



RESPONSE TO THE CLIMATE CHANGE AUTHORITY

REVIEW OF THE CARBON FARMING INITIATIVE LEGISLATION AND THE EMISSIONS REDUCTION FUND CONSULTATION PAPER

by Green Collar Group

To the Climate Change Authority;

GreenCollar is pleased to provide our response to the Consultation Paper – ‘Review of the Carbon Farming Initiative and the Emissions Reduction Fund.’ GreenCollar is well placed to assist the Climate Change Authority (CCA) with its review as GreenCollar is Australia’s leading natural resource management and environmental markets advisor and investor. We are the largest and most successful provider of carbon abatement in the country with a strong history in payment for ecosystem services and are the market leader in the Emissions Reduction Fund (ERF) having;

- » delivered ~38% of all Australian Carbon Credit Units (ACCUs) delivered to the Clean Energy Regulator (CER) in the ERF to date.
- » delivered over 1.5mill ACCUs under the Carbon Pricing Mechanism to Liable Entities.
- » originated and currently managing over 135 vegetation projects across Australia.
- » completed over 100 successful audits of projects – 100% positive results to date.
- » set the benchmark with the Clean Energy Regulator for offsetting reporting under the ERF (a ‘Model Client’).
- » completed the first Native Forest Protection projects in Australia.
- » completed the first Avoided Clearing of Native Regrowth project in Australia under the ACCU (*Carbon Farming Initiative – Avoided Clearing of Native Regrowth Methodology Determination 2015* (Avoided Clearing)).
- » an existing formal relationship with the Queensland State Government to explore co-benefits of carbon projects in key priority areas of environmental concern.
- » unparalleled technical and geospatial analysis capabilities for project identification across the land sector.
- » MoUs with 5 NRM groups in Queensland particularly focused on leveraging carbon project income to realise the co-benefits to water quality and other non-carbon environmental outcomes.

GreenCollar would summarise its position as;

Federal Schemes such as the Carbon Farming Initiative (CFI), which underpin the market for Australian Carbon Credit Units, and the Emissions Reduction Fund (ERF) have ultimately been the most successful climate change policies in the last 5 years. Notwithstanding that a long term emissions reduction target and emissions trading scheme is required, the CFI and ERF have successfully achieved their goal of establishing a framework for measured and verified emissions reduction and providing a purchasing mechanism for the Government to acquire lowest cost carbon abatement and emissions reduction through the reverse auction.

The CFI has had a major impact on the productivity and profitability of agricultural practices and shown to have real environmental, social and community benefits in areas where carbon projects are undertaken.

Market based solutions are the most effective way to measure, value and achieve environmental outcomes in the agricultural sector. The primary barrier to realising multiple benefits on the land is the lack of a value on non-carbon environmental outcomes such as biodiversity, conservation and water quality.

The market for Carbon in Australia is mature and established. Methods are tried and tested and a robust voluntary market is in place as well as an emerging compliance market. The key to this market's success has been the clear, open and transparent nation-wide methodology process for measuring and verifying carbon reduction or sequestration. Having a market buyer (such as the ERF) to supply certainty of offtake of the carbon units from a project has driven the uptake of activity across the carbon industry.

We believe in order to drive further carbon emissions reduction and achieve greater non-carbon environmental outcomes, it is vital to create similar national (or state) markets for the co-benefits generated from carbon projects. This allows projects to 'stack' the measured environmental value of each benefit, without double counting, so as to provide landholders with a payment for the full benefit of their activity change.

In addition there needs to be a review of how new and existing Methods are designed and written. Currently there is too many Methods developed without proper private sector participation or consultation that have had little to no realised abatement. It is imperative that Methods and the Method design process, address this gap in the process to realise much further land sector abatement opportunities.

The income derived from the environmental projects can, as we have seen from the CFI, be used to increase productivity on the remainder of the property, achieving the 'triple bottom line' so eagerly sought.

While the below response to each question is far from comprehensive, GreenCollar is keen to make itself available to discuss each matter raised in further detail should the CCA wish to investigate further or require more information.

Response to Individual Questions.

Development, Approval and review of methods

Q.1. Is the coverage of methods sufficient or should other emissions reduction opportunities that are consistent with the offsets integrity standards be included?

