

Carbon Policy Briefing Note

Date: 15 December 2008
Subject: Commonwealth White Paper

The Commonwealth Government has released a White Paper (final policy position document) outlining the framework for the "Carbon Pollution Reduction Scheme". The White Paper does not contain positions that are significantly different from the Green Paper released in July.



Key Considerations for your Business

- › Are you a liable party under the scheme (do you emit more than 25,000 tonnes)?
- › If you are trade exposed, are you likely to be compensated?
- › Will your energy bill increase?
- › What can you do to reduce emissions and take advantage of opportunities under the scheme?
- › Are there cashflow issues associated with your participation in this scheme?
- › What are the taxation implications of this scheme for your business

Key Targets

The White Paper outlines three fixed targets commencing at 109% of 2000 levels in 2010/11 and declining by one percentage point a year to 107% of 2000 levels in 2012/13. The remaining fixed targets for 2013/14-2014/15 will be announced in early 2010. The Government has also announced a "gateway" of a 5-15% reduction of emissions relative to 2000 levels by 2020. Assuming the CPRS excludes only agriculture, this would result in an initial target of around 500 million tonnes per year declining to 490 million tonnes per year in 2012/13 and 389-435 million tonnes per year in 2020. In 2006, emissions were around 486 million tonnes.

Potential Carbon Prices

Based upon the longer-term gateway of 5-15% reductions in emissions, the price determined by Treasury modelling would commence at around \$23/tonne and increase to \$35/tonne in 2020 (2005 dollars).

Next Steps

- Draft legislation outlining the legislative framework for the Scheme will be released in February 2009;
- The legislation is to be passed in mid-2009;
- Consultation on supporting regulations will occur during 2009; and

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- The final two targets (2013/14 and 2014/15) will be announced in early 2010.

Summary of the Proposed Scheme

- The scheme will commence on 1 July 2010 and operate on a financial year basis with annual compliance obligations
- It will be a cap and trade scheme. Permits will be created and will reflect a cap on total Australian greenhouse gas emissions. Businesses will be required to purchase permits for each tonne of greenhouse gases emitted
- All six greenhouse gases will be covered
- The scheme regulator will have the power to impose a penalty for non-compliance (i.e. failure to surrender sufficient AEU's). The penalty will be set in supporting Regulations.
- The scheme will have a price cap for the first five years. This cap will effectively take the form of a \$40 per tonne (increasing at 5% in real terms per year from 2010/11) sale of permits at the end of a compliance period for compliance purposes. As such, the scheme does not include a make good provision for the first five years (while this is not explicitly stated, a price cap cannot exist if a make good provision exists)
- The difference between the scheme cap and Australia's national obligation will be recognised through the allocation and immediate retirement of permits for non-covered sectors each year
- Early action will not be recognised explicitly through the allocation of permits
- The scheme regulator will be combined with the Greenhouse and Energy Data Officer (NGER) and the Renewable Energy Regulator (RET)
- An independent expert advisory committee will be established periodically to conduct reviews of the scheme

Coverage and Points of Liability

- All sectors are to be included except agriculture. Agriculture is to be included in 2015 with a final decision to be made by 2013
- All businesses in the stationary energy and industrial sectors (e.g. generators, pipeline operators, mines, aluminium smelters) will be required to hold permits for their emissions if they emit more than 25,000 tonnes per year
- Gas retailers will be required to obtain an "Obligation Transfer Number" (OTN) from the regulator which will be submitted to upstream producers and transmission and distribution companies, thereby taking on the liability for upstream emissions. This is a significantly different position from that articulated in the Green Paper and will require further clarification from the Commonwealth
- Retailers will be responsible for emissions produced by small gas customers (<25,000 tonnes) when gas is combusted

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- Transport emissions will be included in the scheme. The point of liability will be placed on upstream fuel suppliers. The Government has committed to cut fuel taxes on a cent for cent basis to offset the initial price impact under the scheme
- Importantly, for both gas and transport emissions, larger users of these fuels will be able to apply for an "Obligation Transfer Number" (OTN) from the regulator. This OTN will allow them to become responsible for their own combustion emissions and when supplied to the gas retailer or fuel supplier will prevent the retailer/supplier from being able to pass through a "carbon charge"
- Emissions from the waste sector will be included. However, 'legacy emissions' from waste deposited prior to July 2008 will not be covered under the scheme. All landfills accepting new waste after this period and emitting more than 25,000 tonnes will be covered
- Emissions from waste water and waste incineration facilities will be covered where emissions are greater than 25,000 tonnes
- Emissions from LPG production and combustion will be covered. Scheme obligations will apply to entities that first supply LPG for use in the domestic market. The Government will implement a fuel credit scheme to provide rebates to LPG users (as provided to petroleum users)
- Forestry is to be included on an opt-in basis. The Government will provide 5 years notice of any change in accounting rules that would materially impact this sector

