

Design and Operation of the Proposed Carbon Pollution Reduction Scheme

Presentation to Legalwise Climate Change Law Seminar

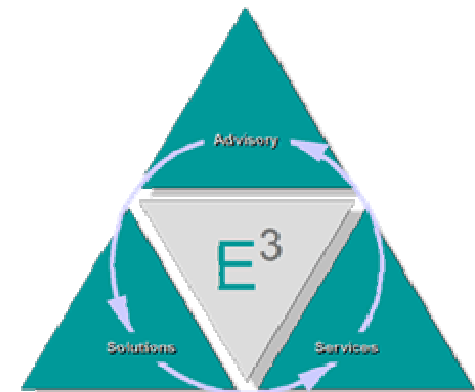
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Srian Abeysuriya
Principal – E3 International
(02) 9868 1422
sriana@e3international.com

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Overview

- **Context**
- **Cap and Trade Overview**
- **Key Design Elements**
- **The Market in Operation**
- **Implications**

The imperative we face...

Outcome or impact	450 mitigation	550 mitigation	No mitigation
2100 temperature from pre-industrial	1.3–2.6°C	1.6–3.2°C	3.5–7.1°C
(a) Percentage of species at risk of extinction	5–23%	8–39%	48–100%
(b) Likelihood of initiating irreversible melt of the Greenland ice sheet	6–54%	12–77%	85–100%
(c) Percentage of mortality in tolerant coral species	0–79%	44–87%	90–100%

Targets and trajectories, Supplementary Draft Report, Garnaut Climate Change Review, September 2008

“Human progress is neither automatic nor inevitable. We are faced now with the fact that tomorrow is today. We are confronted with the fierce urgency of now. In this unfolding conundrum of life and history there is such a thing as being too late... We may cry out desperately for time to pause in her passage, but time is deaf to every plea and rushes on. Over the bleached bones and jumbled residues of numerous civilizations are written the pathetic words: Too late.”

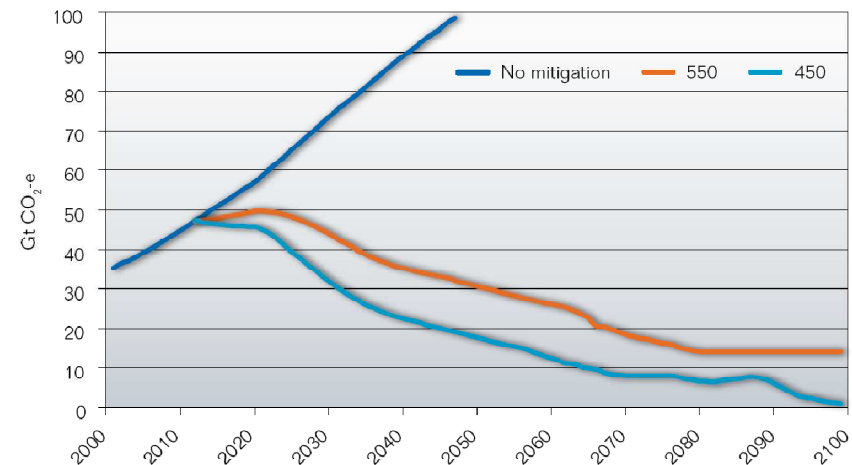
Martin Luther King Jr. ‘Where do we go from here: chaos or community’

Context

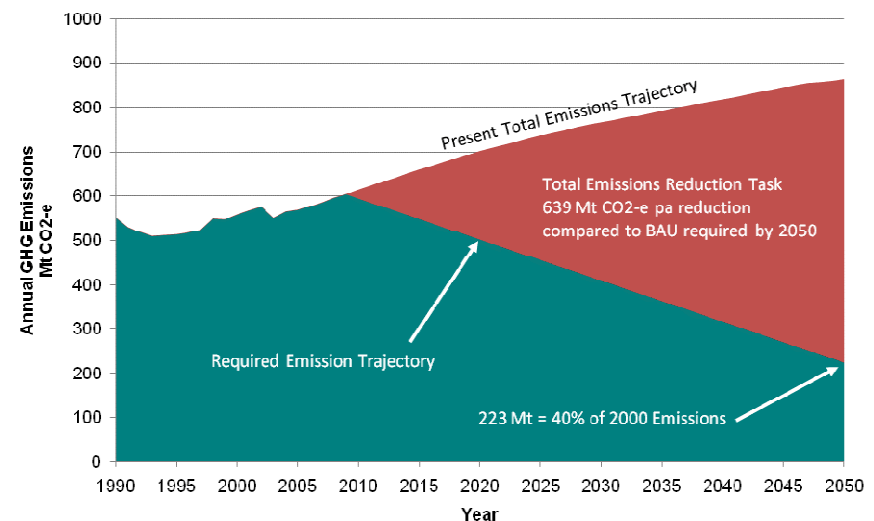
- **National Emissions Targets**
 - Reducing emissions to 60% of 2000 levels by 2050
 - 5% unconditional
 - 15% if agreement by major developing economies to substantially restrain emissions and by advanced economies take on commitments comparable to Australia's.
 - 25% if the world agrees to stabilise CO₂-e @ 450 ppm or lower
- **Central strategy is the CPRS.**
 - Cap and trade
 - Preferred design set out in draft legislation and White Paper.
 - Original start of 1 July 2010; now deferred by 12 months

