The Senate

Economics Legislation Committee

Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012 [Provisions] and related bills

October 2012

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ISBN 978-1-74229-710-1

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Economics Legislation Committee

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Abbreviations and glossary

AFMA	Australian Financial Markets Association
AIGN	Australian Industry Greenhouse Network
AIIU	Australian-issued international unit
ANREU	Australian National Registry of Emissions Units
ANREU Act	Australian National Registry of Emissions Units 2011
APPEA	Australian Petroleum Production & Exploration Association
CDM	Clean Development Mechanism
CE Act	Clean Energy Act 2011
CER	Certified Emission Reduction unit
Clean Energy Amendment Bills	The package of bills including the Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012; the Excise Tariff Amendment (Per tonne Carbon Price Equivalent) Bill 2012; the Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment (Per-tonne Carbon Price Equivalent) Bill 2012; the Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment (Per tonne Carbon Price Equivalent) Bill 2012; the Clean Energy (Charges-Excise) Amendment Bill 2012; the Clean Energy (Charges-Customs) Amendment Bill 2012; and the Clean Energy (Unit Issue Charge-Auctions) Amendment Bill 2012.
Clean Energy Legislative Package	The package of Acts including the *Clean Energy Act 2011*; the *Clean Energy (Consequential Amendments) Act 2011*; the *Clean Energy Regulator Act 2011*; the *Climate Change Authority Act 2011*; the *Clean Energy (Unit Shortfall Charge-General) Act 2011*; the *Clean Energy (Unit Issue Charge-General) Act 2011*; the *Clean Energy (Charges-Excise) Act 2011*; the *Clean*

	Energy (International Unit Surrender Charge) Act 2011; the *Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment Act 2011*; the *Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment Act 2011*; the *Fuel Tax Legislation Amendment (Clean Energy) Act 2011*; the *Excise Tariff Legislation Amendment (Clean Energy) Act 2011*; the *Customs Tariff Amendment (Clean Energy) Act 2011*; and the *Clean Energy Legislation Amendment Act 2012*.
CPM	Carbon Pricing Mechanism
DCCEE	Department of Climate Change and Energy Efficiency
EUAA	European Union Aviation Allowance
EU	European Union
EU ETS	European Union Emissions Trading System
European allowance unit	An allowance within the meaning of the *European Union Greenhouse Gas Emission Allowance Trading Directive*, but excluding allowances issued in respect of aviation activities
GST	Goods and Services Tax
ICAA	Institute of Chartered Accountants Australia
IETA	International Emissions Trading Association
Kyoto unit	An Assigned Amount Unit, a Certified Emission Reduction unit, an Emission Reduction Unit, a Removal Unit or a prescribed unit issued in accordance with the Kyoto rules
MRV	Measurement, reporting and verification
NGER Act	*National Greenhouse and Energy Reporting Act 2007*
RIS	Regulation Impact Statement

Chapter 1

Introduction and conduct of the Inquiry

1.1 On 20 September 2012, the Senate jointly referred the provisions of the following bills for inquiry and report by 29 October 2012:

- Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012;
- 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.

1.2 These bills (the Clean Energy Amendment Bills) make amendments to the *Clean Energy Act 2011* (CE Act) and other acts which cover:

- arrangements to link Australia's carbon pricing mechanism (CPM) to other countries' trading schemes, including the European Union (EU) Emissions Trading System (ETS);
- the removal of the price floor and the repeal of the *Clean Energy (International Unit Surrender Charge) Act 2011*;
- consequential changes to the equivalent carbon pricing of liquid fuels and synthetic greenhouse gases;
- the streamlining of arrangements for relinquished carbon units;
- limits on issue of carbon units at auction without a pollution cap in place;
- the content of measurement determinations under the *National Greenhouse and Energy Reporting Act 2007* (NGER Act);
- the treatment of natural gas under the CPM; and
- the treatment of Goods and Services Tax (GST) joint venture operators in the Opt-in Scheme.

Conduct of the inquiry

1.3 The committee advertised the inquiry on its website and wrote directly to a range of individuals and organisations inviting written submissions. The committee received 19 submissions, which are listed at Appendix 1.

1.4 The committee also held a public hearing in Canberra on 19 October 2012. Witnesses representing seven submissions appeared at the hearing, along with

representatives of the Department of Climate Change and Energy Efficiency (DCCEE) and the Treasury. The names of the witnesses who appeared at the hearing are at Appendix 2.

1.5 The committee thanks all who contributed to the inquiry.

Policy context and background to this inquiry

1.6 The Clean Energy Amendment Bills build on the Clean Energy Legislative Package passed by the Senate on 8 November 2011, which implemented the CPM and provided (*inter alia*) that this mechanism could be linked to credible overseas emissions trading schemes.[1]

1.7 The primary purpose of the Clean Energy Amendment Bills is to facilitate the first of these links, between the CPM and the EU ETS, and to allow for other links with overseas schemes in the future. This follows discussions between the Australian Government and European Commission that commenced following agreement to terms of reference on 5 December 2011, and a subsequent announcement by the two parties on 28 August 2012 that the two schemes would be linked from 1 July 2015.[2]

1.8 The EU ETS is a mandatory emissions trading scheme covering all 27 EU member states, along with Norway, Iceland and Liechtenstein. The EU ETS began operation in 2005, and is the world's largest emissions trading scheme, covering some 11,000 facilities.

1.9 An interim one-way link between the CPM and the EU ETS will operate from 1 July 2015, allowing Australian liable entities to use European allowance units for compliance under the CPM. Under this arrangement, Australian liable entities will be able to meet up to 12.5 per cent of their liabilities using Kyoto units, and up to 50 per cent using European allowance units (taking into account the use of Kyoto units) during the interim linking period.

1.10 Linking the CPM to the EU ETS will provide Australian liable entities with access to a broader range of credible, low-cost abatement from an established market, and help facilitate the transition from a fixed carbon price to a market-based emissions trading scheme.[3]

1.11 A full two-way link, by means of the mutual recognition of carbon units between the two systems, is to commence no later than 1 July 2018. As the Explanatory Memorandum notes, the full linking of the two schemes will 'allow

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1 The Explanatory Memorandum for the Clean Energy Bill 2011 is available at: http://www.comlaw.gov.au/Details/C2011B00166/Explanatory%20Memorandum/Text.

2 The Hon Greg Combet MP, 'Australia and Europe strengthen collaboration on carbon markets,' 5 December 2011, http://www.climatechange.gov.au/en/minister/greg-combet/2012/media-releases/March/mr20120329b.aspx; and the Hon Greg Combet MP, 'Australia and European Commission agree on a pathway towards fully linking emissions trading systems,' 28 August 2012, http://www.climatechange.gov.au/minister/greg-combet/2012/media-releases/August/JMR-20120828.aspx.

3 Replacement Explanatory Memorandum, p. 7.

companies that operate in both Europe and Australia to access units which are fully transferable in both jurisdictions, making compliance simpler and making it easier to manage emissions across operations.'[4]

History of the policy of linking

1.12 The policy of linking an Australian carbon pricing mechanism to credible international schemes is not new. On the contrary, the concept of international linkages has, as DCCEE told the committee, been:

> …a continuous feature of government policy on emissions trading since the development of the Shergold Report [the report of the Prime Ministerial Task Group on Emissions Trading] and the former Coalition government's response to it in Australia's climate change policy in July 2007.[5]

1.13 The Shergold Report stated that, as 'a supporter of the development of a global system, Australia has a direct interest in promoting links between comparable [carbon pricing] schemes.' On this basis, the report contended that any Australian trading scheme 'should be designed to enhance the scope for links, both formal and informal, with as many different systems as possible.'[6]

1.14 The Shergold Report further suggested that Australian recognition of credible foreign permits or credits:

> ...will assist in seeking out abatement opportunities at least cost and optimising the timing of exploitation. Any of these links will provide a conduit for the transmission of emission abatement prices and serve to enhance efficiency globally.[7]

1.15 The Carbon Pollution Reduction Scheme was also designed, as the green paper that preceded it explained, 'to link with other schemes overseas to contribute to a global solution and to ensure that Australian businesses can access low-cost pollution reduction.'[8]

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4 Replacement Explanatory Memorandum, Clean Energy Amendment Bills, p.7. Available at http://www.comlaw.gov.au/Details/C2011B00166/Explanatory%20Memorandum/Text.

5 Mr James White, *Proof Committee Hansard*, 19 October 2012, p. 36. The Shergold Report (more properly known as the *Report of the Task Group on Emissions Trading*), was prepared by the Prime Ministerial Task Group on Emissions Trading. Australian Government, *Report of the Task Group on Emissions Trading* (hereafter Shergold Report) (2007), http://pandora.nla.gov.au/pan/79623/20071127-1411/www.dpmc.gov.au/publications/emissions/index.html.

6 Shergold Report, p. 111.

7 Shergold Report, p. 112.

8 Australian Government, *Carbon Pollution Reduction Scheme: Green Paper* (July 2008), pp. 23-24, http://www.climatechange.gov.au/~/media/publications/green-paper/greenpaper.ashx. Also see Australian Government, *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future: White Paper* (December 2008), vol. 1, chapter 11, http://www.climatechange.gov.au/publications/cprs/white-paper/~/media/publications/cprs/CPRS-report-vol1.pdf.

1.16 The Clean Energy Future Plan also anticipated that Australia's carbon price would be linked to international carbon markets from the start of the flexible price period, allowing 'reductions in carbon pollution to be pursued globally at lowest cost.'[9] As DCCEE told the committee, the fact that discussions proceeded faster than originally expected was, in part, a reflection of 'European confidence in the arrangements we have proposed or now implemented here in Australia.'[10]

Removal of the price floor and introduction of 'designated limits'

1.17 The CPM, as currently legislated, was to include a price floor of $15 per tonne commencing on 1 July 2015, rising at four per cent in real terms each year. The price floor was intended to 'reduce the risk of sharp downward movements in the price, which could undermine long-term investment in clean technologies.'[11]

1.18 The Clean Energy Legislative Package made provision for the price floor by combining auction reserve prices for domestic carbon permits and a surrender charge for international units.

1.19 As part of the linking arrangement with the EU, the Australian Government agreed to remove the price floor and restrict the quantity of eligible Kyoto units that liable entities could use to discharge their carbon pricing liabilities. The Government will also have the capacity to introduce additional or alternative quantitative limits on the use of eligible international emissions units, through the use of a 'designated limit' mechanism.[12]

1.20 The Explanatory Memorandum suggests these amendments are necessary to facilitate the convergence of EU and Australian carbon prices. As a result, from 1 July 2015, Australia's carbon price will 'reflect that of our second largest trading bloc, and be consistent with at least 30 other countries – including the United Kingdom, France and Germany.'[13]

Natural gas provisions

1.21 The bills also make amendments relating to the treatment of natural gas under the Australian scheme. These amendments are unrelated to the link to the EU ETS.

1.22 The Explanatory Memorandum states that the:

> …natural gas industry involves a complex array of supply arrangements which can change over time. Currently, the natural gas provisions cater for the vast majority of supply arrangements in use. In order for the CPM to

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9 Australian Government, Securing a Clean Energy Future: The Australian Government's Climate Change Plan (2011), p. 30, http://www.cleanenergyfuture.gov.au/wp-content/uploads/2012/06/CleanEnergyPlan-20120628-3.pdf.

10 Mr James White, DCCEE, *Proof Committee Hansard*, p. 36.

11 Australian Government, *Securing a Clean Energy Future: The Australian Government's Climate Change Plan* (2011), p. 27.

