EXPLANATORY STATEMENT

Issued by the authority of the Minister for Climate Change, Industry and Innovation

Clean Energy Act 2011

Clean Energy (Reference Price Method) Determination 2013

Purpose

Section 196A of the Clean Energy Act 2011 (the Act) provides that the Minister may, by legislative instrument, determine the method that is to be used by the Clean Energy Regulator to declare the reference price for the per-tonne carbon price equivalent.

The Clean Energy (Reference Price Method) Determination 2013 (the Determination) establishes the methodology that the Clean Energy Regulator must use to calculate the reference price for the per-tonne carbon price equivalent.

The intended purpose of the methodology set out in the Determination does not extend beyond equivalent carbon pricing. Other uses of the reference price are not endorsed in any way by the Commonwealth.

Background

The Act establishes a mechanism to deal with climate change by encouraging reductions in greenhouse gases by placing a price on carbon. This includes eligible liquid fuels, gaseous fuels and synthetic greenhouse gases being subject to a carbon price known as the ‘per-tonne carbon price equivalent’ starting from 1 July 2015.

The per-tonne carbon price equivalent is the weighted sum of the average price paid at domestic carbon unit auctions and an international reference price component. The method used by the Clean Energy Regulator to determine the reference price is the subject of this Determination.

Legislative basis

Subsection 196A(6) of the Act provides that the Minister may, by legislative instrument, determine the method that is to be used by the Clean Energy Regulator to declare the reference price for the per-tonne carbon price equivalent as required under subsection 196A(5).

Under subsection 196A(7) of the Act, in making a determination under subsection 196A(6), the Minister must have regard to:

- prices paid (whether in or outside Australia) for eligible international emissions units included in each of the relevant classes of eligible international emissions units; and
- such other matters (if any) as the Minister considers relevant.
Under subsection 196A(8) of the Act, the Regulator must comply with this Determination.

Consultation
The Australian Government undertook a consultation process with stakeholders, comprising entities liable under the per-tonne carbon price equivalent as well as representatives from the financial services sector and other market experts, as part of the development of the Determination.

In April 2013, stakeholders were invited to provide submissions on a Departmental position paper on the reference price methodology. The final form of the Determination takes into account views from these submissions.

Detailed description of the Determination
Details of the Determination are set out at Attachment A.

Statement of compatibility with human rights
A statement of compatibility with human rights for the purposes of Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 is set out at Attachment B.
Details of the Determination

Section 1 – Name of Determination

Section 1 states that the name of the Determination is the Clean Energy (Reference Price Method) Determination 2013.

Section 2 – Commencement

Section 2 provides that the Determination commences the day after it is registered on the Federal Register of Legislative Instruments.

Section 3 – Authority

The Determination is made by the Minister under subsection 196A(6) of the Clean Energy Act 2011 (the Act).

Section 4 – Definitions

Section 4 sets out definitions for the following terms that are used in the Determination: ‘appropriate market’; ‘certified emissions reduction’; ‘daily price’; ‘listed unit’; ‘RBA exchange rate’; and ‘trade day’. In some cases, defined terms are defined by reference to other laws, or other sections of the Determination. There are other terms used in the Determination, such as ‘eligible international emissions unit’, which are defined in Section 5 of the Act.

Section 5 – Meaning of ‘daily price’

Reference prices will be calculated by referring to the daily prices for eligible international emission units on ‘trade days’ – where ‘trade day’ is defined in section 7 (see below). Each daily price is determined by referencing the price on an appropriate market, which is specified in Section 6 (see below).

If the appropriate market publishes a volume weighted average price for a trade day, this will be the ‘daily price’. However, if the appropriate market does not publish a volume weighted average price for a trade day, the daily price will be the closing price published by the appropriate market for the trade day.

If the appropriate market is a futures market, the daily price must be that of a contract which has a delivery date that is before the surrender deadline for the compliance year in which the designated 6-month period mostly falls. The futures contract identified by the Regulator must be the contract that best represents the trading undertaken by Australian liable entities to meet their obligations for the relevant compliance year.
Example: Identifying a futures contract when the appropriate market is a futures market

If the Regulator is calculating the reference price for a designated period that mostly falls in the compliance year 2015-16, and the final surrender date for the 2015-16 compliance year falls on 1 February 2017, the Regulator must reference the futures contract with an underlying delivery date before 1 February 2017 that best represents the trading undertaken by Australian liable entities to meet their obligations for the 1 February 2017 surrender deadline.

