

Professor Ian Chubb AC FAA FTSE  
Chair, Independent Review of Australian Carbon Credit Units  
c/o Department of Climate Change, Energy, the Environment and Water

Via email

20 September 2022

Dear Professor Chubb,

**Re: Independent Review of Australian Carbon Credit Units**

The Energy Efficiency Council (EEC) is grateful for the opportunity to make a submission to the Independent Review of Australian Carbon Credit Units. The EEC strongly believes that given sensible reform, ACCUs could play a more important role in catalysing the transition of the Australian economy to net zero emissions by 2050.

Energy efficiency and energy management are important avenues to reduce greenhouse gas emissions directly, and to expedite the transition of energy systems to zero emissions systems through better aligning energy demand with supply. However, energy efficiency methods have represented a small fraction of the abatement achieved by the Emissions Reduction Fund to date. We believe that with the advent of enhancements to the Safeguard Mechanism, new sources of demand for ACCUs will be created. This means there is an opportunity for ACCUs to be used to facilitate emissions reduction right across the economy.

The EEC suggests several reforms to reduce barriers to participation in the ERF, including removing the legacy of the contracting framework which has been the dominant feature of the ERF to date. Simplified and streamlined methods for registering projects and crediting abatement could be considered as a way to reduce barriers to participation, as well as ensuring that crediting arrangements do not present unnecessary hurdles to capital investment in energy efficiency and energy management.

Our full submission to the Review is attached, and I would be delighted to provide you with any further information you may require. I can be contacted on 0413 698 181 or at [alex.stjohn@eec.org.au](mailto:alex.stjohn@eec.org.au)

Yours sincerely



Alex St John  
Acting Head of Policy  
Energy Efficiency Council



**energy efficiency**  
COUNCIL

**Energy Efficiency Council submission to the  
Independent Review of Australian Carbon Credit  
Units**

**20 September 2022**

## Summary

The Energy Efficiency Council supports the creation of a strong and robust framework for denominating domestic emissions reduction through Australian Carbon Credit Units. There is an opportunity to revise policy settings for the offsets framework to create an offsets market that is vital and liquid, and provides assurance to all participants in the quality and integrity of ACCUs.

Changes to the Safeguard Mechanism are likely to create a significant source of demand for ACCUs, meaning that a limited window of opportunity exists to make sure that settings for the issuance of offsets are fit-for-purpose in a new mode of operation where government procurement of ACCUs is no longer dominant.

The EEC suggests that the Review consider reforms to the Emissions Reduction Fund / Carbon Farming Initiative settings to encourage participation in offsets generation from a wider range of participants and diversify sources of emissions reduction away from the land sector to sectors including commercial and industrial settings. Energy efficiency and management has a substantial role to play in emissions reduction, but current policy settings in the ERF have failed to substantially catalyse these opportunities.

Reforms to the ERF could simplify the process of participation in the ERF for project proponents, including streamlining additionality requirements to make them fit for purpose and altering crediting arrangements to make participation more attractive where up-front investment is required. Additionally, as the ERF will no longer be primarily a program of government procurement, removing the contracting architecture could streamline the program and pivot the regulator's focus towards establishing systems that reduce barriers to participation.

## 1. Introduction and overview

The Energy Efficiency Council welcomes the opportunity to make a submission to the Independent Review of Australian Carbon Credit Units ('the Review').

The Energy Efficiency Council (EEC) is the peak body in Australia for energy efficiency and energy management. The EEC is a not-for-profit membership association for businesses, universities, governments and NGOs, advocating for healthy, comfortable buildings; productive, competitive businesses; and an affordable, reliable and sustainable energy system for Australia.

The Review is a timely exploration of Australia's system for quantifying tradeable emissions reductions. Reforms to the safeguard mechanism – due to commence from 1 July 2023 – will provide additional demand for ACCUs. At the same time, the market for ACCUs will change from one dominated primarily by government procurement to one with a more diverse range of buyers.

This presents an opportunity for Australian offsets to develop into a more mature and sophisticated marketplace with a broader range of participants. A reinvigorated market for ACCUs could catalyse decarbonisation across a range of economic sectors and provide opportunities for bring the benefits of the transition to a net zero future to a wider cross section of the community.

Energy efficiency and energy management provide an avenue for achieving substantial emissions reduction in the short to medium term. In comparison to land sector methods, energy efficiency upgrades can yield reductions in emissions immediately, with ongoing energy savings both reducing emissions and improving the competitive advantage of Australian business.

