



australian network of environmental defender's offices

Submission on the Garnaut Climate Change
review – Emissions Trading Scheme
Discussion Paper

18th April 2008

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 Environmental Defender's Offices Inc (ANEDO) is a network of 9 community legal centres in each state and territory, specialising in public interest environmental law and policy. ANEDO welcomes the opportunity to provide comment on the *Garnaut Climate Change Review – Emissions Trading Scheme Discussion Paper* ('Discussion Paper'). ANEDO has commented extensively on the design of an Australian Emissions Trading Scheme (ETS). Please refer to our previous submissions when considering this response.¹

ANEDO has made separate submissions on the *Garnaut Review Issues Paper 4 – Research and Development: Low Emissions Energy Technologies*; and the *Interim Report to the Commonwealth, State and Territory Governments*.

ANEDO has consistently advocated for the widest possible coverage of an emissions trading scheme, as well as the full auctioning of permits, sufficiently high penalties to deter non-compliance, and make-good provisions. We therefore strongly welcome these elements being included in the Discussion Paper's recommendations. The ETS put forward in the Discussion Paper is a marked improvement from the previous models proposed by the previous Prime Minister's Task Group on Emission Trading and the state-based National Emissions Trading Scheme.

Our key comments are summarise below.

- The overarching objective of the scheme must be an environmental one – to assist in reducing Australia's greenhouse gas emissions by a minimum of 60% by 2050.
- Short-term and long-term targets that progress Australia towards a 60% reduction in GHG emissions on 1990 levels by 2050 are needed. Progressively stricter trajectories that correspond to levels of international action are supported.
- ANEDO does not support five years notice given to industry when Australia adopts a stricter emissions trajectory based on international developments or improved science. If immediate adjustment is needed this should happen accordingly.
- ANEDO supports a scheme with the broadest possible coverage. We therefore support the inclusion of all greenhouse gases, and the inclusion of stationary energy, industrial processes, fugitive emissions, transport and waste from the schemes outset. However, forestry and agriculture must be added to the scheme as soon as possible.

¹*Submission on Prime Minister's Task Group on Emissions Trading* - 7 March 2007 -

http://www.edo.org.au/edonsw/site/policy/ets_anedo070307.php

Submission regarding the Possible Design for a National Greenhouse Gas Emissions Trading Scheme - 22

December 2006 - http://www.edo.org.au/edonsw/site/policy/net_anedosub061221.php

Ssubmission regarding abatement incentives prior to the commencement of the Australian Emissions Trading Scheme - 3 December 2007 -

http://www.edo.org.au/edonsw/site/policy/ets_abatement_incentive071207.php

- Offsets should only be allowed after on-site mitigation has occurred. Offsets should be limited to projects for which there is a high level of certainty as to the accuracy of measurement methodologies, and those that are additional, permanent and ecologically sustainable.
- ANEDO agrees that in determining the point of obligation under an ETS this should ideally be the source of emissions, where practicable. For transport, the point of obligation should be placed on fuel suppliers.
- ANEDO strongly supports 100% auctioning. Auctioning is the most efficient and environmentally effective means of permit allocation.
- International linkages are supported but only with markets built around sound objectives and design features.
- ANEDO does not support the unlimited banking of permits. We also oppose the lending of permits. If this is allowed then it must be subject to rigorous guidelines to ensure that emitters do not default on these loans.
- ANEDO recognises that there are special circumstances justifying compensation to trade-exposed, energy-intensive industries. However, this should be strictly a transitional measure with progressively lower assistance.
- An independent regulator should be established to administer the ETS. This is important to the integrity and credibility of scheme and will help shield the emissions targets from outside influence.
- ANEDO supports the setting of high penalties to deter non-compliance. We also support a ‘make good’ provision to ensure that the environmental integrity of the scheme remains intact.
- Permit revenue should be first used to address impacts of low-income households. Structural adjustment programs for affected communities and R & D funding for renewable energy projects should also be priority areas.
- An emissions trading scheme should be supplemented by complementary measures that also address climate change. These include renewable energy targets and energy efficiency legislation.