Reporting and Compliance

- The National Greenhouse and Energy Reporting Act (NGERS) will provide the starting framework for monitoring, reporting and assurance under the scheme
- Entities with operational control of an asset will be made responsible for compliance under the scheme
- There will be some flexibility for controlling corporations to shift scheme obligations to another legal entity within their group where certain criteria are met
- Emissions methodologies under the Scheme will be those set out under NGER
- A range of emission measurement methodologies are to be used with staged improvements in accuracy pursued over time and significant amendments which affect all stakeholders made only after five years notice
- Annual reports satisfying obligations under both the Carbon Pollution Reduction Scheme and NGERs will be required by 31 October each year
- Entities with obligations greater than 125,000 tonnes of emissions will be required to have their annual reports independently verified (carried out in accordance with requirements outlined in NGERs). There is likely to be significant compliance costs incurred through these audits

- Permits will be required to be surrendered before 15 December for the previous financial year
- The scheme regulator would release emissions information for the previous financial year as soon as possible after 31 October each year

Nature of Permits

- Permits will be created under the scheme legislation. They are likely to be known as Australian emission units (AEUs)
- Permits will be personal property, transferable and defined as a financial product for the purposes of the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*, but with some minor adjustments to fit the characteristics of the permits
- Permits will be “date-stamped”. They will only be able to be surrendered after the date they are stamped with. This effectively ensures that companies cannot borrow large volumes of future permits to meet current obligations
- There will be no power in the legislation to involuntarily extinguish or for a court to order the relinquishment of permits without compensation
- Voluntary surrender of permits will be permitted (but the person will be required to hold a registry account). For each AEU surrendered, the Government will surrender an appropriate international instrument (i.e. Assigned Amount Unit – AAU – under the Kyoto framework)
- Most of the information about an individual asset’s emissions (and compliance status) will be made available by the Scheme regulator

Banking and Borrowing

- Unlimited banking of permits will be allowed.
- The scheme will allow liable entities to discharge up to 5 percent of their obligations by surrendering carbon pollution permits dated from the following year

Target and Caps

- The White Paper outlines three fixed targets commencing at 109% of 2000 levels in 2010/11 and declining by one percentage point a year to 107% of 2000 levels in 2012/13
- The remaining fixed targets for 2013/14 and 2014/15 will be announced in early 2010
- The caps will be set in regulations, not legislation
- If regulations are not in place at 1 July each year, a default cap of 0.99 multiplied by the previous year’s cap will be added to the end of the scheme caps to ensure that five years of caps are always available
- The Government has announced a “gateway” of a 5-15% reduction of emissions relative to 2000 levels by 2020.

- Gateways (higher and lower bounds of potential targets) will be provided for 2025 at the beginning of the scheme. The “gateways” will be extended by five years after each five year period

International Linkages

- Liable parties will be able to surrender international Kyoto compliant credits for compliance purposes: Joint Implementation (JI) Emission Reduction Units (ERUs); and Clean Development Mechanism Certified Emission Reductions (CERs) except CERs from forestry based projects. There is no limit on the number of these certificates that can be surrendered for compliance purposes
- Assigned Amount Units (AAUs) which are effectively country permits under the Kyoto Protocol will not be able to be exported or imported for the first few years of the scheme. This effectively prevents international linking except for CER and ERU units
- The Government will provide five years notice for changes in international linking arrangements

Allocation of Permits

- Some permits will be provided to trade exposed and electricity generators at the beginning of the scheme
- The remaining permits will be auctioned with progression towards 100 percent auctioning as the scheme matures

Auctions of Permits

- Auction policy and design for 2010 and 2011 will be the responsibility of the Minister for Climate Change (and defined through regulation or rules). The regulator will assume responsibility from 2012 onwards
- Auctions will be held monthly with the first auction to be held early in 2010
- The Government will consult with industry about the possible arrangements for deferred settlement payment arrangements for AEU's bought at auction. This would be transitional in nature
- At least one auction of the previous year's permit vintage will be held after the end of the financial year but within one month prior to the surrender date
- Auctioning will ensure that permits for the following four years will be physically available in the market at any point (with advance auctions to occur annually)
- Any person or company will be able to participate in the auction process
- Simultaneous ascending clock auctions will be used. Entities that receive free permits will be able to sell them through 'double sided' auctions in 2010 and 2011