Alternative Global Emissions Trajectories

Garnaut Climate Change Review – Final Report



Australia's Abatement Task



Cap and Trade 101

Trading ensures that compliance is achieved by all three parties at the lowest total cost; No physical limit on individual emissions

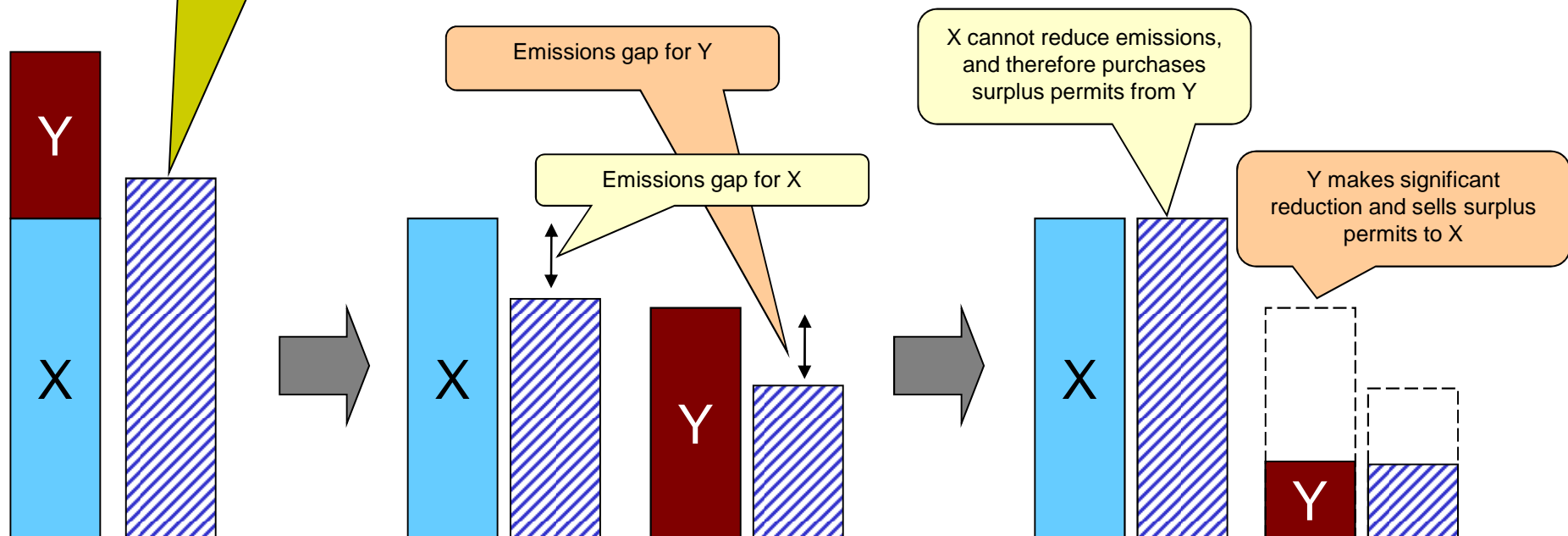
Setting the cap

Permit Allocation

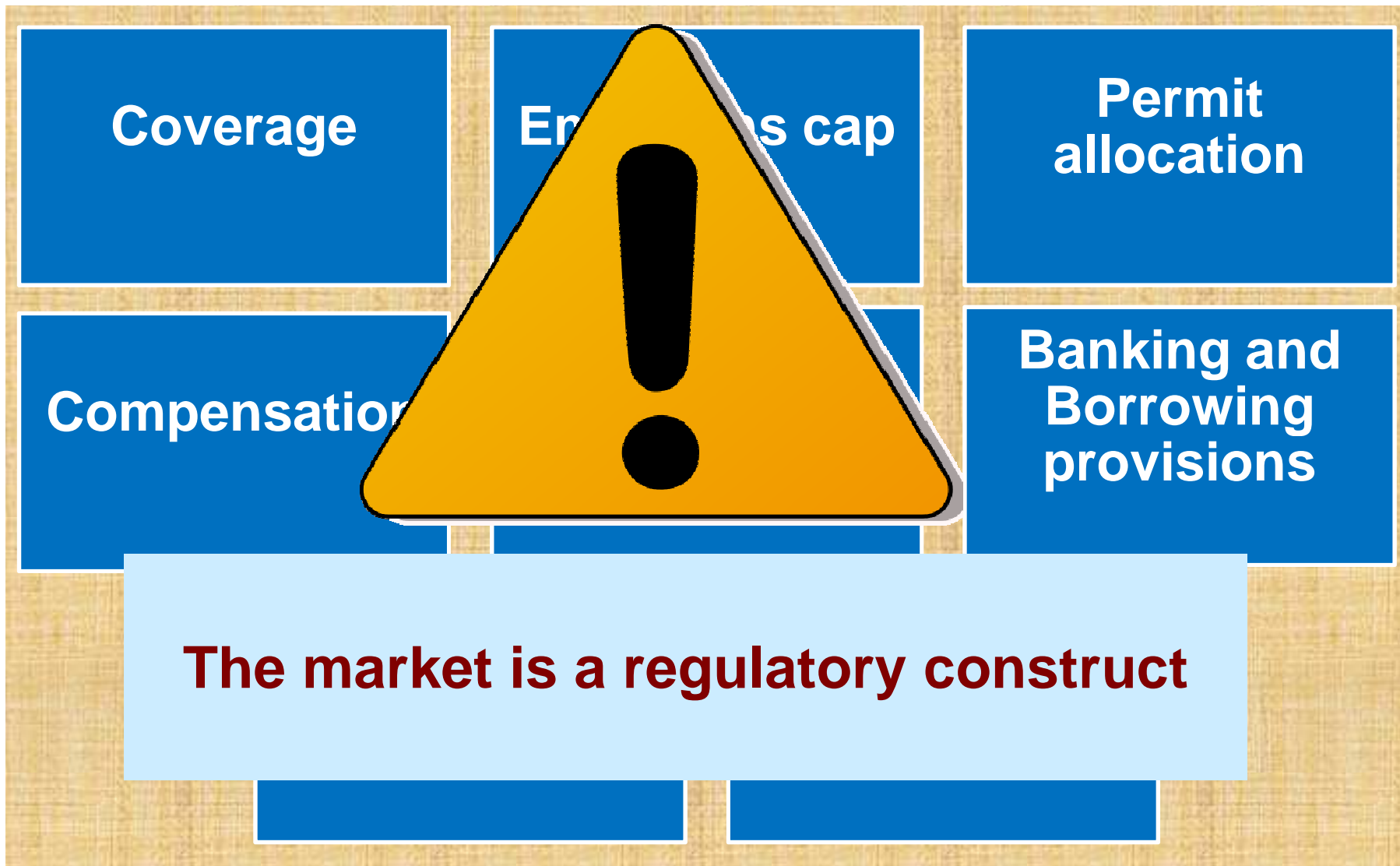
Trading and Compliance