This submission comments on the following areas:

1. Introduction
2. Framework to Guide ETS Design
 - a. Objectives and guiding principles
3. An Australian ETS prior to establishment of an international agreement on greenhouse gas mitigation
 - a. Setting an emissions limit
 - b. Changes to the emissions limit
 - c. Coverage
 - d. Domestic offsets
 - e. Point of obligation
 - f. Issuing of permits
 - g. International linkages
 - h. Price controls
 - i. Inter-temporality
 - j. Treatment of trade-exposed, energy intensive industries
 - k. Governance

- l. Compliance and penalties
- m. Permit sales and public finance
- n. Complementary measures.

1. Introduction

The more up-to-date scientific information that comes to light about climate change impacts, particularly through the latest IPCC reports, the more urgent is the need for action to reduce emissions. It is clear that action must be taken now to halt the burgeoning emissions associated with an industrialised world. A shift away from the reliance on GHG-emitting sources of fuel and energy must be facilitated in order to prevent temperature rises above the 2 degree threshold. This is essential if we want to avoid the most severe impacts of this global phenomenon.

It has been long recognised that a crucial part of a concerted response to climate change is the establishment of an ETS as part of a broader government policy response. Indeed, ANEDO has consistently urged the Australian government to establish an emissions trading scheme on a domestic level, even in the absence of international efforts. We believe that the lack of a coordinated international approach should not be used as an excuse for inaction. The Discussion Paper has recognised that immediate action is needed, which we strongly support.

The design elements put forward in the Discussion Paper are generally supported by ANEDO. They have the potential to ensure that the scheme is consistent with the five principles of a smooth and operating market: scarcity, tradability, credibility, simplicity and integration with other markets. Furthermore, there is a recognition that the scheme needs to import some measure of flexibility, but not at the expense of clearly-defined obligations.

We now make specific comment on the design elements proposed.

2. Framework to Guide ETS Design

a. Objectives and guiding principles

As ANEDO has previously submitted, the key objective of an ETS must be its long term environmental performance. We believe that the overarching objective of the scheme must be an environmental one – a reduction in Australia’s GHG emissions to a minimum of 60% of 1990 levels by 2050.

ANEDO does acknowledge that for an ETS to function efficiently from an economic point of view it must be as simple as possible. In this vein, the singular objective proposed by the Discussion Paper is important. Indeed, it is essential to the workability of an ETS that a market is created whereby resources - namely emissions permits - are transferred to those who place the greatest value on them. However, ANEDO is of the opinion that this should be a secondary objective. It is of no consequence if an efficient market is created while the GHG targets are not being met. The environmental imperative for the scheme could be lost in the quest

for “economic efficiency” if it is not explicitly stated as the overarching policy objective of the scheme. We therefore believe that an explicit environmental objective is needed.

3. An Australian ETS prior to establishment of an international agreement on greenhouse gas mitigation

a. Setting an emissions limit

The emissions target is the most crucial aspect of an emissions trading scheme. The short-term and long-term targets set must therefore be meaningful and assist Australia in achieving real reductions in GHG emissions. This will be the ultimate indicator of the success of the Australian ETS. ANEDO has commented extensively on an appropriate cap for Australia. We support both short-term and long-term targets that progress Australia towards a minimum of 60% reduction in GHG emissions on 1990 levels by 2050. Australian emissions budgets should aim to reduce levels to below the internationally recognised estimate to limit global GHG levels between 450 and 550 ppm in the atmosphere.² 550ppm is too high and Australia should focus on achieving the lower end of the range, namely 450ppm.

The Discussion Paper essentially recognises these goals and makes recommendations accordingly. We welcome the Discussion Paper’s statement that Australia should proceed towards a 60 per cent reduction by 2050 with appropriate interim targets in 2008, 2020 and 2050, even in the absence of a global agreement. Short-term targets are very important as interim goals, and they also provide an opportunity to determine whether Australia is broadly on track to achieve its 2050 target.

