Submission to Australian Government Department of the Environment

on the

Emissions Reduction Fund Green Paper

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NATIONAL ENVIRONMENTAL LAW ASSOCIATION

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1. INTRODUCTION

The National Environmental Law Association (NELA) is Australia's leading environmental law organisation with a membership base of professionals in environment and resources law and related disciplines.

NELA's vision is that ecological sustainability is a guiding principle in regulating energy and resources, utilities, pollution control, protecting biodiversity and cultural values, and land use planning and infrastructure.

We seek to protect the environment by shaping the law through information sharing, analysis and debate.

2. DESIGN PRINCIPLES

In general, NELA supports the Emissions Reduction Fund (**ERF**) being designed to achieve lowest-cost emissions reductions as its primary objective. NELA believes any projects funded by taxpayer money should be "real and additional". NELA would be very concerned if the ERF ended up providing an income stream to projects that would have been undertaken in any event or which do not deliver genuine abatement.

NELA is conscious of the fact that some industry sectors may be "sitting" on abatement activities to ensure that they can be classified as "new" after 1 July 2014. Appropriate due diligence should be undertaken as part of the pre-qualification requirements to ensure that these types of projects are excluded.

NELA expresses caution about how the Government proposes to achieve the objective of securing abatement at "the lowest cost". It is likely that the proposal for reverse auctions for 'activities' and 'facilities' will benefit some sectors and disadvantage others. In particular, NELA is concerned about the ability of the land sector to obtain ERF funding. The reforestation sector, for example, has high costs associated with forest establishment and the long term biological and financial risks associated with reforestation projects.

We refer to research by ClimateWorks that was cited in their submission on the Terms of Reference. They said:

> Afforestation and reduced deforestation were amongst the biggest contributors to national emissions reductions (over 40 $MtCO_2e$) over the past decade. ... [but] there has been almost no progress in delivering land sector abatement since 2010, and achieving this by 2020 becomes more difficult with every year of delay. For example, many forestry projects take around six to seven years to reach their maximum volumes of abatement.... [Climate Works'] research ...estimated that this land-based abatement had an average cost to investors of around $\$25/tCO_2e$. ... higher than energy efficiency and lower than many other abatement options... Forestry projects are also an example of long life projects, and the Fund's contract lengths should be designed to cover costs until they've recovered the economic cost of investment, which may be longer than seven years for projects such as forests or other long life assets.

The exclusion of these projects from the ERF will have long term detrimental consequences that will compromise Australia's ability to reduce its greenhouse gas emissions. ClimateWorks' *Low Carbon Growth Plan for Australia* demonstrates that both energy efficiency and carbon farming are necessary categories of abatement in achieving a 5 per cent target.

NELA therefore supports the Government considering a system of sector-specific auctions in the design of reverse auctions for the ERF.

NELA recommends that the Government consider how it can ensure that the transformation of the economy across all sectors can be achieved, and whether it is necessary for some sectors to receive additional forms of support or incentives aside from the ERF. While NELA understands that the Government does not wish to consider "co-benefits" as part of the assessment process it should be considered as part of the Government's overall policy package.

3. CREDITING EMISSIONS REDUCTIONS

NELA supports an approach to the development of methods which builds upon the methodology development process developed under the Carbon Farming Initiative (**CFI**). However, as has been noted by a number of CFI participants, this process needs to be significantly streamlined and expedited, so that methods can be developed more quickly. In particular, if the Government intends to commence the ERF shortly after 1 July 2014, a number of methods will need to have been developed and "approved" before this date. It is not currently clear how the "approval" will take place, given that the CFI regime does not cover a number of industry sectors expected to participate in the ERF (e.g commercial buildings, coal mines). Further clarity on this aspect should be provided in the White Paper and in the exposure draft legislation which will accompany it.

In relation to the approach to additionality, NELA notes that the Government's expressed intention is to cover this requirement through the methods, rather than under a 'positive list' approach (as currently occurs under the CFI). NELA considers that some high level thresholds or requirements are needed in order to satisfy additionality and should be specified in the legislation, rather than just left to the methods. Our concern with the latter approach is that it may lead to an 'unlevel playing field' between different industry sectors.

NELA supports the continuation of a 'negative list' so it is clear which activities are excluded from participation in the ERF.

In relation to the proposal to develop facility methods, NELA is concerned about how these methods will interact with the development of the 'safeguard mechanism'. In particular, there will need to be baselines developed for these facility methods in advance of baselines being developed by those covered under the safeguard mechanism. NELA considers that there is a risk in developing the 'crediting' baselines before the 'compliance' baselines have been determined, or even before the entities who will be covered by these compliance baselines have been finalised.

Accordingly, NELA recommends that the facility based method approach be delayed until such time as the details of the compliance mechanism have been finalised or at least, clarified (e.g coverage, approach to setting of baselines, etc).

