

UNDERSTANDING THE OVERNIGHT FREEFALL IN THE VALUE OF ACCUs: WHO STANDS TO WIN AND LOSE FROM SURPRISE ANNOUNCEMENT AFFECTING THE EMISSIONS REDUCTIONS FUND?

The Federal Government made significant changes to the Emissions Reduction Fund (ERF) on 4 March 2022. The amendments came by surprise and sent the price of Australian Carbon Credit Units (ACCUs) into freefall. It has been widely criticised by stakeholders as benefitting a few existing players in the carbon market while making emerging carbon projects unviable.

1. Overview

- 1.1 The changes directly affect current holders of 'fixed contracts' with the Federal government for the sale of Australian Carbon Credit Units (ACCUs). Under a fixed contract, the "seller" must provide an agreed number ACCUs to the Government, the "buyer", according to set delivery milestones and at an agreed price.
- 1.2 However, because of the changes to the ERF, fixed contract holders are now allowed to exit their current obligation to sell ACCUs to the Government, thereby allowing them to sell ACCUs on the carbon market at a higher price. This is a clear benefit to fixed contract holders who stand to gain a major windfall, as they will soon be able to sell ACCUs on the open market at a higher price than under their fixed contract price with the Government.
- 1.3 The timing of the sudden change is also curious given an upcoming Federal election and criticisms of the Coalition for taking insufficient steps to reduce Australia's emissions. There are concerns that the money, which the Government saves as a result of the amendments, may instead be invested in more contentious carbon capture, and storage or gas projects, which may help it win votes in certain areas.

2. Why have the changes to the ERF and fixed contract been made?

- 2.1 The Federal Government has explained the amendments to the ERF by reference to the surging prices for ACCUs in the carbon market. Since May 2020, the price of an ACCU has risen from approximately \$17 to a peak of almost \$60 at the beginning of 2022. However, the Government's announcement of the amendments saw prices drop to \$29.
- 2.2 Currently, almost 208 million ACCUs are contracted to the Federal government under fixed contracts and are priced between \$12 and \$18. This is below the current price of ACCUs on the carbon market and significantly lower than the peak price earlier this year. Of these, 76 million ACCUs have already been delivered, meaning that approximately 131 million ACCUs may become available for sale on the carbon market.

3. How can fixed contract holders be released from their obligations?

- 3.1 Holders of fixed contracts who choose to be released of their obligations with the Government will have to apply and, if deemed eligible, must pay an 'exit fee'. The exit fee is calculated by multiplying the fixed contract price by the quantity of ACCUs to be released.

- 3.2 To avoid a sudden exodus of fixed contract holders and corresponding large volume of ACCUs available on the carbon market, which could lead to market volatility, the Government is limiting the number of fixed contracts which can be terminated. It is doing so by restricting the number of contracts that can be terminated in a six-month period. The first six-month period opened on 4 March 2022 and closes on 30 June 2022.

4. What are the benefits of the amendments?

- 4.1 A clear benefit of the amendments is that it allows fixed contract holders to exit the Government's scheme and sell their ACCUs on private market at higher price. TerraCarbon, the trading arm of developer GreenCollar Group, has been pinpointed by media as the biggest beneficiary of the announcements. At current prices, the amendments to the ERF could reportedly mean an approximate \$420 million windfall for TerraCarbon alone.
- 4.2 Further, there is a growing demand for ACCUs given the recent surge in companies announcing net zero targets and relying on offsets to achieve those targets. Further, freeing up more ACCUs also means that Australian businesses may have to rely less on overseas carbon credits, including those which have been exposed to be 'fraudulent'. This is an issue given the intangible nature of carbon credits, meaning that there have been instances of carbon credit being sold numerous times or not even existing in the first place. Comparatively, ACCUs are more regulated and the ERF is perceived to be a system with more integrity and a lower likelihood of carbon credit fraud.

5. What are criticisms of the amendments?

- 5.1 The Carbon Market Institute has raised concerns about the changes to the ERF, given that the amendments were announced and no public consultation was carried out. It and others have also criticised the amendments for not being linked to the Government's overall emissions reduction commitments. There are fears that the money which the Government will save (as well as its collection of exit fees), may be spent on other, arguably more controversial, emissions reductions options such as carbon capture and storage or gas projects.
- 5.2 Further, there have been criticisms that a few companies, such as TerraCarbon, stand to gain from the announcement, but that it will lead to emerging carbon projects stalling. RepuTex, a provider of research, pricing and advisory services in energy markets, has commented that the recent crash in ACCU prices means that many new carbon projects that are in the pipeline to meet demand for corporate net-zero pledges are unlikely to be viable at this stage.
- 5.3 There is also currently little guidance on how additional revenue resulting from the amendments will be shared fairly between landholders who 'host' the carbon projects and carbon companies that have helped them develop the projects. The Clean Energy Regulator has acknowledged that clarity is needed in this respect and expects that it will begin consultations soon to discuss how revenue should be shared. Whilst companies such as GreenCollar have announced that the "vast majority" of windfalls will be passed on to landholders, there is currently nothing obliging them to do so.
- 5.4 Lastly, there is little detail around which fixed contract holders are eligible to be released from their obligations. Other than a statement that they should be 'compliant' and that they will be advised by the Clean Energy Regulator if they are not eligible, there appears to be an absence of information in this regard.

6. What could the amendments mean for you?

- 6.1 Given the abrupt nature of the changes and lack of detail in some aspects, companies may wish to seek professional advice on whether the changes affect them and plan for impacts. For example:
- a. fixed contract holders may wish to seek advice on whether paying the exit fee and selling ACCUs on the open market is the best option for them, whether they are eligible or what to do if they do not currently meet eligibility requirements and how to negotiate with landholders who want their fair share of any windfall profits;
 - b. businesses who have set net zero targets should consider how they can make the most of a larger volume of ACCUs coming on to the Australian carbon market and how to time their purchase of those ACCUs;

- c. carbon project developers who have projects in the pipeline, may need to navigate the uncertain landscape as to whether projects are still viable or whether to move to less capital intensive projects, given the current dip in ACCU pricing; and
- d. landholders, who have engaged a carbon credit management company to register and develop projects on their land, may wish to seek assistance in negotiating with those companies as to whether they should exit their fixed contract, and if so, how to ensure that they receive a fair portion of any expected windfalls from selling ACCUs on the open market.

6.2 Whether the ACCU price will stabilise and how the amendments to the ERF will operate in practice remains to be seen. We will provide further updates on related consultations, including the foreshadowed consultation on the fair sharing of the financial benefits that result from exiting fixed-contract.

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