However, the functioning of a vital offsets market relies on unquestionable integrity of ACCUs. Governments, businesses and other stakeholders must remain assured that each and every ACCU represents a genuine emission reduction. While the EEC understands that the additionality of some classes of ACCUs remains contested, the EEC supports measures to enhance ACCU integrity to ensure confidence is retained in the Carbon Faming Initiative framework.

Further, the EEC recommends that the Review consider appropriate changes to ACCU generation as the market moves away from government purchasing. Among business and industry, participation in the ERF has typically been difficult. The transaction costs and uncertainty associated with registering a project, generating and selling ACCUs have often outweighed any potential benefit from participation, meaning that energy efficiency projects have been poorly incentivised by the ERF. Opportunities exist to lower barriers to participation, which could unlock substantial abatement in energy efficiency and management at low cost.

## **2. The role of ACCUs in the transition to net zero**

Australia faces a substantial challenge as we transition to a net zero economy over the next three decades. Industries based around resource extraction and processing remains some of Australia's largest emitters. Our post-2050 economy will undoubtedly leverage Australia's endowment in mineral resources, as well as the competitive advantage of vast clean energy potential. To achieve a clean economy, substantial progress in decarbonisation of industry, transport and energy supply will need to be made. While decarbonisation of energy supply is in train, decarbonisation of transport is just beginning, and industrial decarbonisation is embryonic.

Offsets – particularly Australian Carbon Credit Units – will play two vital roles in our transformation to a net zero economy. Firstly, ACCUs will be used by businesses to acquit decarbonisation obligations, either arising from requirements to comply with the enhanced safeguard mechanism, or from internal policies or obligations (such as a carbon neutral pledge). This role should be transitional and used to allow some flexibility in decarbonisation progress. Decarbonisation progress – particularly in industrial settings – is likely to follow a non-linear path. Technological and investment cycles operate over the span decades, and the use of offsets will allow businesses to invest in low-emissions technology at the time that makes most sense for their circumstances.

Secondly, even after substantial decarbonisation of energy systems, some emissions will be particularly challenging to abate. Elimination of industrial process emissions will rely on technological progress, but such advances may not occur for some years. In a net zero economy, these emissions will need to be sequestered or offset, meaning that offsets will have a continuing role even after the majority of emissions have been eliminated.

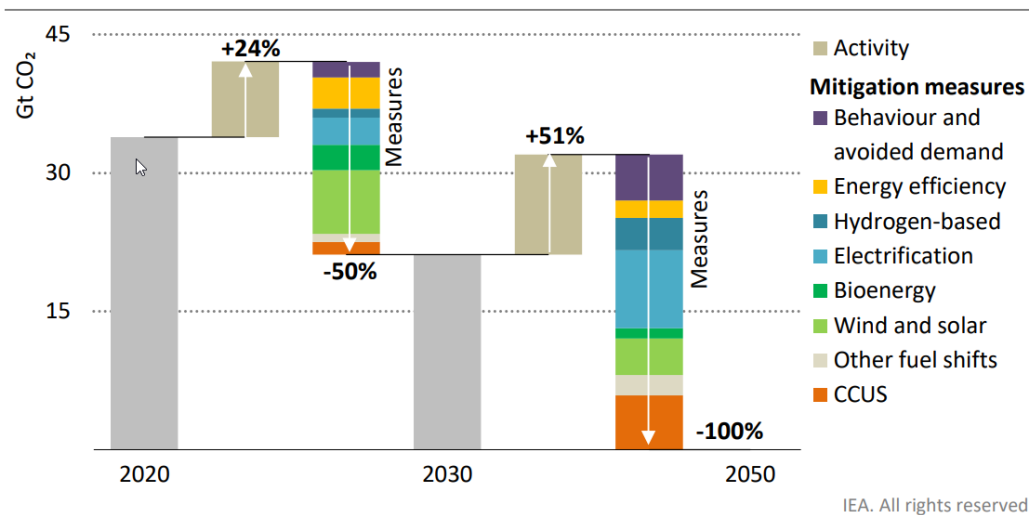
However, it should be noted that volumes of ACCUs are unlikely to be sufficient to offset process emissions associated with coal, oil and gas production. These fugitive emissions are difficult to abate, but these emissions will need to be eliminated rather than offset.

## **3. Energy efficiency and management create immediate abatement**

Activities in energy efficiency and energy management can create substantial, bankable emissions reduction today. This is of particular importance during the transition to net zero – catalysing energy efficiency can reduce both scope 1 and scope 2 emissions and is available at a range of scales from individual households up to large industrial operations.

