

# **STRUCTURING ENVIRONMENTAL OFFSETS FOR A SUSTAINABLE ADVANTAGE**

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## **ABOUT OFFSETS**

Formal offsets policy in many jurisdictions now provides that the environment will gain (or suffer no net loss) from a proposal even if the proposal will result in “acceptable” adverse environment impacts. In order for a proposal that will have impacts (even after all usual mitigatory measures are taken) to be favourably assessed, it must specify what measures will be put in place to ensure the environment is improved as a result of the development.

Offsets are the last approvals tool available to get a proposal across the line environmentally. The goal of net environmental benefit for new proposals is laudable but needs to be balanced with social and economic factors in the final decision.

This paper briefly outlines the nature of offsets and then explores various legal issues which arise in their implementation. It will be seen that if offsets are to be considered for a proposal a high degree of due diligence must be exercised by the proponent and its advisors before an offset is agreed or imposed.

## **What are offsets**

An “offset” is used to match or better the negative impacts of a development by separate activities that have positive impacts. Ideally, they should be “like for like” or “like for better”. They must deliver a “long lasting” benefit. Many jurisdictions are formalising what has in the past been an ad hoc approach to offsets policy. Many mechanisms are now being used to offset negative impacts. For example:

- Greenhouse gas emissions may be offset by tree planting, geosequestration and other carbon sequestration methods;
- Habitat loss in one area may be offset by rehabilitating, conserving or creating a similar habitat in another area;
- An impact on a particular species may be offset by relocation or funding a rescue fund;
- A resource use impact such as using water may be offset by the transfer of water rights (where such a mechanism exists).

Offsets may be broadly categorised as:

- direct: offsets not related to the proposal site that directly counter the impacts of the proposed development (which may include emissions control, rehabilitation, sequestration);
- indirect: offsets which indirectly benefit the environment but do not directly counter the impact of the offset (for example, contributions to environmental trust funds and research, a donation of non related land to the conservation estate).

Industry should very carefully monitor proposals that set offset precedents. Offsets can be very expensive and may threaten the viability of projects. For example, there is debate in Western Australia that CO<sub>2</sub> emissions should be completely offset by the planting of trees or other measures.

## **Offset standards**

It is beyond the scope of this legal paper to discuss the merits of offsets as a management tool. There is significant debate concerning the science supporting offsets policy, such as whether a loss of habitat can be offset by the creation, conservation or enhancement of another “equivalent” habitat. From a legal perspective it is important to be aware of the uncertainty regarding the measurement of offsets and how that impacts on the enforcement of any standard required by a regulatory offset condition.

The standard required by the regulatory regime must be considered when negotiating offset conditions. Generally, two different standards are used. There is a significant difference in the standard required by “no net loss” and that required by “net gain”. The standard required will determine the degree of implementation of a particular proposed offset.

The legal expression of the offset standard required is not consistent across jurisdictions. For example, the offset standard of “net gain” is incorporated into all Victorian Planning Schemes as a means to address land clearing for development. The Western Australian EPA proposes to consider offsets which achieve a “net environmental benefit” in its assessment of proposals that may have a significant impact on the environment (EPA 2004). The Commonwealth *Environment Protection and Biodiversity Conservation Act 1999* imposes a requirement to meet the standard of “net benefit to the conservation of biodiversity” before the Minister can enter into a conservation agreement on behalf of the Commonwealth with another person.

An example of the lesser offset standard, “no net loss”, is incorporated within the *Riverina Highlands Vegetative Management Plan 2003* in New South Wales. The offset principles described in that document state that offsets must aim for long term equilibrium that results in an environment of equal value to (or greater value than) that lost.

## **The implementation of offsets**

The Western Australian EPA has expressly stated that offsets are not a project negotiation tool and that the emphasis should remain on mitigation of impacts and the protection of critical environmental assets (EPA 2004). In other words proponents must first do all the usual things to minimise adverse impacts. They must still do all things reasonably practicable to avoid and minimise harm and rehabilitate proposal affected areas. This is to overcome perceived public concerns about using offsets to allow development in areas where development would not ordinarily be permitted.

