

National Emissions Trading Taskforce
Secretariat
The Cabinet Office
GPO Box 5341
SYDNEY NSW 2001



22 December 2006

Dear members of the National Emissions Trading Taskforce,

BCSE Submission on the Discussion Paper, *Possible Design for a National Greenhouse Gas Emissions Trading Scheme*

Email: submissions@emissionstrading.net.au

The Australian Business Council for Sustainable Energy (BCSE) is an independent member-based industry association representing the broader sustainable energy industry in Australia. The BCSE has more than 270 organisations as members covering renewable, gas and distributed energy generation equipment suppliers and installers, energy retailers and generators and energy service and efficiency providers. The common feature of our membership is their interest in meeting Australia's energy needs with lower greenhouse emissions.

The BCSE would like to commend the Taskforce on what is an excellent piece of work. The Discussion Paper canvasses all the major issues of importance to the design of a national emissions trading scheme and proposes a model that represents a reasonably sound compromise between competing interests and objectives. We would point out that the international community is now shifting rapidly, particularly in the US, and emissions caps that appeared quite impressive a few months ago could now be deemed unacceptably weak. We do not think scenario 1 caps represent a cap level consistent with the challenge posed by global warming and the relatively small cost to address it. Also we question why energy efficiency measures were not modelled for scenario 2 emission caps.

Once again we commend the states for undertaking this process and sincerely hope that any differences between jurisdictions that may emerge can be resolved satisfactorily for the larger benefit of the Australian community.

Yours sincerely

Original signed by

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Australian Business Council for Sustainable Energy

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Scheme start date of 2010

The BCSE supports the proposal for a start date of 2010 for a national emissions trading scheme. We would note it is critical that by the end of 2007 the jurisdictions have in place the mandatory greenhouse emissions reporting scheme currently being progressed by the Commonwealth. This will provide two years of live operation to firm up administrative arrangements, auditing and enforcement to provide confidence in the underlying measurement systems.

Coverage - cap applied to stationary energy, commencing with electricity and then expanded to other stationary sources

The BCSE supports the coverage proposal and thresholds put forward in the discussion paper, but would emphasise the importance of urgent introduction of mandatory, public reporting of emissions not only from the non-electricity stationary energy sectors, but also from other sectors likely to soon be brought into the scheme - such as fugitive emissions. Availability of this information will be critical for participants in the permit market so they can make reasonably informed judgements about possible implications from the future inclusion of these non-electricity sectors. Without this information the confidence in the emissions trading market will be reduced.

We also believe that the timetable for expansion into non-electricity sectors needs to be brought forward to 2012 and that early inclusion of non-stationary energy sectors should also be prioritised. There are concerns about the level of market liquidity in the early years of the scheme, and the speedy introduction of other sectors will improve this. Some further discussion of how other sectors will contribute to the abatement task is also needed.

Exclusion of transport is not ideal and certainly not necessary from a technical perspective, but has benefits for the acceptance of this Scheme by a community sensitive to petrol prices. We would suggest that the States provide consideration to the value of fuel economy/greenhouse emissions standards for new cars similar to what is already done for many electrical appliances (minimum energy performance standards).

Level and time frame of the emissions cap

Level of cap

The level of the cap proposed under scenario 2 will meet one of the key tests set by our previous submission, which was to prevent a major investment mistake such as constructing a new conventional coal-fired power station. In that respect it is a positive step forward. Considering the small economic impact of scenario 2 caps (which would be smaller with sound energy efficiency policies) we can see no justification for adoption of the less stringent scenario 1 caps.

