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A Citizen's Guide to Australia's Carbon Pollution Reduction Scheme: Understanding the Legal Framework for our Carbon Constrained Future

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One of the most important and hopefully widely debated of all Government legislation in 2009 will be the Bill introducing the Rudd Government's central platform for tackling our response to climate change in Australia – the Carbon Pollution Reduction Scheme (CPRS). A draft of the CPRS Bill was released for consultation on 10 March 2009.

The draft CPRS Bill follows the Government's preferred policy positions for the design of the CPRS released in a White Paper by Senator Penny Wong, Federal Minister for Climate Change and Water, on 15 December 2008.

This article presents a snapshot summary of the core features and intended operation of the CPRS, and is intended as a citizen's guide. The draft Bill runs to over 370 pages and the White Paper over 700 pages!

The CPRS sets the legislative framework for a 'cap and trade' emissions trading scheme. The 'cap' is Australia's target or ceiling for greenhouse gas (GHG) emissions; the 'trade' is the market-based method for emitters to set the price for pollution.

Already, the Federal Government has set the aspirational target for Australia's national GHG emissions levels by 2020 – this is an unconditional 5% off the 2000 levels of national GHG emissions,¹ increasing up to 15% off if other nations take similar action. The Government will regularly set a pathway and gateways towards that 2020 goal.

A regulator – the Australian Climate Change Regulatory Authority (ACCRA) – will define (from that national trajectory and within budget) the quantity, terms and timing of the release by the Government of rights to pollute in Australia. These Government rights to pollute will be called an Australian Emission Unit (AEU) and will permit the holder to emit 1 tonne of GHG. Liable emitters will be required to surrender AEU's to 'cover' their emissions. Because AEU's will be tradable, their price will be set in the market-place.

The CPRS will herald a major economic reform for Australia. In order to price carbon and change behaviour, a number of new ideas are being introduced. This article deals with the following major design themes of the CPRS:

- what GHG are included;
- national cap, trajectory and pathways;
- CPRS coverage and thresholds;
- nature of the Australian Emission Unit (AEU);
- Australian Climate Change Regulatory Authority (ACCRA);
- monitoring, reporting and surrender timetable;
- auction mechanism and timetable;
- limitations to AEU's and equivalents;
- banking, borrowing and penalties;
- emissions intensive trade exposed (EITE) and strongly affected industries; and
- international linking.

Greenhouse gases (GHG)

The greenhouse gases covered in the CPRS will be:

- carbon dioxide (CO₂);
- methane (CH₄);
- nitrous oxide (N₂O);
- sulphur hexafluoride (SF₆);
- hydro fluorocarbons (HFCs); and
- per fluorocarbons (PFCs).

These are the GHGs² that Australia reports to the United Nations Framework Convention on Climate Change (UNFCCC) under our international obligations in the Kyoto Protocol.

The GHG pollutants covered by an AEU will be made equivalent by using carbon dioxide as the base unit. Methane, nitrous oxide, sulphur hexafluoride, hydro fluorocarbons and per fluorocarbons will be converted to CO₂ equivalents (CO₂-e) using global warming potentials (GWP) specified in the National Greenhouse and Energy Reporting Regulations 2008 (Cth) as follows:

Carbon dioxide	1
Methane	21
Nitrous oxide	310
Sulphur hexafluoride	23,900
Hydro fluorocarbons	140 to 11,700
Per fluorocarbons	6,500 to 9,200

National cap, trajectory and pathways

Australia is currently tracking to our international targets set in the Kyoto Protocol, at roughly 599Mt CO₂-e annual GHG emissions. Australia's mid-century (2050) aim is to reduce our national GHG emissions to 60% of 2000 levels.³

The CPRS cap will be a subset of the national GHG emissions cap. Indicative national GHG emissions trajectory for the period from 2010-11 to 2012-13 are:

- 2010-11 – 109% of 2000 levels;
- 2011-12 – 108% of 2000 levels; and
- 2012-13 – 107% of 2000 levels.

The intention is for the Government to set caps for at least 5 years in advance, and then to extend them, every year, by 1 year, to maintain a 5-year cap horizon. In early 2010, the

Government will announce the caps for the first 5 years of the CPRS (2010-11 to 2014-15).

The Government will also provide guidance over future caps beyond the initial certainty period through the use of a gateway in each of the following years, to the end of the gateway period. The initial length of the gateway will be 10 years beyond the minimum 5 years of caps. Gateways will be extended by 5 years, every 5 years, as part of a strategic review of international conditions and Australia's likely future international commitments.

The Government expects to raise at least A\$11.5 billion per annum from the CPRS.⁴ The Department of Climate Change (DCC) has suggested an indicative price per t CO₂-e of A\$25.⁵ For a facility emitting 25Kt CO₂-e of GHG, the annual cost of AEU's at A\$25 per tonne of GHG emissions will be A\$625,000.

