# Emission Reduction Fund White Paper

e-bulletin
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## Green Paper Overview

### Background

In seeking to attain carbon emission levels for Australia of 5% below the year 2000 levels by 2020 (as detailed in the Direct Action Plan, launched in 2010), the Australian Government ('the Government') has proposed an Emissions Reduction Fund ('ERF') – with the primary goal of achieving lowest-cost emission reductions.

On 20 December 2013 the Government released its Green Paper outlining design principles for the ERF which it is seeking public comment on. It will then release a White Paper in early 2014 in response to the comments received as a precursor to the introduction of legislation.

This e-bulletin provides a summary of the proposed features of the ERF, and comments on potential impacts this may have on Australian businesses.

The ERF will operate though three mechanisms:

1. Crediting emission reductions – providing incentives for emission reductions that would not have been achieved without the ERF;
2. Purchasing emission reductions – providing funding through a tendering process for emission reduction projects; and
3. Safeguarding emission reductions – encourage businesses to decrease their emissions below their historic levels and provide incentives for not exceeding historical emissions baselines.

The ERF is scheduled to commence on 1 July 2014, with the safeguarding mechanism delayed until 1 July 2015. A review of the ERF is also anticipated for late 2015.

The Government, through the Minister for the Environment is responsible for the ERF policy design, and the Clean Energy Regulator ('CER') will be responsible for the implementation.

The ERF will use current reporting mechanisms in place under the National Greenhouse and Energy Reporting ('NGERs') scheme to track emission reductions, with the Safeguarding Mechanism applying specifically to current NGERs reporters (liable entities) or a subset thereof.

Submissions regarding the ERF Green Paper may be made by businesses and members of the community until 21 February 2014. These submissions can be made confidential upon request.

### Design Principles

The design of the ERF is based on three principles:

1. *Lowest-cost emission reductions* – focusing specifically on lowest-cost emission reductions, rather than any of the co-benefits stemming from the emission reduction initiatives;
2. *Genuine emission reductions* – focusing on a test of 'additionality' (further detailed under 'Crediting Mechanisms), this looks at emission reductions which go beyond standard business activities; and
3. *Streamlined administration* – using existing administrative infrastructure to provide clarity, simplicity and transparency (i.e. Carbon Farming Initiative and NGERs).

## *Crediting Mechanism*

Building on existing arrangements under the Carbon Farming Initiative, the CER will issue Australian Carbon Credit Units for emission reductions.

### *What is proposed?*

The ERF would set out a series of Emissions Reduction Methods (to be developed through industry consultation) which can be used by businesses to identify potential projects eligible to create Australian Carbon Credit Units. The Government proposes two types of methods:

- Activity Methods for specific emissions reduction actions. These methods would apply to specific project activities that reduce emissions in a manner similar to the existing Carbon Farming Initiative
- Facility methods that would allow for aggregation of emissions reductions for facilities reporting under NGERs.

Operators of large facilities could use either method provided that emissions reductions are not covered twice.

*Notably* – the test of 'additionality' prescribes that activities already occurring or activities already receiving incentives under other Government programs will not be eligible to create ACCUs. Similarly, displacement programs (i.e. where the carbon emissions have been moved to another location) are also excluded.

Project's eligible to create ACCUs will be able to bid to enter into an ACCU purchase contract for a period of 5 years with the Government under the ERF (described below).

Additionally, an unsuccessful bid does not preclude other businesses from directly purchasing qualifying Australian Carbon Credit Units (whether under the Carbon Farming Initiative or through an ERF Emissions Reduction Method) though business to business transactions.

## *Purchasing Mechanism*

The CER would run a competitive bidding process to purchase lowest-cost emission reductions. Businesses would submit tenders for emissions reduction projects, with the CER entering into a contracts to purchase emissions reductions from successful bidders – being the lowers cost per tonne of CO2.

### *What is proposed?*

A reverse auction approach would run frequent bidding rounds which would be assessed by the CER on the following criteria:

1. Benchmark price – The CER may set a maximum benchmark for A$ per t CO2-e, whereby it would only consider bids which fell below this benchmark. In encouraging competitiveness – this benchmark would remain confidential to Government.
2. Pre-qualification Requirements – these include:
    a. Acceptance of standard terms and conditions;
    b. Identity and fit and proper person status of the participant;
    c. Project eligibility under the relevant emissions reduction method;
    d. Commercial readiness of the technology or practice to be employed; and
    e. The credibility of the emission reduction estimates.

Successful tenders would enter into a contract with the CER to purchase these emission reductions for a 5 year period.

Notably, forward contracts are proposed as being permissible under this mechanism, whereby the contract may be used as security when applying for project finance – however, such contracts would be made with additional pre-qualification conditions (i.e. security of finance and regulatory approvals within a specified timeframe).

The CER contracts would come with standard terms and conditions, which may include delivery of estimated emissions reductions and associated 'make-good' provisions or cost penalties for under-delivery.

In cases where emissions reductions are in surplus to the contracted amount, these reductions may be bid in future rounds or may be available for business to business transactions.

## *Safeguarding Mechanism*

The ERF seeks to provide positive financial incentives to businesses for not exceeding their historical business-as-usual carbon emission levels.

### *What is proposed?*

Details of the safeguarding mechanisms are yet to emerge with further consultation to be undertaken during 2014 and a scheduled commencement date of 1 July 2015 – a year after the commencement of the ERF.