In fact the BCSE believes the level of the cap needs to be strengthened to a level tighter than proposed under scenario 2 for several reasons:

- It is generally accepted that in order to manage the risk of overshooting 2 degrees C of warming it will be necessary to reduce our emissions by 60 per cent by the year 2050. The cap should be consistent with this target, while not leaving the lion's share of the abatement task to the years post 2030.
- The expected cost per tonne of CO_{2-e} emitted under scenario 2 is at most \$35 over the life of the scheme. This is well below the social cost of carbon estimated by the Stern Review of USD\$85 per tonne CO_{2-e} under a business as usual scenario. Based on the valuations derived by the Stern Review there is a very strong argument for a far more stringent cap than Scenario 2.
- It is not consistent with the NSW Government's commitment to stabilise its overall greenhouse emissions from all sectors (not just electricity) at 2000 levels by 2025. Our understanding is that

NSW emissions from all sectors, not just electricity will grow substantially between now and 2025. According to the NSW Greenhouse Strategy, emissions in NSW are expected to grow from 151m tonnes CO_{2-e} in 2002 to 211m tonnes by 2020 under a business as usual scenario. Unless NSW provides a significantly disproportionate contribution (compared to other states) to the overall emissions reduction task set by NETS, then they will fall well short of their target. This seems unlikely, and there are no abatement measures covering other sectors that could be expected to deliver equivalent reductions to ensure achievement of the 2000 level target.

- It is significantly weaker than targets adopted by a number of other jurisdictions operating overseas (see table 1 below). These other jurisdictions' targets provide an indication of what is likely to be required under an international greenhouse emissions control agreement. Setting a cap that is considerably higher than what may be subsequently imposed through an international agreement creates a high risk that governments will be obligated to provide significant compensation. It is important that this scheme avoid the mistakes that have occurred in relation to over allocation of water rights.

Table 1 - Targets adopted by jurisdictions overseas

Jurisdiction	Target
European Union	15%-20% below 1990 levels by 2020
Germany	40% reduction by 2020 from 1990 levels
California	Reduce to 1990 levels by 2020
North-East US states covered by Regional Greenhouse Gas Initiative (Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York, Vermont, Maryland (Massachusetts expected to also join))	10% below current levels by 2019 for the electricity sector.
US Congress - Safe Climate Act (Sponsored by House Speaker Nancy Pelosi) (yet to be voted on)	Reduce to 1990 levels by 2020
US Congress – Climate Stewardship and Innovation Act (Sponsored by Senators McCain and Lieberman) (not passed but expected to be reintroduced)	Stabilise emissions at 2000 levels by 2010 for electricity generation, transportation, industrial, and commercial sectors
New Mexico	10% below 2000 levels by 2020
Arizona	Stabilise at 2000 levels by 2020
Oregon	10% below 1990 levels by 2020

Time frame for setting of cap

The BCSE supports the proposal for 10 years of firm caps set on a rolling annual basis with another ten years of gateways. However we believe the level of these gateways should be more stringent than that contained within scenario 1 and 2. We believe these levels are likely to be insufficiently stringent to satisfy the requirements of a future international greenhouse emissions control scheme, and open Australian governments to significant compensation claims.

Penalty

The BCSE supports the proposal that there be a civil penalty which also acts as a price cap on emission permits (no “make good” provisions). We suggest that the penalty level be escalated over time, increasing incrementally as the target becomes increasingly stringent and the marginal cost of abatement increases. Thus the penalty should ensure compliance throughout the period of the scheme but not be unnecessarily high such that it might generate a misleading impression of the expected cost of the scheme.

Offsets

The BCSE supports the proposal that offsets be recognised under the scheme, where the sectors are not covered. The BCSE suggests that the NETS scheme build upon the NSW/ACT GGAS methodologies and baselines as much as possible. This will smooth the transition from GGAS to NETS, build on expertise and experience that already exist, and avoid harming investment confidence in GGAS while it is still in operation.

In relation to priority areas for offsets we would suggest methane destruction associated with coal mine operations should be added to the existing priority areas. Considering this option is already included within GGAS, this should pose little methodological difficulties and would pick up another area offering potential for low cost abatement that is not currently proposed for coverage.

The BCSE believes that carbon capture and storage should not be treated as an offset where the CO₂ sequestered is from a covered sector, for example - power generation. In this case, the generators reduce their need to purchase emissions permits through the capture of greenhouse gas emissions.

