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2020 Review of the Emissions Reduction Fund Consultation Paper

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Climate Change Authority ('CCA') on the *2020 Review of the Emissions Reduction Fund Consultation Paper*.

The AEC is the industry body representing 24 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The Emissions Reduction Fund ('ERF') has been Australia's main national policy mechanism for reducing greenhouse gas emissions since 2014. Whilst the ERF has had at this time only minor impact on the energy sector, the AEC is very keen to see it succeed. AEC members' interests in it are for:

- The development of an active Australian Carbon Credit Unit ('ACCU') market, which is necessary for the sale of abated energy, either voluntarily or possibly in future by obligation.
- The exploitation of abatement opportunities outside the energy sector where they are lower cost than within.
- The potential greater use of the ERF to reduce emissions from the energy sector.

The ERF has explored abatement opportunities in areas like vegetation and savannah burning, which has also benefited regional communities. The ERF's reach into other sectors has been more limited and, if broadened, will enable Australia to more comfortably meet its emissions reduction target for 2030.

The AEC submits then that there is a need to review the methodologies of the ERF with a view to incentivising new offset opportunities. Furthermore, we support efforts to mature the ERF's processes to better enable transactions in the ACCU market. Some of the recommendations put forward in the recently published *Report of the Expert Panel examining additional sources of low cost abatement* (the 'King Review') might assist in this regard.

Meeting Australia's climate change targets and the role of the ERF

Australia's current emissions reduction target, agreed to under the Paris Agreement, is to achieve reductions of 26 to 28 percent below 2005 levels by 2030. To meet this target, the Australian Government has estimated it will need to abate approximately 695 million tonnes of carbon

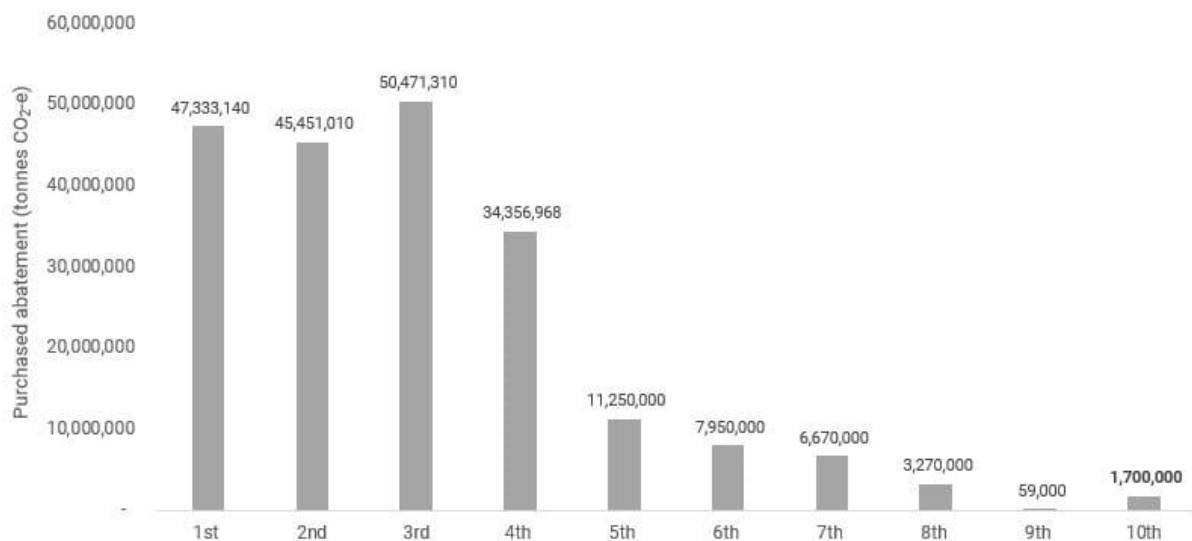
dioxide over the next decade (2021 to 2030).¹ This estimation does not take into account the Australian Government using carryover credits or revising its target in preparation for COP26.

Since the ERF's introduction in 2014, it has purchased 193 million tonnes of abatement through 463 contracts.² About 23 percent of this abatement has already been delivered with the remaining abatement scheduled for delivery across the next ten years.³ Vegetation is the largest portfolio of abatement, responsible for 125 million tonnes, followed by landfill and waste (25 million tonnes), agriculture (18 million tonnes) and savanna burning (13 million tonnes).⁴ Energy efficiency makes up about 5 million tonnes of the contracted abatement.

While these figures appear to represent good progress, the AEC has some concerns that the ERF has begun stalling. The graph below illustrates that over 90 percent of the tonnes abated through contacts occurred during the first four auction periods. Since then, there has been a significant slowdown in demand that will make it difficult for the ERF to fulfil its central role in meeting Australia's emissions reduction target unless new offset opportunities are incentivised.