12 Replacement Explanatory Memorandum, p. 7.

13 Replacement Explanatory Memorandum, p. 7.

> maintain effective and complete coverage of natural gas, a power will be included in the CE Act to allow regulations to be made to provide for coverage of alternative natural gas arrangements. This will help maintain competitive neutrality by supporting the complete coverage of natural gas under the CPM over time.[14]

Consultation

1.23 The Government invited comments on the drafts of the Clean Energy Amendment Bills following the announcement of the linking with the EU ETS on 28 August 2012, and indicated that the legislation would be introduced in the 2012 Spring Parliamentary sitting period. Several public consultation sessions and technical working group discussions were held, including in Sydney, Melbourne and Canberra, and 20 submissions on the draft legislation were received.

1.24 DCCEE informed the committee that it also had approximately 25 direct discussions with interested stakeholders regarding the bills. Some of these stakeholders may have also participated in formal consultations arranged by DCCEE.[15]

1.25 The House Standing Committee on Economics also conducted an inquiry on the Clean Energy Amendment Bills.

14 Replacement Explanatory Memorandum, p. 52.

15 DCCEE, Response to Questions on Notice, 19 October 2012, Question No. 1.

Chapter 2

Overview of the bills

2.1 As noted at the start of the preceding chapter, the Clean Energy Amendment Bills make amendments to the CE Act and other acts.

2.2 The most important of these amendments, and those which submissions focused on, relate to:

- the linking of Australia's CPM with other countries' trading schemes, including the EU ETS;
- the removal of the floor price and surrender charges on international permits;
- a new limit of 12.5 per cent on the Kyoto units that Australian liable entities can use to meet their liability, and a new concept of 'designated limit' that can be applied in the future to specific types of carbon permits and offsets; and
- the treatment of natural gas under the CPM.

2.3 In addition, the Clean Energy Amendment Bills also cover:

- consequential changes to the equivalent carbon pricing of liquid fuels and synthetic greenhouse gases;
- the streamlining of arrangements for relinquished carbon units;
- limits on the issue of carbon units at auction without a pollution cap in place;
- the content of measurement determinations under the NGER Act; and
- the treatment of GST joint venture operators in the Opt-in Scheme.

2.4 After a brief overview of each of the bills, the provisions in the legislation relating to all of the above matters are addressed, under the heading, 'Effects of the Amendments'.

Overview of each bill

Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012

2.5 The Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012 amends the CE Act to facilitate the linking of the CPM to the EU ETS; remove the floor price; limit the use of Kyoto units to 12.5 per cent of an entity's liability; provide for the calculation of an equivalent carbon price that reflects liable entities' cost under the arrangement; limit advance auctions of carbon permits to no more than three years in advance of their vintage year, while increasing the volume of advanced auctioned carbon units; change the treatment of relinquished carbon units; and allow regulations to be made relating to the treatment of natural gas.

2.6 The bill also amends the *Australian National Registry of Emissions Units Act 2011* (ANREU Act) to enable European allowance units to be held in the Australian National Registry of Emissions Units (ANREU), and used for compliance purposes

under the CE Act; and in the event that a direct link with a foreign emissions trading scheme, including the EU ETS, is not possible, to enable the Clean Energy Regulator to issue Australian-issued international units (AIIUs) which correspond to foreign emissions units withdrawn from circulation within the relevant foreign registry, and which can be used for compliance purposes under the CE Act.

2.7 The bill also amends the *Fuel Tax Act 2006* to adjust the calculation of the equivalent carbon price to ensure that it remains equivalent to the effective carbon price for liable entities under the CPM.

2.8 The bill also repeals the *Clean Energy (International Unit Surrender Charge) Act 2011*, which imposed a surrender charge on eligible international emissions units.

2.9 Finally, the bill amends the NGER Act to provide the Minister for Climate Change and Energy Efficiency the power to determine the measurement methods to adjust the amounts of designated fuels for the purpose of ascertaining potential greenhouse gas emissions.

2.10 Sections 1, 2 and 3 commence on the date the bill receives the Royal Assent. Schedule 1, Parts 1 and 3, which make general amendments to the CE Act and the ANREU Act, will commence on the day after the bill receives the Royal Assent.

2.11 Schedule 1, Part 2, which makes amendments relating the fuel to the CE Act and the NGER Act, will commence on 1 July 2013. The amendments to the NGER Act made by this Part will apply to reports relating to the 2012-13 financial year and all subsequent years.

Clean Energy (Charges—Excise) Amendment Bill 2012

2.12 The Clean Energy (Charges—Excise) Amendment Bill 2012 will amend the *Clean Energy (Charges—Excise) Act 2011* by repealing the definition of 'eligible international emissions units' and the methods by which the units are auctioned, providing that the reserve price is removed. It also provides for the creation of a legislative instrument by a Minister to set a 'reserve charge amount' to a specified auction.

2.13 The first schedule in the bill will take effect at the same time as Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. The remainder of the bill will take effect the day the Act receives the Royal Assent.

Clean Energy (Charges—Customs) Amendment Bill 2012

2.14 The Clean Energy (Charges—Customs) Amendment Bill 2012 will amend the *Clean Energy Charges—Customs) Act 2011* consistent with the provisions of the Clean Energy (Charges—Excise) Amendment Bill 2012.

2.15 The first schedule in the bill will take effect at the same time as Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. The remainder of the bill will take effect the day the Act receives the Royal Assent.

Excise Tariff Amendment (Per-tonne Carbon Price Equivalent) Bill 2012

2.16 The Excise Tariff Amendment (Per-tonne Carbon Price Equivalent) Bill 2012 will change the treatment of the liquid fuels, by applying the new 'per-tonne carbon price equivalent' in place of the average carbon unit auction price.

2.17 Schedule 1 takes effect immediately after the commencement of Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. All other sections of the bill take effect the day that Act receives the Royal Assent.

Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment (Per-tonne Carbon Price Equivalent) Bill 2012

2.18 The Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment (Per-tonne Carbon Price Equivalent) Bill 2012 amends the *Synthetic Greenhouse Gas (Import Levy) Act 1995* to repeal the definition of 'benchmark average auction charge' and introduce a 'per-tonne carbon price equivalent'. It provides that the per-tonne carbon equivalent is applied to the import of synthetic greenhouse gas.

2.19 The first schedule will take effect immediately after the commencement of Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. All other sections of the bill take effect the day that Act receives the Royal Assent.

Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment (Per-tonne Carbon Price Equivalent) Bill 2012

2.20 The Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment (Per-tonne Carbon Price Equivalent) Bill 2012 amends the *Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Act 1995* to repeal the definition of 'benchmark average auction charge' and introduce a 'per-tonne carbon price equivalent'. It provides that the per-tonne carbon equivalent is applied to the manufacture of synthetic greenhouse gas.

2.21 The first schedule will take effect immediately after the commencement of Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. All other sections of the bill take effect the day that Act receives the Royal Assent.

Clean Energy (Unit Issue Charge—Auctions) Amendment Bill 2012

2.22 The Clean Energy (Unit Issue Charge—Auctions) Amendment Bill 2012 amends the *Clean Energy (Unit Issue Charge—Auctions) Act 2011* to remove the requirement for a minimum auction reserve price.

2.23 Schedule 1 takes effect at the same time as Part 1 of Schedule 1 to the *Clean Energy Amendment (International Emissions Trading and Other Measures) Act 2012*. The remainder of the bill takes effect the day that Act receives the Royal Assent.

Effects of the amendments

Linkage of Australian CPM to international markets, including EU ETS

2.24 The Clean Energy Amendment Bills allow for the linking of the Australian carbon pricing mechanism with overseas emissions trading schemes, including the EU ETS.

2.25 The CE Act currently allows eligible international emissions units to be surrendered to meet liabilities under the CPM after 1 July 2015. Some units issued under the Kyoto Protocol have already been defined as eligible international emissions units in the CE Act. Under the linking arrangement with the EU ETS, European allowance units will be able to be used for compliance under the CPM from 1 July 2015.

2.26 As the Explanatory Memorandum explains, amendments to the ANREU Act ensure that links to other countries' schemes can occur, even in the event it is not possible to implement a direct registry link. Indirect linking may be given effect by the Government issuing AIIUs to holders of an ANREU account, where these units are backed by foreign emissions units. The Government has also been given powers to open and operate an overseas registry account and to alter the way in which AIIUs are managed in the ANREU as circumstances require.[1]

Removal of the floor price and the surrender charge on international units

2.27 Under the linked arrangement, the floor price will no longer operate in the first three years of the flexible price period. As the Explanatory Memorandum explains, this will facilitate the convergence of the EU and Australian carbon prices.[2]

2.28 This will be achieved by removing the requirement for a minimum auction reserve price for the years 2015-16, 2016-17 and 2017-18; and by removing the requirement for a surrender charge on eligible international emissions units by repealing the *Clean Energy (International Unit Surrender Charge) Act 2011*.

2.29 The Minister may still determine an auction 'reserve charge amount' to enhance price discovery at auctions. The Explanatory Memorandum explains that:

> ...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. When there is a secondary market for carbon units, the reserve charge will ensure that the clearing price of the auction does not significantly diverge from the secondary market price.[3]

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1 Replacement Explanatory Memorandum, p. 9.

2 Replacement Explanatory Memorandum, p. 9.

3 Replacement Explanatory Memorandum, p. 21.

Kyoto units and 'designated limits'

2.30 As the Explanatory Memorandum explains:

> ...the Government may, through regulations, introduce additional or alternative quantitative limits on the use of eligible international emissions units. This will provide the Government the flexibility to respond to changing international circumstances as needed.[4]

2.31 In order to support a stable market and investment environment, the Government has also made a commitment to provide at least three years' notice ahead of the introduction of a new designated limit or change to an existing limit.[5]

The treatment of natural gas

2.32 The Explanatory Memorandum indicates that under the current provisions of the CE Act concerning emissions embodied in natural gas, there is the potential for certain commercial arrangements to lead to situations where liability may not be captured. It further states that the amendments proposed will provide greater flexibility around how the supply and use of natural gas is treated under the CE Act, and 'help to maintain competitive neutrality by supporting the complete coverage of natural gas under the carbon pricing mechanism.'[6]

2.33 Under the existing CE Act, liability applies to a liable entity for a facility where natural gas is used. Alternatively, the liability can apply for a natural gas supplier when they supply natural gas to a person and the natural gas is withdrawn from a natural gas pipeline for use. The CE Act also enables the Obligation Transfer Number to apportion liability between suppliers and end users.

2.34 The amendments provide that where the existing direct emitter or natural gas supply provisions of the CE Act do not apply, regulations may set out specific circumstances in which liability would arise for a supplier or end user of natural gas. 'Own-use notifications' and 'follow-up notifications' are mechanisms intended to enable suppliers to identify when the gas they supply is applied to a person's use. This will allow suppliers to determine where liability applies. Regulations may modify the definition of supply for the purpose of the new provisions and determine when supply occurs to facilitate their application.

2.35 The Explanatory Memorandum explains that these provisions:

> ...are intended to apply to specific commercial arrangements in the natural gas sector. In general, they are not intended to cover natural gas used at large gas consuming facilities as liability would ultimately arise from the direct emitter provisions. Furthermore, the amendments are not intended to apply to small end users, such as households, as they obtain gas through

4 Replacement Explanatory Memorandum, p. 8.

5 Replacement Explanatory Memorandum, p. 8.

6 Replacement Explanatory Memorandum, p. 10.

generic supply arrangements which give rise to liability for a supplier under section 33 of the CE Act.[7]

2.36 The regulation would be a legislative instrument for the purposes of the *Legislative Instruments Act 2003* and is a disallowable instrument.

