

## Issues in the bills

### Overview

2.1 The purpose of this report is to identify and address matters surrounding the provisions of the Clean Energy Amendment Bills 2012.<sup>1</sup> The Government has flagged that these bills will help to build the framework to link Australia's carbon pricing mechanism with international emissions trading schemes.<sup>2</sup> During the inquiry, four central provisions emerged as areas worthy of analysis, namely:

- the implications of linking Australia's carbon trading scheme with international systems, including the European Union Emissions Trading System (EU ETS);
- the removal of the floor price;
- the limits placed on the use of eligible international carbon units to discharge an emitter's liability; and
- the treatment of natural gas supply and use.

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1 The key amendments are contained in the Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012 (the bill). The package of bills will be referred to as the 'Clean Energy Amendment Bills 2012' and covers all seven bills, including: Clean Energy (Charges-Excise) Amendment Bill 2012, Clean Energy (Charges-Customs) Amendment Bill 2012; Excise Tariff Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012; Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012; Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012; and Clean Energy (Unit Issue Charge-Auctions) Amendment Bill 2012.

2 Explanatory Memorandum, Clean Energy Amendment Bills 2012, p. 8.

- 2.2 The Clean Energy Amendment Bills 2012 build on the Government's Clean Energy Legislative Package and will provide the framework for entities to purchase and surrender eligible international carbon units to discharge liabilities in the flexible price period of Australia's emissions trading scheme. This flexible price period will start in 2015 and the amendments in the bills facilitate a link between the Australian carbon pricing mechanism and the EU ETS from this time. The provisions also provide the flexibility for Australia to link with other emissions trading schemes in the future.
- 2.3 Witnesses generally supported the concept of linking emissions trading schemes. The committee heard that to the extent Australia wants to be part of a global carbon market, then the measures in the amendment bills are an important step towards that. However, some witnesses postulated that linking to the EU ETS could weaken Australia's control over scheme design.
- 2.4 To facilitate the link with the EU ETS, there will no longer be a 'floor price' in Australia's scheme. The floor price was to be implemented by imposing a minimum auction reserve price and a charge on the surrender of eligible international emissions units. Instead, it is proposed that the Minister may establish a 'reserve charge amount' for a specific auction.
- 2.5 During the inquiry, budget implications and price volatility resulting from the removal of the price floor were discussed. It was submitted that linking to a large carbon market like the one supporting the EU ETS would achieve commensurate price certainty for participants in Australia's carbon market. The Government's carbon price revenue estimates also remain as published in the 2012-13 Budget.
- 2.6 A designated limit of 12.5 per cent has been set for Kyoto units. The general limit – which allows for entities to meet 50 per cent of their liability through the purchase and surrender of international units – remains in place. Both limits will continue until 2020. It was submitted that the designated limit on Kyoto units will artificially increase costs for liable entities, undermining the intent of the scheme to provide least-cost abatement. The committee heard compelling evidence that the designated limit was necessary to ensure the integrity of Australia's emissions trading scheme.
- 2.7 Provisions are made in the bills that seek to ensure liability for carbon emissions is realised as high as possible in the natural gas supply chain and that the principle of universal coverage for all liable entities in this chain applies. Gas producers were concerned that the bills' provisions might have broader, unanticipated implications for the industry. The

Department of Climate Change and Energy Efficiency (DCCEE) assured the committee that the intent of the provisions was narrow and that ensuing regulations would be dependent on the outcome of consultation with stakeholders due to occur in the near future.

