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Garnaut Climate Change Review Secretariat,  
Level 2, 1 Treasury Place,  
East Melbourne, VIC 3002

### **Submission to ETS Discussion Paper**

Thankyou for the opportunity to present a response to the 'Garnaut Climate Change Review: Emissions Trading Scheme Discussion Paper (March 2008)'. We congratulate the Review Secretariat on the breadth and content of the discussion paper. We believe the paper provides for a well balanced consideration of key design features around the introduction of an emissions trading scheme and that the conclusions drawn in the paper are, on balance, justified.

We are strongly supportive of the introduction of a national emissions trading scheme and firmly believe that a cap-and-trade based scheme, underpinned by meaningful mandatory caps, will be critical to driving the substantial private sector investment required to lower Australia's greenhouse gas emissions profile. Such a scheme should seek to achieve broad sectoral coverage, this to include forestry from the outset and agriculture in the shortest possible timeframe. We provide specific commentary along these lines in the pages that follow.

The paper necessarily takes a high level view of certain scheme design features. We would urge the Review Secretariat and, more importantly, the Federal Government to now move rapidly toward the finalisation of the finer detail around scheme design elements. In particular, it is our view that the specifics around reduction targets, the intended timetable for sectoral coverage, the emissions penalty figure and emissions 'make good' provisions need to be announced sooner rather than later in order to provide for improved business certainty.

We hope you and the Federal Government will consider these comments when developing policies around emissions management and the introduction of the national trading scheme. Should you contact us directly we would be happy to provide further feedback and share our own unique experience in operating as a commercial emissions abatement provider.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Andrew Grant', written over a horizontal line.

Andrew Grant  
Chief Executive Officer



## About our submission

This submission presents CO2 Group Limited's views on design considerations for a national emissions trading scheme (ETS) as outlined in the 'Garnaut Climate Change Review: Emissions Trading Scheme Discussion Paper'. CO2 Group has gained extensive experience over the last four years in establishing a number of accredited carbon sink projects in partnership with corporate Australia and rural communities.

CO2 Group is currently the largest manager of dedicated carbon-sink projects in Australia and has been responsible for establishing a number of large reforestation projects under the NSW Greenhouse Gas Abatement Scheme (NSWGGAS) and Greenhouse Friendly™ Program (GHF). CO2 Group is recognised as the market leader in this field and has pioneered the establishment of dedicated carbon sinks which are without parallel in scale or sophistication at the international level. The CO2 AUSTRALIA™ Carbon Sequestration Program has been awarded a number of prestigious Australian and International environmental and sustainability awards.

## Emissions trajectories and limits

Experience with the European Union Emissions Trading Scheme and other market based interventions highlight the need for careful consideration of three elements: The emissions cap or target, the number of permits allocated and the emissions penalty. These three elements interact so that if, for example, emissions permits do not reflect the intended market cap (i.e. lead to emissions that exceed the cap) the resultant carbon price will be too low to stimulate emissions reduction actions.

We agree with the proposal outlined in the paper relating to the setting of emissions limits. These limits should provide for substantive reductions against baseline projections from the earliest stages of the scheme and should be announced well in advance of full scheme implementation to provide for business certainty and risk management planning.

Related to the above, it will be important that the methodology used to calculate the number of emissions permits released is well thought out, robust and based on sound emissions baseline data. It is of critical importance that the number of permits released is substantially **lower** than the emissions associated with a 'business as usual' trajectory. CO2 Group favours a permit auction system and believes that this will provide for the most efficient 'price discovery' mechanism.

## Compliance and penalty

The setting of an emissions fee, or penalty, is of crucial importance to the success of a trading scheme. In short, the emissions fee will be the 'price signal' by which firms make decisions around abatement projects. Setting this signal too low will almost certainly result in continued inaction. A higher penalty price, with no tax deductibility, will provide a significant motivator for liable parties to seek abatement solutions. An emissions fee in the order of A\$30 is required during the early stages of an ETS in order to provide for real business certainty and incentive. The emissions penalty could be finalised and announced well in advance of the introduction of the scheme so

that, provided the fee is sufficiently high, a strong incentive for early abatement activity would be created.

Since the goal of the ETS should be to achieve an emissions trajectory over the long-term, it is our view that payment of a penalty should not translate to 'acquittal' of any emissions over-run. An appropriate make good arrangement could include carry-over of the over-run amount into the subsequent compliance period combined with an increase in the penalty fee.

### **Sectoral coverage**

Any ETS should seek to achieve broad sectoral coverage with the inclusion of all sectors at, or shortly after, the commencement of the ETS. Where sectoral coverage is too narrow, or the 'phase-in' period for certain sectors overly extended, there is not only a risk that some sectors will carry an unfair burden with respect to meeting national emissions reduction targets, but from a design point of view a narrow sectoral coverage is more likely to limit abatement opportunities. In this respect, we support the papers proposal that stationary energy, industrial processes, fugitives, transport and waste be covered from scheme commencement.

