



**CARBON MARKET**  
INSTITUTE

**Carbon Market Institute**  
**Submission – Emissions Reduction Fund**  
**Green Paper**

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## **ABOUT THE CARBON MARKET INSTITUTE**

The Carbon Market Institute is an independent membership-based not-for-profit organisation. Our aim is to assist Australian businesses in meeting the challenges and opportunities associated with market-based approaches to emissions reduction and the transition to a low carbon economy.

As the peak body for carbon market participants, CMI has established an important role in the evolution of the carbon market in Australia. The Institute facilitates the networks, knowledge exchange and commercial interaction amongst key government policy makers and regulators, industry, financiers and investors, professional services companies and technology solution providers.

CMI membership represents a broad range of professionals, organisations and industry. Our members include leading professional service providers, NGERs reporting entities, secondary market participants, offset providers, academia and international organisations. Individuals within the CMI membership base are some of the most respected Australian carbon market innovators and leaders.

CMI's Working Groups have played a key role in connecting government, bureaucrats and regulators with industry to facilitate the constructive input of member views into policy implementation. Drawing on the expertise of the CMI membership, the Working Groups have provided a vital forum for the exchange of information between market participants, policy makers and government agencies.

This CMI submission to the Emissions Reduction Fund Green Paper has been developed from extensive consultation with CMI members through dedicated Working Groups, workshops with the Minister for the Environment and the Department of the Environment and in many one-on-one meetings with members. This submission represents a synthesis of CMI member views, but is not representative of any individual company/member view.

## **EXECUTIVE SUMMARY**

The Government proposes in its Emissions Reduction Fund (ERF) Green Paper to reduce Australia's greenhouse gas emissions to meet internationally agreed targets through its Direct Action Plan with the (ERF) as its centrepiece. The Government's intention is for the ERF funding and the safeguard mechanism to be designed and implemented to provide a direct incentive for businesses across the Australian economy to reduce their emissions.

In framing the Carbon Market Institute's submission, the following key issues and guiding principles have been taken into account.

- Australia's commitment to a 5% reduction on 2000 emissions levels by 2020 is maintained as a minimum and the ERF should make a significant contribution to meeting this target.
- To cost effectively meet current and future targets, the ERF and safeguard mechanism should incorporate a market-based approach.
- An enduring policy framework should involve the transition from predominantly public sector funding to private sector funding of emissions abatement.
- All projects funded by the ERF should achieve real, measurable, additional and verifiable emissions reduction.
- To meet emissions reduction targets at lowest cost to the economy, the design of Australia's national scheme should keep open opportunities to link and trade with other international markets.

### **MEETING NATIONAL EMISSIONS TARGETS**

The policy design and implementation must meet the basic requirement to achieve Australia's emissions reduction targets to 2020 and beyond.

- The design of the ERF needs to be flexible to accommodate any potential change to the 2020 target and the post-2020 target.
- If the ERF is to be the primary means to meet emissions targets, more analysis needs to be done to determine the funds required out to 2020 for the ERF to meet targets under different national target scenarios.
- The design of Australia's national scheme should be considered in context with the policy measures and market developments that are taking place in international markets.

In particular, CMI recommends the following key design features to enable emissions to be reduced at lowest cost and so that Australia reaches its greenhouse gas emissions reduction targets – both current and future. Each of these design features are expanded on in the submission.

### **CREDITING**

- The existing Carbon Farming Initiative (CFI) framework should be used and expanded to provide governance and environmental integrity to projects funded under the ERF.
- It is important that abatement funded under the ERF meets clear additionality criteria.
- There are challenges to deliver real, additional, verifiable abatement using the 'facility methods' as they are described in the ERF Green Paper.

- In parallel with the design and implementation of the ERF, the existing CFI methodology development and approval process should be streamlined.
- Priority areas for methodology development need to be identified and should be informed by research into low cost abatement opportunities.
- A number of options exist to fast track the development and approval of new methodologies.
- The ERF's operations should be structured in such a manner as to allow for the participation of project aggregators.
- Under the ERF, there should be a single tradable unit representing a tonne of CO<sub>2</sub>e of abatement, an Australian Carbon Credit Unit (ACCU), which should form the basis of a secondary market and provide a link between the ERF and the safeguard mechanism.

## **PURCHASING**

- The annual allocation of ERF funds should be appropriated in legislation and effectively ring-fenced to provide certainty of funding to project proponents.
- In pursuing lowest cost abatement, the ERF should avoid undermining the development of the existing market for abatement.
- The pre-approval and auction participation eligibility process will be important to manage risks.
- Standardised contracts will generate a clear price signal and lead to greater confidence for project developers and investors to participate.
- The proposed five year contracting term is too short for many methodologies and may make projects unbankable.
- There should be a make-good provision for the under delivery of contracted project abatement.
- The auction design should be flexible and involve pre and post price disclosure and involve a learning-by-doing approach.

