, which can then be used to offset the increase in monetary costs it faces due to its use of electricity or natural gas and its components as a feedstock, rather than hold these units for surrender.⁶¹

It can be assumed that the Act would not introduce such a system if the industry were small or the monetary value insignificant. The question is then, why take with one hand and give back with the other when the same result can be achieved by setting a smaller amount which can be more easily digested by industry and also achieve a clear reduction of carbon emissions? Arguably, the system the Act proposes will, on paper, achieve the Kyoto reduction obligation, but it will in fact fall short as industry is governed by cost factors, and the question will always arise whether a reduction of carbon or trading out of the obligation would be cheaper.

VII. Jobs and Competitiveness Program

By proposing to enter into “closure contracts with highly emissions intensive coal fired generators,”⁶² the government acknowledges and seeks to give effect to its international obligations in relation to carbon abatement.⁶³ It also intends to link the allocation of free carbon units to this policy. In the long-term, a significant carbon reduction will be achieved, but the costs will depend on the length of the buyback attempt. The downside is that the generators will not invest in the generator facilities and the question of who pays for the write-down of the value of the asset will remain an important focal point in the government's endeavour to compensate foreign-owned electricity companies. Furthermore, the success of the policy is dependent on the pace of generating alternative electricity facilities.

The question posed above, which appears to be unanswered, is why a tax should be imposed on gas, which is used to generate electricity with fewer emissions than coal. The result is that the inevitable cost increase is unnecessarily pushed further as cheap brown coal generation is replaced by higher cost gas generation. To put it differently, coal is the cheapest electricity generator and any other facility will drive up electricity costs (at least in the short term). If imple-

⁶¹ *Id.* at 100.

⁶² *Id.*

⁶³ *Id.*

mented slowly, the Australian economy can absorb the increases. The buyback proposition is generally sound, however, if executed properly.

The Act recognises that the carbon price will impact the international competitiveness of its industries.⁶⁴ To address this, support for jobs and emissions-intensive, trade-exposed industries is proposed. However, the main aim is to avoid the risk of carbon leakage.⁶⁵ Arguably this is not the greatest risk as the generation of FTAs has produced a more than favourless playing field for importers. The rules of origin are already being used to avoid otherwise applicable import duties and the Act has not addressed this problem.

The US too may at some stage seriously consider a carbon price/tax. If this comes to fruition, the US will arguably shift its focus onto "dirty" imported goods, as the US always looks to border measures to adjust for loss of competitiveness. This will especially be the case in the light of current economic and political problems. Once the US engages with the issue, others will follow. Anecdotally, the EU is also considering what to do about "dirty" imports. Certainly, there are different approaches that can be taken.

When the carbon price or the cost of ETS permits is high enough to have a significant effect on carbon emissions, political pressure will grow for the introduction of tariffs on imports to offset the advantages that countries with no, or a low, carbon or permit price have.⁶⁶ There are numerous complexities in comparing and adjusting for carbon abatement policies among countries. Feldman remarks that a "system of complex differential tariffs" is precisely the kind of protectionism that governments have been working to eliminate for more than fifty years under the GATT and now the WTO.⁶⁷

The introduction of offsetting tariffs is thought by many to threaten the global system of free trade.⁶⁸ Others consider that some form of border tax adjustment ("BTA") is reasonable and necessary in order to maintain the competitiveness of domestic producers.⁶⁹ However, problems of WTO compatibility aside, there are significant doubts and challenges attending the calculation of BTAs. Some of these have been canvassed by Whalley:

One of the difficulties is that border adjustments used to offset cost disadvantages imposed on domestic producers would reflect added production costs not only occurring directly but also indirectly (e.g., emissions involved in the production of the steel that goes into a car as well as the carbon emitted assembling the car). Also, the chain of component inputs would itself need to be followed across (potentially many) borders. Another complication is that such calculations should presumably be relative to costs abroad and not just based on home markets. There would thus be

⁶⁴ *Commentary on Provisions*, *supra* note 9, at 127.