## Linking carbon markets

### Background

- 2.8 Carbon markets are a prime vehicle to meet carbon pollution reduction targets. There exist a number of carbon markets around the world. Individually, these markets work in a localised way to reduce pollution, but linked, they can create a global market place that fosters least-cost abatement and contributes to an international solution to climate change.
- 2.9 Linking the Australian emissions trading scheme has been a policy priority of the Government's for some time. Since 2007, it has variously said:

As an Australian scheme begins to take shape, the Australian Government will begin discussions with other nations which are developing or contemplating complementary emissions trading regimes, and which share Australia's broad approach to climate change ... The Australian scheme will be designed to maximise the prospect of linkages with other schemes, and with policy-based arrangements such as offsets, where offshore emissions reducing activities could be counted by Australian firms in determining their net emissions.<sup>3</sup>

As a supporter of the development of a global system, Australia has a direct interest in promoting links between comparable schemes. Any Australian domestic trading scheme should be designed to enhance the scope for links, both formal and informal, with as many different systems as possible.<sup>4</sup>

The Government acknowledges the overwhelming support of stakeholders for linking and recognises the benefits of linking in

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3 Australian Government, *Australia's Climate Change Policy*, 2007, p. 11.

4 Australian Government, *Prime Ministerial Task Group on Emissions Trading*, 2007, p. 113.

providing low-cost compliance options for liable entities and in supporting an efficient global response to climate change.<sup>5</sup>

Australia's carbon price will be linked to carbon markets around the world from the start of the flexible price period. This will allow reductions in carbon pollution to be pursued globally at the lowest cost.<sup>6</sup>

... it is common sense to support international linking because it assists in providing emissions reduction at least cost and it contributes to knitting together different national and regional schemes. It develops a common carbon price across economies, a common incentive to cut emissions, and fairly shares the burden of doing so.<sup>7</sup>

- 2.10 The amendment bills provide the legislative framework for linking Australia's emissions trading scheme to other schemes, including in the first instance the EU ETS. The Explanatory Memorandum to the bills states:

The amendments are designed to enable the Government to make and implement arrangements to link with a variety of schemes, and are therefore designed to provide appropriate flexibility for the Government in implementing these technical arrangements.<sup>8</sup>

- 2.11 The EU ETS is a mandatory emissions trading scheme covering at least 30 countries in Europe. It has operated since 2005 and by 2011, it had delivered emissions reductions of 17.5 per cent below 1990 levels in the EU.<sup>9</sup> The carbon market supporting the EU ETS is also the largest in the world. In 2011, trade in European carbon units represented at least three quarters of all trade in global carbon units, in both volume and value terms.<sup>10</sup>

## Analysis

- 2.12 The concept of linking emissions trading schemes was generally supported by submitters and witnesses who appeared before the committee. The committee heard that to the extent Australia wants to be
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5 Australian Government, *Carbon Pollution Reduction Scheme White Paper*, 2009, p. 11-3.

6 Australian Government, *Securing a Clean Energy Future*, 2011, p. 30.

7 The Hon Greg Combet AM MP, Minister for Climate Change and Energy Efficiency, *House of Representatives*, 19 September 2012.

8 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 8.

9 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 7.

10 World Bank, *State and Trends of the Carbon Market*, 2012, p. 10.

part of a global carbon market, then the measures in the amendment bills are an important step towards that.<sup>11</sup> The committee also heard that broadly, the amendments were a positive thing that would better deliver the policy intent of the *Clean Energy Act 2011*.<sup>12</sup>

2.13 Evidence presented to the committee indicated there are multiple benefits to linking. These include expanding the scope of abatement opportunities available to Australian liable entities and providing them with access to well-established markets to assist with hedging risk.<sup>13</sup>

2.14 Linking Australia's emissions trading scheme to the EU ETS as the amendment bills facilitate will also simplify compliance for entities liable in both Australia and Europe. These entities will be able to use fungible carbon units – either European allowances or Australian carbon units – to acquit their liability under either scheme.<sup>14</sup>

2.15 The Australian Financial Markets Association submitted that:

Linking of the Clean Energy Scheme with sound international schemes has been consistently requested by AFMA as a mechanism to increase market depth, achieve least cost abatement and reduce overall risks for participants.<sup>15</sup>

2.16 Likewise, the Clean Energy Council stated that it:

... supports the linking of Australia's carbon pricing scheme with international emissions trading systems. International linking allows Australian businesses to access emissions reductions opportunities at least cost. With international linking, the carbon price in Australia will essentially be set by international supply and demand for abatement.<sup>16</sup>

2.17 Beyond the broader economic and commercial benefits, witnesses before the committee suggested that linking carbon markets also generates momentum towards a global carbon market to reduce carbon pollution. The IETA stated:

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11 Mr Martijn Wilder, Baker & McKenzie, *Committee Hansard*, 27 September 2012, p. 1.