Assistance for Emissions Intensive Trade Exposed Industries (EITE)

- EITEs will receive an allocation of permits at the beginning of each compliance period, contingent on production
- Trade exposure will be assessed on lack of capacity to pass through costs or trade share (defined as the ratio of the value of imports and exports to the value of domestic production) greater than 10 percent in any of the previous 4 years
- The assessments of emissions intensity will be based on either: weighted average emissions per million dollars of revenue; or emissions per million dollars of value added. The second methodology will require agreement on a case by case basis with the Commonwealth
- Initial assistance to eligible activities will be set at: 90 percent of an allocative baseline for activities that have an emissions intensity above 2000t/\$million revenue or 6000 t/\$million valued added; and 60 percent of an allocative baseline for activities that have an emissions intensity between 1000t/\$million revenue and 1999t/\$million revenue or between 3000t/\$million revenue and 5999t/\$million revenue
- The allocative baselines will reflect the costs associated with direct emissions and generic factors (one permit per MWh and State-based gas emission factors) for electricity and gas consumption to reflect higher energy costs
- Over time the rate of assistance will decline by the carbon productivity contribution of 1.3 percent a year
- The EITE program will be reviewed every five years by an Independent Expert Advisory Committee. Assistance will be withdrawn when key competitor economies introduce comparable emission reduction schemes
- Examples of industries which are likely to qualify include aluminium smelting, lime production, cement production, integrated steel manufacturing and pulp and paper manufacturing
- Around 25% of AEU's will be allocated to EITE industries at the beginning of the scheme
- A guidance paper is to be released in early 2009 to assist companies navigate their way through the requirements to qualify for assistance

Assistance for Electricity Generators

- Only coal-fired electricity generators in existence at 3 June 2007 will be eligible for the Electricity Sector Adjustment Scheme
- The Government will deliver a fixed quantity of permits (up to 130.7 million) over the first five years of the scheme to impacted generators. These permits have a nominal value based upon modelling of \$3.9 billion
- This quantity is around 5% of total permits
- The quantity of permits provided will be determined using the individual generators emissions intensity relative to a benchmark of 0.86 tonnes per MWh and capacity and output

- Generators will be required to apply for permits within 90 days of the scheme legislation coming into force. The scheme regulator will determine individual allocations
- The Government will require each recipient of assistance to submit to a 'windfall gains' review. The likelihood of windfall gains will be assessed by the regulator by comparing the generator's actual revenue and predicted revenue prior to the scheme commencing
- The Minister will have the discretion to withhold the final two years of allocation from the generator depending upon the outcome of the 'windfall gains' review

Tax and Accounting Issues

- Discrete provisions of the income tax law will be developed
- If the permit is banked, the effect of the deduction would be deferred until the permit is surrendered or sold
- Free permits will be included as assessable income
- Scheme transactions will be treated under normal GST rules
- Penalties paid will not be deductible

Transitional Issues

- The White Paper provides little guidance on how the QLD Gas Scheme and NSW Greenhouse Gas Abatement Scheme will be 'transitioned' into the CPRS. However, the Commonwealth has indicated that it will consider providing some direct assistance to adversely affected cogeneration, landfill gas and coal mine methane generators and holders of unused NGACs

Household Assistance

- The Government will provide cash assistance through a 2.5% pension and allowance benefits increase of around \$276-380 per person per year or a Seniors Concession Allowance of similar amount
- The Government will also increase the Low Income Tax Offset by \$390 and increase Family Tax Benefits A and B by 2.5%
- These additional payments will commence on 1 July 2010
- The Government will introduce household energy efficiency measures prior to the commencement of the CPRS on 1 July 2010

Climate Change Action Fund

- The Government has committed to introducing a \$2.15 billion (over 5 years) Climate Change Action Fund
- The Fund will provide information to business and the community about the scheme; provide grants and incentives for business to invest in energy efficiency and technology; provide structural assistance to impacted



communities; and structural assistance to coal mines with high fugitive emissions

- A Stakeholder Consultative Committee, comprising business and community representatives will be established to provide advice on the detailed design and implementation of the Fund in 2009