Emissions cap = total permits. Shortfall equals reduction task

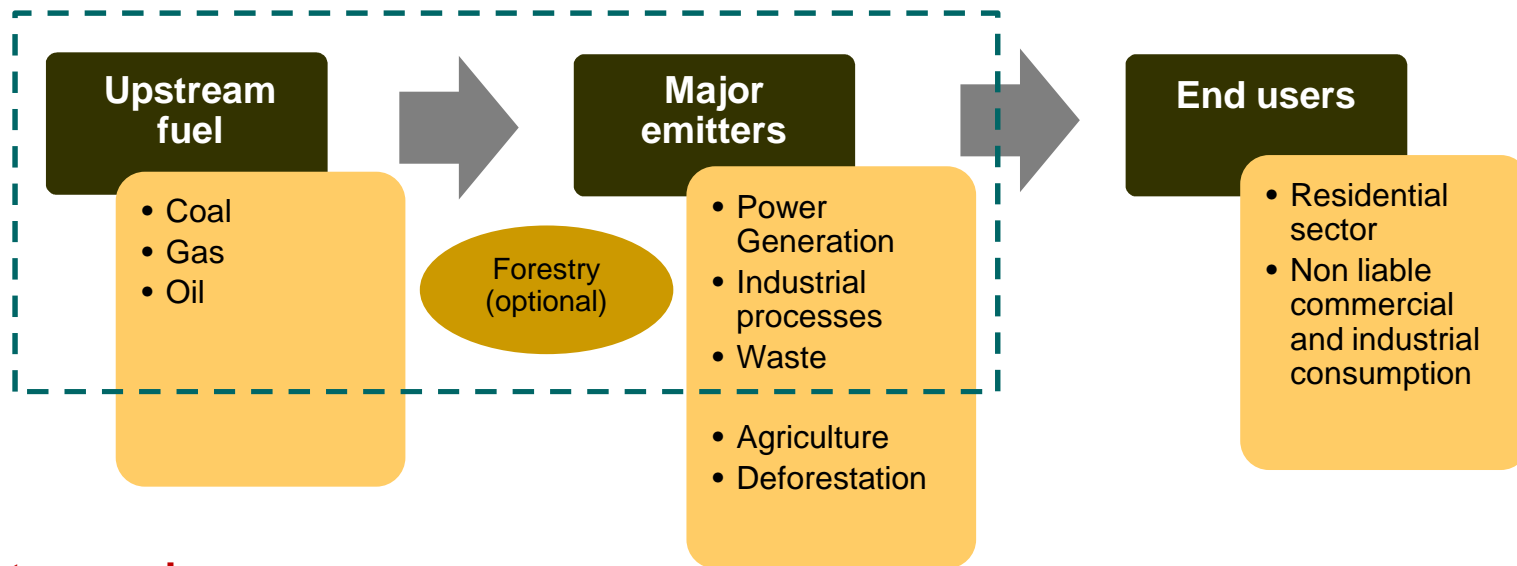
- World comprises of 2 emitters – X and Y
- Emissions cap is set below the sum of current emissions from X and Y
- X cannot make any emissions reductions; Y is able to make significant reductions.
- Y trades surplus permits with X leading to least cost reduction for total market (X + Y)



