



australian network of environmental defender's offices

Submission on the Issues Paper for a National Energy Savings Incentive

27 February 2011

The Australian Network of Environmental Defender's Offices (**ANEDO**) consists of nine independently constituted and managed community environmental law centres located in each State and Territory of Australia.

Each EDO is dedicated to protecting the environment in the public interest. EDOs provide legal representation and advice, take an active role in environmental law reform and policy formulation, and offer a significant education program designed to facilitate public participation in environmental decision making.

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Executive Summary

The Australian Network of Environment Defenders Offices (**ANEDO**) welcomes the opportunity to make a submission on the design of a National Energy Savings Initiative (**NESI**). A NESI is a major step towards improving Australia's energy efficiency and reducing our greenhouse gas emissions.

We strongly support the introduction of a NESI. It is a proven mechanism for reducing greenhouse gas emissions and reducing rising energy costs. It will complement the carbon price by removing non-price barriers which inhibit it. It will consolidate and expand the energy efficiency obligations in Victoria, New South Wales (**NSW**) and South Australia (**SA**). It should be implemented without delay.

It is important to design the NESI so as to make it as effective as possible. The following submission makes a number of recommendations for doing that. Those recommendations are grouped under three headings:

1. Interaction with other schemes
2. Objectives
3. Major Design Elements

As a network of public interest environmental lawyers, we have confined our recommendations to matters of legal and regulatory policy, and have accordingly answered only some of the questions in the Issues Paper. The footnotes to each section explain which questions from the Issues Paper are addressed in that section.

We are happy to provide further comment on our submission or the NESI, including at meetings or public hearings, if that would be helpful. Please contact Michael Power on (03) 8341 3100 or michael.power@edo.org.au for more information.

Summary of Recommendations

1. Interaction with other schemes

- A single national NESI should be implemented without delay.
- Rather than wait for the consent of COAG, the Commonwealth should move to implement a NESI, and consult with the States while it is doing so.
- The NESI should be implemented through Commonwealth legislation.
- The NESI must not credit activities mandated or supported by other schemes.
- The NESI should run indefinitely, in recognition of the resilience of the non-price-barriers that it is designed to address.
- The NESI should run in 3 year phases, with a review before each phase ends.

2. Objectives

- The primary purpose of the NESI must be to improve energy efficiency.
- The purposes of doing that should be (in order of priority):
 - (1) to reduce greenhouse gas emissions and mitigate climate change
 - (2) to reduce household energy costs (particularly low-income households)
 - (3) to reduce business costs and improve economic competitiveness.

3. Major Design Elements

- The NESI should be a baseline-and-credit scheme like those in other states.
- The NESI should use tradeable certificates.
- The NESI should cover all sectors with non-price barriers to energy efficiency.
- The NESI should cover electricity and gas under one target.
- The NESI must use sub-targets ('ring-fences') to prioritise energy efficiency improvements in those sectors where the public benefits of doing so are highest.
- The NESI target should be measured in tCO_{2e} reduced.
- NESI targets should set based on what is environmentally necessary.
- The penalty for not surrendering certificates should be at least 130% of the 'benchmark price' for certificates, coupled with a 'make-good' obligation.
- The NESI should allow banking of certificates, for up to 3 years initially
- The NESI should not allow borrowing.
- The NESI should include a sub-target ('ring-fence') for low-income households.
- The point of obligation should be energy retailers with over 5,000 customers.
- The regulator must not approve eligible activities unless they pass an 'additionality test'.
- That test should exclude activities which are already mandated or supported by other programs, or which are likely to have happened anyway.
- The independent regulator must decide which activities are eligible.
- That decision must be based on statutory criteria based on science.
- Third parties should be able to apply to have an activity listed as eligible.
- Any person should be able to apply for merits review of the regulator's decision.
- Whether savings are deemed or calculated should depend on what is economic.
- The NESI should adopt the verification rules used in the Victorian Energy Efficiency Target (**VEET**).
- Liable entities should bear liability for certificates that don't meet requirements
- The NESI should adopt the penalty and offence provisions used under the *Clean Energy Act 2011* (Cth) and the Carbon Farming Initiative

1. Interaction with other climate programs

1.1 Interaction with State schemes¹

ANEDO strongly supports the introduction of a single national scheme. A NESI would expand the scale and reach of the existing energy efficiency obligations in Victoria, SA and NSW. It would also simplify them by harmonising the differing schemes into a single consistent legal framework, reducing cost and complexity.