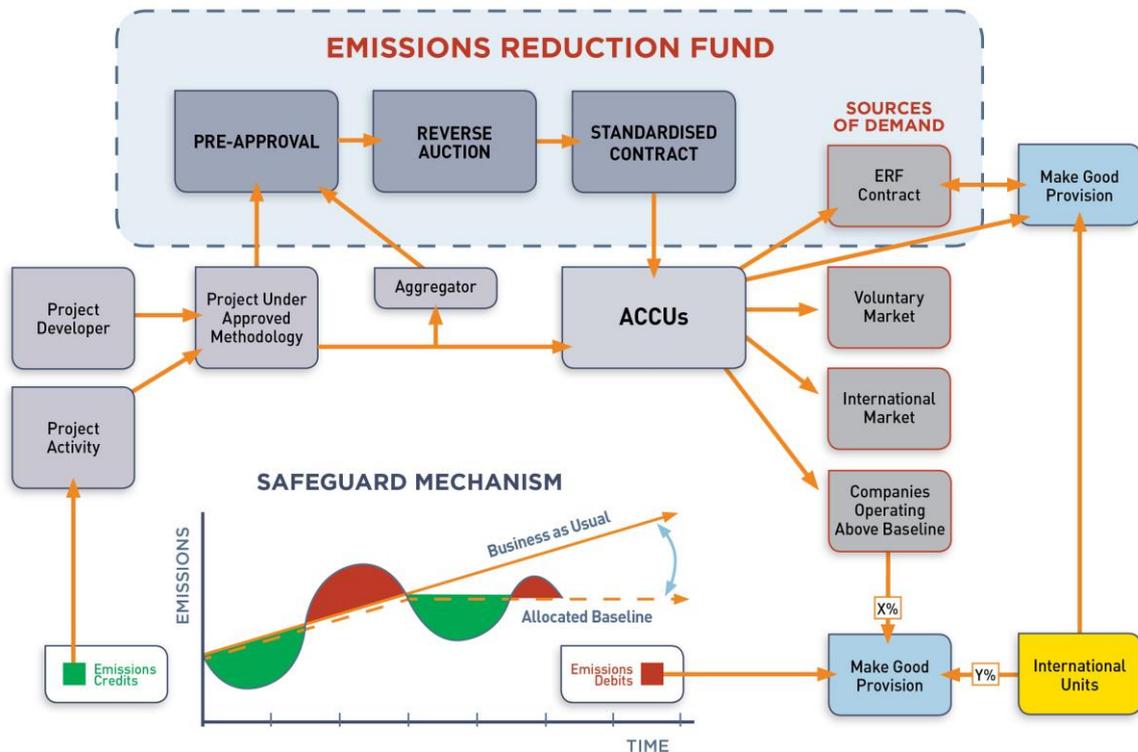
## **SAFEGUARDING**

- The safeguard mechanism should provide incentives for companies to operate below their baseline and include a compliance obligation/cost for companies exceeding their allocated baseline.
- The coverage of entities under the safeguard mechanism should initially include a significant proportion of Australia's largest greenhouse gas emitting companies.
- There needs to be flexibility and more consultation in setting industry baselines under the safeguard mechanism.
- Through the safeguard mechanism, the Government should have the ability to adjust allocated baselines over time to limit emissions growth and meet future emissions targets.
- The make-good provision for companies exceeding their baseline should be to purchase eligible units – either ACCUs or international units.
- The final design of the ERF and safeguard mechanism should allow for a secondary market to evolve, facilitating trading between entities participating in the ERF and/or covered under the safeguard mechanism.

## GOVERNANCE AND ADMINISTRATION

- The ERF and the safeguard mechanism should be administered by the Clean Energy Regulator but where appropriate draw on the appropriate external experience in managing a range of investment risks relevant to the portfolio of projects funded.
- Both the Emissions Reduction Fund and the safeguard mechanism must be underpinned by a rigorous, risk-based monitoring, reporting and verification (MRV) framework.
- Outreach should be an important factor in the roll out and uptake of the ERF.

The following diagram summarises the conceptual design features outlined in this submission and how the ERF and the safeguard mechanism is linked through a market-based approach.



**Figure 1: Summary of the design features of the Direct Action Plan, linking the ERF and the safeguard mechanism and including the ability for Government to adjust the baselines, as illustrated under the safeguard mechanism.**

# 1. KEY ISSUES AND PRINCIPLES FRAMING CMI'S SUBMISSION

In framing CMI's submission, the following key issues and principles have been taken into account.

## **1.1 Australia's commitment to a 5% reduction on 2000 emissions levels by 2020 is maintained as a minimum and the ERF should make a significant contribution to meeting this target.**

No single policy initiative will, in isolation, enable Australia to meet its internationally-agreed 2020 targets in a cost-effective manner. In addition to the ERF and the safeguard mechanism, a suite of policies will be required to contribute to meeting the target, including: the Renewable Energy Target, land use regulations, fuel emissions standards and energy efficiency policies as well as the possible purchase of eligible international units. Policy stability is important. The interaction between the ERF and other policy measures, particularly the RET, will need to be considered.

## **1.2 To cost effectively meet current and future targets, the ERF and safeguard mechanism should incorporate a market-based approach.**

Consistent with the Coalition's position before and after the September 2013 Federal election, the ERF and safeguard mechanism should involve a market-based approach. Market mechanisms allow the greatest reduction in emissions at the least cost and are crucial to efficient carbon price discovery and ensuring allocative efficiency across the economy. The final design of the ERF should allow for the development of a secondary market, facilitating trading between entities participating in the ERF, covered under a safeguard mechanism or as part of a voluntary market. The continuation of the Carbon Farming Initiative (CFI) should continue to provide an opportunity for Kyoto-compliant credits to be generated and traded in the primary and secondary markets established under the scheme and potentially traded internationally. The initial design of the ERF and the market-based safeguard mechanism should include the ability for the Government to adjust allocated industry baselines to meet current and future abatement targets.

## **1.3 An enduring policy framework should involve the transition from predominantly public sector funding to private sector funding of emissions abatement.**

The initial scheme should be designed so it is an enduring mechanism that provides long-term policy certainty and a market-based approach to meet emissions targets at least cost to the economy. Funding the 5% emissions reduction target, or any future increased target, will involve significant investment from both the public and private sector. Initially, the Government is committed to using public funds, through the ERF, to achieve emissions reduction. If the ERF is to continue as the primary basis for reducing emissions beyond 2020, the call on the Government budget may increase to very high levels. Therefore the transition into a market-based scheme, using the safeguard mechanism or other market-based approaches, will be necessary to defray the ongoing, indefinite public cost of funding emissions reduction.

## **1.4 All projects funded by the ERF should achieve real, measurable, additional and verifiable emissions reduction.**

Publicly funded emissions reduction/avoidance projects through the ERF or projects submitted for funding by companies operating below their baseline should be covered under an approved methodology. Verified abatement should be issued in the form of Australian Carbon Credit Units

(ACCUs) from the Clean Energy Regulator and redeemed against the ERF contract. Additionality, the requirement that emissions reductions be additional to 'business as usual' emissions, and that the reduction in emissions would not have occurred without the project having been implemented, must be a key feature of any projects funded under the ERF.

**1.5 To meet emissions reduction targets at lowest cost to the economy, the design of Australia's national scheme should keep open opportunities to link and trade with other international markets.**

The policy approach adopted in Australia should evolve in parallel with developments in other international markets. The design features of the ERF should maintain a line of sight to our Kyoto target and the international fungibility of ACCUs so as to enable linkages with other markets to be developed over time. This would benefit, for example, companies that have compliance obligations under the safeguard mechanism that could potentially manage exposure in a cost effective manner using a range of trading and hedging strategies such as the use of international units to meet compliance obligations, particularly so for large multi-national companies with operations in Australia. The development and expansion of the CFI could enable the potential export of ACCUs to international markets.

## **2. MEETING OUR NATIONAL EMISSIONS TARGETS**

### **2.1 The design of the ERF needs to be flexible to accommodate any potential change to the 2020 target and the post-2020 target.**

Under the United Nations Framework Convention on Climate Change (UNFCCC), Australia has an undertaking to reduce emissions unconditionally by 5% from 2000 levels by 2020. The target increases to 15% if there is an international agreement where major developing economies commit to substantially restrain emissions and advanced economies take on commitments comparable to Australia. The commitment is 25% if there is comprehensive global action capable of stabilising CO<sub>2</sub>e concentrations at 450ppm or lower. The Australian Government also has a long-term target to reduce emissions by 80% from 2000 levels by 2050.

In November 2013, the UN Climate Change Conference in Warsaw resulted in agreement to set a universal climate agreement at the 21st Conference of the Parties (COP) of the UNFCCC in Paris in November 2015. Countries will be detailing their national contributions and targets ahead of the 2015 COP. Once these are known, there is a distinct possibility that the conditions for a 15% target could be met and the Australian Government will need to be able to respond accordingly. It is important in the design of the ERF and the safeguard mechanism that Australia's emissions reduction target and the policy initiatives to achieve it need to be flexible to take into account any change to the 2020 target and post-2020 target under the new climate agreement made in Paris in 2015.

### **2.2 More analysis needs to be done to determine the funds required out to 2020 for the ERF to meet emissions reduction targets under different national target scenarios.**

At this point, it is not clear exactly what form and cost of abatement would be bid into the ERF and the appetite of potential bidders to invest. Therefore, it is also unclear what is the quantum of funds required out to 2020 to purchase the required abatement to meet current targets. It is also not clear exactly what proportion of the emissions reduction task, (detailed in the Green Paper as 431 MtCO<sub>2</sub>e from 2014 to 2020) is intended to be funded through the ERF and what proportion through other complementary policy measures.