Key Design Elements



Coverage



- **Sectors and gases**

- Stationary energy, transport, fugitive emissions, industrial processes, waste
- All six greenhouse gases
- Approx 75% of national emissions

- **Principal liable parties**

- Liability on corporate groups
- Major emitters (>25Kt); fuel importers producers and suppliers
- Provision to transfer obligation & liability
- Reporting via NGERS

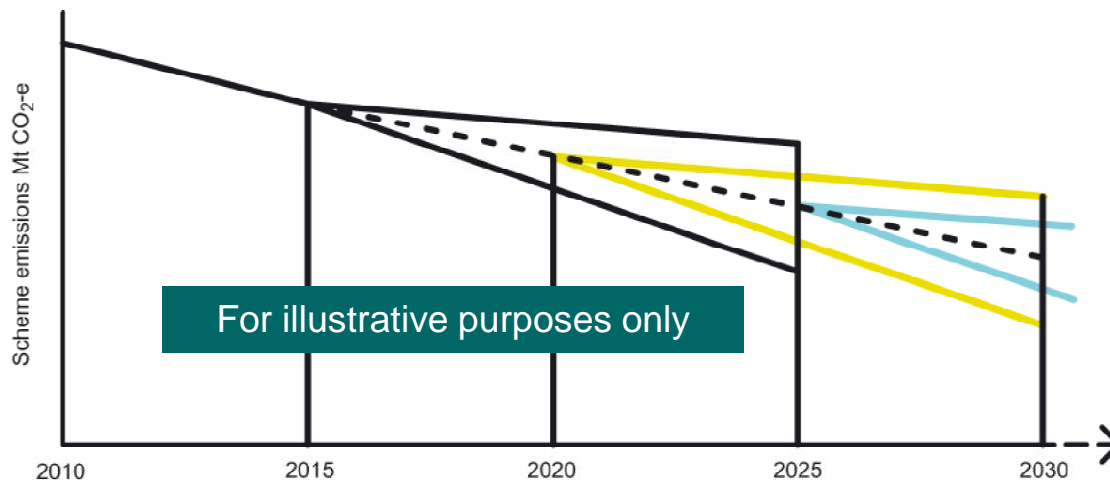
Emissions cap – What is the reduction pathway?

- **Scheme Caps**

- Lower than national targets (due to uncovered sectors)
- Specified in regulations
- Will reflect targets, international policy, economic considerations, emissions in uncovered sectors and voluntary action,
- Announced at least 5 years in advance
- Gateways (upper and lower bounds)



= # of Permits



Source: CPRS White Paper , December 2008

**Rolling caps + Gateways
provide way of balancing:**

- flexibility to change trajectory
- Market certainty

Permit Allocation – How will cap be distributed?

- **Emissions intensive trade exposed (EITE) sectors**

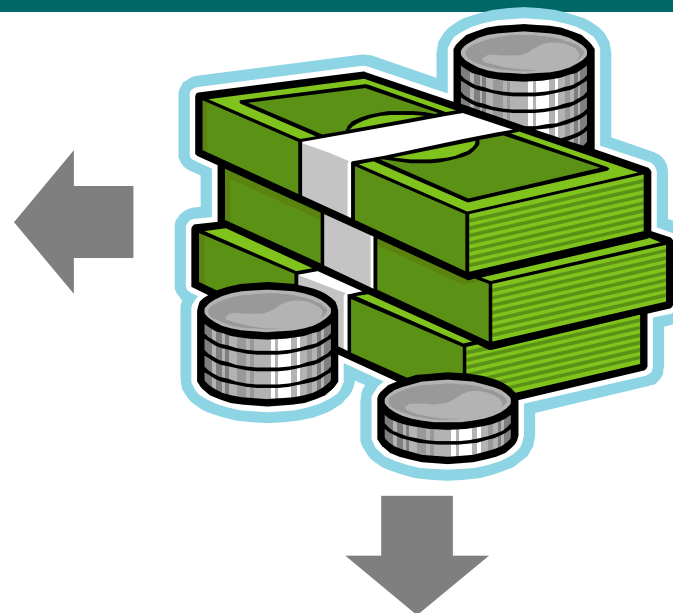
- *Eligibility*: definition of trade exposure, threshold for qualification
- *Assistance rate*: 90% or 60% of fixed historical baseline (direct + indirect emissions); rates reduce at 1.3% per year
- Rules for new and closing facilities
- 5 years notice of any changes