The NESI must be implemented without delay. The longer we wait to implement a single national energy efficiency obligation scheme, the more environmental and economic opportunities are lost. Delay creates uncertainty and discourages other governments and firms taking action to improve energy efficiency.

We are therefore concerned that the Government has made the introduction of a NESI conditional on the endorsement of COAG. Although it is obviously important that state measures be folded into a national scheme to avoid duplication, the Commonwealth is best placed to achieve this outcome by moving to implement a national scheme and encourage the states to follow suit in folding their schemes into it. This approach is more likely to yield a scheme that is genuinely best practice, rather than a lowest-common-denominator scheme agreed between all parties.

The NESI should therefore be implemented through Commonwealth legislation. There are several other benefits to this approach. It is a much simpler and easier option than relying on harmonised state laws in the manner of the National Energy Market or the COAG principles for feed-in tariffs. It also reflects the development of the Renewable Energy Target, and reflects the place of the Clean Energy Future package in federal law.

Legislation to implement a NESI is within the Commonwealth's constitutional powers. It could be supported by the corporations power (in requiring energy retail companies to meet their obligations)² and the external affairs power (in implementing Australia's international climate change commitments).³

Recommendation

- A single national NESI should be implemented without delay.
- Rather than wait for the consent of COAG, the Commonwealth should move to implement a NESI, and consult with the States while it is doing so.
- The NESI should be implemented through Commonwealth legislation.

1.2 Interaction with other energy efficiency programs⁴

It is important that the NESI adhere to the principle of additionality. In other words, it should reward energy efficiency improvements that would not otherwise have occurred in the absence of the scheme. There is little policy justification for using the NESI to subsidise energy efficiency improvements that would have happened anyway.

¹ Issues Paper Questions 2-5, 63-64.

² *Constitution of Australia 1901* s 51(xx); *New South Wales v Commonwealth* (2006) 229 CLR 1.

³ *Constitution of Australia 1901* s 51(xxix); *Commonwealth v Tasmania* (1983) 158 CLR 1.

⁴ Issues Paper Questions 6-9.

The best way to do this is to define eligible activities under the scheme to exclude activities that are already mandated or supported by other programs. The process for listing eligible activities should also include a test of additionality, to ensure that the NESI is not supporting activities that are already widespread or imminent. For more detail, see (section 3.12) below.

Recommendation

- The NESI must not credit activities mandated or supported by other schemes.

1.3 Lifespan of the NESI⁵

With an economy-wide carbon price in place, the purpose of an energy efficiency obligation is to address non-price barriers that inhibit it driving efficiency improvements. The NESI should therefore remain in place so long as there are non-price barriers which prevent the carbon price driving energy efficiency improvements on its own.

Those barriers might remain in place for quite a long time. Some of them — like split incentives and information barriers — may remain indefinitely. It is therefore important to phase-out the NESI only if and when these non-price barriers have actually disappeared — not simply on an arbitrarily selected date in the future.

To recognise the long-term nature of the problems which the NESI is designed to address, and provide maximum certainty to companies engaged in the scheme, we recommend that the NESI be a permanent scheme, remaining in place indefinitely.

The best way to monitor the non-price barriers which inhibit energy efficiency improvements (which the NESI is designed to address) is through periodic reviews built into the NESI. These will allow the scheme administrator and the government to evaluate the effectiveness of the scheme, and decide what role the NESI plays in the broader set of climate policies.

