

The start of Australia's much talked-about carbon trading scheme has been put back a year to 2011. Andrew Petersen and Eros Artuso at PricewaterhouseCoopers discuss the details of the proposed Carbon Pollution Reduction Scheme

TO COPENHAGEN VIA AUSTRALIA

The clock is ticking for governments around the world to enact a national policy to address climate change before the United Nations Conference on Climate Change in Copenhagen in December 2009. The aim of the conference (COP15), hosted by the United Nations Framework Convention on Climate Change, is to reach a global framework beyond 2012 when the Kyoto Protocol expires.

As the most greenhouse gas (GHG)-intensive country per capita, Australia has actively been working towards the introduction of its own emissions trading scheme (ETS). This journey picked up pace following the election of the Labor government led by Prime Minister Kevin Rudd in November 2007.

In December 2007 the Australian government ratified the Kyoto Protocol, demonstrating officially for the first time its commitment to tackling climate change and showing it was a key priority of the Australian government, even in challenging economic times.

Despite announcing on May 5 this year that the start of Australia's Carbon Pollution Reduction Scheme (CPRS) would be put back a year (to 2011), the government is moving ahead with drafting the legislation to

implement the CPRS based on the policy positions announced in a White Paper released in December 2008. The draft legislation (the *CPRS Bill*) provides depth and functional detail on the CPRS design and compliance requirements. The government tabled the *CPRS Bill* in Parliament on May 14, 2009, with the intention that it be passed in June, ahead of the first compliance period scheduled to begin on July 1, 2011.

The CPRS is a market-based instrument (MBI) that uses price or other economic variables to provide incentives for polluters to reduce harmful emissions. It is the cornerstone of the Australian government's objective to meet Australia's emissions reduction targets. The targets aim to achieve a 60% reduction from the emissions levels reported in 2000 by 2050 in the most flexible and cost-effective manner possible. There is also a medium-term target to reduce emissions by between 5% and 25% below 2000 levels by 2020. These targets reflect the government's decision to balance making a strong contribution to international efforts with preventing any serious shocks to the Australian economy, which has a number of trade-exposed and carbon-intensive industries.



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The CPRS includes a number of measures intended to minimise its impact on the most vulnerable households and organisations. The two main strategies to protect industries are the Strongly Affected Industries (SAI) and Emissions Intensive Trade Exposed (EITE) assistance programmes. The SAI assistance is primarily targeted at the local coal-fired electricity generation industry. By comparison, the main focus of the EITE assistance is to prevent carbon leakage.

These assistance measures entail a free distribution of Australian Emission Units (AEUs) to eligible entities. It is projected these free allocations will make up over 25% of the total AEUs in the scheme in 2011 and the percentage has been modelled to show an increase to 45% by 2020.

Core features of the CPRS

The core principles of the scheme, as outlined in the *CPRS Bill*, are as follows:

- The CPRS will include all GHGs included under the Kyoto Protocol and in all sectors (as defined in the *Intergovernmental Panel on Climate Change Guidelines Revised 2006*), except for agriculture and land use and with the forestry sector able to 'opt in' on a voluntary basis;



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- Entities (both Australian and non-Australian) with operational control of a facility located in Australia that have annual direct (better known as Scope 1) emissions in excess of 25,000 tonnes of carbon dioxide equivalent (CO₂-e) will be liable under the CPRS;
- Certain landfill facilities will be liable under the CPRS where they emit less than 25,000 tonnes of CO₂-e;
- There are instances where the entities liable under the CPRS will have different reporting requirements from those only reporting under the *National Greenhouse and Energy Reporting Act 2007 (NGER Act 2007)*, under which all carbon- and energy-intensive entities operating in Australia are required to report their GHG emissions and energy consumption data to the Department of Climate Change;
- Those entities that are eligible to claim EITE assistance (in the form of free permits) will need to submit verified (assured) data in relation to emissions and revenue to the Australian government in order to qualify for industry assistance. In many cases, aspects of that data would otherwise be commercially sensitive;
- The Australian government has set a medium-term target to reduce emissions by 5% below 2000 levels by 2020 with the possibility of extending this target to 25% if all major economies commit to substantially reducing GHG emissions and advanced economies take on reductions comparable to Australia;
- A price-cap per permit has been set for five years, commencing at A\$40 per permit and increasing annually by 5%, in real terms, until 2015. The eligibility thresholds (tonnes CO₂-e/\$million revenue) to qualify as an EITE have been reduced, and affected industries will receive a higher-than-expected 25% of available permits in the first year, rising to an estimated 45% by 2020;
- Emitters will be required to acquire