Section 6 – Meaning of ‘appropriate market’

Section 6 sets out the process the Regulator must follow to determine the appropriate market. The appropriate market is the market the Regulator will refer to when determining the daily price. The process is an order of preference that is determined by reference to specified criteria.

The first preference is for the appropriate market to be the most liquid Australian spot market for the relevant eligible international emissions unit, taking into consideration all sufficiently liquid Australian spot markets that publish a spot price for the relevant unit.

When identifying the appropriate market, the market will be ‘sufficiently liquid’ if the Regulator considers, on reasonable grounds, that trade in the relevant eligible international emissions unit has been sufficiently frequent and the volume of trade and open interest on the market has been sufficiently high over the relevant designated 6-month period. The Regulator will take the same criteria into account when determining the ‘most liquid’ market.

If there is not a sufficiently liquid Australian spot market, the most liquid Australian futures market is to be used. When identifying the appropriate futures contract to reference, the Regulator should consider the contract that best represents the trading undertaken by Australian liable entities to meet their obligations for the compliance year in which the designated 6-month period mostly falls.

If there is not a sufficiently liquid Australian spot or futures market, the most liquid overseas spot market will be used. If none of these markets are sufficiently liquid, the appropriate market is the overseas futures market that has the highest trading volume for the relevant eligible international emissions unit over the relevant designated 6-month period.

Where the appropriate market is an Australian market the relevant market must, in accordance with the Corporations Act 2001, operate under an Australian Markets Licence and must not be exempt from the Market Integrity Rules. The Regulator must identify daily prices that are publicly visible, meaning that prices that are not made visible to the public (for example, because they require a paid subscription) should not be used for the purposes of the reference price.

Section 7 – Meaning of ‘trade day’

A trade day is a day on which an eligible international emissions unit was traded on a financial market, where a financial market is a market as defined in section 6. Importantly, if there is a day over the designated 6-month period in which a trade does not occur, then this day will not be designated a ‘trade day’ and therefore not
included for the purpose of section 9 or section 10. This ensures that when the Regulator performs the calculations set out at Step 3 in section 9 and section 10 that there will always be the same number of prices in the numerator as days in the denominator.

Section 8 – Purpose of Part

Section 8 states that the purpose of Part 3 of the Determination is to set out the method that the Regulator must use when declaring the reference price for a class of eligible international emissions units for a designated 6-month period.

Section 9 – Reference Price for 2015 and 2016

Section 9 sets out the method that the Regulator must use to declare a reference price for the per-tonne carbon price equivalent before 2017, that is, the calendar years 2015 and 2016.

The first step includes three elements, with Steps 1B and 1C applying according to the relevant applicable circumstances.

The reference price in 2015 and 2016 will be calculated in three steps and will take into account the daily prices of Certified Emission Reductions (CERs) only – where daily price is defined in section 5.

If the daily prices are published in a foreign currency, the Regulator must convert each daily price to Australian dollars before performing further calculations. This should be done by multiplying each daily price by the daily exchange rate that was published by the Reserve Bank of Australia (RBA) for that trade day.

Note: At the commencement of this section, the daily exchange rate could be found at http://www.rba.gov.au/statistics/hist-exchange-rates/index.html under the heading “Daily Data”.

If the appropriate market is a futures market, the Regulator must adjust each daily price according to its time value. Daily prices of the relevant futures contract will be adjusted using the following formula:

\[
\frac{\text{daily price in AUD}}{(\text{return} + 1)^{\text{time}}}
\]

where:

\(\text{daily price in AUD}\) is the daily price, as defined in section 5, and converted to Australian dollars if the daily prices were originally in a foreign currency;

\(\text{return}\) is the rate published by the RBA, in yields per cent per annum, for corporate bonds with 1 to 5 years maturity and a BBB rating; and

\(\text{time}\) is the number of days between the trade day of the futures contract and the unit’s delivery date.
Note: At the commencement of this section, the annual yield could be found at http://www.rba.gov.au/statistics/tables/ under the heading “Capital Market Yields and Spreads—Non-government Instruments—F3”.

