



Getting serious about climate change in Australia in 2012

An overview of Australia's
Clean Energy legislation

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RARE

On 8 November 2011, the Clean Energy Legislative Package passed through the Senate and will result in the staged introduction of a carbon pricing mechanism from 1 July 2012.

This paper provides an overview of the intended scheme and discusses some of the key challenges that will likely need to be negotiated during the early years of the scheme's operation.

A long and winding road

Australia's journey towards the introduction of a price on carbon has been a rocky one. The key milestones encountered along this journey were:

- **The ETS Agenda (2007).** The release of a government White Paper on the introduction of an emissions trading scheme by the previous Howard Liberal Government was the first manifestation of serious consideration of a carbon price for Australia. This agenda subsequently dissolved following the election of the Rudd Labour Government in 2008.
- **The CPRS Bill (2008).** The Rudd Labour Government built on the early work of the Howard administration by developing its own solution – the Carbon Pollution Reduction Scheme. The draft CPRS legislation followed the release of two discussion papers seeking public comment on the construct of the proposed scheme. Parliamentary debate about the legislation faltered and the legislation was subsequently defeated in late 2009. In fact, the protracted parliamentary debate arguably resulted in both the Prime Minister and the Liberal Opposition Leader being ousted from their positions.
- **The 2010 Federal Election.** The subsequent election of the Gillard Labour Government in August 2010 was the 'game changer' in respect of the national debate on carbon pricing in

Australia. This administration formed a minority government with the aid of the Australian Greens and a small number of Independents. During the negotiations on the nature of the future political collaboration, a commitment was made to revisit the introduction of a carbon pricing scheme in Australia.



The rest, as they say, is history. In July 2011, against the background of an often vicious public debate, the draft legislation for the Clean Energy Bill 2011 was released for public comment. It was subsequently ratified by the Lower House of the Australian Parliament in October 2011, and passed by the Senate in November 2011.

The Australian Government has now secured a carbon pricing mechanism from 1 July 2012.

Key elements of the Clean Energy legislation

The clean energy legislation comprises nineteen legislative Bills – a primary Bill and eighteen supporting and associated legislative amendment Bills. Although the provision of a detailed discussion of the legislation is outside the scope of this paper, the key elements of the legislation can be summarised as follows.

- 1 Scheme coverage.** The scheme extends to emissions from all industry sectors other than agriculture, forestry and fisheries. Emissions from road transport fuels are specifically excluded (although the government has indicated its intent to incorporate heavy vehicle fuel use in 2014, subject to approval of future legislation). Coal facilities producing less than 25 kt CO₂-e (i.e. 10,000 tonnes of coal) per annum are also excluded from the scheme. A 'shadow' carbon price will be applied to the use of liquid and gaseous fuels in non-transport applications via changes to current fuel excise concessions.
- 2 Pricing mechanism.** The pricing mechanism will evolve from a fixed tax to an unconstrained market scheme in three stages.
 - Between 1 July 2012 and 30 June 2015, the scheme will operate with a fixed price of \$23 per tonne, rising at 2.5% above CPI until 1 July 2015.
 - In the three years between 1 July 2015 and 30 June 2018 the carbon tax will be replaced by a market price constrained within a price floor and price ceiling. The price floor will be set at \$15 per tonne (rising by 4% per annum) and the price ceiling will be \$20 above international pricing (rising by 5% per annum).
 - From 1 July 2018, the price caps will be removed. It is intended that the staged transition will provide certainty in the first three years of the scheme's operation and then smooth the transition to a flexible market price over time (shown in Figure 1).
- 3 Point of obligation.** Energy producers with direct control over a facility that emits more than 25 kt CO₂-e per annum will be liable for their emissions. Provision has been made for these 'liable entities' to transfer liability to a third party under certain circumstances. This transfer will be formally booked using an Obligation Transfer Number to be quoted by both the energy producer and the third party.
- 4 Carbon trading limitations.** Permits will be offered by the government via an initial auction process and liable parties will then participate in the secondary trading market after 1 July 2015. Liable parties will be permitted to purchase up to 50% of their credits from international schemes and a further 5% (maximum) from domestic offsets (Kyoto compliant credits only).
- 5 Compensation arrangements.** The scheme provides compensation for energy-intensive trade-exposed industries (such as petroleum producers and mining companies) via the Jobs and Competitiveness Program. Compensation will be provided by way of 'free permits' of up to 94.5% of permits, decreasing at 1.3% per annum. Unusually, the scheme also makes provision for direct payments to households as compensation for increased energy costs arising from the scheme.
- 6 Scheme revenue.** All revenue derived from the scheme will be redeployed into the national economy. Half of the revenue will be handed to households while the other 50% will be divided between:
 - the Jobs and Competitiveness Program
 - energy security and transformation packages
 - clean energy technology funding and business energy efficiency measures.