T1. Synopsis – towards an Australian CPRS <small>Source: PricewaterhouseCoopers Australia</small>		
Feature	White Paper	Draft CPRS Bill
Coverage	<ul style="list-style-type: none"> Covers all GHGs covered under the Kyoto Protocol Covers the heavy emission producers in Australia 	<ul style="list-style-type: none"> Aligned with White Paper
Liable entity	<ul style="list-style-type: none"> The controlling corporation of a group will be the liable entity for facilities under the operational control of a member as defined in the <i>NGER Act</i> 	<ul style="list-style-type: none"> While the White Paper definition still stands, a broader range of entities can have operational control due to proposed amendments to the <i>NGER Act</i> so that any person may have operational control of a facility
Target	<ul style="list-style-type: none"> 5-15% cut in GHG emissions from 2000 levels by 2020, 60% cut in emissions from 2000 levels by 2050 	<ul style="list-style-type: none"> Maximum target for 2020 changed to 25% if an ambitious agreement is reached in Copenhagen
Property of AEU's	<ul style="list-style-type: none"> AEU's to have status of 'financial products' 	<ul style="list-style-type: none"> AEU's will be treated as personal property
Pricing of units	<ul style="list-style-type: none"> Price ceiling will start at A\$40 per permit and escalate 5% per annum plus CPI 	<ul style="list-style-type: none"> Aligned with White Paper
National emissions cap	<ul style="list-style-type: none"> Medium-term target to reduce emissions levels by a minimum 5% below 2000 levels by 2020, 60% by 2050 	<ul style="list-style-type: none"> The cap will be set by future 'regulation'
Compliance provisions	<ul style="list-style-type: none"> Reporting and compliance based on NGER's EITE and SAI entities may need to provide confidential information 	<ul style="list-style-type: none"> Providing misleading information will be treated as fraud Penalties will be established for entities that fail to surrender sufficient units
Monitoring and enforcement provisions	<ul style="list-style-type: none"> Monitoring of GHG emissions is generally in line with NGER's guidelines/requirements Broad statement that the regulatory authority would have necessary investigative powers 	<ul style="list-style-type: none"> The government will have significant powers to search premises and to take other measures to monitor emitters
Strongly Affected Industries (SAIs)	<ul style="list-style-type: none"> The highest-emission coal-fired power generators will receive compensation 	<ul style="list-style-type: none"> Aligned with white paper
Corporate liability and transfer certificates	<ul style="list-style-type: none"> Transfer of liability process outlined 	<ul style="list-style-type: none"> 'Liability transfer certificate' system established – this is a detailed process allowing entities to transfer their liability for emissions and reporting to another party
Definitions and principles	<ul style="list-style-type: none"> Broad, non-legal terminology surrounding core principles of the ETS 	<ul style="list-style-type: none"> A number of legal definitions and principles clarified
Auction rules	<ul style="list-style-type: none"> Auctions to be held monthly; specific auction rules and processes have yet to be disclosed 	<ul style="list-style-type: none"> Aligned with White Paper
Inclusion of international carbon units	<ul style="list-style-type: none"> Kyoto units will be recognised and in some cases eligible to be surrendered in the Australian CPRS AEU's will not be eligible for export 	<ul style="list-style-type: none"> Aligned with White Paper
Windfall gains limitation	<ul style="list-style-type: none"> An entity is required to relinquish units (if provided free in assistance) where it stops generating carbon pollution 	<ul style="list-style-type: none"> Aligned with White Paper
Landfill threshold	<ul style="list-style-type: none"> Landfill facilities to be liable if they exceed 25,000 tCO₂-e 	<ul style="list-style-type: none"> Certain landfill facilities will be liable under the scheme where they emit less than 25,000 tCO₂-e
Tax	<ul style="list-style-type: none"> Australia's tax laws to be amended to establish a rolling balance treatment of registered emission units GST will apply to AEU's 	<ul style="list-style-type: none"> Aligned with White Paper

and pay off one AEU for each tonne of carbon dioxide equivalent (tCO₂-e) emitted. Each unit has a unique identification number noting the first year in which it can be validly surrendered. AEU's have the characteristics of personal property. A person with more than 5% of the AEU's from any one 'vintage' will have to declare their holding;

- AEU's will be issued either through auctions or will be freely allocated

- to certain assisted industry groups. Alternatively, AEU's will be sold for a fixed charge. They will also be issued for eligible abatement projects;
- Any perceptions that climate change might be handled in a 'warm and fuzzy' way have been dispelled by the draft legislation, which makes it clear the government will fully use civil and criminal enforcement measures to ensure compliance and there will be regular monitoring;

