# Emissions Trading and the GATS Financial Services Provisions: A Case Study of the Australian Carbon Pricing Mechanism

## 1.1 INTRODUCTION

The *General Agreement for Trade in Services* (the **GATS**) regulates the international trade in all services.[1] Within this agreement there are specific provisions for the international trade in financial services. The purpose of this paper is to consider the regulation of the financial services sector by the GATS and determine whether this regulation will encompass emissions trading schemes. In particular the Australian carbon pricing mechanism (the **CPM**) is used as a case study to provide a practical analysis of how the GATS provisions may regulate emissions trading schemes.

In order to achieve this objective it is necessary to examine the meaning of financial instruments within the GATS and determine whether emissions units may be classified accordingly. It suggested that emissions units display qualities that enable their inclusion within the category of financial products. For this reason the contention within this article is that the GATS provisions that are applicable to financial services will extend to emissions trading schemes.

There have been significant reforms to Australia's financial sector since the GATS was introduced. These reforms have been motivated by efficiency gains and increased competition.[2] The Australian commitments specific to the financial services sector within the GATS are based on the *Understanding on Commitments in Financial Services* (the **Understanding**).[3] Although some limitations remain in

[1] *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force1 January 1995) Annex 1B ('*General Agreement on Trade in Services').*

[2] Department of Foreign Affairs and Trade, 'Joint Study into the Costs and Benefits of Trade and Investment Liberalisation between Australia and Japan' (Joint Study Report, 2005) 71.

[3] Uruguay Round Agreement, *Understanding on Commitments in Financial Services*.

insurance and banking services,[4] Australian representatives have committed to avoid discrimination within this sector.[5] With this in mind, this paper examines whether the Australian legislators have honoured these commitments when they drafted the CPM framework.

This paper is presented in four substantive parts, which reflects the methodology employed in this research. The first part considers emissions trading schemes generally and contrasts the tradable units introduced by the schemes with a specific focus on the Australian CPM. Following this, this paper provides an overview of the GATS. Specifically the structure of the GATS is important to understand before undertaking analysis using its provisions. The third and most substantial part of this research examines the financial services provisions of the GATS, and considers how emissions trading schemes, in particular the Australian CPM, may be regulated by these provisions. Finally the GATS exceptions are considered to determine whether any potential breaches of the WTO rules may be justified accordingly.

## 1.2 EMISSIONS TRADING AND THE CPM

Emissions trading schemes (**ETSs**) are set to become more common throughout the world, as a consequence of the global acceptance of the necessity to limit GHG emissions. As Garnaut (2011) recognised, 'more than half of the population of the developed world [already] lives in countries with emissions trading schemes'. Certainly, ETSs represent one of the most popular instruments for pricing GHG emissions. This popularity may be related to the knowledge that these frameworks enable nation states to include the GHG units and GHG credits created by the international climate change regime flexible mechanisms in their domestic strategies to reduce GHG emissions. For this reason, it is important to consider the broader implications of these new markets and their impacts on global economic circumstances.

By imposing a cost on entities that emit GHGs, ETSs operate by encouraging regulated parties to reduce their GHG emissions when the cost of doing so is less than

[4] Department of Foreign Affairs and Trade, 'Joint Study into the Costs and Benefits of Trade and Investment Liberalisation between Australia and Japan' (Joint Study Report, 2005) 71.
[5] Subject to the limitations contained in the horizontal commitments.

the cost the scheme imposes (Lyster 2007, 452). To facilitate this outcome, ETSs harness market forces by enabling the price of GHG emissions, represented by a prescribed unit, to be traded on an open market (Lefevere 2005, 104). While this approach is designed to encourage least-cost abatement of emissions, it may result in barriers to trade. These units and the markets associated with their trade have not yet been sufficiently considered in the context of international trade.

The European Union (the **EU**) introduced the first regional GHG emissions trading scheme in 2005. Since then national schemes have been introduced in New Zealand and Australia. More recently governments in Asian nations are turning to emissions trading schemes to address their escalating GHG emissions inventories. China introduced its first regional trading scheme in Shenzhen in June 2013 (Combet 2013). Chinese authorities will implement another six regional schemes before 2015, which will collectively represent the world's second largest ETS (Combet 2013). In addition to this, South Korea has plans to launch its nationwide emissions trading scheme in January 2015 (White Paper 2013).

The emissions trading scheme that is the subject of the analysis of this paper is the Australian CPM. The CPM is a hybrid emissions trading scheme (Garnaut 2008, 310). It displays a number of similarities to both the EU ETS and the NZ ETS. However, the design of the CPM also contains a number of unique features that have not previously been exhibited in other emissions trading legislation. The framework for the CPM in Australia creates a system to:

- assess and impose liability on certain entities for GHG emissions;
- require payment and surrender for such action; and,
- impose a charge in the event of a failure to comply with the above obligations.[6]

A fundamental feature of the CPM is the design of the GHG tradeable units: namely eligible emissions units. Eligible emissions units include carbon units,

[6] Revised Explanatory Memorandum, Clean Energy Bill 2011 (Commonwealth of Australia) 131.

Australian carbon credit units (**ACCUs**) and eligible international emissions units.[7] The attributes of these units and their conditions for surrender have ramifications for the framework of the CPM, and the compliance of the CPM with the WTO rules. These attributes are examined subsequently within this paper.

### 1.3 THE SCOPE OF THE GATS

Article 1.1 of the GATS defines the scope of the agreement. This article states that 'this Agreement applies to *measures* by Members *affecting trade in services.*'[8] There have been very few disputes exploring the provisions of the GATS. However, a test has been established to resolve when the agreement itself is applicable. In this regard, the Appellate Body in the *Canada – Autos* dispute suggested:

> at least two key legal issues must be examined to determine whether a measure is one "affecting trade in services": first, where there is "trade in services" in the sense of Article I:2; and, second, whether the measure in issue "affects" such trade in services within the meaning of Article I:1.[9]

'Service' is not strictly defined within the GATS, although there exists a variety of commonly understood definitions. For example, a definition of 'services' is provided by Morrison (1997), who notes that:

> A service is essentially an act, even though the result of the service may be embodied in a person, thing or data. A good on the other hand, is clearly a thing even though it results from an act (its production).