In the context of offsets, energy efficiency and management activities can avoid emissions that would have occurred under a business-as-usual scenario. In some cases, this can be relatively simple to determine – replacement of inefficient lighting or other appliances with more efficient alternatives leads to easily calculable energy savings. In some cases, more sophisticated measurement and verification methods are needed to determine the actual emissions reduction associated with energy efficiency upgrades, which leads to high confidence in the genuine, additional emissions reductions created by these methods.

Energy efficiency and other demand reduction measures, as well as electrification (which combines both fuel-switching and energy efficiency) make more than half of the emissions reduction required in the International Energy Agency's Net Zero Emissions scenario (see figure 1).



**Solar, wind and energy efficiency deliver around half of emissions reductions to 2030 in the NZE, while electrification, CCUS and hydrogen ramp up thereafter**

Notes: Activity = energy service demand changes from economic and population growth. Behaviour = energy service demand changes from user decisions, e.g. changing heating temperatures. Avoided demand = energy service demand changes from technology developments, e.g. digitalisation. Other fuel shifts = switching from coal and oil to natural gas, nuclear, hydropower, geothermal, concentrating solar power or marine.

Figure 1 - Emissions reduction in the IEA's Net Zero Emissions scenario

However, energy efficiency activities have represented less than two per cent of ACCUs registered under the Emissions Reduction Fund, meaning that significant potential to achieve emissions reduction at low cost is being overlooked.

The EEC suggests that the Review would be well placed to consider reforms to increase the amount of non-land sector abatement delivered through the ERF/CFI. Increasing the diversity of activities that lead to abatement will bring a greater variety of participants in the sector and reduce reliance on any one source of abatement. This would reduce risks of illiquidity in the offsets market, increase the integrity of offsets and distribute the benefits of participation in the ERF/CFI to a broader cross section of the community.

## 4. Reduce barriers to participation in the ERF

There are currently a range of significant barriers to participation in the ERF. Addressing these barriers would permit diversification of the generation of ACCUs and unlock a larger pool of abatement.

### 4.1 Additionality requirements

Reflective of its current incarnation as a program designed to encourage abatement via government procurement, the ERF currently has a range of requirements related to additionality. Currently, these include the newness requirement, the regulatory additionality requirement, and the government programs requirement.

Taken together, these requirements essentially dictated that a project would be ineligible for participation in the ERF unless it would not be possible for the project to proceed in the absence of the intervention of the ERF. As a government procurement program, it is understandable that these additional requirements were an attempt to ensure that expenditure of government funds went to those projects in greatest need of funding. However, the additionality requirements set a high bar for project participation, excluding a range of projects that could have delivered significant abatement.

In a reformed ERF, additionality requirements will play an important role in ensuring that only genuine abatement is credited. However, the three current additionality requirements should be removed and replaced with a generalised additionality requirement to demonstrate that the proposed abatement is genuinely additional to business-as-usual. Individual method requirements can be set to ensure that projects under each method have a robust method of demonstrating additionality to business-as-usual. In general, regulatory additionality would be retained, however the newness requirement and the government programs requirement should be reformed.

In particular, the government programs requirement should be abolished in favour of a list of specified programs that ERF activities are incompatible with (principally where involvement would lead to double counting of emissions reduction in the National Greenhouse Gas Inventory). For example, activities under the ERF should be able to leverage funding from state or territory governments, or energy efficiency schemes as well as receiving ACCUs. While other energy or greenhouse gas reduction schemes may be denominated in units of greenhouse gas saved, certificates or awards under those schemes do not count towards Australia's emission reduction target themselves (rather, their effect would be seen in lower inputs into the National Greenhouse Gas Inventory), and so there would not be a risk of double counting of effort. Allowing ERF projects to leverage other sources of government funding would improve the business case for some projects.

For energy efficiency and energy management activities, there are highly robust avenues to ensure that emissions reductions are genuine and additional. Project-based activities that include measurement and verification (M&V) regimes have demonstration of the abatement generated by a program built into the conduct of the project and can easily demonstrate that emissions reduction associated with a project such as an equipment upgrade, or a process change, are additional to business-as-usual. In some cases, energy efficiency and energy management activities require up-front capital investment, acting as a clear delineation from business-as-usual activities.

Streamlining additionality requirements and making them fit-for-purpose would be a significant improvement to the ERF, and a way to ensure that a greater range of emissions reduction activities could participate in the ERF. The EEC recognises that determination of additionality is always a difficult exercise, and that the additionality of some existing ERF projects is contested. However, there remains opportunities to attract additional, genuine abatement into the ERF through commercial and industrial processes, and we suggest that the Review consider recommending changes to make additionality requirements fit-for-purpose under the new paradigm of operation for the ERF.

