



Deacons

Australian Local Government Association

**Briefing Paper on National Greenhouse
and Energy Reporting Scheme, Carbon
Pollution Reduction Scheme and
Complementary Measures**

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1. Introduction

- 1.1 On 1 July 2008, the National Greenhouse and Energy Reporting System (**NGERS**) commenced. The NGERS regulatory framework is underpinned by the *National Greenhouse and Energy Reporting Act 2007* (Cth) (**NGER Act**) as well as regulations and determinations made under the Act. It is intended to provide a national approach to the collection of information on greenhouse gas emissions and energy use and production
- 1.2 On 4 July 2008, Professor Ross Garnaut, who is undertaking a Climate Change Review, on behalf of the Federal and State governments released his draft report. His final report is anticipated to be released in September, with an interim report on economic modelling issues scheduled to be published on 5 September 2008.
- 1.3 On 16 July 2008, the Federal Government released a green paper (**Green Paper**) on the proposed Carbon Pollution Reduction Scheme (**CPRS**), which is a 'cap and trade' emissions trading scheme. The Government intends to commence the CPRS on 1 July 2010. It is proposed that the CPRS will wherever practical follow the NGERS as the starting framework for the monitoring, reporting and assurance of emissions. The Federal Government has indicated that the NGERS will need to be strengthened to support the market confidence and financial importance attached to emissions trading, and that the CPRS will be complemented by other schemes (referred to as complementary measures) to achieve the government's emission targets.
- 1.4 Comments on the Green Paper are due on **10 September 2008**. A White Paper with proposed legislation is programmed to be released by the end of the year, with the legislative framework for commencement of the CPRS expected to be introduced into Parliament in March 2009.
- 1.5 This Briefing Paper provides an overview of the NGERS, Garnaut's draft report, the CPRS and relevant complementary measures. The Briefing Paper also seeks to identify implications and opportunities, arising out of climate change and the proposed policy and regulatory responses, for the Australian Local Government Association (**ALGA**) (and its state members) to consider.
- 1.6 Due to the current uncertainties of the Federal Government's policy and regulatory response to climate change (particularly surrounding the final design of the CPRS), this Paper is not able to provide a conclusive assessment of the impacts for local government. However, the Paper is intended to assist ALGA formulate its submission to the Government on the Green Paper, and identify issues for further consideration.

2. Introduction to carbon markets and emissions trading

- 2.1 Australia became a full member of the Kyoto Protocol under the United Nations Framework Convention on Climate Change (**UNFCCC**) in March 2008. The Kyoto Protocol requires developed countries to reduce their greenhouse gas emissions to certain set targets. The emissions reduction target for Australia is 108% of 1990 levels by 2012. One of the "flexibility features" by which parties to the Kyoto Protocol can achieve their emissions reduction targets is by emissions trading.
- 2.2 The European Union commenced an emissions trading scheme (**EUETS**) in 2005 in order to meet the collective EU Kyoto target of 8% reduction below 1990 levels by 2012. Phase I ran from 2005-2007. Phase II (2008-2012) is now underway. The EU has proposed that the target will increase to 20% reduction by 2020 (or 30% in the event of international agreement). Penalties of €40 per tonne in Phase I and €100 in Phase II apply. Free permit allocation took place in Phase I and II however from 2013 permits will be auctioned¹. The EUETS is also proposed to be expanded in Phase III to have a broader coverage of greenhouse gases and emissions sources. At present, the EUETS only covers CO₂, and not the rest of the greenhouse gases².
- 2.3 Several other countries are also proposing to introduce emissions trading schemes in the near future, including Canada, a group of Northeast and Mid-Atlantic US States (the Regional Greenhouse Gas Initiative) and possibly USA as a whole, as well as New Zealand. The New Zealand emissions trading scheme is due to commence on 1 January 2009.

Voluntary Carbon Market

- 2.4 In addition to mandatory emissions trading schemes (such as the EUETS), there is a growing market in Australia and internationally for voluntary offset credits. These offset credits can be purchased by companies wishing to reduce their 'carbon footprint' or even to become 'carbon neutral'. The carbon offset industry is likely to continue to grow but will change significantly in the lead up to the introduction of the CPRS.
- 2.5 Voluntary carbon offsets can currently be accredited (verified by a third party) under a range of schemes, varying in levels of quality assurance, including the Commonwealth's Greenhouse Friendly™ scheme, the Voluntary Carbon Standard and the Gold Standard. The Green Paper indicates that an Australian Carbon Offset Standard will be developed by

1 Commission of the European Communities Communication "Europe's climate change opportunity"
http://ec.europa.eu/environment/climat/pdf/com_2008_30_en.pdf

2 The six greenhouse gases are carbon dioxide (CO₂), methane, nitrous oxide, sulphur hexafluoride, HFCs and PFCs



the Government and foreshadows that voluntary carbon market participants will continue to be able to trade in offsets that are not recognised under the CPRS.

- 2.6 The Carbon Offset Guide Australia (www.carbonoffsetguide.com.au) provides examples of voluntary carbon offset products available for purchase in the voluntary market.

The evolution of an Emissions Trading Scheme in Australia

- 2.7 The design of an Emissions Trading Scheme (**ETS**) for Australia has been under discussion for some time. Prior to a commitment by the previous Prime Minister John Howard to implement a national ETS, COAG resolved that a national scheme would be implemented through cooperation of the States and Territories and established the National Emissions Trading Taskforce to advise on the possible design features of such a scheme. The State and Territory governments also commissioned the Garnaut Climate Change Review to which Prime Minister Rudd later confirmed Commonwealth participation.
- 2.8 Prime Minister Howard established a joint government-business Task Group on Emissions Trading to advise on the possible design of an ETS. On 3 June 2007, he announced that he accepted the Task Group's recommendation to adopt an ETS, to commence in 2011. The Rudd Labor Government subsequently committed to establishing an ETS as part of its election platform and have committed to a scheme commencement of 2010 in their recent Green Paper.

Emissions Trading vs other policy responses

- 2.9 The policy responses which could be used by the Federal Government to meet the objective of reducing greenhouse gas emissions (ie mitigation) can be classified as either:
- (1) regulatory (for example, mandating or banning particular technologies or products);
or
 - (2) market-based approaches (ie imposing a price on carbon/greenhouse gas emissions).
- 2.10 An emissions (or carbon) tax and an emissions trading scheme are both examples of a market-based approach. An emissions trading scheme restricts the quantity of emissions (issuing permits up to the level of emissions set by the government) and then allows the market to set the price of those permits. A carbon tax is determined by the government, with the market then deciding how much emissions reduction to undertake. This decision will depend upon whether it is more cost effective to pay the carbon tax or undertake the abatement required to achieve emissions reduction.



- 2.11 One of the benefits of implementing an emissions trading scheme over a carbon tax is that it is a more certain way of ensuring actual emissions reductions. That is, the government has more control over the quantity of emissions released. Another benefit of emissions trading is that domestic schemes can be linked to other operating schemes, allowing firms the opportunity to access the least cost abatement opportunities available internationally. Further, trading schemes provide for the creation of derivative products, which provide mechanisms to help manage uncertainty around future carbon prices.
- 2.12 As part of its Climate Change Policy, the Australian Government has committed to introducing an emissions trading scheme based on a 'cap and trade' model, rather than a carbon tax.
- 2.13 There are two distinct elements of a 'cap and trade' scheme—the cap itself, and the ability to trade. The cap achieves the environmental outcome of reducing greenhouse gas emissions. The act of capping emissions creates a carbon price. The ability to trade ensures that emissions are reduced at the lowest possible cost. The emissions subject to the cap are referred to as the 'covered' sectors.
- 2.14 The Green Paper sets out the mechanics of a 'cap and trade' emissions trading scheme as follows:
- Step 1: Significant emitters of greenhouse gases need to acquire a 'carbon pollution permit' for every tonne of greenhouse gas that they emit.
- Step 2: The quantity of emissions produced by firms will be monitored and audited.
- Step 3: At the end of each year, each liable firm would need to surrender a 'carbon pollution permit' for every tonne of emissions that they produced in that year. The number of 'carbon pollution permits' issued by the Government in each year will be limited to the total carbon cap for those sectors of the Australian economy covered by the scheme.
- Step 4: Firms compete to purchase the number of 'carbon pollution permits' that they require. Firms that value carbon permits most highly will be prepared to pay most for them, either at auction, or on a secondary trading market. For other firms it will be cheaper to reduce emissions than to buy 'permits'. Certain categories of firms might receive some 'permits' for free, as a transitional assistance measure. These firms could use these or sell them.
- 2.15 The alternative to a 'cap and trade' scheme is a 'baseline and credit' scheme or a combination of the two models (referred to as a 'hybrid' scheme). A baseline and credit



scheme, of which the NSW Greenhouse Gas Abatement Scheme is an example, allocates existing emitters with a level of entitlement to emit (commonly based on the emissions in a particular year or average emissions per unit of production based on either installed technology or best practice technology). If an emitter's actual emissions are below this entitlement then the surplus entitlement is converted into tradable permits which can be sold, while emitters which exceed their entitlement must purchase permits to account for any emissions above the baseline allocated to them.

- 2.16 The rationale behind emissions trading is to allow the market to incentivise abatement measures which have the least cost. It is based on the idea that, once the rules of the scheme are established, government intervention will be minimal and only necessary to correct 'market failures'.
- 2.17 Professor Ross Garnaut's view is that a well-designed, broadly based emissions trading scheme has important advantages over other market-based arrangements (such as carbon taxes and hybrid schemes). In particular, it is able to accommodate more easily international trade to lower mitigation costs and to facilitate developing country participation in international agreements. However, he has expressed the view that a carbon tax would be better than a heavily compromised emissions trading scheme.