The BCSE supports the proposal that NETS would **not** apply a financial/investment additionality test on a project by project basis. This kind of exercise is fraught with subjective, excessively bureaucratic assessment processes that are characterised by very high transaction costs and delays. In addition they work against innovation by penalising businesses that can find ways to achieve abatement at the lowest possible cost. The experience of the Federal Government's Greenhouse Gas Abatement Program is a powerful lesson in the problems of such an assessment process.

It is far better for government to set transparent and unambiguous rules upfront that apply to all so that businesses can independently make their own decisions about the commerciality of a particular abatement project within the bounds of the rules.

The BCSE would only support the use of CERs from CDM projects under strict conditions. Australia is one of the most greenhouse intensive economies in the world. One of the key rationales for implementation of emissions trading scheme now is to lower Australia's risk exposure in the interests of better positioning the country in the event that an international greenhouse control agreement is put in place down the track. Widespread use of CERs, instead of lowering domestic emissions, will do little to address this carbon risk exposure and send money overseas to support other economies in lowering their own carbon price exposure. The BCSE believes CERs should only be allowed in lieu of Australian permits or offsets if:

- CERs can only be utilised once the price of domestic permits or offsets exceeds the penalty price; or
- There is a limit on use of CERs to no more than 10% of the total cap.

Nature of permits and permit allocation

Time period of permits

The BCSE supports the proposition that there be only one form of permit – the annual permit.

Objectives of permit allocation and manner of allocation

While the emissions cap will impact on future investment decisions and NEM dispatch, the decision as to the balance to strike between allocation and auctioning will depend on wider economic and political considerations.

The BCSE believes there are a number of objectives of permit allocation, including:

- compensating those who are genuinely adversely impacted by emissions trading, including:
 - generators who will not be able to pass their full cost increases through to the market
 - communities and low-income households, and
 - trade-exposed energy intensive industry, thereby
- maximising the political acceptability of the scheme, while
- minimising windfall gains for pre-existing polluters and risk of market collapse

Emitting companies will be able to pass through to the market most of the cost increases incurred through their permit liability. Allocating permits to these companies creates a strong risk of over compensating them, creating windfall profits and repeating the errors of the European Union Emissions Trading Scheme (EU ETS). Therefore, allocations to these companies should strictly only cover their likely reduced profitability. Indeed, NY State in the US is so concerned to avoid the European Union's mistake of allocating too many permits, that according to the draft rules on how the state will implement the Regional Greenhouse Gas Initiative, all of the state's emissions allowances under the programme will be auctioned.

If a negative impact on economic growth is our primary concern we may be able to get a better economic outcome from auctioning the permits to fund reductions in distortionary state taxes such as payroll tax or stamp duty, rather than allocation. Another option with economic benefits is using funds from auctioning to fund energy efficiency programs that overcome market imperfections and reduce Australia's exposure to future increases in carbon prices.

Social dislocation and equity concerns are also relevant. Changes caused by emissions trading may lead to some people and communities suffering losses that are a significant proportion of their income or wealth such that they are placed in a vulnerable economic position. Citizens of communities heavily dependent upon incomes flowing from employment associated with coal fired power stations may fit into this vulnerable group. It is unlikely that they will be in any way assisted by substantial free allocation of permits to emitting companies. Another vulnerable group may be low income households for whom energy makes up a substantial proportion of their income. These people may be best assisted through measures to improve the energy efficiency of their residence.

Assistance may also need to be provided to companies to shield them from unfair overseas competition where greenhouse emissions remain unpriced. For this reason the BCSE supports free allocation of permits to energy-intensive, trade-exposed industries likely to face significant adverse impacts on profitability. This seems reasonable due to the current lack of a global agreement that prices carbon in a number of nations that are trade competitors but could be removed once a global regime is put in place. We support the proposal that this be linked to output levels and that permits are provided on an annual basis and not an up-front basis. However those receiving this benefit should be subject to an independent and publicly available evaluation of the competitiveness, profitability and environmental impact of a carbon pricing regime as would exist under NETS (taking into account those carbon pricing schemes already operating in other international jurisdictions) versus one applied uniformly across the globe. Free allocation of permits is a substantial form of compensation and it is reasonable to expect that claims of hardship should be subject to public scrutiny. Of concern to the BCSE is the repeated claim that global emissions would increase if companies move operations overseas when often our overseas competitors rely on electricity sources with substantially lower greenhouse intensity. Claims for assistance should be backed with data and rigorous analysis. Also those receiving such assistance should be required to enter into agreements to minimise their emissions through such things as improved efficiency.