Feedback from CMI members on the Green Paper indicate there may be inadequate funding to deliver all of the required emissions reductions to meet the 5% minimum 2020 target if the ERF was to be the primary means to achieve emissions abatement. To better inform the budgeting process, including any allocations made following the initial three year period, it is proposed that a research and modelling exercise should be undertaken to identify an indicative portfolio of projects, the range and volume of available abatement and the expected cost per tonne for the categories of abatement. This will need to be updated on a regular basis following the initial auctions to inform the budget process for allocating funds in subsequent years of the operation of the ERF. If Australia's 2020 emissions reduction target increases then the ERF's capped allocated funding of \$1.55 billion (for the first three years) is not scalable to allow for this.

There are concerns that the ERF will not create sufficient demand and provide sufficient incentive for investment in abatement projects and the design features of the ERF need to take into account such concerns. One option for scalability can be provided for by linking the ERF to the safeguard

mechanism to account for more private sector funding of abatement through the purchase of ACCUs as a make-good provision for compliance obligations.

### **2.3 The design of Australia's national scheme should be considered in context with the policy measures and market developments that are taking place in international markets.**

A range of market-based policy instruments is being utilised by countries to meet their national emissions reduction targets. In designing Australia's national scheme, the policy developments in international markets should be taken into consideration.

It is particularly important to consider the emissions reduction policy measures taken in Australia's key trading partners, a few of which are detailed below.

- *China* - Australia's largest trading partner<sup>1</sup> has committed to a 2020 emissions reduction target of 40% to 45% per unit of GDP, relative to 2005 levels. It has established seven regional pilot emissions trading schemes with the aim of developing a national emissions trading scheme by 2020. The seven schemes comprise 25% of total GDP.
- *USA* - Australia's third largest trading partner has committed to a 17% reduction in emissions by 2020 from 2005 levels. This is being driven by a combination of emissions trading programs in California and the Regional Greenhouse Gas Initiative (RGGI) covering nine north eastern states, along with EPA regulation introducing new carbon pollution standards under the Clean Air Act that will reduce existing power plant emissions 26% by 2020 relative to peak emissions in 2005.
- *South Korea* - Australia's fourth largest trading partner has committed to an emissions reduction target of 30% by 2020 based on a BAU scenario. A mandatory cap and trade emissions trading scheme will commence on 1 January 2015 covering 60% of national emissions.
- *UK* - Australia's sixth largest trading partner introduced the world's first national, economy-wide emissions trading system in 2002. In 2005, the UK became part of the European Union's Emissions Trading System (EU ETS), the world's largest carbon market.
- *New Zealand* - Australia's seventh largest trading partner has committed to an emissions reduction target of 5% below 1990 levels. The New Zealand Emissions Trading Scheme (NZ ETS) introduced in 2008, is a national level, intensity-based uncapped system that gradually phases in covered sectors from 2008 to 2015.

It will be important to understand the dynamics of these markets and monitor their demand for international units. Given the scale of the European, US and Chinese markets, any step change in demand would significantly impact the price of international units in Australia, should they be eligible for in the domestic scheme.

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<sup>1</sup> Department of Foreign Affairs and Trade (DFAT) – Composition of Trade Australia 2012-13. See <https://www.dfat.gov.au/publications/stats-pubs/cot-fy-2012-13.pdf>

### **3. KEY DESIGN FEATURES – CREDITING**

#### **3.1 The existing CFI framework should be used and expanded to provide governance and environmental integrity to projects funded under the ERF.**

The existing Carbon Farming Initiative (CFI) should be maintained as the overarching framework to govern the development and approval of methodologies and the issuance of credits in the form of Australian Carbon Credit Units (ACCUs). The infrastructure and governance is in place and project developers and proponents and secondary market participants are familiar with the process from registering as an Offset Entity, to conducting a project through to being issued ACCUs and then subsequently transacting them.

All projects bidding into the ERF should be covered under an approved CFI methodology determination or a new methodology developed under similar or streamlined rules.

#### **3.2 It is important that abatement funded under the ERF meets clear additionality criteria.**

Under the existing CFI process, administered by the Clean Energy Regulator, additionality of abatement activities is ensured if projects are delivered under an approved methodology. Each methodology determination specifies the applicable additionality requirements as well as clear rules for carrying out the activity for determining the project baseline, procedures for estimating abatement and data collection, monitoring, reporting and record-keeping requirements. To ensure consistency with the existing rules, all ERF project activity should fall under an approved methodology and be appropriately audited and verified against the methodology requirements. Although there are costs for the services necessary to meet audit requirements, the integrity of the verified emissions reduction is critical to provide confidence in the ACCU as a single tradable unit.

Projects potentially funded under the ERF may also be applicable to be funded under other government schemes such as state-based energy efficiency schemes. To ensure additionality, it will be important to verify that abatement is not double counted.

#### **3.3 There are challenges to deliver real additional verifiable abatement using the ‘facility methods’ as they are described in the ERF Green Paper.**

To assess the emissions reduction at a facility level, a baseline for crediting emissions will need to be set and reductions measured against it. The Green Paper proposes that NGERs data be used to determine these baselines. However, this data alone may not be sufficient to determine the specific abatement activities which have produced the emissions reductions as it will only reflect historical outcomes. There are distinct challenges for verifying additionality under the proposed facility method, as a reduction in NGERs reported numbers may be due to factors other than new investment in technology or practices.

For facilities that may be covered under the safeguard mechanism, the establishment of a baseline to assess emissions reduction credits could be different to the baseline that is set to manage emissions growth. This would be the case, for example, if an intensity-based baseline is used for the safeguard baseline and absolute emissions are used for the crediting baseline. The consultation,

establishment and operation of two separate baselines could be time consuming, confusing and an administrative burden.

An option for facility wide abatement that could be bid into the ERF would be for the abatement activities that are undertaken at a facility to fall under an approved methodology and aggregated and submitted as one consolidated bid. This process should still involve auditing and verification of each project activity.

### **3.4 In parallel with the design and implementation of the ERF, the existing CFI methodology development and approval process should be streamlined.**

The Government has proactively approached the task of streamlining the CFI. CMI members have been active in engaging with the Department of the Environment and advocating changes and improvements. Some of the proposed actions suggested by CMI members include:

- Reviewing the role and make-up of the Domestic Offset Integrity Committee.
- Improving the process and timeline for responding to applications for new methodologies.
- Improving transparency of the decision making process for approval of methodologies.
- Investigating the fast-track approval of international methodologies.
- Revising rules for carbon accounting.
- More direct ongoing industry involvement in implementing improvements.

A number of these changes and proposed improvements are underway and should be progressed irrespective of the policy development, design and implementation plan for the ERF.

### **3.5 Priority areas for methodology development need to be identified and will be informed by research into low cost abatement opportunities.**

Under the ERF a suite of new methodologies will need to be developed to complement the land-based emissions avoidance and sequestration methodologies under the current CFI. To enable funding across a wide range of projects, new methodologies will need to cover energy efficiency, waste coal mine gas, transport, biofuels, soil carbon, compost/recycling, building energy efficiency, industrial processes and other emissions reduction technologies and processes. It is important that in the initial stages of the ERF the priority new methodologies are identified that need to be developed and approved to enable the potential projects to be bid into the ERF.