3. National Greenhouse and Energy Reporting System (NGERS)

Overview of the NGERS

- 3.1 The *National Greenhouse and Energy Reporting Act 2007 (Cth)* (**NGER Act**) introduces a single national reporting framework for the reporting of greenhouse gas emissions, energy use and energy production. It is intended to underpin the introduction of an emissions trading scheme.
- 3.2 The NGER Act is supported by the following subordinate legislation:
- the *National Greenhouse and Energy Reporting Regulations 2008 (Cth)* (**NGER Regulations**);
 - the *National Greenhouse and Energy Reporting (Measurement) Determination 2008 (Cth)* (**NGER Measurement Determination**) which sets out the basis for emission factors measurements and standards.
- 3.3 There is detailed guidance on compliance with the NGER Regulations and NGER Measurement Determination in the following documents:



National Greenhouse and Energy Reporting Guidelines
<http://www.climatechange.gov.au/reporting/guidelines/index.html>

and

National Greenhouse and Energy Reporting (Measurement) Technical Guidelines
2008 v1.0 <http://www.climatechange.gov.au/reporting/guidelines/index.html>

The Department of Climate Change has also published a National Greenhouse and Energy Reporting System Calculator, which can be accessed through the Department's website at <http://www.climatechange.gov.au/reporting/calculator/index.html>.

- 3.4 Further subordinate legislation is expected in early 2009 covering external audit requirements. This legislation is expected to clarify the data capture and record keeping requirements for NGERs. In the meantime, the Department of Climate Change has flagged that the appropriate standard for work performed by auditors appointed under the NGER Act is the *Auditing and Assurance Standards Board's ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.
- 3.5 On line training materials for the Online System for Comprehensive Activity Reporting (**OSCAR**) are also anticipated to be released during the first reporting year.

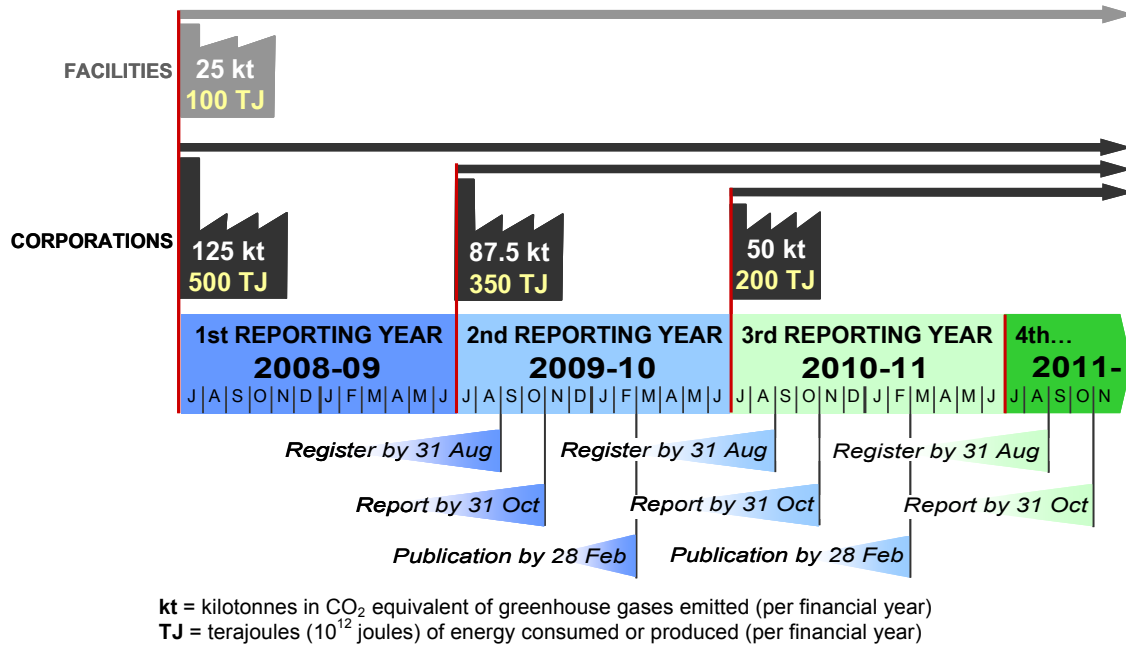
Obligations under NGERs

- 3.6 The NGER Act requires a 'controlling corporation' to register with the Greenhouse and Energy Data Officer (**GEDO**) and submit a report on emissions and energy data if certain thresholds are triggered. There are two types of thresholds: corporation based thresholds and facility based thresholds.
- 3.7 The corporation thresholds for the 2008-2009 financial year are:
- Emissions of 125 kilotonnes or more of greenhouse gases (measured in CO₂ equivalent³) or use or production of 500 terajoules or more of energy per year.
- These thresholds reduce over a three year period (see below).
- 3.8 The facility threshold is
- Emissions of 25 kilotonnes or more of greenhouse gases (measured in CO₂ equivalent), or use or production of 100 terajoules or more of energy per year.

³ The expression CO₂ equivalent or CO₂-e is used as the common denominator. Other greenhouse gases (which have different global warming potential) are converted into this factor for ease of referencing.



3.9 The following diagram sets out the reporting thresholds, and registration and reporting cycle.



Who has registration and reporting obligations?

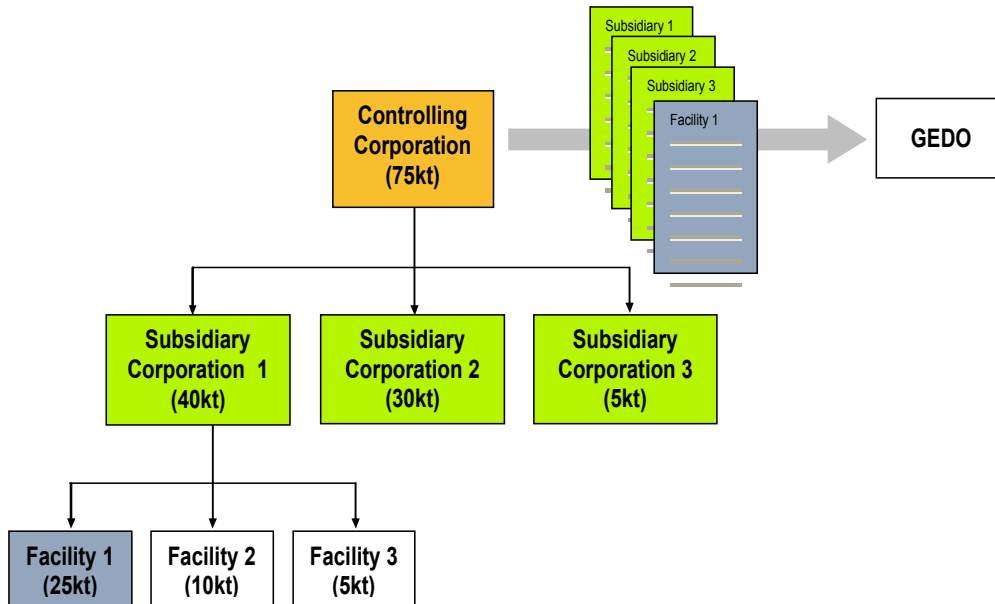
- 3.10 Under the NGER Act, the obligation to register and report lies with the ‘controlling corporation’ which is defined to be a ‘constitutional corporation’. In turn, a ‘constitutional corporation’ is defined as a corporation to which paragraph 51(xx) of the Constitution applies. Paragraph 51(xx) of the Constitution covers foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth.
- 3.11 Most local councils do not fit within this definition and therefore would not be bound by the NGER Act.⁴ However, the Government has indicated in the Green Paper⁵ that it proposes to amend the NGER Act so that unincorporated entities (including partnerships, trusts, government and non government organizations) with “operational control” over a covered “facility” would also have obligations under the scheme. Deacons has been advised by the Department of Climate Change that this amendment will not be formulated until after publication of the White Paper (scheduled for the end of the year).
- 3.12 A controlling corporation must also report in relation to facilities under the operational control of entities that are members of the corporation’s group, such as subsidiary companies, joint ventures and partnerships.

4 The recent Federal Court decision of *Australian Workers’ Union of Employees, Queensland v Etheridge Shire Council* [2008] FCA 1268 has confirmed this conclusion, in finding that Etheridge Shire Council is not a “trading” or “financial” corporation, because its predominant and characteristic activity is that of local government.

5 Green Paper page 196



3.13 The following diagram is an example of a corporate group's obligation to report:



3.14 The NGERs Regulations also include additional reporting obligations for contractors where a contractor has been engaged by a registered corporation under the NGERs and that contractor by itself triggers reporting obligations under the NGERs. These additional reporting obligations have the effect of identifying the contractor and separating out the contractor's emissions and energy data for reporting purposes under the NGERs.

3.15 There are two key aspects of the NGERs: the concept of "operational control" and the definition of a "facility".

What is operational control?

3.16 A corporation is considered to have operational control over a facility if it has the authority to introduce and implement:

- operating policies;
- health and safety policies; and
- environmental policies.

3.17 If this would apply to more than one corporation at any one time, then the corporation that has the *greatest authority* to introduce and implement these policies is considered to be the controlling corporation. Where there is uncertainty, only operational and environmental policies are considered.



What is a facility?

- 3.18 A facility is defined under the NGER Act as an activity, or series of activities (including ancillary activities) that involve the production of greenhouse gas emissions, or produce or consume energy, and that form a single undertaking or enterprise. The NGER Regulations clarify the circumstances in which an activity or activities will form part of a single undertaking or enterprise. The primary criteria is that the activities occur at a single site. If there is more than one activity, that is, there are other production processes in addition to the primary production process, then provided that all of the production processes occur at the same site, all of the activities involved in those processes will form part of a single undertaking or enterprise.
- 3.19 There are two areas (networks and transport) where the single site criteria for facilities do not apply.
- 3.20 Where certain listed activities (such as record keeping, human resources, finance, storage, cleaning, equipment maintenance) are undertaken at a different site to the main activity, but within the same State or Territory, then the corporation with overall control of those listed activities and the main activity, must determine whether the listed activities are ancillary to the main activity. If the listed activity is not ancillary to the main activity, the listed activity will itself form part of a single undertaking or enterprise.

What must be reported?