The three-year phases used by the Victorian Energy Efficiency Target (**VEET**) scheme (with reviews before the end of each phase to plot the course for the next one) are a good timeframe for a federal scheme to emulate. These reviews should evaluate the success of the scheme and recommend changes (for example, increased targets, increased coverage) to be implemented in future years.

Recommendation

- The NESI should run indefinitely, in recognition of the resilience of the non-price-barriers that it is designed to address.
- The NESI should run in 3 year phases, with a review before each phase ends.

2. Objectives⁶

It is worth recognising at the outset that the NESI is a scheme to improve energy efficiency. Whilst this is in a sense simply restating the obvious, not all of the objectives suggested by the Issues Paper are consistent with this aim.

⁵ Issues Paper Questions 10 & 20.

⁶ Issues Paper Questions 11-19.

For example, neither reducing energy prices nor reducing peak demand are the same thing as improving energy efficiency. In some cases (for example, where they encourage reductions in the cost of energy generation, or increases in load shifting during peak times) they may actually conflict with the objective of improving energy efficiency. They are therefore inappropriate objectives for the NESI.

The next question is, ‘what are the objectives of improving energy efficiency?’ We submit that the primary objective must be to reduce greenhouse gas emissions. The NESI is first and foremost an emission reduction policy. Whilst reducing energy costs may alleviate the pressure on low-income households, and help businesses improve their economic efficiency, these outcomes are secondary to (and in some cases may hinder achievement of) the primary aim of reducing total final energy use.

It is therefore worth formally recognising that:

1. The NESI is a scheme to improve energy efficiency.
2. The objectives of improving energy efficiency are to (in order of priority):
 - reduce greenhouse gas emissions and mitigate climate change;
 - reduce household energy costs (particularly low-income households);
 - reduce business costs and improve economic competitiveness.

Recommendation

- The primary purpose of the NESI must be to improve energy efficiency.
- The purposes of doing that must be (in order of priority):
 - (1) to reduce greenhouse gas emissions and mitigate climate change;
 - (2) to reduce household energy costs (particularly low-income households);
 - (3) to reduce business costs and improve economic competitiveness.

3. Major Design Elements

3.1 Baseline and Credit System⁷

The NESI should be a baseline-and-credit scheme along the same lines as the schemes in Victoria, NSW and SA. This will build on the substantial knowledge and experience that already exists around these schemes, making it easier for liable entities, regulators and potential beneficiaries of the scheme to make the transition to a national scheme. It also recognises the considerable success of these schemes in achieving low-cost or cost-negative energy efficiency improvements.

Recommendation

- The NESI should be a baseline-and-credit scheme like those in other states.

3.2 Trading and certificates⁸

We support the inclusion of trading and certificates in the NESI. The creation of tradeable credits facilitates the creation of an energy efficiency services sector, focussed specifically on improving energy efficiency — an assertion borne out by the experience

⁷ Issues Paper Question 23.

⁸ Issues Paper Questions 24-26.

with tradeable credits under the Victorian and NSW schemes. It should also facilitate greater fluidity in the market for energy efficiency improvements, allowing them to be made at least cost.

However, as noted in the Issues Paper, it is critical that these certificates not be made a form of offset tradeable under the carbon price mechanism, to preserve additionality.

To maximise these benefits of certificate trading, the NESI should consider online trading through an online exchange like that proposed under the *Clean Energy Future* scheme — a step that could increase pricing transparency, and strengthen control and security in certificate trading.

Recommendation

- The NESI should use tradeable certificates.

3.3 Sectoral Coverage⁹

The NESI should apply to all sectors where non-price barriers prevent the carbon price driving energy efficiency improvements. As an environmental law organisation, we are not best placed to say which sectors meet that description.

However, in making that decision, the following should be kept in mind:

- The broader the sectoral coverage of the NESI is, the deeper the pool of available emissions reductions, and the higher the target must be.
- Activities which are already mandated or supported by other energy efficiency programs must be excluded from the NESI (see section 3.13 below for more).
- If the NESI has broad sectoral coverage, energy efficiency reductions in certain sectors can still be prioritised by setting sub-targets (see section 3.10 below).

