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Clean Energy legislation

The imposition of a carbon price and establishment of the Carbon Farming Initiative are significant new initiatives representing key elements of the Government's clean energy plan.

The legislation that establishes liability to pay a carbon price has now received Royal Assent and the main provisions have been proclaimed to commence on 2 April 2012. Liability to pay the price will start from 1 July 2012. The 3 Acts establishing the Carbon Farming Initiative (the CFI) received Royal Assent on 15 September 2011.

Each of these 2 legislative regimes is part of the Government's broader clean energy policy reflected in *Securing a clean energy future: The Australian Government's climate change plan*. The other elements of the policy are:

- encouraging investment in clean energy technologies through a new Clean Energy Finance Corporation, a new Australian Renewable Energy Agency and the existing Renewable Energy Target
- improving energy efficiency, including through the Low Carbon Communities Program and a national energy savings initiative.

Both legislative regimes will be relevant to a range of other policy development initiatives and in a range of legal contexts. As we discuss below, the legislation may directly affect some Commonwealth agencies. This note briefly summarises each legislative regime.

Carbon pricing

The legislative package establishing the carbon price comprises 18 Acts:

- the *Clean Energy Act 2011*, which contains the main provisions establishing liability to pay a carbon price by surrendering emissions units (the carbon pricing mechanism)
- a number of associated charging Acts
- an Act establishing the Clean Energy Regulator, which will administer the carbon pricing mechanism, the Renewable Energy Target, the CFI, the National Greenhouse and Energy Reporting system (which has been extended to encompass reporting for the purposes of the carbon pricing mechanism) and the Australian National Registry of Emissions Units (which presently exists but which has been put on a statutory footing)

- an Act establishing the Climate Change Authority, which will advise the Government on a range of matters such as pollution caps and the operation of the carbon pricing mechanism
- a consequential amendments Act
- various taxation amendment Acts which impose a carbon price on some fuel users and on import and manufacture of synthetic greenhouse gases
- a household assistance Act.

The Clean Energy Regulator will commence operation on 2 April 2012. The carbon price will start on 1 July 2012.

Carbon pricing mechanism

The carbon pricing mechanism will apply to around 500 'liable entities'. There will be 2 main types of liable entity: direct emitters and natural gas suppliers.

Direct emitters

Direct emitters are entities responsible for facilities that have covered greenhouse gas emissions of 25,000 tonnes of carbon dioxide equivalent or more per year (excluding emissions from transport fuels and synthetic greenhouse gases). The entity responsible will usually be the entity that has operational control of the facility, but it is possible in some circumstances for liability to be transferred to another entity or entities (such as a person with financial control of the facility or the participants in a joint venture related to the facility).

The emissions covered by the mechanism are 'scope 1 emissions' – that is, greenhouse gases released into the atmosphere as a direct result of an activity or series of activities (including ancillary activities) that constitute the facility. This is subject to some exclusions (such as agricultural emissions). Examples of the emissions that are covered are:

- emissions from electricity generation
- emissions from manufacturing processes, such as gas emitted while making cement
- landfill emissions
- fugitive emissions, such as methane emissions from coal mines.

Emissions from, for instance, the energy used to heat and cool an office building are not 'scope 1 emissions' and are not covered.

Most direct emitters are already reporting their emissions to the Greenhouse and Energy Data Officer (whose functions will transition to the Clean Energy Regulator) under the *National Greenhouse and Energy Reporting Act 2007*. The biggest group of direct emitters not currently reporting is local councils operating landfill facilities.

Natural gas suppliers

Natural gas suppliers will generally be liable for the emissions embodied in the natural gas they supply to small- and medium-sized customers. In some circumstances, the recipient of the natural gas can choose to take on liability for the gas (through an obligation transfer number) rather than have liability passed on to them by the supplier.

Natural gas acquired by large customers will be captured by the direct emitter provisions.

How the mechanism works

Liable entities will pay the carbon price by surrendering a number of emissions units equivalent to their carbon dioxide emissions. If a liable entity does not surrender sufficient units, it will become liable for a unit shortfall charge (a tax), which is imposed at a premium above the value of the unit.

The mechanism will operate in 2 stages:

— **Fixed price period**: For the first 3 years, the carbon price for each tonne of carbon pollution will be fixed, starting at $23 per tonne and rising by 2.5% in real terms each year.

— **Flexible price period**: From 1 July 2015, the mechanism will shift to a 'cap and trade' emissions trading scheme.