- 3.21 It is mandatory to report both Scope 1 and Scope 2 emissions. Scope 3 emissions can be reported on a voluntary basis.
- 3.22 Scope 1 emissions are direct emissions from the activity undertaken by the facility, and Scope 2 emissions are emissions arising from electricity, heating, cooling or steam consumed by the facility. Scope 3 emissions are emissions which occur outside the boundary of a facility and are a result of day-to-day operations that occur across the wider economy and are not Scope 2 emissions (for example, emissions due to airflights of employees, emissions arising from disposal of waste generated at a facility, etc).
- 3.23 Reporting is undertaken by industry sector, and the corporation with operational control over a facility must determine the principal activity of that facility so that it can be attributed to the correct industry sector. The 'industry sectors' used are those set out in the Australian New Zealand Standard Industry Classification (**ANZSIC**⁶). Schedule 2 of the

⁶ Australian Bureau of Statistics, 28 February 2006, 'Australian and New Zealand Standard Industrial Classification Code', [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/10AD7A6DDB4190BFCA257122001ACD9E/\\$File/12920_2006.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/10AD7A6DDB4190BFCA257122001ACD9E/$File/12920_2006.pdf)



NGER Regulations sets out the relevant industry sectors, and in general the three-digit level will be used.

3.24 The NGER Regulations also include specific provisions for reporting on greenhouse gas emissions from particular sources (in terms of what information is required to be provided). For example, for a landfill, the following matters will need to be reported upon:

- (1) The location of the landfill site by State or Territory;
- (2) The number of years in operation;
- (3) The tonnes of average annual amount of disposal of solid waste over the lifetime of the facility prior to the first year of reporting;
- (4) The total tonnes of waste entering the landfill;
- (5) The break down of the source of the waste (e.g municipal, commercial and industrial or construction and demolition).

Compliance provisions of the NGERs

3.25 The NGER Act's civil penalties include:

- failure to register under the NGER Act by the due date (\$220,000);
- failure to report greenhouse gas emissions, energy production, and energy consumption to the GEDO by the due date (\$220,000);
- failure to report emissions data to the GEDO as required (\$220,000);
- failure to keep records as required for emissions reporting or to enable the GEDO to determine whether the NGER Act has been complied with (\$110,000).

3.26 The NGER Act also provides for a specific civil penalty for a Chief Executive Officer (**CEO**) in the event of the following circumstances:

- “(a) a corporation contravenes a civil penalty provision; and*
- (b) a chief executive officer of the corporation knew that, or was reckless or negligent as to whether, the contravention would occur; and*
- (c) the officer was in a position to influence the conduct of the corporation in relation to the contravention; and*
- (d) the officer failed to take all reasonable steps to prevent the contravention.”*



3.27 The NGER Act provides guidance as to what matters a Court is to have regard to when determining whether a CEO of a corporation had failed to take all reasonable steps to prevent a contravention. These matters are:

- arranging for professional compliance assessment;
- implementation of any recommendations from such an assessment; and
- whether the corporation's employees, agents and contractors have a reasonable knowledge and understanding of the NGER Act.

3.28 Other enforcement provisions under the NGER Act are:

- infringement notices;
- enforceable undertakings; and
- monitoring compliance powers, including search and interrogation powers such as use of electronic equipment.

Proposed amendments to the NGER Act

3.29 On 26 June 2008, the Federal Government introduced a Bill to amend the NGER Act on the following matters:

- mandatory separate publication by government of Scope 1 and Scope 2 greenhouse gas emissions (at the corporate group level);
- allowing publication of information by government relating to the methodologies used by corporations to calculate their emissions (at corporate group level);
- allowing the Scope 1 and Scope 2 emissions and information about methodologies to be broken down to the level of members of a corporation's group (including business units);
- creating separate voluntary reporting and publication provisions for greenhouse gas offsets (i.e. splitting offsets from the existing provisions relating to greenhouse gas projects);
- increased flexibility in the requirements for registration applications so that it is clear a corporation can apply for registration in advance of a threshold being met;



- clarifying that certain requirements apply to both the controlling corporation and each member of the corporation's group.

4. The Garnaut Climate Change Review

- 4.1 The Climate Change Review being undertaken by Professor Ross Garnaut was commissioned by Kevin Rudd (as leader of the Opposition) and the State and Territory Governments in April 2007. Following the November 2007 election, the Commonwealth Government joined the Review. The objective behind the Review was to examine the impacts of climate change on the Australian economy, and look at medium to long term policies for Australia to achieve the best possible outcomes.
- 4.2 The Garnaut draft report (**Draft Report**) was released on 4 July with the final report due for publication at the end of September 2008. Professor Garnaut has also indicated that he will release an interim report dealing with the economic modelling aspects on 5 September 2008. The economic modelling is intended to assist in the setting of the short to medium term emissions reduction targets. During the course of the Review's work, other reports have also been released to encourage public discussion and debate, such as the February 2008 Interim Report and the March 2008 Discussion Paper on the design elements of an Emissions Trading Scheme for Australia.

Content of Draft Report

- 4.3 The Draft Report looks at matters such as the current science of climate change; the impacts of climate change on Australia, and the economic consequences of those impacts; the costs and benefits of climate change mitigation within Australia; and the international context of, and response to, climate change.
- 4.4 A summary of the above aspects includes the following:
- The Review takes as its starting point the majority opinion of the Australian and international scientific communities that human activities have caused substantial global warming since the mid 20th century, and continued growth in greenhouse gas emissions would lead to high risks of dangerous climate change;
 - The Review considers 4 different future scenarios concerning mitigation: no-mitigation; ad hoc mitigation; strong global mitigation; and ambitious mitigation. Strong global mitigation would restrict greenhouse gas emissions to 550 ppm CO₂-e, with a likely global mean temperature increase of 3°C above pre-industrialised levels, whereas ambitious mitigation would stabilise emissions at 450 ppm CO₂-e,



with a 50% chance of limited global mean temperature increase to 2°C above pre-industrialised levels.

- Economic growth, the energy intensity of that growth and the emissions intensity of energy use, are growing at higher projections than previously predicted, particularly in China;
- Emissions from other developing countries are growing, and with no mitigation, could account for about 80% of emissions growth over the next two decades;
- Growth in emissions is expected to have a severe and costly impact on agriculture, infrastructure, biodiversity and ecosystems in Australia. As an example, a global mitigation scenario of 450 ppm CO₂-e would result in a 6% decline in irrigated agricultural production in the Murray-Darling Basin, compared to 20% at 550 ppm CO₂-e, or 92% in a no mitigation scenario. For the next two decades, the impacts of climate change on Australia are likely to be dominated by stressed urban water supply, and the effects of changes in temperature and water availability on agriculture;
- Australia's per capita emissions are the highest in the OECD and amongst the highest in the world (4 times the world average), primarily as a result of the emissions intensity of energy used in Australia and our high reliance on the use of coal to generate electricity;
- Mitigation effort is increasing around the world, but at a pace which is currently too slow to avoid high risks of dangerous climate change, and given the recent and projected growth in emissions, the mitigation strategies by all major economies will need to be stronger and earlier than previously considered necessary;
- All developed and high-income countries, including China, will need to be subject to binding emissions limits from 2013.

Themes of the Draft Report

4.5 The central themes of the Draft Report are:

- Uncertainty surrounding the climate change science should lead to disciplined analysis and decision, not the delaying of decisions;
- Australia is well placed to meet the climate change challenge because it has a prosperous, flexible, market-orientated economy;



- An effective market-based system (i.e., an emissions trading scheme) needs to be as broadly based as possible, and should therefore include transport and petroleum products;
- Australia's domestic policy must feed into achieving international agreement, because only a global agreement has any prospect of reducing the risks of dangerous climate change to an acceptable level.

Design of emissions trading scheme

4.6 Professor Garnaut supports an emissions trading scheme as the main mitigation measure.

4.7 The Draft Report builds on the March 2008 Discussion Paper, taking on board comments and submissions received by the Review team. The design proposed in the Draft Report includes the following elements:

- Expressing the overall national emissions limit as a trajectory of annual emission targets, with a number of trajectories specified upon establishment of the scheme. Movement between trajectories will depend upon international policy developments and agreements, with a 5 year notice period of movement between different trajectories. There would be 5 years of firm caps, with longer trajectories of indicative caps, up to 2050.
- The ETS should cover all 6 greenhouse gases and stationary energy, industrial processes, fugitive emissions and transport from the outset. Waste and forestry should be included as soon as practicable, and the inclusion of agriculture will be subject to progress on measurement and administration issues.
- If a sector is not covered by the scheme, other policies should be developed to achieve emissions reductions from that sector.
- The point of obligation would usually be the emissions source, and can be set at the facility level for oil and gas production, gas processing, industrial processes and fugitive emissions from coalmining. Emissions from transport can be covered at the point of excise for petroleum, subject to excluding petrol sales related to manufacturing processes.
- Domestic offsets would have a small role, however offset credits from the forestry sector should be allowed both before and during coverage in the scheme. International offset credits should be allowed, with restrictions on the source and quantity.



- All permits should be auctioned.
 - There should be no controls over pricing, except perhaps during an initial transitional period (up to 2012).
 - Unlimited banking should be allowed, and borrowing of permits within a 5 year period also allowed.
 - For trade-exposed emissions-intensive industries, global sectoral agreements should be pursued as a matter of priority, with assistance provided in the interim (through cash or free permits).
 - The emissions limit and policy framework should be set by the Government, but the administration should be undertaken by an independent regulator (e.g Independent Carbon Bank, similar to the Reserve Bank).
 - There should be a financial penalty for non-compliance as well as a make-good provision (ie requirement to purchase permits to cover shortfall).
- 4.8 The Draft Report suggests that it may be appropriate to have an initial transitional period, covering 2010-2012, during which permits could be sold at a low fixed price. Alternatively, if permits from the EU ETS were accepted under the Australian ETS, this would set the price at the current European level (around €25-28).
- 4.9 With respect to the revenue that the ETS will generate, the Draft Report suggests that this should be allocated as follows:
- 50%: households, through adjustments to the tax and social security systems to enhance energy efficiency, particularly amongst low-income households;
 - 30%: business sector, primarily to the trade-exposed, emissions-intensive industries;
 - 20%: research, development and commercialisation of new, low-emission technologies.