CPRS coverage and thresholds

The CPRS will cover the following sectors: stationary energy, transport, fugitive emissions, industrial processes, waste, and (from 2015) agriculture.⁶

The obligation to monitor and report GHG emissions and to surrender sufficient AEU's (or substitutes) to cover the reported GHG emissions will be upon the 'controller' of each facility which meets a relevant threshold:

- stationary energy – facilities with direct emissions⁷ greater than 25Kt CO₂-e per annum, and suppliers of fuel to small energy users;
- transport – upstream fuel suppliers (excluding exports and international transport, plastics and defence);

- fugitive emissions – facilities with direct emissions greater than 25Kt CO₂-e per annum;
- industrial processes – facilities with direct emissions greater than 25Kt CO₂-e per annum, including synthetic GHGs;
- waste – landfill facilities with direct emissions greater than 25Kt CO₂-e per annum; except for landfill sites closed before 30 June 2008, legacy emissions (until 2018) and methane from waste landfill (zero rated).

The preferred position is for any carbon capture and storage (CCS) at facilities to be netted out of gross emissions at the facility level, for determining the threshold. CCS facilities will be covered for fugitive emissions.

It is proposed that all current fuel excise and customs duty remitters will be covered for all fuel combustion emissions and emissions from synthetic liquid fuels. LPG emissions will be covered by entities that first supply LPG for use in Australia's domestic market. LNG emissions will likewise be covered by entities that first supply LNG for use in Australia. Natural gas combustion emissions will be covered by facilities with direct emissions greater than 25Kt CO₂-e and entities that first supply natural gas for use in Australia. Biofuels and biomass will not be covered.

Coal and coal by-product emissions will be covered by entities that first supply coal and coal-by-products for use in Australia.

An administrative mechanism, to be known as the Obligation Transfer Number (OTN), will be established to enable obligations to be transferred with supplies from upstream to downstream in prescribed circumstances,



thereby transferring the CPRS obligation.

Coverage will also extend to:

- agriculture – to be covered only from 2015 (inclusion and the threshold for coverage if included are to be decided from 2013);
- forestry – there is to be a voluntary opt-in for activities covered by Australia's Kyoto commitments.

Nature of the Australian Emission Unit (AEU)

The CPRS emissions permit will be the AEU. An AEU will have an indefinite life (until surrendered); there will be no power in ACCRA to extinguish AEU's without compensation. An AEU may only be surrendered once, and only AEU's held on the National Registry can be surrendered.

When surrendered, 1 AEU will cover the holder for the emission of 1 tonne of carbon dioxide equivalent (t CO₂-e) GHG pollution in the relevant pollution period (provided that this is not before the first year of permitted use).

The AEU will be personal property, and may be transferred (but legal title will only be transferred by entry in the National Registry). The creation of equitable interests and security interests in AEU's will be permitted. An AEU will be a bearer instrument and a financial product for the purposes of the *Corporations Act 2001* (Cth), with a unique identification number, marked by the year of first-use (vintage). It will be uncertified, represented instead by an electronic entry in the National Registry.

As a general rule, an AEU of a later vintage may not be used to satisfy a reporting obligation of an earlier period (except where a borrowing is permitted), but an AEU of an earlier vintage may always be used to satisfy a reporting obligation of a later period (ie, AEU's may be banked).

Australian Climate Change Regulatory Authority (ACCRA)

CPRS will be administered by ACCRA, which will also assume responsibility for reporting under Australia's greenhouse gas and energy reporting scheme and mandated renewable energy target scheme.

Reporting will all be done online using OSCAR – the Government's online system for comprehensive activity reporting.

Monitoring, reporting and surrender timetable

The CPRS reporting period will be one year, from 1 July to 30 June. The CPRS report will be due to be lodged by 31 October following the reporting year.

Surrender of AEU's (or equivalent) to cover reported GHG emissions in the reporting year will be required by 15 December (6 weeks after the 31 October report date).

Auction mechanism and timetable

ACCRA will control the release of the stock of AEU's into the market via auction. There will be 12 auctions in any year of AEU's of the single vintage that may be surrendered for the current period. There will be an annual auction of AEU's of vintages for the following three years. Auctioning will start prior to 1 July 2010, and there will be at least one auction between the end of the reporting year (30 June) and the report date (31 October).

The Australian approach to auctioning departs from the

approach of the European Union Emissions Trading Scheme (EUETS). In Europe, detailed National Allocation Plans (NAPs) for covered enterprises were formulated by member States. In phase one of the EUETS, from 2005 to 2007, 95% of European allowances (EUAs) were issued free. In the current phase two of the EUETS, from 2008 to 2012, 90% percent of EUAs are issued free.⁸

The Australian auctions will be ascending clock auctions – the vendor (Government) will set a price (effectively a reserve), and keep increasing the price until demand matches supply (which becomes the clearing price). In the case of the annual auction, the ascending clock auctions will be simultaneous.