In the fixed price period, the Clean Energy Regulator will issue carbon units (units created under the Clean Energy Act) on application to liable entities only. The units will be automatically surrendered and the value of any excess surrender refunded. Liable entities will be able to surrender Australian carbon credit units (created under the CFI) to meet up to 5% of their liability (100% in the case of some entities with landfill facilities). International units will not be able to be surrendered in the fixed price period.

For the flexible price period, the Clean Energy Regulator will auction carbon units. The number of carbon units available for auction will be limited by a pollution cap. Pollution caps will be set for the first 5 years from 1 July 2015. The caps will be extended each year. There will be no limit on surrender of Australian carbon credit units. Eligible international units will be able to be surrendered, but for the first 4 years of the flexible price period these units will only be able to be used to meet 50% of liability. Excess surrender of any type of unit will be 'banked' for use in a following year.

Carbon units will be able to be issued to persons other than liable entities and will be able to be traded along with Australian carbon credit units and international units. They will be personal property, and will be financial products for the purposes of Ch 7 of the *Corporations Act 2001*, which means that people who provide financial services in relation to them may require an Australian financial services licence.

For the first 3 years of the flexible price period, there will be a price ceiling and a price floor for carbon units to avoid price spikes and plunges. The ceiling and floor will be set by regulating the auction price of carbon units and imposing a top-up charge on the surrender of international units.

In both the fixed and flexible price periods, the Clean Energy Regulator will issue carbon units without charge by way of industry assistance. The Jobs and Competitiveness Program will provide free carbon units to emissions-intensive, trade-exposed industries. Free units will also be provided to some coal-fired electricity generators. These units could be traded even in the fixed price period.

Fuel

A price equivalent to the carbon price will be applied to fuel:

- used in domestic aviation, marine and rail transport
- used by business for off-road transport
- for non-transport business uses (such as a diesel generator on a mine site).

The price will be imposed by reducing the fuel tax credit or remission of excise duty available in respect of the fuel or imposing increased excise duty on the fuel. The price will be based on the fixed price in the fixed charge period and the average carbon price over the previous 6 months in the flexible price period. It will vary according to the level of emissions embodied in the particular fuel.

The carbon price will not be applied to fuel used in the agriculture, forestry and fisheries industries or to on-road use of light vehicles.

The Government has stated its intention to introduce legislation to seek to apply the carbon price to heavy on-road transport from 1 July 2014.

The Clean Energy Act also allows for the establishment by regulations of an 'opt-in scheme' to enable large users of liquid fuels to voluntarily opt in to the carbon pricing mechanism from 1 July 2013 instead of paying the equivalent carbon price through the fuel tax or excise system.

Synthetic greenhouse gases

A price equivalent to the carbon price will be applied to synthetic greenhouse gases. The price will be imposed by increasing existing levies on the import and manufacture of the gases. The price will be based on the fixed price in the fixed charge period and the average carbon price over the previous 12 months in the flexible price period. It will vary according to the level of emissions embodied in the particular gas.

Application of the carbon pricing mechanism to Commonwealth agencies

The legislation will generally apply to the Commonwealth as a legal person and to Commonwealth authorities in the same way as other entities. The most likely application of obligations to the Commonwealth or a Commonwealth authority would be:

- where the greenhouse gases emitted from the operation of a facility by the Commonwealth / Commonwealth authority have a carbon dioxide equivalence of 25,000 tonnes or more per year
- if the Commonwealth / Commonwealth authority is a large user of natural gas and is required to assume liability for that gas.

Commonwealth agencies may also be subject to increased costs for electricity and natural gas supply. The price of other goods and services may also increase because of the imposition of the carbon price. The ability of suppliers to pass through the carbon cost in long-term contracts will need to be assessed on a case-by-case basis, depending on the terms of the contract.

Carbon Farming Initiative

The CFI rewards farmers and land managers who undertake carbon storage and carbon pollution reduction activities by allowing them to generate carbon credits which can be sold on domestic and international carbon markets.

The 3 Acts establishing the CFI are:

- the *Carbon Credits (Carbon Farming Initiative) Act 2011*
- the *Carbon Credits (Consequential Amendments) Act 2011*
- the *Australian National Registry of Emissions Units Act 2011*, which creates an electronic register for the purpose of tracking the location and ownership of carbon credits issued under the CFI, international units and, in future, carbon units issued under the Clean Energy Act.

The CFI commenced on 8 December 2011 and is administered by the Carbon Credits Administrator. From 2 April 2012, the CFI will be administered by the Clean Energy Regulator.