Another major consideration in favour of assisting those adversely affected by emissions trading is to increase the political acceptance of the scheme such that it is ultimately implemented. If this is an important criteria then assistance may need to be focussed not so much at energy consuming or supplying companies, but rather final consumers.

Maximising auctioning will maximise the funds available to do this – to compensate adversely impacted households and communities as well as energy-intensive, trade-exposed industry. It will also create a funding stream for demand side abatement projects, which, while economically very attractive, will not otherwise be sufficiently incentivised by the scheme.

The BCSE supports the proposition that permits be structured as secure property rights and that use it or lose it rules be avoided for generators, but we are concerned about the proposal that permits be allocated in a lump sum fashion to generators free of charge on the basis of profitability impacts for the next 20 years. This principle has some sound reasons behind it (expedite efficient restructuring of electricity sector, life of generating assets is often as much if not more than 20 years) but we have a concern that this could create a situation that would hinder governments' flexibility to increase the stringency of the scheme after the first 10 years of firm caps.

In summary, the BCSE advocates that at a significant proportion of permits be auctioned, with revenue used for a mix of purposes including:

- Directly assisting private individuals adversely impacted by structural adjustment and increased energy prices brought on by the emissions trading scheme;
- Funding demand side abatement incentive and information schemes to overcome behavioural barriers and market imperfections, thereby ultimately reducing the economic impacts of emissions trading;
- Supporting the research, development, demonstration and deployment of low emission energy technologies with the aim of reducing long-term abatement costs and developing new industries to replace those made less viable from a carbon constraint.

The funds from auctioning should be funnelled into an independent statutory entity not unlike the Carbon Trust that operates in the United Kingdom. This entity would have criteria and processes for determining how funds are to be allocated defined within its charter. The charter would be open to public comment and periodically revised subject to a public consultation process every few years.

Institutional arrangements

Ideally the Commonwealth would take ownership of this emissions trading proposal and this would be the BCSE's preferred model, but the implementation of this scheme should not be contingent on their involvement. The Stern Review, in addition to a range of other pieces of substantial scientific and economic research, shows we need to take action now to price greenhouse emissions. Implementation of emissions trading by 2010 is a sound and necessary government initiative. If the Commonwealth does not wish to be involved, the States should seek to find alternative institutional arrangements to make the scheme a functioning and effective reality. The States would each elect a member to the board of any central bodies charged with managing the emissions trading scheme.

We question whether oversight by the Ministerial Council on Energy is too narrow considering that greenhouse emissions and pollution matters more generally are often primarily a responsibility of environment ministers. For example Victoria has just appointed John Thwaites as the Minister for Climate Change, but has another minister responsible for energy. Environment ministers already take carriage of pollution regulation that applies to power stations and other large stationary energy users. It may be better to have emissions trading as a joint responsibility of the MCE and the Environmental Protection and Heritage Council.

We support the proposal for a central body responsible for advising on a range of ongoing policy issues surrounding the scheme and another body charged with being the regulator of the scheme. We have also recommended that a central statutory body be established to allocate funds from auctioning revenues to assist individuals adversely affected by the scheme, encourage energy efficiency and support development of low emission energy technologies, similar to the UK's Carbon Trust.

Emissions monitoring, reporting and verification

The BCSE has made several submissions to other reviews related to developing a greenhouse reporting framework, including the current COAG process for harmonisation of energy and greenhouse

reporting. These submissions are publicly available and indicate our views on the appropriate emissions monitoring, reporting and verification regime.