There will be no limitation at all on participation in the auction process – controllers of covered Australian facilities will compete for AEU's with non-covered enterprises (including foreign enterprises). Enterprises will be free to decide whether to acquire their AEU's from the regulator through auction or from sellers in the CPRS or off-market by private treaty. Thus, trading in AEU's will be an activity independent of auctioning. It is expected that the initial market depth will be set by financial institutions, speculators, and other investors not obliged to acquire AEU's to acquire pollution activity.

Limitations to AEU's and equivalents

An AEU will be substitutable without limitation in the CPRS with:

- CERs (United Nations (UN) certified credits from Clean Development Mechanism projects);
- ERUs (UN certified credits from Joint Implementation projects); and
- RMUs (Removal Units under the *Kyoto Protocol*).

AAUs (Assigned Amount Units under the *Kyoto Protocol*) will not be accepted for compliance under the CPRS in the period 2010-11 to 2012-13.

Banking, borrowing and penalties

Generally, AEU's may be banked without limitation. If AEU's are carried on balance sheet at the end of the financial year, then they will be treated as trading stock. The usual trading stock election for cost or market valuation at balance date will be available in respect of banked AEU's, so as to effectively remove any exposure to income tax on unrealised gain in value of banked AEU's and also to defer any income tax deduction for the acquisition of banked AEU's until the year they are surrendered.

An enterprise may be able to satisfy a current surrender obligation by borrowing up to 5% of that current obligation from a future AEU vintage held by the enterprise (rather than borrowing from the regulator).

An unlimited amount of AEU's may be purchased from ACCRA under a safety valve price cap of A\$40 per AEU, only in the years 2010-11 to 2014-15. The price cap will rise by 5% per annum. Price-capped AEU's cannot be traded or banked.

Any shortfall in surrender of AEU's will be subject to a compliance penalty and a requirement to 'make good'. The compliance penalty will not be tax deductible.

EITE and strongly affected industries

Transitional assistance measures will apply for emissions intensive trade exposed (EITE) enterprises and coal fired

electricity generators, in the form of an allocation of free AEU subject to certain conditions, including continued output.

International linking with other emissions trading schemes

Emissions trading schemes are in operation in Europe, New Zealand and some states and regions of the USA. During the early phase of the CPRS, the scope for linking to other international emissions trading schemes will be limited. However, the Government has left open the possibility for linking in later years.

References

- ¹ Department of Climate Change, *White Paper* (2008), 4-1.
- ² Measured by CO₂-e: tonne equivalence of carbon dioxide determined by global warming potential (GWP).
- ³ Australia's GHG emissions in 1990 were 553.773Mt CO₂-e: Department of Climate Change, *Tracking to the Kyoto Protocol 2007* (2008) (subsequently revised to 547.7Mt CO₂-e by the UNFCCC Secretariat). Emissions in 2000 were approximately 551Mt CO₂-e.
- ⁴ Department of Climate Change, above n 1, Appendix E (Budget Summary).
- ⁵ By way of contrast, in 2005-2006, the net income tax collected from private and public companies in Australia was in the order of A\$48 billion: Australian Taxation Office, *Taxation Statistics 2005-6* (2008). The current rate of corporate income tax in Australia is 30% of taxable income.
- ⁶ Australia reports to the UNFCCC under the *Kyoto Protocol* for stationary energy, transport, fugitive emissions from fuels, industrial processes, agriculture, waste, land use change and forestry.
- ⁷ Known as Scope 1 emissions. The *GHG Protocol 2004* (World Business Council for Sustainable Development and World

Resources Institute) defines Scope 1, 2 and 3 emissions as follows:

Scope 1: Direct GHG emissions – Direct GHG emissions occur from sources that are owned or controlled by the company (eg, emissions from combustion in owned or controlled boilers, furnaces, vehicles); emissions from chemical production in owned or controlled process equipment. Direct CO₂ emissions from the combustion of biomass are not included in Scope 1, but may be reported separately. GHG emissions not covered by the *Kyoto Protocol* (eg, CFCs, NOx) are not included in Scope 1, but may be reported separately.

Scope 2: Electricity indirect GHG emissions – Scope 2 accounts for GHG emissions from the generation of purchased electricity consumed by the company. Purchased electricity is defined as electricity that is purchased or otherwise brought into the organisational boundary of the company. Scope 2 emissions physically occur at the facility where electricity is generated.

Scope 3: Other indirect GHG emissions – Scope 3 is an optional reporting category that allows for the treatment of all other indirect emissions. Scope 3 emissions are a consequence of the activities of the company, but occur from sources not owned or controlled by the company. Some examples of Scope 3 activities are extraction and production of purchased materials, transportation of purchased fuels, and use of sold products and services.

- ⁸ The EUETS trade volume exceeded €60 billion in 2007 and €100 billion in 2008, an increase of 171% in trade volume in 2008.

Reflect and debate:

Do we need this sort of government regulation to change our carbon footprints and polluting activities? Is this a legitimate role for the Australian Government?