- An unlimited number of eligible Kyoto units (Certified Emission Reductions (CERs)), Emission Reduction Units (ERUs) and Removal Units (RMUs)) can be used by liable entities for compliance under the scheme; however, Assigned Amount Units (AAUs) are not recognised for compliance purposes unless subsequently prescribed in future regulations;

- The potential recognition of voluntary offset schemes is under review by the Australian government, as is the possibility of linking the Australian scheme to others that might be established in countries such as New Zealand;
- Australia's key tax laws will be amended to establish a rolling balance treatment of registered emission units for income tax. Essentially this means a deduction will be available for the cost of an AEU in the year in which it is surrendered or sold, with any balance held at the end of an income year being included in assessable income on revenue account only (that is, there will be no capital gains treatment for transactions in AEU's). Under Australia's Goods & Services Tax (GST) regime (which taxes supplies of goods and services in Australia and on goods imported into Australia) an eligible emissions unit or a Kyoto unit will be a supply of a personal property right and not a supply of real property and thus will broadly be a taxable supply subject to GST at the current rate of 10%.

On May 5, 2009, the Prime Minister, Treasurer and Minister for Climate Change and Water announced new measures for the CPRS. The main points the new measures addressed were:

- a delay in the start of the scheme for an additional year (it is to begin in 2011 instead of 2010 as was previously planned);
- For the first year of the CPRS the price of each AEU will be fixed at A\$10;
- Industries eligible for EITE assistance will benefit from an increased free allocation of permits; and
- An Australian Carbon Trust is to be created to invest directly in energy efficiency for Australia's buildings. Formal public consultation in relation to the draft Bill ended on April 14, 2009. See table 1 for a synopsis of differences between the White Paper and the *CPRS Bill* (including the new measures announced by the government on May 5, 2009).

**The path towards July 1, 2010
Climate change policy has developed significantly since the Australian government ratified the Kyoto Protocol. In chronological order, a summary of the policy developments are:**

● **Compiling an Australian GHG inventory:**

As a precursor to developing an effective ETS, the Australian government recognised that it was necessary for companies to compile an inventory of their GHG emissions. To address the lack of quantitative emissions data, the Australian government passed the *National Greenhouse and Energy Reporting Act 2007 (NGER Act)* in September 2007. The *NGER Act* provides both guidelines and requirements for entities and facilities with specific energy and GHG emitting thresholds to report to a specialist agency within the Australian government, the Department of Climate Change. The *NGER Act* superseded and streamlined many existing state and federal GHG reporting requirements for which Australian and international companies were liable. Amendments to be tabled in parliament this year will include a number of changes to the *NGER Act* and will prepare for its alignment with the proposed ETS.

● **Garnaut Review on climate change, impacts and responses:**

On April 30, 2007, Australia's Commonwealth, state and territory governments commissioned leading Australian economist, Professor Ross Garnaut, to examine the impacts of climate change on the Australian economy and recommend medium- to long-term policies and policy frameworks to improve prospects for sustainable growth in a carbon constrained global economy. The outcomes of the *Garnaut Review* have been used by the government as a tool in policy development.

● **The CPRS Green and White Papers**

The *Garnaut Review* was the precursor to the government's Green and White Papers, released in July and December 2008 respectively. The Green and White papers outlined the intended design of

the ETS, to be known as Carbon Pollution Reduction Scheme (CPRS). The CPRS is a market-based instrument (MBI) that uses price or other economic variables to provide incentives for polluters to reduce harmful emissions. The CPRS is the cornerstone of the federal government's objective to meet Australia's emissions reduction targets. The reduction targets aim to achieve a 60% reduction of emissions reported in 2000 by 2050 in the most flexible and cost-effective manner possible. The White paper also foreshadowed a medium-term target to reduce emissions by between 5% and 15% below 2000 levels by 2020. These targets reflect the government's decision to balance making a strong contribution to international efforts while preventing any serious shocks to the Australian economy, which has a number of carbon-intensive industries.

● **CPRS draft legislation:**

On March 10, 2009, the Minister for Climate Change and Water, Senator Penny Wong, released the exposure draft legislation and explanatory materials for the implementation of the CPRS. The draft legislation also provides legal definitions and many of the compliance and monitoring measures. The main draft bill is entitled the *Carbon Pollution Reduction Scheme Bill 2009 (CPRS Bill)*.

