

## Understanding Carbon Trading: A Net Zero Future for Japan and Australia on the Horizon

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### 1. The Australian Energy Market – An Introduction

The Australian energy market is undergoing a rapid transformation as the country transitions to a lower emissions economy. The Australian government's initiative known as the Renewable Energy Target (**RET**) sets a benchmark for the amount of electricity to be generated from renewable energy sources, whilst penalising entities for failing to source a percentage of their energy from renewable sources.

These types of policies are becoming increasingly critical as, according to the Australian Energy Market Operator (**AEMO**), approximately 63% of coal-fired generation is set to retire by the year 2040, replaced by wind and solar farms, complemented by firming energy sources such as pumped hydro, battery storage and gas.

In the private sector, many corporations are moving toward reducing their carbon footprint by purchasing carbon credits, thereby supporting the global cause of reducing greenhouse gas emissions.

### 2. What is Carbon Trading?





In a nutshell, carbon trading refers to the practice of buying and selling a 'credit' which grants the right to emit a ton of CO<sub>2</sub>. Whilst carbon credits can be acquired by anyone, in practice, they are usually obtained by corporations for either regulatory compliance or Corporate Social Responsibility (**CSR**) purposes.

Globally, international agreements and conventions such as the Kyoto Protocol and Paris Agreement govern global efforts to reduce carbon emissions and set objectives with respect to accounting guidance and transparency for carbon trading markets.

Another important distinction to be drawn within the carbon trading market relates to the compliance trading market and voluntary trading market. Compliance trading markets are a creature of national, regional or international carbon reduction schemes, whereas voluntary markets function outside of compliance markets and enable entities to purchase carbon credits on a voluntary basis, with no intended use for compliance purposes.

The trading of carbon credits, for both compliance and voluntary markets, occurs much the same way as any other commodities, where futures exchanges exist to facilitate spot and longer dated deliveries plus options. In the alternative, carbon credits may also be acquired ‘over-the-counter’ via a brokering arrangement.

Refer to the below infographic for a simple overview of how carbon trading works in practice.

	
<p>Without a price on carbon, big polluters don't pay for the CO2 they emit.</p>	<p>In a trading scheme, polluters must purchase a permit or an allowance for every ton of CO2 they emit.</p>
	
<p>A free market is created where carbon allowances can be traded. Entities which need to emit more can buy more permits from those who require less. A classic supply and demand situation is created.</p>	<p>The idea is very simple. The cost creates an incentive to reduce pollution and invest in cleaner forms of energy.</p>

### 3. Australian Carbon Trading Regulatory Landscape

In Australia, Australian Carbon Credit Units (**ACCUs**) are issued by the Clean Energy Regulator (**CER**) through the Emissions Reduction Fund and are able to be used to offset emissions against compliance liabilities in accordance with Australian Government emissions reduction legislation, make voluntary carbon neutral claims, or to become carbon neutral certified.

Since ACCUs are classified as a financial product under the *Corporations Act 2001* (Cth), ACCUs have the potential to be more than just offsets on the path to net zero, and if implemented correctly, they could be a valuable class of collateral which can be used as security to finance net zero initiatives.

ACCUs are tracked by the Australian government through the Australian National Registry of Emissions Units (**ANREU**). When an organisation wishes to make a carbon neutral claim, it must retire or cancel the respective ACCU in a public registry at the time of the claim.

Another cornerstone development for the Australian carbon trading market is championed by the CER, being the Australian Carbon Exchange (**ACE**), which shall make the trading of ACCUs simpler through a marketplace environment. The ACE platform is intended to be launched in 2023 and shall permit ACCUs credited from approved Energy Emission Fund projects to be traded among

individuals and businesses.

#### 4. Carbon Trading Activity between Japan and Australia

There have been several recent acquisitions of Australian carbon credit trading and production businesses by Japanese corporations, including by:

- a) Mitsui & CO, with respect to its investment into Climate Friendly, a consultancy that generates and sells carbon credits;
- b) Mitsubishi, in regard to the acquisition of a 40% stake in Australian Integrated Carbon, a nature-based carbon credit trader; and
- c) Osaka Gas Energy Oceania, with respect to its interest in Australian Integrated Carbon.

Although Mitsui & Co is seen as the major player in the carbon trading sector, with its plan to generate more than 70 million tons of carbon credits between 2022 and 2025 together with Climate Friendly, more and more Japanese trading houses are looking to diversifying into this market in Australia.

To further drive market activity, a report published by the Australian National University (ANU) in 2021 called for the establishment of bilateral agreement to facilitate the trade of carbon credit units between Australia and Japan. This will be a great step toward establishing further trade activities between the two countries and increase the capacity to finance renewable energy projects both in Australia and Japan through the voluntary carbon market.

#### 5. Conclusion

As many governments and private sector corporations move toward reducing their carbon footprint, there is an increasing abundance of investment opportunities in renewable energy projects and nature-based carbon credit providers. Despite higher labour costs, Australia is seen as a suitable jurisdiction for investment for foreign corporations and trading hours. It is imperative for both the Australian and Japanese governments to continue their discussions with respect to bilateral carbon trading arrangements which could significantly bolster the economies of both countries and position themselves as leading renewable energy powerhouses internationally.

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