The current abatement activities being utilised under the ERF are the most economically viable and effective methods available. There does not appear to be any unknown methods requiring attention however focus should be placed on further research and development to make certain Methods more applicable and commercially viable. There is no point designing what may be technically a good Method if it cannot be applied practically or is too cost prohibitive for broad participation. Attention should be focused on amending the Avoided Clearing Method as its eligibility requirements make it largely unworkable. Currently the only 2 registered projects under this Method have been developed by GreenCollar and does not represent the true emissions as a result of land clearing across states such as QLD and NSW.

Avoided clearing/deforestation of native vegetation is clearly the lowest cost and lowest economic impact, therefore more work should be done on increasing the eligibility of properties to enter an avoided clearing project. The current criteria are most often technically unworkable and do not properly reflect the true driving factors that motivate land clearing within the land sector; it should be made to be more accessible for prospective candidates.

Q.2. Are the existing methods fit for purpose, including with respect to the offsets integrity standards?

Yes some Methods are fit for purpose but many Methods have generated little or no verified emissions reductions or project participation. The Methods themselves may address the offsets integrity standards as outlined in the legislation but this is in the absence of any real ability to generate the required emissions reductions the Commonwealth requires to meet its emissions reduction targets.

We need Methods that both address the Offsets Integrity Standards and facilitate the uptake of real and additional abatement.

Q.3. Would emissions reductions from some ERF offset projects be delivered more efficiently through regulation or some other policy?

Potentially. However, this question enters into the territory of the balance between the most efficient emissions reduction policy and the politically successful policy, which are historically incompatible in most cases.

The ERF has been extremely successful in creating emissions offsets and purchasing lowest cost abatement. In the absence of a market based carbon pricing mechanism, the ERF primary purchasing model achieved the results it set out to achieve, whereas other regulation and policies have failed over the same period.

Q.4. Is the process for method development and ERAC assessment efficient and transparent?

As much as it can be, yes. There could be more efficiency in amending methods that are not achieving their potential outcomes due to certain cost or additionality issues, specifically the soil carbon and Avoided Clearing (AC) methods, irrigated cotton Methods etc.

One of the critical aspects of the Method development, assessment and review is the need to engage more actively with the Private Sector. There should be much more focus placed on encouraging private sector R & D to develop suitable, implementable and technically robust Methods. Having Methods controlled and developed by the Department of Environment misses one of the most critical factors that drives the successful application of abatement activities within an industry or sector context.

Q.5. Why do some methods have low uptake?

It is GreenCollar's view that it is a combination of factors. The current process for Method development driven by government agencies without proper input from the private sector is a significant issue in uptake. There needs to be a review of how Methods are developed with a much more involved role from the Private Sector. Designing Methods in a "vacuum" without proper analysis of how it will work within a particular sector or industry is an inefficient use of resources and will continue to result in Methods that have little participation and minimal realized abatement.

Another contributing factor is the price of carbon being achieved in the auction that dictates the uptake of abatement from different methods and that the price of carbon will always dictate uptake as the price moves up the marginal abatement cost curve. There are two exceptions to this;

Soil Carbon – The current measuring requirements in the method are currently too costly, which drives up the required price of carbon to make a soil carbon project economically viable. There are potential changes to the measuring requirements that could bring down the compliance cost and achieve greater uptake.

However, whilst this is a barrier to registration and implementation of projects, it has not deterred the success of soil carbon methodologies at the Clean Energy Regulators (CER) regular auction.

Avoided Clearing – The avoided clearing method is clearly failing to achieve the economic incentive to reduce land clearing in Queensland. Figures soon to be released will show that land clearing in Queensland has increased dramatically in the last few years and yet the uptake of carbon projects under this Method is minimal. This is primarily due to the additionality rules for eligibility under this Method being too restrictive and not matching the

risk of clearing on properties. A review of the eligibility criteria for the AC method is needed to achieve the potential abatement from this method.

Q.6. Should methods with very few or no registered projects be subject to less frequent reviews?

There is no binary answer to this question. Some methods should be reviewed more regularly, and others have no need to be reviewed at all.

Additionality

Q.7. Is the ERF delivering additional abatement?

Certainly.

It could be argued that in the first year of the scheme's operation, that some projects were registered where additionality could be questioned. Some Energy Efficiency upgrades for example, would have potentially been done anyway.

However, one clear success of the ERF is that it has largely removed the additionality question from the carbon market through the policy's longevity and robust method framework. By this, we mean that if there were questions about a project's additionality in the early days of the scheme, these are no longer in play as any project that was likely to have been done without the ERF will have been done now.

Q.8. Could the additionality requirements be improved?