- **Coal fired electricity generators**

- Addresses investor perceptions of regulatory risk by partially offsetting loss of value
- Total of 130.7 million permits over 5 years (~26.1 million permits per year)
- *Beneficiaries*: existing or committed assets as at 3 June 2007; GHG intensity > 0.86 tCO₂-e/MWh
- Windfall gains test for last 2 years

- **Auctions**

- Double sided ascending clock; 12 per year; multiple vintages
- Move to 100% over time
- Cashflow impacts



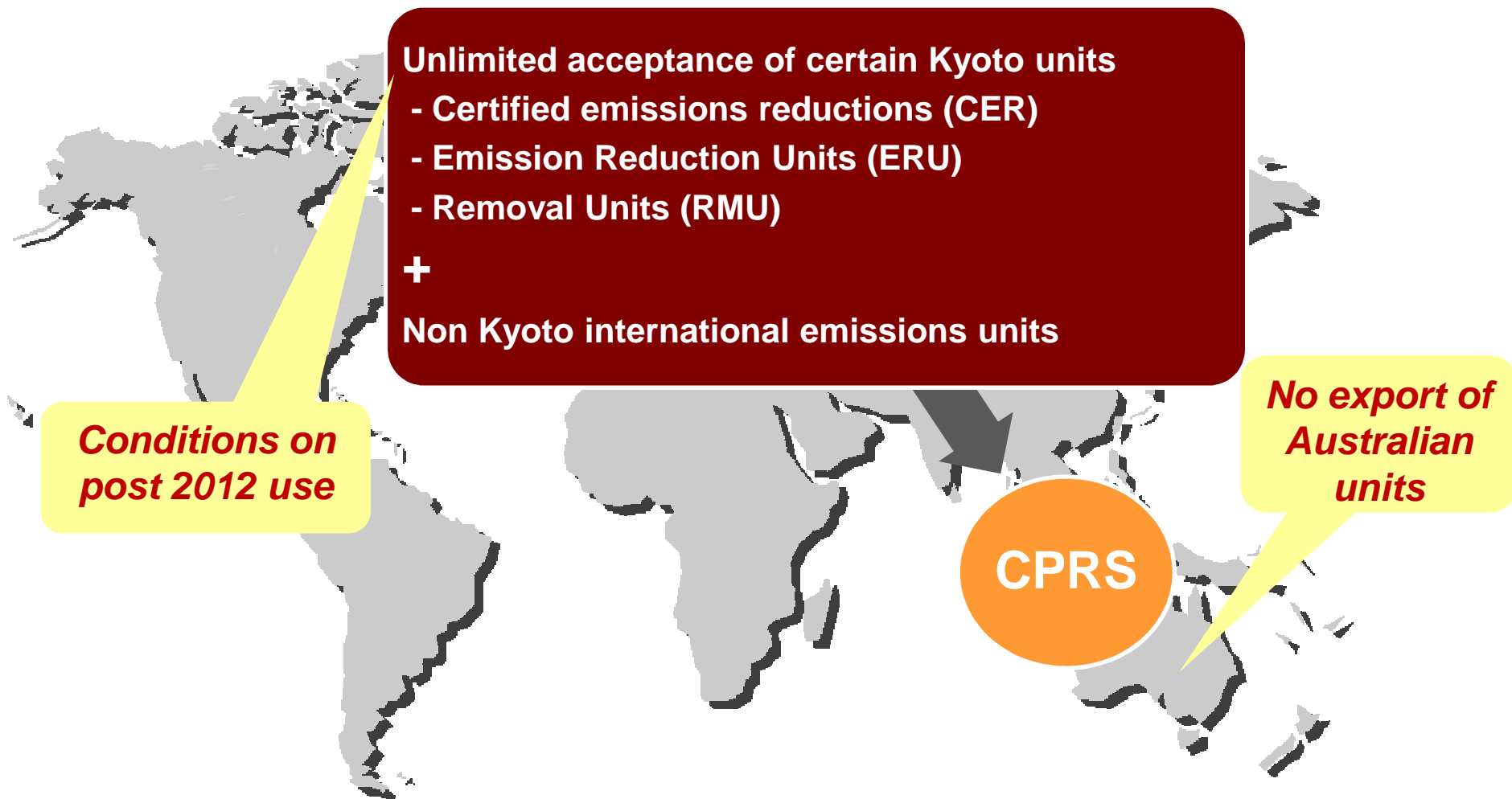
Offsets – Emissions reductions outside covered sectors