● **Press release detailing the new measures of the CPRS:**

The Prime Minister, Treasurer and Minister for Climate Change and Water announced new measures for the CPRS in a press release on May 5, 2009. The new measures included concessions to industry by announcing a delay of the scheme for one year (from July 2010 to July 2011), a price cap on AEU's for the first year of the scheme at A\$10 and increased support for EITE industries. There was also a major concession to environmentalists by raising the maximum target of GHG reductions for 2020 to 25% reductions of 2000 levels if an aggressive international agreement is reached in Copenhagen. By catering to lobbies on both sides of the issue, the Labor government is hoping these new measures help the *CPRS Bill* to be passed into law before the conference in Copenhagen.

Implications for businesses

Many organisations continue to question whether the CPRS will become a reality in Australia. With two Senate enquiries under way, there is certainly some reason for doubt. However, the government is adhering to the outlined timetable. The window to comment on legislation that closed in April may have been one of the last

chances for businesses to shape the new regime before it becomes black-letter law.

Companies that fall within the remit of the CPRS will have a financial incentive to ready themselves for commencement. Companies will need to clearly understand their legal obligations under the CPRS in order to minimise their risk of non-compliance and associated

T2. CPRS timeline	
2009	
Q1	Government releases guidance paper on data requirements of the EITE assistance programme
	Entities engaged in potential EITE activities submit data requested in the guidance paper
	Public release of exposure draft CPRS legislation
Q2	Exposure draft legislation consultation period closes
	CPRS Bill and NGERs consequential amendments introduced into parliament
	Public release of key draft CPRS regulations (including activities covered by EITE)
	Government aims to achieve passage of the <i>CPRS Bill</i> through parliament
Q3	Registration under NGERs
	Applications under the SAI assistance programme to be made to the regulator
	Private entities able to open national registry accounts for Kyoto units
Q4	Submission of first year reporting under NGERs
	CPRS regulations and legislative instruments made and tabled in parliament following passage of Bill
	United Nations Climate Change Conference in Copenhagen, Denmark (COP15)
2010	
Q1	Government to announce: <ul style="list-style-type: none"> • Extension of national emissions trajectory up to 2014–15 • Scheme caps for first five years of scheme (2011–12 to 2015–16) • 10 years of scheme gateways after 2014–15 • Approach for expanding cap to accommodate increases in coverage
	Applications under the EITE assistance programme made to the regulator and subsequent allocation of permits to EITE-eligible entities
Q3	Submission of second-year reporting under NGERs
Q4	Submission of second-year reporting under NGERs
2011	
Q3	Start of first CPRS compliance year
Q4	Deadline for liable entities to submit emissions reports through the NGERs, including audited information for large emitters
2012	
Q1 & Q2	First auction of permits
Q2	End of first CPRS compliance year
Q3	Start of first CPRS market trading year
Q4	Deadline for surrender of eligible compliance permits for first compliance year
2013	
	<ul style="list-style-type: none"> • Government to announce final decisions on coverage of agriculture • A decision to allow for the sale and transfer of Australian carbon pollution permits internationally
2015	
	Possible inclusion of agriculture in the scheme

- KEY**
- Government action
 - Company action
 - NIGERS deadline

that Australia's proposed climate change response presents to their operations.

All companies with significant Australian operations should mobilise now, if they have not done so already, to provide clarity around their obligations under the CPRS. This takes the form of compliance measures and cost management, as well as understanding how to benefit from the opportunities presented in this framework.

What next?

The *CPRS Bill* was tabled in the Australian parliament on May 14, 2009, with no certainty as to the outcome from debate in parliament or the timing of the passage of the legislation. The Australian Government intends that the *CPRS Bill* will be passed by both houses of parliament in June 2009, but this timing seems increasingly unlikely due to political positions taken by the opposition government, minor parties and independent senators at the time of writing.

There also remains a number of issues to be addressed, including:

- Specifying the licensing requirements for financial services groups to trade in AEU's;
- Auction rules;
- Whether state and territory governments will charge stamp duty on AEU transactions between 2010 and 2013; and
- Details on forestry project provisions that could provide significant area for firms to generate offset credits.

Australia is in a unique position with regard to the costs and opportunities it faces in addressing climate change. The economy is underpinned by carbon-intensive industries, yet the continent is especially vulnerable to the predicted impacts of climate change. The only certainty surrounding Australia's CPRS is debate will continue. ■

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penalties. Part of a company's CPRS readiness strategy should be to understand the policy positions.

The complex and far-reaching nature of the scheme underlines the onerous challenges the Australian government

will face in its effort to introduce the scheme by July 2011. While there are many specifics to be finalised after the release of the draft CPRS legislation, companies are now in a better position to analyse the threats and opportunities