Although actual targets will not be revealed until the final report, the Discussion Paper proposes 4 broad trajectories, representing progressively deeper cuts in emissions. The fourth target is the most stringent and is dependent on the existence of comprehensive international action. Targets have therefore been set for both contingencies – action only by the developed world and coordinated international action. We agree that Australia should adopt best practice targets that are consistent with those in other developed countries such as the EU, in the absence of international agreement. However, in the context of a global scheme, Australia should adopt stricter targets.

The ultimate goal is of course an international scheme. However, the Discussion Paper recognises that action must be taken domestically while we wait for a global accord. Although this will not result in significant cuts in GHG emissions on a global scale, it nonetheless sets an example for the rest of the world, enables industry to adapt to operating within a carbon market, and can contribute to international discussions on a successful framework for global mitigation.

² Royal Commission on Environmental Pollution (2000) *Energy- The Changing Climate*, RCEP, London; O’Neill, B. and Oppenheimer, M, (2002) ‘Dangerous climate impacts and the Kyoto Protocol’ *Science* 296 1971-1972.

ANEDO acknowledges that there are several ways of reaching the 2050 target as revealed in the Discussion Paper. However, it must be remembered that if generously low targets are put in place in the short term, then more drastic cuts will be needed later, which will most likely have more significant economic impacts. The exact nature of the four trajectories is to be revealed in the Final Report. ANEDO is keen to further engage on this issue upon release of the report.

b. Changes to the emissions limit

ANEDO questions the Discussion Paper's recommendation that 5 years' notice should be given to liable parties under the ETS before a movement to a stricter trajectory is made. Where international commitments demand a more immediate change, the independent authority to be established would purchase international permits during that 5 year period with taxpayers' money.

ANEDO has consistently supported emissions targets that are based on the best available scientific knowledge, and that accord with international developments. Where changes to targets or a move to a new trajectory is needed to meet international targets or due to improved science, this must happen as soon as possible. Industry sectors have known about the need for emissions cuts for some time. Climate change has been on the international agenda since the 1980's. Since that time, it has been abundantly clear that emissions targets will get stricter over time if Australia is to meet its reduction target of 60% by 2050. There are therefore no compelling equity arguments that support 5 years' notice for industry. Moreover, there is no reason why taxpayers should foot the bill where the Government has to buy international permits to fill the shortfall during the 5 year notice period. This is inconsistent with the polluter-pays principle. GHG emitting industries are responsible for the need to regulate in the first place, and they should not be given further concessions and allowed to further delay necessary action to reduce emissions. The environmental goals of the scheme must operate to ensure that GHG targets are met in the short and long term.

c. Coverage

ANEDO has consistently called for a broad-ranging scheme applicable to all major emissions sectors and covering all greenhouse gases. The World Resources Institute agrees. They believe that an ETS should strive to incorporate a broad and diverse set of emissions sources. The rationale for this is that it serves to lower costs, achieve environmental objectives, accelerate innovation, and spur deeper engagement with the private sector.³

We have previously submitted that coverage should be as broad as possible and should extend beyond the stationary energy sector. ANEDO therefore welcomes the much broader coverage proposed by the Garnaut review, with all GHG and sectors to be eventually included in the scheme. However, we note that agriculture and forestry will be initially excluded due to problems of measurability. ANEDO

³ World Resources Institute, *Greenhouse Gas Emissions Trading in US States – Observations and lessons from the OTC Nox Budget Program*, (2005) www.wri.org, accessed on 9 April 2008, p.32.

calls for these sectors to be included in the scheme as soon as possible as they contribute significantly to greenhouse gas emissions. For example forestry contributes 20 per cent of global emissions. Studies have shown that where previously unlogged forests are logged, there is a 'permanent' loss of 40-60% of the carbon previously stored in those forests.⁴

We note that the New Zealand ETS, which commences in 2008, includes forestry as a liable industry from the scheme's inception.⁵ Australia should follow this example and include forestry as a liable sector by the ETS's commencement in 2010, or as soon as possible.

d. Domestic offsets

ANEDO is cautious about the Discussion Paper's recommendation that domestic offsets should be unlimited under an ETS. As we have noted elsewhere, ANEDO has significant concerns relating to the use of offsets as a means of "reducing" emissions.⁶ Our primary view is that offsets should not be relied upon as the predominant means of compliance with an ETS. We believe that offsets fall at the bottom of the climate action hierarchy. First, on-site environmental impacts must be avoided or reduced by using all cost-effective prevention and mitigation measures. Offsets can then be used to address remaining loads of pollutants. Moreover, under no circumstances should the overall level of direct emissions from a facility increase as a result of "abatement" through offset projects.