Article XXVIII(b) of the GATS clarifies that '*supply of a service* includes the production, distribution, marketing, sale and delivery of a service.'[10] Although services are not defined within the GATS it does describe the *modes* of service that fall within the agreement. These modes are described in Article I:2 of the agreement. They include the supply of services:

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[7] Eligible international emissions units include a number of the units created by the international climate change regime. See *Australian National Registry of Emissions Units Act 2011* (Cth) ss45 and 54.

[8] *The General Agreement on Trade in Services* Article 1.1 (emphasis added).

[9] Appellate Body Report, *Canada - Certain Measures Affecting the Automotive Industry*, WTO Doc WT/DS139/AB/R, WT/DS142/AB/R (adopted 19 June 2000) 51 [155] quoted in (Matsushita, Schoenbaum, and Mavroidis 2006) 614.

[10] GATS Article XXVIII (b) (emphasis added).

> (a) from the territory of one Member into the territory of any other Member (Mode 1);
> (b) in the territory of one Member to the service consumer of any other Member (Mode 2);
> (c) by a service supplier of one Member, through commercial presence in the territory of any other Member (Mode 3);
> (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (Mode 4).[11]

Panels have considered the meaning of 'affect' within the context of the GATS. In this regard, it has been determined for a measure to 'affect' a service or service supplier that measure must modify the conditions for competition for that service or supplier (Martin 2007, 461). This was confirmed by the Appellate Body in the *EC – Bananas III* dispute.[12] In its report the Appellate Body suggested that a wide meaning was intended for the term 'affecting':

> In our view, the use of the term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous Panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing".[13]

The reasoning in *EC – Bananas III* demonstrates that for a measure to *have an effect* on a service it is not necessary for the measure to govern or regulate the service itself (Van Den Bossche 2008, 339). It also appears that the object or intention of a measure need not be to affect the trade in services in order to be subject to the GATS (Martin 2007, 453). In this regard, Article XXVIII(c) of the GATS provides a non-exhaustive list of the measures that may have an effect on the supply of services. This list includes measures in respect of:

> (i) the purchase, payment or use of a service;

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[11] *General Agreement on Trade in Services* Article I:2.
[12] Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas,* Report of the Appellate Body, WTO Doc WT/DS27/AB/R (9 September 1997).
[13] Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas,* Report of the Appellate Body, WTO Doc WT/DS27/AB/R (9 September 1997) [220].

> (ii) the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally;
> (iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member…[14]

The purpose of the GATS is to provide a legal framework that promotes international trade in services. This is done with an objective to increase economic growth for all members, in particular for developing countries.[15] During the negotiation of this agreement representatives acknowledged that there were difficulties in liberalising the trade in services. These difficulties were not experienced during the negotiations for the *General Agreement on Tariffs and Trade* (the **GATT**),[16] which dealt only with trade in goods. It was these difficulties that caused negotiators to develop a significantly more flexible agreement for services than had been in existence under the GATT. Despite this relative flexibility, there is no option to 'opt out' of the GATS and all members are bound by it (subject to specific requirements) (Dobson and Jacquet 1998, 72).

The GATS has a number of different components. The main framework and the Annexes to the GATS incorporate the general obligations and specific commitments provisions, as well as defining the scope of the agreement.[17] The GATS is also associated with a number of protocols. These are binding only on those members that choose to adopt the provisions contained therein. Finally, each member's specific Schedule of Commitments defines the unique boundaries for that member, in relation to the specific commitments.

The general obligations, including the most favoured nation (**MFN**) provision (Marchetti and Mavroidis 2004, 516),[18] bind all WTO members. The specific commitments, including the market access and national treatment (**NT**) provisions are only binding to the extent that they are included in a member's Schedule for a

[14] *General Agreement on Trade in Services* Article XXVIII (c).
[15] *General Agreement on Trade in Services 1994* Preamble.
[16] *General Agreement on Tariffs and Trade 1994.*
[17] The specific commitment obligations in the framework agreement are different from the specific commitments in a member's Schedule. This is discussed more throughout this chapter.
[18] This means members are unable to discriminate between foreign services and service suppliers.

particular service sector. Therefore, the specific commitments are adopted by members on a voluntary basis.

## 1.4 FINANCIAL SERVICES WITHIN THE GATS AND THE AUSTRALIAN CPM

### 1.4.1 THE FINANCIAL SERVICES AGREEMENTS

The liberalisation of financial services by WTO members has, in the past, involved complicated negotiations. Herfindahl and Brown (2007) suggest that the goal of representatives of developed countries in these negotiations was to gain market access to developing economies and to benefit from the profits that the developing countries' financial markets promised. However, developing countries face potentially mixed results from this liberalisation. Although a liberal financial sector within developing countries may lead to greater access to foreign capital markets and decrease the costs of borrowing, it could also reduce the potential profitability of domestic banks through increased competition. These concerns have lead to different approaches in members' Schedules (Marchetti and Mavroidis 2004, 513).

The complications associated with the liberalisation of financial services are also reflected in the documentation and instruments of interpretation associated with it and the GATS. Applicable instruments include the *Understanding on Commitments in Financial Services* (the **Understanding**),[19] introduced as part of the original GATS. [20] Another is the Fifth Protocol to the GATS is also known as the Financial Services Agreement,[21] introduced in 1997 together with the Annex on Financial Services. Each of these serves a different purpose.

The Understanding has unique legal status within the GATS (Von Bogdandy and Windsor 2008c, 651). By itself the Understanding has no legal status, but when its provisions are included within a member's Schedule it becomes binding on that member. Once this insertion is made, it becomes an integral part of the GATS and subject to the provisions of the dispute settlement (Von Bogdandy and Windsor 2008c). The Understanding allows members to opt for a higher standard of

[19] Uruguay Round Agreement, *Understanding on Commitments in Financial Services*.
[20] Uruguay Round Agreement, *Understanding on Commitments in Financial Services*.
[21] There is also a Second Annex on Financial Services in the *General Agreement on Trade in Services*. This Annex was only applicable 6 months after the entry into force of the *WTO Agreement.*

commitments for this service sector (Alexander 2008). It provides non-discriminatory access to all foreign financial service providers (Alexander 2008). This commitment has been described as opening financial services markets as far as reasonably possible (Von Bogdandy and Windsor 2008b, 646).

