



Australian Government



Starting Emissions Trading on 1 July 2014

Policy Summary

July 2013



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Policy Summary

The Australian Government is bringing forward the start of emissions trading to 1 July 2014.

This change will establish binding annual limits (pollution caps) on Australian industry's greenhouse gas emissions from 1 July 2014 onward. This will ensure that Australia meets its international emissions reduction targets under the second commitment period of the Kyoto Protocol (2013 to 2020) and under the United Nations Framework Convention on Climate Change.

The change will end the fixed-price period of the carbon pricing mechanism and bring the Australian carbon price into line with the carbon price prevailing under the European Union Emission Trading System (EU ETS). This is currently expected to be around \$6 per tonne of emissions in 2014-15.

The move to flexible-price emissions trading will provide Australian businesses with greater opportunities to reduce their carbon pollution at low cost and will increase the flexibility available to liable entities to manage their compliance obligations. The move will provide liable entities and other intermediaries with access to a mature international carbon market with well-established risk management products, enable banking and borrowing of carbon units, and provide the maximum scope for use of domestic offset credits from land sector abatement.

In summary, the Government's commitment to starting emissions trading on 1 July 2014 will ensure that Australia meets its international emissions reduction commitments, reduce compliance costs and transaction costs for businesses, increase flexibility, and improve risk management.

Part 1 of this Policy Summary explains the background to the flexible-price period and the emissions trading scheme.

Part 2 explains the elements of the policy that will change under the new plan.

Part 3 sets out the opportunities for consultation on these policy changes for members of the public, the business community, non-government organisations and other interested parties.



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1. Carbon Pricing Design

In July 2011, the Government announced the Clean Energy Future Plan, the Government's comprehensive plan to address climate change by reducing greenhouse gas emissions, investing in clean and renewable energy technologies, encouraging energy efficiency and through action on the land.

The carbon pricing mechanism

The central element of the Clean Energy Future Plan is the carbon pricing mechanism, which provides incentives for Australia's largest polluters to reduce their greenhouse gas pollution, by requiring them to acquire and surrender an eligible emissions unit for each tonne of greenhouse gas pollution they release into the atmosphere or pay a shortfall charge.

It was designed to commence with a "fixed-price period" from 1 July 2012 to 30 June 2015. The price of carbon units was set in 2011 to be a fixed level for each of the fixed-price years, with the Government making an unlimited number of carbon units available to Australia's largest polluters in those years. Fixed-price emissions units are valid only in relation to the compliance year for which they are issued, and cannot be banked for use in future years or borrowed from future compliance years. In fixed price years, liable entities are also prohibited from surrendering eligible international emissions units and are generally limited in their surrender of domestic offsets to 5 per cent of their emissions liabilities.

The fixed-price period was designed to:

- provide liable entities with stability while they adjusted to the carbon pricing mechanism and their emissions reporting and compliance management obligations, and
- ensure sufficient time for liable entities and the Clean Energy Regulator (the Government agency responsible for administering the carbon pricing mechanism) to implement the systems and processes they would need for flexible-price emissions trading.

The scheduled transition to emissions trading

The carbon pricing mechanism has always been designed to automatically transition from fixed-price carbon pricing to flexible-price emissions trading. In the flexible-price period, the price of emissions units is not fixed but varies according to the balance between the supply of those units from within the emissions trading scheme pollution cap, domestic offset projects and international carbon markets, and the demand for those units by liable entities and others.

The cap on emissions under the emissions trading scheme sets the maximum level of greenhouse gas pollution that Australia's largest polluters can collectively release in any given year by setting the limit on the total number of Australian carbon units that are available. Liable entities can only exceed this cap by surrendering units from offset projects or international carbon markets (both of which represent emissions reductions from sources outside Australia's emissions trading scheme).



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From the start of the flexible-price period, entities with a liability to surrender emission units will be able to use emission units from international markets, including the EU ETS, to acquit up to 50 per cent of their annual liabilities. Liable entities will also be able to surrender emission units generated under Kyoto Protocol mechanisms including the Clean Development Mechanism and the Joint Implementation mechanism. For the first flexible-price compliance year in 2014-15, a limit of 6.25 per cent of an entity's overall liability will apply to the use of Kyoto units, moving to 12.5 per cent from 1 July 2015.

Other flexibility arrangements, such as banking (holding carbon units over from one year to another) and borrowing (surrendering carbon units from a future year in the current year) are also available from the start of the flexible-price period.

In addition, the 5 per cent limit on the use of credits generated under the Carbon Farming Initiative (CFI) will be removed from the start of the flexible-price period. The CFI allows farmers and other land managers to earn carbon credits by storing carbon or reducing greenhouse gas emissions on the land. These credits, known as Australian carbon credit units (ACCUs), generate demand for projects that have significant economic and environmental benefits for regional Australia.

Starting emissions trading early

Implementation of the carbon pricing mechanism has gone very smoothly since it started on 1 July 2012.

The Clean Energy Regulator (the Regulator) is well-advanced in its preparations for flexible-price emissions trading, and liable entities have indicated significant interest in, and capacity to accommodate, an early move to emissions trading.

