

## **Clean Energy Bill 2011: The carbon price has landed**

**By Scott Higgins and Stephanie Venuti**

The House of Representatives last week passed the *Clean Energy Bill 2011* along with 17 other bills which together make up the legislative framework for the Clean Energy Future Plan.

The legislation establishes the framework for a Carbon Price Mechanism (**CPM**) and looks destined for commencement by July 2012 assuming support in the Senate.

The CPM introduces sweeping, economy-wide reforms. Businesses should now be considering the new legislation and how it may affect their operations.

### **Cutting through the politics – a carbon tax, a carbon price or an emissions trading scheme**

Understanding the CPM is assisted by some appreciation of its forbear, the now-defunct Carbon Pollution Reduction Scheme (**CPRS**).

The backbone of the CPM is almost identical to the CPRS (in its final form as negotiated between the Turnbull-led Coalition and the Rudd Labor Government in 2010). That is, a permit-based scheme consisting of two stages:

1. an initial period where there is a fixed price on carbon; and
2. a flexible price period where a cap and trade system is in place.

This fundamental similarity of policy between the schemes is rarely acknowledged in the tumultuous political and public discourse surrounding the issue.

At its most basic, the initial fixed price period of the CPM operates in a similar fashion to a 'tax' whereas the flexible price period is more accurately described as an 'emissions trading scheme' (**ETS**).

However, even in the fixed price period, liable entities are required to acquire and surrender permits, tradeable as personal property and regulated as financial products. This is quite different to an ordinary levy or tax and, even in the fixed price period, trading is permissible for trade-exposed liable entities who have had their permits freely allocated, but have reduced their emissions from historical baselines.

A 'carbon price' is therefore the best way to accurately describe this 'hybrid model' in its entirety.

### **Carbon price: Why the hybrid model?**

The Rudd Government's CPRS was initially a cap-and-trade ETS from the outset. Whilst this provided certainty in terms of capping emissions, the price that the market would set to achieve these reductions was highly uncertain.

The adoption of a 'hybrid model' carbon price avoids a risk of the John-Hewson-GST-Cake-Analogy whilst allowing for a simpler system to administer in the opening years (even if it takes a little longer to transition to better emissions certainty under a cap-and-trade ETS).

### **The fixed price period: Carbon price certainty**

Under the CPM, the price of carbon, ( the price of the permits liable businesses will be required to purchase) is fixed at \$23 per tonne of CO<sub>2</sub>-e from 1 July 2012 to 31 June 2013 and then rises by 2.5 per cent (to account for inflation) in each of the next two years.

The fixed price period therefore creates 'price certainty' because liable businesses (and their customers down the supply chain to whom the costs will be passed) will have three years where they can more accurately predict the exact cost of their carbon emissions and how that cost will affect their bottom line.

### **The flexible price period: Emissions certainty**

The second stage of the CPM is intended to create emissions certainty. From 1 July 2015 the Government will limit the number of permits issued each year thereby 'capping' the level of Australia's net emissions.

The limited number of permits will be auctioned to the market with the market determining the price. As the number of permits reduce (in line with the emissions reduction targets) companies should be further incentivised to reduce emissions and trade excess permits for profit.

### **What you need to know about the CPM**

Below is snapshot of the highlights of the CPM. It is not an exhaustive list of issues which companies should consider.

Coverage: The CPM covers the following sources of emissions:

1. Stationary energy;
2. industrial processes;
3. fugitive emissions (other than from decommissioned mines); and
4. emissions from non-legacy waste.

It will only affect Scope 1 emissions in the above categories where these emissions are capable of measurement under the Measurement Determination of the *National Greenhouse and Energy Reporting Act 2007* (Cth).

The *Clean Energy Bill 2011* now expressly excludes biofuel, biogas and biomass from covered emissions.

### **Transport**

Transport fuels are excluded from the CPM (ie emissions will not be counted towards the threshold for liability). However, changes to fuel tax credits and fuel excise will be introduced to achieve an equivalent to the carbon price, on the following sectors:

1. domestic aviation, domestic shipping, rail transport, off-road vehicles and non-transport use of liquid fuels; and
2. heavy on-road liquid fuel use from 1 July 2014 (if the Government can win support for this measure).

[Click here](#) to see article below for more information in respect of the changes to the Fuel Tax Credit scheme.

Otherwise, a carbon price will not apply to household transport fuels, light vehicle business transport and off-road fuel use by the agriculture, forestry and fishing industries.

