

EXECUTIVE SUMMARY

The Climate Change Authority is an independent statutory agency, which provides expert advice to the Government on climate change policy.

The Emissions Reduction Fund (ERF) is an emissions reduction offsets scheme combined with Government purchasing of abatement, which has been accomplished to date through competitive auctions. As of 16 November 2017, the ERF had contracted 189 million tonnes of emissions reductions at a cost of \$2.23 billion and around \$300 million remained.

The Authority is required to review the ERF every three years. This review covers the crediting and purchasing elements of the ERF. The safeguard mechanism is the third element of the ERF and will be covered in the Authority's review of the *National Greenhouse and Energy Reporting* legislation in 2018.

The Authority considered the role the ERF could play in meeting Australia's Paris Agreement obligations in its report *Towards a Climate Policy Toolkit: Special Review on Australia's climate goals and policies* (CCA 2016). The Authority recommended that ERF crediting and purchasing continue until other policies to reduce emissions are put in place and envisaged an ongoing role for ERF crediting in the land sector.

The Authority considers its recommendations on the ERF in the 2016 *Special Review* remain current. This review focuses on the operational aspects of the ERF, in particular whether the scheme is well administered and delivering low cost and genuine emissions reductions.

MAINTAINING INTEGRITY

The ERF's methods stipulate how abatement is estimated and reported as well as giving effect to offsets integrity standards (which set standards for the environmental integrity of ERF projects). Some stakeholders want to develop their own ERF methods to realise new abatement opportunities. This could result in methods that do not meet the scheme's legal requirements and the Authority recommends instead the Department of the Environment and Energy seek proposals from stakeholders on new methods, continue to involve them in method development and publish priorities for method development every two years. Recent research suggests that there is still untapped abatement potential on the land but new research and development is needed to capture these genuine opportunities. The Authority recommends that additional funding be provided to the Department to work with research organisations and stakeholders to develop new methods.

The Authority notes that ERF projects can have very long crediting periods and projects can continue to generate Australian Carbon Credit Units (ACCUs) even if changes are made to the original method. To improve integrity, the Authority recommends that scheme participants be required to transition projects to new methods within two years of a method being varied, including for any changes to the way abatement is estimated.

The Authority considers that the Emissions Reduction Assurance Committee (ERAC) plays a vital role in maintaining the integrity of the ERF. The ERAC's current method reviews will need to ensure that projects remain additional given changes in technology and practices as methods come up for a possible extension of their crediting periods. The Authority recommends the ERAC look closely at whether methods for soil carbon, human-induced regeneration, native forest managed regrowth and landfill gas continue to meet the offsets integrity standards.

The Authority notes that the ERF was set up with the expectation that methods would be refined over time. While some problems have emerged in the small number of methods mentioned above, this is to be expected given the complex, innovative and technical nature of the scheme. The Authority has not seen evidence that additionality is a systemic problem in the ERF but it remains a key watch point.

The Authority recommends accountability for the ERAC secretariat be separate from method development in the Department to avoid any perception of a conflict of interest and that the ERAC develop guidance on how it interprets the offsets integrity standards to ensure consistency in its decision making over time.

The potential for reversal of some of the 139 million tonnes of carbon that will be stored in vegetation and soil projects is a significant risk. To bolster understanding of permanence obligations, the Authority recommends that scheme participants submit plans to the Clean Energy Regulator (CER) outlining how they will maintain carbon in their projects and deal with the risk of fire. To enhance information available to purchasers of land with ERF projects, the Authority recommends that scheme participants can no longer withhold a project from the CER's project register. The Authority is of the view that the CER should prepare guidance for conveyancers on permanence obligations 'running with the land' and enhance the search functions on their website to make it easier to find projects with permanence obligations. The Authority also recommends that the threshold for relinquishment of ACCUs to the CER (in the event of significant reversals) be reviewed.

The CER withholds ACCUs to address permanence through the risk of reversal buffer and discounts for the 25 year permanence period option. The Authority will review these discounting arrangements at regular intervals to test their effectiveness.