Notably, on 17 June 2013, around 260 liable entities made their first surrender of units under the carbon pricing mechanism. This was a provisional surrender of carbon units representing around 75 per cent of their estimated emissions obligations for the 2012-13 financial year. In relation to this provisional surrender, the Clean Energy Regulator reported:

- 100 per cent compliance from entities required to report emissions data; and
- acquittal of 99.75 per cent of the total provisional carbon pricing liability of all liable entities by the due date.

The Government's assessment is that there are significant benefits of moving to flexible-price emissions trading on 1 July 2014, one year earlier than currently scheduled, and that the systems and processes required for emissions trading can be established and implemented ahead of a 1 July 2014 start date.



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2. Moving to Emissions Trading

What will change?

The Government has committed to bringing forward the start of emissions trading to 1 July 2014. It proposes that the architecture of the flexible-price period to be shifted forward so that the policy settings for 2014-15 are broadly consistent with those intended for 2015-16.

The implementation process has several elements, as outlined below.

Single compliance point

As a flexible-price year, 2014-15 will only have a single compliance point: 1 February 2016. There will no longer be a requirement for liable entities to make a provisional surrender of units on 15 June 2015.

Use of international units

The carbon pricing mechanism is designed to link to international carbon markets, including the EU ETS and eligible units generated by emissions reduction projects or sequestration activities under the Kyoto Protocol.

To facilitate a move to early emissions trading with international linking, the Government will move to amend the *Clean Energy Act 2011* to allow liable entities to surrender eligible international emissions units (including European Union allowances and eligible Kyoto units) from 1 July 2014.

The 50 per cent limit on the use of eligible international emissions units to make up a liable entity's annual liability will also be brought forward to apply in 2014-15. The Government is also phasing in access to Kyoto units. The sublimit on Kyoto units will be 6.25 per cent of an entity's liability in 2014-15, moving to 12.5 per cent from 1 July 2015.



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Linking to the European Union Emissions Trading System

In August 2012, the Australian Government and the European Commission announced their intention to link their emissions trading schemes. An interim one-way link is scheduled to start by 1 July 2015, under which Australian liable entities can surrender European Union allowances for compliance with their Australian carbon price liabilities. This will be followed by a full two-way link by 1 July 2018.

These arrangements accommodate an early start to emissions trading, as the interim link will be in place by 1 July 2015, which is seven months before the 2014-15 compliance date of 1 February 2016.

In the meantime, liable entities and other market participants are able to open accounts in the European Union Registry and trade in European Union allowances.

The timing for the full link is unaffected by the decision to bring forward the start of emissions trading.

Pollution caps

The pollution cap refers to the number of Australian carbon units that will be available in each year of the carbon pricing mechanism. The *Clean Energy Act 2011* provides that the Government must set the caps for the first five years of emissions trading (for the years from 2015-16 to 2019-20) by 31 May 2014, before the start of emissions trading. The caps are to be extended by one year every year from 2016, so that there are always five years of caps known in advance.

To begin emissions trading on 1 July 2014, the Government will set a pollution cap for 2014-15, following advice from the Climate Change Authority.

The Climate Change Authority is an independent statutory body established to provide expert advice to the Government on Australia's climate change mitigation activities, including making recommendations on Australia's pollution caps and emissions reductions targets. The Authority is currently considering the level of the pollution caps for 2015-2020 in order to make recommendations to the Government. This is being undertaken as part of the Climate Change Authority's Caps and Targets Review.

The Minister for Climate Change will request the Climate Change Authority to complete a special review to recommend a pollution cap for 2014-15 under section 59 of the *Climate Change Authority Act 2011*. His recommendation will be provided alongside the Authority's current Caps and Targets Review, which will recommend pollution caps up to 2020. The Authority's final report will be completed by 28 February 2014.



The 2014-15 pollution cap will be set in regulations once the *Clean Energy Act 2011* is amended to make 2014-15 the first flexible-price year. The existing default cap arrangements will be extended to apply in 2014-15 consistent with the methodology currently in the legislation. This will equate to a default of 25 million tonnes below covered emissions in 2012-13. The default cap for all years after 2014-15 will be 12 million tonnes below the previous year's cap.

Table 1: Changes to pollution caps

Previous policy	Under early emissions trading
<ul style="list-style-type: none"> The Climate Change Authority makes recommendations on pollution caps to the Government. The Government sets caps for the first five years of emissions trading (2015-16 to 2019-20) by 31 May 2014. The default cap for 2015-16 is 38 million tonnes less than the total covered emissions for the 2012-13 compliance year. The default cap for each year after will be 12 million tonnes less than the previous year's cap. 	<ul style="list-style-type: none"> The Minister will request the Climate Change Authority to complete a special review to recommend a 2014-15 pollution cap. Pollution caps including 2014-15 cap to be set before 1 July 2014. Default cap arrangements will be consistent with the current methodology and brought forward to apply in 2014-15.

Auctioning carbon units

During the flexible-price period the Government will allocate some carbon units to businesses to support jobs and competitiveness, and to help affected industries make the transition to a clean energy future. The remaining units will be auctioned by the Regulator.