Setting the equivalent carbon price on liquid fuels and synthetic greenhouse gases

2.37 The bills also update the approach to calculating the equivalent carbon price on liquid fuels and synthetic greenhouse gases from 1 July 2015. The updated approach will ensure that the equivalent carbon price closely tracks the carbon price faced by liable Australian entities.

Treatment of relinquished units

2.38 The Government has decided that there will no longer be auctions of relinquished carbon units. Instead, if a carbon unit is relinquished, it will be cancelled, and a new carbon unit will be auctioned.[8]

Amendments to the auction scheme

2.39 The bills include technical amendments to enhance the auction of carbon permits.

2.40 Under the Clean Energy package, a carbon auction limit was established to limit the amount of units from a compliance year that can be auctioned in an earlier year. This limit is aimed at preventing over-allocation before the pollution cap is known for a given compliance year.

2.41 The amendments increase the limit on advance-auctioned carbon units to 40 million units for carbon units whose vintage is 2015-16 that are auctioned in 2013-14, and 20 million units for other advance auctions where there is no carbon pollution cap number for that year. The Explanatory Memorandum indicates that the final details of the auction arrangements are determined by the legislative instrument under section 113 of the CE Act which is expected to be made in early 2013 after further consultation with industry.

Measurement determinations under the NGER Act

2.42 Technical amendments to the CE Act and the NGER Act provide the Minister with the power to determine methods to measure amounts of designated fuels for the purpose of ascertaining potential greenhouse gas emissions.

Treatment of GST joint venture operators in the Opt-in Scheme

2.43 Minor amendments to the CE Act clarify the treatment of GST joint venture operators in the Opt-in Scheme.'

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7 Replacement Explanatory Memorandum, p. 53.

8 Replacement Explanatory Memorandum, p. 9.

Scrutiny of Bills Committee

2.44 The Senate Scrutiny of Bills Committee, in its Alert Digest number 12 of 2012, noted that Schedule 1, item 79, proposed subsection 123A(1) of the CE Act would grant the Government the power to make legislative instruments to introduce one or more designated limits on eligible international emissions units. The committee noted that there is a guarantee from the Government to provide at least three years notice before new limits are to be introduced, or changes to existing designated limits are due to take effect. The Committee questioned whether this reference could be inappropriate delegation, as there is no statutory guarantee that the notice periods will be respected.

2.45 The Senate Scrutiny of Bills Committee also raised concerns about the operation of proposed subsection 57(2) of the ANREU Act, which provides for what is referred to as a Henry VIII clause (that is, a clause that enables the Executive branch of government to modify the operation of primary legislation passed by the Parliament). The provision in question will enable regulations to be made which 'modify' the provisions of new Division 3 of Part 4 of the ANREA Act in relation a specified class of AIIUs. [9]

2.46 The committee draws these concerns to the attention of the Government.

9 Senate Scrutiny of Bills Committee, Alert Digest no. 12 of 2012, p. 2.

Chapter 3

Linking carbon markets

3.1 Submissions to the inquiry and testimony to the committee indicated broad support for the concept of linking to international carbon markets.

3.2 Submissions identified a range of advantages that would accrue to Australia as a result of linkages to international carbon markets generally and to the EU ETS specifically. These advantages included promoting access to low cost abatement for Australian liable entities, strengthening the Australian carbon market and improving its efficiency, and building on and contributing to a growing global push to price carbon and tackle dangerous climate change.

3.3 While most submissions indicated support for the link to the EU ETS, several submissions expressed some concerns regarding the integrity of the EU ETS and the impact the linkage would have on Australian control over the CPM.

Promoting lowest cost abatement

3.4 The Minister for Climate Change and Energy Efficiency explained the logic of linking Australia's CPM to international markets in his second reading speech:

> It is common sense to support international linking because it assists in providing emissions reduction at least cost and 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.[1]

3.5 The committee heard that the structure of the Australian economy makes linkage to international carbon markets key to low-cost carbon abatement. The fact that Australia is a primary producer and exporter of fossil fuels and energy means, as the International Emissions Trading Association (IETA) explained:

> …we will always have a challenge of how we effectively meet the increases in our emissions trajectory from our own domestic economic capability. It is important for us that we are linked into effectively the mitigation frameworks of our trading partners so that we are able to source abatement at its lowest cost.[2]

3.6 IETA also made the point that Australia is an open economy, and it is appropriate that Australia seeks to ensure its scheme includes 'all the flexibility mechanisms that we can have to be able to make the adjustments that an open economy has to have.' Australia has been 'very successful' in building an open

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1 The Hon Greg Combet MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 19 September 2012, p. 1159.

2 Mr Emile Abdurahman, IETA, *Proof Committee Hansard*, p. 27.

economy through reform and economic regulation and deregulation; there is no reason to approach Australia's carbon policy any differently.[3]

3.7 In assessing the linkage, submissions from industry groups tended to emphasise the importance of lowest-cost abatement, and welcome the linkage, at least in principle, as a step in this direction. As Mr Alex Gosman of the Australian Industry Greenhouse Network (AIGN) told the committee, 'we do welcome movement towards linkages and we do welcome the move towards an international approach on carbon pricing, so this is one step towards that.'[4]

3.8 In a similar vein, the Institute of Chartered Accountants Australian (ICAA) told the committee that it was 'imperative that Australian businesses be allowed to access the lowest cost abatement through accessing global carbon markets.'[5] Expanding on this point, ICAA told the committee that its support for allowing Australian businesses to access lowest cost abatement through international carbon markets was very much related to its advocacy of the broader principles of ensuring that Australian business can compete effectively on a level international playing field.[6]

3.9 Conversely, the costs of Australia pursuing a stand-alone carbon pricing scheme would, as IETA told the committee, prove 'exceptionally high.' Without access to international carbon markets, domestic power and manufacturing costs would rise 'to levels that would be exceptionally disadvantageous to the economic structure.'[7]

3.10 In evidence to the committee, Treasury officials were able to quantify the impost a stand-alone scheme would create for Australian entities: even at the more modest end of the emissions reduction spectrum, if the CPM did not allow access to international units, the price of carbon would likely rise to about $62 per tonne.[8]

Strengthening the Australian carbon market and enhancing risk management capacity

3.11 Both ICAA and IETA explained to the committee how the link to the EU ETS would provide the Australian carbon market with the liquidity and depth it required to operate efficiently. This advantage was underlined by the fact that, whereas the Australian carbon market was relatively small and might struggle to generate sufficient liquidity and depth if operating in isolation, the EU ETS is the largest and most liquid carbon market in the world.[9]

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3 Mr Emile Abdurahman, *Proof Committee Hansard*, p. 31.

4 Mr Alex Gosman, AIGN, *Proof Committee Hansard*, p. 18.

5 Mrs Geraldine Magarey, ICAA, *Proof Committee Hansard*, p. 18.

6 Mr Yassar El-Ansary, ICAA, *Proof Committee Hansard*, pp. 18-19.

7 Mr Emile Abdurahman, *Proof Committee Hansard*, pp. 27, 29.

8 Mr James White, DCCEE, *Proof Committee Hansard*, p. 38.

9 Mrs Geraldine Magarey, *Proof Committee Hansard*, p. 18; and Mr Emile Abdurahman, *Proof Committee Hansard*, p. 25.

3.12 IETA further explained that the linkage with the EU ETS would promote price discovery and provide investors in power generation and other assets with an enhanced capacity to manage long-term price risk. Under the proposed arrangements, Australian businesses can 'link to Europe, which has a very well-developed long-term pricing structure,' meaning 'that we now have the ability to tap into market-based mechanisms to manage long-term price risks.'[10]

3.13 In its submission, the Australian Financial Markets Association (AFMA) made similar points, suggesting that links 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.'[11]

Building on the global push to price carbon and tackle climate change

3.14 The committee heard that the link to the EU ETS both reflected and would further add to the growing global momentum towards pricing carbon and tackling climate change.

3.15 IETA told the committee that the linkage would promote additional bilateral trading links with other nations, and provide the architecture for new and emerging carbon pricing schemes. There needs to be an efficient, low-cost, and consistent global approach to reduce carbon emissions and prevent dangerous climate change, and IETA suggested 'the current amendments are [a] step in the right direction.'[12]

3.16 The Climate Institute made a similar point, suggesting the linkage would provide 'a template for how future linkage arrangements between other countries are developed, and that is a good thing.' Australia's negotiating position in seeking other linkages, including linkages with emerging carbon markets in China, South Korea and other parts of Asia, would be strengthened by its link to the EU ETS.[13]

3.17 Sustainable Business Australia also argued that 'the linking arrangements between Australia and the EU will strongly influence similar agreements with other emission trading markets.'[14]

3.18 ICAA, meanwhile, noted the importance of Australia remaining alert to the possibility of additional links with new and emerging carbon markets.[15]

3.19 As IETA explained to the committee, the linkage arrangement will allow a new global pricing benchmark to be established, providing a 'more robust mechanism'

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10 Mr Emile Abdurahman, *Proof Committee Hansard*, pp. 24, 27.

11 Australian Financial Markets Association, *Submission 8*, p. 1.

12 Mr Emile Abdurahman, *Proof Committee Hansard*, p. 24.

13 Mr Erwin Jackson, The Climate Institute, *Proof Committee Hansard*, pp. 25-26.

14 Sustainable Business Australia, *Submission 14*, p. 1.

15 Mr Yassar El-Ansary, *Proof Committee Hansard*, p. 20.

for new entrants to carbon pricing markets, particularly Australia's trading partners in Asia and the United States.[16]

3.20 WWF Australia emphasised that the link to the EU ETS would strengthen the environmental integrity of the global carbon market at a time when there is growing global momentum toward carbon pricing, including in nations like China and South Korea.[17]

3.21 The committee also heard from DCCEE that international linkage would promote 'greater global ambition' to reduce emissions, and foster the growth of global carbon markets.[18]

Business and industry issues regarding competitiveness

3.22 A number of submissions argued that the linkage would do little to address the broader impact of Australia's carbon pricing scheme on the competitiveness of Australian industry.

3.23 The Australian Petroleum Production & Exploration Association (APPEA) argued that while the link may provide short-term cost savings, the competitive challenge to trade exposed industries, including the Australian LNG export industry, continues to be from countries that are not taking action to introduce carbon pricing.[19] The Australian Coal Association, AIGN and the Cement Industry Federation expressed similar concerns to the committee.[20]

3.24 The Australian Coal Association also told the committee that Australia was locking in the world's 'highest explicit economy-wide carbon cost impost on industry over the next few years.'[21]

3.25 However, some of these claims from industry bodies were challenged by other submitters. For instance, the Climate Institute contended in both its written submission and in evidence to the committee that Australia's carbon price is neither the highest in the world nor unusually broad in its coverage.[22]

3.26 The Australian Coal Association also acknowledged that while Australian and European coal producers did not compete in Asian export markets, they did compete in providing coal to European markets, particularly in thermal coal.[23]

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16 Mr Emile Abdurahman, *Proof Committee Hansard*, p. 27.

17 WWF Australia, *Submission 11*, p. 3.

18 Mr James White, *Proof Committee Hansard*, p. 36.

19 Mr Damian Dwyer, APPEA, *Proof Committee Hansard*, p. 7.

20 Australian Coal Association, *Submission 17*; AIGN, *Submission 16*; and Cement Industry Federation, *Submission 4*.

21 Mr Peter Morris, Australian Coal Association, *Proof of Committee Hansard*, p. 9.

22 Mr Erwin Jackson, Climate Institute, *Proof Committee Hansard*, p. 25. Also see the Climate Institute, *Submission 1*, p. 3.

