

CARBON PRICING UNDER THE FEDERAL GOVERNMENT'S CLIMATE CHANGE PLAN "SECURING A CLEAN ENERGY FUTURE JULY 2011" ("CLIMATE PLAN")

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1. INTRODUCTION

This Newsflash is the fourth of our briefing series on the Climate Plan following our earlier Newsflashes on Energy Efficiency; the Carbon Farming and Biodiversity Initiatives; and Innovation in Renewable Energy. We now highlight the "first pillar" of the Climate Plan, namely the workings of the Carbon Pricing regime detailed in Chapter 3 of the Climate Plan.

Only the top 500 "polluting" Australian Companies will be liable to pay the "carbon price" from within those sectors "covered" under the scheme. The 50 largest polluters are in fact responsible for approximately 75 per cent of the pollution covered by the scheme. "Polluters" will be required to purchase a "carbon permit" for every tonne of Greenhouse Gas ("GHG") emissions from their business operations. A "carbon permit" is characterised as "personal property" and a "financial product" regulated by ASIC.

Because climate change is a "global" atmospheric problem (because GHGs are emitted by all countries not just Australia) it does not really matter whether GHGs emissions are reduced in "India" or "Australia" as long as there is a "overall" decrease in GHG emissions globally. It is for this reason (and the fact that "carbon pricing" incentivises the "polluter" to meet their liability by adopting the "least cost" solution) that trading of credible "international permits" is permitted as they maybe the "least cost" solution for that

However, as Australia is seeking to do, it is often "environmentally" more prudent to limit the amount of "international" off-sets allowed to be used by "polluters" so that domestic action is taken to reduce domestic emissions and that the "international permit" price does not act as a fixed "floor" to the Australian "carbon price".

However, the "least cost" concept will not immediately incentivise the development of "renewable energy" or adoption of "energy efficiency" practices or "carbon farming" if it is cheaper for a "polluter" to trade in international/domestic "carbon permits". It is for this reason that specific measures are required for these other initiatives in the form of "complementary measures" as has been discussed in our earlier briefing notes.

2. THE DESIGN ELEMENTS OF THE CARBON PRICE

We now highlight the core design elements of the "carbon price" (in table format for ease of use), namely:

Design Element	Detail of Design Element and Impact
GHGs Covered	<p>There will only be four GHGs covered (as opposed to the six Kyoto Protocol GHGs covered under the Kevin Rudd's carbon pricing regime) under the "carbon price", namely:</p> <ul style="list-style-type: none">▪ Carbon dioxide;▪ Methane (mainly emissions from landfills);▪ Nitrous Oxide (released by burning of fuels in internal combustion engines etc); and

GHGs Covered	<ul style="list-style-type: none"> ▪ Perfluorocarbons (released by heavy industrial processes such as aluminum production etc). <p>The remaining two GHGs, “hydrofluorocarbons” and “sulphur hexafluoride” will face an equivalent “carbon price” which will be applied through existing synthetic GHG legislation (i.e. the Ozone Protection and Synthetic Greenhouse Gas Management legislation).</p> <p>All Scope 1 (i.e. direct emissions) will be covered.</p>
Price	<p>The “carbon price” is to be implemented in two stages:</p> <ul style="list-style-type: none"> ▪ firstly, a “fixed price” period for three years (2012-2015) of \$23 rising at 2.5 per cent per annum in real terms (for inflationary purposes); and ▪ secondly, a “flexible price” period from the end of the “fixed price period” at 1 July 2015 under a market based “emissions trading scheme”.
The Fixed Price Period	<p>During the “fixed price” period, unlimited “carbon permits” will be able to be purchased by the “polluters” from the Government for every tonne of GHG emissions they emit (i.e. in this phase, there is no “cap” on emissions). Any “permits” purchased at the “fixed priced” will be automatically surrendered and cannot be “traded” or “banked” for future use.</p>

