



Submission Cover Sheet: Clean Energy Legislative Package

Overview

This submission cover sheet should be used to provide comments on the Clean Energy Legislative Package.

Contact Details

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Date:	24 August 2011

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Do you want this submission to be treated as confidential? Yes No

Submission Instructions

Submissions should be made by **5pm on Monday, 22 August 2011**. The Department reserves the right not to consider late submissions.

Where possible, submissions should be sent electronically, preferably in Microsoft Word or other text based formats, to the email address – cleanenergybills@climatechange.gov.au

Submissions may alternatively be sent to the postal address below to arrive by the due date.

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Carbon Strategy and Markets Division
Department of Climate Change and Energy Efficiency
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Environment and Planning Law Committee

Submission to the Department of Climate Change and
Energy on the Clean Energy Package

24 August 2011

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1 About Us

The NSW Young Lawyers Environment and Planning Law Committee (**Committee**) brings together a network of the state's young practitioners to discuss a shared interest in our environment. The Committee focuses on environmental and planning issues, raising awareness in the profession and the community about developments in legislation, case law and policy. We also concentrate on international environment and climate change laws and their impact within Australia.

2 Introduction

The Committee welcomes the opportunity to make a submission in response to the Department of Climate Change and Energy Efficiency's call for submissions in relation to the Exposure Draft of the Clean Energy Bill 2011 (**CE Bill**) and associated draft legislation.

The Committee recognises the significance of a carbon pricing mechanism towards reducing Australia's greenhouse gas emissions, driving investment in low carbon technology and shifting the Australian economy towards a sustainable, low carbon path.

This submission will focus on:

- o the treatment of the transport sector;
- o the calculation of the "effective carbon price" as relevant to fuel use emissions; and
- o the auctioning process

3 The Transport Sector

The Clean Energy Package reduces the value of fuel tax credits (**FTCs**) available to businesses and increases the level of excise paid on aviation fuels. FTCs will not be reduced for the agriculture, forestry and fishing industries and for heavy on-road vehicles. The government has indicated that it intends to commence FTC reductions for heavy on-road vehicles from 2014-2015, but this is not covered by the Clean Energy Package and has not been agreed by the Multi-Party Climate Change Committee (**MPCCC**).

The Clean Energy Package may provide a competitive advantage to heavy on-road vehicles. To the extent that there is elasticity of demand for freight transported by rail and shipping, a shift in demand from rail and shipping to road will reduce the overall effectiveness of the scheme in reducing carbon emissions from the transport sector.

We recommend including heavy on-road vehicles in the broader carbon pricing scheme through FTC reductions starting on 1 July 2012, as is the case with other transport sectors. Alternatively, we recommend a FTC reduction for heavy on-road vehicles to be phased in by 2014 or as soon as possible.

4 Calculation of the "Effective Carbon Price"

An "effective carbon price" is calculated on a "cent-for-cent" basis by determining the carbon emission rate of each fuel, calculating the carbon price faced by sectors covered by the CPM based on six monthly assessments of the averaged auction price (from the beginning of the flexible price period), and adjusting the FTC or aviation tax accordingly. To simplify the scheme, the FTC reduction for liquid fuels other than petrol or diesel will be based on the diesel rate.

The "cent-for-cent" basis for calculating the "effective carbon price" creates a straightforward incentive for businesses to use lower emission fuels, invest in energy efficient vehicles and manage carbon emissions through their operations and supply chain. Modifying the current tax regime simplifies the regulatory process instead of adding another layer of complexity and associated administrative burden.

The "effective carbon price" may, however, disadvantage larger operations in the transport sector because such operations will have less flexibility in managing their risks and liabilities compared to liable entities covered by the emissions trading scheme. The imposition of a fluctuating tax level also fails to provide one of the principal advantages that usually comes with imposition of carbon pricing policy through taxation; that is, certainty in the actual price paid. Further, dealing with transport fuel emissions through changes in taxation levels does not provide policy certainty in relation to the quantum of emissions reduced across the economy.

We recommend considering allowing entire and discreet transport sectors (such as the aviation sector) or larger operations (such as those that meet the general thresholds for liable entities under the CE Bill) to "opt-in" to the CPM during the flexible price phase or to purchase Kyoto compliant CFI credits in lieu of reductions in FTCs or increases in fuel excise levels.

We further recommend that the government should not yet specify the specific method of calculation of the equivalent carbon price under the CPM based upon averaged auction prices under section 196 of the CE Bill, but rather should wait until early forward auctions are held and clear forward trading exchanges are in operation, so that the method of calculation that best represents the actual or "real" carbon price for covered sectors engaged in the market is discovered.

5 Auctioning of Carbon Units

By auctioning carbon units, the government pursues multiple goals:

- (1) Ensuring that the permits are efficiently allocated;
- (2) Promoting efficient price discovery; and
- (3) Generating public revenue .

The precise auctioning framework is not outlined in the CE Bill, but rather will be detailed in the Regulations. As such, we note the auctioning process suggested in the CPRS White Paper, which was characterized by:

- o iterative sealed-bidding in multiple rounds;
- o uniform pricing with ascending clock auction;
- o aggregate demand revealed in each round;
- o simultaneous auctions of different vintages whenever applicable;
- o allowing emissions-intensive trade-exposed (**EITE**) industries and other recipients of free permits to sell these permits in the auction;
- o proxy bids to accommodate small participants; and
- o monthly auctions.