- **Interchangeable with permits**
- **Domestic + International**
- **Wide coverage**
 - Limited scope for domestic offsets
 - Renewable energy and energy efficiency are not eligible
- **Domestic avenues**
 - Forestry
 - Destruction of synthetic greenhouse gases



Increases the abatement pool and therefore lowers the cost of compliance.....but compromises integrity of the cap

International Linkages – Acceptance of international units



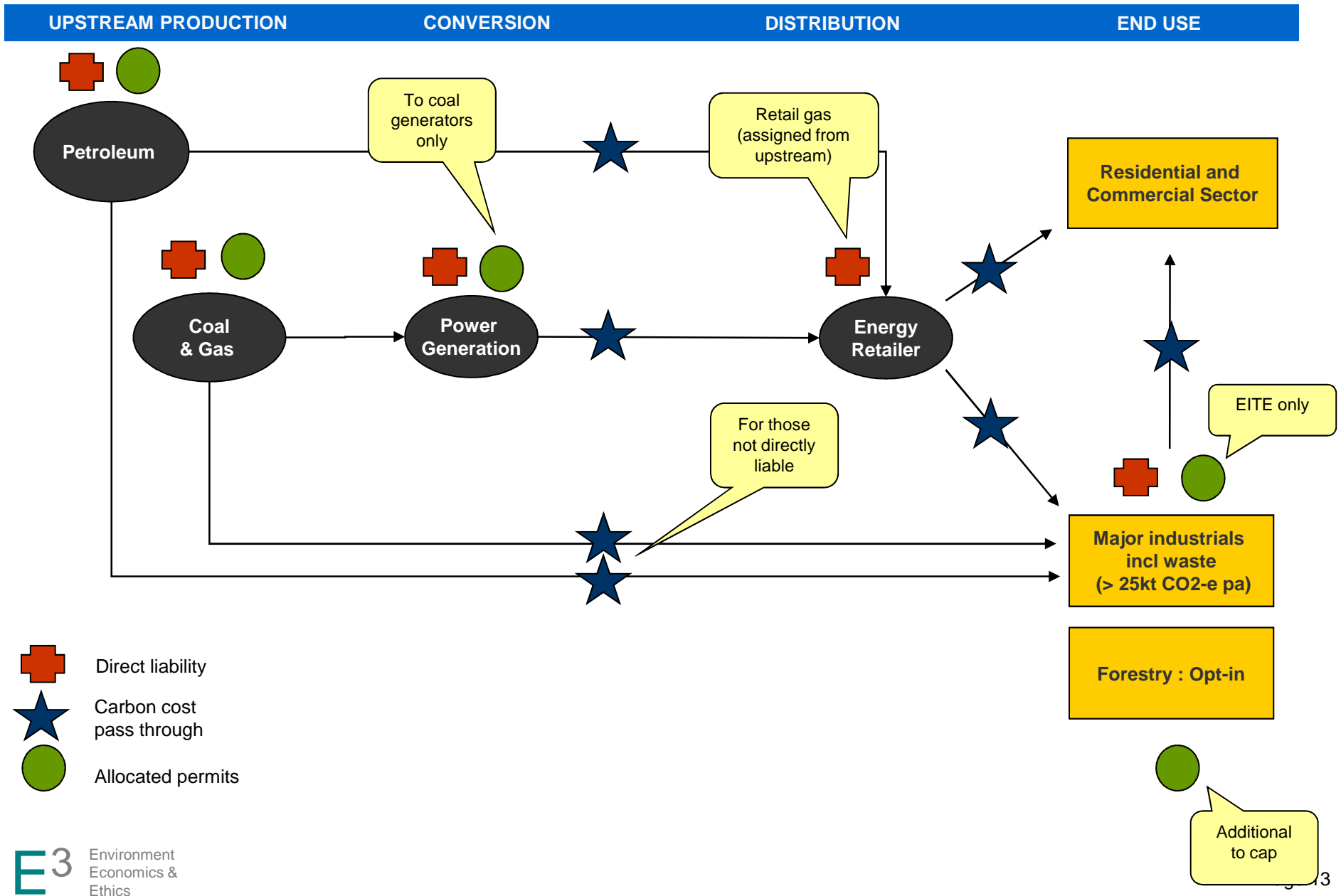
Effect on domestic carbon price depends on supply demand balance