Example calculation: Adjusting for time value

Suppose that the daily price in AUD for CERs is $12 on 5 January 2015, and that this price is taken on a futures market for the delivery of CERs on 1 September 2015. There are 239 days between 5 January 2015 and 1 September 2015, so time is equal to 239 ÷ 365. If the return, when the reference price is calculated, is 6% (i.e. 0.06), then the result of this step is $11.55 (i.e. $12 ÷ [0.06 + 1]^{239 ÷ 365} = $11.55).

Steps 2 and 3 provide that, once any necessary currency and time adjustments have been made, the Regulator must sum the daily prices of CERs for each trade day in the designated 6-month period, and then divide the result by the number of trade days over the designated 6-month period.

Section 10 – Reference Price after 2016

Section 10 sets out the method that the Regulator must use to determine a reference price for the per-tonne carbon price equivalent after 2016.

The reference price after 2016 will be calculated in six steps and will take into account all units within each class of eligible international emissions units for which a reference price must be declared.

Steps 1 to 3 set out the way in which the Regulator must sum the daily prices of an eligible international emissions unit within a class, and then divide the result by the number of trade days for that unit over the relevant 6-month designated period. Step 1 operates in a similar fashion to Step 1 of section 9.

If necessary, adjustments for time value and currency will be made prior to summing and dividing the daily prices according to the methods set out in section 9 and section 10 of the Determination.

The Regulator must repeat this process of summing and dividing daily prices for every eligible international emissions unit within a class as defined in the Clean Energy Act 2011 or in the Clean Energy Regulations 2011. (Note: no such regulations are currently in force). The exception is when a given unit type is disregarded in accordance with Step 4B, which provides that the Regulator may exclude from the calculation of the daily prices for any unit types that make up less than five per cent of all units surrendered in that class. The percentage shares will then be recalculated to find the new weights that will be applied in Step 5. This process is described in the example below.

The Regulator must source the data for Steps 4A and 4B from the Australian National Registry of Emissions Units, with regard to units surrendered by Australian liable entities.

In Step 5, for each type of unit within a class, the Regulator must multiply the amount worked out under Step 3 by the percentage shares calculated under Step 4A or Step 4B, as appropriate.
The weighted prices found in Step 5 will be summed in Step 6 in order to find the *reference price* for that class of units for the designated 6-month period.

*Example calculation: Steps 4-6*

<table>
<thead>
<tr>
<th>Step 4A: In the most recent financial year, 3 type A units, 27 type B units and 70 type C units were surrendered. The percentage share of those different types of units is 3% (i.e. $3 \div [3 + 27 + 70] \times 100%$), 27% (i.e. $27 \div [3 + 27 + 70] \times 100%$) and 70% (i.e. $70 \div [3 + 27 + 70] \times 100%$) respectively.</th>
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<tr>
<td>Step 4B: Disregarding the type A units with the 3% share of the total number of units, the percentage share of the remaining types of units is 27.84% for type B (i.e. $27 \div [100 - 3] = 27.84%$), and 72.16% for type C (i.e. $70 \times 100% \div [100 - 3] = 72.16%$).</td>
</tr>
<tr>
<td>Step 5: If the price as determined by Steps 1-3 for type B units was $10, the result is $2.78 (i.e. $10 \times 27.84% = $2.78$). If the price for the 70 type C units was found to be $15, the result is $10.82 (i.e. $15 \times 72.16% = $10.82$).</td>
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<tr>
<td>Step 6: The reference price is $13.61 (i.e. $2.78 + $10.82 = $13.61$).</td>
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Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Clean Energy (Reference Price Method) Determination 2013

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview of the Legislative Instrument

The Clean Energy (Reference Price Method) Determination 2013 establishes the methodology that the Clean Energy Regulator must use to calculate the reference price for the per-tonne carbon price equivalent as required under subsection 196A(5) of the Clean Energy Act 2011.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

The Hon Greg Combet AM MP
Minister for Climate Change, Industry and Innovation