⁶⁵ *Id.*

⁶⁶ Feldstein, *supra* note 29, at 43.

⁶⁷ *Id.*

⁶⁸ Feldstein, *supra* note 29, at 43.

⁶⁹ *Id.*

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gradations of adjustments across supplying countries, together with potentially complex rules of origin as now occur in preferential trade agreements.⁷⁰

A carbon tax on imports could potentially put Australia in breach of international trade agreements, so Australia will probably not tax imports. This means that Australian companies competing with importers will be disadvantaged. At the same time, Australian carbon exports will be taxed with the possibility of subsidies being paid to export companies which would otherwise be disadvantaged. The issue is highly complex and belies a simple trade adjustment, as a rebate greater than the value of the tax may constitute an actionable export subsidy. It will be essential to ensure that competition corrections are WTO-compliant to avoid litigation and unwinnable trade wars with powerful economies.⁷¹ There is therefore a risk that a carbon tax will compromise the trade competitiveness of Australian industry by penalising the export sector without affecting imports.⁷² The competitiveness of Australian producers will potentially slide until there is an adjustment to wages and the exchange rate.⁷³

In recognition of the potential trade difficulties arising from such action, the Act in Part 7 acknowledges that the jobs and competitiveness program has to be consistent with Australia's international trade obligations.⁷⁴ The assistance is also linked to production levels and "provided on the basis that production continues in Australia."⁷⁵ Thus:

The linking of assistance to production levels, and not future emission levels, means that the allocation of free carbon units will maintain the financial incentives for firms to reduce their emissions intensity.⁷⁶

The veracity of this statement depends not on what happens in the Australian economic climate, but rather on the price structures of their overseas competitors. At first glance, it appears to be wishful thinking to expect a company to reduce their carbon levels if they cannot or are hard pushed to compete against imports under the current economic climate.

As the carbon price will be reflected in the price of a producer's products, the carbon tax affects that producer's international competitiveness. The Act recognises that "some entities are constrained in their ability to pass on the costs

⁷⁰ John Whalley, *On the Effectiveness of Carbon-Motivated Border Tax Adjustments* 4-5 (Asia-Pac. Research & Training Network on Trade Working Paper Series, No. 63, 2009), available at <http://www.unescap.org/tid/artnet/pub/qp6309.pdf>.

⁷¹ *Media Release, Trade Competitiveness at Risk from Carbon Tax: Trade Expert*, AUSTRALIAN CHAMBER OF COM. & INDUSTRY (Mar. 23, 2011), <http://www.acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement/TRADE-COMPETITIVENESS-AT-RISK-FROM-CARBON-TAX—TRA>.

⁷² *Id.*

⁷³ Peter Gallagher, *CO₂ Tax: A Tax On Trade*, AUSTRALIAN CHAMBER OF COM. & INDUSTRY (Mar. 22, 2011), <http://www.acci.asn.au/Files/Peter-Gallagher-Carbon-Tax-Presentation-to-ACCI-Tr>.

⁷⁴ *Commentary on Provisions*, *supra* note 9, at 128.

⁷⁵ *Id.*

⁷⁶ *Id.*

of the carbon price while competitors do not face similar costs which have been imposed through . . . regulatory mechanisms.”⁷⁷ Arguably, this assessment, though correct, is only linked to the desire of the government to reduce carbon leakage. In effect, carbon leakage is the least serious problem arising. Issues such as cheaper imports, a general increase in prices in Australia (which have the effect of reducing consumption), and the capital flight of potential investors are far more serious issues.

VIII. Conclusion

In the light of current international and domestic economic difficulties, the *Clean Energy Act* may be viewed as untimely and excessively ambitious. Considering that the Act has far reaching consequences into the future, the lessons learned from the inception of CDM projects should be heeded. First, “when time is measured in centuries, the creation of durable institutions and frameworks seems both logically prior to and more important than [the] choice of a particular policy program that will also most surely be viewed as too strong or too weak within a decade.”⁷⁸ This is shown to be true if the historical development of the CDM experience is considered. As Dyck succinctly stated, “[i]t was a policy choice before it was an institution, and in practice its administration has involved the constant struggle to reconcile a grand vision with bureaucratic realities.”⁷⁹ The track record of climate change projects and policies in Australia confirms this view.