5. The proposed Carbon Pollution Reduction Scheme (CPRS)

- 5.1 On 16 July 2008, the Federal Government released a green paper (**Green Paper**) on the proposed Carbon Pollution Reduction Scheme (**CPRS**). The CPRS is a “cap and trade” emissions trading scheme, which the Government has stated will commence in 2010. The



following sections set out the main design elements of the CPRS. The key issues arising under the scheme are:

- caps;
- coverage; and
- compensation.

Permits

- 5.2 The permits issued under the scheme will be known as 'carbon pollution permits', and it is intended that the majority of permits will be auctioned, rather than given out freely. Ultimately, the Government will move to auctioning all permits.
- 5.3 Permits will be personal property, such that they could not be extinguished without compensation being payable. Each permit would represent 1 tonne of CO₂ –e, and they would be date stamped for a particular year. It is not proposed to impose any barriers on who may buy or hold permits, in order to encourage liquidity in the market.
- 5.4 Permits will be able to be banked (ie used in future years). There will also be limited borrowing allowed of permits from the following year, with the limit yet to be determined. It is also proposed that there be an initial cap on the price of permits (up until 2015), which will be set at a level above the estimated market price.
- 5.5 It is proposed that four auctions of permits will be held each year. At one of these auctions, permits for the subsequent 3 years will also be auctioned. Hence, liable parties will be able to purchase advance quantities of permits required to satisfy liability. Alternatively, liable parties will be able to partake in the futures market as a hedging mechanism.

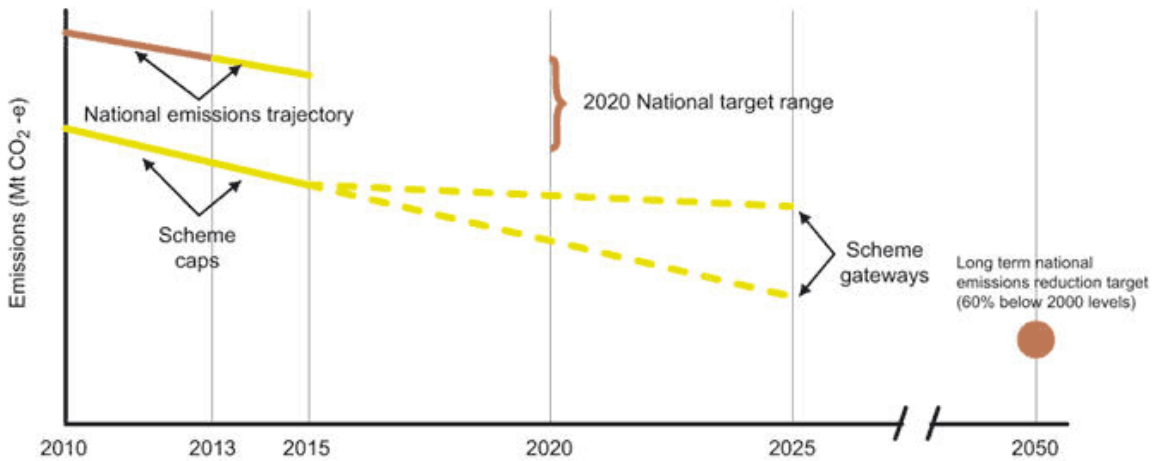
Caps

- 5.6 The significance of the caps for the scheme is that they will determine the price of the permits. The long term emissions reduction target set by the Federal Government is a 60% reduction of 2000 levels by 2050. The issue is, however, how this target will ultimately be reached (ie will there be a gradual reduction of emissions over the relevant timeframe, or will steep reductions be required at some point within the timeframe). It is anticipated that a steeper reduction would result in higher permit prices, hence recent submissions from the business community to start with a lower reduction target, at least initially.



5.7 It is proposed that annual scheme caps would be set for a 5 year period, which would be extended every year by a further year. Gateways would also be set beyond the 5 year period covering a 10 year period. The following figure illustrates how this would work.

Figure 1. 2008-10 guidance over scheme caps and indicative national emissions trajectory



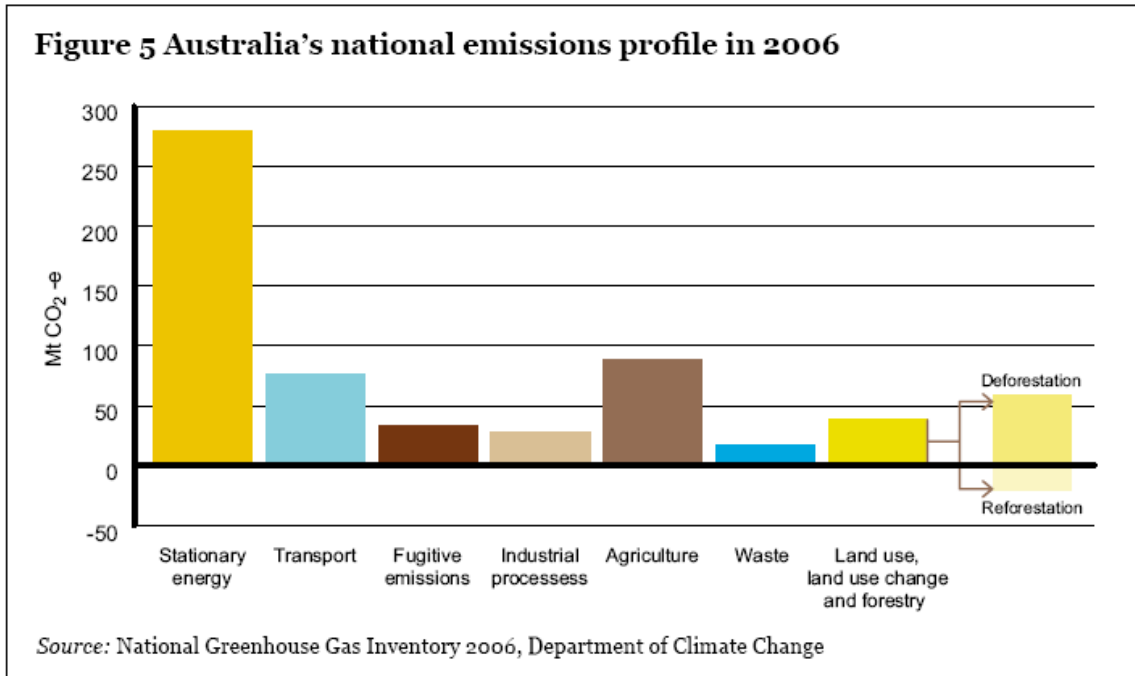
5.8 It is proposed that the Government will announce at the end of the year (in the White Paper) the indicative trajectories for the period 2010 to 2013, with the trajectories for the period 2014 to 2015 being provided in 2010, once the international situation is clearer. It is not intended that the annual caps would be announced until early 2010.

5.9 The White Paper will also provide an indication of the medium-term emission targets (ie the target as at 2020).



Coverage

5.10 Australia's emissions profile is shown in the following diagram:



- 5.11 The Government proposes that the CPRS should cover all 6 greenhouse gases. In terms of the above sectors, it is proposed to apply to stationary energy, transport, fugitive emissions, industrial processes, waste and forestry.
- 5.12 In relation to agriculture, the Government considers it is appropriate to include agriculture if issues such as emissions estimation and reporting can be resolved. However, agriculture would not enter the scheme until 2015, with a final decision being made on inclusion or exclusion by 2013.
- 5.13 The transportation sector would be included by imposing the liability on the upstream fuel suppliers, however in order to ensure that the cost is not felt (at least initially) by households, the Government proposes to cut fuel taxes to offset the price increases likely to result from this liability. This measure would be put in place for an initial 3 year period, with a review undertaken at the end of this period. A similar mechanism will be put in place for heavy vehicle road users for an initial one year period.
- 5.14 It is not intended to cover deforestation (i.e. land clearing) under the scheme, however forestry will be provided with the ability to voluntarily “opt-in” to the scheme. Forest landholders would be given free permits to reflect the net quantity of CO₂ stored in the forest. However, in accordance with the Kyoto Protocol rules, only those forests established after 1990 would be eligible for such permits. The detailed design issues, such



as reporting, acquittal periods, accounting rules and participation thresholds are still to be determined.

- 5.15 With the coverage proposed, the estimate is that around 1000 companies will face a liability under the scheme (less than 1% of Australian businesses). This estimate is based on a threshold of 25 kt of carbon per year being emitted by a company or entity, which matches the facility threshold set out in the NGERs.

Domestic Offsets and Forestry

- 5.16 Given the wide coverage proposed under the scheme, the Government is not proposing that there will be a role for domestic offset credits. The rationale being that offsets can usually only be created in uncovered sectors, and given the extensive coverage proposed, there is limited opportunity for creation of offsets by uncovered sectors. In particular, as agriculture may be covered in the scheme eventually, it is not considered that it makes sense to develop offset methodologies and put in place the necessary administrative arrangements to accredit such offsets for what may be a relatively short period (ie 5 years).
- 5.17 While not an "offset", as mentioned above, the Green Paper proposes that forest landholders could voluntarily 'opt-in' to the scheme. If this option was exercised, forest owners would receive free permits (which could then be sold for profit) for their net sequestration. The benefits of participation in the scheme would be greatest for owners of new forests (which have the greatest sequestration potential) who intend to maintain them (for harvest and non-harvest purposes), however it may not be cost effective for very small forest areas⁷. The definition of forest for the purpose of the Kyoto Protocol accounting specifies a minimum of 0.2 hectares, tree crown cover of 20% and a tree height of 2 metres.
- 5.18 Most States have enacted specific carbon sequestration rights legislation which creates legal property rights in trees which can be separate from the ownership of the land. For example the Western Australian *Carbon Rights Act 2003* provides for the creation of statutory carbon rights on registration and once registered, these rights becomes a separate interest in the land. A proprietor of a carbon right is given the legal and commercial benefits and risks arising from the sequestration of carbon from the land in respect of which the carbon right has been registered. Carbon covenants can also be registered in relation to any matter that might affect carbon sequestration on the land. The Act provides that no more than one carbon right can be created in any particular time in respect of the same area of land.