PURCHASING, DELIVERY AND THE SECONDARY MARKET

The Authority considered whether the ERF's purchasing principles' emphasis on least cost abatement should be changed to better address risks like non-permanence, or to allow the ERF to pay directly for co-benefits like biodiversity. Moving away from least cost could make CER's purchasing decisions harder to justify and the Authority believes that the ERF's limited resources should be focused on helping Australia meet its Paris Agreement targets.

There is a risk that abatement contracted through the ERF may not eventuate if some scheme participants rely on the secondary market to source ACCUs rather than investing directly in projects themselves. The Authority recommends that new ERF contracts require scheme participants to supply a proportion (30-50 per cent) of their contracted ACCUs from projects they use to register at auction. The market damages provision should also be reviewed for new ERF contracts to encourage delivery even if secondary market prices rise to the point where scheme participants have a strong incentive to default.

The risk of an ACCU shortfall could be further reduced if the secondary market is more transparent and liquid. The Authority recommends that the CER publish timely information about holdings of ACCUs for prospective purchasers and a regular statement of opportunities to signal when new investment is needed.

Some stakeholders remain concerned about the risk of unscrupulous carbon service providers in the ERF. The Authority recommends that the CER require a declaration from landholders that they have read the Department's ERF aggregation agreement resources so they are aware of the obligations they will be taking on. The Authority recommends that scheme participants be required to notify the CER of any individuals or firms they paid for advice, and

the Fit and Proper Person requirement be extended to designated agents involved in the scheme.

The Authority recommends some industry organisations or local government associations consider offering a trusted source of advice on ERF projects to their stakeholders.

ENVIRONMENTAL AND SOCIAL IMPACTS

The Authority found that arrangements to address adverse environmental or social impacts from ERF projects are working reasonably well. However, the Authority recommends that scheme participants provide the CER with evidence that they advised the local Natural Resource Management (NRM) body of their project (rather than just saying whether it is consistent with their local NRM plan) to facilitate engagement between scheme participants and the NRM planning bodies.

The Authority is of the view that uncertainty on legal issues related to native title, consultation and consent is a barrier to ERF savanna fire projects delivering further benefits to Indigenous communities and other stakeholders. The Authority recommends that the CER finalise its guidance to clarify expectations on consultation with Indigenous communities. The Authority recommends that scheme participants notify Registered Native Title Body Corporates of project applications on determined Native Title land and other known eligible interest holders before projects are registered with the CER. Scheme participants would be required to provide the CER with evidence of this consultation. The Authority also recommends that the CER not allow scheme participants to bid at auction until all eligible interest holder consents have been obtained.

ADMINISTRATION OF THE EMISSIONS REDUCTION FUND

In general, stakeholders gave positive feedback on how the ERF is administered. The auctions and project administration appear to run reasonably smoothly, particularly given the scheme's complexity. In response to some feedback however, the Authority recommends the CER examine its processes to see if it can respond to complex enquiries more promptly.

The Authority examined the costs of administering the ERF to see whether it represents value for money. For a complex and evolving scheme, the Authority found that the ERF's administrative costs stack up well when benchmarked against similar government initiatives.

The Authority considered whether the CER has sufficient tools to facilitate smooth administration. The Authority recommends legislative change so that the CER can issue penalty infringement notices similar to fines for lower level infringements rather than seeking remedies in the courts and to clarify that administrative decisions can be reversed in cases where the original decision was based on incorrect information.

LOOKING TO THE FUTURE

Overall, this review has found that the ERF is generally performing well. It has successfully incentivised new domestic abatement at low cost that will help contribute to Australia meeting its international target commitments. The ERF has effective compliance architecture that supports both the crediting and purchasing arms of the measure.

This is no small feat. Establishing a robust approach to emissions reduction offsets is challenging given the complex blend of policy, administrative judgement and technical emissions estimation that is required as well as the need for timely and efficient client service.

The Authority remains of the view that ERF purchasing will need to perform less of Australia's emissions reduction task over time and that other policies will need to take up the challenge of decarbonising Australia's economy and deliver structural change. That said, the investment by both Government and the private sector in offsets through the Carbon Farming Initiative and now the ERF should be built on as part of the policy tool kit Australia needs to meet its Paris Agreement goals.