



## **Submission to the Climate Change Group - Department of the Prime Minister and Cabinet by the Australian Climate Exchange**

### **Introduction**

This submission to the Climate Change Group (CCG) is made by the Australian Climate Exchange Limited (ACX), the developer and operator of Australia's first exchange traded greenhouse gas emissions market.

As Australia transitions to a compliance based National Emissions Trading Scheme, ACX would like to acknowledge the rigorous assessment and high standard of work carried out by the Australian Greenhouse Office (AGO) through the various initiatives and programmes over many years. ACX is a strong advocate of those standards and urges that they be maintained and integrated as much as possible during the transition to an Australian Emissions Trading Scheme (AETS).

In general the ACX believes that early abatement incentives should be given, where appropriate, to both abatement and offsets activities, in order to encourage emission reduction that is truly additional to business as usual. Failure to do this will result in an inherent market supply overhang that will reduce the efficacy of market caps to encourage the development and deployment of low emission technologies. ACX is, however, concerned about the added administration costs if this early action is delivered via arrangements that are additional to existing greenhouse gas reduction programs rather than logical extensions of them.. ACX is also concerned that businesses that have reduced or offset emissions under the various Federal and State emission reduction schemes in the past are recognised for their efforts prior to the commencement of the AETS

ACX would propose that the Task Group on Climate Change consider the following points:

## **Greenhouse Friendly™ VERs**

There is a concern amongst participants of the Greenhouse Friendly™ program that existing Verified Emission Reduction units (VERs), that is VERS created pre June 3<sup>rd</sup> 2007, will not be accepted as offset instruments that can be used to meet compliance obligations sectors covered by the upcoming AETS. ACX considers the inclusion of VERs in the AETS as positive as it would:

- Ensure that there is supply and therefore sufficient liquidity in the market in the early stages of the scheme to enable the maintenance of an orderly market.
- Established offset supply and market liquidity will contribute to the creation of a robust contracts for future delivery market thereby reducing the disruptive effect of the transition to a compliance market for industry while providing the facility to encourage the development of emission reduction projects.
- Avoid unfairly disadvantaging companies that have acted to reduce emissions pre 3<sup>rd</sup> June 2007 via existing Federal Government lead programs and ensure that the economic benefits that underpins the continuity of these actions is maintained.
- Ensure the maintenance of a robust and orderly voluntary market which continues to provide an indicative price for the assessment and commercialisation of emission reduction projects post June 3 2007. The voluntary market also serves as an essential framework for the development of the required resource capability and systems in preparation for a the start of the compliance scheme.

Given that the projects that are accredited under the Greenhouse Friendly Approved Abatement program are finite and the number of VERs that have not been acquitted (and are therefore still in circulation) are known and the capacity for these projects to produce future offset is also reasonably well known, the overall market quantity of permits that are issued in the early years of the AETS can easily be adjusted to take into account the effect of these VERs.

Further the fact that a tonne of CO<sub>2</sub> abated last year has more value (in terms of its avoided global warming effect) than a tonne of CO<sub>2</sub> abated tomorrow, allowing VERs to be used in the AETS will not affect the environmental outcome of an AETS, provided that an equal reduction in the volume of permits issued is made to account for the volume of VERs in circulation at the time.

At the very least VERs should be treated in the same way as the proposed Early Action Credits and be eligible for conversion into permits.

### **NGACs and the winding up of the NSW GGAS**

Certain NSW Greenhouse gas Abatement Certificates (NGACs) generated for compliance with the NSW Greenhouse Abatement Scheme NGAS should be considered for similar treatment under the provisions of the AETS.

Only NGACs which:

- were generated under a rule or project type that complies with the additionality permanence and emissions factors recognised by the scheme; and
- the measurement and verification of both the baselines and resulting abatement are both sufficiently robust and transparent;

should be considered for conversion into permits in the AETS.

### **Emission Permits**

When allocating emission permits to industry, consideration should be given to increasing the transparency of the allocation process to the full extent possible so that market participants can correctly assess offset demand and subsequent project investment.

It is, in our view, essential that the number of permits that are issued to participants for free should be limited to the minimum level as is practical in order to avoid significant market distortion. It should be noted that the issue of free permits represents a significant subsidy and asset to the recipients and has the potential to be a barrier to entry for potential new competitors in their market. ACX therefore urges the AETS designers and administrators to place a significant burden of proof on applicants for free permits when demonstrating that a carbon price will cause them undue and unfair hardship.

#### **1. Standards for Abatement Recognised by the Scheme**

*“It is proposed that credits only be provided for activities that represent abatement that has actually occurred, is additional, permanent, measurable, and verifiable”<sup>1</sup>.*

It is paramount that credits and offsets awarded prior to and during the proposed AETS are done so according to international standards and best practice. Using best practice standards will facilitate integration with the various international trading schemes, subsequently assisting Australian business seek out the lowest emission offset cost.

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<sup>1</sup> Section 3.1 *Abatement incentives prior to the commencement of the Australian Emissions Trading Scheme*, Climate Change Group, Department of the Prime Minister and Cabinet

In addition, offsets are at risk of becoming redundant if they do not meet international best standards, particularly as climate change policies and science are concluding that more aggressive action and firmer offset accreditation standards are required in order to prevent the harmful effects of global warming.

It is ACX's view that the framework and protocols adopted by the AGO in the prosecution of the Greenhouse Friendly Approved Abatement Scheme has in all material respects met UNFCCC protocols for flexible mechanisms and should be used as the basis for the Offset and EAC accreditation program going forward.

## **2. Initial Arrangements – Approval via *Greenhouse Friendly*™**

Response to discussion paper, section 3.3.1 *"It is proposed that the Australian Governments Greenhouse Friendly programme provide the initial administrative mechanism for approving offsets and early action credits for use in the emissions trading scheme"*<sup>2</sup>.