Overall the additionality framework is robust. Attention still needs to be paid to each methodology as best practice changes occur, or regulatory requirements tighten.

Effort should be put into looking into methods where uptake is low due to additionality requirements that may be too onerous or unworkable, such as the Avoided Clearing method.

Q.9. Do any methods or projects raise particular additionality concerns?

With respect to methods, the only concern we see is where projects are not able to meet the additionality requirements and the abatement or avoided emissions are lost, as per the Avoided Clearing method.

Project specific issues do arise around additionality where projects seek to value the co-benefits through 'stacking' income from those co-benefits with the realized carbon value of a project. The ERF was designed to purchase the carbon reduction only from any land based project and allow the market to realise value for the co-benefits from those projects. It would be a perverse outcome if such stacking were to cause issues with additionality, notwithstanding the basic rule for double counting carbon should be adhered to.

Emissions measurement

Q.10. Are current emissions estimation approaches and tools fit for purpose? If not how can they be improved?

The current estimation approaches are fit for purpose. The existing review framework is sufficient to ensure the estimation approaches continue to be fit for purpose.

Permanence

Q.11. Are the ERF permanence arrangements fit for purpose? If not, how could they be improved?

Yes.

Q.12. Do 25 year and 100 year permanence timeframes raise particular issues?

The different permanence periods are acceptable and useable by project developers and participants. In general the majority of our projects are 100-year permanence projects.

Q.13. Is the discount rate set appropriately for the 25 year permanence period and the risk of reversal buffer?

Most of the projects within our portfolio are selected as 100-year permanence projects. Interestingly, the ability to apply the discount rate and chose a 25-year permanence period has not been a huge driver for shorter term permanence periods.

GreenCollar goes to great lengths to make sure any project is implemented with an active land use plan and integrates successfully within a landholders overall enterprise. This tailored approach to individual property land management has meant that issues around permanence have not been significant barriers to uptake as perceptions around productivity have been addressed upfront.

Q.14. Is there sufficient information available to inform land purchasers about permanence obligations?

Yes, CER and Department of Environment have enough material available to assist landholders, project developers and aggregators. In addition the new industry code of conduct will provide an added safeguard to stakeholders concerning critical issues such as permanence.

Aggregation

Q.15. Is aggregation working effectively under the ERF? If not how can any issues be addressed?

Given the major role aggregators have played in contracting under the ERF, it would appear that aggregation is working very well from a contracting and purchasing stand point.

As Australia's largest aggregator by contracted volume, GreenCollar supports the current settings around aggregation.

Q.16. Is concentration in the market an issue and how can it be managed?

The make-up of the aggregator market, with 3 large organisations, approximately 8 medium sized aggregators and over a dozen smaller companies is by any measure a typical market concentration.

The larger market participants are differentiated by their business models, which further provides 'clients' of aggregators diversity of services provided.

The biggest issue around concentration is the large 'tail' of companies offering aggregation services. This tail is made up of smaller companies whose expertise and ability to manage aggregation risk often raises concerns. The cost of holding an Australian Financial Services Licence (AFSL) is generally the limiting factor to the size of the smaller companies. Those providing aggregation services without an AFSL are the major concern to the integrity of the market.

Q.17. Should contracts between carbon service providers or aggregators and other participants be made available to the Clean Energy Regulator?

No this should not be a requirement.

It would be outside the regulatory reach of the CER to demand such contracts in all cases. The ACCC, ASIC and general contract law principles also provide oversight as to how these contracts are and can be written.

This is a very sensitive issue. Much of a company's commercial IP, business model and other interests are reflected in contracts. Depending on how the Clean Energy Regulator used this information it could have a perverse impact on market participation. GreenCollar would make itself available to the CER in consultation to discuss general principles of contract formation within the industry if this were considered useful

At this point in time there seems to be no benefit to requiring private contracts to be provided to the CER in all cases.

Q.18. Are there any barriers to entry for new carbon service providers?

Other than the ASIC requirements for an AFSL, there are no material barriers to entry.

The development of an industry code of conduct may require further financial investment in setting up a new aggregator but it would be argued that this is an industry safeguard against poor practice and keeping out participants who cannot commit to a code of conduct would be a positive outcome.

Indigenous Participation

Q.19. What are the barriers to Indigenous participation in the ERF and how can they be addressed?

The lack of a requirement for Full Prior and Informed Consent can mean that Indigenous stakeholders are not engaged in projects early enough to actively participate in the design, implementation and reward of undertaking a carbon project under the ERF.