## 4.2 Barriers resulting from the contracting process

There are currently several barriers to participation in the ERF which are a legacy of the ERF's current mode of operation, where government contracts have been the primary method by which ACCUs are acquired. Examples of these barriers include the requirement for proponents to deliver minimum volumes of ACCUs, compliance and contracting terms, and the inability of ACCUs to be forward-issued.

### 4.2.1 Abolishing contract-related barriers

As the ERF transitions away from government purchasing, a new approach to ACCU generation could be considered to streamline project registration and ACCU issuance. In the future, carbon abatement contracts will not be required, as the primary source of demand for ACCUs should come from non-government sources. This means that there will no longer be a need for the carbon abatement contract framework, and the process for registering a project should be extensively reviewed and streamlined. The Regulator should transition from a procurement-focused operation to an operation that is concerned with establishing simple, easy-to-use systems for project registration and progress reporting.

Similarly, many ERF processes have been designed to minimise risks to government of non-delivery – essentially financial controls to ensure that Commonwealth moneys are not expended on projects that fail to deliver contracted abatement, or that deliver non-genuine abatement. In the future, controls need to be centred on ensuring that ACCUs generated represent genuine and additional abatement, rather than mitigating financial risk to the Commonwealth.

In the future, should governments wish to purchase ACCUs for any purpose, a simple tender process for ACCU procurement should be sufficient. Beyond fulfilling existing contracts, the framework for carbon abatement contracts should be abolished, and frameworks for registering ACCUs should be reviewed to ensure they are fit-for-purpose to facilitate participation from a wide range of potential ACCU generators.

### 4.2.2 Accommodating up-front capital investment

In contrast to land-sector methods, energy efficiency and other commercial and industrial methods frequently require upgrades to equipment involving significant capital expenditure. This imposes requirements for project proponents to make all necessary investments for the project many months, and potentially years, in advance of the ability to recoup any of these costs through the sale of ACCUs.

In a regime based on the awarding of carbon abatement contracts through auctions, the uncertainty around progressing a project created significant barriers to matters such as arranging finance, determining optimal periods for installation of equipment (requiring reduction or stopping of production), or securing the



acquisition of specialised equipment, trades and services. While these barriers are largely removed when auctions are not involved, the security provided by assured payment on contracted terms is also removed.

This means that the proximity between the capital outlay and the associated revenue is large, and also introduces significant price risks. If the market for ACCUs is volatile, the economics of projects may become less favourable if proponents are required to include a large discount factor on ACCU revenue to take into account potential future price changes, or hedging or other forms of insurance is required.

The EEC suggests the Review consider recommending partial forward issuing of credits in some circumstances, particularly where large initial outlays of capital are required for project progress. This could allow project proponents to recoup some of the costs of capital outlay more quickly, reducing project risk profiles and encouraging greater ERF participation.

Registering a project would normally include a requirement to lodge an accurate estimate of the expected timeframe under which credits could be generated. Forward issuing of credits – for example, issuing 50% of the credits due in the first or second year immediately on verification of project commissioning, could help business cases for commercial and industrial projects be more attractive. A true-up of credits at the end of each year would ensure that credits had been issued only in respect of actual abatement.

#### 4.3 Promoting market confidence

As the market for ACCUs transitions to a more open and diverse market, it is important for all participants – governments, ACCU creators, purchasers, and the community – to maintain confidence in both the integrity of ACCUs and the financial operation of the market. Purchasers need access to a ready supply of credits and relatively predictable prices, and ACCU generators need confidence that the market will deliver price outcomes that will make their projects economically viable.

As with all markets created on the basis of trading instruments created by regulation, the market is highly susceptible to risks associated with changes in policy or other government intervention. In similar schemes, price volatility in the traded instrument has robbed the market of confidence – creating higher than necessary levels of risk for project proponents. In some schemes, regulators have altered relative incentives or other scheme settings to address issues of scheme integrity, rather than making other administrative or compliance controls. These types of interventions should be avoided in the interests of promoting a vital, robust and confident market for ACCUs. Policy settings that do not promote confidence will mean that opportunities for abatement catalysed through ACCUs will be needlessly delayed or not proceeded with.

The EEC therefore suggests that the Review consider how reforms might enhance and improve market confidence while assuring integrity in Australia's offsets market.