



**THE NEW CARBON FARMING
INITIATIVE AND EMISSIONS
REDUCTION FUND:
WHAT YOU NEED TO KNOW**

CLAYTON UTZ

www.claytonutz.com

The new Carbon Farming Initiative and Emissions Reduction Fund: What you need to know

Australia will once again have a legislative scheme intended to assist it achieve its 2020 emission reduction target. The passage of the Carbon Farming Initiative Amendment Bill (CFI Amendment Bill) to establish the Government's Emissions Reduction Fund also provides a much needed boost to Australia's domestic offset scheme, as well as a reprieve for a number of climate change advisory and finance agencies.

CARBON FARMING INITIATIVE AMENDMENT BILL

In June 2014, the Government introduced the CFI Amendment Bill into Parliament to establish the Emissions Reduction Fund (ERF), the centrepiece of its climate change policy.

The ERF proposes to fund emissions reductions by establishing a reverse auction process by which project proponents or aggregators can bid to supply emissions reductions to the Government from pre-approved emission reduction projects. Based on the Carbon Farming Initiative (CFI), the ERF proposes to build on the existing approved methodologies for emissions reductions, and expand them beyond the land sector.

The CFI Amendment Bill stalled in the Senate with insufficient support to pass the Bill in its then form.

After negotiations with the independent Senator Nick Xenophon and the Palmer United Party (PUP), the Government amended the Bill to secure its passage through the Senate. Key amendments contained in the Bill include:

- ▶ the extension of the standard contract period for the supply of emissions reductions to Government from 5 to 7 years, with an option for longer contract periods for projects with longer crediting periods;
- ▶ a legislative framework for a “safeguard mechanism” to regulate carbon emissions from major emission sources. This includes a legislative timeline for the establishment of the mechanism, including baselines and penalties. The safeguard mechanism however is not due to commence until 1 July 2016;
- ▶ enhanced powers for the Emissions Reduction Assurance Committee (ERAC). It will now be able to veto the approval of any methodology such that the Minister cannot make or amend a methodology if the ERAC considers that it is inconsistent with the offsets integrity standards. The ERAC can also recommend to the Minister the increase in crediting periods for particular methodologies;
- ▶ savannah burning projects will now have a 25 year crediting period, instead of a 7 year period.

The one significant amendment moved by Senator Xenophon that was not adopted was the proposal to create a “strategic reserve”; a \$500m fund to enable the Clean Energy Regulator (CER) to purchase eligible international emissions credits to ensure that Australia met its 2020 target.

The CFI Amendment Bill now must be passed by the House of Representatives which is not expected to occur until late November 2014 when Parliament resumes. This will be a formality. The Government has announced its intention to commence the first reverse auction under the ERF in the first quarter of 2015.

AGREEMENT WITH PUP

Other aspects of the agreement with PUP that did not feature in amendments to the CFI Amendment Bill include:

- ▶ the agreement of the government to withdraw its Bills to abolish the Climate Change Authority (CCA), the Clean Energy Finance Corporation and the Australian Renewable Energy Agency;
- ▶ the prioritisation of the development of methodologies for certain emissions reducing activities including energy efficient building and street lighting, energy efficiency for low income households and transport emissions reductions;
- ▶ the Minister’s proposed instruction to the CCA to undertake a “special review” to assess whether Australia should have an emissions trading scheme (ETS) in the future, and what conditions should trigger the introduction of an ETS. The review will also consider actions by key trading partners to introduce an ETS or equivalent schemes. The CCA is to be appropriately resourced in order to undertake this review;
- ▶ the Minister’s proposed request to the CCA to advise on what Australia’s emissions target should be post-2020, and what Australia should agree to as a target at the COP21 conference in Paris in 2015.

WHAT IS THE ERF?

The ERF is the centrepiece of the Government's Direct Action Plan. Funded with \$2.55bn, the ERF is a scheme to be operated by the CER by which the government will purchase Australian Carbon Credit Units (ACCUs) generated under the CFI.

The CFI Amendment Bill will amend the CFI legislation (primarily the Carbon Credits (Carbon Farming Initiative) Act 2011) to provide for Government's purchasing of ACCUs and to improve the efficiency and effectiveness of the key parts of the CFI scheme.

The ERF works through a reverse auction process by which the CER will invite bids from proponents of projects already approved under the CFI (or aggregators of ACCUs from such projects) to offer to supply emissions reductions in the form of ACCUs. Potential bidders will need to obtain pre-approval from the CER to participate in the auction. Although the auction rules are not yet publicly available, the Government has indicated that:

- ▶ bidders will submit an offer in a standard form, comprising a delivery schedule and a unit price; and
- ▶ the CER will then accept offers, starting with the lowest-priced, and continuing until either bids representing 80% of the abatement on offer at the auction have been accepted or there are no more projects bidding at below the CER's benchmark price (set by the government).

The Government will enter into standardised contracts with the successful bidders for the delivery of ACCUs.

The Government will only enter into a contract with successful bidders for a period not exceeding seven years (increased from five years in an earlier proposal for the ERF), although the CFI Amendment Bill will permit some exceptions.