Two alternative solutions to reduce carbon emissions are immediately discernable. The first is simply to attach a cost such as a tax to all polluters, private or business, which is digestible by all. The Swiss system takes this approach.⁸⁰ Persistently, literature recognises the point that a “single group of decision-makers may be ill equipped to develop a consistent framework across sectors and incorporate both engineering and economic phenomena.”⁸¹

Second, a bottom-up approach, in conjunction with a small charge, may be preferred. In the bottom-up approach, the collected tax becomes the seed fund for new developments and the government becomes a partner in these projects. Such a system has been envisaged by the Australian government and is already proposed by establishing the new ten billion dollar commercially-oriented Clean Energy Finance Corporation.⁸² It will not only build on available opportunities, it will also bring about a change of attitudes among inventors and investors, who will take the necessary steps to invest in new and exciting projects. This option will therefore encourage and speed up a process which has already begun in Australia, albeit in a haphazard way. Simply put, the paddock into which the

⁷⁷ *Id.* at 135.

⁷⁸ Richard Schmalensee, *Greenhouse Policy Architectures and Institutions*, in *ECONOMICS & POLICY ISSUES IN CLIMATE CHANGE* 137, 141 (William D. Nodhaus ed., 1998).

⁷⁹ Dyck, *supra* note 55, at 357.

⁸⁰ Zeller & Longo, *supra* note 16, at 196.

⁸¹ Millard-Ball & Ortolano, *supra* note 49, at 545.

⁸² *Commentary on Provisions*, *supra* note 9, at 15.

government wishes to sow the carbon reduction seeds has not been adequately prepared. It is well known that one can only reap if the seeds are viable and the soil is prepared. On examination, the Act's language reveals that more preparatory work needs to be done to achieve the desired results. The Act's political foundation is all too evident and pervasive and this has detracted from the viability of the proposals.

Furthermore, in order to change the reliance on dirty coal-fired generators and break the reliance of the Australian economy on highly polluting export-oriented industries, investments need to be made. In developing a carbon abatement scheme, the consideration that investing in CDM projects in developing countries gives higher returns than in a developed country should be cause for concern. Dyck observed that "[a]s of May 15, 2011, more than 3000 projects had been registered with the CDM with over 2,500 more in the pipeline for registration."⁸³ It is obvious that Australia needs to compete for investments and this can only be done in a secure, uncomplicated and cost effective environment. Considering the strength of the Australian dollar, the high cost of Australian labour and the higher compliance costs relative to developing countries, procuring investments may prove difficult.

It is plausible to argue for measured, proportionate and effective steps on carbon abatement by states pending a binding global agreement which secures emissions reductions in the post Kyoto period. Governments should refrain from playing politics on an issue where the "boundary between politics and policy is often blurred."⁸⁴ It is acknowledged that a carbon price will be necessary in order to achieve the Australian target of an eighty percent reduction by 2050, though a hefty price on carbon at this point in time is not necessarily the best or only way of tackling the problem.⁸⁵ States should strive for policy coherence and consistency between climate change policies and related policies. Innovation in renewable energy is imperative. European initiatives in waste management are highly successful and are at the forefront of carbon reduction efforts.⁸⁶ These and other innovative grassroots projects would have the added benefit of not unduly advantaging imported goods over domestic goods. They deserve to be seriously considered.

⁸³ Dyck, *supra* note 55, at 15. This number has grown considerably. As of April 24, 2013 registered projects had reached 6713.

⁸⁴ Posting of Helen Sullivan, *supra* note 24.

⁸⁵ *Commentary on Provisions*, *supra* note 9, at 27.

⁸⁶ Zeller & Longo, *supra* note 16.