Further project specific research on the possible abatement pipeline would be useful to inform which methodologies should get priority. The research should define an indicative portfolio of projects with their relative abatement potential, capital costs, greenhouse gas reduction potential and costs per tonne of abatement. Industry consultations and research would inform modelling of the potential ERF portfolio and could include the investigation of:

- Project types and abatement opportunities from major sectors.
- The indicative capital costs, payback and emissions reduction potential for the projects/technologies.
- Approximate cost per tonne for the project types.
- Expected crediting period for abatement technologies and processes.
- Potential pipeline of projects under each current CFI methodology.

- The major sources of likely large scale low cost abatement that could be bid into the ERF.

Consideration in the research and analysis should be given to the emissions reduction profile (the timing of ACCU generation) associated with the priority methodology to be developed. Availability of methodology specific technologies and the readiness of the sector to invest in and integrate the technologies into their processes should also be considered. The outcome of the research would be to identify an indicative portfolio of projects, the range of volume of abatement and the range of funding required under the ERF for the prioritised methodologies.

Once the priority abatement project types are identified, new methodologies can be developed under the existing CFI governance framework.

### **3.6 A number of options exist to fast track the development and approval of new methodologies.**

The range of approved methodologies that projects could bid into the fund can be expanded in four main ways:

- New methodologies proposed and approved under the existing CFI framework.
- ‘Import’ and adapt methodologies that have been approved in other jurisdictions.
- Adapt methodologies from existing Australian schemes.
- Establish a carbon Offset Project Registry

These are each discussed below.

#### **a) New methodologies proposed and approved under the existing CFI.**

Currently the Domestic Offsets Integrity Committee (the DOIC) accepts methodology proposals for assessment. Project proponents can follow the existing and revised streamlined processes to propose new methodologies.

#### **b) ‘Import’ methodologies from international markets.**

Internationally, credits for the abatement of greenhouse gases have been generated in Kyoto markets, voluntary markets, compliance markets and bilateral schemes. A range of government and non-government agencies have overseen the development and approval of methodologies and issuance of credits. Some of the leading global organisations involved in the development of methodologies include the CDM Executive Board, Gold Standard, Verified Carbon Standard (VCS), the Climate Action Reserve and American Carbon Registry. Collectively these organisations have developed 270 methodologies which have resulted in over 2.2 billion tonnes of emissions reductions.<sup>2</sup>

Some of the benefits of importing and adapting internationally approved methodologies and protocols include: fast tracking the number of abatement projects to be eligible to be funded under ERF; avoiding the need to undertake detailed methodology development, assessment and approval domestically; ensuring the availability and use of high quality methodologies that will enable quantification of emissions reductions under funding from the ERF and ensuring a high level of

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<sup>2</sup> CMI research.

environmental integrity and the use of Kyoto compliant methodologies (to contribute to Australia's 5% target).

The process to 'import' and adapt methodologies developed under international standards would involve a number of key stages that can potentially be aligned with the critical timeline for the initial operation of the ERF. For each methodology to be imported, a review would need to be undertaken to assess and identify any changes that need to be made to adapt the methodology to Australian conditions. The assessment for each methodology may include technical, scientific, legal and commercial criteria. Once the review is completed, and the proposed adaptations to the methodologies identified, the new methodologies can then be submitted through the existing process for methodology determination and ministerial approval.

**c) Adapt methodologies from existing domestic schemes.**

A number of domestic schemes have established guidelines for assessing emissions reductions through energy efficiency projects that could be adapted as new methodologies under the ERF. Two of those examples include the Victorian Energy Efficiency Target (VEET) scheme<sup>3</sup> (also known as the Energy Saver Incentive) and the New South Wales Energy Savings Scheme (NSW EES).<sup>4</sup> Another domestic initiative for commercial buildings that could be adapted into a methodology to cover commercial buildings is the National Australian Built Environment Rating System (NABERS).<sup>5</sup> Through NABERS, the Australian property industry has a credible standard that uses a national rating system to measure the environmental performance of Australian buildings.

**d) Establishing a carbon Offset Project Registry**

To increase the range of methodologies that could be used under the ERF over a longer term, the Californian model for the establishment of carbon Offset Project Registries (OPR) could be adapted. In California, the regulator of the cap-and-trade program, the Air Resources Board (ARB), accredits organisations to help facilitate the listing, reporting and verification of offset projects and to issue registry offset credits. These OPRs, including the Climate Action Reserve and American Carbon Registry, develop their own suite of methodologies or protocols to create credits that can be converted into offset credits used for compliance in the cap-and-trade program or sold into the voluntary market.

In Alberta, Canada, under the Specified Gas Emitters Regulation, C3 is a non-profit climate change and sustainability agency that facilitates the protocol development and review process for Alberta's offset system on behalf of the provincial government.

This model could be adapted to the ERF and would enable Australia's Clean Energy Regulator to set the rules for the role of the OPR and to recognise the methodologies developed under

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<sup>3</sup> VEET scheme is to reduce greenhouse gas emissions, encourage the efficient use of electricity and gas, and to encourage investment, employment and technology development in industries that supply goods and services which reduce the use of electricity and gas by energy consumers. See <http://www.energyandresources.vic.gov.au/energy/environment-and-community/energy-efficiency/energy-saver-incentive-scheme>.

<sup>4</sup> The Energy Savings Scheme is established under NSW legislation. Its main objective is to assist households and businesses to reduce electricity consumption and electricity costs. Businesses that save energy by installing, improving or replacing energy savings equipment can gain financial incentives by participating in the scheme.

<sup>5</sup> See <http://www.nabers.gov.au>.

internationally credible third party standards. Organisations such VCS, Gold Standard, the American Carbon Registry and the Climate Action Reserve could be registered to oversee the adaptation of methodologies they have developed that are applicable to adapting to Australian conditions and abatement projects. These organisations have significant experience in the operation of all aspects of carbon offset programs including the methodology development, project verification, registration and issuance. Involvement of these organisations could help leverage significant international expertise into the Australian system. Alternatively a national not-for profit organisation could be engaged to work with the Government to coordinate the integration of these offset programs and the adaptation and ongoing development of the methodologies.

### **3.7 The ERF's operations should be structured in such a manner as to allow for the participation of project aggregators.**

The ERF's operations should be structured in such a manner as to allow for the participation of project aggregators. By the very nature of their business model, the operation of aggregators will stimulate the market for abatement. Aggregation of projects to be bid into the ERF could help achieve projects of sufficient economies of scale, increase the diversity of projects and potentially support lowering the cost of emissions to bid into the fund. Larger bids will lower transition costs for project developers and for the administrators of the ERF.

It also makes sense for aggregators to be prequalified to participate in the ERF auctions but because they would be sourcing their carbon abatement from a range of projects, the prequalification of the projects themselves should be kept to a minimum.

### **3.8 Under the ERF, there should be a single tradable unit representing a tonne of CO<sub>2</sub>e of abatement, an ACCU, which should form the basis of a secondary market and provide a link between the ERF and the safeguard mechanism.**

Under the ERF all abatement should be issued with ACCUs as the consistent, unitised, tradable unit. For projects that are successful in securing a contract from the ERF, each tonne of abatement generated under an approved methodology should be issued with an ACCU which would then be redeemed for the contracted value from the ERF.