The *Clean Energy (Auction of Carbon Units) Determination 2013* (the Determination) commenced on 11 May 2013. The Determination sets the rules and procedures for the conduct of auctions by the Regulator. The Regulator is now implementing the electronic auction platform to conduct auctions.

A total of eight auctions are scheduled to be held for each flexible-price year, including three advance auctions, four auctions during the compliance year, and one auction after the compliance year but before the final surrender date.

A similar auction schedule will be used for 2014-15, and the following schedule is proposed:

- two advance auctions, between February 2014 and June 2014;
- four auctions during 2014-15; and
- one auction after 30 June 2014 and before the final surrender date for the 2014-15 year, which is 1 February 2016.

The volume of units to be sold at the two advance auctions will be set at 20 million per auction, consistent with auctions for other vintage years that occur before the emissions cap is set.



By linking with the EU ETS, the price of Australian units is intended to track the price of European Union allowances. Consistent with this intent, and to simplify the process for determining the opening price at auction, the opening price will set be at 80 per cent of the European Union allowance price for the duration of the interim link.

Table 2: Changes to the opening auction price

Previous policy	Under early emissions trading
<ul style="list-style-type: none"> The opening price is set at 80 per cent of the Australian carbon unit price. If there is not a sufficiently liquid domestic market to determine the Australian carbon unit price, the opening price is set at 60 per cent of the European Union allowance price. 	<ul style="list-style-type: none"> The opening price is set at 80 per cent of the European Union allowance price.

Use of units generated under the Carbon Farming Initiative

During the fixed price period quantitative restrictions apply on the use of ACCUs, which are generated under the Carbon Farming Initiative. Non-landfill facilities may use ACCUs to meet up to 5 per cent of their liability, while landfill facilities may meet their entire liability with ACCUs.

Consistent with existing policy for the flexible-price period, there will be no limit on the use of ACCUs for compliance from 1 July 2014.

Banking and borrowing

Commencing the flexible-price period in July 2014 means that carbon units issued in 2014-15 will be flexible-price period units, meaning they can be banked for use in later compliance years.

A liable entity will also be able to borrow carbon units with a 2015-16 vintage for surrender in relation to the 2014-15 compliance year, up to a limit of 5 per cent of its liability in 2014-15.

Price ceiling

A price ceiling provides certainty for liable entities and other carbon market participants as to the maximum cost of compliance under the scheme.

The price ceiling was to be set in regulations to be \$20 above the expected international price in 2015-16, escalating in real terms by 5 per cent each year for three years.



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With the move to emissions trading on 1 July 2014, the Government proposes to bring forward the setting of the price ceiling to start in 2014-15. Regulations to set the price ceiling will be made before 1 July 2014, following consultation.

Table 3: Changes to the price ceiling

Previous policy	Under early emissions trading
<ul style="list-style-type: none"> • Price ceiling to be set for 2015-16 on 31 May 2014. • Price ceiling to commence on 1 July 2015. • Price ceiling to be set at \$20 above expected international price in 2015-16. 	<ul style="list-style-type: none"> • Price ceiling to be set before 1 July 2014. • Price ceiling to commence on 1 July 2014.

Free permit allocations

No changes are being made to the Jobs and Competitiveness Program which provides free permits to support emissions-intensive trade-exposed (EITE) industries. It should be noted that because the assistance provided to EITE industries is provided in carbon units, the value of assistance will automatically adjust to the level of the carbon price. The Productivity Commission will be reviewing EITE industry assistance in 2014-15, consistent with current arrangements.

Assistance to the most emissions intensive coal-fired generators under the Energy Security Fund is being reduced to help fund the early transition to emissions trading. The Government has decided to bring forward the generators' 2015-16 free permit allocations to 2014-15, and to discontinue the program after 2014-15.



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3. Having Your Say: Consultation

There will be several stages of consultation where interested parties may outline their views about the details and implementation of the Government's commitment to move to emissions trading on 1 July 2014, including views on any matters that should be addressed in the drafting of legislation to give effect to the proposed plan.

Announcement

The Government announced its commitment on 16 July 2013, and has published this Policy Summary to give stakeholders detailed information about the policy decisions it has made.

Preparing legislation

The Government will consult on draft legislative changes.

This will include releasing an exposure draft of legislation and accompanying explanatory material on the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education (DIICCSRTE) website and inviting interested parties to make written submissions with sufficient time to allow stakeholders to consider all the issues.

DIICCSRTE may also conduct consultation sessions to address specific concerns or to draw out stakeholder views on specific issues. These views will inform the final drafting of the legislative changes.

Public consultation on the 2014-15 pollution cap

As discussed above, the Minister for Climate Change will make a special request to the Climate Change Authority to recommend to the Government a pollution cap for 2014-15. This recommendation will be made alongside the Authority's expected report on the caps for the years from 2015 to 2020.

Interested parties will have the opportunity to comment on the recommended 2014-15 cap as part of the review conducted by the Climate Change Authority.

More information

For more information visit: www.climatechange.gov.au
www.treasury.gov.au