FACT Sheet: Regulatory Framework

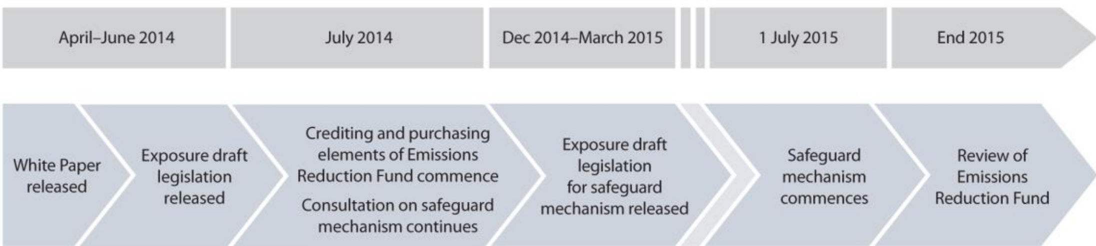
Emissions Reduction Fund update

The Carbon Pricing Mechanism was successfully repealed by the Senate on July 18. All eyes are now on the government's ability to secure support for its Carbon Farming Initiative (CFI) Amendment Bill, establishing the first phase of its Direct Action Plan (DAP), being the Emissions Reduction Fund (ERF).

The CFI Amendment Bill is expected to return to the Senate on August 26. If passed, the first auction for the ERF will be held prior to the end of this year, the October quarter of 2014.

The design of the safeguard mechanism (or 'penalty' mechanism imposed to liable entities emitting more than their baseline) is expected to commence in July 2015. The safeguard mechanism are an integral part of the ERF. See figure 1.7 from the whitepaper.

Figure 1.7: Implementation timeline for the Emissions Reduction Fund



Characteristics of the ERF

ERF FUNDING

The Government has committed AU$2.55 billion for direct purchase of Australian Carbon Credit Units (ACCUs) under the ERF.

STEPS TO PARTICIPATE

Step 1—Estimate emissions reductions and register project (Step 1 and 2 under the CFI)
Project proponents will use an approved method (previously read as methodology determination under the CFI) to estimate the likely emissions from their proposed projects. The Government will provide guidelines and estimation tools to help proponents to do this.

Proponents will register their emissions reduction projects with the Clean Energy Regulator. Proponents can also register to participate in a forthcoming auction. Prior to the auction, the Regulator will check the following:

- the identity, probity and capability of the proponent
- that the project is consistent with an approved method
- the proponent's legal right to undertake the project and the existence of any necessary consents by landholders for sequestration projects
- the commercial readiness of the project, and
- the credibility of the proponent's emissions reduction estimates.

This pre-qualification process will involve due diligence checks to ensure that projects can generate the stated emissions reductions within the timeframes indicated.

Step 2—Submit auction bid
Proponents of approved projects can submit a bid into the auction to sell emissions reductions on the basis of price per tonne of carbon dioxide equivalent (tCO2-e). Auctions will be designed to achieve the best value for money.

Step 3—Enter into a contract
Successful bidders will enter into contracts in which the Government agrees to purchase emissions reductions from their projects. Contracts will include provisions to 'make-good', unless under-delivery is not reasonably within the control of the proponent.

Step 4—Report project abatement and receive payment for contracted credits (step 3.4.5 and 6 under the CFI)
Proponents will undertake their projects and report their emissions reductions to the Clean Energy Regulator. The ERF will provide proponents with flexibility to report any duration between six months and two years. Longer reporting periods up to five years will be available for sequestration projects with longer

crediting periods. The Regulator will verify reports and issue credits to the proponent. These credits will be recognized as Australian Carbon Credit Units (ACCUs), as currently occurs under the CFI.

Proponents will receive payment from the Regulator for credits at the contract price.

ACCUs will constitute a personal property, giving project proponent the flexibility to sell their ACCUs into the ERF or to use them in other ways, such as in voluntary offset programs.

It will be possible for overseas buyers to own ACCUs. However, the Australian Government will not export credits into foreign registries for at least three years as this will make it harder for Australia to meet its five per cent emissions reduction target.

EXISTING CFI METHODOLOGIES (under the ERF referred to as Methods)

Methodologies made under the CFI legislation will continue to apply but will be simplified to make them easier and more cost-effective to use. CFI participants will be able to decide whether to continue with existing methods or transfer their projects to applicable updated methods.

ADDITIONALITY AND COMMON PRACTICE

Consistent with the CFI, only project activities that go beyond business as usual are eligible. Projects that have already passed the additionality tests under the CFI will remain eligible under the ERF for the remainder of their crediting period.

The positive list under the CFI is removed from the CFI Amendment Bill. Instead, under the ERF project proponents need to determine what the emissions would have been in the absence of the ERF. The so-called baseline emissions or the 'Alternative emissions scenario'. The method will determine how the baseline approach and the associated baseline emissions.

CREDITING PERIOD

The crediting period is the period of time over which a project is likely to deliver additional emissions reductions and can create ACCUs. The crediting period is different to the contract period.

Consistent with the CFI, the standard crediting period under the ERF will be seven years with reforestation (and soil carbon) activities having a fifteen years crediting period. Variations to these crediting period may apply provided well justified in the method.

PROJECT APPROVAL AND AGGREGATION

To simplify approval of projects under the ERF, the Government will amend existing CFI rules so that project start dates are the same for the land sector as for other ERF projects.