4. PURCHASING EMISSIONS REDUCTIONS

NELA strongly opposes the proposal to keep the benchmark price confidential as it considers this will inhibit development of abatement activity and participation in the ERF auctions, particularly in the early days of the scheme. For example, it will be extremely difficult for possible project participants to develop their business cases if they have no idea whether their bid price will be "in the right range". NELA members have heard references to abatement/credit prices of $5, $8 and $12. Whether a project could be viable at $5 is likely to be completely different to a project which is viable at $12.

If the Government does not wish to publish the benchmark price, another option is to set a range within which it would expect bids to be lodged. In providing this range, the Government could still set a benchmark price (which would presumably fall within this range) and keep this price confidential.

NELA fully supports the wide publication of auction results and contract information, as this will ensure market transparency.

NELA considers that a five year contract term will prove to be a significant inhibitor in terms of ERF participation. In particular, NELA is aware that none of the big 4 banks are likely to be willing to offer project finance for ERF projects, unless a longer contract term is available.

Project developers will therefore need to either source alternative forms of funding or put up equity. The former has the ability to significantly push up the cost of abatement, given that the financing costs will need to be absorbed in the overall project costs. The latter is likely to keep out a significant part of the market, particularly given that the income through the ERF will not start to be generated until some time (likely to be a year) after project implementation.

If the policy position remains that the maximum contract term is limited to 5 years, the Government will need to consider alternative mechanisms to facilitate participation. One such route could be use of funding through the Clean Energy Finance Corporation. In the energy efficiency area, a funding mechanism could be the use of Environmental Upgrade Agreements.

Another option could be a "deemed" approach to calculation of the abatement, whereby a certain amount of abatement is deemed to occur and payment is made upfront for this amount and subsequently, after the project has been implemented and abatement has been verified, a "true up" process is applied to cover any under or over payment. It is recognised that appropriate safeguards would be needed if this approach was adopted.

NELA supports the principle of "make good" arrangements provided that the provisions are extremely clear and not open to interpretation. "Make good" arrangements requiring the purchase of units would also have the function of stimulating the secondary market.

5. SAFEGUARDING EMISSIONS REDUCTIONS

As highlighted above, NELA is concerned about the one year delay in implementing the "safeguard mechanism". NELA views this component of the Government's Direct Action Plan as a significant element for achieving the Government's abatement target. A one year delay will only intensify the scale of the challenge of achieving the target. This is particularly the case if it were to be determined that the currently proposed target of 5% was no longer adequate and a higher target (of 10% or 15%) was deemed to be appropriate (in line with possible recommendations from the Climate Change Authority).

NELA believes there is insufficient information available in the Green Paper to make detailed comment on the different design components for the safeguard mechanism. In broad terms NELA supports:

- Broad coverage (of both sectors and emissions)
- A robust approach to the determining baselines (to ensure the safeguard mechanism is actually effective)
- Compliance options which facilitate secondary markets (for example, allowing ACCUs to be used for compliance purposes); and
- A consistent approach across sectors to new investment or business expansion; and
- The capacity to reduce baselines over time.

NELA supports the concept of flexible compliance arrangements being available to covered sectors or facilities, but would be concerned if these flexible arrangements delayed the transition to a lower carbon economy or to meeting Australia's domestic abatement target.

NELA also has concerns about the resources required to set the compliance baselines and the amount of 'rent seeking' that is likely to take place on the part of the covered sectors. Measures should be implemented to minimise both of these aspects.

6. CARBON FARMING INITIATIVE

A number of NELA's members have had direct experience in participating in, or assisting clients to participate in, the Carbon Farming Initiative. The consensus is that streamlining of positive list amendments, project approvals and methodology development is definitely warranted. NELA supports any proposals to improve the timeframes associated with these activities, provided that the integrity of the scheme is not undermined.

Further, a key objective (which is also relevant to methods developed under the ERF) should be to ensure that project costs (both in respect of implementation and in relation to monitoring, reporting and verification) are minimised. In this respect, NELA supports a risk-based approach to verification and more frequent crediting periods, backed up by a "true up" mechanism.

NELA believes the proposal to reduce the permanence period to 25 years will have an impact on the fungibility of the credits. This is particularly important given that the Government has highlighted that international markets provide a potential demand source for Australian generated offsets credits. A shorter permanence period, and the associated cost impact on the income able to be generated from a sequestration project, is also likely to impact on the feasibility of these types of sequestration projects, such that they may not ultimately be viable.

FURTHER INFORMATAION

NELA wishes to acknowledge the contribution of one of its senior members in preparing this submission.

For any inquiries about matters raised in the submission please contact Amanda Cornwall, President, NELA on 0432 134 936 or c/o secretariat@nela.org.au