Market activity can be enhanced as ACCUs earned under the expanded CFI framework can be sold to the ERF, to businesses wishing to offset compliance obligations under the safeguard mechanism, to the voluntary market or into international markets.

ACCUs should remain 'financial products' and advisory services and/or trade in ACCUs should continue to be governed by an Australian Financial Services Licence (ASFL). An ACCU is transferable within Australia between accounts in the Australian National Registry of Emissions Units (ANREU).

## **4. KEY DESIGN FEATURES – PURCHASING**

### **4.1 The annual allocation of ERF funds should be appropriated in legislation and effectively ring-fenced to provide certainty of funding to project proponents.**

Certainty of funding allocated to the ERF is required to encourage participation from project proponents. The Green Paper outlines the ERF which will extend from 1 July 2014 to 2020 with initial allocations of \$300 million, \$500 million and \$750 million over the forward budget estimates. The ERF funding allocations beyond the initial three year period need to be modelled against what is required to achieve the ERF's contribution towards the overall 2020 emissions reduction target and the quantum detailed in the White Paper and legislation.

Should the full annual allocation of ERF funding not be utilised in a given financial year, through either lack of auction participation or project under-delivery, then the balance of funds should be rolled over into the following year's allocation to ensure that the ERF maintains its full funding commitment to purchase the required abatement to meet the 2020 target.

### **4.2 In pursuing lowest cost abatement, the ERF should avoid undermining the development of the existing market for abatement and risk of participation.**

Many CMI members support a banded approach for the ERF's purchase of abatement. There are good arguments for banding or allocations of funding to abatement classes or methodology types, including the following.

- Banding is a good risk management approach as allocations to specific categories of abatement projects avoid funds being absorbed by large volume, low cost projects and the associated risks that would bring for potential non-delivery for those large projects.
- A wide range of carbon abatement projects are in different stages of being developed and deployed and as technologies and abatement processes mature and commercial deployment increases, the cost per tonne of abatement typically reduces.
- There is an existing pipeline of over 100 registered CFI projects and many project developers and technology providers have invested in developing methodologies and emissions reduction projects.
- Banding would enable projects competing in an auction to compete on costs with other projects in their band on a like-for-like basis stimulating technology specific or sector specific competition.
- Banding supports projects with co-benefits that can create real value for project stakeholders across environmental, social as well as economic dimensions.

However it is clear from the Green Paper that the primary focus of the ERF is on the procurement of lowest cost abatement.

If the reverse auction process of the ERF only funds lowest cost abatement, there is no guarantee that different types of abatement projects will be funded or be financially viable, putting at risk the involvement of many experienced project developers (including a number of CMI members) from participating in the ERF auctions.

The Government needs to be mindful of investments made in existing CFI projects, including investments in methodology development. Ensuring that effective transitional arrangements are in place for existing CFI projects to move from the Carbon Pricing Mechanism to the ERF will minimise potential economic wastage associated with stranded investments made in good faith and avoid the perverse outcome that an expanded CFI might actually undermine the existing CFI market.

As detailed above, the ERF should be designed so that only projects operating under an approved methodology are allowed to bid into the auction. If auctions were held early after the proposed start date of 1 July 2014, it will result in a natural first mover advantage and positively favour the incumbent land-based CFI project proponents who can bid in under the existing approved methodologies, as many new methodologies would not have been approved at this stage. This implies a limited pool of abatement projects in the initial auctions. This may provide a viable avenue for incumbent project developers who may be outbid in future auctions when the scope for abatement projects that can be bid is broadened through the introduction of new methodologies.

It is expected that the range of bidders will expand over time as more methodologies are approved. The ERF's cost per tonne is likely to decline as the pipeline of abatement projects grow, technologies and processes mature and the scale of commercial deployment increases. The progressive roll out of new methodologies will enable the ERF to effectively build a portfolio of projects over time. It may, however, be prudent to keep open the option of some form of banding once the lessons are learnt from the initial auction results.

#### **4.3 The pre-approval and auction participation eligibility process will be important to manage risks.**

Conducting appropriate due diligence on prospective auction participants in the pre-approval stage will help to screen out unsuitable bidders and will be an important tool in managing abatement delivery risk. Prospective bidders should be required to successfully complete the pre-approval process in advance of auction participation. The pre-approval process could be administered by the Clean Energy Regulator or partially outsourced in cases where a particular set of expertise is required to evaluate project feasibility.

There are two principal sets of criteria that need to be considered in evaluating auction participation eligibility.

- a) The eligibility of the project itself, including a consideration of project specific factors such as delivery risk, financial resources, etc and the requirement for the project to operate under an approved methodology.
- b) Appropriate due diligence on the project proponent. As the ERF proposes to grant Government funding to project proponents it is prudent that it seeks to ensure that such recipients have the characteristics to safeguard against failure or abuse of the publically funded scheme. A 'fit and proper' person test should be used to determine eligibility.

The rigour and corresponding level of cost associated with the pre-approval process will also depend on the Government's objectives. There is a trade-off between ensuring that only projects with a reasonable likelihood of successful delivery are eligible to bid and encouraging maximum auction participation so as to drive down the auction clearing price and spread delivery risk.

#### **4.4 Standardised contracts will generate a clear price signal and lead to greater confidence for project developers and investors to participate.**

The Green Paper details the use of standardised contract terms and conditions so as to allow the lowest cost emissions reductions to be identified in the most efficient and transparent way, as successful auction participants will have access to the same terms. There is an implied commercial value to the range of contractual terms and conditions included in bespoke contracts which could distort the price signal generated from the reverse auction. The use of a post-auction standardised contract will generate a clear price signal to support allocative efficiency, streamline the contracting process and ensure probity.

The standardised offtake contract for projects successful in the auction should provide for payment upon delivery of abatement. Project proponents can utilise the Government-backed contract to leverage private sector finance. The use of a standardised offtake contract would assist in the financiers' familiarity with the contract structure and should facilitate greater levels of confidence for private sector investors. To assist in this regard, the Government should engage with project developers, aggregators, legal professionals, banks and the broader investment community prior to developing the ERF contract.

#### **The proposed five year contracting term is too short for many methodologies and may make projects unbankable.**

The Green Paper outlines that contracts will have a maximum duration of five years from their date of effect. This will restrict the bankability of medium to long term emissions reduction projects as, in absence of other reliable sources of ACCU demand, it is only possible to model a five year cash flow. As such, there is an opportunity cost; capital deployed to smaller scale projects with shorter payback periods at the expense of large scale projects with longer payback periods is likely to result in an increased cost of abatement over the long run.

The maximum five year contract term will focus investment on short term projects with immediate abatement profiles so as to meet the fund's objective of contributing towards the cumulative 431m tonne by 2020 task. New investment in projects with large initial capital outlays and longer commissioning periods may not be bankable without the contract covering the full term of the project. As a result, the limited tenure of the ERF contracts may inhibit the delivery of large volumes of low cost abatement in the later years of the fund. Should the 431m tonne 2020 target be increased through changes in the structure of the economy or through the process of international negotiation, the five year contract term will limit the scalability of the fund as it will likely be difficult to leverage additional private sector investment to meet this challenge.