Members who have accepted the Understanding without reservations are bound to allow their residents to purchase, in the territory of any other member, those services listed in the Annex on Financial Services. This incorporates trading of certain instruments listed in paragraph 5 (v) through to (xvi). These instruments include negotiable instruments, financial assets, and securities. Interestingly, Vranes suggests that the Understanding does not allow members to limit the purchase of these instruments (Vranes 2009, 723). This premise is disputed here. It is suggested as an alternative that the GATS requires that the *service of trading* these instruments cannot be limited by any member that has accepted the terms of the Understanding.

The Fifth Protocol to the GATS is also known as the Financial Services Agreement (Alexander 2008, 569). Both the Financial Services Agreement and the GATS Annex on Financial Services came into effect on 1 March 1999. This protocol has the same legal status as other protocols under international law.[22] Parties, through WTO membership alone, are not required to adopt protocols. However, when a member chooses to adopt a protocol, it acquires the status of commitments similar to those contained in the main WTO agreements. Therefore, the Financial Services Agreement liberalised financial services for the signatories to this agreement.

The provisions in the Financial Services Agreement replaced the MFN exemptions that existed for the signatory parties. This agreement effectively enabled the MFN provision to apply to all financial services for those members who agreed to be bound by it. At the time it was agreed, the Financial Services Agreement was thought to be a step towards liberalising trade in financial services across WTO membership. It has since been argued that the Financial Services Agreement did little more than formalise the existing status quo (Dobson and Jacquet 1998, 89).

The combined effect of these instruments is the financial services sector is one of the most liberalised sectors globally. However, there is one important proviso for

[22] That is as a supplementary agreement to the agreements they are adopted in response to.

this sector's liberalisation that is part of the Annex on Financial Services. That is, the 'prudential carve-out' provision.

### 1.4.2 FINANCIAL SERVICES DEFINITION AND GHG TRADEABLE UNITS

The definition of financial services, contained in the Annex to the GATS, incorporates the trading 'for own account or account of customers' of the following:

> (A) money market instruments (including cheques, bills, certificates of deposits);
> (B) foreign exchange;
> (C) derivative products including, but not limited to, futures and options;
> (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
> (E) transferable securities;
> (F) other negotiable instruments and financial assets, including bullion.[23]

There have been no WTO disputes to clarify these definitions. For this reason, the scope of the terms contained in the Annex to the GATS is largely untested. However, if generally accepted definitions are applied to these terms, it appears that GHG tradeable units could possibly be included within the categories of transferable securities, negotiable instruments or financial assets.

The Australian legislation declares carbon units, eligible international emissions units and ACCUs to be financial products for the purpose of the Australian financial service regime set out in the *Corporations Act 2001* (Cth) (the **Corporations Act**) and the *Australian Securities and Investment Commission Act 2001* (Cth) (the **ASIC Act**).[24] This does not mean that a Panel or Appellate Body would come to the same conclusion (Wemaere, Streck, and Chagas 2009, 55).[25] Similarly, it may be irrelevant that some EU members' legal frameworks deem emissions allowances *not to be*

[23] *General Agreement on Trade in Services*, Annex on Financial Services [5] (emphasis added).
[24] Australian Securities and Investments Commission, 'Carbon Markets: Training and Financial Requirements' (Consultation Paper No 175, ASIC, March 2012) 7; *Corporations Act 2001* (Cth) s764A.
[25] Notably, NZUs are classified as investment securities within the Personal Property Securities Act 1999.

financial instruments (Anttonen, Mehling, and Upston-Hooper 2007, 103).[26] These interpretations may be more relevant if they represent an international norm.

The European Commission (the **EC**) is currently considering redefining EUAs as financial instruments. If this does occur, there will be an argument that these instruments are globally recognised as financial instruments. However, while discourse on this point continues, it is necessary to formulate internationally accepted definitions for the terms within the GATS and determine if eligible emissions units will fit within these.

***Negotiable Instrument***

Werksman (1999) suggests that a GHG tradeable unit may well conform to the definition of negotiable instruments. Werksman bases this argument on the premise that a GHG instrument will have financial value. Although these instruments will most certainly have financial value, this thesis suggests that the definition of negotiable instrument requires that a negotiable instrument demonstrates other qualities.

In the English matter of *Crouch v Credit Foncier of England Ltd*[27] Blackburn J articulated the classic definition of a negotiable instrument:

> Where an instrument is by the custom of trade transferable like cash by delivery … then it is entitled to be considered negotiable.[28]

Therefore, a 'negotiable instrument may be transferred like cash, by mere delivery, and a bona fide holder for value without notice takes a good title free of any prior

[26] Note, the EC is considering deeming all EUAs to be financial instruments. Consider Europa, *Review of the Markets in Financial Instruments Directive (MiFID) and Proposals for a Regulation on Market Abuse and for a Directive on Criminal Sanctions for Market Abuse: Frequently Asked Questions on Emission Allowances* (20 October 2011) <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/719&format=HTML&aged=0&language=EN&guiLanguage=en>; Currently EUAs are afforded different legal treatment depending on which EU country is considered. See (Wemaere, Streck, and Chagas 2009) 51.

[27] *Crouch v Credit Foncier of England Ltd* (1873) LR 8 QB 374.

[28] *Crouch v Credit Foncier of England Ltd* (1873) LR 8 QB 374, 381-2

equities.'[29] This means, 'the essence of a documentary intangible is that in mercantile usage the right travels with the document' (McKendrick 2009, 53).

The concept of negotiability critically turns on the nature of the title of the instrument and the transferability of this title between owners. For an instrument to be negotiable, it must be that the title transfers upon delivery of the instrument. There is difficulty in applying this definition to an instrument that is in no way tangible. An eligible emissions unit exists only through an entry in an electronic register. As Ma suggests when discussing negotiability:

> Many regard this function as the most difficult to replicate electronically, since most legal regimes require "tangible original paper document, susceptible to immediate visual verification on the spot" (Ma 2000).

Tyree and Weaver (2006) recognise that courts have concluded that the following instruments do not possess the qualities of negotiable instruments:

- Share certificates;
- Money orders;
- Postal orders;
- Bankers' deposit notes;
- Commercial letters of credit;
- IOUs; and
- Bills of lading.