ANEDO further submits that offsets recognised under an ETS should be limited to projects for which there is a high level of certainty as to the accuracy of measurement methodologies, and those that are additional, permanent and ecologically sustainable.⁷ We have previously examined these principles in the context of forestry offset projects and there are real concerns relating to the permanence of forestry offsets, the measurement of carbon actually sequestered, and the ecological sustainability of such projects especially in a drying climate. Therefore, forestry offsets under the ETS should be treated with much caution and should be subject to rigorous assessment prior to being accepted as valid offset projects. ANEDO notes that Federal Government guidelines on offsetting and carbon neutrality will be released later this year. These guidelines have the potential to place strict limitations on the use of offsets that take into account the constraints detailed above.

⁴ Roxburgh, S, Wood S, Mackey B, Woldendorp, G, Gibbons, P, 2006, Assessing the carbon sequestration potential of managed forests: a case study from temperate Australia, *J Appl Ecology*, 43, 1149-1159.

⁵ See *The Framework for a New Zealand Emissions Trading Scheme – Executive Summary*. Available at www.mfe.govt.nz (11 April 2008).

⁶ See *ANEDO submission regarding abatement incentives prior to the commencement of an Australian Emissions Trading Scheme* – 3 December 2007. Located at: http://www.edo.org.au/edonsw/site/pdf/subs07/ets_abatement_incentives071207.pdf (10 April 2008).

⁷ This is the approach taken by Gold Standard, which is widely recognised as the international accreditation system for premium quality carbon credits generated by projects that have sustainable development benefits. For more information see www.cdmgoldstandard.org (10 April 2008).

e. Point of obligation

ANEDO agrees that in determining the point of obligation under an ETS, this should be the emission source, where possible. If this is not feasible, then moving upstream or downstream is recommended, depending on the reliability of measurement at that level.

For stationary energy, ANEDO agrees that the source of emissions is the best point of obligation. Similarly, industrial process emissions and waste emissions should also be covered at the point where emissions are generated.

It is obvious that emissions relating to transport cannot be measured at the point of emissions as this is impractical and would involve tens of millions of vehicles. An upstream liability in this case is appropriate. Fuel producers should therefore bear the obligation to comply with the ETS.

f. Issuing of permits

ANEDO strongly supports Garnaut review's recommendation for 100% auctioning. We have consistently called for full auctioning as opposed to a grandfathering approach. Auctioning is the more efficient and environmentally effective means of permit allocation. This is for four main reasons.

First, despite assertions of 'disproportionate loss' and economic disadvantage, it has been shown by the Review that the method of permit allocation makes no difference in terms of the price of goods and services. That is, in either case electricity prices will rise. A grandfathering approach therefore constitutes a vast wealth transfer to emitters with no discernible benefit in terms of public impact through electricity prices. Indeed, economic modelling has shown that a grandfathering approach will make electricity generators better off under an ETS, but leave consumers substantially worse off.⁸

Second, studies have shown that auctioning is dramatically more cost-effective than a grandfathering approach – roughly 50% cheaper.⁹

Third, there are significant advantages of an auctioning approach in terms of abatement. That is, if liable emitters are made to buy their permits at auction, then there will be a significant financial incentive to reduce emissions or invest in abatement technologies in order to reduce the number of permits they must acquire. On the other hand, if permits are allocated free, emitters will not be spurred into abatement action, and may even increase their emissions by buying additional permits, since they have not paid for their initial allocations. ANEDO believes that without the significant abatement action that an auctioning approach

⁸ Dallas Burtraw, "Carbon Emission Trading Cost and Allowance Allocations: Evaluating the Options (2001), *Resources* 13-16 at 15.