12 Mr Seb Henbest, Bloomberg New Energy Finance, *Committee Hansard*, 27 September 2012, p. 3.

13 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 7.

14 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 7.

15 Australian Financial Markets Association, *Submission 5*, p. 1.

16 Clean Energy Council, *Submission 1*, p. 2.

We think that Australia's concrete steps towards creating a real link between two different carbon markets on different sides of the planet encourages those other countries to see that their own domestic efforts to create carbon markets can have a further step where they can link to other countries. It is not just theory; it is becoming practice.<sup>17</sup>

2.18 While support for the general concept of linking was widespread, the committee is aware that views vary on this and that some believe that linking Australia's scheme to the EU ETS may not be as beneficial.<sup>18</sup>

2.19 The committee heard the view that jurisdictions, including Europe, will design their emissions trading schemes specific to their national circumstances, and changes in foreign schemes to which we are linked may not be consistent with our national interest. The Australian Coal Association stated:

... the EU will design a scheme to meet its purposes and Australia will have no say really in that design ... there is a significant risk that what is in the best interests of the European Union is not in the best interests of Australia.<sup>19</sup>

2.20 The Cement Industry Federation also said:

... it appears that Australia has very little say over any major scheme changes that are contemplated by the European Union ... Australia should not be willing to hand over 'sovereignty' on scheme design unless the scheme becomes a truly international scheme.<sup>20</sup>

2.21 Witnesses discussed with the committee that linking by its very nature subjects participants to a degree of loss of sovereignty. Just as global markets for other commodities are influenced by exogenous factors which participants must manage, so too will global carbon markets. Baker & McKenzie stated:

The truth of the matter is that ... these are global markets. If OPEC makes a decision on oil, the oil price changes. What you are seeing

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17 Mr Rob Fowler, IETA *Committee Hansard*, 27 September 2012, p. 4.

18 Mr Steven Ciobo MP, *Committee Hansard*, 27 September 2012, p. 12.

19 Mr Peter Morris, Australian Coal Association, *Committee Hansard*, 27 September 2012, p. 5.

20 Cement Industry Federation, *Submission 3*, p. 5.

is that, in a global marketplace, you have to manage the carbon price.<sup>21</sup>

- 2.22 Bloomberg New Energy Finance also pointed out that the market that operates under the auspices of the United Nations and which generates Kyoto units already involves an inherent loss of sovereignty for Australia:

Any time a link is forged between an Australian carbon market and any other market – whether it is the international offset market, the European market or the New Zealand market – there will be an element of policy-taking from Australia. In the CER [a form of Kyoto unit] market – where, in the current legislation, we are linked to the value of 50 per cent of companies' liabilities, potentially – that market price is determined by a melting pot of demand and supply across the entire world, driven by the UN policy negotiations and subject to a significantly larger number of forces than the EU ETS price.<sup>22</sup>

- 2.23 Bloomberg further argued that treaty negotiations with Europe in the context of the two-way link between Australia's scheme and the EU ETS provides the opportunity for Australia to mitigate any potential loss of sovereignty:

So while it is very true that there is a risk of Australia having to accept policy decisions from other markets, I think this is actually a lower-risk move, because at least Australia can have a bilateral discussion with the EU and negotiate its position up-front rather than essentially accepting what comes out of a UNFCCC slightly messy international negotiation.<sup>23</sup>

## Conclusion

- 2.24 The committee considers that linking the Australian emissions trading scheme to other emissions trading schemes, including to the EU ETS, will provide clear benefits to Australian entities. The combined EU ETS and Australian emissions trading schemes will allow the inter-continental pursuit of low cost abatement and is an important step to achieving a global carbon market and, ultimately, a global solution to climate change. The committee supports the provisions in the bills that facilitate linking.