23 Mr Peter Morris, *Proof of Committee Hansard*, p. 15.

3.27 On the whole, concerns raised by some business and industry groups related to pre-existing concerns with the broader Clean Energy Package, rather than with the amendments under consideration. These concerns should be weighed against the acknowledgement from business and industry groups that the linkage to the EU ETS will provide new compliance options and likely result in potential cost savings for Australian entities in meeting their carbon liabilities.

Assessing the strength and integrity of the EU ETS

3.28 While there was broad support for the concept of linking Australia's CPM to international markets, some submissions expressed concerns regarding the integrity of the EU ETS. Areas of particular concern included the apparent over-allocation of permits and less-than-rigorous monitoring, reporting and verification (MRV) mechanisms.

3.29 While supportive of the linkage, COzero noted that over-allocation of permits had proven problematic in the EU ETS. The EU experience highlights the importance of regularly reviewing carbon inventory, and COzero suggests that the Government should consider a higher frequency of inventory reviews than is currently mandated in the CPM.[24]

3.30 Professor Paul Frijters and Mr Cameron Murray (School of Economics, University of Queensland) were particularly concerned with these integrity issues, as was evidenced in both their joint written submission and their subsequent evidence to the committee. They discussed at some length the problems of over-allocation of permits in the EU ETS, and what they characterised as weak MRV systems that were subject to fraud, manipulation and politically driven 'fudge factors.'[25]

3.31 Prof. Frijters and Mr Murray expressed strong doubts regarding the capacity of the European Commission to enforce more robust MRV systems in individual member states. The EC does not have any budgetary powers, making it difficult for it to provide incentives for concerted action by member states to implement proper accounting systems. Moreover, tackling climate change is now a secondary political concern in Europe, and that makes it even harder 'to corral all of those countries into an equally strong enforcement system.'[26]

3.32 ICAA also noted well documented problems around integrity and fraud in the EU ETS. ICAA told the committee that to address these issues, the EU has undertaken a review, and in October 2011 the European parliament passed regulations to improve the integrity of both its energy market and its emission trading scheme.[27]

3.33 From ICAA's perspective, the problems that have previously been apparent in the EU ETS serve to highlight the importance of regulators in Australia working 'closely with their EU counterparts in order to minimise the risk or likelihood of

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24 COzero, *Submission 9*, p. 2.

25 Prof. Paul Frijters and Mr Cameron Murray, *Submission 6*.

26 Prof. Paul Frijters, University of Queensland, *Proof Committee Hansard*, p. 4.

27 Mrs Geraldine Magarey, *Proof Committee Hansard*, p. 18.

disruptive or confidence-damaging shocks to the linked schemes.'[28] In contrast to Prof. Frijters and Mr Murray, the ICAA suggested the EU ETS remained fundamentally robust and efficient. Indeed, compared to the Australian carbon market, the European carbon market:

> …is a more mature market that has had the benefit of a longer time frame over which to develop and refine those safeguards and protections that ultimately will flow through to the benefit of Australian businesses as well.[29]

3.34 In an exchange between Senator Cameron and Mr Emile Abdurahman from IETA, the point was made that fraud and manipulation, far from being unique to the EU ETS, can and does occur in all markets. What matters, then, is having a robust regulatory and enforcement framework to prevent occurrences of fraud and manipulation to the greatest extent possible. Mr Abdurahman told the committee that integrity problems could be largely avoided through 'mechanisms of diligent oversight and also sanction,' adding that Australia had a proven capacity to implement robust financial regulatory mechanisms.[30]

3.35 For its part, DCCEE assured the committee that it remained confident that the EU ETS MRV system was sound.

3.36 DCCEE told the committee that it believed the European approach of having MRV settings made a central level (that is, by the European Commission), but implemented at a national level (that is, by individual EU member states), was sound. Indeed, this approach was analogous to how Australian governments work together through the Council of Australian Governments—except that in the EU, agreements between governments are legally binding. There may be variations in the how EU member states undertake MRV, just as there are variations in Australia when the Commonwealth and states need to work together on national reforms. However, there are also review processes in place to ensure MRV systems are not compromised. In particular, the overall EU ETS system is subject to an external review by the United Nations. This ensures that units that will be transferred between the Australian and EU systems 'are matched by equivalent emission reductions in each economy.'[31]

The impact of linkage on Australian policy control

3.37 Some submissions expressed concern about the apparent heavy reliance of EU member states on policy drivers to shape the EU carbon market. A related concern was that Australia would be surrendering a substantial measure of control over its CPM to the EU, with a corresponding reduction in Australia's control over the price of carbon itself.

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28 Mrs Geraldine Magarey, *Proof Committee Hansard*, p. 18.

29 Mr Yassar El-Ansary, *Proof Committee Hansard*, p. 19.

30 Mr Emile Abdurahman, *Proof Committee Hansard*, p. 31.

31 Mr James White, *Proof Committee Hansard*, p. 43.

3.38 Professor Frijters told the committee that the unequal treatment of Australian permits under the one-way linking arrangement did not augur well for Australia's likely influence over European decisions affecting the price of carbon. Europe's decisions will be informed by internal considerations and dynamics, and Australia's interests 'will count for very little in the internal deliberations of the European Union.'[32]

3.39 Others submitters suggested that, due to the imbalance in market size, the Australian carbon price will effectively be determined by policy decisions in Europe. As Mr Peter Morris of the the Australian Coal Association put it, this raises the risk 'that the EU will be making scheme design decisions in line with their own interests and economic structures that will not necessarily be in Australia's interest.'[33]

3.40 Similarly, in its submission, the Business Council of Australia suggested that a key question for business was how, in the negotiations for the two-way link, Australia's competitiveness and economic strengths will be ensured, given 'the EU will be making scheme design decisions in line with their own interests and economic structures.'[34]

3.41 The Business Council of Australia expressed particular concern regarding the Government setting the Australian carbon price ceiling in reference to the likely EU ETS price in 2015-16, given the EU 'will determine the price in their scheme to suit its policy agenda and economy. This may not be in Australia's best interest.'[35]

3.42 This being the case, the Business Council of Australia recommended that the Government consult with business in the course of setting a new price ceiling and negotiating the two-way link between the CPM and EU ETS.[36]

3.43 The Cement Industry Federation questioned whether the Australian Government would have 'sufficient negotiating power with the EU on future scheme changes (particularly after the establishment of a two-way link) given the relative size of the two schemes.' On this basis, Cement Industry Federation argued that Australia should not surrender control over scheme design unless the scheme becomes truly international. Moreover, Australia 'should adopt an aggressive stance toward supporting Asian friendly (international) scheme design, particularly with regard to allowable offsets.'[37]

3.44 DCCEE conceded that given the larger size of the European carbon market, 'decisions about the parameters of the European emissions trading scheme will have

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32 Prof. Paul Frijters, *Proof Committee Hansard*, p. 5.

33 Mr Peter Morris, *Proof of Committee Hansard*, p. 12.

34 Business Council of Australia, *Submission 2*, p. 3.

35 Business Council of Australia, *Submission 2*, p. 3.

36 Business Council of Australia, *Submission 2*, pp. 3-4.

37 Cement Industry Federation, *Submission 4*, p. 5.

more influence on the overall price than decisions about the parameters of the Australian emissions trading scheme.'[38]

3.45 Consistent with this analysis, a Regulation Impact Statement (RIS) prepared by DCCEE acknowledged that under the linking arrangement the domestic carbon price 'will be affected by decisions taken in Europe to support the price of European allowance units'. However, on balance this cost was outweighed by 'the advantages of providing liable entities with access to another secure source of international units, greater effective assistance to recipients of free permits and reduced administrative complexity.'[39]

Fungibility of European Union Aviation Allowances (EUAAs)

3.46 In its submission, Qantas registered its concern that the draft legislation does not allow for the use of EUAAs in the Australian CPM. Qantas argues that EUAAs should have the same fungibility as European allowance units.[40]

3.47 The Explanatory Memorandum notes that EUAAs are a subclass of European allowance units that can currently only be used for compliance by aircraft operators that have a liability under the EU ETS. They are not intended to be eligible for surrender in the CPM.[41]

Committee view

3.48 The committee commends the linkage of the CPM to the EU ETS, and the broader principle of linkages to international carbon markets, on the basis that such linkages will assist in facilitating emissions reduction at least cost.

3.49 The committee acknowledges that international linkages will help develop a common carbon price across economies and a common incentive to cut emissions and tackle dangerous climate change.

3.50 The committee recognises that, for an open, growth-orientated and outward focused economy like Australia, it is common sense to seek out market-based linkages to international carbon markets. It further notes that such linkages build on the growing global push to price carbon through market-based mechanisms, and will place in Australia in a good position to link to new and emerging markets, particularly in the major economies of Asia.

3.51 The committee notes that some submitters were concerned by issues relating to the integrity of the EU ETS, but concludes that there is strong countervailing evidence to suggest the European carbon market is robust and well regulated.

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38 Mr James White, *Proof Committee Hansard*, p. 43.

39 RIS summary in Replacement Explanatory Memorandum, pp. 13-14.

40 Qantas, *Submission 15*, p. 2.

41 Replacement Explanatory Memorandum, p. 25.

Chapter 4

Amendments to the price floor and access to international permits

4.1 As noted in chapter one, to facilitate the link to the EU ETS, the Australian Government has agreed that it would remove the price floor and restrict the quantity of eligible Kyoto units that liable entities can use to discharge their carbon liabilities.

4.2 For the most part, submissions were supportive of the removal of the price floor and the surrender charge on international units. Several submissions from clean energy and environmental groups expressed some reservations about the removal of the price floor, while acknowledging that the link to the EU ETS is a good alternative mechanism to provide certainty to the CPM.

4.3 Submissions were sharply divided on the amendments limiting the use of Kyoto units in the CPM and the introduction of the concept of 'designated limits.' Whereas a number of business and industry groups argued that sub-limits were inconsistent with the principle of least-cost abatement, other submissions noted that such limits were necessary to protect the Australian carbon price from falling too low to drive investment in clean energy.

Removal of the price floor

4.4 For the most part, submissions supported the removal of the price floor.

4.5 A number of submissions argued that the price floor would have potentially distorted the market, created inefficiencies, and imposed an administrative burden on liable entities. For example, IETA suggested its preference was for market-based mechanisms, and the proposed link to the EU ETS 'was a lot more robust than what was previously proposed by the carbon price floor mechanism.'[1]

4.6 Several submissions suggested that the removal of the price floor created a measure of uncertainty regarding the Australian carbon price. The Climate Institute argued that a gradually rising price floor has three beneficial effects:

1. it helps deter investment in highly emission-intensive technologies that would become stranded under the stronger policies needed in the future;
2. it reduces downside financial risk premiums associated with low carbon investments, thereby reducing the costs of such investments; and

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1 Mr Emile Abdurahman, *Proof of Committee Hansard*, p. 24. Also see Business Council of Australia, *Submission 2*; Cement Industry Federation, *Submission 4*; Greenfleet, *Submission 5*; APPEA, *Submission 7*; Australian Financial Markets Association, *Submission 8*; COzero, *Submission 9*; ICAA, *Submission 10*; AGL Energy, *Submission 12*; Sustainable Business Australia, *Submission 14*; AIGN, *Submission 16*; and the Australian Coal Association, *Submission 17*.