⁷ Green Paper, page 129



- 5.19 While the detailed design of the CPRS is still being established, one approach would be for the legislation implementing the CPRS to recognise the state-based carbon sequestration rights legislation. This would mean that CPRS permits would be allocated to the registered owner of the carbon right which may be different to the registered owner of the land. This is the approach adopted in the Carbon Sequestration Rule of GGAS⁸ under which, a party must own or control the Carbon Sequestration Rights registered on the title to the land on which the eligible forest is planted in order to be a certified abatement provider, in addition to other requirements such as being able to demonstrate that the carbon sequestration achieved by the forest project will be maintained for 100 years.
- 5.20 As mentioned above, the detailed design issues, including how the CPRS will interact with existing state based carbon sequestration legislation, remains to be determined.

Linkage with other trading schemes

- 5.21 It is intended that covered sectors will be able to purchase offset credits from other existing emissions trading schemes to meet their emissions liability, however initially, only certified emissions reductions (**CERs**) created under the Clean Development Mechanism (**CDM**), emission reduction units (**ERUs**) created under the Joint Implementation Mechanism and removal units (**RMUs**) created in respect of land use, land use change and forestry activities would be accepted. There would also be limits on the amount of these credits that could be surrendered by a covered party.
- 5.22 Selling Australian carbon pollution permits into the international market would not be allowed, at least in the initial years of the scheme.

Compensation and financial assistance to affected sectors

- 5.23 The Government has committed to using every cent raised through the trading scheme to assist households and businesses to adjust to a lower carbon economy. Low income households will be provided with assistance through the existing tax and payment systems. Business will be assisted through the establishment of a Climate Change Action Fund (**CCAF**), which will provide funding for activities such as innovative new low emissions processes and industrial energy efficiency projects with long payback periods.
- 5.24 In accordance with previous indications, the Government has confirmed that financial assistance will be provided to trade-exposed emissions-intensive industries. The rationale behind this approach is that it avoids "carbon leakage" (ie these industries relocating to other parts of the world where there is no cost imposed on carbon emissions). Free permits will be provided to these industries, based on the emissions intensity per unit of

⁸ Greenhouse Gas Benchmark Rule (Carbon Sequestration) No. 5 of 2003



revenue. For example, activities with an emissions intensity over 2,000 tonnes CO₂ –e per one million dollars of revenue would receive free permits equalling 90%, and activities with an emissions intensity between 1,500-2,000 tonnes CO₂ –e will receive assistance at a rate of 60%. Firms with an emissions intensity below 1,500 CO₂ –e will not receive any compensation. The allocation of free permits to this sector would be around 20% of the total pool of permits (or 30% if agriculture becomes a covered sector).

5.25 A limited amount of assistance would also be provided to existing coal-fired electricity generators, as an industry which is likely to be strongly affected by the introduction of the scheme. To provide this assistance a new mechanism, called the Electricity Sector Adjustment Scheme (**ESAS**) will be established. The Green Paper defines strongly affected industries as having the following characteristics:

- Non-trade-exposed;
- Emissions-intensive;
- Unable to pass on carbon costs with the consequence of experiencing significant losses in asset value;
- Significant sunk capital costs; and
- No significant economically viable abatement opportunities available.

5.26 Four industry sectors are identified with Green Paper as possible strongly affected industries: electricity generation; waste; production of natural gas; and gas supply. In relation to the waste industry, the Government's initial view is that the industry may be able to pass on its carbon costs and that there appears to be economically viable abatement opportunities (e.g landfill gas flaring or capture). Hence, waste is not viewed as a strongly affected industry. Feedback has been sought from the industry on these two aspects.

6. Complementary measures

6.1 There are two primary complementary measures proposed in addition to the CPRS. The first, expansion of the Mandatory Renewable Energy Target, has been proposed by the Federal Government. The second, introduction of Energy Efficiency Target schemes, is being driven by a number of State Governments. The following section provides a brief description of both initiatives.



Expanded Mandatory Renewable Energy Target

- 6.2 At present, the Mandatory Renewable Energy Target (**MRET**) as established under the *Renewable Energy (Electricity) Act 2001* (Cth) seeks to encourage the additional generation of electricity from renewable sources to 9,500 GWh per annum by 2010. The MRET scheme came into force in April 2001 with the objectives to encourage the additional generation of electricity from renewable sources, reduce the emission of greenhouse gases, and ensure that renewable energy sources were ecologically sustainable. The MRET scheme creates a guaranteed market for renewable electricity by placing a legal liability on wholesale purchasers of electricity (retailers and large users) to purchase renewable energy certificates (**RECs**) that are created by renewable energy generators or pay a shortfall penalty of \$40 per MegaWatt hour (**MWh**).
- 6.3 In 2007, the new Federal Government flagged its intention to expand MRET so as to achieve additional generation of electricity from renewable sources to 20% of Australia's electricity supply (an increase of renewable energy generation of 45,000 GWh per annum by 2020). In July 2008, the COAG Working Group on Climate Change and Water issued a consultation paper titled 'Design Options for the Expanded National Renewable Energy Target Scheme' (**MRET consultation paper**). It would appear that the MRET will become known as the Renewable Energy Target (**RET**) going forward.
- 6.4 The MRET consultation paper seeks to:
- consolidate the existing MRET and state-based renewable energy schemes (such as the Victorian Renewable Energy Target (**VRET**) scheme) into a single RET scheme;
 - phase out the RET between 2020 and 2030 as the emissions trading scheme matures and prices become sufficient to ensure that a RET is no longer required;
 - retain all renewable energy projects approved under existing state-based renewable energy schemes.
- 6.5 Two approaches for implementation of the RET have been identified:
- Approach 1: based on the existing MRET having a focus on achieving 2020 RECs target at least cost – this approach creates a strong investment incentive early in the scheme and encourages the early creation of RECs that can be used in future years to help minimise RECs prices over the duration of the scheme;
 - Approach 2: seeks to balance the least-cost considerations under Approach 1 with managing the risk that RET is not achieved in 2020 – this approach seeks to



encourage a smoother investment profile to help bring forward new technologies in the latter part of the scheme.

6.6 The implementation timetable of the RET under the MRET consultation paper is as follows:

- final design of RET presented to COAG meeting in October 2008; and
- amending legislation for transforming MRET to RET, in place by mid-2009.

Energy Efficiency Target Schemes

6.7 As stated above, while the CPRS will be the primary measure to achieve emissions reduction targets, the Green Paper explains that other complementary measures will be required.

6.8 There is international consensus that many cost-effective improvements in energy efficiency may not be delivered by emissions trading schemes alone, because of market failures and barriers which prevent the full uptake of the commercial energy efficiency opportunities created by the price on emissions.

6.9 The Ministerial Council on Energy is considering the possibility of a national energy efficiency trading scheme. In the meantime, Victoria, New South Wales and South Australia are acting independently to bring in such schemes. A harmonised multi-state scheme could eventually form the basis of a national scheme.

VEET Scheme

6.10 The Victorian Energy Efficiency Target Scheme (**VEET Scheme**) is designed to achieve the Victorian Government's commitment of reducing GHG emissions from households by 10% by 2020 and Victoria's overall emissions to 60% below its 2000 level by 2050. The *Victorian Energy Efficiency Target Act 2007* was passed in December 2007 and draft regulations were released on 11 August 2008 in anticipation for a start date of 1 January 2009.

6.11 The VEET Scheme will require all electricity and gas retailers (with more than 5,000 Victorian customers) to surrender Victorian Energy Efficiency Certificates (**VEECs**). One VEEC will equal 1t of CO₂-e avoided.

6.12 The liability of retailers (ie how many VEECs they will be required to surrender) will be based on the market share of that retailer and the target attributed to that fuel. The overall emissions reduction target set for the first three years is 2.7 million tonnes per annum.



- 6.13 VEECs can be traded and must be registered on the scheme registry. VEECs can be banked for use in future years for up to 6 yrs though borrowing from future years is not permitted.
- 6.14 VEECs can be created by anyone who has been accredited under the scheme for activities that are scheduled in the regulations. Eligible activities will initially be “household” in nature, for e.g.
- More efficient appliance use (e.g. 5-star appliance v market average, CFL lighting)
 - Switching to less greenhouse intensive fuels (e.g. solar hot water)
 - Building shell improvements (insulation, window treatments)
- 6.15 Liable entities will be required to pay a shortfall penalty of \$40 for 2009 (indexed) for each VEEC required to be, but not, surrendered.

NEET Scheme

- 6.16 The NSW Department of Environment and Climate Change and Water and Energy published a discussion paper in July 2008 on the introduction of an Energy Efficiency Trading Scheme (**NEET Scheme**) which is also proposed to commence on 1 January 2009. The scheme will be based on the energy efficiency component of the Greenhouse Gas Abatement Scheme (**GGAS**) whereby activities that would currently qualify as Demand Side Abatement Activities (**DSA Activities**) under GGAS will be eligible to create the new class of NEET Certificates. The remainder of the GGAS will continue as it has in the past until it is replaced by the CPRS. (It is anticipated that there will be transitional arrangements associated with the ending of GGAS). The ACT has a scheme that mirrors the GGAS however it is not clear whether the ACT government will also undertake a similar energy efficiency initiative.
- 6.17 DSA Activities would no longer be eligible to create NGACs.
- 6.18 About 75 companies are currently accredited to undertake energy efficiency projects under the GGAS DSA provisions. These include major commercial building operators and industrial facilities, as well as companies involved in mass deployment to the household sector.
- 6.19 GGAS currently covers all electricity used by grid-connected customers in NSW. The NEET Scheme proposes the following liable parties:
- All holders of NSW electricity retail licences;



- Electricity generators that supply directly to retail customers;
- Market customers that take their electricity supply directly from the National Electricity Market (NEM) and have a load that is classified as a market load with NEMMCO.

6.20 It is proposed that initially, the NEET Scheme will only cover electricity use. However, scheme coverage could be expanded later to include other sources of stationary energy, including natural gas (to assist harmonisation with schemes in other states). The NEET Scheme will allow NEEC creation by accredited Abatement Certificate Providers for improving the efficiency of electricity use in the residential, commercial and industrial sectors.

6.21 The proposed new NEET rule will expand the number of activities for which simple, broadly applied certificate calculation approaches such as the Default Abatement Factors method are available and will update existing Default Abatement Factors, the main case being lighting.