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21 Mr Martijn Wilder AM, Partner, Baker and McKenzie, *Committee Hansard*, 27 September 2012, p. 6.

22 Mr Seb Henbest, Bloomberg New Energy Finance, *Committee Hansard*, 27 September 2012, p. 6.

23 Mr Seb Henbest, Bloomberg New Energy Finance, *Committee Hansard*, 27 September 2012, p. 6.

- 2.25 The committee notes views that linking schemes could involve a loss of autonomy over the design of Australia's emissions trading system. However, it is also the committee's view that in the process of formally linking with international emissions trading schemes, the Government will be able to participate in treaty negotiations to ensure Australia's interests are safeguarded.

## Removal of the floor price

### Background

- 2.26 The price floor in Australia's emissions trading scheme represented a minimum carbon price which was to be implemented through a minimum auction reserve price and a charge on the surrender of eligible international emissions units.<sup>24</sup> While enabling legislation existed to implement these features, the Government had not made regulations pursuant to this legislation, pending consultation with stakeholders.
- 2.27 The price floor was intended to provide a degree of carbon price certainty, but it is also not the only way to achieve this. Access to large and liquid carbon markets, like the EU ETS, can provide commensurate carbon price certainty.<sup>25</sup>
- 2.28 To remove the surrender charge on eligible international emissions units, the current amendments will repeal section 124 of the *Clean Energy Act 2011*, which introduced the surrender charge, and the entire *Clean Energy (International Unit Surrender Charge) Act 2011*. Under current law, if an eligible international emissions unit is surrendered in the 2015–16, 2016–17 or 2017–18 financial years, a charge would be imposed. However under the amended law, no charge will be imposed on the surrender of eligible international emissions units.<sup>26</sup>
- 2.29 Reference to a minimum auction reserve price will also no longer be provided in subsection 111(5) of the *Clean Energy Act 2011*. Under current law, provision is made for minimum auction reserve charges of \$15 for 2015–16, \$16 for 2016–17 and \$17.05 for 2017–18. There will be no

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24 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 42.

25 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, pp. 9–10.

26 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 42.

minimum auction reserve charge automatically applied under the amended law.<sup>27</sup>

- 2.30 The Minister may establish a 'reserve charge amount' for a specific auction in a legislative instrument. According to the Explanatory Memorandum:

The 'auction reserve charge amount' is a mechanism aimed at enhancing the price discovery of the auction. A reserve charge amount can serve to counteract bid shading (that is, bidding an amount which is less than the amount that the participant believes that the unit is worth) or collusion by auction participants by minimising the potential gains from such behaviour.<sup>28</sup>

## Analysis

- 2.31 There has been both support for, and argument against, the removal of the floor price in evidence presented to the committee.

- 2.32 In its submission to DCCEE, the Business Council of Australia indicated its support for the removal of the floor price:

The BCA supports the removal of the floor price and a surrender charge. Both these elements of the legislation distorted the market that is intended by the legislation and will bring additional costs to the economy and consumers at a time when all efforts should be directed at maintaining a strong and growing economy.<sup>29</sup>

- 2.33 Similarly in its submission, COZero approved of the removal of the floor price and linking as a way to promote least cost abatement in Australia and to reduce uncertainty for liable parties:

Prior to the amendment of the legislation, COZero's market experience showed that the floor price and proposed surrender charge for international units would significantly diminish the demand for these permits. Subsequently, it is our stance that the removal of the price floor and 12.5% import cap (very close to European levels) will promote demand for these units and allow for affordable abatement.<sup>30</sup>

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27 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 43.

28 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 43.

29 Business Council of Australia, Submission regarding the Draft Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012 and Related Bills, September 2012, p. 3.

