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Practice Group(s):
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What Will the End of the Carbon Tax and Start of Carbon Trading Mean?

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Draft legislation¹ released on 25 July 2013 proposes terminating the carbon tax and bringing forward carbon emissions trading to 1 July 2014. This article sets out some key features of what the move to carbon emissions trading will mean.

What Will Moving to Carbon Trading Mean?

'Terminating the carbon tax' refers to ending the fixed price period of the carbon-pricing mechanism set out in the *Clean Energy Act 2011* (Cth) one year early.

Under the proposal, from 1 July 2014 the price of carbon will not be fixed at AUD25.40 per tonne of emissions, but will instead be a market price. In addition, the interim one-way link with the European Union Emission Trading Scheme (EU ETS) which was scheduled to start on 1 July 2015 will be brought forward to 1 July 2014². This will bring the Australian carbon price into line with the carbon price prevailing under the EU ETS one year ahead of schedule. The carbon price under the EU ETS is expected to be much lower than the Australian fixed price and is currently trading at around AUD6 per tonne of emissions.

Some of the key features of the proposed move to carbon trading one year early are:

- The Government will set a new pollution cap for the year beginning 1 July 2014 (the pollution cap refers to the number of Australian carbon units that will be issued each year) with the legislated default position being 25 million tonnes below total covered emissions for 2012-2013.
- Eligible international emission units, including European Union allowances and eligible Kyoto units, which may be used to acquit liability under the carbon trading scheme from 1 July 2014, are subject to a 50% quantitative limit on the surrender of eligible international emission units (and a 6.25% sub-limit for Kyoto units (certified emission reductions and emission reduction units) in the first year from 1 July 2014 and a 12.5% sub-limit from 1 July 2015).
- A price ceiling will be set for the year beginning 1 July 2014. The ceiling will be set by regulations, following consultation.
- It is expected that the Australian carbon unit price and the price of certain units created under the Carbon Farming Initiative³, which can be used to acquit liability under the Australian carbon trading scheme (CFI Units), will track slightly higher than the European price.
- The Regulator will conduct eight auctions of Australian carbon units in each flexible price year, including the year beginning 1 July 2014 (including two advance auctions held between February

¹ The draft Clean Energy Legislation Amendment (Emissions Trading Scheme) Bill 2013.

² Under this link Australian liable entities can surrender European allowances for compliance with their Australian carbon liabilities. A two-way link is scheduled to start on 1 July 2018.

³ Carbon Credits (Carbon Farming Initiative) Act 2011.

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2014 and June 2014 of up to 40 million units, with an opening price of 80% of the European allowance price). Businesses wanting to participate in the auction will need to hold an ANREU registry account.

- Consistent with the move to an emissions trading scheme from 1 July 2014, Australian units issued in the year beginning 1 July 2014 and beyond can be banked for use in later compliance years, and units with a 2015-2016 vintage can be borrowed to satisfy up to 5% of an entity's liability in the year beginning 1 July 2014.
- Assistance provided to eligible emissions intensive coal fired generators under the Energy Security Fund will end one year earlier than anticipated to reflect the earlier start of the carbon trading scheme. In addition, the allocation due in 2015-2016 year will be brought forward and combined with the 2014-2015 year.
- For the year beginning 1 July 2014, there will no longer be a requirement to make a provisional surrender of units on 15 June 2015. Instead, units will be surrendered in one tranche on 1 February 2016.

A choice of Trading Documentation is Available

- The International Swaps and Derivatives Association, Inc (ISDA) has prepared Part 7 to the ISDA Agreement for trading eligible international emission units referable to compliance under the EU ETS.
- The Australian Financial Markets Association's Carbon Markets Committee has also prepared a Part 7 to ISDA based documentation for trading Australian carbon units and eligible international emission units referable to compliance under the Australian carbon trading scheme.
- In addition, the Australian Financial Markets Association's Environmental Products Committee has prepared ISDA based documentation for trading CFI Units referable to compliance under the Australian carbon trading scheme.
- Australian parties therefore have a choice of documents to utilise for trading eligible international emission units. The choice of which document to use will largely be dictated by price and risk of repeal, with the lowest price being associated with ISDA Part 7 (as under that document the repeal risk is a risk of repeal of the EU ETS and not the Australian carbon trading scheme).
- The greatest area of uncertainty is scheme regulatory risk and the documentation has taken an 'all or nothing' approach to this risk which may mean the documentation needs to be revised to address specific concerns of trading parties.

As a final point, it is expected that the 'black' electricity wholesale price will fall from around AUD55 MWh to AUD37 MWh, reflecting the drop in the carbon price, and the renewable energy certificate price should increase by a similar amount. The overall effect on electricity consumers however is an anticipated reduction in the electricity prices of around 7.5%.

Consultation

Submissions on the draft legislative amendments can be made to the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education by Thursday, 15 August 2013.

Further developments

What Will the End of the Carbon Tax and Start of Carbon Emissions Trading Mean?

On 30 July 2013 the Clean Energy Regulator announced that it has signed a Memorandum of Understanding with the California Air Resources Board to establish a framework to share information and move towards an international carbon market. If the Australia scheme is subsequently linked with California the consequence will be a link between the trading schemes of Australia, California, Quebec⁴ and the EU ETS with further price convergence between units which can be surrendered under each scheme.

With our global presence we are well placed to keep you informed of international developments as they occur.

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