6.22 The system for setting the obligations under NEET would be to determine the total annual energy savings requirement as a percentage of the liable electricity sales for that year. The percentage would then be applied directly to each liable party's electricity sales (or purchases for market customers) to determine the individual obligation of each liable party. Liable parties will be required to pay a penalty if they do not surrender sufficient NEET certificates to meet their obligation in a particular year. There is currently no detail on the proposed penalty price.

REES

6.23 The South Australian Residential Energy Efficiency Scheme (**REES**) is also proposed to commence on 1 January 2009.

6.24 The REES will be mandatory for all licensed retailers of electricity and gas who supply residential customers (a minimum threshold of 5,000 customers is proposed). If a retailer holds more than one retail licence (for example, both an electricity and a gas licence), its liability under the REES will be assessed separately for each of those licences



6.25 For each year of the REES, obliged retailers will be required to achieve three targets in respect of each relevant licence:

- (1) Greenhouse Gas Reduction Target (**GGRT**) – to achieve a set amount of greenhouse gas savings (t CO₂-e) by implementing approved energy efficiency activities in households;
- (2) Priority Group Greenhouse Gas Reduction Target (**PGGGRT**) - A set proportion of the GGRT must be achieved in priority group households; and
- (3) Energy Audit Target – to undertake a set number of energy audits in priority group households.

6.26 Penalties (the option of either a civil penalty or prosecution) are proposed if a retailer fails to meet more than 90% of its target. The civil penalty is made up of a flat rate not exceeding \$100 and a dollar value for each unit of shortfall. A 'make good' provision, where the retailer is required to make up the shortfall in the following year, will apply to the Energy Audit Target.

Comment

6.27 The implementation of state-based energy efficiency targets has not been without some criticism. Critics argue that these schemes are exactly what the CPRS and other national measures are designed to avoid, and that state-based energy efficiency measures will lead to increased business compliance costs. As the following table illustrates there is some merit in these concerns, as there are some inevitable differences between the currently proposed state-based schemes.



| | VEET scheme | NEET scheme (proposed) | REES (proposed) |
|----------------------------------|--------------------------------|---------------------------------|---|
| Start date | 1 January 2009 | 1 January 2009 | 1 January 2009 |
| Participation trigger | Vic customers >5,000 | All | SA customers >5,000 |
| Coverage | Electricity and gas | Electricity (gas in the future) | Electricity and gas |
| Eligible activities | “Household” efficiency actions | Demand side abatement rules | “Household” efficiency actions, including priority group households and energy audits |
| Certificate penalty price | \$40 for 2009 | Unknown | Unknown (up to \$100) |
| Certificate escalation | Yes | Yes | N/A |

6.28 Conversely, non-government organisations have criticised both Federal and State governments for not acting enough on implementing measures to facilitate energy efficiency measures. These organisations argue that a focus on facilitating energy efficiency opportunities, as potentially one of the cheapest forms of greenhouse gas abatement activities, must be part of Australia’s policy suite to tackle climate change.

6.29 Clearly, there is still uncertainty over whether these schemes will be introduced, however it would appear at the very least that the VEET scheme will come into force on 1 January 2009 (being more advanced in terms of legislation and supporting regulations than either of the other proposed schemes).

7. Application of the NGERs to Local Government

Is a Council a “constitutional corporation”?

7.1 As explained above, the NGER Act does not presently apply to unincorporated entities including most local government councils. However, the Government has stated that it intends to amend the NGER Act so that it will apply to “unincorporated entities”, such as local councils. We therefore recommend that if a council meets one of the thresholds of the NGER Act, it should prepare for obligations to register and report.

7.2 We have recently received confirmation from the Department of Climate Change that any amendments to the NGER Act will not be retrospective. Consequently, it is likely that councils will not have to report on their 2008/2009 financial year. Councils will need to



have regard to the thresholds for the 2009/2010 and 2010/2011 years to ascertain whether these thresholds may be triggered. Our advice is that Councils should seek to ascertain their emissions and energy use profile as soon as possible. Use can be made of the Department of Climate Change on-line calculator for this purpose.

- 7.3 There are landfills in several states which are owned and operated by groups of local governments (Regional Councils) acting as one entity, as well as many other examples of resource sharing. The nature and structure of these bodies vary and they may or may not be incorporated. Depending on how the NGER Act is amended, these regional bodies may also be caught by the Act.

Corporate threshold

- 7.4 The commencement of the NGERS and emissions trading under the CPRS will directly and indirectly impact on the carrying out of local government functions. It is difficult to advise as to whether particular local councils are likely to be liable to report energy and emissions data under the NGER Act and acquit permits under the CPRS without detailed information about the emissions profiles and energy use of individual local councils.
- 7.5 However, the following generalisations can be made. In considering whether a local council meets the 2009/2010 company threshold of 350 tj of energy consumed (we consider it unlikely that a local council would meet the company threshold of 87.5kt of CO₂-e emissions), the entirety of the council's functions will need to be assessed, including for example, energy use from vehicle fleets and all council buildings and infrastructure. To provide some guidance on what 350 tj energy consumption means, it equates to the annual energy use of around 6,650 households.
- 7.6 If a company threshold is met, all data must be reported (ie. energy consumed, energy produced and emissions), not just the data which triggered the threshold (i.e., energy consumed).

Facility threshold – landfills

- 7.7 The aspect of local government functions that is most likely to meet the facility threshold of 25kt CO₂-e emissions are methane gas emissions from landfills.
- 7.8 If the facility threshold for a landfill due to its greenhouse gas emissions is met but the corporate threshold is not, data from that facility (i.e., energy produced, energy consumed and emissions) must be reported but corporation-wide data (e.g., energy used in Council buildings) does not need to be.



- 7.9 The methods by which emissions and energy from a facility, such as a landfill, are measured and recorded are set out in the NGER Measurement Determination.
- 7.10 Methane from landfills can be captured for flaring or electricity generation. We note that as the production of energy from methane is generally carried out by a separate entity it is therefore unlikely that a council landfill operator will need to report on the energy produced by methane capture, as this requirement should fall to the separate entity.

Facility threshold – public streetlights

- 7.11 The public lighting area is complex. There are discrepancies in regulatory arrangements between jurisdictions and a level of confusion and disagreement between distributors and councils with respect to ownership of existing street lighting. In several states there are public lighting codes and service level agreements between distributors and local councils which set minimum standards for the maintenance of public lighting.
- 7.12 As a general rule however, we understand that the majority of public lights are owned, operated and maintained by licensed electricity distributors while local councils (as well as the relevant roads authority and other authorities) incur all on-going costs for these assets. The energy consumed by streetlights is a major cost for local government, accounting for between 25% - 70% of a council's greenhouse gas emissions (and on average one third of their electricity bill)⁹.
- 7.13 It is feasible that the Scope 2 emissions from all streetlights within a local council's area could meet the facility threshold of 100 tj of energy consumption. A network of streetlights would be considered as one "facility" under the NGER Act if within one state or territory and under the operational control of the same corporation. While local councils may have varying degrees of responsibility for the management of public lights, it is likely to be the relevant distributor of electricity which will have the greatest authority to introduce and implement operational, environmental and occupational health and safety policies in relation to the network of public lights. Therefore the distributor, rather than the council, may ultimately have the responsibility for reporting under the NGER Act. Detailed analysis of the contractual arrangements between the electricity distributor and council is likely to be required, to determine where the responsibility rests.

Industry Sector

- 7.14 As mentioned above, the Australian and New Zealand Standard Industrial Classification Code (2006) (**ANZSIC**) is used as the reporting mechanism under the NGERs.

⁹ ICLEI Submission to the Garnaut Review, April 2008



7.15 Local government functions are broad, providing a wide range of services and infrastructure. While not intended to be a thorough review of all the ANZSIC codes relevant to local government, we have identified the following as an example of the ANZSIC codes covered by the NGERs relevant to local government operations:

Division D Electricity, gas, water and waste services

291 Waste collection services

292 Waste treatment, disposal and remediation services

Division O Public administration and safety

753 Local government administration

771 Public order and safety services

Division R Arts and recreation services

892 Parks and gardens

911 Sports and physical recreational activities

8. The implications and opportunities for Local Government from the CPRS

Are Councils likely to be covered by the CPRS?

8.1 Our assessment is that the only sector which may lead to local government inclusion within the CPRS is the waste sector. Councils that operate landfills which trigger the emission threshold under the CPRS would therefore need to purchase carbon pollution permits to cover those emissions, or seek to reduce the emissions through measures such as landfill gas flaring or capture. Reduction of emissions below the threshold would mean that councils would not be covered by the scheme and therefore would not need to purchase permits. Alternatively, reduction of emissions (if the threshold is still triggered) would result in less permits having to be purchased.

8.2 There is currently uncertainty over what the threshold will be for the waste sector, and whether it will generally follow the threshold adopted for the other sectors (ie 25 kt CO₂-e/year) or whether a lower threshold (ie 10 kt CO₂-e/year) will be adopted. The concern expressed in the Green Paper is that adopting a threshold of 25 kt CO₂-e may result in displacement of waste from covered to uncovered facilities. Another option identified in the Green Paper is to lower the threshold only for urban centre landfills, and not for regional landfills.

8.3 Other issues which require resolution in relation to coverage of the waste sector include:



- (1) Historical liability (ie waste deposited before the commencement of the CPRS, which results in a liability post commencement)
- (2) Closed landfills
- (3) Future liability (funding the emissions liability after a landfill has closed, and the income stream ceases)
- (4) Measurement issues (ie whether the methods proposed in the NGERs Measurement Determination are appropriate, and accurate enough, to determine liability under the CPRS).

8.4 The waste industry, through the Waste Management Association of Australia and the Barton Group (on which ALGA sits), is currently in a dialogue with the Department of Climate Change in relation to these threshold, measurement and liability issues.

8.5 If, notwithstanding the Government's preferred position to include waste in the CPRS from scheme commencement, a decision was made to exclude waste or defer its inclusion, it is possible that other measures would be pursued to address emissions reduction in the sector. For example, regulation requiring compulsory landfill gas flaring or capture or other engineering techniques, or banning of organic materials from landfill.