30 COZero, *Submission 7*, p. 1.

- 2.34 The Australian Financial Markets Association also supported the removal of the floor price, arguing that it would improve the design of the Australian carbon market, reduce costs and simplify administration.<sup>31</sup>
- 2.35 On the other hand, the Climate Institute argued its preference for an extended floor price ‘because of the predictability it provides investors and the economic efficiencies it could deliver’. The Climate Institute noted three benefits from a gradually rising floor price:
- It helps deter investment in highly emission intensive technologies that would become stranded under the stronger policies needed in the future.
  - It reduces downside financial risk premiums associated with low carbon investments thereby reducing the costs of investments.
  - It encourages investment in low emissions technologies through more predictable price signals. This brings down their costs through ‘learning by doing’ and economies of scale.<sup>32</sup>
- 2.36 The Climate Institute noted that ‘without a carbon price or strong limits on the import of international offset credits from developing countries, Australian carbon prices would likely fall to single digits in 2015’. This would allow an Australian company to ‘buy a credit from a country like China for a renewable energy project that they had built for less than \$5 per tonne’. The result of this would be that Australia would be locked into ‘the polluting technology of the past’ and would not be prepared for ‘the emerging and inevitable low-carbon economy’.<sup>33</sup>
- 2.37 The Climate Institute did concede, however, the viability of ‘linking with the world’s biggest carbon market with a limit on international permits’, provided ‘it is combined with strong policies for domestic clean energy and energy efficiency’.<sup>34</sup>
- 2.38 In evidence before the committee, DCCEE noted that the floor price was only ever intended as an interim measure, for the first three years of the flexible price period, while domestic markets develop.<sup>35</sup> DCCEE also noted that the link to the EU ETS operated as an alternative to the floor price in providing price stability by granting access to a mature carbon market:

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31 Australian Financial Markets Association, *Submission 5*, p. 1.

32 The Climate Institute, *Submission 9*, p. 2.

33 The Climate Institute, *Submission 9*, p. 3.

34 The Climate Institute, *Submission 9*, p. 2.

35 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012 p. 9.

They have well-established futures markets. They provide an alternative way in which domestic liable parties can actually lock in the future liabilities under the scheme ... The link to the European scheme is a different way of providing long-term price security, because you can already, today, bank on the price which is trading in futures markets within the European Union.<sup>36</sup>

- 2.39 The evidence received by the committee at its public hearing indicated widespread support for the removal of the floor price.<sup>37</sup>

## Conclusion

- 2.40 The committee considers that removing the floor price and repealing the legislative mechanisms which would have given effect to it will make linking the Australian emissions trading scheme with the EU ETS administratively simpler, facilitating the overall policy outcome. The link to the EU ETS and access to associated derivative markets should offer the Australian carbon market commensurate carbon price stability in absence of the floor price.

## Surrender limits on Kyoto units

### Background

- 2.41 A key part of the linking arrangement with the EU ETS and to which the amendment bills give effect is the introduction of a surrender limit on Kyoto units (referred in the bills as a 'designated limit') of 12.5 per cent of an entity's annual liability. The limit will be in place until 2020, after which regulations may change the percentage. The amendment bills provide a new power at section 123A of the *Clean Energy Act 2011* to enact this limit.

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36 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 9.

37 Mr Damien Dwyer, Director, Economic, APPEA, *Committee Hansard*, 27 September 2012, p. 2; Mr Alex Gosman, CEO, Australian Industry Greenhouse Network, *Committee Hansard*, 27 September 2012, p. 2; Mr Rob Fowler, Australia and New Zealand Representative, International Emissions Trading Association, *Committee Hansard*, 27 September 2012, p. 4; Mr Martijn Wilder AM, Partner, Baker and McKenzie, *Committee Hansard*, 27 September 2012, p. 31.