Australian Carbon Credit Units

Australian carbon credit units (ACCUs) may be earned by:

- reducing or avoiding emissions – for example, by reducing methane emissions from livestock
- capturing carbon from the atmosphere and storing it in trees and soil by a process known as sequestration.

ACCUs may be Kyoto ACCUs or non-Kyoto ACCUs, depending on when they are issued and whether the relevant abatement activity meets Australia's obligations under the Kyoto Protocol.

Offsets projects

Abatement activities are conducted as offsets projects. A number of requirements must be met before an offsets project may be established:

- An offsets project must be conducted by an offsets entity. In order to be recognised as an offsets entity, a person must pass a fit and proper person test. In determining whether a person is fit and proper, regard is had to whether the person:
  - has been convicted of an offence relating to dishonest conduct
  - has breached the clean energy scheme legislation
  - has breached various other Acts
  - has had any orders made against them by the ACCC
  - is insolvent or is under external administration.
- An offsets entity must have the legal right to carry out the offsets project. In the case of a sequestration project, the offsets entity must also have the exclusive legal right to obtain the benefit of sequestration of carbon in the land.

— Offsets projects must adopt and comply with an approved methodology. Approved methodologies contain the detailed rules for implementing and monitoring specific abatement activities under the CFI. Methodologies can be developed by private persons or government agencies and are determined by the Minister, following endorsement by an independent expert committee (the Domestic Offsets Integrity Committee).

— Offsets projects must be additional to abatement activities already undertaken in the relevant industry. ACCUs will not be issued for activities that are already common practice in the industry or a relevant part of the industry.

One ACCU will be issued, on a net basis, for each tonne of carbon dioxide equivalent either avoided or sequestered under an offsets project. ACCUs will only be issued after project reporting requirements have been complied with.

Sequestration projects

Carbon abatement achieved by a sequestration project is only counted if it is permanent (that is, maintained for at least 100 years). As such, if a sequestration project is terminated, or if a carbon store is deliberately destroyed, ACCUs already issued in relation to the project may be required to be relinquished. If a sufficient number of ACCUs are not relinquished, a penalty will become payable. If the penalty is not paid, the area of land connected with the sequestration project may become the subject of a carbon maintenance obligation. A carbon maintenance obligation may prevent activities that would reduce sequestration on the land below a benchmark level. The obligation endures until all outstanding penalties are paid or for 100 years after the commencement of the project, whichever occurs first, and binds current as well as future owners of the land. Civil penalties apply if carbon maintenance obligations are breached.

ACCUs will not be required to be relinquished where carbon stores are destroyed by natural causes or by causes outside of the landowner's control. The risk of such losses will be covered by deducting a risk of reversal buffer from the ACCUs issued for sequestration projects.

Using Australian carbon credits units

ACCUs are personal property and can be traded. They are financial products for the purposes of Ch 7 of the Corporations Act, which means that people who provide financial services in relation to them may require an Australian financial services licence.

Under the Clean Energy Act, entities that are subject to the carbon pricing mechanism may meet their liability by buying and surrendering Kyoto-compatible ACCUs:

— During the fixed charge years (from 1 July 2012 to 30 June 2015), up to 5% of a liable entity's liability under the carbon pricing mechanism may be met by surrendering eligible ACCUs. If at least 50% of the liability arises from landfill emissions then all of the liability may be met by surrendering eligible ACCUs.

— In the flexible charge years (from 1 July 2015 onwards), all of a liable entity's liability under the carbon pricing mechanism may be met by surrendering eligible ACCUs.

Kyoto ACCUs may also be exchanged for internationally recognised Kyoto units and sold on international markets. Non-Kyoto ACCUs may be sold to individuals and companies wishing to offset the emissions they generate during their everyday activities.

Application of the Carbon Farming Initiative to Commonwealth agencies

Where land is subject to a carbon maintenance obligation, the activities that may be undertaken on that land, including land clearing, may be limited. When acquiring land, Commonwealth agencies should inquire as to whether any offsets projects have been conducted on the land and whether any carbon maintenance obligation exists. State and Territory land registers, and the Register of Offsets Projects kept by the Clean Energy Regulator, should be checked for any notes about the existence of projects and any carbon maintenance obligation.

AGS continues to assist the Department of Climate Change and Energy Efficiency with the development of the Acts and regulations establishing the carbon price, the CFI and the Australian National Registry of Emissions Units.

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