The restrictive contract term of five years may disadvantage project developers of standalone projects, who may struggle to get financing, against larger companies who can use their own resources, debt or equity, to fund projects they may bid into the ERF.

The ERF should make clear how longer-term abatement projects will be considered and evaluated when applying for funding. One option would see the ERF effectively working as seed funding for the initial five years of development but this will disincentivise participation. Alternatively, while the intention is that the ERF will fund abatement on delivery, another option could include payment for

longer term abatement within the five year term, while ensuring that make-good provisions are in place for the duration of the agreed project duration.

Clarity around plans for the allocation of funding after the initial three years of operation is needed to ensure a pipeline of developments. Proponents need to understand how projects will be dealt with as we move closer to the 2020 deadline.

Additionally, it should be noted that the unspecific ability of the Clean Energy Regulator to vary contracts if implementation of projects is delayed, as currently drafted (ERF Green Paper section 3.3.2), would similarly make projects requiring financing unbankable.

#### **4.5 There should be a make-good provision for the under delivery of contracted project abatement.**

The ERF should require a make-good provision for the under delivery of contracted abatement to ensure that the Fund meets its objective of substantially contributing to the 2020 emissions reduction target and to do so with a preference for domestic abatement.

The ERF make-good provision could be managed using a waterfall mechanism as follows:

- a) In circumstances where a project underperforms and is unable to deliver the contracted volume of ACCUs, the project proponent could procure ACCUs from other sources (such as projects generating surplus ACCUs, aggregators and other secondary market participants) to make-good on the shortfall, upon which the balance of payment will be received at the contract price. In this instance, the project proponent's make-good through delivery of ACCUs ensures that the contract remains valid. It is expected, particularly in the early years of the operation of the ERF, that there is likelihood to be a limited supply of uncontracted/surplus ACCUs necessitating the need for an additional, more liquid alternative to manage the make-good provision.
- b) In circumstances where the project proponent is unable to purchase additional ACCUs to make up the shortfall, the project proponent could procure eligible international units, for example CERs, to make-good on the under delivery. The project proponent would receive payment for the CERs on par with or at a discount to the Clean Energy Regulator's CER reference price. In this instance, the project proponent's make-good through delivery of CERs also ensures that the contract remains valid.
- c) In circumstances where the project proponent is unable to procure ACCUs or eligible international units to make-good on under delivery within a given timeframe, this would constitute a breach of contract and the contract would be terminated. The ERF could then purchase eligible international units to cover the shortfall and any future tranches of abatement associated with that contract. The balance of funds (expected to be considerable due to the current large discount on international units relative to ACCUs) would then be rolled over into the next auction to provide additional demand for domestic abatement.

Using such a waterfall mechanism for the make-good provision ensures an appropriate balance of risk between the Government and private sector participants. Allowing access to liquid international markets enhances the bankability of the ERF offtake contracts and ensures that the ERF contributes significantly to the 2020 target while preferencing domestic abatement.

An alternative means of standardising the make-good provision could be to include a condition precedent in the ERF contract which requires successful bidders to purchase call options for international units with the volume and timing corresponding to the contract's schedule of delivery. The requirement to maintain appropriate levels of insurance is a common feature in many markets, though it will result in additional participation costs. The cost of the option premium would be borne more or less equally by all successful bidders and will therefore result in a marginally higher auction clearing price. As with the waterfall mechanism, access to international markets is required for the ERF to better manage delivery risk at lowest cost.

#### **4.6 The auction design should be flexible and involve pre and post price disclosure and involve a learning-by-doing approach.**

If the reverse auction is to function as a market mechanism, it should incorporate fundamental principles of best practice market design. The single round sealed bid auction process with an undisclosed benchmark price, as proposed in the Green Paper, does not promote transparency or efficient price discovery and may discourage ERF participation.

Whereas emissions trading schemes result in an explicit cost of carbon, the ERF's reverse auction process will generate an implicit, incentive-based carbon price signal. It is critical to design intra-auction and inter-auction price discovery processes to allow for the iterative formation of a price signal on the marginal cost of abatement across the economy. The efficient formation of this price signal will be used to inform investment decisions and quantify potential risks associated with bidding into the fund.

By reconfiguring the existing infrastructure for the auction of carbon units, a multiple round reverse auction could be run on a real-time electronic platform. Such an auction would open at a publicly disclosed auction benchmark price, with the price incrementally stepping down until the value of the remaining bids just covers the total value of the funds allocated to the auction. The auction would then clear at a single auction clearing price, which would subsequently be disclosed. Successful bidders could enter into a standardised offtake contract at the auction clearing price. Through their participation in multiple bidding rounds, unsuccessful bidders will know if their project was close to the auction clearing price or out significantly. It is important to note that there is as much price information in an unsuccessful bid as there is in a successful bid. This information will be used by ERF participants to better inform their future investment decisions in emissions reduction projects.

There will be significant learning-by-doing in conducting the first few auctions as in the early phases it will not be clear what type of projects will be bidding and at what price the auction may clear. Over time there should be efficient price discovery and auction volumes should increase. The Clean Energy Regulator should have discretion on the timing and frequency of the auctions, particularly in the early phases.

## 5. KEY DESIGN FEATURES – SAFEGUARD MECHANISM

### **5.1 The safeguard mechanism should provide incentives for companies to operate below their baseline and include a compliance obligation/cost for companies exceeding their allocated baseline.**

From CMI's understanding of the Green Paper, the safeguard mechanism would in practice operate separately from the ERF and provide an important policy lever to limit emissions from the economy. Whereas the ERF provides the 'carrot', the safeguard mechanism provides the 'stick'.

The main incentive for companies, which would fall under the safeguard mechanism to reduce emissions, would be the imposition of a compliance obligation if they exceed their allocated baseline.

Companies operating below their baseline could create credits through the generation of ACCUs by bidding for projects under an approved methodology to the ERF. As the Government does not seek to raise any revenue from the safeguard mechanism, companies exceeding their allocated baseline would face a make-good which may take several forms (see below).

However, a key issue to consider in adopting the safeguard mechanism is that, unlike a cap-and-trade scheme, overall emissions levels are not capped. In addition, increases in economic activity for an individual company can outweigh the emissions reductions associated with the project related reductions in a particular business unit that may be funded under the ERF.

The introduction and operation of the safeguard mechanism should follow further extensive industry consultation to determine coverage, the setting of baselines, compliance obligations and the mechanism and timing to adjust allocated baselines to meet future emissions targets. The rules and regulations around the safeguard mechanism should be established so that the mechanism can be an enduring policy instrument to manage emissions growth in the economy

### **5.2 The coverage of entities covered under the safeguard mechanism should initially include a significant proportion of Australia's largest greenhouse gas emitting companies.**

The safeguard mechanism could be applied to either a very broad range of companies/sectors or to a relatively narrow set. If all NGER reporting entities were covered under the safeguard mechanism, the scheme would extend to over 800 companies.<sup>6</sup> The Green Paper proposes that coverage could be set at a level that maximises emissions coverage but minimises the number of entities that would be covered under the safeguard mechanism. This approach has merit.