- 2.42 The designated limit on Kyoto units is in addition to an existing 'general limit' on other international units. The general limit for international units is set at 50 per cent of an entity's annual liability.
- 2.43 DCCEE advised the committee that the surrender limit on Kyoto units was part of the negotiated deal struck with the European Commission to link emissions trading schemes.<sup>38</sup>
- 2.44 The amendment bills provide the Government with the regulation-making power to introduce additional designated limits on eligible international units in future. The Explanatory Memorandum says:
- The setting of designated limits through regulations reflects the requirement for flexibility in both setting and changing limits over time, reflecting the maturation of Australia's emissions trading arrangements, the enhancement of existing links with overseas emissions trading schemes and the development of new links and international emissions trading systems.<sup>39</sup>
- 2.45 To provide sufficient notice to liable entities of new limits, designated limits will come into effect one to three financial years after the regulation is registered.<sup>40</sup> In general, three years notice must be given before a new designated limit is introduced or an existing limit is changed. However, to give effect to an international arrangement, at least one year's notice must be given before a designated limit associated with the arrangement is introduced.

## Analysis

- 2.46 The Explanatory Memorandum to the bills states that the purpose of limiting units is to safeguard the environmental integrity of Australia's pollution reduction efforts. The designated limit on Kyoto units will also assist with the convergence of the price of European units and Australian carbon units.<sup>41</sup>
- 2.47 However several submitters and witnesses were concerned about the limit, arguing that because it will restrict access to comparatively cheap Kyoto units, it is inconsistent with the broader objective of linking to achieve pollution reduction at least-cost.

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38 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 9.

39 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 26.

40 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 27.

41 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 26.

2.48 During the hearing APPEA asked:

If we are about reducing emissions and meeting the targets that we have domestically and as part of our international obligations at lowest cost, why introduce constraints that frustrate that goal?<sup>42</sup>

2.49 Similarly the Cement Industry Federation submitted:

It is not clear that Australia has gained any specific advantage by agreeing to put sub thresholds in place. By definition, the sub threshold does not encourage access to lowest cost abatement.<sup>43</sup>

2.50 Conversely, some submitters supported the surrender limit on Kyoto units, recognising that it would still allow access to relatively cheap units. COZero stated:

... it is our stance that the removal of the price floor and 12.5% import cap (very close to European levels) will promote demand for these units and allow affordable abatement.<sup>44</sup>

2.51 The committee also heard that Kyoto units would unlikely effectively realise the transition to a low-carbon economy that the *Clean Energy Act 2011* sought to achieve. In particular, the supply of Kyoto units is not capped which contributes to a low price for them, currently around \$2.50 per unit. Bloomberg argued:

... I think that we need to be careful of buying carbon for the sake of buying carbon. While the carbon price mechanism is a least-cost mechanism, having the cheapest carbon – that is, a \$2 carbon price – is not going to achieve the objectives that it has been put in place to achieve. Look at the power sector and the coal-gas fuel-switching price. Just turning off coal and turning on gas as an abatement measure is at least \$30 today and, depending on the gas prices as we move to more LNG exports, is probably moving up towards \$60 and beyond. That is just for the power sector. So, if we are serious about reducing emissions inside Australia, we need a higher carbon price than \$2.50. That will increase costs for carbon-intensive businesses, but that is the nature of reducing emissions: it does cost something.<sup>45</sup>

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42 Mr Damien Dwyer, Director, Economic, APPEA, *Committee Hansard*, 27 September 2012, p. 15.

43 Cement Industry Federation, *Submission 3*, p. 6.

44 COZero, *Submission 7*, p. 1

45 Mr Seb Henbest, Bloomberg New Energy Finance, *Committee Hansard*, 27 September 2012, p. 16.

2.52 Due to a lack of global legal agreement around the future form of the United Nation's mechanisms which govern Kyoto units, Baker & McKenzie further pointed out that there is currently no certainty around the prospects for Kyoto units beyond this year:

CERs are produced under the international rules of the Kyoto Protocol. There is absolutely no guarantee at this point in time that you are going to be able to use those post-2012. There needs to be a negotiation under the Kyoto Protocol about facilitating the extension of Kyoto and how those units are used ... I think people have forgotten that that is not yet a done deal – the use of those international permits.<sup>46</sup>

2.53 Similarly, the committee also heard that much greater business certainty is provided by allowing Australian liable entities to use European units to acquit their pollution liabilities. Unlike the market for Kyoto units, the European market is much larger, more established and presents more of a going concern.<sup>47</sup> These features are important as it provides a better basis on which to make investment decisions around long-lived, low carbon technologies.