Penalty for Non Compliance

- **Could be set to:**
 - Manage compliance costs; or
 - Ensure that the emissions cap is achieved (eg., EU ETS penalty = 100 euro/t CO₂)
- **CPRS Proposal**
 - *“To be effective, this penalty will need to be significantly above the cost of compliance under the Scheme”* (White Paper)
 - Plus ‘make good’ provision
- **5 year price cap**
 - Issue of unlimited permits to meet any shortfalls during first 5 years
 - Starting at \$40/tCO₂-e and increasing by 5% in real terms



Liability, Permit allocation and Cost Pass Through Under the CPRS

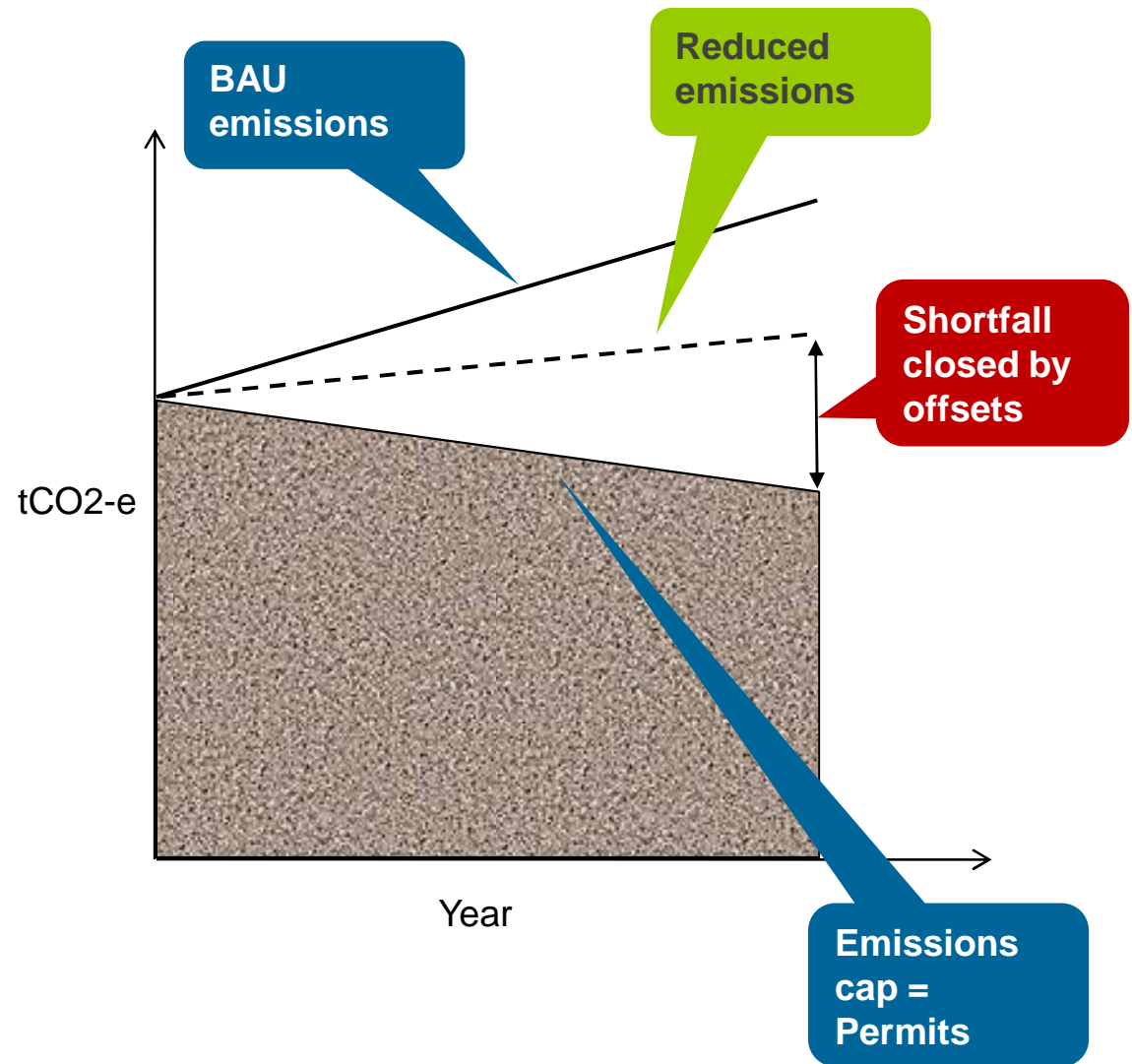


Changes to Draft Legislation (May 2009)