⁹ *Ibid* at 14.

would facilitate, the proposed ETS may be largely ineffectual in achieving greenhouse emissions reductions, which is its overarching environmental objective.

Finally, full auctioning ensures that the ETS is simpler, with less administrative rules and it would prevent wrangling over appropriate exemptions, exceptions, and other issues. For example, the auctioning of permits would easily solve the problems associated with measuring allocations and developing a methodology to determine who is entitled to free permits, and how many. As the Report says “free allocation would be highly complex, generate high transaction costs, and require value-based judgments”. Full auctioning avoids these problems.

The above discussion demonstrates that an auctioning approach is preferable from an economic, equitable, environmental and administrative point of view. ANEDO strongly urges the Federal Government to adopt a full auctioning approach in line with the Report’s recommendations.

g. International linkages

ANEDO agrees that a wide-ranging international trading scheme is preferable and necessary in ensuring that a concerted effort is taken to address climate change. Only a coordinated global effort can truly arrest the projected consequences of climate change. It is therefore crucial that any Australian scheme be able to link effectively with other schemes as a precursor to a truly global scheme. This will make transition to a true international market easier. It will also reduce costs of compliance and facilitate the development of abatement and modification technologies in the most cost-effective manner. Moreover, it will provide financial incentives for developing countries to conduct activities that generate carbon credits. However, caution should be exercised in determining which international markets are appropriate for linkage. The Government must ensure that linkage only occurs with markets built around sound objectives and design features. Australia should strive to establish a best practice ETS, and not settle for a ‘lowest common denominator’ approach.

ANEDO supports the Discussion Paper’s recommendation that linkages between an Australian ETS and the EU scheme should be explored in establishing an ETS. Further, we also support integration with the New Zealand market.

h. Price controls

ANEDO supports the Discussion Paper’s recommendation of no price control by Government. The price of permits should be determined by the market, which is vital in ensuring an efficient market is established that is free of outside influence. We also agree that setting price ceilings or floors would be arbitrary and will depend on subjective predictions of variables including consumer preferences, seasonal conditions and income growth. Of most importance, the Discussion

Paper finds that the presence of price ceilings or floors may present a barrier to necessary international linkages in the future.

i. Inter-temporality

ANEDO does not support the unlimited banking of permits. If these permits are used in future periods when there is a tight budget in place, then there is the potential for emissions targets to be breached.

ANEDO also has significant reservations with the Discussion Paper's recommendation that the lending of permits should be permitted. We have previously supported a prohibition on lending in relation to the proposed NETS scheme in 2006. Our primary reasoning is that the risk of emitters defaulting on these loans in future periods has the potential to severely undermine the environmental integrity of the scheme, which is a risk we cannot take. Large defaults on 'loans' would inevitably lead to a failure to meet emissions targets. In contrast, emitters have the flexibility to purchase more permits from the market if they anticipate a shortfall of permits as an alternative to borrowing. This has a lower risk and is an equitable approach.

If lending is allowed, then it should be strictly limited and subject to rigorous guidelines. The Discussion Paper says that the risk of default should be a matter of governance and should not be a reason to prohibit lending of permits. It recommends that loans should only be given to credit-worthy borrowers with adequate security, and that limits be placed on the amount of lending to prevent the risk of the emissions budget being breached. Although these guidelines may go some way to ameliorating the risk, ANEDO is still strongly opposed to the lending of permits.

j. Treatment of trade-exposed, energy-intensive industries

Although ANEDO is opposed to 'compensation for regulation' as a general rule, we recognise that there may be special circumstances justifying compensation to trade-exposed, energy-intensive industries as a transitional measure. There are compelling economic and environmental arguments that support limited transitional assistance to trade-exposed, energy-intensive industries.

It is likely that as a result of inclusion in an ETS, there will be some impact on trade-exposed industries if international competitors are not equally restrained. Increased costs may cause firms to reduce their production and investment in Australia and shift overseas. This may have significant economic impacts for Australia. There is also an environment consequence of a shift overseas. This is because production may shift to countries without regulations that limit emissions. This is counterproductive from an environmental perspective. Hence, compensating trade-exposed industries in the short term whilst still monitoring their emissions is preferable.