Supporting legislative agendas

In considering the policy environment in which the clean energy legislation will operate, it is also worth noting that the effective operation of the legislation will be supported by the continued operation of two existing pieces of legislation. This legislation includes:

- **EEO (2006).** The *Energy Efficiency Opportunities Act 2006* requires that large energy-using corporations (>0.5 PJ of energy per annum) report annual energy use and

develop energy efficiency improvement plans. Annual reports demonstrating both actions must be lodged with the Australian Government.

- **NGERS (2007).** The *National Greenhouse and Energy Reporting Scheme Act 2007* requires large and moderate energy-using corporations to report energy use and GHG emissions to the Australian Government on an annual basis.

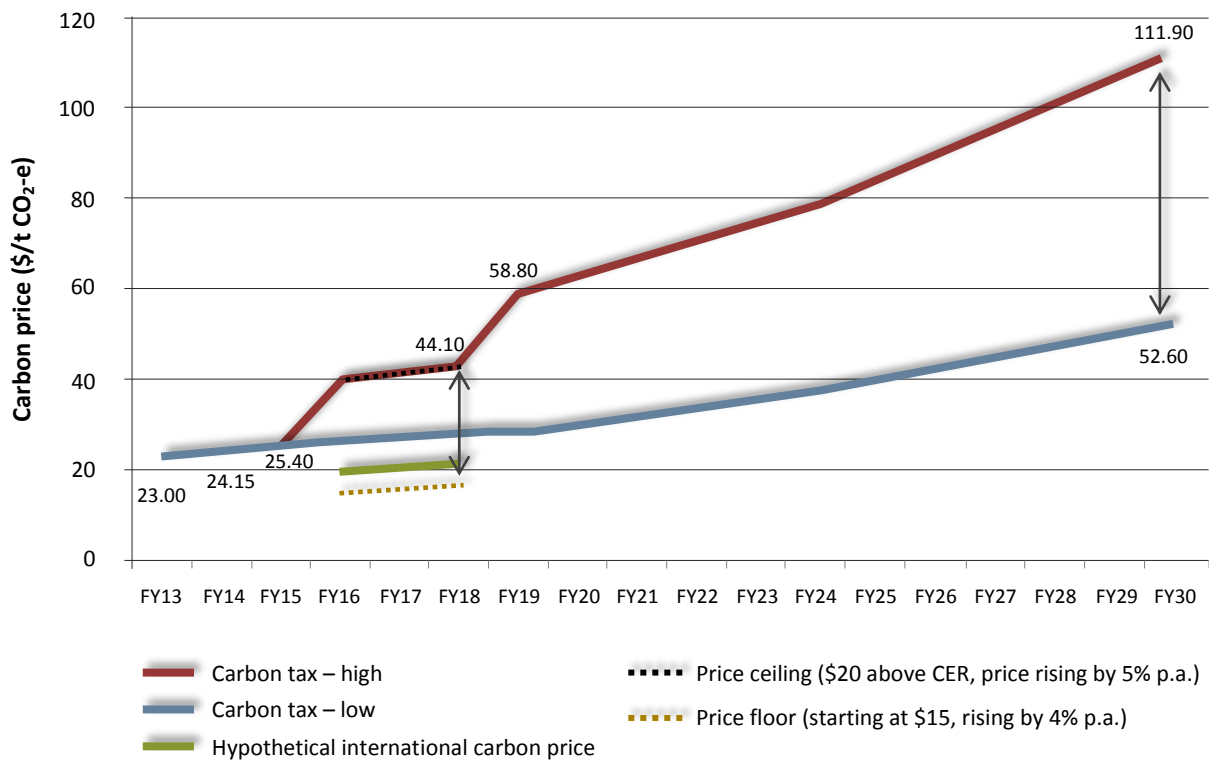


Figure 1

Graphical representation of the staged pricing mechanism (fixed price to variable) to be adopted by Australia