Recommendation

- The NESI should cover all sectors with non-price barriers to energy efficiency.

3.4 Fuel Coverage¹⁰

We submit that the NESI should cover electricity and gas, and they should both be covered under the one target. This is consistent with the Victorian, SA and United Kingdom (UK) schemes, and will prevent any distortions which might otherwise arise from regional differences in the fuel mix, or from customers switching from electricity to gas. It recognises the importance of driving energy efficiency improvements across the stationary energy sector, and making the pool of available energy efficiency reductions as broad as possible without introducing undue complexity into the scheme.

Recommendation

- The NESI should cover electricity and gas under one target.

⁹ Issues Paper Questions 27-29.

¹⁰ Issues Paper Questions 30-33.

3.5 Energy consumed outside the major grids¹¹

Including energy consumed outside the major grids in the NESI will create greenhouse gas emissions reductions that benefit the whole community. Whilst it is true that the benefit of lower energy costs will be enjoyed by private companies rather than the public in these cases, the NESI can ameliorate this inequity by ring-fencing a portion of the NESI for activities with the greatest public benefit (for example, low-income households). See section 3.10 below for more detail.

Recommendation

- The NESI must use sub-targets ('ring-fences') to prioritise energy efficiency improvements in those sectors where the public benefits of doing so are highest.

3.6 Unit of Measurement¹²

Energy efficiency improvements should be measured in tCO_{2e} reduced. This reflects our recommendation that the primary objective of the NESI should be to reduce greenhouse gas emissions (see above). It is consistent with our recommendation that electricity and gas be included under the same target. It is also consistent with the schemes in NSW, SA, Victoria and the UK.

Recommendation

- The NESI target should be measured in tCO_{2e} reduced.

3.7 Setting targets¹³

Whilst we are not qualified to comment on the economic modelling that the Working Group intends to use to underpin the setting of targets for the NESI, we submit that the costs and benefits of energy efficiency improvements should not be given undue weight in setting those targets. Whilst economic costs and benefits are important, they are secondary to the primary consideration of environmental necessity (which, as the Stern Review and the Garnaut Review pointed out, is of far graver economic importance).¹⁴ The key question in setting targets should be, 'what energy efficiency improvements are necessary to allow Australia to successfully avoid dangerous climate change?'

Recommendation

- NESI targets should be set based on what is environmentally necessary.

3.8 Penalties¹⁵

The experience under the NSW Energy Savings Scheme (**EES**) illustrates the importance of tough penalties. A large number of companies in NSW have failed to

¹¹ Issues Paper Questions 34-35.

¹² Issues Paper Question 36.

¹³ Issues Paper Question 37.

¹⁴ The Garnaut Climate Change Review (2008) available [here](#); N Stern, *Stern Review on the Economics of Climate Change* (2006).

¹⁵ Issues Paper Question 38.

honour their obligations under the ESS and opted to pay a fine instead.¹⁶ This is a terrible policy outcome (imposing costs on energy retailers without achieving any environmental gains) and must be avoided under the NESI.

We therefore strongly support a penalty that is at least 130% of the ‘benchmark price’ of certificates in that year. The ‘benchmark price’ is a concept drawn from the *Clean Energy Future* scheme, meaning the average price at which permits were sold during that compliance period.¹⁷ Setting the penalty in these terms ensures that the penalty price will not drop below the permit price, thus avoiding the ‘lose-lose’ situation where firms are encouraged to break their obligations and pay the penalty. It is regulatory best practice.¹⁸

We also recommend that the NESI include a ‘make-good’ requirement — whereby a retailer who fails to meet their target in a given year must ‘make good’ that shortfall in the subsequent year. This sort of provision is used under the UK scheme, and was included in the Carbon Pollution Reduction Scheme (CPRS). It also provides a guarantee against outcomes like those experienced in NSW.