It is suggested here, on the basis of these views, that it is unlikely that a Panel or an Appellate Body will consider GHG tradeable units to be negotiable instruments. In general the ownership of GHG tradeable units is aligned with a registry. This is certainly the case for Australian eligible emissions units (Keyzer et al, 2012). Therefore, ownership must be transferred through appropriate documentation, as opposed to transferring on delivery.

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[29] Lawbook, *The Laws of Australia* (at 1 October 2010) 18 Finance, Banking and Securities, 'Negotiable Instruments' [18.5.10].

***Transferable Securities***

Jinnah (2003) disputes Werksman's analysis classifying GHG tradable instruments as negotiable instruments. Rather, Jinnah suggests that a GHG instrument could be a 'security' within the WTO law. The dictionary definition of securities, provided by Jinnah (2003), has four requirements:

- The maker or drawer signs the instrument;
- The instrument includes an unconditional promise *or* order to pay a specified sum of money;
- The instrument is payable on demand or at a definite time; and,
- The instrument is payable to order or bearer.

Although Jinnah argues that a GHG instrument is a security on the basis of the above definition, the usage of the term 'security' within the GATS is uncertain as there has been no judicial consideration of its meaning. Therefore, to be comprehensive the meaning of security needs more detail.

The Encyclopaedic Australian Legal Dictionary defines security as:

> A *document* issued by a government ... in return for funds *invested* for a specified purpose by purchasers. Such securities are *marketable*. They include bonds, debentures, shares, units and interests in managed investment schemes ... The relationship between purchaser and borrower varies in each case, some securities carrying a fixed rate of interest and a date for maturity. In the case of shares, money is invested without certainty of income, appreciation, or eventual recovery in the case of liquidation.[30]

Lord and Oldham (2008) define 'security' as follows:

> the term security is used in the context of *documents* issued by entities in return for money *invested* with the issuer, such as bonds, debentures, shares, notes and negotiable instruments.

[30] LexisNexis Australia, *Encyclopaedic Australian Legal Dictionary*, (at 9 February 2012) (emphasis added).

These definitions have three important, common elements. Primarily, a security is an entitlement. That is, the definitions all require an investment of money in return for an entitlement. The nature of the entitlement may differ between different types of securities. In the case of a share, it is an entitlement to a nominated portion of a company. This aspect of the definition of a security is evident for eligible emissions units. Although eligible emissions units do not necessarily represent an entitlement to money of a designated amount, they are an entitlement to value nonetheless.

The second feature apparent from the definitions of a security is that it must be transferable. The Annex on Financial Services makes this more apparent by reference to *transferable securities*. Eligible emissions units issued during the flexible price period (and those freely allocated during the fixed price period) can be transferred between entities.[31] However, eligible emissions units issued during the fixed price period are generally not transferable and therefore will not be securities.[32]

The final requirement set out in the above definitions of a security is that the security is in the form of a document or an instrument. Although one may consider that a document requires tangible form, conventional definitions of 'documents' note that electronic data may also be a document (Soanes, Hawker, and Elliot 2010, 219). Therefore, despite the intangible nature of eligible emissions units, the electronic registry satisfies this requirement.[33]

It follows that GHG tradeable units may be classified as *transferable securities* for the purposes of the GATS. The above discussion indicates that the eligible emissions units of the CPM will generally be classified accordingly. However, units issued during the fixed price period of the CPM will not comply with all the elements of this definition, as they cannot be traded.

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[31] *Clean Energy Act 2011* (Cth) s104.
[32] *Clean Energy Act 2011* (Cth) ss100(7) – (8).
[33] See *Electronic Transactions Act 1999* (Cth) s4. This Act ensures that a requirement to produce a document can be met in electronic form. This is the international position also on electronic documents.

***Financial Asset***

Financial assets are a sub-category of 'assets'. An asset is either 'tangible or intangible … and can be converted into money for the owner's benefit.'[34] Financial assets as a sub-category of assets have other features that distinguish them from assets generally.

Both International and Australian Accounting standards define financial assets as:

> (a) cash;
> (b) a contractual right to receive cash or another financial asset from another entity;
> (c) a contractual right to exchange financial instruments with another entity under conditions that are potentially favourable; or
> (d) an equity instrument of another entity;[35]

Within Australia, the *Social Security Act 1991* (Cth) defines financial assets as:

> a financial investment, [which] means:
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> (a) available money; or
>
> (b) deposit money; or
>
> (c) a managed investment; or
>
> (d) a listed security; or
>
> (e) a loan that has not been repaid in full; or
>
> (f) an unlisted public security; or
>
> (g) gold, silver or platinum bullion; or
>
> (h) an asset-tested income stream (short term). [36]

Classes of financial assets generally include items such as stocks and bonds (McGuire 2010, 80) and claims to income generated by real assets (Lee and Lee 2006,

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[34] LexisNexis Australia, *Encyclopaedic Australian Legal Dictionary,* (at 9 February 2012).
[35] Accounting Standard AASB 1030: Application of Accounting Standards to Financial Year Accounts and Consolidated Accounts of Disclosing Entities other than Companies ; (Epstein and Mirza 2002) Chapter 5.
[36] *Social Security Act 1991* (Cth) s9.

119). Financial assets are usually associated with investment instruments.[37] Importantly, financial assets can generally be purchased and sold on an open market.[38] It is suggested here that all securities are financial assets; however, financial assets may include instruments that are not securities.

Given the disparity between definitions of financial assets, it is uncertain how a Panel or Appellate Body will define this term for the purposes of the GATS. Jinnah (2003) considers that Assigned Amount Units (**AAUs**)[39] will fall within the category of financial assets. This is justified because a purchaser may be able to profit from trading these units in an emissions market even if they are not a liable entity under a scheme. Jinnah (2003) also suggests that a GHG instrument is more likely to be a financial asset where an entity can buy and sell these instruments on the open market.

To extend this reasoning to eligible emissions units of the Australian CPM means that it is unlikely that a Panel or Appellate Body would classify fixed price units as financial assets. These units are not transferable, nor can an entity purchase them if they are not liable under the CPM.[40] These may be distinguished from all other eligible emissions units. An entity that acquires units by auction may transfer these units to entities that are not liable under the mechanism.[41]

It is expected that most types of eligible emissions units will be classified as transferable securities. This means they should also be classified as financial assets. It does not appear that fixed price units of the CPM will satisfy the conditions of either of these categories. Therefore, it may be that the trade of units in the flexible price period may be subject to the rules of the GATS, where units under the fixed price period are free from such obligations.