> 3. 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.[2]

4.7 While expressing a preference for an extended price floor, the Climate Institute acknowledged that a link with the world's largest market (that is, the EU ETS) was a good alternative, as long as it was combined with strong complementary policies for domestic clean energy and energy efficiency.[3]

4.8 The Clean Energy Council made a similar argument in its submission. While the removal of the price floor might reduce certainty for businesses making investment decisions and 'potentially lower the incentive for developing low-carbon technologies,' linking with the EU ETS is a 'good alternative' to the price floor:

> It safeguards the Australian carbon price framework from future political pressure as repeal will now also mean severing connection to the world's largest carbon market. Furthermore, mutual recognition of carbon units between the two cap and trade systems sends the message that Australia is not acting alone.[4]

4.9 In its submission, WWF Australia noted that the possibility that there will be a price significantly lower than the former proposed floor underscored the importance of complementary clean energy policies, such as the Renewable Energy Target.[5]

The limit on Kyoto units and 'designated limits'

4.10 Business and industry groups were generally critical of the 12.5 per cent limit on the use of Kyoto units and the concept of a 'designated limit.' Such limits, it was argued, are inconsistent with the principle of least-cost abatement. Mr Dwyer, representing APPEA, underlined this apparent inconsistency for the committee:

> It is certainly the case that the introduction of a possible range of sub-limits does seem to run against accessing permits as long as they are credible wherever they may be available. It seems strange to us to acknowledge that access to international markets is a positive development and then seek to then arrange ways to constrain that access.[6]

4.11 Mr Morris of the Australian Coal Association made the case that Australia, as a net buyer of permits, needs to access markets that need to sell permits. Yet the EU is also a net buyer of permits. In effect, this means that Australian entities will be restricted from freely purchasing permits from markets with lower marginal costs of abatement, and this will have the effect of making the EU carbon price the Australian price floor.[7]

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2 Climate Institute, *Submission 1*, p. 2.

3 Climate Institute, *Submission 1*, p. 2.

4 Clean Energy Council, *Submission 3*, p. 1.

5 WWF Australia, *Submission 11*, pp. 6-7.

6 Mr Damian Dwyer, *Proof Committee Hansard*, p. 12.

7 Mr Peter Morris, *Proof Committee Hansard*, pp. 10-12.

4.12 In addition to the representations from APPEA and the Australian Coal Association, the committee received submissions expressing opposition to the limits on Kyoto units or the concept of designated limits from BCA, the Cement Industry Federation and Qantas.

4.13 Some submissions also suggested there is a lack of scrutiny in the amendments providing the Minister with the regulatory power to introduce new designated limits or change existing limits. For instance, AGL Energy suggested that providing the Minister with these regulatory powers would create uncertainty, increase risk premiums and thereby adversely impact on investment in low-carbon projects.[8]

4.14 On the same matter, the Cement Industry Federation suggested the government enshrine in legislation its commitment to neither introduce a new designated limit or change an existing limit without three years notice. Moreover, any such changes should be subject to greater public scrutiny, including analysis by the Productivity Commission.[9]

4.15 However, both AIGN and APPEA indicated they were satisfied with changes made to the legislation since the exposure draft was released, which limited the Minister's capacity to change designated limits with little notice (although APPEA reiterated that it would prefer the concept of designated limits to be removed altogether).[10]

4.16 By way of contrast, other submissions argued that it was important to maintain carefully considered limits on the importation of international offsets to prevent the Australian carbon price falling too low to drive clean energy investment. As the Climate Institute told the committee:

> If you have no limit on Kyoto units and you have no price floor then the Australian price would have crashed, and it would have been a mechanism which we had gone through a whole bunch of pain to implement, which would not have driven the outcomes that we are already starting to see in the electricity sector and across the broader economy—that is, reducing emissions.[11]

4.17 Similarly, the Clean Energy Council argued that the limit would ensure that the Australian carbon price was not set in the Clean Development Mechanism (CDM)

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8 AGL Energy, *Submission 12*, p. 2.

9 Cement Industry Federation, *Submission 4*, pp. 6-7.

10 Mr Damian Dwyer, *Proof Committee Hansard*, p. 12; Mr Alex Gosman, *Proof Committee Hansard*, p. 12.

11 Mr Erwin Jackson, *Proof Committee Hansard*, p. 26.

market,[12] and safeguard against Australia's carbon price falling too low to encourage clean energy investment.[13]

4.18 IETA told the committee that the 'fundamental fact' is that Australia needs to have a 'level of domestic national ambition' for reducing emissions, and the price of CERs does not align to that level of ambition. Therefore, it 'makes eminent sense' that this is the way we will become linked to EU ETS and global markets.[14]

4.19 The committee also heard from DCCEE that while greater access to Kyoto units might help Australia meet abatement targets at a lower cost in the short term, this would not necessarily produce a least-cost outcome in the period beyond 2020. That is, unrestricted access to Kyoto units might undermine efforts to transition to clean energy and meet the longer term target of 80 per cent emissions reductions by 2050. As DCCEE told the committee:

> The objects of the Clean Energy Act include to achieve Australia's international obligations and commitments—which, within those, would include our target range for 2020, to contribute to achieving an 80 per cent reduction in emissions by 2050 and also to encourage investment in clean energy—and to do this in a flexible and cost-effective way. So if you narrowed the target range down to 2020 only and you had no concern whatsoever about what happened after 2020, then access to Kyoto units, which are trading at very low levels at the moment—if those prices were to continue through that period, it may have that effect at 2020, but it may not set Australia up very well for the further emissions reductions that will be required to 2050 or for achieving the 80 per cent the reduction target.[15]

The credibility of Kyoto units and the 12.5 per cent limit

4.20 With regards to the CDM and the CERs it produces, the committee heard from Professor Frijters that the low price and credibility issues in the CDM market suggested 'a market in decline.'[16]

4.21 However, the Climate Institute told the committee that while there had been problems with Kyoto units in the past, the rules have become more stringent regarding the development of units. It further emphasised the importance of the Kyoto mechanism in developing the global carbon market and investment in clean energy.[17]

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12 The CDM is a mechanism under the Kyoto Protocol that provides for emission reduction projects in the developing world. These projects generate Certified Emission Reduction units (CERs), a type of Kyoto unit which may be purchased by developed countries to meet part of their emission reduction commitments under the Kyoto Protocol.

13 Clean Energy Council, *Submission 3*, pp. 1-2.

14 Mr Emile Abdurahman, *Proof of Committee Hansard*, p. 30.

15 Mr James White, *Proof of Committee Hansard*, p. 37.

16 Prof. Paul Frijters, *Proof of Committee Hansard*, p.3.

17 Mr Erwin Jackson, *Proof Committee Hansard*, p. 30.

4.22 In its submission, COzero provided a strong endorsement of Kyoto units, stating that it 'believes in the integrity of credits generated through the Kyoto flexibility mechanisms and the additional social/economic benefits that many projects bring to developing countries.'[18]

4.23 In contrast to the views expressed by Professor Frijters, IETA argued that Kyoto units were a 'victim of [their] own success.' The number of units generated had proven far in excess of what anyone had expected, and with essentially only one market for these units to be utilised in – that is, the European Union – the price collapsed as a result of oversupply. The solution to this problem will come from 'the expansion of other emissions trading schemes that would be able to absorb those.'[19]

4.24 DCCEE assured the committee that Kyoto units 'are credible and reliable sources of abatement,' and noted that they are backed up by sound validation and verification processes. DCCEE further noted that 'the methodologies that are used to create them go through the CDM executive board, which makes decisions about the additionality of those methodologies.'[20]

4.25 DCCEE told the committee that the 12.5 per cent limit on Kyoto units is not related to their reliability or credibility, but instead to the Government's position that Australia's carbon price should match or be similar to the carbon price that applies in most other developed countries that are operating market-based carbon pricing mechanisms. DCCEE did, however, allow that it was legitimate to raise questions about continued reliance on Kyoto units 'when the continued existence of those units depends on the international negotiations and also the extent to which the current price trajectories of Kyoto units may actually be sustained in the future.'[21]

Impact on revenue

4.26 The committee heard that the Treasury has not amended its projection of a $29 per tonne carbon price in Australia in 2015-16. Treasury explained that:

> …the fundamental assumptions in the modelling…have not changed in the sense that [the modelling] always envisaged Australia linking to credible international markets and was essentially a proxy for an international cost of abatement. I think we would regard the European scheme as the largest, deepest, most liquid market currently trading, as consistent with those modelling assumptions that were outlined.[22]

4.27 Treasury further pointed out that because of the volatility in spot prices for carbon and even futures market expectations, Treasury tends to rely 'on longer term

18 COzero, *Submission 9*, pp. 1-2.

19 Mr Emile Abdurahman, *Proof of Committee Hansard*, p. 30.

20 Mr James White, *Proof of Committee Hansard*, p. 37.

21 Mr James White, *Proof of Committee Hansard*, p. 37-38.

22 Mr Robert Raether, Treasury, *Proof of Committee Hansard*, p. 39.

estimates rather than intermittent peaks and troughs that might come through with the spot market.[23]

4.28 Treasury also pointed out that the:

> …fundamental environmental targets and commitments that were embodied in the Treasury modelling have not changed. The modelling was based on commitments of 89 countries through the [United Nations Framework Convention on Climate Change] process to emission reductions by 2020. It assumed a long-term environmental target of stabilisation of atmospheric greenhouse gases of 550 parts per million. Those assumptions remain valid.[24]

4.29 Professor Frijters expressed scepticism regarding Treasury's revenue projections. Drawing on projections produced by Deutsche Bank and Point Carbon, and taking into account the over-allocation of permits in the EU ETS and reduced economic growth in Europe, he suggested that 'revenue is going to be something like a third of what has been forecasted.'[25]

4.30 Treasury acknowledged that economic growth in Europe is now projected to be somewhat slower than predicted at the time of the modelling. However, it was Treasury's view that what matters for carbon price projections from a modelling point of view 'is a very long-term outlook for world GDP growth,' and assumptions about long-term world GDP growth remain valid.[26] Treasury did, however, acknowledge that these are projections that refer to 'three years into the future with an internationally traded commodity where there are a lot of variables, so in that sense it is less certain than over the shorter term when the price is fixed.'[27]

4.31 The Climate Institute pointed out that there is a broad spread of views on where the carbon price will be in coming years. The Climate Institute's own view is that the chance of the carbon price being under $10 per tonne by 2020 has diminished, and it is more likely prices will be in the $15 to $20 by that time. IETA further suggested that, while the carbon price over the short-term might not be sufficient to drive sufficient investment in clean energy, a linked Australian CPM will serve as a mechanism to reduce emissions over the long term.[28]

The role of the cap in determining Australia's aggregate emissions

4.32 Professor Frijters suggested that the likely low price of carbon under the arrangement made carbon abatement less likely:

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23 Mr Robert Raether, *Proof of Committee Hansard*, p. 39.

24 Mr Benjamin Dolman, Treasury, *Proof of Committee Hansard*, p. 39.

25 Prof. Paul Frijters, *Proof of Committee Hansard*, p. 5. Also see Prof. Paul Frijters and Mr Cameron Murray, *Submission 6*, p. 1.

26 Mr Benjamin Dolman, *Proof Committee Hansard*, p. 40.

27 Mr Robert Raether, *Proof Committee Hansard*, p. 40.

28 Mr Erwin Jackson, *Proof Committee Hansard*, p. 29.

> [T]he internal incentives in Australia to reduce carbon emissions depend directly on the price and, since that will be fairly low, the local impacts on innovation will be fairly minor as well and there will be certainly almost no knock-on effect within the European Union because it is expected that they are just going to sell us reserve permits if we buy any of them at all and the reserve permits are so enormous they already have three times more than our total annual usage in reserve permits that there is no pressure on their internal system from the meagre demand that we might actually put on their system.[29]

4.33 In response, Treasury made the point to the committee that ultimately it is not the price of carbon that determines Australian's aggregate emissions so much as the cap, at least from 2015-16 onwards:

> Aggregate emissions are fundamental to the scheme and are determined by the cap, and to the extent that the cap binds, and we would all expect it to bind, that determines Australia's aggregate emissions. It is the reduction in the cap that achieves Australia's emissions reduction target.[30]

Committee view

4.34 The committee considers that the removal of the price floor will help facilitate the linkage of the Australian CPM to the EU ETS.