Projects awarded contracts at Emissions Reduction Fund Auctions

Source: Clean Energy Regulator



A related problem to the slowdown in demand is the gradual increase in the average per tonne price of abatement, which is a sign that cheap abatement sources are drying up and new offset opportunities are needed. Further supporting this need is the concentration of current abatement

¹ Emily Hanna, Kate Loynes & Sophie Power, 'Climate Change', Parliament of Australia, https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/Briefing_Book46p/ClimateChange.

² Clean Energy Regulator, 'Tenth Emissions Reduction Fund auction results', Australian Government, 3 April 2020, <http://www.cleanenergyregulator.gov.au/ERF/Pages/News%20and%20updates/News-item.aspx?ListId=19b4efbb-6f5d-4637-94c4-121c1f96fcfe&ItemId=770>.

³ Clean Energy Regulator, 'Emissions Reduction Fund scheme performance', Australian Government, 1 August 2019, <http://www.cleanenergyregulator.gov.au/PublishingImages/Auction-results-July-2019/Ninth%20Auction%20July%202019%20Scheme%20performance-Ninth%20Auction%20July%202019.jpg>.

⁴ Clean Energy Regulator, 'Emissions Reduction Fund contract portfolio', Australian Government, 1 August 2019, <http://www.cleanenergyregulator.gov.au/PublishingImages/Auction-results-July-2019/Ninth%20Auction%20July%202019%20Contract%20portfolio-Ninth%20Auction%20July%202019.jpg>.

contracts in western New South Wales and south-western Queensland where almost 80 percent of contracts are located. While this has not created any challenges yet, diversifying the offsets sector should better protect the ERF in the event of a crisis, like the recent bushfires or COVID-19, disproportionately impacting these regional communities.

Incentivising new offset opportunities

The tenth ERF auction introduced flexible option contracts for the delivery of abatements with the apparent intent to encourage greater participation. It led to an increase in the purchased abatement from the previous auction and many of the contracts awarded adopted the flexible option. The AEC sees the piloting of flexibility in contracts as a positive initiative that the Clean Energy Regulator should build upon.

This should include looking at establishing avenues that enable proponents to bring forward their own methods to create new abatement opportunities. This is consistent with the CCA's first recommendation in its 2017 *Review of the Emissions Reduction Fund*⁵ while the recent King Review also recommended as such.⁶ The King Review went on to suggest that a pilot program, like what was used at the tenth auction to test flexible contracts, should be established for new method ideas and underpinned by administrative support. The AEC supports these proposals as a way to encourage innovation in future projects. In addition, we believe there should be a publicly available database that explains why certain methods are accepted or rejected based on the ERF criteria (e.g. integrity standards). This will help lower barriers to participation because it will enable stakeholders to self-assess what type of projects are most likely to succeed.

Additionally, the CCA should consider whether the ERF could provide for stewardship programs that target regions vulnerable to economic hardship (whether due to natural disasters or the transition away from fossil fuel industries). In this regard, the AEC notes that the Australian Government announced last year that it would be piloting a \$30 million Agriculture Biodiversity Stewardship Program, which would reward farmers for projects that boost biodiversity and absorb carbon emissions. The merits of piloting stewardship programs in other sectors, particularly those which have not yet strongly participated in the ERF, should also be considered. Such programs can enable information sharing and provide administrative support for regions that are not fully aware of the offset opportunities available under the ERF.

Consolidating the ERF architecture

Given that the ERF will remain critical to Australia's long-term climate policy, the AEC believes its processes should be matured and consolidated. This is necessary for participants to have confidence in the market when exchanging carbon credits. For the near future, demand for ACCUs will be based more upon government purchases rather than private sector demand. This is creating some uncertainty for participants because the regulator determines whether to purchase ACCUs based on price (rather than volume). Introducing a volume target, possibly linked to Australia's commitments under the Paris Agreement, might help instil more confidence in the market and encourage greater participation. As is more common for such volume-specified markets, it may be appropriate to consider a common-clearing price auction rather than pay-as-bid.

⁵ Climate Change Authority, 'Review of the Emissions Reduction Fund', Australian Government, December 2017, p13.

⁶ Grant King, Susie Smith, David Parker & Andrew Macintosh, 'Report of the Expert Panel examining additional sources of low cost abatement', Australian Government, February 2020, p8 (recommendation 6.1).

Finally, to support voluntary demand for ACCUs from the private sector, the King Review considered ways for the ERF to enhance the visibility of ACCUs. It recommended an ACCU registry system that would show who holds ACCUs and enable potential buyers to make contact.⁷ The AEC endorses this recommendation as a way to develop deeper confidence in the ACCU market.

The AEC looks forward to continuing working with the CCA to support Australia's transition to a cleaner future.

Any questions about this submission should be addressed to Rhys Thomas, by email to Rhys.Thomas@energycouncil.com.au or by telephone on (03) 9205 3111.

Yours sincerely,

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⁷ Id at p63 (recommendation 7.2).