Currently our primary concern is that the process for development of a greenhouse and energy reporting framework is being led by the Commonwealth who is yet to indicate a strong desire to pursue a domestic emissions trading scheme, and is likely to have different priorities to those of the States. The States must apply a very strict timetable to the process being led by the Commonwealth otherwise it could undermine the feasibility and timetable for implementation of emissions trading.

Transition to NETS and complimentary measures

The Stern Review has set out that, *“policy to reduce emissions should be based on three essential elements: carbon pricing, technology policy, and removal of barriers to behavioural change.”*

An emissions trading scheme covers off on the first and probably most important item which is carbon pricing. However the other two items are also essential and should not be seen as alternatives that need to be phased out, but rather as complements that work with carbon pricing to deliver a sound long-term, affordable response to climate change. There are market imperfections in relation to technological development related to the appropriability of gains from innovation and learning and also transaction cost barriers related to energy efficiency. Leaving these market imperfections untouched will increase the long-term economic cost of emissions trading and potentially hold back political acceptance of necessary emission reductions.

Renewable energy target schemes such as MRET, VRET and now the NSW Renewable Energy Target all need to continue in parallel with emissions trading. These schemes have objectives beyond abatement related to technology development (these schemes should be seen as part of a broader international effort) and industry development. Abolition of these schemes would be a significant sovereign risk issue with several hundred million dollars of investment associated with these schemes. According to the Stern Review, *“the scale of existing deployment incentives worldwide should increase by two to five times, from the current level of around \$34 billion per annum. Such measures will be a powerful motivation for innovation across the private sector to bring forward the range of technologies needed”*. If there is concern that these market-based measures provide insufficient support for a broader suite of less mature technologies, then the schemes should be expanded and amended, not scrapped. The UK, for example, is considering altering the structure of their Renewables Obligation to encourage a broader suite of technologies. Any scheme needs to balance achieving the benefits from competition between technologies with the need to bring on new technologies whose promise may be great but which are immature and expensive. A fine balance that is unlikely to ever be perfectly resolved.

The Queensland Gas Target stimulus could, however, largely be replaced with emissions trading providing the cap was set at a level beyond that contained with scenario 2. The key concern with any phase out of the Gas Target is that it should not unduly threaten the viability of new investments that were undertaken on the basis that the Scheme would last until 2020. It is conceivable that the price of Gas Electricity Certificates could drop rapidly due to over-supply in the not too distant future which could facilitate an easier transition - but this is not certain.

The NSW GGAS scheme is largely an attempt to price carbon and thus should be phased into the national emissions trading scheme with inclusion for all offsets currently covered by GGAS.

However GGAS also incorporates a number of innovative features related to demand side abatement (DSA) which will not be covered by the proposed cap and trade emissions trading scheme. Indeed, despite a wealth of economically attractive technologies and options, demand side abatement will be poorly covered by a NETS, with only significant power price hikes likely to promote many DSA projects. Furthermore, any limited DSA activity is likely to be confined to the commercial and industrial

sectors. Measures need to be put in place to counteract the loss of support for demand side abatement once GGAS is phased out. A possibility is implementing a national energy efficiency target under stage 2 of the National Framework for Energy Efficiency. The Victorian Government has committed to the introduction of an energy efficiency target involving tradeable certificates, and this could be merged with GGAS demand side abatement and rolled out nationally as one harmonised scheme. Another possibility is use of emission permit auction revenues to fund a nation-wide energy efficiency incentive and promotion program.

In terms of providing support for technologies that are not yet at the deployment stage, a proportion of permit auction revenues could be funneled into low emission energy technology research, development and demonstration.

Finally, while the BCSE is strongly supportive of this scheme commencing on a national basis, in a circumstance where not all the states choose to ratify the proposal, we would still support the scheme commencing. A modified scheme initially involving at least NSW and Victoria (at a minimum), would still achieve reasonable coverage of the electricity generation sector.