Sections 4.1 – 4.5 of the Emissions Reduction Fund – Green Paper set out a number of factors being considered by the Government including:

***Coverage***

For the purpose of simplicity, the ERF proposes that coverage be limited to entities already reporting under NGERs – implying that this mechanism would not apply to entities which fall beneath the liability threshold.

Furthermore, there is consideration of raising the coverage threshold to 100,000 t CO2-e, which would reduce the number of covered facilities to around 190, while still covering around 50% of Australia's carbon emissions.

For the purpose of consistency, the ERF proposes that coverage be based on both Scope 1 and Scope 2 emissions, but in such a way as to avoid double counting of Scope 2 emissions.

***Baselines***

There is support for both: (1) a business as usual baseline based on emissions intensity (average rate) and (2) a business as usual baseline based on absolute emission levels. In both cases, operational variability may be factored into the baseline.

Another proposed method is to set initial baselines at the high point of historical emissions data, which may overcome the complexities of the aforementioned methods.

It has also been recommended through submissions from industry members that new facilities should be allowed five years of steady state operation to establish a baseline.

***Compliance***

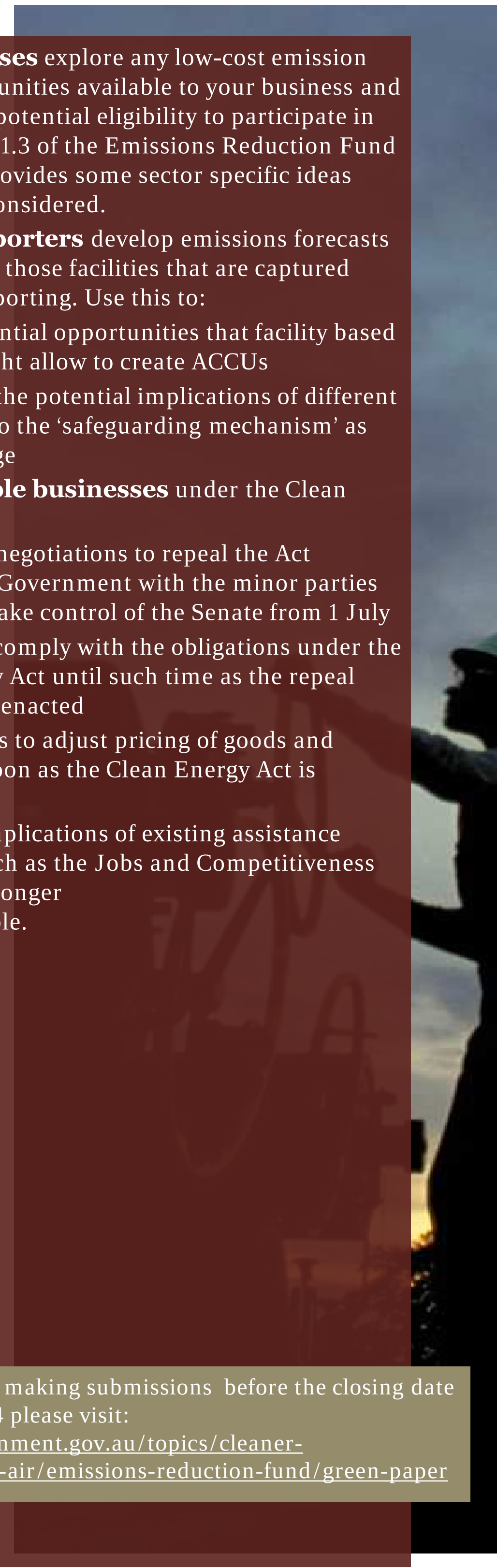
A number of compliance options have been presented for exceeding baseline emission rates. These include (1) an initial transition period with where any compliance actions are waived; (2) a multi-year approach allowing for the averaging of emissions over a certain period; (3) an option for business to purchase emission reduction credits to 'make-good' and emissions above baseline; and (4) using international carbon credits / permits to offset any emissions exceeding the baseline.

***New Investments***

In addition to considerations of how best practice baselines are to be determined for new investments, there is also as to what classifies a new investment – i.e. does this apply to expansions of existing facilities, what are the thresholds, etc? There is also a question of how best practice can be defined, and made comparable to different facilities. Also should best practice be based on a single best performer, or averaged across say the top 10?

Reconciling this mechanism may prove to be particularly challenging for the coal and LNG sectors – being the two sectors with the largest projected growth in emissions.

## *Actions to consider*



1. **For all businesses** explore any low-cost emission reduction opportunities available to your business and investigate their potential eligibility to participate in the ERF. Section 1.3 of the Emissions Reduction Fund – Green Paper provides some sector specific ideas which could be considered.
2. **For NGERS reporters** develop emissions forecasts and scenarios for those facilities that are captured under NGERs reporting. Use this to:
   a. Identify potential opportunities that facility based methods might allow to create ACCUs
   b. Understand the potential implications of different approaches to the 'safeguarding mechanism' as details emerge
3. **For permit liable businesses** under the Clean Energy Act 2012:
   a. Monitor the negotiations to repeal the Act between the Government with the minor parties expected to take control of the Senate from 1 July
   b. Continue to comply with the obligations under the Clean Energy Act until such time as the repeal legislation is enacted
   c. Prepare plans to adjust pricing of goods and services as soon as the Clean Energy Act is repealed
   d. Model the implications of existing assistance measures such as the Jobs and Competitiveness Program no longer being available.

For information on making submissions before the closing date of 21 February 2014 please visit:
http://www.environment.gov.au/topics/cleaner-environment/clean-air/emissions-reduction-fund/green-paper

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