The critical environmental assets identified by the Western Australian EPA are viewed by some as too widely drawn and others as too narrowly drawn.

Offsets may be voluntary or mandatory. This paper is concerned with offsets that impose some legal obligation on a proponent. Offsets may be imposed as part of the permission to:

- (a) begin operations;
- (b) continue operations;
- (c) cease operations.

The other significant legal area which arises in offsets consideration is contract. It will often be the case that an offset condition will require the involvement of a third party with the proponent.

For the minerals industry, the conditional right to operate not only arises by virtue of a grant to access land (such as a mining licence or tenement) but also under relevant environmental approvals. Environmental approvals may be issued for indefinite or finite terms (depending on the nature of the approval) and generally subject to strict performance conditions. Failure to meet those conditions may lead to prosecution and substantial penalties. Further, the right provided by the authorisation may be revoked, suspended or otherwise limited.

### **Legal Threats and Opportunities - Enforceability**

While the nature and extent of an offset may be negotiated between the regulator and industry (and, to a certain extent, the community) offsets will generally be imposed as conditions of regulatory approval or by legislative requirement. The precise terms of the offset should be carefully considered to ensure that the terms can be met. The proponent should direct particular attention to the requirements for monitoring and measuring the offset to ensure those requirements are reasonable, practical and achievable and that the proponent is not liable if the offset fails for reasons outside the control of the proponent.

Arguably, there remains broad scope for a proponent to develop its own criteria as to how it will manage the impacts of its activities by implementing offsets. However, in practice that may not be the case as demonstrated by the Redbank Power Station proposal in New South Wales. The development application for the construction and implementation of the Redbank Power Station was rejected by the NSW Minister for Planning and Infrastructure on the basis that the proponent had failed to secure appropriate greenhouse gas offset measures with appropriate certainty.

The proponent proposed an offset strategy for a coal fired gas station by sourcing additional energy from methane from the nearby Bulga coal mine. The uncertainty surrounding the offset strategy arose because:

- there was uncertainty associated with the quantity and quality of the methane resource at the Bulga mine;
- the availability of that resource was contingent on the operator of that mine receiving a development consent for the extension of underground coal mining, an outcome that could not be pre-determined; and
- the proponent would be required to make further application to the Department and received consent from the Minister, prior to being allowed to transport, handle and manage methane at the site.

The proponent will need to ensure that any liability arising from breach of approval condition is minimised for the duration of the offset. The legal regime for achieving that will vary depending on the nature of the offset requirement.

### **Transfer of Liability**

Often the implementation of an offset requires the involvement of third parties. For example, a proponent may pay a third party to undertake environmental works, or may need to rely on rights conferred by a third party (such as a lease for land) to implement an offset.

Where third parties are involved, suitable legal agreements must be put in place. For example, part of the proposed Gorgon Gas Development is to be located on Barrow Island which is an A Class nature reserve. A State Agreement Act (the *Barrow Island Act 2003*) has been specifically implemented to provide for the development of the Gorgon project on Barrow Island. The Agreement Act includes provision for a Net Conservation Benefit, which, in summary, is the payment of \$40 million in instalments for ongoing programs that will provide conservation benefits.

Net Conservation Benefit is defined in the *Barrow Island Act 2003* as:

“demonstrable and sustainable additions to or improvements in biodiversity conservation values of Western Australia, targeting, where possible, the biodiversity conservation values affected or occurring in similar bioregions to Barrow Island.”

For the Joint Venture operating the Gorgon Gas Project, the offset requirement here is satisfied by the payment of money to a government agency to implement the net conservation benefit.

While payment of money to a third party to implement an offset is the easiest way to manage the offset obligation, care should be taken to ensure that the regulatory condition does not still bind the proponent for example, in the event of the demise of the third party. The involvement of a third party in the implementation of the offset may require a performance agreement with that third party. The performance agreement should include terms of how and when the offset will be measured and audited to ensure ongoing compliance with the relevant conditions.

Where the offset is enshrined within an approval, the requirement to maintain that offset will rest on the proponent for the duration of the proposal unless government agrees to transfer responsibility to a third party.

### **Tenure**

If a proposed offset is to be maintained on land that is owned by the proponent, the future of that offset may be controlled by way of invoking proprietary rights over either the land or the offset.