As stated previously, ACX views the Australian Governments' Greenhouse Friendly programme as a very high standard initiative. ACX is proud to support and promote this programme. ACX operates an Electronic Emissions Trading Platform (EETP) in order to accommodate Greenhouse Friendly™ VERs as they possess all the elements required to be used as an international trading instrument and are:

- accredited by a federal government agency;
- technically compatible with international flexible mechanisms;
- are a sound and rigorously assessed offset option that is known and already used by Australian businesses.

Building on the strong brand and level of integrity used to generate Greenhouse Friendly VERs™ can only bode well for current voluntary trading and future compliance (AETS) offset markets.

The only caveat that ACX would put on this endorsement of the Greenhouse Friendly™ framework would be that it would need to be far better resourced than the current program and there would need to be a far greater number of accredited verifiers available to validate Project Design Documents and an accreditation infrastructure with a transparent process that has strict turnaround and decision timetables. The current arrangements have unacceptable delays and transaction costs which have been a significant barrier to the realisation of abatement projects. It is the view of the ACX that

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<sup>2</sup> Section 3.3.1 *Abatement incentives prior to the commencement of the Australian Emissions Trading Scheme*, Climate Change Group, Department of the Prime Minister and Cabinet

the existing Greenhouse Friendly infrastructure would be overwhelmed by the Early Action proposals that will emerge once the rules of the AETS are clear.

Consideration should be given to streamlining the Greenhouse Friendly™ Approved Abatement accreditation process to reduce the transaction costs associated with the realisation of abatement projects with particular attention given to arrangements for small volume projects. ACX would point to the concessions given to small projects (including aggregating provisions) under the Clean Development Mechanism (CDM) rules.

### **. Positive Incentives To Undertake Additional Abatement**

*“The Government proposes to develop as soon as practical a national offset register to track early action credits, and offsets, that could be recognised under the emissions trading scheme”<sup>3</sup>.*

A robust and transparent national registry that can be interrogated by the market providing real time price sensitive information is a prerequisite for any trading system and the AETS will be no exception. This has been correctly identified by the Department of the Prime Minister and Cabinet’s (PM&C) Climate Change Group as an early prerequisite for offsets and early action credits activities prior to the implementation of the proposed AETS.

ACX has been, and continues to be, a very strong advocate for developing a national offset register as soon as possible. We believe it must be one that provides an auditable trail of custody for emission offsets and permits and early action credits, from creation to acquittal in order to give the market confidence in the provenance of the instruments traded and form a mechanism for assuring the transfer of good title to the offsets from party to party.

We also strongly advocate that the registry must be able to provide real time data on the volume of offsets that are potentially available to the market at any point in time. It is our view that this will avoid some of the severe “market corrections” and price volatility that have been characterised this style of compliance market in the past.

ACX cannot overstate the importance of having a Registry to support the tracking of *“early action credits, and offsets that could be recognised under the emissions trading scheme”<sup>4</sup>* as it would:

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<sup>3</sup> Section 3.3.1, *Abatement incentives prior to the commencement of the Australian Emissions Trading Scheme*, Climate Change Group, Department of the Prime Minister and Cabinet

<sup>4</sup> *Abatement incentives prior to the commencement of the Australian Emissions Trading Scheme*, Climate Change Group, Department of the Prime Minister and Cabinet

- improve transparency when exchanging offsets and early action credits;
- provide the necessary foundation for the 2011 AETS;
- support the current VER market;
- encourage abatement activities in the short term, before the implementation of an AETS;

Early experience from operating the ACX Registry (and associated Electronic Emissions Trading Platform) has shown that the design of a national Registry for Australia should consider:

- the capacity of the Registry system to interlink with international and domestic emission trading platforms and thus streamline emission trading activities;
- the national offset Registry will need to facilitate the tracking of mandatory offset instruments acquitted in a voluntary offset market;
- the depth of registration information when registering offsets. A greater offset project transparency would allay queries from the voluntary market concerning offset origin, but also satisfy increasing international Registry standards regarding offset origin transparency.

The Australian Climate Exchange (ACX) operates a Registry to support the trading of the rigorously assessed Greenhouse Friendly™ Verified Emission Reduction Units. The ACX Registry tracks generation, ownership, transfer and acquittal of VERs. ACX facilitates the transparent trading of VERs by listing the offset on the ACX Emissions Trading Platform.

***ACX strongly advocates that the design, construction and administration of the AETS registry should have a market bias rather than a bureaucratic or compliance one. While confidentiality of market participants is important it cannot be allowed to compromise market transparency, price discovery or the maintenance of an orderly market.***

### **3. Administrative Arrangements**

Response to discussion paper, section 3.3.2 *“it is proposed that streamlined protocols be developed for eligible early action and offset projects.*

*Stakeholder feedback is sought on priority project activities for protocol development.”*

Any project activities considered for accreditation must conform to the guidance and regulations issued by the UNFCCC for activities that reduce greenhouse gases. It is important that they are also truly additional under the terms of this convention.

As the ACX is a firm believer in using market mechanisms to deliver the most cost efficient abatement economy wide in order to achieve any given

reduction target, we are not in the business of picking winners. We would however point out that there are many low emission technologies that are currently not being approved for accreditation as abatement under Greenhouse Friendly because of an overly simplistic application of the principle of financial additionality.

ACX therefore urges that consideration be given to developing a far more sophisticated and commercially realistic framework for the assessment of financial additionality in order to streamline the assessment of low emission and abatement technology based projects. A methodology for the assessment of the impact of commercial and technical risks associated with the deployment of new technology (e.g. varying discount rates in DCF calculations) and the provision of expert assessment of these factors by commercially sophisticated analysts.

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