

The five principles of carbon pass-through



The price on carbon will soon hit Australia's businesses and consumers. The Treasury modelling forecasts an average 0.7% cost increase across the economy – most will experience an increase in the order of 0.1 to 0.5% (although not to be dismissed if your business operates at low margins). However what will be a surprise are the untapped marketing opportunities. Those businesses that closely analyse their carbon exposure, develop a robust methodology for passing on the carbon cost and take the time to understand their competitive position, may identify a new market opportunity.

And not all is lost if your business can't pass on the carbon cost in the short term. Remember what may not be achievable in the short term will come into effect in the medium term as prices for goods and services become carbon inclusive. The key is to develop a transparent approach and methodology and ask your suppliers to also demonstrate transparency.

The “**five principles of carbon pass-through**” have been developed by Energetics to help Australian industry cut through to the key numbers quickly and manage this economic change with minimal disruption.

- **Principle 1** - Agree on a transparent methodology for carbon pass-through, not just a price or %
- **Principle 2** - The accrual of liability should be separated from the timing of payments. You can negotiate on cash flow.
- **Principle 3** - The price you pay may not be the official \$23 fixed price
- **Principle 4** - Benchmark the level of carbon pass-through against other suppliers
- **Principle 5** - Choosing to pass-through at an amount less than your competitors, or not at all, may be a market winning strategy.

Principle 1

Agree on a transparent methodology for carbon pass-through, not just a price or %

As part of developing a methodology you should undertake an evaluation of your organisation's emissions intensity, assessing the direct, indirect and other emissions that can be attributed to your business.

The approach adopted by companies will depend on how supply contracts are set up. Businesses with CPI adjustment provisions in contracts may want to roll the carbon cost into price increases via this mechanism. The Treasury has forecast that the carbon price impact will be in the order of 0.7%, however most companies will be facing a carbon cost impact of 0.1 to 0.5%. You need to understand how material this impact is to your bottom line, and to your customers, and decide the most appropriate approach. In doing so, you must observe the requirements set out by the ACCC for accuracy and reasonableness.

[ACCC website.](#)

Principle 2

The accrual of liability should be separated from the timing of payments. You can negotiate on cash flow.

Liability under the carbon pricing mechanism is incurred at different times, with the surrender of 75% of permits required by 15 June 2013 and 'true up' (surrender) for the remainder 25% of the obligation by 1 February 2013. The issue becomes one of cashflow management and requires the application of a discount rate to cash flow.

Principle 3

The price you pay may not be the official \$23 fixed price.

The cost of carbon for some suppliers may be reduced due to direct government compensation, or if others in their supply chain receive government support. You can request from your suppliers the details of any government support received. This will be significant for industries such as steel and cement that will be heavily compensated under EITE status, and their carbon pass-

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through should be low in percentage terms. However large electricity users such as data centres and suppliers of refrigerants that produce synthetic greenhouse gases, are amongst those most likely to be able to justify significant carbon-related price rises. You can also request evidence of any carbon offset programs that create Australian Carbon Credit Units (ACCU) through the Carbon Farming Initiative (CFI) including retrospective ACCUs.

In terms of your energy supply contracts the carbon cost pass-through will vary across individual energy suppliers, as not all retailers have access to the same mix of generation. Even across state borders generation fuel sources will vary. For example, Victorian electricity generation has a dominance of brown coal fired generation, which constitutes one of the highest carbon intensive baseload electricity emission sources. As a result a high proportion of the Commonwealth compensation will go to these generators. End-users will need to turn to the relevant contract provisions in their energy supply agreements that will detail the manner upon which these costs will be calculated, and ultimately passed through.

Principle 4

Benchmark the level of carbon pass-through against other suppliers

How carbon-intensive are your products and services compared to your competitors? Consumers should start to opt for products and services that are less carbon intensive in order to lower their costs. Organisations that are advanced in their journey to lower their emissions and energy intensity may have a competitive advantage.

Taking the step now to understand exactly how your business compares to others in your sector will help determine how much of the carbon cost to pass-through to customers. This analysis may reveal that the better response is not to pass any of the cost through. If your business is trade exposed you may have no choice but to absorb the carbon cost as your competitors carry no such expense. However, such businesses are protected with compensation awarded under the Jobs and Competitiveness Program of the Clean Energy Future. Although, of course, as compensation decreases over time, trade exposed businesses will have to find ways of reducing their emissions intensity and explore offsets.

Principle 5

Choosing to pass-through at an amount less than your competitors, or not at all, may be a market winning strategy.

Your customers will have varying levels of understanding of the Clean Energy legislative package. Choosing to not pass-through the carbon cost may be a market winning strategy as customers rush to minimise their carbon exposure.

Energetics can help your business understand and manage carbon pass-through. With our experience and

technical knowledge in carbon emissions profiling, we can support you in a number of ways:

- providing a sense check on your numbers and approach to ensure your methodology is accurate and reasonable. We can do this over the phone in the first instance.
- conduct detailed technical reviews which model the impacts of different assumptions and the points at which carbon liability is incurred and payment required.
- provide independent expert reports that you can use to explain to your customers the methodology you've adopted for carbon pass-through.
- act as independent arbiters to help with change-of-law disputes between parties
- undertake benchmarking across your industry to understand your business' position relative to your competitive in order to inform a marketing strategy. You need to differentiate your business at a time when your competitors are likely to be solely focussed on cost impacts.

Energetics has worked with Australia's largest energy users for over 25 years and helped many with their energy and carbon strategies.

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