For example, a proposed conservation corridor offset may be implemented and maintained over private land. A proponent that owns the land not only preserves access rights but controls the maintenance of that offset. Liability arising from failure to implement or maintain that offset is within the direct control of the proponent.

If a conservation corridor is implemented on land not owned by the proponent, a contract with the landholder should be negotiated to recognise the obligations of the proponent and the landholder in the implementation and maintenance of the offset. Consideration should

also be given to protecting the interest that the proponent has in the land and its assets in the event that the land is transferred. Instruments such as caveats on the title may be used to protect that interest on transfer.

Different considerations may be required if the offset is located on Crown land. For example, the limits of tenure granted under the Crown lease or licence and the powers of the government authority in which the land is vested will be relevant.

It is often the case, to avoid ongoing management and legal obligations proponents will seek to gift land to a conservation agency or relinquish rights (such as a mining tenement) to enable a conservation agency to take control.

## **Trust Schemes**

Offsets may be negotiated by simple financial contribution to existing trust schemes. The scope of the trust scheme needs to be determined to ensure that liability for the proponent is reduced, preferably extinguished, if the trust scheme cannot maintain the required offset. The conditional approval requirement should be constructed to ensure that the requirement is only in relation to the transfer of funds to the trust. Further obligations, if any, may then be recognised in contract between the proponent and the trust fund manager.

If required, a proponent will wish to ensure that any offset is appropriately maintained to meet ongoing requirements (and for reputation reasons).

In addition, a proponent may wish to market the environmental benefit arising from the offset.

## **Risk of offsets not being last resort**

Proponents need to ensure that the regulator follows policy. That is, avoiding offsets being used not as a last resort but as matter of course. It must be demonstrated by the regulator that offsets are needed. There is a risk that regulators may seek to impose offsets as an additional “tax” on proponents to secure wider societal environmental benefits.

## **IS THERE INCENTIVE NOW FOR GOOD CORPORATE PRACTICE?**

We have considered to this point the regulatory drivers for offsets. A corporation can propose its own offset initiatives beyond those required by regulation.

However, without commercial incentive, industry in Australia is likely to remain regulated with respect to environmental offsets that will require a significant economic contribution.

There is scope for offset trading, similar to that contemplated for greenhouse gas emissions trading, to arise in the future. For example, biodiversity credits may provide incentive for private individuals and companies alike to preserve or enhance biodiversity (see Agius (2001)). It may provide more certainty than regulation of offsets by ascribing value to biodiversity units. That valuation will then assist in meeting a measurement target of net environmental benefit without further regulatory imposition. Offset trading is a long way off and is unlikely to be considered by companies in the absence of a Federal regime.

## **CONCLUSION**

Environmental offsets are being increasingly considered in Australian jurisdictions as a means of granting conditional project approval.

The intent of offset regimes is not to allow projects in areas where access was not previously permitted, but to ensure there is at least no net negative impact on the environment. Whether that impact is matched by requiring a standard of “no net loss” or “net environmental benefit” depends on the policy requirements of each jurisdiction.

The outcome of the policy is that the offset often becomes a condition of approval. A proponent should ensure that the conditions are appropriately worded to allow the proponent to comply with the condition, to get the project operational and to ensure the project remains viable.

If the condition requires the implementation and ongoing management of the offset, the offset arrangement chosen should protect the proponent’s obligations under the project authorisation by mechanisms including land tenure arrangements and contract under management agreements.

Failure to put forward an appropriate offset mechanism may lead to a project not being approved. Failure to protect the integrity of the offset once in place may result in a breach of environmental approval and damage to reputation. Penalties may include financial penalties as well as revocation, suspension or other limitation of the approval.

## REFERENCES

Agius, J (2001) Biodiversity Credits: Creating Missing Markets for Biodiversity Environmental and Planning Law Journal 18(5)

Barrow Island Act 2003

Environmental Protection Authority (2004) *Environmental Offsets* Preliminary Position Statement No 9 Government of Western Australia

Environment Protection and Biodiversity Conservation Act 1999

Riverina Highlands Vegetative Management Plan 2003