Recommendation

- The penalty for not surrendering certificates should be at least 130% of the ‘benchmark price’ for certificates, coupled with a ‘make-good’ obligation.

3.9 Banking and Borrowing¹⁹

We recommend that the NESI allow certificates to be banked for up to 3 years. This is consistent with the limited banking approach used under the VEET. It will allow companies to bring forward energy efficiency improvements, and allow the market to adjust smoothly to peaks and troughs. The 3 year limit will act as a safeguard against accidental gluts in the market (like that which occurred under the RET) by containing the impact of large certificate surpluses. This limit can be reviewed as part of the periodic 3 year reviews (recommended in section 1.3 above) to re-examine the risk of such ‘certificate gluts’ occurring, and the desirability of allowing unlimited banking.

We recommend that borrowing not be allowed under the NESI. This is also consistent with the approach taken by the VEET. Borrowing creates a risk that one or more companies will fall too far ‘into the red’, putting pressure on the government to waive their obligations and undermine the scheme. Further, it is hard to see why liable entities would need to defer the energy efficiency improvements that they are obliged to make.

Recommendation

- The NESI should allow banking of certificates, for up to 3 years initially.
- The NESI should not allow borrowing.

¹⁶ Independent Pricing and Regulatory Tribunal, *Compliance and Operation of the NSW Energy Savings Scheme during 2010* (July 2011) p 5.

¹⁷ *Clean Energy Act 2011* (Cth) s 114; *Clean Energy (Unit Shortfall Charge – General) Act 2011* (Cth) s 8.

¹⁸ Wayne Gray and John Shimshack, ‘Monitoring, Enforcement & Environmental Compliance: Understanding Specific & General Deterrence’ (Whitepaper, Environmental Protection Agency (US), October 2007); John K Stranlund, James J Murphy and John M Spraggon, ‘An Experimental Analysis of Compliance in Dynamic Emissions Markets’ (Working Paper No 2010-3, University of Massachusetts Amherst, Department of Resource Economic, 2010).

¹⁹ Issues Paper Question 39.

3.10 Sub-targets²⁰

We recommend that the NESI include a sub-target for low-income households. Low-income households are the most affected by rising energy costs, which constitute a disproportionately high share of their income. They are also in a disadvantaged position in terms of improving their energy efficiency and avoiding those costs, because the non-price barriers (like information barriers, capital constraints and split incentives) are particularly high in this group. There are therefore strong equitable and environmental grounds for ensuring that the NESI does not leave this group behind in favour of other, cheaper sectors.

This is consistent with the principle of environmental justice — a subject of interest to ANEDO. Environmental justice is the equal distribution of environmental harms and benefits in society, and the fair and just application of environmental laws and regulations.²¹ Low-income households should not have to bear a disproportionate share of the burden of climate change or policies that respond to it.

The level of the sub-target will depend on the level of the target for the entire NESI. However, the 40% sub-target for ‘priority group’ customers (vulnerable and low-income households, over 70 and receiving welfare benefits) under the UK Carbon Emissions Reduction Target (**CERT**), and the 35% sub-target for low-income households under the SA Residential Energy Efficiency Scheme (**REES**), provide a good benchmark.

Recommendation

- The NESI should include a sub-target (‘ring-fence’) for low-income households.

3.11 Obligation points and thresholds²²

The NESI should use energy retailers with over 5,000 customers as its obligation point. Using energy retailers as an obligation point has the benefit of consistency with existing schemes in NSW, SA and Victoria, making it much more administratively easy to introduce. It also has the benefit of imposing the obligation as close to the consumer as possible, without imposing the obligation on the consumers themselves.

The 5,000 customer threshold places the obligation on those large companies most able to bear it, thereby increasing the chance of compliance. It may also increase competition in the energy retail market by sparing small retailers this obligation. It has the added benefit of consistency with the VEET and the SA REES.

Recommendation

- The point of obligation should be energy retailers with over 5,000 customers.

²⁰ Issues Paper Questions 40-43.