2.54 The committee further heard that the limit would still allow for significant access to Kyoto units in the Australian scheme. While estimates vary, around 230 million Kyoto units could be used in the Australian scheme between now and 2020.<sup>48</sup>

## Conclusion

2.55 The committee acknowledges the concerns expressed in relation to the limit placed on the use of Kyoto units in Australia's scheme.

2.56 The limit was a condition of the linking arrangement agreed between the Government and the European Commission. For the link to the EU ETS to work effectively and for this to help foster a transition to a low-carbon economy in Australia, consistent with the broader objectives of the *Clean Energy Act 2011*, some limitation on Kyoto units is necessary. The committee supports the provisions in the bills which facilitate surrender limits on eligible international units.

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46 Mr Martijn Wilder AM, Partner, Baker and McKenzie, *Committee Hansard*, 27 September 2012, p. 19.

47 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 17.

48 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 17.

## Natural Gas

### Background

2.57 The amendments relating to the treatment of natural gas aim to ensure that liability for carbon pollution is realised as high as possible in the natural gas supply chain and that the principle of universal coverage for all liable entities applies.<sup>49</sup> The Explanatory Memorandum notes that:

Currently, there is the potential for certain commercial arrangements to lead to situations which may not be captured by the current provisions of the CE Act concerning emissions embodied in natural gas. Regulations may set out the circumstances in which liability applies to a supplier or end user in specific circumstances, enabling the Government to maintain competitive neutrality across the industry by supporting the complete coverage of natural gas under the carbon pricing mechanism. The specific provisions would be consistent with the current natural gas provisions in that liability would arise where the use of the natural gas results in greenhouse gas emissions.<sup>50</sup>

2.58 The Explanatory Memorandum also notes that these provisions would not come into effect unless and until the necessary regulations are made, and that the Government would consult on the development of these regulations prior to their implementation.<sup>51</sup>

### Analysis

2.59 In its submission to DCCEE, AGL rejected the proposed amendments relating to natural gas. AGL stated:

These changes to the already complex gas supplier provisions of the *Clean Energy Act 2011* (the Act) will introduce significant new obligations for natural gas suppliers, including the development of new systems, processes and capabilities, and as they are currently drafted, may prove impossible to comply with.<sup>52</sup>

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49 Mr Simon Writer, Assistant Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 26.

50 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 43.

51 Explanatory Memorandum (Combined), Clean Energy Amendment Bills, p. 43.

52 AGL, submission to the Clean Energy Future Consultation of the Department of Climate Change and Energy Efficiency, *Exhibit A*, p. 2.

2.60 AGL considered that the existing coverage of natural gas supply under the carbon pricing mechanism is very near complete, and that the amendments are not required at this time.<sup>53</sup>

2.61 APPEA also raised concerns about how the amendments relating to the treatment of natural gas would operate and called for their removal from the bills.<sup>54</sup> In evidence before the committee, APPEA argued that the proposed amendments were ‘a very complicated part of the scheme’, and that they had ‘some reasonably significant commercial implications for gas suppliers in terms of negotiating their commercial arrangements with their customers and with others in the gas supply chain’. APPEA urged further consultations before these provisions were dealt with by Parliament.<sup>55</sup>

2.62 In response, DCCEE emphasised that it was important to understand the context and overarching principles of the proposed amendments :