One option would be to apply the baselines to the companies currently liable under the Carbon Pricing Mechanism (CPM) or a subset of those companies.<sup>7</sup> If for example, the top 100 emitters under the CPM were covered under the safeguard mechanism (perhaps excluding landfill/waste), it would mean that a significant proportion of Australia's overall emissions would be captured under the mechanism.

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<sup>6</sup> <http://www.cleanenergyregulator.gov.au/National-Greenhouse-and-Energy-Reporting>

<sup>7</sup> This prospect was raised by the Environment Minister in the CMI workshop on October 2013.

In July 2013, CMI undertook an extensive survey of over 200 entities liable under the CPM to determine the lessons learnt in the first year of the scheme. One of the key findings was that there were ‘two tiers’ of liable entities, with the top tier being larger companies that typically have the internal capacity, management capability and established systems to be able to effectively report and operate under the CPM.<sup>8</sup> These top tier companies are those that are positioned to potentially draw on this capability, meet compliance and optimise their position under the safeguard mechanism.

Another option, as flagged in the Green Paper, would be to stage the coverage of the safeguard mechanism so that it would initially apply to a subset of industry – for example, those that exceed 100,000 tonnes of CO<sub>2</sub>e a year – and gradually expand the scheme to sectors where baselines may be more difficult to set and agree.

The safeguard mechanism should cover both Scope 1 and Scope 2 emissions.

### **5.3 There needs to be flexibility and more industry consultation in setting industry baselines under the safeguard mechanism.**

Setting baselines for entities covered under the safeguard mechanism should build on lessons learnt from other schemes and involve a flexible approach whereby emissions thresholds could be set on an ‘absolute emissions’ basis or an ‘emissions intensity’ basis as is appropriate for the facility. For example, an absolute emissions approach may be more appropriate for a facility that produces multiple products, while an emissions intensity approach (based on business as usual production) may be more appropriate for a facility that produces a single product.

While emissions intensity baselines work well for commoditised products such as electricity, cement, aluminium and steel, they can create anomalies and can become progressively more complex where there is a degree of product differentiation across a company or a facility.

How ‘business as usual’ is applied in the context of individual facilities, particularly where there is growth or changes in emissions intensity over time, needs to be carefully considered.

Once the methodology is determined to set the emissions baseline, there must be flexibility built into the system to allow businesses to account for any genuinely justifiable increases in emissions without the incurrance of a cost or compliance obligation. Also, absolute emissions thresholds set at a company/corporation level will be problematic to administer as companies grow, divest, merge and so on.

If the option to incorporate a subset of CPM liable entities as those covered under the safeguard was adopted, some of the processes and reporting could be leveraged to reduce time delays in ageing baselines and administrative complexity. The Emissions Intensive Trade Exposed (EITE) activity definitions for sector specific baselines developed under the Jobs and Competitive Package (JCP) could be adapted to set sector based baselines and companies would be covered under the mechanism on a facility/activity basis. The framework of the JCP provides a basis for sector wide baseline reporting and there are at least two years of audited historical data reported to the Clean

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<sup>8</sup> [http://www.carbonmarketinstitute.org/knowledge/lessons\\_learnt\\_from\\_the\\_cpm\\_year1](http://www.carbonmarketinstitute.org/knowledge/lessons_learnt_from_the_cpm_year1).

Energy Regulator through submissions for Government assistance that can be used in setting baselines.

Under the Clean Energy legislative package, the businesses that performed better than industry baselines were rewarded. Under the CPM, the EITE activities did not, however, extend to all industries that would potentially require baselines under the safeguard mechanism and many existing baselines may need to be updated.

Further investigation, analysis and industry consultation are required to determine how baselines should be set whether on a sector, activity, facility or a corporate wide basis.

#### **5.4 Through the safeguard mechanism, the Government should have the ability to adjust allocated baselines over time to limit emissions growth and meet future emissions targets.**

In the initial years of the operation of the safeguard mechanism, baselines can be potentially set to track against business as usual, meaning that few companies will be required to incur a financial compliance obligation (ie only in exceptional circumstances when their emissions intensity or overall emissions blow out). However, over time baselines can be set, or allocated, to decline against business as usual increasing the incentive to limit emissions growth and to invest in low carbon technologies or processes.

If allocated baselines for entities covered under the safeguard mechanism are reduced over time, it transfers the 'heavy lifting' to meet emissions reduction targets to covered entities, rather than the tax payer funded ERF. The cost for emissions reduction is transferred to those who are required to buy the credits. Over time the safeguard mechanism can become the primary means to manage emissions growth.

This declining baseline is consistent with driving sustained decarbonisation of major emitting sectors and incentivising more industry funded abatement to enable Australia to meet its 5% emissions reduction target.

# SAFEGUARD MECHANISM

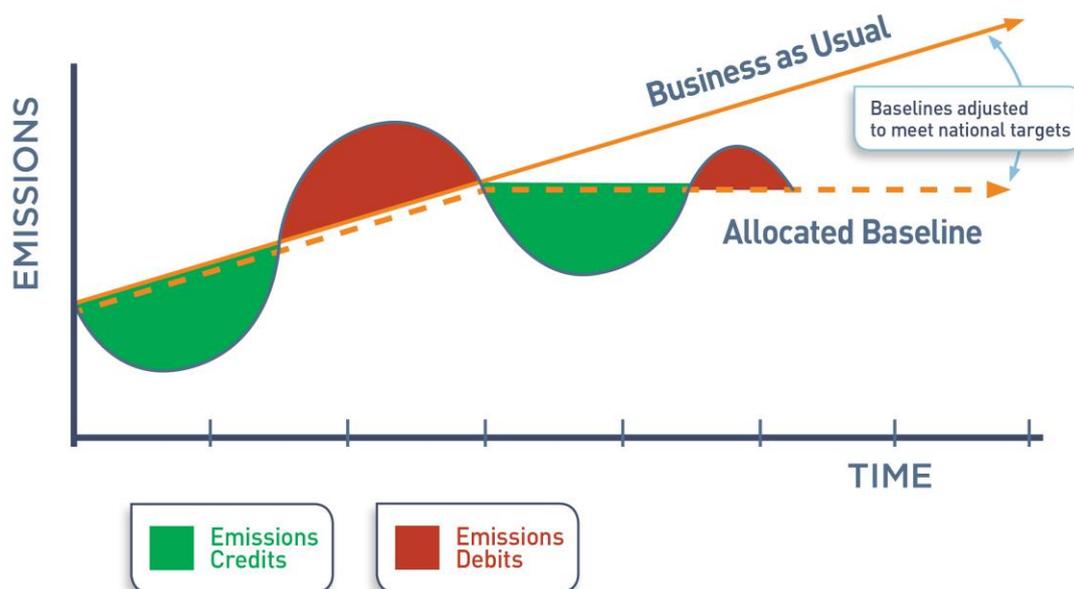


Figure 2: Safeguard mechanism with a declining allocated baseline against business as usual

In this scheme design it will be critical to define business as usual for the sectors covered.

The 'soft start', ie baselines track business as usual for the first few years, means that companies covered will have time to operate under the mechanism without the prospect of a financial compliance obligation. If the allocated baselines are planned to decline against business as usual over ensuing years, businesses covered under the mechanism will have time to plan for the change and make investments accordingly.