The legislation now makes provision for large users of covered fuels (ie. indirect emitters as opposed to direct emitters) to opt-in to the CPM from 1 July 2013 instead of being subjected to the reduction in fuel tax credits.

### **Liability**

The liable entity under the CPM is the person with 'operational control' of the emitting 'facility' (the *National Greenhouse and Energy Reporting Act 2007* (Cth) establishes the rules for defining facilities and determining operational control).

This is a significant change from the CPRS where the liable entity was the 'controlling corporation' in Australia. This should ensure that costs can be more easily passed through the supply chain due to direct contracting relationships usually resting with the operator of the facility.

The *Clean Energy Bill 2011* now includes a definition of a 'large gas consuming facility' (25kt or more). Operators of these large gas consuming facilities are required to quote an Obligation Transfer Number (**OTN**) to transfer liability from the gas supplier to the operator. For smaller gas consuming facilities, taking on liability under an OTN is voluntary. This change was introduced following the three week consultation period after the exposure draft legislation was released in July.

There is also provision for unincorporated joint ventures to have the carbon liability imposed on each of the participants in proportion to the equity share rather than simply on the operator of the facility (as was the case under the CPRS). The ability of operators to transfer all of their liability to the owner of the facility, other JV participants or others in their corporate group remains, and they are no longer required to provide a statutory guarantee for payment in such circumstances.

### **Threshold**

A threshold of 25,000 tones of CO<sub>2</sub>-e (scope 1) emissions per year will apply in determining whether a facility is covered by the CPM.

### **Compliance**

Failure to acquit the necessary permits by liable entities at the correct times incurs a fine of 1.3 times the fixed price (during the first three years) and double the average market price for that year during the flexible period.

A new Clean Energy Regulator will be established to monitor and enforce compliance.

### **Permits**

Carbon permits will be considered as personal property. Companies and individuals will be able to take security interests over the carbon units and should consider the requirements under the Personal Property Securities Act 2009. Please [click here](#) for more information on the PPSA.

Carbon permits will also be regulated as financial products and there will be licensing requirements for certain entities dealing or advising in relation to the permits. The tax treatment of permits will depend on the time permits are acquired and the way in which they are traded, broadly:

- any income from the sale of carbon units will be treated as ordinary income rather than capital gain and is tax deductible;
- the rolling balance method can be used; and
- transactions will be GST-free supply, except for derivative transactions.

### **The cap**

The Government plans to announce the first five years' worth of caps in 2014. Every five years after that, the cap for the next five year period will be announced.

When setting the caps, the Government must consider the recommendations of the Climate Change Authority – a new independent body chaired by former Reserve Bank Governor and former Treasury Secretary, Bernie Fraser.

The caps are to be introduced via regulations passed by parliament. To the extent parliament does not pass the regulations at each five year gateway, a default cap will apply which is consistent with the 5% target reduction of 2000 level emissions by 2020.

The Government's long-term target is to reduce carbon pollution by 80% compared with 2000 levels by 2050.

### **Price**

Permits issued during the fixed price period will be \$23 with the price increasing annually by 2.5% in real terms.

During the flexible price period, the price will be determined by the market however a price floor and price ceiling will be in place.

The price ceiling will apply for the first three years of the flexible price period. This will be \$20 above the expected international price for 2015-16 and will rise in real terms each year. A price floor will also apply for the first three years of the flexible price period. This is expected to start at \$15 and rise at 4% in real terms each year.

## Governance

The Clean Energy Future legislation package provides for the following governing bodies:

1. Climate Change Authority: advises on emission caps, a progress towards meeting targets and undertakes reviews of the carbon pricing mechanism.
2. Clean Energy Regulator: administers the CPM as well as the Carbon Farming Initiative.
3. Productivity Commission: will undertake reviews relating to industry assistance, fuel tax arrangements and carbon pollution reduction activities internationally.

## How are you placed for the CPM coming into effect 1 July next year?

If your business made preparations in anticipation of the CPRS coming into effect you will be well placed to take into account the direct and indirect risks associated with the CPM, however, the scheme is different in a number of respects and you should ensure that you understand these differences and seek advice on how the new laws will affect your business operations.

Liable entities under the CPM as well as businesses dealing with supply contracts or carbon intensive products/services need to be aware of liabilities and risks under their current and future contractual relationships. [Click here](#) to see article below for more information in respect of contracting for a carbon price.

sustainability and climate change update - october 2011