²¹ See Environment Defenders Office (Victoria) Ltd, *Discussion Paper: Environmental Justice in Australia* (2011) available [on the EDO website here](#).

²² Issues Paper Questions 48-49.

3.12 Additionality²³

The scheme administrator should be required to ensure that an activity passes an ‘additionality test’ before approving it as an eligible activity.

The additionality test should ensure as a minimum that the activity is not already required by law. This should exclude activities that are required by legislation (for example, under minimum efficiency standards, or the Victorian EREP program). It should also include activities that are already required by funding agreements (for example, under the Clean Technology Investment Program).

The additionality test should also ensure that eligible activities achieve efficiency gains beyond what is already common practice. This will require the regulator to ascertain how prevalent a given action or technology is before deeming it as an eligible activity. Where eligible activities produce certificates based on an individual calculation of energy savings, the regulator must compare actual savings against a counterfactual scenario.

Recommendation

- The regulator must not approve eligible activities unless they pass an ‘additionality test’.
- That test should exclude activities which are already mandated or supported by other programs, or which are likely to have happened anyway.

3.13 Pathways for including and excluding activities²⁴

The NESI needs an independent process for approving new eligible activities. The list of eligible activities should be compiled and managed by an independent regulator, as is the practice in Victoria and South Australia. This will ensure that the process is non-political and scientifically accurate.

Third parties should be able to apply to the regulator to have new eligible activities listed, and existing eligible activities delisted (for example, once they are widespread and have become ‘common practice’). The regulator’s decision on these matters should be subject to merits review on the application of any person. This will ensure that the regulator is responsive to developments in the industry.

When deciding whether or not to list an activity as an eligible activity, the regulator must apply statutory criteria based on best available evidence. The criteria must include an additionality test like that mentioned above, and a method for working out the likely energy and CO_{2e} savings that the activity will produce.

Recommendation

- The independent regulator must decide which activities are eligible.
- That decision must be based on statutory criteria based on science.
- Third parties should be able to apply to have an activity listed as eligible.
- Any person should be able to apply for merits review of the regulator’s decision.

²³ Issues Paper Questions 52-53.

²⁴ Issues Paper Questions 54-56.

3.14 Crediting and verifying savings²⁵

Whether or not the NESI uses deeming should depend on whether or not it is economic to calculate the energy savings from each particular project. Whilst ANEDO is not qualified to make that assessment, we would expect activities in the household sector to use deeming, and activities in the large-scale commercial sector to use calculation.

Recommendation

- Whether savings are deemed or calculated should depend on what is economic.

3.15 Accreditation, audit and compliance²⁶

It is important to the accuracy and credibility of the scheme (in the eyes of both certificate purchasers and the public) that the NESI have tough verification and compliance rules. We recommend that the NESI use the same accreditation and verification requirements as the VEET, including the requirement that every certificate be associated with a street address, which can be verified by inspectors if necessary.

For the same reasons, we submit that the buyer (i.e. the energy retailer) should bear the liability if the activity that a certificate represents does not meet the relevant regulatory requirements. It is likely that energy retailers will transfer this risk to the seller through contract. But by giving the buyer primary responsibility, the regulator is still able to hold them liable if the seller (which is likely to be a smaller energy services company) goes insolvent. This shifts the difficult task of recovering an unsecured debt from the insolvent energy services company from the government to the retailer.

We also recommend that the NESI contain the same penalties, offences and compliance provisions as the *Clean Energy Act 2011* (Cth) and the *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth). In particular, it should include criminal offences and personal liability for executive officers, in cases of fraud or recklessness.

Recommendation

- The NESI should adopt the verification rules used in the VEET.
- Liable entities should bear liability for certificates that don't meet requirements.
- The NESI should adopt the penalty and offence provisions used under the *Clean Energy Act 2011* (Cth) and the Carbon Farming Initiative.

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²⁵ Issues Paper Questions 57-58.

²⁶ Issues Paper Questions 59-60.