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Committee Secretary
Senate Standing Committees on Environment and Communications
PO Box 6100
Parliament House
Canberra ACT 2600

Inquiry into the Government's Direct Action Plan

Energetics welcomes the opportunity to make a submission to the inquiry into the Government's Direct Action Plan. We are a specialist management consultancy with 30 years experience in energy and carbon management. Energetics delivers measurable outcomes to address key business needs in areas improving energy productivity, identifying and developing business opportunities, reducing costs and, mitigating climate change risk. We have a national multi-disciplinary team of over 100 professionals in five offices across Australia.

Our views on the Direct Action Plan have been outlined in a number of places¹ and in this submission our comments relate to the development of a suite of policies designed to fulfil Australia's international obligations for reducing greenhouse gases.

We believe Australia's climate change response must consist of several complementary measures. Some are included in the Government's Direct Action Plan, while others are already included in Australia's current mix of climate change policies. These policies include:

1. A significant and consistent commitment to the **Renewable Energy Target (RET)**. Our own analysis of the gap between business as usual emissions and Australia's current 5% reduction target² showed that while the gap to the target is reducing, much of the work is being done by renewable energy generation especially solar PV. Any move to relax the RET could see the gap begin to widen. Further, we believe that the many reviews of the RET introduces uncertainty into decisions related to investment in renewable energy generation and are therefore not helpful. A sustained bipartisan commitment to the RET at its current level is required.
2. The **National Strategy for Energy Efficiency (NSEE)** and the work programs. Work by the former Department of Climate Change and Energy Efficiency highlighted the impact of

¹ <http://www.energetics.com.au/insights/direct-action-information-centre>

<http://www.energetics.com.au/insights/latest-news/climate-change-matters/designing-the-emissions-reduction-fund>

² "Rethinking Australia's greenhouse emissions reduction challenge", available from <http://www.energetics.com.au/getmedia/ecaafaaf-df36-4041-9a09-d68bbcaa320d/Australia-s-greenhouse-abatement-challenge.pdf.aspx>

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programs that are part of the NSEE³. An analysis reported in Climate Spectator⁴ showed that energy efficiency contributed to 28% of the fall in demand in the National Electricity Market between 2006 and 2013. ClimateWorks also studied the potential impact of energy efficiency in meeting Australia's emissions reduction target⁵. They found that in 2020 somewhere in the order of 50 million tonnes of CO₂-e abatement could be achieved by energy efficiency measures that are cost effective from the perspective of both the investor and society as a whole. The role of the NSEE is to reduce the barriers that impede the realisation of energy efficiency benefits. As such, the continuation of the NSEE and its programs is an important and effective complementary measure.

3. A **baseline and credit emissions trading scheme** to be implemented. Energetics believes that a baseline and credit trading scheme could provide an efficient market mechanism. Flexibility is required to ensure that the mechanism meets Australia's current and future obligations. This mechanism enables the most effective realisation of the 'safeguard' mechanism and make-good provisions outlined in the government's ERF Green Paper. We discuss this in more detail below.
4. A **project based program** to promote investment in abatement projects and support productivity. This is the role of the Emissions Reduction Fund (ERF).
5. Support investment into energy efficiency and renewable energy through effective finance mechanisms. The **Clean Energy Finance Corporation** has provided an effective body to support business and should be continued.

A fair and equitable scheme

Our own clients have told us two things about what they would like to see in our national climate change policy:

1. Business strongly favours a scheme that is equitable. Australian companies believe in a 'fair go' and look for certainty in government policy to conduct business.
2. Businesses overwhelmingly (88% of those surveyed) support the application of penalties for organisations that increase their emissions above what is considered fair. Further, most of these organisations feel that penalties should be set at a level that matches the cost of action to reduce emissions.

Energetics therefore considers that the 'safeguard' mechanism discussed in ERF Green Paper is a key component of the Direct Action Plan. The safeguard mechanism can act to prevent business from increasing their emissions to an extent that may cause problems for other sectors of the economy. In the absence of an equitably applied safeguard mechanism, sectors may be forced to decrease their emissions by more than 5% in absolute terms in order for our country to meet our 5% reduction target. This does not meet the fair and equitable ('fair go') test.