Implicit in this design is the need for long term certainty on allocated baseline levels and the timing of any changes/review to the mechanism rules. Targets and thresholds could be set and adjusted according to changes in national emissions reduction targets. The review and allocation of baselines could be conducted at regular predetermined intervals by a body such as the Productivity Commission.

## **5.5 The make-good provision for companies exceeding their baseline would be to purchase eligible units – either ACCUs or international units.**

The Government is not seeking to raise revenue from the implementation of the safeguard mechanism, however this does not necessarily mean there is no cost for companies covered under the mechanism that exceed their allocated baseline. Once the threshold of a compliance obligation is determined, companies could 'make-good' through the purchase of a) domestically sourced standardised, fungible carbon units – ACCUs or b) eligible international units or c) a mixture of domestic and international units.

The make-good provision requiring the purchase of ACCUs will stimulate the demand for domestic abatement but may come at a greater cost for compliance than the use of international units. Solely sourcing international units may undermine the domestic price for abatement and reduce the incentive for domestic abatement activity. A proposed option would be to limit the percentage of international units used in any make-good provision to say a maximum of 50% of any compliance obligation.

Any international units used by companies to meet their make-good requirements should be sourced from credible trading systems, that is, internationally recognised and verified.

### **5.6 The final design of the ERF and safeguard mechanism should allow for a secondary market to evolve, facilitating trading between entities participating in the ERF and/or covered under the safeguard mechanism.**

The ERF and the safeguard mechanism can be linked through the generation of ACCUs (ERF) and the purchasing of ACCUs (make-good provision for the safeguard). Depending on the final design of the two components, trading in the secondary market can help manage risk and meet obligations at lowest cost. As detailed in *Figure 1: Summary of the design features of the Direct Action Plan, linking the ERF and the safeguard mechanism* secondary markets activity can include:

- Sale/purchase of ACCUs generated under an approved methodology to the voluntary market.
- Sale/purchase of ACCUs generated under an approved methodology to the international market.
- Sale/purchase of ACCUs as a make-good provision for ERF contracted parties to meet any abatement shortfall requirements.
- Sale/purchase of eligible international units as a make-good provision for ERF contract parties to meet any abatement shortfall requirements.
- Sale/purchase of ACCUs generated under an approved methodology to the companies with a compliance requirement under the safeguard mechanism.
- Sale/purchase of eligible international units to the companies with a compliance requirement under the safeguard mechanism (taking into consideration the threshold for international units).

An active secondary market will create a demand for abatement, encourage investment in emissions reductions and provide sufficient liquidity for companies covered by the safeguard mechanism to manage their risks and make informed investment decisions.

## 6. KEY DESIGN FEATURES – GOVERNANCE AND ADMINISTRATION

### 6.1 The ERF and the safeguard mechanism should be administered by the Clean Energy Regulator but where appropriate draw on the appropriate external experience in managing a range of investment risks relevant to the portfolio of projects funded.

Where possible the existing infrastructure, governance processes and resources should be used to administer the ERF and safeguard mechanism. The Clean Energy Regulator has gained significant experience in administering the National Energy and Greenhouse Reporting (NGER) Scheme and the CFI.

Through a 'client' focussed approach in administering the Carbon Pricing Mechanism, the Clean Energy Regulator has built good relationships with industry and sector specific understanding of issues related to emissions reporting and management.

The existing CFI framework should be maintained as the overarching framework to govern the development, approval and expansion of methodologies and the issuance of credits by the Clean Energy Regulator in the form of Australian Carbon Credit Units (ACCUs). The NGER data could be used in baseline setting for the safeguard mechanism and provide the systems for monitoring and reporting emissions.

The Clean Energy Regulator as the ERF fund manager will need to manage a range of risks in each stage of the project approval, bid evaluation and contracting of projects and delivery of the abatement. Some of these risks include:

- *Delivery risk*: The risk the contracted project does not deliver the abatement.
- *Technology risk*: the risk the technology deployed on the project does not deliver at the level required to achieve the abatement contracted.
- *Counterparty credit risk*: assessment of the creditworthiness and financial status of the project proponent.
- *Regulatory risk*: the ability to manage the ERF investment strategy based on changes to regulations and policy.

The management of these risks is not currently a function for the Clean Energy Regulator and would require the addition of skills and experience. One option would be to leverage the existing capability and skills built up in investing in energy efficiency, low carbon technology and clean energy drawing from the expertise in the Clean Energy Finance Corporation (Low Carbon Australia). Another option would be to establish a panel of expert service providers that could be drawn upon to assist in assessments of pre-approval of ERF bidders and due diligence on projects.

### 6.2 Both the ERF and the safeguard mechanism must be underpinned by a rigorous, risk-based, monitoring, reporting and verification (MRV) framework.

A rigorous MRV framework is essential to underpin the Government's ERF policy position of '*ensuring emissions reductions are genuine*' and that the safeguard mechanism has robust audit procedures enabling a defensible response to '*compliance options in the event baselines are exceeded*'.

Regarding the ERF MRV framework:

- It is suggested a risk-based approach be applied to all abatement projects successful in obtaining ERF assistance on a 'sliding scale'.
  - 'Large' scale abatement projects should be subject to a reasonable assurance audit prior to the execution of the forward contract to ensure the projected abatement and expenditure is achievable, defensible and in-line with the applicable methodology.
  - 'Medium' scale abatement projects should be subject to a limited assurance audit prior to the execution of the forward contract.
  - 'Small' scale abatement projects may be subject to random limited assurance audits prior to the execution of the forward contract.
- It is suggested that for large and medium scale projects the audit costs are borne by the proponent.
- Select, random audits for small scale projects may be funded by the ERF in order to negate barriers to participation for small scale projects.

Regarding the safeguard mechanism MRV framework:

- It is suggested that a risk-based approach be applied to both the setting of initial baselines and a liable entity's performance against baselines for the given compliance period.
- Again, a sliding scale should be applied to determine mandatory audit requirements depending on the total facility emissions, regardless of whether an 'absolute' or 'emissions intensity' baseline is implemented.
  - 'Large' emitters would be subject to a mandatory reasonable assurance audit of their baseline to ensure the baseline is defensible and in-line with the applicable methodology. Annually their performance against the baseline for each compliance period would be subject to a reasonable assurance audit.
  - 'Medium' emitters would be subject to a limited assurance for initial baselines and for subsequent compliance periods.
  - 'Small' emitters may be subject to random limited assurance audits for initial baselines and for subsequent compliance periods and should also be encouraged to undertake voluntary audits in the absence of mandated audits.

In the event that sector level baselines are set, each sectoral methodology must also be subject to a reasonable assurance audit program and minimum participation rates (of covered entities within the sector) must be set to ensure baselines are representative of the population as a whole.

The existing CER audit functions, including Registered Greenhouse and Energy Auditors (RGEAs), would form the basis of the MRV framework under the ERF and the safeguard mechanism.

### **6.3 Outreach should be an important factor in the roll out and uptake of the ERF.**

The uptake of participation in the ERF will be enhanced through the provision of outreach services. Once the Government publishes a white paper, the legislation is written and the design features known, an extensive program of industry engagement should be undertaken to inform potential bidders about how to participate. Services could include the provision of webinars, seminars, policy briefings, information sessions, website portals and e-learning resources.

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