4.35 The committee acknowledges concerns expressed by some submitters regarding the 12.5 per cent limit on Kyoto units and the concept of 'designated limits'. However, the committee believes that some limit on Kyoto units is necessary to drive the transition in Australia to a low-carbon economy, consistent with the objectives of the CE Act.

4.36 The committee further notes that unlimited access to Kyoto units might create a higher long-term cost to the Australian economy in the transition to a clean energy future.

4.37 The committee acknowledges the need to establish provisions for the future introduction or setting of designated limits to, as the Explanatory Memorandum put it, provide 'flexibility in both setting and changing limits over time, reflecting 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.'[31]

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29 Prof. Paul Frijters, *Proof Committee Hansard*, p. 5.

30 Mr Robert Raether, *Proof Committee Hansard*, p.41.

31 Replacement Explanatory Memorandum, p. 26.

Chapter 5

Natural gas and concluding comments

5.1 As noted in chapter two, amendments relating to the treatment of natural gas aim to ensure that the liability for carbon emissions is realised as high as possible in the natural gas supply chain, and that the principle of universal coverage for liable entities applies.

5.2 The committee heard concerns from a number of submitters regarding the amendments. DCCEE, meanwhile, assured the committee that the provisions would not come into effect unless and until the necessary regulations are made, and that the Government would conduct consultations on the development of these regulations before they are implemented.

Concerns expressed by industry groups

5.3 Several submissions from business and industry groups suggested the amendments and yet-to-be-determined regulations relating to the treatment of natural gas created a number of concerns, including the possibility of commercial distortions and administrative complexities. These submissions recommended the removal of the amendments relating to natural gas, pending further consultation with stakeholders.[1]

5.4 In part, industry concerns related to the apparent uncertainty the amendements create. As APPEA explained to the committee:

> We are in a situation where we do not necessarily disagree with the proposals that have been made, but we are not sure. Why [are we] rushing this through? Why has this emerged so quickly? There is an unrelated legislative change going through the parliament in the form of the linking provisions we have been talking about, raising a range of uncertainties that we now have to deal with and try to fix to regulation. While we acknowledge the consultation process has been set forward, our deep concern is that, if we reach a point of time through that consultation when we find the legislation which has been developed very rapidly does not quite address the problems that the department thinks it has identified, how do we fix it? Amending next year or amending late this year amendments that we have just put through parliament is not a situation that I think anyone wants to see happen. It limits our ability through the regulations to fix those issues if those issues are identified.[2]

5.5 As APPEA's comments indicate, some submissions suggested that the Government's consultation process regarding the amendments was inadequate. This

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1 These points were made, in varying degrees, in the following submissions: Business Council of Australia, *Submission 2*; AIGN, *Submission 16*; APPEA, *Submission 7*; and AGL Energy, *Submission 12*.

2 Mr Damian Dwyer, *Proof Committee Hansard*, p. 14.

argument was made, in varying degrees, by the Business Council of Australia, AGL Energy and AIGN.[3]

5.6 In its submission, AGL Energy argued that the coverage of natural gas supply under the current legislation is very near complete, suggesting the amendments are not required at this time. AGL Energy recommended that, at a minimum, the first compliance year should be completed and a review of any coverage issues be undertaken, before any amendments are made to the legislation on this front.[4]

5.7 In addressing these concerns for the benefit of the committee, DCCEE emphasised that the bill would create the capacity for the government to make regulations consistent with the general principle that liability should be at the highest point in the natural supply chain and that there should be universal coverage for all liable entities.[5]

5.8 DCCEE further indicated that the amendments do not make any current changes to coverage arrangements or compliance requirements. Such changes would only be given effect through regulations, which are yet to be drafted.[6]

5.9 The committee also heard from DCCEE that it has put in place a process for consultation on the development of any regulations resulting from the amendments, and the Minister has outlined this process to relevant industry groups and market participants. This process will inform 'the development of those regulations so that the detail can be worked through with them and those quite specific concerns that they have raised' can be considered and addressed.[7]

5.10 AIGN noted that since the amendments came forward, DCCEE had been in consultation with AIGN, and 'we welcome that.'[8]

5.11 APPEA also noted that it has now received correspondence from the Minister for Climate Change and Energy Efficiency, 'setting out a more detailed consultation process to produce the regulations that will underpin the natural gas liability aspects of the bill. We felt it important in participating today to acknowledge that development.' Still, APPEA maintains its recommendation that the consultation process should precede the introduction of the amendments.[9]

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3 See Business Council of Australia, *Submission 2*; AIGN, *Submission 16*; and AGL Energy, *Submission 12*. Also see APPEA, *Submission 7*.

4 AGL Energy, *Submission 12*.

5 Mr Simon Writer, DCCEE, *Proof Committee Hansard*, p. 45.

6 Mr Simon Writer, *Proof Committee Hansard*, p. 45.

7 Mr Simon Writer, *Proof Committee Hansard*, p. 45.

8 Mr Alex Gosman, *Proof Committee Hansard*, p. 7.

9 Mr Damian Dwyer, *Proof Committee Hansard*, p. 8.

Committee view

5.12 The committee recognises that the provisions in the bill relating to the treatment of natural gas supply and use are necessary to ensure the policy intent of the original legislation is properly realised.

5.13 The committee welcomes the Government's commitment to undertake detailed consultations with interested stakeholders in developing any regulations consequent to the legislation relating to the treatment of natural gas under the CPM.

Recommendation 1

5.14 The committee recommends that the Government continue to consult with interested stakeholders in the development of regulations resulting from the bills, including regulations that impact on the treatment of natural gas under the carbon pricing mechanism. This recommendation should be brought to the attention of the Department of Resources, Energy and Tourism.

Concluding comments

5.15 The committee notes the long-standing commitment by successive Australian governments to link an Australian carbon pricing mechanism to credible international emissions trading schemes.

5.16 Linking to the European Union Emissions Trading System is the first step toward ensuring that the Australian carbon pricing mechanism has a strong foundation that will provide necessary incentives to drive the transition to a clean energy future in Australia.

Recommendation 2

5.17 The committee recommends that the Senate pass the bills.

Senator Mark Bishop
Chair

Coalition Senators' Dissenting Report

1.1 The Coalition has opposed Labor's carbon tax at every step of its implementation, based on our concerns about its impact on the competitiveness of Australian industry, consequences for employment in Australia and significant hit to the costs faced by every Australian household and business, as well as its failure to achieve its stated objective and address Australia's domestic emissions.

1.2 We will continue to oppose every aspect of the carbon tax, including by opposing these dramatic changes to a policy that is only a few months old. Our concerns that once again Labor's changes run contrary to what had been promised, are ill considered and will have negative consequences for many parts of the Australian economy were matched by evidence from a range of stakeholders, which is highlighted in this report.

Overall lack of policy transparency/consultation

1.3 Coalition Senators share the concerns expressed by, in particular, industry groups regarding a lack of consultation and lack of policy transparency over what are significant changes to a policy having potentially and intended huge ramifications for the Australian economy.

> ... the ability to comment in detail on the original significant policy changes was limited by the lack of previous consultation and limited explanatory notes, as well as limited time for appropriate and comprehensive analysis of the issues.[1]
>
> APPEA believes the consultation process that has given rise to this package of Bills has been inadequate.[2]

1.4 This is hardly surprising given the carbon tax was itself borne of a political deal rather than as a result of broad community support and these changes have come just months into its implementation.

1.5 This mismanagement of good public policy process was especially on display in the proposed changes to the treatment of gas liability arrangement, which were highlighted in particular by the Australian Petroleum Production and Exploration Association in their submission:

> ... changes to the natural gas liability arrangements ... Raise a series of potential commercial distortions, complications and administrative burdens that extend to the entire natural gas liability provisions currently contained in the *Clean Energy Act 2011* ... and Appear targeted at a problem that has

[1] Australian Industry Greenhouse Network, *Submission 16*, p. 1

[2] Australian Petroleum Production and Exploration Association, *Submission 7*, p. 1

> not been fully assessed before the first compliance period under the Act has even been completed.[3]

European control

1.6 Labor ministers have lined up to hail the linkage of Australia's carbon tax to the European ETS, as enabled by this bill. However, evidence indicates this linkage would see the level of Australia's carbon pricing mechanism, or the rate of Australia's carbon tax, effectively set by decisions made in the European Union.

1.7 Decisions made in the European Union will now have a direct impact on the rate of Australia's carbon tax, as a result of the linkage, with evidence indicating that impact will almost certainly be greater than similar policy positions taken in Australia.

> **Mr Dwyer:** Very explicitly, the explanatory memorandum to the bill sets out, at paragraph 1.34, that the intention of the designated limit, for example, is to drive convergence between the two schemes—and, I think, by convergence what we are really talking about is the EU price. So it follows from that that changes to the price in the EU scheme flow directly to the Australian scheme.
>
> **Mr Morris:** We have already seen with the 12½ per cent decision, which I understand was a policy decision, that that was probably necessary for having a relationship with the EU.
>
> **Senator BIRMINGHAM:** So Australia is, in a sense, paying a price in its public policy determinations there to get the agreement with the EU?
>
> **Mr Morris:** There was clearly a relationship, yes.
>
> **Senator BIRMINGHAM:** And that being a decision—the 12½ per cent subquota—that you have each expressed concerns about because it limits the capacity to achieve lowest cost abatement through this type of process?
>
> **Mr Morris:** Yes. There is other evidence before the committee in submissions that suggests there will be some $1 billion and growing each year to buy permits from the EU. That could be a lower sum if there were availability of alternative abatement purchasing options—for example, if the 12½ per cent were a higher figure or if there were opportunities to buy abatement from other areas of the world.[4]

1.8 Evidence regarding Europe's control over Australia's carbon pricing mechanism or carbon tax rate was also given by the Department of Climate Change and Energy Efficiency at the most recent round of Senate Estimates:

> **Senator BIRMINGHAM:** If Europe were to take steps that saw them adopt a more ambitious target than they currently have, that would result in

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[3] Australian Petroleum Production and Exploration Association, *Submission 7*, p. 3

[4] Mr Damian Dwyer, Australian Petroleum Production and Exploration Association Limited, and Mr Peter Morris, Australian Coal Association, *Proof Committee Hansard*, pp. 13-14.

> a higher carbon price in Europe and therefore a higher carbon price in Australia?
>
> **Mr Comley:** Other things being equal, that is right.
>
> **Senator BIRMINGHAM:** If Europe were to, as they are discussing doing, potentially restrict the number of permits that are available, that would result in a higher carbon price in Europe and all other things being equal a higher carbon price in Australia?
>
> **Mr Comley:** That is right.
>
> **Senator BIRMINGHAM:** If the Australian dollar were to deteriorate relative to the euro, that would result in the relativity of the Australian carbon price being higher once those transactions occurred?
>
> **Mr Comley:** Assuming, again, that the thing that caused the Australian dollar change was not either linked or had a consequence for the carbon price in Europe, which I think is an important caveat here, then that would be the case.[5]

1.9 Submissions by industry groups have also noted with the concern the level of control that rests with decision making in Europe and over which Australia has little if any influence.