Q.20. Are the eligible interest holder arrangements working effectively? If not, how could they be improved?

The current lack of certainty about current and future EIH requirements is causing concern to project developers and indigenous groups. A solution to this issue which provides certainty is required.

The industry code of conduct will hopefully address best practice EIH consent arrangements.

Managing Perverse Outcomes

Q.21. Are the ERF arrangements to prevent adverse outcomes from ERF projects sufficient? If not, how could they be improved?

The methods are an effective tool against perverse outcomes. The Dept. Environment should be commended for the detailed thinking on this topic that it undertook to ensure against perverse outcomes. The CER should likewise be commended for its agile approach to regulating the methods to avoid perverse outcomes that might arise from gaps in the methods.

Project Registration Process

Q.22. Is the guidance provided for participation in the ERF user friendly and easy to understand?

As much as it can be for a complicated process. The process needs to be rigorous to ensure market integrity.

Q.23. Are there administrative barriers that are preventing participation in the ERF?

No.

Q.24. Could the process for project registration and variation be improved?

The current processes strike an effective balance between market integrity and scheme participation.

Q.25. Do scheme participants feel that enquiries about project registration or other administrative matters are dealt with efficiently?

The CER and Dept. Environment do an exceptional job in answering enquiries. The Contact Centre at the CER is highly effective.

Q.26. Is CER decision making consistent, transparent and timely?

Generally yes. The CER often has to deal with new unforeseen issues requiring thoughtful decisions. On some issues, particularly those of a legal nature, time must be taken to ensure the correct decision is reached.

However it is noted that not all decisions are agreed by all participants and many will argue that there is inconsistency and lack of transparency.

Crediting

Q.27. Are the ERF crediting arrangements fit for purpose? If not, how could they be improved?

Generally yes. Dealing with peaks in crediting applications (most commonly based around quarterly delivery on contracts is an ongoing issue which the CER is currently trying to manage)

GreenCollar would take this opportunity to commend the crediting team within the CER for its continual high performance in this area.

Auditing

Q.28. Are the ERF reporting and auditing arrangements and guidance fit for purpose? If not, how could they be improved?

The ERF reporting and auditing arrangements in general strike the right balance between balancing compliance, integrity and potentially prohibitive transactions costs.

The requirement for additional audits in certain circumstances such as project size, random selection and other factors is generally fit for purpose.

Q.29. Are there any opportunities for further streamlining reporting and auditing while maintaining the integrity of the scheme?

Auditors appointed by the CER to undertake independent audits have been poorly managed and ineffective. One audit in particular took over 10 months, cost GreenCollar 10's of thousands of dollars in time and labor to assist the auditors. Auditor requests were impractical, ill conceived and difficult to replicate in any scientific way. In many cases GreenCollar was required to educate the auditor as to how to undertake surveys and measurement.

Purchasing

Q.30. Are the purchasing principles fit for purpose? If not, how should they be changed?

The current reverse auction is working particularly well. The purchasing principles have achieved exactly what they set out to achieve, namely lowest cost abatement.

Q.31. Is too much emphasis placed on the least cost principle?

In GreenCollar's opinion, no. The least cost principle ensures that the Government is not paying for unmeasured co-benefits and has done a good job of providing the market with clear pricing signals for the cost of domestic abatement.

Q.32. Is the contracting and auction process fit for purpose?

The contracting principles appear to be working well. There may be issues developing around the risk of non delivery to the CER and the 'pushing back' of delivery could be an issue, however these settings were made to encourage participation and appear to have worked. There is no counter-factual to suggest that there would have been a better way with all evidence (participation and efficiency) pointing to these processes working well.

Q.33. Are there improvements that could be made to the auction design or contracting process?

No. Any change has a risk of perverse outcomes. Markets (even the primary market) need consistency and certainty to function effectively.

Contracts

Q.34. Are the ERF contracting arrangements fit for purpose? If not, how could they be improved?

Yes. The contract has been the basis of the success of the ERF to date. The CER may have reasons it can see for changing the contracting arrangements but any change should be communicated years in advance to allow sunk costs to be recovered for project origination under existing arrangements. The market needs consistency and certainty, any sudden changes may have detrimental effects on market participants.

Secondary Market

Q.35. How has the secondary market been operating?

The secondary market is small and illiquid, but is operating at a level of maturity above that expected from such a small and emerging market.