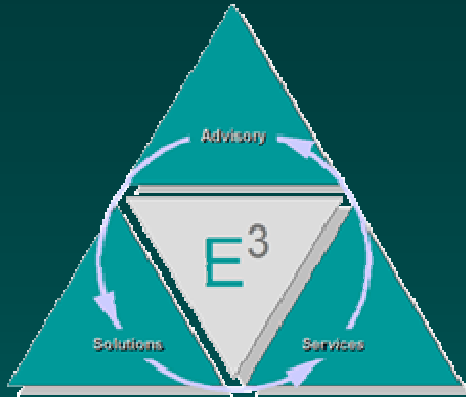
- **Phased start**
 - Obligations on liable entities deferred to 2011-12.
 - Auctions commence in 2010-11, for permits used to meet obligations in the 2012-13 and following financial years
 - Forestry projects can earn permits from 1 July 2010
- **Scheme caps are no longer required for 2010-11 and 2011-12**
 - Caps for 2012-13 to 2014-15 to be set before 1 July 2010, after UNFCCC Copenhagen conference
- **Price cap**
 - Unlimited permits at \$10 for 2010-11; thereafter joins White Paper trajectory
 - Provision for government to buy back surplus at \$10
- **Enhanced EITE compensation**

Carbon Price Drivers

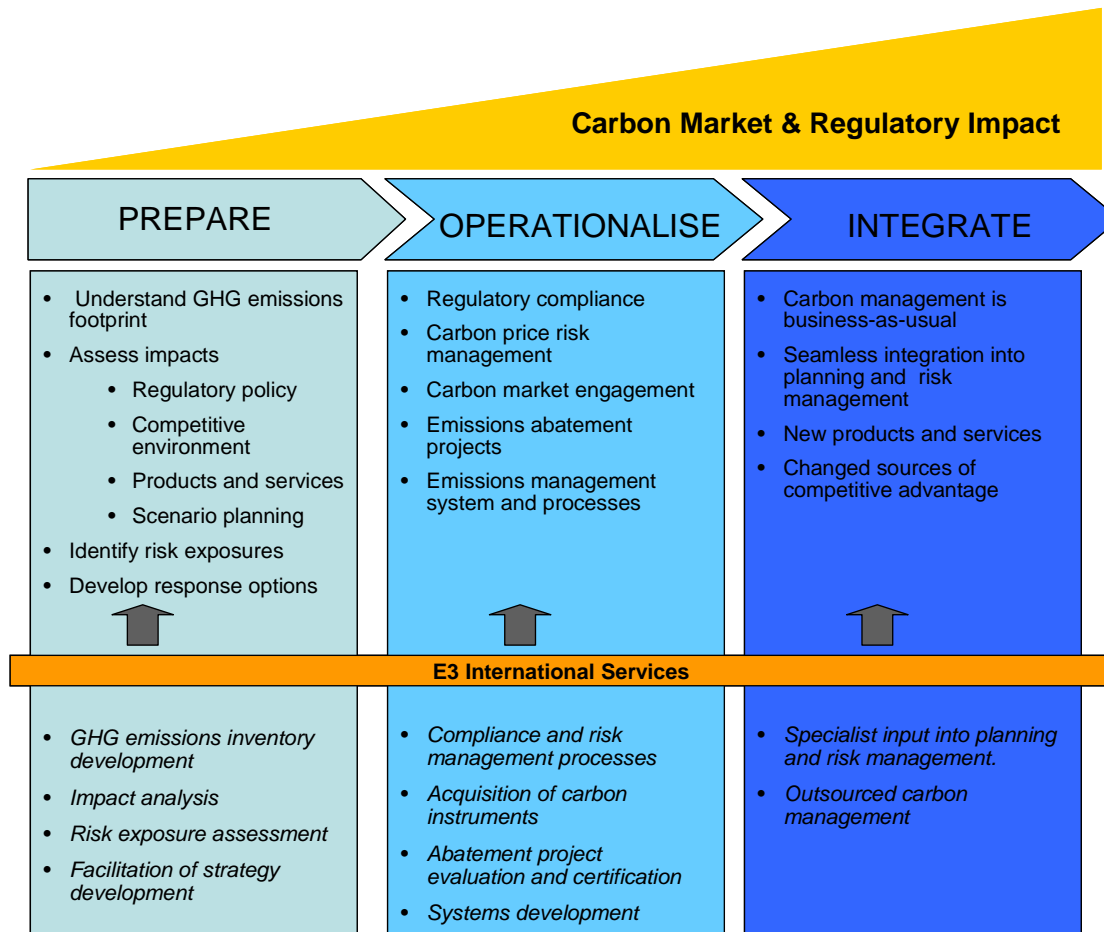
- **Carbon price set by supply/demand balance**
- **Demand = Liability = GHG Emissions**
 - Influenced by
 - economic conditions
 - abatement (including voluntary) within covered sectors
 - Renewable Energy Target
- **Supply = Permits (i.e cap) + offsets**
 - Influenced by:
 - Cost of offsets
 - Prices in linked jurisdictions
 - Trading strategies



QUESTIONS?



E3 International is a niche consultancy delivering pragmatic solutions to the pressures and opportunities arising from market-orientated environmental regulation



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