We note that the CE Bill provides for full auctioning of carbon units, subject to free allocations as outlined under the Jobs and Competitiveness Program and associated industry assistance packages. This contrasts with the position in the European Union (**EU**) Emissions Trading Scheme (**ETS**) which provides for gradually increasing the share of auctioned emissions allowances (Phase I (2005-2007): up to 5 %; Phase II (2008-2012): up to 10%; and Phase III (2013-2020): up to 100% in the power sector). In Phase III of the EU ETS, emissions allowances will be auctioned in a single round, uniform price, sealed-bid auction on a European level and throughout the participating countries.

In our view, the government's policy aims as outlined above are clear and acceptable. In light of this, we note the following:

- o where there are few large bidders that dominate the market, uniform pricing may encourage bid shading and demand reduction. As a result the price may not reflect the true value of carbon units. However, a similar dynamic may occur in pay-your-bid auctions and the demand reduction is advantageous for smaller bidders.
- o sealed-bidding is generally simpler to understand and manage administratively than the ascending-bidding process which requires amendments to function properly (such as intra-round bidding, second-stage sealed-bid rounds and roll-

back procedures for unsold permits). While the ascending-bid process is advantageous where multiple vintages are simultaneously sold, the bidding process provides a transparency that may facilitate coordination of bidding behaviour. Particularly in a market as small as Australia, there is a material risk of collusion and price distortion. Therefore, a sealed-bid auction such as under the EU ETS should be favoured.

- o EITE industries that have been allocated free carbon units which they do not require, should be able to sell those units either in the secondary market or in a double auction. The simultaneous auction of permits by government and other sellers allows overcoming initial illiquidity in the Australian carbon trading market and while adding complexity to the auctioning process, creates a more reliable and liquid pricing mechanism.
- o carbon units for future compliance periods should not be auctioned in large numbers too far ahead of time, but in line with the business practice regarding investment decisions not more than 3 years prior to validity.
- o the multi-clock format of simultaneously auctioning different vintages is very complex and might encourage bidders to only bid on the cheaper vintage and distorting certainty in price discovery for particular compliance periods. This needs to be addressed by rules restricting shifts of demand.

6 The Process for International Offset Restrictions

The CE Bill sets out the process by which specified eligible international emissions units may be restricted in section 123. It notes that the timing for these restrictions, which are to be made in the Regulations, “must not take effect before the beginning of the eligible financial year next following the eligible financial year in which the regulations are registered under the Legislative Instruments Act 2003”.

This mandates the time limit as between the “eligible financial year” and the following eligible financial year in which proposed regulations for offsets take effect. This contrasts with the process set out in the comparable European Union Emissions Trading Scheme (**EU ETS**) which, at Article 11a (9) of the Revised EU Directive 2003/87/EC, states that the relevant time for making those regulations “shall be, at the earliest, six months from the adoption of the measures or, at the latest, three years from their adoption”.

In our view the time limit specified in s 123(3) of the CE Bill could adversely affect both the forward trading market in eligible international offsets and direct project investments in overseas offset markets. The difficulty in setting a time limit of less than one year is that it gives those projects which will be subject to offset regulations inadequate time to prepare for new restrictions. This may limit the efficacy of the proposed offset and trading market as follows:

- o affecting the certainty of investments for those investors holding offset accounts;
- o creating greater risk potential that must be built into offset and other products; and
- o unnecessarily increasing transaction costs, including cost of finance and the need for greater due diligence in transactions.

The Committee recommends the following:

- o that section 123(3) of the CE Bill in its final form should specify a greater time gap of between 6 months and 3 years, in line with the EU ETS Directive. In our view this approach would balance the interests of certainty for investors and flexibility to maintain the environmental integrity of the scheme;
- o that the factors that guide the Minister's decision to specifying certain eligible international offsets for the purposes of section 123(1) of the CE Bill should be clearly identified in the Regulations; and
- o that the Minister should be precluded from making Regulations specifying certain eligible international offsets for the purposes of section 123(1) of the CE Bill without first seeking the advice of the Climate Change Authority and responding publicly to that advice. This would bring the decision making process in line with other similar processes under the CE Bill, such as the setting of emissions caps, and would provide the market with much needed transparency and certainty.

In our view these recommendations will assist in the creation of greater certainty and a more efficient market.

7 Joint venture liability allocation

We note that the CE Bill does not anticipate the agreed reallocation of liability for joint venture participants where one of the joint venture participants is also the party with operational control. We recommend that this approach should be revisited in light of the following issues:

- o joint venture structures do not always result in the entity with the largest beneficial interest having the greatest degree of operational control at the facility level; and
- o joint venture participants in such arrangements may have significant existing primary liabilities from other facilities and may wish to collectively manage their carbon liabilities.

In light of this, we recommend that the CE Bill should specify a procedure for voluntary designation as a joint venture where one joint venture participant has operational control, under Division 5 of Part 3 of the CE Bill. This would of course need to specify the consent of each of the joint venture participants.