The underpinning principle for natural gas liability is that it should be at the point highest upstream that it can be, and that has been what has driven the question of the point of liability in natural gas from the outset – that was a recommendation from the Shergold review and there have been some iterations in the way in which that has been applied. The carbon pollution reduction scheme had a particular approach and, after that approach no longer proceeded, the issue was revisited and the approach that was set out in the *Clean Energy Act 2011* was adopted. What that does is reinforce the principle of liability as high as possible in the supply chain but then provide flexibility about where that point of liability might be moved to reflect the commercial arrangements in the gas sector.<sup>56</sup>

2.63 DCCEE also noted that the proposed amendments were designed to ensure the original intent of the legislation was not subverted:

These provisions are there to address what we consider to be a potential gap in liability that may emerge around specific arrangements that exist in the gas supply chain. The overarching objective here is to ensure that emissions embodied in natural gas are all covered, regardless of where their point of liability might

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53 AGL, submission to the Clean Energy Future Consultation of the Department of Climate Change and Energy Efficiency, *Exhibit A*, p. 3.

54 APPEA, *Submission 2*, p. 5.

55 Mr Damien Dwyer, Director, Economic, APPEA, *Committee Hansard*, 27 September 2012, p. 23.

56 Mr Simon Writer, Assistant Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 24.

be. The objective of the legislation and these amendments is to ensure that that gap cannot be opened and that arrangements can be made through regulations in a flexible way in consultation with industry to ensure that the point of liability is put at the appropriate point reflecting the commercial arrangements which exist in the industry and which may evolve over time. Those commercial arrangements in this sector, partly reflecting the dynamism and growth in the sector over recent years, change fairly rapidly, so the objective with these amendments is to provide that liability to put the point of liability at the appropriate point and to do so in a way that does not allow potential gaps in liability to emerge in this area.<sup>57</sup>

2.64 DCCEE highlighted that the proposed amendments are targeted to the particular issue in question and narrow in scope.<sup>58</sup> DCCEE also emphasised that without the regulations, nothing in the amendments would be given effect and that there would be extensive consultation in conjunction with drafting of the regulations. DCCEE noted that these ‘amendments are really largely providing for a regulation-making power to make sure that people operating in this industry understand that emissions embodying gas will be covered one way or the other’. This would provide ‘a degree of certainty to the industry about the rules of the game’.<sup>59</sup>

2.65 DCCEE outlined the proposed consultation process, stating that:

There will be a paper setting out the options around the precise regulations that are proposed. The indication has been, really, that that should be done probably by the end of October. Then by the end of the year the department would release draft regulations for consideration by the industry. Those regulations would be made by March of next year, giving people a lead period before 1 July 2013 to understand the implications of any compliance changes that may arise.<sup>60</sup>

2.66 APPEA acknowledged that the intention of the proposed amendments was limited in nature and that the rationale behind them was not

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57 Mr Simon Writer, Assistant Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 24.

58 Mr Simon Writer, Assistant Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 26.

59 Ms Jenny Wilkinson, Acting Deputy Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 25.

60 Mr Simon Writer, Assistant Secretary, DCCEE, *Committee Hansard*, 27 September 2012, p. 26.

controversial.<sup>61</sup> It also acknowledged the Government's stated intention to consult with industry over the regulations.<sup>62</sup>

## Conclusion

- 2.67 The committee is satisfied that the provisions in the bills dealing with the treatment of natural gas supply and use are necessary to give effect to the policy intent of the original legislation.
- 2.68 Moreover, the committee is satisfied that the proposed method of implementing these changes, by providing a framework in legislation which will then be detailed in regulation, is consistent with current legislative practice, and will allow sufficient consultation to address the concerns of industry. The committee therefore supports these provisions of the bills.
- 2.69 The committee also notes and supports the Government's stated intention to carry out detailed consultation over the provisions of the regulations.

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### Recommendation 1

- 2.70 **The House pass the Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012 and associated bills as proposed.**

Julie Owens MP  
Chair  
9 October 2012

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61 Mr Damien Dwyer, Director, Economic, APPEA, *Committee Hansard*, 27 September 2012, p. 24.

62 Mr Damien Dwyer, Director, Economic, APPEA, *Committee Hansard*, 27 September 2012, pp. 24-5.