Interestingly, a Panel specifically excluded securities and other types of financial instruments from categorisation as a 'good' within the SCM Agreement.[42] This exclusion has some relevance to the examination of whether eligible emissions

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[37] Lexis Nexis, *Personal Property Securities in Australia* (at 23 April 2012) 'Proceeds' [4.10.250].
[38] Lexis Nexis, *Personal Property Securities in Australia* (at 23 April 2012) 'Proceeds' [4.10.250].
[39] AAUs are the units assigned through the Kyoto Protocol to Annex I parties. See generally (1997) Article 3.
[40] *Clean Energy Act 2011* s100(1).
[41] *Clean Energy Act 2011* s111(2).
[42] Panel Report, *United States — Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WTO Doc WT/DS236/R (27 September 2002) [7.22]

units may be a 'product' contemplated by the GATT rules. Although this relevance is recognised, it is important to recall that more than one identity may be afforded an object within the WTO law.[43]

### 1.4.3 THE IMPLICATIONS OF TREATING AN ELIGIBLE EMISSIONS UNIT AS A FINANCIAL PRODUCT

If an eligible emissions unit is a financial product for the purposes of the GATS there will be obligations imposed by this agreement on the *trade* of these instruments. It is *the act of the trade* of the units that the GATS regulates, rather than the units themselves (Hufbauer, Charnovitz, and Kim 2009, 62).[44]

To understand the outcomes of finding that eligible emissions units are transferable securities or financial assets, it is important to clarify whether Australia includes the financial services sector within its Schedule. This inclusion binds Australia to the obligations of the nominated provision of the GATS.

Australia, similar to many other countries in the Organization for Economic Co-Operation and Development (**OECD**), has fully liberalised trade in financial services through the acceptance of the Understanding and the *Fifth Protocol to the General Agreement on Trade in Services*.[45] As a result, regulation of the Australian financial services sector must adhere to the requirements of the general and specific commitments of the GATS.[46] Additionally, members who have accepted the Understanding without reservations are bound to allow their residents to purchase, in the territory of any other member, those *financial services* listed in the 'Annex on Financial Services' to the GATS in paragraph 5 (v) through to (xvi).[47] These financial services include the trade in financial assets and securities.[48]

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[43] GATT Panel Report, *Canada - Measures Affecting the Sale of Gold Coins,* GATT Doc L/5863 (17 September 1985, unadopted) [23].

[44] The commentators in this publication suggest that even if the trade of emissions allowances is a financial service within the *General Agreement on Trade in Services*, there is nothing to suggest that the emissions allowance is itself a financial service.

[45] *Fifth Protocol to the General Agreement on Trade in Services*, WTO Doc S/L/45 (3 December 1997) (Jinnah 2003), 742. In this commentary, Jinnah suggests that Canada has liberalised financial services through the *General Agreement on Trade in Services* Schedule of Specific Commitments. Canada has, as has Australia, committed to the Understanding on Commitments in Financial Services.

[46] *General Agreement on Trade in Services* Article XVII.

[47] *Understanding on Commitments in Financial Services* Article B4(c).

[48] *Understanding on Commitments in Financial Services* Article B4(c) states: Each Member shall permit its residents *to purchase* in the territory of any other Member the *financial services* indicated in:

An eligible emissions unit is not a 'financial service' in and of itself (Hufbauer, Charnovitz, and Kim 2009, 62). Rather, it is the *trade* of these units that is a service, and therefore the regulation of the trade must comply with the GATS obligations. This means foreign services associated with trading, such as brokerage, advice or otherwise dealing in financial products,[49] must be permitted in the relevant jurisdiction. This is not to suggest that all types of financial product must be available. Nor does it mean that all financial products must have the same regulatory treatment within the domestic jurisdiction.

In order to allow foreign service providers to participate in dealing with these products, these service providers must be eligible to own the products. Ownership of eligible emissions units is regulated by the *Australian National Registry of Emissions Units Act 2011* (Cth) (the **Australian Registry Act**). Any person is eligible to hold units,[50] other than fixed price units, where they are the registered holder of a registry account. The procedures for opening a registry account are proclaimed in the *Australian National Registry of Emissions Units Regulations 2011* (Cth). A foreign person is not excluded from opening a registry account. However, they are subject to different identification procedures.[51]

Another regulatory requirement that may be applicable to financial service providers is the requirement to hold an Australian Financial Services licence (**AFSL**).[52] Persons who wish to deal in financial services are required to hold an AFSL.[53] This requirement is the same for foreign entities who wish to deal in financial services, unless one of the exemptions applies.[54] This requirement may be

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(c) subparagraphs 5(a)(v) to (xvi) of the Annex. The Annex 5(a)(x) includes: (x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following: (E) transferable securities; (F) other negotiable instruments and financial assets, including bullion.

[49] Australian Securities & Investment Commission, 'Doing Financial Services Business In Australia' (Regulatory Guide No. 121, ASIC, April 2011) 9.

[50] *Australian National Registry of Emissions Units Act 2011* (Cth) s4, any person is defined broadly to include an individual, a body corporate, a trust, a corporation sole, a body politic and a local governing body.

[51] *Australian National Registry of Emissions Units Regulations 2011* (Cth) Schedule 2.

[52] *Corporations Act 2001* (Cth) s911A.

[53] *Corporations Act 2001* (Cth) s911A.

[54] Australian Securities & Investment Commission, 'Doing Financial Services Business In Australia' (Regulatory Guide No. 121, ASIC, April 2011) 4.

classified as a 'domestic regulation' and therefore one of the GATS' general obligations is relevant here.[55]

***The Domestic Regulation Rule***

The domestic regulation rule is one of the general obligations of the GATS. Domestic regulations are measures that exist 'behind a nation's borders'[56] just as 'internal measures' apply to domestic goods under GATT. Article VI of the GATS addresses the possibility that protectionism may occur as a result of domestic regulation (Cottier and Oesch 2005, 832). Article VI recognises that domestic regulation in the form of licensing requirements and technical standards may cause an unnecessary trade burden and excessive compliance costs, even where these do not breach the national treatment obligation (Alexander 2008, 579).