Direct cost implications

8.6 If a council is covered by the CPRS (e.g because it operates a landfill triggering the threshold) and has to purchase permits to cover its emissions, the cost implications may be significant. For example, if the threshold of 25 kt CO₂-e/year was adopted and the initial permit price was \$20 per tonne CO₂-e (as currently anticipated), then the cost of purchasing permits would be in the order of \$500,000 (ie 25 kt CO₂-e X \$20). If the permit price were to rise to \$40 per tonne CO₂-e, this cost would double to \$1,000,000. If the emissions were greater than the threshold, the cost would rise accordingly.

8.7 Councils would presumably seek to recover these costs through rates for waste management services. Alternatively, the council would look at ways of achieving emissions reductions from its landfill, in order to lower its liability. For example, installation of landfill gas flaring or capture technology, diversion of organic waste into composting or alternative waste technologies, etc. The premise behind emissions trading is that an entity will take the route that is most cost effective (therefore if it is cheaper to pursue such technologies, than purchase permits, this is the action that will be taken).

8.8 As noted above, if it is possible to reduce emissions below the relevant threshold, then the liability under the scheme will cease. This fact emphasis the importance of the threshold,



particularly, if as currently anticipated, the Government may be considering a lower threshold than 25 kt CO₂-e.

- 8.9 If a council does not operate its own landfill, but contracts this service out to a private contractor, there are also likely to be cost implications. This is because the contractor will no doubt seek to pass on to the council any costs incurred under the scheme. Whether this option is available to the contractor may depend upon the terms of the relevant waste disposal contract, and we would strongly recommend that councils review their current waste disposal contracts to ascertain the legal position.
- 8.10 If Councils have a direct liability under the CPRS and are required to purchase permits to cover their emissions, they may need to consider whether they need to participate in the secondary market (i.e purchasing futures and other derivative products). Whether this option is available to a particular council is likely to depend upon the legislation and regulations governing that council's financial operations, and governance requirements imposed through other mechanisms (e.g guidelines, charters, audit standards, etc).

Indirect cost impacts

- 8.11 The indirect cost impacts for local government which will flow from introduction of an emissions trading scheme are higher costs of electricity and fuel, and consequently, goods and services. Those goods and services which are emissions intensive (ie use large quantities of energy or fuel) can be expected to be more expensive, than those which are less emissions intensive.
- 8.12 A report titled "The Impact of an Emissions Trading Scheme on State Government Budgets"¹⁰ has found that the cost of energy, transport and wages paid by State and Territory governments will increase as a result of the CPRS with the likely cost to be \$1.4 billion per annum when the scheme is introduced in 2010-2011. This amounts to a 1% increase in total costs for State governments. The report argues that State governments have a strong claim for compensation from the Federal Government.
- 8.13 There are presumably similar arguments open to local government based on the economic impact¹¹, however, in our view, such arguments are unlikely to be successful. As indicated above, the sectors which the Federal Government is currently planning to compensate are

¹⁰ The Australia Institute, The Impact of an Emissions Trading Scheme on State Government Budgets' August 2008, <https://www.tai.org.au/>.

¹¹ We note the findings of the "National financial sustainability study of local government" report by PWC commissioned by the ALGA in 2006 that a significant number of councils have financial operating deficits. In these circumstances, the argument that if there are not major reforms in the way councils are funded many councils will have no option but to cut back on the level of community services and infrastructure is made stronger given the anticipated financial impacts of the CPRS.

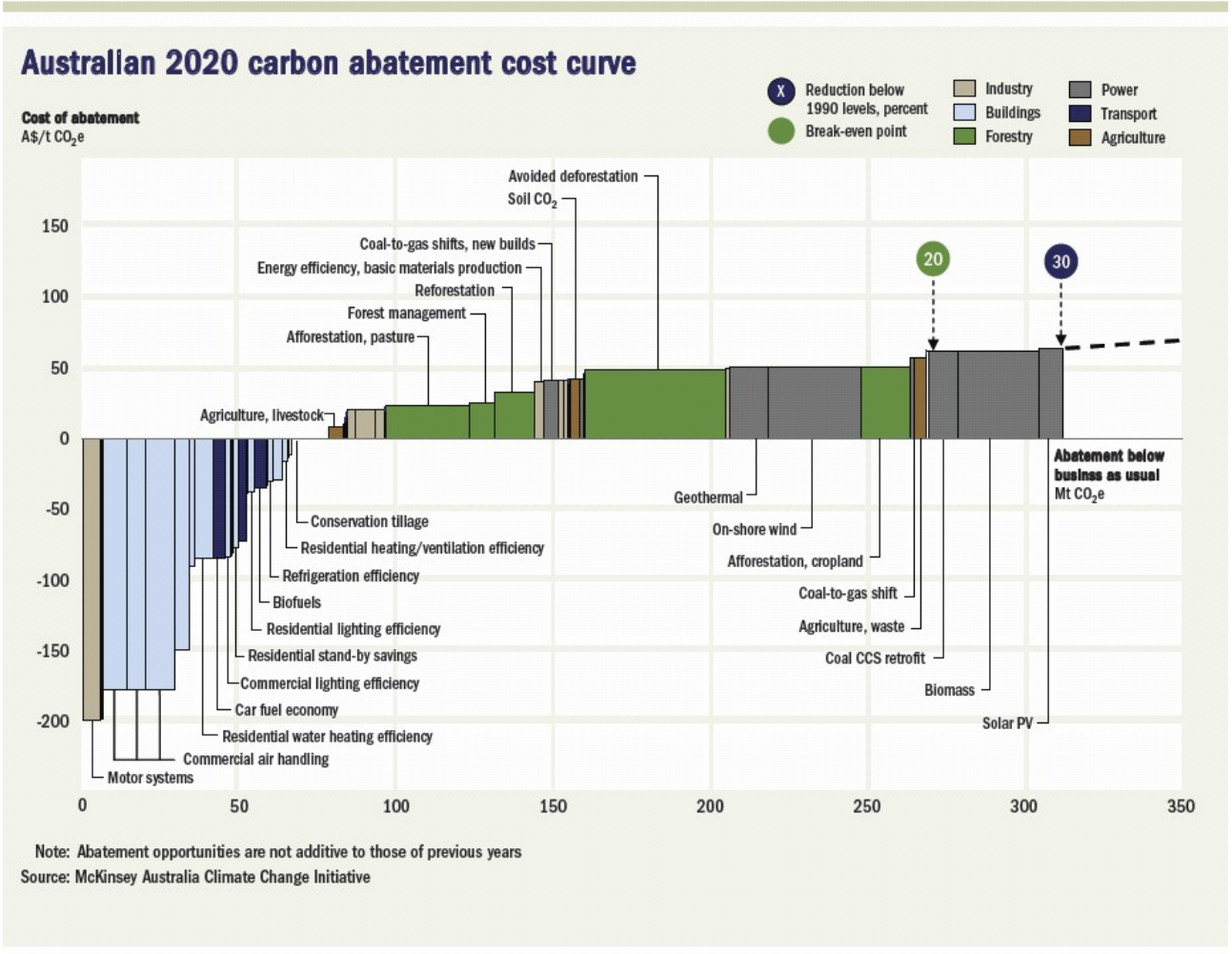


households and business, energy-intensive trade exposed industries and coal fired power stations. This approach to a large degree fits with the intention of emissions trading, which is to encourage behaviour change (ie reduction of energy consumption; take up of energy efficiency measures; etc) as a result of the increased costs. Rather than seeking to argue for compensation, local government may be better placed to investigate measures and strategies that can assist it to negate the cost implications.

8.14 In this context, we note that McKinseys have undertaken research to assess the cost of imposing a cost on carbon. Their report, published in February 2008, "*An Australian Cost Curve for Greenhouse Gas Reduction*" reached the following conclusions:

- (1) A significant reduction in Australian GHG emissions is achievable—30 percent below 1990 levels by 2020 and 60 percent by 2030 without major technological breakthroughs or lifestyle changes. These reductions can be achieved using existing approaches and by deploying mature or rapidly developing technologies to improve the carbon efficiency of our economy. They require significant changes to the way we operate in key sectors, for example, changes in our power mix, but can be achieved without major impact on consumption patterns or quality of life.
- (2) Reducing emissions is affordable—with an average annual gross cost of approximately A\$290 per household to reduce emissions in 2020 to 30 percent below 1990 levels. This compares to an expected increase in annual household income of over A\$20,000 in the same time period. Such a reduction would require implementing all opportunities with a cost of A\$65 or less per tonne of carbon dioxide equivalent (CO₂e), at a gross cost to the Australian economy of approximately A\$2.9 billion per year in 2020. Although the marginal cost of the required abatement will be A\$65 per tonne CO₂e, a large share of opportunities represents net savings to the economy. McKinseys estimated that by 2020, almost 80 Mt, or 25 percent of the total reductions potential, could be realised with positive returns. Most of these positive return (or 'negative-cost') opportunities are energy-efficiency measures related to improvements in buildings and appliances. Many can be categorised as market failures arising from misaligned incentives, for example, those between builders and tenants, where it benefits the tenant but not the builder to install insulation or energy efficient lighting. For 2020, the remaining 75 percent of opportunities examined have a volume-weighted average cost of ~A\$45 per tonne of. For 2030, almost 20 percent of the measures examined present net economic benefits, with the remaining 80 percent having a volume-weighted average cost of ~A\$40 per tonne of CO₂e.

A copy of the McKinsey cost curve for 2020 is set out below.



8.15 As can be seen from the above, a number of initiatives can be undertaken within the commercial and residential building sector, which have a negative cost impact (which generally means that the costs savings made as a result of the particular initiative, are greater than the cost of the initiative itself over certain payback periods).

Contractual issues

8.16 As discussed above, the cost allocation of liabilities arising under the CPRS may depend upon the relevant contractual position of the parties. In the first instance, councils may wish to consider reviewing their waste disposal contracts and street lighting contracts to ascertain where the cost liability is likely to fall. Future contracts should also be carefully considered so as to ensure that liabilities arising under the CPRS are appropriately allocated or apportioned. One option may be for the ALGA to assist its members by developing standard contractual clauses to deal with the CPRS.