> Of concern to Qantas is that the EU will have the ability to artificially control the price of carbon in Australia and the impact on Australian industries through the EU carbon price.[6]
>
> ... it appears that Australia has very little say over any major scheme changes that are contemplated by the European Union.[7]
>
> The CIF is concerned that Australia's future scheme design, the setting of caps and the inclusion of allowable offsets may be unduly influenced by the European Union...[8]

1.10 It should also be noted that, at present, only a one-way linkage with Europe has been negotiated, where Australian entities may utilise European permits, but this cannot occur in reverse. Full linkage still needs to be negotiated, with witnesses suggesting Australia may have to further compromise its policy objectives to achieve this outcome:

> **Mr Jackson:** The commission now needs to get a mandate from the member states to negotiate a full treaty to have full linkage. This is why we have pointed out, for example, that our [Australia's] posture on the Kyoto Protocol over the next few months will be important … it is also critical to understand the decision-making processes in the EU. We have an

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[5] *Senate Environment and Communications Legislation Committee Proof Hansard*, 15 October 2012, pp. 20-21

[6] Qantas Airways Limited, *Submission 15*, p.2

[7] Cement Industry Federation, *Submission 4*, p. 5

[8] Cement Industry Federation, *Submission 4*, p. 6

> agreement with the European Commission but that needs to be ratified by member states in terms of a mandate to negotiate a treaty. If Australia is not playing ball in Doha and not playing ball in Kyoto, that will have an impact on how European member states view the negotiation of the links between the two schemes...[9]

1.11 It was also suggested that other changes, particularly limits this legislation will place on the use of other international permits by Australian entities through a sub threshold mechanism, would not only result in higher prices (as discussed elsewhere) but also see Australia having already traded away a potential negotiating point in future discussions with the European Commission over full linkage:

> It is ... difficult to see how a sub threshold during the one way linking period could impact negatively on the European scheme to an extent greater than the negative impact of losing access to lower cost abatement for Australian liable entities. The sub threshold serves only to prop up the European price, while giving away a point of negotiation with respect to the scheme design at the two way linking stage.[10]

Integrity

1.12 Given the importance placed by the Government on this link with Europe, Coalition Senators are concerned at the evidence provided to the inquiry, including by Professor Paul Frijters of the University of Queensland, regarding doubts about the integrity of the EU ETS and scope within it for fraud and manipulation:

> If we then look at the verification mechanisms, the crucial aspect of the scheme whereby you see how much a company has actually used, this is to a large extent self-reported. The verification scheme is that you have almost like a yearly account, you say on the books how much you have used, how much of the various fuels, what your efficiency factor is, and then you have a verifier come in to look at your reports. So all that the verifier in principle needs to do is just look at the documentation that you have provided. Nominally, they are supposed to do spot checks, but as yet there are is still no operational peer review mechanism for these verifiers and hence there is a strong possibility that people choose the verifiers who go easy on them. This is, of course, an unverifiable statement in itself precisely because there is no peer review mechanism as yet—it is a murky world of verifiers. [11]
>
> …
>
> If you then think about further worries about the enforcement mechanisms, you look at the actual verification documents. We went through some of the actual documents which verifiers have to send in and there was a lot of room for interpretation or manoeuvring in what we saw. So there is a lot of room to manoeuvre on what you actually count as the fuel that went into a

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[9] Erwin Jackson, The Climate Institute, *Proof Committee Hansard*, p. 28

[10] Cement Industry Federation, *Submission 4*, p. 4

[11] Professor Paul Frijters, University of Queensland, *Proof Committee Hansard*, p. 4

> company, as to the efficiency factors that you would allocate and the level of cross-border trades that had these carbon components in them. This then falls back to the local national legal system to enforce proper accounting mechanisms. Of course the incentives to, as it were, penalise your own companies are very limited within the European Union. So those were the main concerns we had.[12]
>
> ... there has been some room for concern recently as a result of it becoming known that the EU emissions trading scheme being exposed to various integrity issues around registry security and fraud.[13]

1.13 These integrity issues and question marks over the effective operation of the European scheme also bring into doubt the level of available permits, the impact on actual emissions and highlight the exposure to risk faced by Australian industry, as identified by various witnesses:

> Because of these reserve over---allowances, Australia could be sold EU permits without any change to the price or volume for any emitter in Europe, implying that we would buy 'spare' permits from the EU, without anything happening to overall carbon emissions.[14]
>
> ... the overall levels of permits will be determined by an intra-EU game of transfers and limited enforcement.[15]
>
> the EU ETS involves substantial assistance to industry. In the EU the majority of permits have been, and continue to be, allocated without charge to the traded sector during a lengthy transitional period. The linkage with the EU ETS highlights the disadvantage imposed on Australian coal producers.[16]

Removal of floor price

1.14 The Coalition is concerned at the policy confusion and apparent hypocrisy of the Gillard Government in removing the floor price. Labor have, on no fewer than eleven occasions, affirmed their commitment to the floor price as a crucial element of their carbon tax legislation:

> The bill also provides for a price cap and a price floor to apply for the first three years of the floating price period.

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[12] Professor Paul Frijters, University of Queensland, *Proof Committee Hansard*, p. 4

[13] Institute of Chartered Accountants Australia, *Submission 10*, p. 2

[14] Professor Paul Frijters and Cameron Murray, University of Queensland, *Submission 6*, p. 1

[15] Professor Paul Frijters and Cameron Murray, University of Queensland, *Submission 6*, p. 7

[16] Australian Coal Association, *Submission 17*, p. 2

This will limit market volatility and reduce risk for businesses as they gain experience in having the market set the carbon price.

Julia Gillard, House Hansard, 13 September 2011

Well we have set a floor and cap so that there can be stability in pricing but by internationally linking the scheme we will see the Australian price linked to the global price when we move to the emissions trading scheme in three years time, but we did think it was appropriate, because people are making very long term investments, to have a band in which the price will move so that we've got the benefits of linking with the international price but also the benefits of stability.

Julia Gillard, Doorstop Interview, 9 November 2011

PM: There is a price ceiling and price floor which we announced yesterday. The price ceiling is $20 more than the international price.

JOHN LAWS: Why?

PM: Well we just thought for stability, particularly when we move to an emissions trading scheme where the market is setting the price that it was wise for a period to have bands, a ceiling and a floor.

Julia Gillard, Radio 2SM, 11 July 2011

GREG COMBET: We have legislated the floor price, that's quite well-known. I am discussing with the European Union the linkage of our schemes, it is an issue that's in those discussions but we are committed to the arrangements we have legislated.

DAVID SPEERS: At $15.

GREG COMBET: That's the floor price.

Greg Combet, Sky News, 21 August 2012

This bill imposes the charge payable by a person to the Commonwealth for the surrender of an international unit in the years beginning on 1 July 2015, 2016 and 2017, as a tax within the meaning of section 55 of the Constitution.

The bill imposes the charge, but only to the extent the charge is neither a duty of customs nor a duty of excise. The charge will ensure that a minimum charge—or in economic terms, a 'price floor'—applies to all units that are surrendered by liable entities for the first three flexible charge years of the carbon pricing mechanism, whether they are domestic units or international units. I commend the bill to the House.

Greg Combet, House Hansard, 13 September 2011

> Well we've put in a floor price and a price cap to provide some confidence over the first few years about the potential variability of the price.
>
> Greg Combet, ABC Radio National, 12 July 2012

> Mr Combet told The Australian last night that the federal government had negotiated the price floor as part of the Multi-Party Climate Change Committee agreement "and we have legislated a three-year fixed price period". "We are committed to the whole package," he said.
>
> Greg Combet, The Australian, 5 July 2012

> Climate Change Minister Greg Combet said yesterday the price floor and ceiling would avoid sharp price spikes or plunges.
>
> "This will reduce risks for businesses as they gain experience in having a market set the carbon price," Mr Combet said.
>
> Greg Combet, *The Australian Financial Review*, 28 September 2011

> It is the case that our policy does include a price floor which acts as a safety valve for investors in low-emissions technology by establishing a minimum price for the first few years of a flexible price period.
>
> Penny Wong, Senate Hansard, 28 February 2012

> For the first three years of a flexible price emissions trading scheme there will be a price floor mechanism that aims to ensure the price of permits do not fall below a pre-determined level. A price floor provides participants with greater certainty upon which abatement decisions to make. For those investing in abatement technologies whose value is sensitive to the level of the carbon price, a price floor helps reduce downside risk.
>
> Mark Dreyfus, Address to Carbon Expo 2011, 8 November

1.15 These arguments advanced by the Government in very recent times either make a case against the Government's own actions now in abolishing the floor price, or stand testament to the lack of credibility attached to any arguments advanced by the Government over its carbon tax and climate change mitigation policies.

1.16 While Coalition Senators note some evidence to the inquiry in favour of the abolition of the floor price, we note also evidence provided by The Climate Institute conversely in favour of a price floor extension:

> ... the Institute's preference is for an extended price floor because of the predictability it provides investors and the economic efficiencies it could deliver.

> The signal sent by a gradually rising price floor has three beneficial effects:
>
> 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.
>
> Among others, these are the reasons why the UK and California have implemented price floors and why China is considering floors in its emerging pilot schemes.[17]

1.17 Removal of the floor price is among significant and substantial changes given effect by this bill to the carbon tax, itself implemented despite express commitments taken to the most recent election, in 2010, that there would be no carbon tax under a government led by the current Prime Minister.

1.18 There is already substantial community angst at the carbon tax itself and the manner of its implementation against express election promises to the contrary.

1.19 For the Government to seek to make such a major structural change to its carbon tax inside three months of its operation gives little comfort to those who opposed its original introduction in its original form, and gives rise to Coalition Senators' serious concerns about the soundness of the Government's policy development processes and all arguments it prosecutes for their implementation.

Policy and budgetary uncertainty

1.20 Consideration of the Government's significant carbon tax policy changes is done against a backdrop of enormous uncertainty over what the carbon price will be in just a few years. The Government has provided no updated modelling, insisting previously released modelling completed years ago remains current, despite the changes to the policy or the many global economic factors its assumptions were built upon.

1.21 At recent Senate Estimates hearings, the Department of Climate Change and Energy Efficiency refused to endorse the Government's estimated carbon price in 2015-16 of $29, not even ruling out a rise to $50:

> **Senator BIRMINGHAM:** We will come to some of the policy rationale or otherwise behind that decision shortly. What is the estimated carbon price meant to be in 2015-16?

[17] The Climate Institute, *Submission 1*, p. 2

Mr Comley: The number that is, I believe, in the budget papers is round $29 in 2015-16.

Senator BIRMINGHAM: Is that an accurate reflection?

Mr Comley: It is the current government estimate of the price in 2015-16.

Senator BIRMINGHAM: Is the current government estimate of the price in 2015-16 an accurate estimate of the price in 2015-16?

Mr Comley: I am not going to revise the estimate, Senator.

Senator BIRMINGHAM: Is it the best available estimate?

Mr Comley: This is where I think again we are straying a little bit into Treasury's territory which is responsible for that price. We obviously provide advice to them. It is longstanding government practice that at each point where you have a major economic publication you put out your best estimate of a particular parameter at that point in time and it is also longstanding practice to not speculate about the change of the parameters between releases of major economic updates.

Senator BIRMINGHAM: Does that mean you are standing by the $29 price as the best estimate?

Mr Comley: The point I am making is that it is not my position or accountability to stand by a particular estimate or to revise that estimate between major updates. I would comment that much of the commentary about what is happening with carbon prices tends to have a very short-term focus. We are talking about a price which is three years away. We are also talking about a price in a market where there is current regulatory action by the European Union to directly influence that price. I suppose what I would say is that while I am not going to say that this is the best estimate or move away from the estimate in any way, I think there are quite reasonable arguments that that is not an implausible estimate of the price in 2015-16.

Senator BIRMINGHAM: Was it updated in this year's budget papers, in the last major economic statement of the government?