The most relevant section of Article VI of the GATS for current purposes is paragraph 5.[57] Article VI:5 prohibits members that have undertaken specific commitments from maintaining technical standards and licensing requirements that do not comply with the following conditions for the sectors listed:

> (a) based on objective and transparent criteria, such as competence and the ability to supply the service;
> (b) not more burdensome than necessary to ensure the quality of the service;
> (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.[58]

Article VI:5(a)(ii) introduces a test to narrow the number of breaches of the Domestic Regulation provision. This article requires that the licensing requirements, qualification requirements and technical standards do not nullify or impair any specific commitments made in a manner which 'could not reasonably have been expected of that Member at the time the specific commitments in those sectors were

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[55] The Market Access provision in Article XVI would be relevant to the extent that restrictions were placed on the number of available licences.
[56] Trade in Services Division of the WTO Secretariat, 'Disciplines on Domestic Regulation Pursuant to GATS Article VI:4 : Background and Current State of Play' (Briefing Document, World Trade Organization, June 2011) 1 [2].
[57] Article VI:4 is only relevant to the extent that the Council for Trade in Services has developed disciplinary guidelines for licencing and qualifications. There have been none in the financial services sector and therefore it is not relevant here.
[58] These criteria are contained in the *General Agreement on Trade in Services* Article VI:4.

made.'[59] Matushita et al (2006) suggest that this test is so difficult to satisfy that it effectively leaves the obligations in Article 5 of the GATS unenforceable. Unfortunately there has not been a review of this provision in a dispute to clarify its meaning. However, Alexander suggests that a necessity test may be applied to determine whether a member's qualification and licensing requirements or technical standards do not nullify or impair a member's scheduled commitments.[60]

In Australia, the Corporations Act regulates financial services. The provisions of the Corporations Act relating to financial services and licensing requirements are unchanged through the inclusion of eligible emissions units as financial products. Therefore, the conditions that existed for foreign financial service providers are unchanged following the introduction of the CPM. [61]

Both the AFSL and registry requirements are measures of 'general application affecting trade in services.'[62] In accordance with the domestic regulation provisions of Article VI of the GATS, if these measures apply to a sector where specific commitments are undertaken, [63] then these measures must be 'administered in a reasonable, objective and impartial manner.'[64]

A critical analysis of the Corporations Act and the licensing requirements contained therein is beyond the scope of this paper.[65] However, two important points must be made in relation to these licensing requirements as they relate to this subject matter. First, the amendments to the Corporations Act incidental to the introduction of the CPM do not substantially alter the licensing requirements of the financial services sector. For this reason, if a violation of this provision is established, this violation is not caused by the CPM. The second important point to make is that the requirements to demonstrate a breach of Article VI:5 (a) of the GATS are recognised as onerous by

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[59] *General Agreement on Trade in Services* Article VI:5(a)(ii).
[60] Kern Alexander, 'The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets' in Kern Alexander and Mads Andenas (eds), *The World Trade Organization and Trade in Services* (Martinus Nijhoff, 2008) 561, 570.
[61] *Clean Energy (Consequential Amendments) Act 2011* (Cth) s260.
[62] The *General Agreement on Trade in Services 1994* Article VI:1.
[63] Australia has liberalised the financial services sector, therefore this sector is classified as one that Australia has undertaken specific commitments.
[64] The *General Agreement on Trade in Services 1994* Article VI:1.
[65] There are also a number of exclusions contained within the Corporations Act for foreign entities carrying on a financial services business in Australia. See Australian Securities & Investment Commission, 'Do I Need an AFS Licence to Participate in Carbon Markets' (Regulatory Guide No. 236, ASIC, March 2012) 33 – 34; *Corporations Act 2001* (Cth) s911A(2).

some commentators. Some suggest the requirement noted above, that the 'nullification or impairment could not reasonably have been expected', effectively neutralizes this provision (Matsushita, Schoenbaum, and Mavroidis 2006, 629). Certainly, this paragraph leaves significant scope for any Panel to find that licensing requirements *do not* violate this provision.

The AFSL requirements may be compared to the treatment of foreign financial service providers in the EU ETS. The EU ETS Directive[66] prohibits the direct trading of allowances by 'non-E.C. legal persons and entities from non-Kyoto party countries in the E.U ETS' (Martin 2007, 244). Therefore, the provision of any financial service necessarily involving the transfer of allowances is limited for some WTO members (Martin 2007, 439). However, to demonstrate a breach of the GATS obligations, an aggrieved member would need to demonstrate that an EU member state had a measure in place that restricted the provision of foreign financial services. If a complainant could demonstrate that foreign financial service providers were unjustifiably disadvantaged,[67] then a breach of the obligation is foreseeable. In this case, the EU would need to rely on one of the exceptions for validation.

If a breach is demonstrated under the EU or the Australian framework — which appears unlikely — it may be possible to justify the measures based on the 'prudential carve out' exception. The prudential carve out exception allows for the following:

> Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a *financial service supplier*, or to ensure the integrity and stability of the *financial system*...[68]

[66] *Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC* [2003] OJ L 275/46, 32, , Article 12.
[67] To justify a breach would require either the exceptions contained in the *General Agreement on Trade in Services 1994* Article XIV or Article XIV *bis* were applicable or that the prudential carve out provision could be relied upon.
[68] *General Agreement on Trade in Services 1994* Annex on Financial Services (emphasis added).

This exception cannot be relied on to avoid a member's commitments or obligations under the GATS.[69] Therefore, as noted above, there may need to be an element of necessity demonstrated in order to rely on this particular exception.

***The Market Access Rule and Financial Services***

The other provision that is relevant if eligible emissions units are deemed financial instruments is the market access provision. The market access provision prohibits, amongst other things:

- limitations on the number of service suppliers;
- limitations on the total value of service transactions or assets.[70]

For this reason, if there were restrictions on the number of available AFSLs, a violation of this provision could be established. There are no such limitations.

It may be more readily established that the second prohibition, on the limitation of total value of service transactions, has been violated by the CPM limitations. The designated limit, the general limit or the exclusions of certain eligible international emissions units may actually cause a limitation on the total value of service transactions on the Australian emissions trading market.