Resourcing issues

- 8.17 If an individual council is covered by either the NGERs or the CPRS, there are likely to be resourcing issues related to compliance with these schemes. Councils will need to consider whether they will require additional personnel to cover the requirements, or whether they will seek to outsource compliance requirements.

Opportunities for Local Government from the CPRS

- 8.18 As discussed above, given the broad coverage of the CPRS, there will be limited (if any) scope for the creation of offsets within the regulated market (i.e., within the CPRS).
- 8.19 However, there may be ability for councils to generate income through the CPRS in relation to the forestry sector. As mentioned above, the current proposal is that permits will be issued for free in relation to reforestation activities. Councils with surplus landholdings (particularly regional councils) may decide to establish new forests and thereby receive free permits, which they could sell back into the market.
- 8.20 In relation to the voluntary carbon market, there is still some degree of uncertainty. Matters will become clearer once the Government has published the Australian Carbon Offset Standard (expected by the end of the year). However, the Department of Climate Change has confirmed that emissions not covered by the CPRS should be able to create offset credits for sale into the voluntary market (subject to satisfying the Australian Carbon Offset Standard). In practice, what this means is that if a landfill was not covered by the CPRS (because its emissions were under the threshold), it may be able to generate offset credits for sale into the voluntary market by undertaking emissions abatement action (e.g., landfill gas capture). It is unknown whether the Australian Carbon Offset Standard would include additionality hurdles, such as those which currently exist under Greenhouse Friendly™, so it is difficult to provide more definitive advice at present as to whether there are real opportunities for local government to generate income from the voluntary carbon market.

9. Implications and opportunities for Local Government from complementary measures

- 9.1 Councils will not be directly affected by the proposed complementary measures (i.e., they will not have a liability under the proposed schemes), however, there may be income generating opportunities available from these schemes.

Renewable energy certificates

- 9.2 As mentioned above, the Federal Government is proposing to expand the existing Mandatory Renewable Energy Target. This will mean that there will be more demand for



Renewable Energy Certificates. RECs can currently be created from certain eligible renewable energy sources, including food waste, food processing waste, biomass-based components of municipal solid waste and landfill gas.

- 9.3 There is nothing in the Green Paper or any other policy papers released to date to suggest that the treatment under the expanded Renewable Energy Target of these type of renewable energy sources will be any different with the introduction of the CPRS. We therefore assume that they will continue to be eligible for the creation of RECs.
- 9.4 The impact on the market for RECs due to the implementation of the CPRS and the expanded RET is not yet clear however it could be anticipated that a higher demand for RECs (due to the increased target) and a higher price for electricity in general could impact favourably on REC prices.

Energy efficiency certificates

- 9.5 As also considered above, there are a number of state-based energy efficiency trading schemes currently proposed to be introduced from 1 January 2009. Both the South Australian and Victorian schemes are intended to apply to the residential sector only, but the New South Wales scheme is intended to apply to the commercial and industrial sectors in addition to the residential sector. In short, the schemes require electricity and gas retailers to purchase energy efficiency certificates. Energy efficiency certificates can be created by anyone accredited under the relevant scheme.
- 9.6 At present, only the private sector has participated in creation of such types of certificates (for example, certificates created under the New South Wales Greenhouse Gas Abatement Scheme for Demand Side Abatement Activities), however it would also appear to be open to councils to apply for accreditation to create such certificates.

Local Government Initiatives

- 9.7 Local councils have been active in implementing a range of initiatives to reduce both greenhouse gas emissions generated as a result of local council operations and to assist their constituent businesses and households reduce emissions. For example, the Cities for Climate Protection Program, community green energy options, green purchasing and sustainable housing demonstration homes.
- 9.8 Now more than ever it will be in the interests of local councils to implement energy efficiency measures in relation to the provision of services and infrastructure and to undertake energy audits, with a view to implementing energy management plans.



- 9.9 The role of local government in implementing policy and education programs will not change as a result of the CPRS however the types of initiatives may need to be reviewed and expanded. A key challenge for Councils will be dealing with the disparate needs of metropolitan, rural and regional communities as a result of the CPRS.
- 9.10 The policy approaches can be expected to change as a result of the implementation of the CPRS and complementary measures. For example, there will be a market created for the implementation of energy efficiency measures such as replacing energy intensive lightglobes with energy efficient lightglobes.
- 9.11 One of the greatest areas where local government will have a major role to play is in adapting to the unavoidable impacts of climate change. The remit of this Briefing Paper does not cover issues surrounding adaptation. However, we note that the issue of adaptation is intended to be addressed by Professor Garnaut in his final Report scheduled for publication in late September. There are also initiatives being progressed at all levels of government on this issue including the Commonwealth's report titled 'Climate Change Adaptation Actions for Local Government', which is part of the *National Climate Change Adaptation Programme* and vulnerability and risk assessments for individual councils.

10. Frequently Asked Questions

At the presentation to the Board, Deacons was asked to put together answers to frequently asked questions. The following sets out what we anticipate are the most likely questions to be asked by councils and council ratepayers. For ease of reference, we have also prepared a separate document for circulation as appropriate.

10.1 What is the National Greenhouse and Energy Reporting System?

The National Greenhouse and Energy Reporting System (**NGERS**) is a national approach to the collection of information on greenhouse gas emissions and energy use and production across Australia. It commenced on 1 July 2008 and applies to entities which trigger certain thresholds. The facility based threshold is 25 kilotonnes of CO₂e emissions or 100 terrajoules of energy use or production per year. [25 kilotonnes of CO₂e emissions is the equivalent of emissions from 6,200 cars; 100 terrajoules of energy use is the equivalent of energy used by 1900 households]. The corporation based threshold for the 2008/2009 year is 125 kilotonnes of CO₂e emissions or 500 terrajoules of energy use or production. The corporation threshold reduces every year, for the first three years of the scheme.



10.2 **Will councils be covered by the NGERS?**

The NGERS currently applies to “constitutional corporations”. Councils are not generally considered to be “constitutional corporations” and recent caselaw has confirmed this. However, the Federal Government proposes to amend the NGERS legislation so that it **will** apply to unincorporated entities, such as councils. This amendment is likely to take effect for the 2009/2010 financial year.

It is unlikely that councils will trigger the corporation based thresholds, unless they have extremely high energy use (e.g., for the 2009/2010 financial year energy use which is the equivalent of energy used by approximately 6650 households per annum or for the 2010/2011 financial year energy use which is the equivalent of energy used by approximately 3800 households per annum).

It is more likely that councils will trigger the facility based threshold. In particular, if councils operate landfills which have emissions greater than the threshold (currently proposed to be 25 kilotonnes of CO₂e emissions, but may end up being lower), they will be covered by the NGERS.

10.3 **What is the Carbon Pollution Reduction Scheme?**

The Carbon Pollution Reduction Scheme is a “cap and trade” emissions trading scheme. It is not a carbon tax. A “cap and trade” emissions trading scheme operates by placing a limit on the total emissions allowed from certain activities or sectors covered by the scheme. This limit is generally set below what it would be under “business as usual”. Emitters covered by the scheme will need to acquire permits (either in an auction or through a free allocation) with each permit representing the right to emit 1 tonne of CO₂-e. These permits can be bought and sold. Sufficient permits to cover an entity’s emissions will need to be surrendered each year to the Government. Penalties apply for non compliance.

The intention behind “cap and trade” emissions trading schemes is to allow emissions reductions to be achieved in the most cost effective way. For example, if it is cheaper for an emitter to implement emissions reduction technology within its operations, rather than buy carbon permits, it is expected that this is the route that will be pursued by that emitter.

10.4 **Will councils be covered under the CPRS?**

Councils are only likely to be directly covered by the CPRS if they operate a landfill, and the methane emissions from that landfill exceed the threshold set under the CPRS. (The threshold is currently proposed to be 25 kilotonnes of CO₂e emissions, but may end up being lower).



It is important to understand that an obligation to report under the NGERs does not automatically lead to a liability under the CPRS.

10.5 Will councils be able to create offsets under the CPRS?

Offsets can be created by projects which reduce or abate greenhouse gas emissions. The Government is proposing that there will be limited opportunity for creation of offsets under the CPRS, because of its broad coverage (e.g only agriculture is proposed to be excluded initially). If the waste sector is covered by the CPRS, offsets will not be able to be created by those facilities (i.e., landfills) captured by the scheme. However, there may be opportunities for offset credits to be created in the voluntary carbon market by facilities which are not captured by the scheme (i.e., because they do not exceed the threshold). Further clarification on this option will be possible when the Government releases its Australian Carbon Offset Standard (due out by the end of the year).

The only possible income generating opportunity from the CPRS itself for councils arises in the forestry sector. If a council owns forested land or decides to plant new forests (which comply with the rules of the CPRS) it may be eligible to receive free permits, which could then be sold into the carbon market. The detailed rules for forestry are yet to be determined.

10.6 What other implications will the CPRS have for local government?

The rationale of emissions trading schemes is to place a cost on carbon in the economy, thereby influencing the behaviour of those sectors directly impacted by the scheme to pursue the least-cost abatement of emissions. For those sectors not directly impacted by the scheme the impacts are likely to be increased costs of energy and fuel. In particular, emissions intensive goods and services are likely to be more expensive.

Local government contracts associated with waste disposal and street lighting should be reviewed to ascertain whether existing provisions enable councils to pass on any direct costs which arise under the scheme (e.g if councils operate landfills which trigger a requirement to purchase permits), or to identify whether increased costs being borne by council contractors will be automatically passed onto the council.

10.7 Will councils be able to generate income from complementary measures?

Local council operated landfills which generate electricity from methane will continue to be eligible to generate Renewable Energy Certificates under the expanded Renewable Energy Target Scheme.



Councils may be able to achieve accreditation and create Energy Efficiency Credits from energy efficiency abatement actions under the forthcoming state based Energy Efficiency Target Schemes.

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Renewable Energy (Electricity) Act 2000

13. Legislation - State

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Victorian Renewable Energy Act 2006 (VIC)
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