Likely future challenges

The carbon pricing mechanism identified in the clean energy legislation will create significant challenges for the Australian community in terms of structural adjustment. In addition, the negotiation process has resulted in several concessions that are likely to reduce the environmental effectiveness of the scheme in the near term.

Key challenges likely to be encountered in the future management of the scheme include:

- **Future management of transport sector emissions.** As has occurred with most of the national schemes to date, the Australian Government has chosen to exclude emissions from fuels consumed in road transport. The Gillard Government has publicly stated that in the future fuel used in passenger cars will not be included, but has foreshadowed the inclusion of heavy vehicle transport fuels under separate legislation to be drafted and ratified by 2014. Given that the direct GHG emissions from road transport are the second largest contributor to GHG emissions, and that the sector has the fastest annual growth in emissions, it is hard to understand why road transport has not been formally incorporated in the future staging of the scheme (apart from the obvious political risks). Ultimately, emissions from the sector will have to be addressed. Failure to do so risks undermining the achievement of national GHG emission reduction targets.
- **Maintenance of competitive neutrality between electricity and gaseous fuels for stationary energy applications.** The scheme proposes the application of a dynamic market price for electricity and a shadow carbon price (by way of six-month rolling average) for liquid

and gaseous fuels used for non-transport applications. The collection of the carbon tax via the fuel tax mechanism essentially 'locks in' the costs of the carbon price component for the liquid and gaseous fuels industries. Conversely, the electricity industry will have the opportunity to reduce the cost of the carbon price component on their energy product via selective purchasing and price hedging strategies for the purchase of carbon permits. The net effect of these differences is the likely creation of a competitive distortion in the stationary energy market that could result in the inherent carbon price component of gas use being higher than electricity, despite the fact that the use of gas in stationary applications typically delivers lower GHG emissions than the use of coal-fired electricity.

- **Revenue leakage.** The move to allow Australian corporations to purchase up to 50% of their liability from international markets constitutes a significant risk to future scheme revenues – at least in the early years of market operation. The proposed floor price of \$15 per tonne CO₂-e is higher than current international trading prices and it is therefore very likely that liable parties will choose to take advantage of hedging opportunities by pre-purchasing international permits. This, in turn, will result in the leakage of carbon capital from the Australian economy and will reduce the pool of revenue available for the proposed compensation and industry adjustment programs.

While a number of additional challenges have been cited by others, it is strongly suggested that the successful management of these three challenges will be crucial to ensuring the integrity of the scheme in the near term.



Some certainty, but for how long?

The 2011 clean energy legislation marks the end of a long road towards the development of a carbon pricing mechanism for Australia. While the scheme has attracted well-founded criticism from both business and environmental groups (albeit from different ends of the carbon pricing debate), the legislation provides a good foundation for the future operation of a carbon pricing mechanism in Australia.

That said, the Federal Opposition has committed to repealing the legislation in the event that they win office during the 2013 Federal Election.

So business, industry, the environmental movement and the Australian community still face a degree of continued uncertainty after the scheme commences on 1 July 2012.



Rare Consulting is a specialist consultancy that provides strategic services in the areas of transport and the environment, with a major focus on transport technologies, transport energy use and greenhouse strategy.

Our diverse suite of strategic services ranges from the preparation of carbon management plans and fleet strategies for corporate organisations, through to providing advice to government and industry on the economic and environmental merits of low carbon innovations and new vehicle technologies.

Our team comprises highly qualified, experienced professionals who not only have a deep understanding of the issues associated with our core service areas, but have the practical capability to develop and implement innovative solutions.

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