We see the safeguard mechanism working with the following features:

³ Department of Climate Change and Energy Efficiency 2010, Australia's emissions projections 2010, DCCEE, Canberra, ACT

⁴ "The demand drop mystery explained", Hugh Saddler, Climate Spectator, 6 Jan 2014, available from <http://www.businessspectator.com.au/article/2014/1/6/energy-markets/demand-drop-mystery-explained> (accessed Jan 2014)

⁵ "Low Carbon Growth Plan for Australia", ClimateWorks, March 2010

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- Operating as a baseline and credit trading scheme.
- The baselines will be derived from agreed emissions intensities for the activities undertaken by a business (within sectors), with adjustments for changes in levels of business activity. In addition, the baselines are adjusted downwards at regular intervals to account for the reasonable expectation that businesses will achieve an on-going energy/emissions productivity improvement. Baselines should also be periodically reviewed and altered to reflect any changes in the national emissions reduction target.
- Sites or facilities that achieve emissions below their baseline can offer the abatement for sale to the ERF or to any other buyer such as corporations whose emissions exceed their baseline. Sites or facilities that achieve emissions above their baseline must purchase verified abatement from other participants or purchase approved international offsets. Under this model, the ERF remains revenue neutral.

Implementation is practical, either through the mechanism discussed in the ERF Green Paper or by amending the existing Jobs and Competitiveness Package in a minor way – extending the EITE compensation to cover all liable entities and increasing the level of compensation of the baselines (possibly to 100%) derived from consideration of the level of business activity.

Comments on the Terms of Reference

In the remainder of our submission, we comment on specific issues raised in the Terms of Reference.

Does the Direct Action Plan have the capacity to deliver greenhouse gas emissions reductions consistent with Australia's fair share of the estimated global emissions budget that would constrain global warming to Australia's agreed goal of less than 2 degrees?

Energetics would like to see Direct Action designed to meet Australia's international obligations. The current consultation period offers the opportunity to provide expert advice and design assistance. Australia has arguably led the world in the development of emissions assessment, evaluation and reporting programs such as the National Greenhouse and Energy Reporting Act. Businesses engaged in these schemes have a wealth of experience and knowledge that can be drawn upon in order to design a new emissions reduction policy and program framework.

Does the Direct Action Plan have the capacity to reduce greenhouse gas emissions adequately and cost effectively?

Careful design is needed to ensure that the Direct Action Plan promotes sufficient emissions abatement to meet international obligation, currently a 5% reduction target. In particular, we believe the ERF, as the centrepiece of the Direct Action Plan, should be supported with a range of complementary measures. Our analysis of potential abatement arising from the ERF shows that:

- The ERF will not provide sufficient additional incentive beyond the value of the energy savings themselves to promote widespread additional adoption of energy efficiency. For instance, the contribution of the ERF to savings due to improvements in energy efficiency is the order of 15% when the energy source is electricity or natural gas.

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- The high cost of natural gas relative to coal means that even with the contribution of ERF funds, additional switching from coal to gas will not occur. All the more so given the proposed cap of five years on the contracts for the purchase of abatement.
- Sequestration in soil carbon has too many unknowns to be a significant part of the measures to achieve the 5% emissions reduction target. For instance, a study by the Melbourne School of Land and Environment at the University of Melbourne⁶ examined the viability of the land use practices that may lead to sequestration in soil organic carbon. This study came to the same conclusion as the CSIRO⁷, namely that *studies that have quantified the effects of improved management practices in croplands on soil carbon have generally been inconclusive and contradictory for different soil depths and durations of the management changes*. This uncertainty would undermine the ability of the ERF to deliver its desired outcomes.

While the ERF is the most significant element of the Direct Action Plan, 'One Million Solar Roofs' is an important element of the Direct Action Plan, with the objective of achieving the goal of one million additional solar energy roofs by 2020 through the payment of an extra \$1000 rebate for either solar panels or solar hot water systems. Putting aside work that has shown that rebates are the least economically efficient means of promoting action⁸, the recent history of the uptake of solar PV in Australia driven by the changing economics of solar PV has clearly indicated that an additional rebate from the Commonwealth is not required to support these activities.

Direct Action's policy could be successful if a fair and equitable baseline and credit trading scheme is included. This mechanism must include flexibility to ensure Australia can fulfil its current and future international obligations. Bipartisan support is essential to provide certainty in climate change policy to business.

What is the effect of technical issues that arise for measuring abatement under the Direct Action Plan, including additionality and establishing emissions baselines for emitting entities and long-term monitoring and reporting arrangements?

Commenting on the complexity associated with establishing emissions baselines, in our work with clients we found that this was one of the most contentious aspects in the design of Direct Action. Even within industry associations where companies undertake equivalent activities, we found that it was not always possible to come to agreement on whether activity or site specific baselines were preferred over company baselines. This is further complicated by the differing opinions of companies on whether baselines should be intensity based or absolute. While there is provision in the Direct Action Plan for adjusting absolute baselines over time, this presents an ongoing complexity within the program as it will be necessary to go through whatever processes are developed to support baselines to which companies agree every time the baseline is adjusted.