Mr Comley: I think it is fair to say that it was in with a range of parameters. They were all reconsidered. Whether there is any change made is a matter for the Treasury. My understanding is that there was not a change made in the budget from the previous parameter estimate in the previous major economic release. **Senator BIRMINGHAM:** Is that because the government believed it was still the best estimate or is it because it was too hard to model or estimate an update?

Mr Comley: Again, I think that is really a matter for Treasury.

Senator BIRMINGHAM: Mr Comley, I have given you numerous chances to say that the carbon price that will apply now in less than three years' time is an accurate price or a best estimate, and you are going to great lengths to avoid using anything that might sound remotely like a convincing endorsement of that price.

CHAIR: Senator Birmingham, this is a commentary on the response that you got. I do not think that is appropriate. Mr Comley—

Senator BIRMINGHAM: Mr Comley is quite able to respond.

CHAIR: It is not my view of what Mr Comley said. If you want to keep up the commentary, that is fine but, Mr Comley, you do not need to respond to any commentary.

Mr Comley: Thank you, Chair. I suppose what I am trying to do, Senator, is be very careful between two things. One thing is the institutional accountability within the government as to who makes and puts within the budget the estimate of the carbon price. I am probably taking a little bit of licence in going to areas of Treasury to be helpful to the committee but trying to draw that clear distinction between the institutional accountability for the carbon price into the budget, which is the Treasury, in the same way that the Treasury has institutional accountability for a range of estimates that figure in budget reckoning. The second thing—and where I think there is a slight distinction but it is related to the first—is what is actually happening in carbon markets at the moment and what that may mean for the future.

It is the case that in the institutional accountabilities within government we take great interest and monitor what is happening in carbon markets at the moment and what implications that may have for further budget estimates. We then provide that information to Treasury. What I have said to you is that it is not my role to stand by and endorse or reject any particular budget parameter and, given my understanding of carbon markets—particularly the European carbon market—I do not think the current market estimate is implausible.

Senator BIRMINGHAM: You do not think that the current estimate of $29 is implausible?

Mr Comley: No.

Senator BIRMINGHAM: Okay. If that is the best endorsement we can get for it, that is what I will take—the not implausible $29.[18]

...

Senator BIRMINGHAM: Indeed, which I appreciate is the nature of those markets. As to the changing variability of such prices, then, is it plausible that by 2016 the European carbon price could be $50?

Mr Comley: It is an interesting figure to pluck. Is it plausible? It is not what is in the budget papers as the current estimate, and I am not aware of any market commentators even outside the futures market that have picked that number. It is true, though, that in the recent past the European Union allowances did trade up to $50.

My recollection is that probably before the global financial crisis was the last time we saw a trade of around the $50 mark. In the sense that European

[18] Senate Environment and Communications Legislation Committee Proof Hansard, 15 October 2012, pp. 7-8

> Union units have traded at that price so is it completely conceivable, it is not completely inconceivable.[19]

1.22 Professor Paul Frijters and Cameron Murray gave evidence of a potential revenue variation of $6 billion based on differences between Treasury carbon price projections and their own expectations[20], while The Climate Institute highlighted that the totality of these latest changes by Labor would likely result in higher prices than would otherwise have been the case:

> Note that the EU price has been over $30 in the last three years. ... What can be predicted with confidence is that based on the proposed linkage and limits, Australian carbon prices in 2020 will likely be substantially higher than the recent forecasts...[21]

1.23 The simple fact is that if Labor's estimates of the future rate of the carbon tax prove too low, Australian households and businesses will face even higher electricity and other bills as a result, while if it is lower than forecast it will blow yet another hole in Labor's budget predictions.

Surrender limits for Kyoto units

1.24 Coalition Senators acknowledge concerns by submitters that sub-limits applying to Kyoto permits as a result of this legislation are at odds with the Government's stated intention to achieve lowest cost abatement:

> If the Australian coal producers are to reduce their emissions at least cost, they should be allowed unrestricted access to international permits. If Australia is happy to link with the European Union, why impose a constraint on the proportion of permits being purchased overseas? Why not go all the way to secure the lowest cost abatement solutions? There is also a policy determined quota of 12½ per cent for CDMs which represents a high cost to be paid as a trade-off for linkage with the EU price.[22]

> ...businesses can still only use international permits to acquit 50 per cent of their carbon tax liability. This restriction has been made more onerous by limiting the use of low-cost Kyoto carbon units to 12.5 per cent.[23]

> The limit proposed in the Bill is 12.5 per cent. ... the limitation ... introduces additional cost and uncertainty for liable entities and is inconsistent with the policy goal of reducing greenhouse gas emissions at least cost.[24]

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[19] Senate Environment and Communications Legislation Committee Proof Hansard, 15 October 2012, pp. 10-11

[20] Professor Paul Frijters and Cameron Murray, University of Queensland, *Submission 6*, p. 1

[21] The Climate Institute, *Submission 1*, p. 5

[22] Peter Morris, Australian Coal Association, *Proof Committee Hansard*, p. 8

[23] Australian Coal Association, *Submission 17*, p. 2

> ... the limit reduces our flexibility to meet our liabilities under the schemes and artificially increases our cost of compliance.[25]
>
> Sub thresholds are a major concern for the CIF. ... There has been little justification or rationalisation for this feature other than it was a condition of achieving an agreement.[26]

1.25 Once again the Gillard Government has been exposed through these changes of saying one thing, but doing another, to the detriment of Australian businesses and industry.

Carbon Tax is hurting Australian industry

1.26 Ultimately, while there are many concerns about specific detail within this legislation, the Coalition's greatest concerns remain those about the total cost of Australia's carbon tax, which is imposing greater costs on more of Australia's economy than any other vaguely similar scheme worldwide.

1.27 Submitters to the inquiry highlighted that these proposed changes do nothing to alter the bad fundamentals that lie at the heart of this policy, especially its costs and its impact on Australia's economic competitiveness:

> Despite the changes proposed in the Amendment Bill, Australia will still lock-in the world's highest economy-wide carbon tax for the next three years. While the EU permit price is currently around AUD$9 a tonne, the carbon tax locks in fixed carbon prices, starting at $23 a tonne and rising to $25.40 plus inflation over the next three years. This cost is simply not borne by competitors to Australia's coal export industry.[27]
>
> Imposing an additional cost on Australia's coal industry in the form of a carbon tax that is not imposed by our trade competitors simply diminishes our competitive advantage. ... Any loss in coal supply from Australia will be made up by one of our competitors in countries such as Canada, Colombia, Indonesia, Mongolia, Mozambique, Russia, South Africa and the US. ... Australia risks losing investment, export and taxation revenue and jobs, without actually realising the concomitant reduction in global emissions.[28]
>
> The current amendments, and the yet to be released regulations, create considerable uncertainty and disquiet for all gas market participants. ... AIGN does not support the approach taken in the Bill and we recommend further industry consultation on these matters. ... many of Australia's trade competitors are outside of the EU. Concerns with respect to international

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[24] Australian Petroleum Production and Exploration Association, *Submission 7*, p. 2

[25] Qantas Airways Limited, *Submission 15*, p.1

[26] Cement Industry Federation, *Submission 4*, p. 6

[27] Australian Coal Association, *Submission 17*, p. 1

[28] Australian Coal Association, *Submission 17*, p. 3

> competitiveness have not reduced as a result of the decision to legislate and operationalise a unilateral link with the EU ETS. ... Australian industry has concerns as to how will Australian competitiveness be 'preserved' if the EU continues to use policy drivers to change their scheme. The EU will do that in their interest which will not necessarily be in ours. It will simply drive up our costs and should be addressed in both the bilateral agreement and the regulation.[29]
>
> In terms of cement manufacturing, our major competitors are based in South East Asia.
>
> Australia is at risk of losing competitiveness against countries that do not have market based mechanisms to deal with carbon of a similar design to Australia's scheme.[30]
>
> .. the competitive challenge to Australian liquefied natural gas (LNG) projects continues to be from countries that are not taking action to introduce carbon pricing. Most importantly, a link between the Australian and EU schemes will do little to alter the fundamental cost/competitiveness issues facing the Australian LNG industry. Indeed, in the medium-term, should a higher EU-ETS price eventuate, this will place additional competitive pressure on trade-exposed industries, like LNG.[31]

1.28 Put simply, the carbon tax is a bad tax, which has a seriously negative impact on Australia's economic competitiveness and the cost of living pressures faced by all Australians. In some instances these changes look set to compound these problems, with no demonstrable improvement in the meagre environmental outcomes this tax purports to achieve.

Recommendation

1.29 That the Senate does not pass the bill; and, further, that it repeal the Clean Energy legislative package.

Senator David Bushby
Deputy Chair

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[29] Australian Industry Greenhouse Network, *Submission 16*, p. 3

[30] Cement Industry Federation, *Submission 4*, p. 4

[31] Australian Petroleum Production and Exploration Association, *Submission 7*, p. 2

Senator Alan Eggleston
Senator for Western Australia

Senator Simon Birmingham
Senator for South Australia

APPENDIX 1
Submissions received

Submission Number	Submitter
1	The Climate Institute
2	Business Council of Australia
3	Clean Energy Council
4	Cement Industry Federation
5	Greenfleet
6	Professor Paul Frijters and Cameron Murray
7	Australian Petroleum Production & Exploration Association (APPEA)
8	Australian Financial Markets Association (AFMA)
9	COzero
10	Institute of Chartered Accounts Australia (ICAA)
11	WWF-Australia
12	AGL Energy
13	International Emissions Trading Association (IETA)
14	Sustainable Business Australia
15	Qantas
16	Australian Industry Greenhouse Network (AIGN)
17	Australian Coal Association (ACA)
18	Institute of Public Affairs
19	Name withheld

Additional information received

- Answers to three Questions on Notice taken at a public hearing in Canberra on 19 October 2012, received from the Department of Climate Change and Energy Efficiency on 23 October 2012.

APPENDIX 2

Public Hearings and Witnesses

CANBERRA, 19 OCTOBER 2012

ABDURAHMAN, Mr Emile, Co-Chair, Australia/New Zealand Working Group, International Emissions Trading Association

BESLEY, Mr Daniel, Acting Director, Carbon Price Architecture, Department of Climate Change and Energy Efficiency

DOLMAN, Mr Benjamin Trevor, Acting General Manager, Macroeconomic Modelling Division, Treasury

DWYER, Mr Damian Michael, Director, Economics, Australian Petroleum Production and Exploration Association Limited

EL-ANSARY, Mr Yasser, General Manager, Leadership and Quality, Institute of Chartered Accountants Australia

FRIJTERS, Professor Paul, School of Economics, University of Queensland

GOSMAN, Mr Alex Tod, CEO, Australian Industry Greenhouse Network

JACKSON, Mr Erwin, Deputy Chief Executive Officer, The Climate Institute

MAGAREY, Mrs Geraldine, Manager, Sustainability and Regional Australia, Institute of Chartered Accountants Australia

McDERMOTT, Mr Jai, Acting Deputy Chief Executive, Australian Coal Association

MORRIS, Mr Peter, Director, Economic Policy, Australian Coal Association

MURRAY, Mr Cameron, School of Economics, University of Queensland

PANKOWSKI, Dr Andrew Henry, Director, Coverage Section, Department of Climate Change and Energy Efficiency

RAETHER, Mr Robert, Principal Adviser, Industry, Environment and Defence Division, Fiscal Group, Treasury

WHITE, Mr James Ronald, Assistant Secretary, Carbon Pricing and Markets Division, Department of Climate Change and Energy Efficiency

WRITER, Mr Simon, Acting First Assistant Secretary, Carbon Pricing and Markets Division, Department of Climate Change and Energy Efficiency