There is some evidence to suggest that this limitation need not be expressly stated in order to infringe the market access requirement. In the *Mexico – Telecoms* dispute the Panel noted:

> While this element ... does not expressly prohibit cross-border supply over leased capacity on the originating segment, it means that supply over leased capacity on the terminating segment is prohibited. Therefore, this element ... *effectively eliminates* the possibility of any cross-border supply of services over leased capacity. In this sense ... the routing restriction falls within the scope of Article XVI:2(a), (b) and (c).[71]

For this reason, it is possible that the limitations within the CPM on the surrender of eligible international emissions units may indeed infringe the market access rule. Because Australia has fully liberalised the financial services sector, it

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[69] Ibid.
[70] *General Agreement on Trade in Services 1994* Article XVI.
[71] Panel Report, *Mexico – Measures Affecting Telecommunications Services,* WTO Doc WT/DS204/R (2 April 2004) [7.86] (emphasis added).

may be necessary to use one of the exception provisions to excuse the CPM limitations.

## 1.5 RELEVANT GATS EXCEPTIONS

The GATS general exceptions are contained in Articles XIV and XIV *bis* of the GATS. These exceptions apply to all GATS obligations, including any specific commitments.[72] There are five categories of exceptions within Article XIV.[73] Of these, one is most relevant for emissions trading legal frameworks. This exception allows measures that are 'necessary to protect human animal or plant life or health'.[74]

Article XIV of the GATS states:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures … necessary to protect human, animal or plant life or health.

The GATS provision was compared with a similar exception contained in Article XX of the GATT in the *EC – Bananas III* dispute. In this dispute the GATT Article XX jurisprudence was examined to understand the application of the GATS Article XIV. This approach was also adopted in the *US – Gambling* dispute.[75] The Appellate Body in this case concluded that the Article XIV of the GATS required a two tier test to be satisfied:

> A Panel should *first* determine whether the challenged measure *falls within the scope of one of the paragraphs* of Article XIV. This requires that the challenged measure address the particular interest specified in that paragraph and that there be a sufficient nexus between the measure and the interest protected. The required nexus—or "degree of connection"—between the

[72] Panel Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/R (10 November 2004); Appellate Body Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/AB/R (7 April 2005).
[73] Article XIV *bis* contains a 'national security' exception.
[74] The *General Agreement on Trade in Services 1994* Article XIV.
[75] Appellate Body Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/AB/R (7 April 2005) [292].

> measure and the interest is specified in the language of the paragraphs themselves, through the use of terms such as "relating to" and "necessary to".[76] Where the challenged measure has been found to fall within one of the paragraphs of Article XIV, a Panel should then *consider whether that measure satisfies the requirements of the chapeau* of Article XIV.[77]

This reasoning by the Appellate Body may be summarised. First, the interest identified in the exception must be examined and compared with the purpose of the measure a member wishes to use this provision to excuse. In this case the interest is the protection of human, animal or plant life or health. The second element requires that there is a nexus between the measure and the interest, and that this nexus is adequate. The nexus in this case, must be sufficiently close to be considered 'necessary' for the protection. Finally, just as is required for the GATT Article XX exceptions, the requirements of the *chapeau* — the opening paragraph — must be fulfilled.

#### 1.5.1 NECESSARY TO PROTECT HUMAN, ANIMAL OR PLANT LIFE OR HEALTH

There have been no disputes to examine the exceptions contained in paragraph (b) of Article XIV of the GATS. Nevertheless, this paragraph is identical to Article XX(b) of the GATT. For this reason, panels may consider the Article XX jurisprudence to determine the application of this measure.

The first criterion that must be established to rely on this exception is that human, animal or plant life or health is protected. The dispute settlement bodies have interpreted the identified interest broadly. This means that it is enough to identify a *risk* of a threat to human animal or plant life or health that is lessened by a measure (Tran 2010, 351). Therefore, identifying the alignment of the interest is relatively straightforward when a member wishes to rely on this exception.

The second criterion of this exception is that the policy measure is 'necessary' to achieve the protection. In the *Korea – Imported Beef* dispute the meaning of

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[76] Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* WT/DS58/AB/R, (adopted 6 November 1998).
[77] Appellate Body Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/AB/R (7 April 2005) [292] (emphasis added).

necessary was examined.[78] In this dispute the Panel suggested that there was a continuum that covered the meaning of necessary, and that this continuum ranged from 'indispensible' through to 'making a contribution to'.[79] It was concluded that the meaning of necessary was closer to the 'indispensible' end of the continuum.[80]

This criterion of the GATS exception has been examined in a dispute, although by reference to a different paragraph of the Article XIV exceptions. Despite this, the reasoning is applicable here. The Appellate Body in the *US – Gambling* dispute concluded that to identify 'necessity' a Panel is required to evaluate:

> - The relative importance of the regulatory objective pursued;
> - The contribution of the means used to the realization of the end sought; and,
> - The restrictive impact of the means used on international commerce. When performing this task, a Panel must make sure that there is no other alternative which is both less restrictive and reasonably available … to realise the ends sought.

This test presents a strict standard for members that attempt to justify measures using this 'necessity' based exception.

The *chapeau* of the GATS exception is substantially identical to the *chapeau* contained in Article XX of the GATT. For this reason, panels and the Appellate Body have suggested that the jurisprudence for the interpretation of Article XX of the GATT *chapeau* can be applied to Article XIV of the GATS. Evidence supporting this suggestion can be found in the *US – Gambling* dispute. The Panel for this dispute suggested that the same requirements would apply to the Article XIV provision as apply under Article XX of the GATT.[81] The Panel considered GATT disputes such as *US – Gasoline*[82] and *US - Shrimp*[83]and concluded that consistency of application was

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[78] Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161/AB/R, WT/DS169/AB/R (11 December 2000).
[79] Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161/AB/R, WT/DS169/AB/R (11 December 2000).
[80]Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161/AB/R, WT/DS169/AB/R (11 December 2000) 270.
[81] Panel Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services,* WTO Doc WT/DS285/R (10 November 2004) [6.581] cited in (Van Den Bossche 2008) 663.
[82] Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* WT/DS58/AB/R, (adopted 6 November 1998).

required for the chapeau to be satisfied.[84] The Appellate Body upheld the findings of the Panel, although emphasised that the consistency of application requirement of the *chapeau* can only be disproved through patterns of enforcement rather than individual instances of differential treatment.[85]

It follows that in order to justify otherwise discriminatory measures under the GATS using this exception a member would necessarily need to demonstrate that the discrimination itself was necessary to protect human, animal or plant life or health. This means that the discrimination, or at least the measure that results in the discrimination, was indispensible — or is close to being indispensible — for this protection. Further, the measure that causes the discrimination would necessarily need to be applied equally to other members in order to satisfy the requirements of the *chapeau*.