The CFI Amendment Bill gives the CER a considerable amount of discretion as to how it purchases ACCUs, and the CER has already indicated that it may consider purchasing strategies outside of the proposed auction process (for example, individual contracts for very large-scale ACCU transactions).

The CER's existing carbon offsets register would be renamed the "Emissions Reduction Fund" register, and it would be expanded to include the name of each entity which has entered into an ERF contract, the contract duration, the number of units contracted to be sold and the number of units actually sold.

SAFEGUARDING EMISSIONS REDUCTIONS

The Government had not intended to legislate for the proposed safeguard mechanism until early 2015. Amendments to the National Greenhouse and Energy Reporting Act 2008 (NGER Act) to be made by the CFI Amendment Bill, however, now establish a framework for the safeguard mechanism and a timeframe for development of rules which will underpin it, including baselines and penalties.

The amendments introduce the concept of a "responsible emitter". Like a liable entity under the Carbon Price Mechanism, a responsible emitter is the person with operational control of a facility which is a designated large facility. The emitter will be obliged to prevent the net emissions from that facility exceeding the baselines emissions levels during a monitoring period. A monitoring period can be a financial year, or be declared to be a multi-year period. The relevant obligation will commence after 1 July 2016.

A vexed issue in the debate over the safeguard mechanism has been whether a penalty should be imposed for exceeding a facility's emissions baseline in any reporting period. The Government accepted as part of its compromise with the cross-bench senators that civil penalties will apply to a failure to comply with obligations under the safeguard mechanism. The amount of the penalty has yet to be prescribed, but the Government has already indicated that any penalty regime will be revenue neutral. An option for responsible emitters who exceed their baselines is to meet their obligation by acquiring and surrendering to the Government ACCUs. The amount of the civil penalty may therefore be an important influence on the market price for ACCUs.

The Minister is required to take all reasonable steps to develop the rules for the safeguard mechanism no later than 1 October 2015 (section 61 to be included in the NGER Act). Those rules will need to address a number of critical issues with the design of the scheme, most importantly how baselines for facilities are to be calculated and what facilities will be covered and the relevant threshold.

A ROLE FOR INTERNATIONAL CREDITS?

There has always been concern from some stakeholders that the ERF, by itself, is insufficient to achieve Australia's 5% emissions reduction target. The concept of a strategic reserve of funds as proposed by Senator Xenophon would have provided the Government with the ability to purchase eligible international credits to meet any short fall. The passage of the CFI Amendment Bill without the amendments to establish a strategic reserve arguably presents another fillip to the domestic offsets sector.

However there may still be scope for international emissions credits to have a role in Australia through the Safeguard Mechanism. Under section 22XM to be included in the NGER Act, responsible emitters will be able to use ACCUs generated under the CFI or other units prescribed by the safeguard rules to ensure that emissions do not exceed set baselines. The section expressly states that "[i]t is immaterial whether a unit specified in the safeguard rules was issued in or outside Australia". This leaves open the potential for eligible international credits to be prescribed by the rules.

Whether there will be a demand for credits, domestic or otherwise, will depend on a number of factors, not least the level at which baselines are set. While these details are yet to be worked out, the Government's stated position is that baselines will be set using absolute historical emissions without any mechanism to reduce the baselines over time. Whether this remains its position is likely to be influenced by the outcome of international negotiations and any post-2020 reduction target it agrees to in 2015.

WHAT'S THE PROSPECT OF AN ETS?

Perhaps one of the more puzzling aspects of the agreement that the Government brokered with PUP to get the CFI Amendment Bill passed is the proposal for the CCA to investigate the option and circumstances in which Australia might adopt an ETS. Having just supported the repeal of the Clean Energy Act which contained an ETS, PUP required that the Government commit to this review as part of the price for its support for the Bill. Although it is only a commitment to have the CCA undertake a review, and the Government has made clear that it will not introduce an ETS, given the evolution (and devolution) of climate change policy in Australia over the years, nothing can be taken as written in stone (or blood for that matter).

CONTACTS



Brendan Bateman
Partner
T +61 2 9353 4224
bbateman@claytonutz.com



Brad Wylynko
Partner
T +61 8 9426 8552
bwylynko@claytonutz.com



Graeme Dennis
Partner
T +61 2 9353 4106
gdennis@claytonutz.com



Nick Thomas
Partner
T +61 2 9353 4751
nthomas@claytonutz.com

Sydney
Level 15
1 Bligh Street
Sydney NSW 2000
+61 2 9353 4000

Melbourne
Level 18
333 Collins Street
Melbourne VIC 3000
+61 3 9286 6000

Brisbane
Level 28
Riparian Plaza
71 Eagle Street
Brisbane QLD 4000
+61 7 3292 7000

Perth
Level 27
QV.1 Building
250 St Georges Terrace
Perth WA 6000
+61 8 9426 8000

Canberra
Level 10
NewActon Nishi
2 Phillip Law Street
Canberra ACT 2601
+61 2 6279 4000

Darwin
17–19 Lindsay Street
Darwin NT 0800
+61 8 8943 2555

www.claytonutz.com

Persons listed may not be admitted
in all states and territories. This document
is intended to provide general information.
The contents do not constitute legal advice
and should not be relied upon as such.
© Clayton Utz 2014

CLAYTON UTZ