Liquidity, in particular a lack of supply of ACCUs is a developing issue. The supply demand balance is weighted towards demand for the following reasons;

The ERF is a large, single buyer with no differentiation on source of ACCUs. While this is the only material support for the market, it does have the effect of soaking up all supply.

The Government's ERF contracts for 'Prospective projects' means that the market is currently 'short' as project developers complete their project pipelines.

Interest from the voluntary sector (specifically internationally) is picking up. The International Carbon Reduction and Offset Association (ICROA) has recently endorsed ACCUs and NKACCUs as valid voluntary offsets globally. This has led to an increase in buyers from off-shore.

Higher than expected interest from the liable entities under the safeguarding mechanism is also being observed.

This lack of supply vs demand means the secondary market may see spot prices rise well above the auction prices and even the expected marginal abatement cost curve.

Q.36. Is the secondary market sufficiently transparent and are any changes needed to increase its effectiveness?

Brokers do not currently show prices for ACCUs on any transparent platform (e.g. Reuters), as there are so few transactions and a large majority of those are bilateral (between two parties directly). As such, the market lacks transparency. As liquidity increases, this may start to occur.

Governance

Q.37. Could the current governance structure of the ERF be improved? If so, how?

The Governance seems to be agile and effective. An industry code of conduct would add efficiency to the governance reach.

Q.38. In what ways could transaction costs be minimised for ERF participants while maintaining environmental integrity?

GreenCollar believe that the transaction costs are immaterial, notwithstanding the Measurement and Verification requirements of the Soil Carbon method, which should only be changed with careful consideration of the consequences to environmental integrity.

The main issue to address is not transaction costs for participants but Method development processes. More attention needs to be directed too engaging the private sector, those close to the industry, capable of identifying real, verifiable and commercially applicable opportunities for sourcing abatement. It is the absence of commercial application that is of most concern to ERF participants.

Compliance

Q.39. Is the current compliance regime effective including for relinquishment of ACCUs in cases of a lack of permanence?

With few examples to work from it would appear that the compliance regime is effective.

Q.40. What would improve its effectiveness?

No comment.

International Linkages

Q.41. Should the Government allow the export of ACCUs or imports of carbon credits to meet contractual obligations under the Emissions Reduction Fund?

The wording of this question appears poorly defined. It seems to refer to International units being used to meet delivery on contracts with the CER under the ERF.

If so, our answer would be that without serious consideration of the market outcomes, there should be no ability to import ACCUs to meet 'contractual obligations under the ERF'. The ERF is a domestic market with domestic constraints, and any ability to use international units could create market disrupting outcomes.

If the question is proposing that international units be available for liable entities to deliver under the Safeguard Mechanism, then we would suggest that this should be explored only as a two way eligibility between trading partners with transparent carbon pricing mechanisms and similar governance regimes.

Q.42. How can Australia ensure that ACCUs would be eligible in future international markets?

The Australian market would need to be more transparent, however this would naturally occur should an international linkage seriously proposed.

Future of the ERF

Q.43. What role should the ERF play in meeting Australia's future international targets?

The demand side of the ERF should eventually be replaced by an emissions reduction target or tighter Safeguard baselines. A robust safe guarding mechanism that can drive demand should be the highest priority for transitioning the ERF.

In the absence of such a policy, the ERF funding should be increased for the following reasons:

- The ERF Auction is a very effective price finding mechanism for a tonne of CO₂e.
- Safeguard Mechanism liable entities need a clear and transparent price of carbon to ensure they are able to effectively manage future compliance risk.
- The ERF Auction process has been very successful in achieving lowest cost abatement ,

The CFI framework, underpinning the supply side of ACCUs should continue to be the source of ACCU supply in any future market.

Q.44. How would this affect its crediting and purchasing elements?

The crediting element should not change, unless to match method requirements with international partners.

The purchasing element should continue 'as is' until an alternative demand mechanism comes into reality.

Q.45. To what extent (if at all) is uncertainty around the future of the ERF affecting investment decisions in offset projects and the secondary market?

Uncertainty around the future of ERF funding is affecting the ability for project developers to plan beyond 2018. Small – Medium aggregators will certainly be considering the economic viability of their businesses. Without further funding or alternative demand sources, the industry will go through an inevitable consolidation.

With public debate about the Clean Energy Target, liable entities (particularly in the energy sector) are holding off making decisions around Safeguard liability.

Both of these issues are effecting the ability of the secondary market (project developers and liable entities) to forecast future supply and demand and therefore long term contracts are difficult if not impossible to enter into.