In consideration of the legal framework of the CPM, a member may argue that discrimination has occurred through the limitation of international credits where there is no corresponding limitation on Australian credits, such as ACCUs. The Australian legislators may justify the limitation on the basis of scheme credibility and stability.[86] However, some commentators suggest that these restrictions are merely protectionist measures that 'reduce the legitimacy of international units'(Hepworth 2012).

For the protection of life exception to excuse discrimination associated with eligible international emissions units, the discrimination would have to be demonstrated as necessary on the basis of scheme environmental integrity. This could perhaps be achieved through a claim that the environmental credibility of any credits excluded is questionable or incompatible with the CPM objectives. However, this may be difficult to argue given that some of the CPM limitations apply to all eligible international emissions units, regardless of their underlying project. For example, the 'designated limit' and the 'general limit' impose limitations without any apparent

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[83] Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products* WT/DS58/AB/R (1998) .
[84] Panel Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/R (10 November 2004) [6.584]. [6.584]
[85] Appellate Body Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/AB/R (7 April 2005) [356].
[86] Australian Government, Commonwealth of Australia, *Securing a Clean Energy Future: The Australian Government's Climate Change Plan* (2011) 108.

environmental considerations. However, it is possible that the exclusion from tCERs and lCERs may be more readily justified by this exception. Failing this, there is one other exception provision that members may rely upon for financial services measures. That is, the prudential carve out provision.

#### 1.5.2 THE 'PRUDENTIAL CARVE-OUT'

The liberalisation of financial services through the Understanding and the Financial Services Agreement must be balanced by measures that support the stability of the financial system in which the trading of financial instruments takes place (Alexander 2008, 584). The GATS provides members with an exception for this reason.

The second paragraph of the Annex on Financial Services, commonly known as the 'prudential carve-out', is basically a broad exception for financial services. This provides domestic regulators a level of autonomy to regulate financial service supply. The relevant paragraph of the Annex states:

> Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a *financial service supplier*, or to ensure the integrity and stability of the *financial system*...[87]

This means, for example, that if carbon markets are vital to the integrity and stability of the financial system governments would have substantial scope to take 'prudential measures' to protect the functioning of that market (Howse and Eliason 2009b).

The term 'financial system' describes the flow of funds from savers to borrowers. It is composed of financial markets and intermediaries (Tyree and Weaver 2006, 3). Financial markets are exchanges and 'over the counter markets' where financial assets can be traded (Tyree and Weaver 2006). The integrity and stability of this system could be compromised in a number of ways. The instability of one of the exchanges or markets that form an integral part of the financial system would presumably lead to the same instability in the system as a whole. If this is accepted,

[87] *General Agreement on Trade in Services* Annex on Financial Services (emphasis added).

then it is possible to argue that the integrity of any market for trading in GHG units is vital to the stability of a financial system in which it is situated.

As noted above the general exception provisions require satisifaction of a necessity test. This imposes an onerous standard of proof.[88] In this regard, a necessity test compels a member to demonstrate that no reasonable alternative could have been employed. No such necessity test appears to be required for the prudential carve out however. As a result, Wang argues that the prudential exception is 'flexible and, to some extent, subjective' when compared with the other exception provisions (Wang 2008, 604).

Despite this, the second sentence of the prudential exception confuses the meaning of the provision substantially. It states:

> Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's *commitments or obligations* under the Agreement.[89]

Commentators suggest that this sentence makes the scope of the provision unclear (Wang 2008, 605). The interpretation will remain uncertain until raised in a dispute settlement proceeding. Hence the necessity test[90] actually provides a fair compromise to what would otherwise be a vague exception (Wang 2008, 606).[91] For this reason, it may be equally difficult to rely on the prudential carve out provision as it is to rely on the other GATS general exception provisions.

## 1.6 CONCLUSION

The purpose of this paper has been to consider the regulation of the financial services sector by the GATS and determine whether emissions trading schemes will fall within its scope. In particular this paper has considered the detail of the Australian CPM to describe where breaches of the GATS may arise if eligible emissions units are deemed financial instruments.

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[88] See Section 1.5.
[89] *General Agreement on Trade in Services* Annex on Financial Services (emphasis added).
[90] That is, that a measure is necessary for the integrity and stability of the financial system.
[91] This commentator suggests that there are 4 possible interpretations that span full prudential autonomy to none. This thesis suggests that the carve out provision must have had some purpose and therefore the latter is unlikely. In the same vein the second sentence was also included for a purpose and therefore it seems a compromise between the two is needed.

This paper has demonstrated that flexibly priced carbon units and other types of GHG *transferable* units are expected to be categorised as transferable securities or financial assets for the purposes of the law of the WTO. This means that the rules of the GATS will regulate the trade of eligible emissions units. Notably, the services associated with trading these units must be open to all other WTO members. This is because Australia has agreed to liberalise the financial services sector by committing to the Understanding.

It may be because of this commitment that there are no apparent restrictions for service providers to access the Australian financial services market. The requirements for ownership of eligible emissions units and for an AFSL present no evidence of discrimination against foreign participants. However, the CPM limitations on the surrender of eligible international emissions units may demonstrate an infringement of the market access rule prohibiting limitations on the 'total value of service transactions'.[92]

For this reason, it may be necessary for Australian representatives to rely on the GATS general exceptions or prudential carve out provision if a member complaint is initiated on the basis of this exclusion or limitation of units. However, as this paper demonstrates, in order to rely on these provisions a necessity test must be satisfied. The necessity test represents an onerous standard, as it requires that a measure is classified as indepensible.

In sum, members must ensure legislation to implement emissions trading schemes and create units of trade comply with the requirements of the GATS. Failing this, they may be forced to amend domestic schemes to ensure that access to the market is not restricted for other WTO members' financial service providers. This therefore represents an issue for the compliance of domestic emissions trading schemes with the WTO law.

## 1.7 ENDNOTES

[92] The *General Agreement on Trade in Services 1994* Article XVI:2.

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