Under the streamlined arrangements, projects from all sectors will need to start after they are registered by the Clean Energy Regulator and cannot be backdated.

Where existing CFI provisions allow a project commencement date earlier than 1 July 2014, projects will have 12 months after the start of the ERF to register under those rules.

The ERF will encourage aggregation by removing barriers that might otherwise prevent companies and other organisations from developing business models to create economies of scale. Under the existing CFI, forestry and soil carbon projects can be aggregated only if the project developer owns or has a property interest in the project area. These arrangements will be streamlined under the ERF so that a project aggregator must only show that it has the agreement of landholders to participate in the project

PERMANANENCE

Under the CFI, forestry, revegetation and soil carbon projects (called 'carbon sequestration projects') are subject to a 100-year permanence obligation. This means that carbon stores must, on average, remain on the site for 100 years because the environmental benefits from these projects can be lost when vegetation is cleared or soil carbon is lost and not replaced.

The 100-year permanence rule also means that sequestration credits are seen as equivalent to credits from other emissions reduction activities and have the same value.

However, the 100-year rule can be a significant barrier for some types of sequestration projects, particularly for soil carbon and replanting projects. The ERF includes a 25-year permanence option for sequestration projects. If opted for, the number of ACCUs issued for these projects will be discounted by 20 per cent relative to 100-year projects. This discount reflects the potential cost to Government of replacing carbon stores if 25-year projects are discontinued.

Land managers will retain the option of undertaking projects that will remain in place for 100 years. Land managers will be able to agree to the full permanence period and receive the full carbon value for their project. Existing CFI project proponents will be able to choose to move to the shorter permanence period by relinquishing credits in line with the discount rate.

The new permanence option will not affect the 'risk of reversal' buffer that currently applies to all sequestration projects. Under existing CFI, a risk buffer of five per cent is applied to such projects, meaning that for every 100 tonnes of carbon stored by a project, 95 ACCUs are issued. This buffer means that a project proponent does not have to replace credits if carbon stores are lost because of natural events such as a bushfire.

AUCTION

The Clean Energy Regulator will conduct auctions to purchase ACCUs at the lowest available cost. The auctions will start in the fourth quarter of 2014, and will be run quarterly. The Clean Energy Regulator will set a benchmark price for each auction, above which bids will not be considered.

Auctions will be conducted solely with regard to the criterion of cost, with other project attributes such as project risk and commercial readiness being assessed in the pre-qualification phase. This process will ensure that all projects meet minimum requirements, rather than ranking or weighting bids.

Participants will submit a bid—specifying a price per tonne of emissions reductions—with the lowest-cost projects being selected. Participants will not be able to see what other companies are bidding as bids will be 'sealed' or secret. Successful participants will be paid the price that they bid (often called a 'pay-as-bid' auction).

To ensure value for money, the Clean Energy Regulator will apply a benchmark price—which is the maximum amount it will pay for emissions reductions. Only bids costing less than the benchmark price will be considered.

The Clean Energy Regulator will set the benchmark price in advance of each auction, having regard to factors such as:

- the overall objective of achieving low-cost emissions reductions
- the observed cost per tonne of emissions reductions in projects previously bid at auction
- the amount of funding allocated at previous auctions, and
- emissions reductions required to meet the five per cent target.

The Government has settled on an initial minimum bid size of 2000 tonnes of ACCUs a year on average over the life of the contract.

CONTRACTS

The Government will design standardized contract including the following terms:

- The Government will enter into five year contracts with successful bidders.
- The ERF will not provide upfront payment for emissions reductions.
- The contracts will include make-good provisions to support the delivery of emissions reductions.
- Make-good provisions will apply if a proponent is unable to deliver emissions reductions through their own project. A proponent that does

not deliver contracted emissions reductions can obtain emissions reductions from another project.
- The Government will pay the contract price originally established at auction for emissions reductions delivered under make-good provisions.
- Liquidated damages may be imposed and payable by the proponent if make-good requirements are not met.

Replacement credits must be sourced from domestic projects to ensure that ERF monies are directed towards reducing Australia's emissions, improving the productivity of Australian businesses and supporting the domestic carbon market.

SAFEGUARDING EMISSION REDUCTIONS

Under the ERF, liable entities need to keep emissions below or at their historical baseline emissions. If not, safeguard mechanism will apply the details of which are still to be determined through consultations.

The safeguard mechanism will commence from 1 July 2015, to enable this consultation process with businesses on policy detail.

The safeguard mechanism will only apply to a small number of large facilities currently reporting information under the National Greenhouse and Energy Reporting Scheme. It will not require new mandatory reporting obligations.

Specific provision will be made for new projects that will play an integral role in Australia's economic development.

No revenue from firms is sought, nor will any be budgeted by the Government, as part of the safeguard mechanism.

What is the position of landholders?

Landholders will continue to receive a financial incentive for project activities that sequester or reduce emissions, provided they meet the CFI standard and proposed amendments under the CFI Amendment Bill as explained above.

Landholders will be able to sell ACCUs under the ERF or directly to liable entities on the secondary market. For the coming three years no export of ACCUs is allowed and this restriction is likely to continue during the full ERF period.

Further Information

For further information, call CarbonQuest Australia on 08 9938 0110 or email info@carbonquestaustralia.com.au