The technical issues associated with defining project additionality are also not insignificant. In this context we err on the side of caution and propose that it is best to define additionality requirements so that they are not a barrier to project implementation. While our preferred position is to adopt the

⁶ "The potential for carbon sequestration in Australian agricultural soils is technically and economically limited", Shu Kee Lam, Deli Chen, Arvin R. Mosier & Richard Roush, Melbourne School of Land and Environment, The University of Melbourne, SCIENTIFIC REPORTS 3:2179, DOI: 10.1038

⁷ "Soil Carbon Sequestration Potential: A review for Australian agriculture", Jonathan Sanderman, Ryan Farquharson and Jeffrey Baldock, CSIRO Land and Water, 2010

⁸ See "Learning the hard way: Australia's policies to reduce emissions", The Grattan Institute, April 2011

project additionality requirements used in international carbon credit programs such as CDM, there is a pragmatic position which relates to actually delivering abatement projects within 24 months.

What is the impact of the absence of policy certainty derived from the Direct Action Plan to encourage long-term business investment in the clean, low carbon economy?

In proposing the Direct Action Plan and the ERF, the government seeks to remove the burden of the carbon tax on Australian business believing that the carbon tax is constraining investment in Australia. However, Energetics believes that repealing the tax will not remove the issue of reducing carbon emissions from the risk profiles of Australian business unless it is replaced by a scheme that receives support from the Labor opposition.

History has demonstrated that a failure to implement a scheme that largely satisfies the policy objectives of both parties merely introduces uncertainty sometime in the future. Businesses will factor an uncertain carbon price into long term investments. Australia's energy sector provides a stark example of the effects of uncertainty in Australia's climate change response with delays in both investment in conventional power generation and supply infrastructure, and large scale renewable projects remaining on hold.

Only a scheme that has bipartisan support will offer business a more certain investment environment and will thus enable the sustainable growth of the Australian economy.

What is the impact of the abolition of the Clean Energy Finance Corporation on the availability of capital for clean technology and industry investment?

Energetics believes that the CEFC has a key role in financing the uptake of emerging clean energy technologies – not by offering 'free money' but by having a focus on clean energy technology, which allows the CEFC to price the risks associated with investments in clean technology compared to the pricing of risk by the commercial banks. The longer payback period accepted by the CEFC, in comparison to alternative financiers, means that it is better equipped to drive large scale investment in renewable energy capacity.

The Clean Technology Investment Program (CTIP) was successful at facilitating investment in energy efficiency and at a cost per tonne of abatement that the ERF is seeking. The CTIP achieved this by allowing applicants to bring forward abatement reductions and receive payment for those future emission reductions prior to investing in the abatement project. This meant that the applicants saw the CTIP program as providing a contribution of low cost equity for the project rather than a future income stream.

The ERF Green Paper is quite explicit on the Government's desire to only pay for abatement that has been delivered. The Green Paper does speak of the up to five year contracts for the purchase of abatement as being "*an initial bankable off-take agreement*", which will allow the abatement project proponents to convert future sales revenue into capital to support the delivery of the project.

Energetics is concerned that the commercial banks will not effectively assess the risks associated with these contracts. They will therefore heavily discount the value of future revenue from the abatement project and so decrease the value of the contract as a means of funding the implementation of the project. The CEFC is likely to be better placed to assess the risk and be less conservative in providing loan funds backed by the future revenue of the abatement project.



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The CEFC could therefore have a key role in facilitating uptake of abatement driven by the ERF. Policy certainty will drive investment and provide a low cost abatement path. This will assist in the market realising cost effective abatement opportunities.

What is the impact of repealing the Clean Energy Package on Australia's ability to systemically address climate change?

Whilst both parties agree on the science of climate change and, in principle, agree that a market based mechanism is the best way to address the risk of climate change, without a bipartisan policy position, it is unlikely that Australian domestic climate change policy will advance beyond uncertain rhetoric to driving wholesale behavioural changes. Whilst effective in the short-term, the uncertain future of Clean Energy Package marred the potential impact it may have had on changing Australia's electricity generation mix.

What is the impact of repealing the Clean Energy Package on Australia's carbon pollution cap?

The existence of a carbon pollution cap is the most simple approach to meeting Australia's 5% emissions reduction target. However, a carbon pollution cap in, and of itself, is not the only mechanism to ensure the emissions reduction target is met. With the appropriate design of continued review and amendment of sectoral baselines, Australia may be able to mirror the effects of a carbon pollution cap through the ERF.

Thank you for this opportunity to make this submission.

Yours sincerely

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