The Flexible Price Period	<p>Before the commencement of the “flexible price” period, a “cap” will be set and imposed on Australia’s annual GHG emissions from all sources of “pollution” covered by the “carbon price” for the first five years from 1 July 2015. The Government will then issue a set number of “carbon permits” available to “polluters” up to the “cap”: there will be no limits on individual sectors, firms or facilities. The “cap” will decline over time increasing the “scarcity” of “permits” and thus having an “upward affect” on the “carbon price” (by reducing “supply”) as well as driving “innovation”.</p> <p>“Polluters” will then have to compete with other “polluters” during the “flexible price” period for permits through the “auction” of permits.</p> <p>During the “flexible price” period, “polluters” will have to make a decision based on the “marginal abatement cost” of implementing new technology and the impact of the “carbon price” whether:</p> <ul style="list-style-type: none"> ▪ it is cheaper to implement new technology that reduces their “pollution” which often will involve replacing “dirty” assets; or ▪ it is cheaper to “buy” carbon permits; or ▪ it is cheaper to “buy” domestic off-sets; or ▪ it is cheaper to “buy” international off-sets.
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<p>The Flexible Price Period</p>	<p>If the “polluter” cannot meet its compliance obligation, then it must pay a “penalty” for each tonne of GHG not subject to a “carbon permit”.</p> <p>In this way, the “polluters” determine what is the “least cost” option for them to reduce their “pollution” which is quite different from simply paying a 10 per cent tax (i.e. the GST).</p>
<p>Coverage</p>	<p>Sectors covered by the “carbon price” that are “large polluters” (e.g. “facilities” that emit 25,000 tonnes of GHGs or more) are:</p> <ul style="list-style-type: none"> ▪ stationary energy (i.e. electricity generation); ▪ industrial processes (i.e. the steel/aluminum/cement - heavy industrial sector); ▪ non-legacy waste (i.e. waste deposited to landfill prior to 1 July 2012); and ▪ fugitive emissions (i.e. emissions escaping from a process, such as coal mining, pipes etc BUT not decommissioned coal mines). <p>A “carbon price” will NOT apply to household transport fuels, light vehicle business transport (i.e. vehicles 4.5 tonnes or less gross vehicle mass) and off-road fuel use by the agriculture, forestry and fishing industries.</p>

<p>Coverage</p>	<p>Transport including “domestic aviation”, “domestic shipping”, “rail transport” and “non-transport use of fuels” will be subject to an “indirect/shadow carbon price” through changes in fuel tax credits.</p> <p>The Government will seek to establish an effective “carbon price” for heavy on-road liquid fuel use from 1 July 2014.</p> <p>The broad coverage of the “carbon price” will send a “price signal” to the economy to start to move towards a clean energy future at “least cost”.</p>
<p>Price Ceiling and Floor</p>	<p>A price ceiling and floor (cost “collars”) will apply for the first three years of the “flexible price” period.</p> <p>The “price ceiling” will be set at \$20 above the expected international price and will rise by five per cent in real terms each year.</p> <p>The “price floor” will be \$15, rising annually by 4 per cent in real terms each year.</p> <p>The “collar” concept provides a “safety value” for the “carbon price” to avoid price spikes or plunges as can occur on market based schemes and reflects international measures to be adopted under the UK Renewable Energy Obligation.</p>

International Linking/Off-Sets	<p>From the commencement of the “flexible price” period, international linking will be permitted with credible international carbon markets and emissions trading schemes for up to 50% of a “polluters” compliance obligation (e.g. CERs; ERUs; RMUs; and probably under the EU ETS; NZ ETS; RGGI; MGGRA; California; WCI etc).</p> <p>International linking allows “polluters” flexibility in meeting their “compliance obligation” to purchase international “permits” if they are cheaper than buying domestic permits, and places a downward pressure on “permit pricing”.</p>
Domestic Off-Sets	<p>Kyoto Compliant Carbon Farming Initiative Credits can be used by “polluters” to off-set their need to purchase “carbon credits” as a means of “compliance” subject to a five per cent cap during the “fixed price period”.</p> <p>Domestic off-sets will have a similar price impact as International Linking.</p>
Banking & Borrowing of Carbon Permits	<p>“Polluters” will be entitled to “bank” an unlimited amount of permits during the “flexible price” period; and “borrow” from the future up to 5% of the “polluters” present liability.</p> <p>No “banking/borrowing” will be allowed during the “fixed price” period.</p>

Governance	<p>Climate Change Authority to be established to advise on pollution caps and progress towards meeting targets and undertake reviews of the “carbon pricing” mechanism.</p> <p>Clean Energy Regulator to administer the carbon pricing mechanism.</p> <p>The Productivity Commission will undertake reviews relating to industry assistance, fuel tax arrangements and carbon pollution reduction activities internationally.</p> <p>The Australian Competition and Consumer Commission which regulates the New Australian Consumer Law is gearing itself up to monitor the impact of “carbon pricing” to reduce price gouging by companies.</p>
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We have assisted numerous stakeholders in reviewing their contractual provisions for climate change liabilities either directly or passed through from larger organisations.

If you would like a similar review or any further information in relation to the “carbon price” mechanism and how it will impact on your business, please contact Dermot Duncan or Glenn Crisp on their details below.

Our next briefing paper will discuss the impact of the “carbon price” on householders.