ANEDO does not support indefinite compensation. Compensation should be granted in the form of an annual allocation that progressively decreases to an eventual phase-out. The Discussion Paper accommodates this suggestion. It proposes a discount factor on compensation that is calculated by taking into account the expected rate of annual improvement in emissions efficiency. ANEDO supports this approach. It is also consistent with the view that lack of international action should not be used to justify compensation in perpetuity. It is inevitable that trade-exposed industries will have to reduce their activities in the future in order for Australia to meet tightening emissions targets. On-going free allocations provide no incentive to reduce emissions or invest in new technologies.

ANEDO agrees with the Discussion Paper that any transitional arrangements must be “environmentally and economically efficient, equitable and built on sound governance principles”. To this end, we support an independent authority administering compensation to trade-exposed industries as recommended by the Discussion Paper.

k. Governance

Governance is crucial to the integrity and credibility of an ETS. Furthermore, without effectively monitoring and policing of targets, emissions goals will not be met.

ANEDO therefore supports the Discussion Paper’s recommendation that an independent regulator be established with a “high degree of executive independence in the exercise of its powers”. This would help to shield the scheme from political pressures that may come to bear. It is important that the most crucial aspect of the scheme – the emissions budget – remains untainted by outside influence.

ANEDO is keen to make further comment on the establishment of such an authority in the Final Report.

l. Compliance and penalties

ANEDO strongly supports the Discussion Paper’s recommendation that financial penalties for non-compliance need to be high enough to discourage non-compliance and to avoid it becoming merely a price cap. This would avoid the problem of emitters merely “writing off” the penalty as a cost of doing business. Penalties need to provide a significant deterrent. This could include provisions establishing personal liability for company Directors.

ANEDO also strongly supports the recommendation that high penalties should be accompanied by a ‘make-good’ provision, which requires that defaulting emitters make up for their failure to account for all their emissions. This is crucial to the integrity of the scheme as it ensures that the emissions limit remains on track despite the non-compliance.

m. Permit sales and public finance

ANEDO believes that in determining how to use revenue from the auctioning of permits, priority should be given to providing compensation for low-income households likely to be affected by the scheme. This will address some of the social equity issues that arise with the rise in energy costs that an ETS is projected to cause. We therefore agree with the Discussion Paper's comment that low income households will have strong claims for compensation on equity grounds. We also support structural adjustment for communities that will require assistance through the retraining of workers and towards establishing new industries for communities that are reliant on emissions-intensive activities.¹⁰

Moreover, revenue should also be used to support research and development into renewable energy, as well as providing tax breaks and other incentives to that industry. Developing renewable energy and zero-emission technology should be prioritized over the development of certain 'low-emission' technologies, such as CCS.¹¹ A rapid transition towards renewable energies is crucial to meeting emissions targets so this should be a particular focus of assistance.

n. Complementary measures

While ANEDO supports the development of an ETS as the centerpiece of Australia's domestic emissions reduction policy, we note that there are a range of other complementary mechanisms that are needed to support emissions reduction processes. In advice to the Climate Action Network of Australia, the EDO in NSW identified 20 preliminary areas of law reform needed to comprehensively address the climate change challenge.¹² Recommendations included amendments to: the *Environment Protection and Biodiversity Conservation Act 1999*, energy efficiency legislation, coal export permits, GHG reporting requirements (we note that this has subsequently been done¹³), director's duties, financial products disclosure, electricity bill regulations, feed in laws, public transport regulations, and environmental management plans. Accordingly, an ETS should not be treated as a solution to climate change in and of itself.

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¹⁰ However, please see our separate submission on Issues paper 4 regarding concerns relating to over-reliance on Australia's CCS potential: available at <http://www.edo.org.au/edonsw/site/policy.php>.

¹¹ See our separate submission on Issues paper 4 for further detail: available at <http://www.edo.org.au/edonsw/site/policy.php>.

¹² CANA, 'Turning Down The heat – A Climate Change Action Agenda for Australia', p50-51.

¹³ National Greenhouse and Energy Reporting Act (Cth) (2007).