It is our view that the forestry sector should also be a covered industry from the outset. As a highly experienced manager of forest plantings, we see no compelling technical, or administrative, reason that would preclude coverage of the forestry sector at the commencement of an ETS. Forest carbon sinks are presently being successfully employed on a commercial basis under the Kyoto Protocol's CDM mechanism, the NSW GGAS and the Greenhouse Friendly™ Program. The forestry sector was also the first sector to be included under the recently launched New Zealand ETS.

At the point that forestry enters as a covered sector, it will be important that some mechanism exist that provides for the recognition of abatement from re-forestation projects. In short, there needs to be a capacity to convert verified abatement amounts from such projects into emissions permits, or an equivalent tradable unit that can be acquitted against a liable party's emissions profile. Where this is not possible, there will be no commercial incentive to pursue the substantive emissions reduction opportunities available through the development of forest sinks.

A recent McKinsey study concluded that forestry has very high mitigation potential, greater even than for the energy or transportation<sup>1</sup> industries. Carbon sinks, such as tree plantings, have several major advantages over technological solutions in that they are less capital intensive, they deliver significant abatement outcomes within the first few years following investment and they can provide for a range of other positive environmental, social and economic outcomes in addition to carbon sequestration.

### **Eligibility dates and forest sinks**

In considering the introduction of an ETS, it is important the designers recognise government regulated emissions reductions schemes (NSWGGAS and GHF) which have existed for several

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<sup>1</sup> Point Carbon. Carbon Market Europe. 25 May 2007

years and the range of abatement projects which have, and continue to be, established under them. Organisations which have, in good faith, supported the development of forest carbon sink projects under these schemes with an immediate objective of abating emissions, but with a longer-term objective of recognition under a national scheme, should not be penalised for demonstrating leadership in reducing emissions. Should recognition of these ‘early-mover’ projects not occur, the commercial argument for their ongoing maintenance may be removed. A possible perverse outcome would be the removal of at least a proportion of already planted forest carbon sinks and subsequent conversion to an alternate, commercially viable, enterprise (e.g. traditional agricultural use) *increasing* rather than *decreasing* emissions. In any case disallowing the sequestration gained from these accredited projects is clearly not in the national interest; Australia would effectively be disallowing some of the cheapest and effective abatement from being recognised in the current (2008-2012) and future commitment periods. Clearly such a situation would not act to help Australia meet its obligations under the Kyoto framework.

### **Carbon sinks and ‘additionality’**

In practice, defining and applying the concept of ‘additionality’ has proven complex. As a guiding principle, the emissions reduction challenge is so great that any project that contributes to reducing greenhouse gases should be encouraged. Tree plantings established as dedicated forest carbon sinks, and which comply with the Kyoto Protocol Afforestation, Reforestation and Deforestation definitions and requirements, should automatically be considered to be ‘additional’.

Our argument is based on the reasonable assumption that, in the absence of an ETS, management of cleared agricultural landscapes is likely to continue either unchanged, or at an increased level of intensity with an elevated emissions profile. This observation is well supported by numerous research studies. According to ABARE, for example, “there is a significant proportion of broad-acre farmers who are estimated to rarely earn sufficient taxable income to enter the top marginal tax brackets and many others who are estimated to earn less than the tax free threshold. The current concessions offer these groups modest or no additional incentives to undertake landcare works”<sup>2</sup>.

### **International linkages and cross-border trading**

Abatement credits, or ‘offsets’, generated from international sources should not be recognised and traded under an Australian ETS unless formal bilateral, or multilateral, agreements are entered into under which comparable credits generated in Australia can be sold to participating international partners. It makes no economic sense to limit Australia to a position of being an offset credit importer when we have substantial potential to be a major offset exporter. The pursuit of such bilateral arrangements is to be encouraged and efforts should be made to ensure there is consistency between the ETS and the major international trading frameworks, particularly the JI mechanism and Kyoto Protocol.

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<sup>2</sup> ABARE. Landcare tax deduction provisions versus alternative instruments (1996)

### **Inter-temporality**

We agree with the proposal that permit banking and some limited borrowing be allowed under the ETS. While banking and borrowing add administrative complexity, they allow flexibility in the market-place and are likely to produce a greater range of abatement activities at a cheaper cost. Since biological sinks sequester carbon at varying rates across the life of the project, a capacity for banking and borrowing verified abatement amounts provides for smoothed revenue flows and flexibility in the matching of permit availability to shifting client abatement requirements. The advantage of this is that it is one way that participants in the market would be able to manage carbon price volatility - an important ingredient in creating market confidence.

### **Governance**

We agree with the proposal that while the policy framework should be set by government, the scheme itself should be administered by an independent authority. This model has already been successfully employed under the NSW GGAS. As a general comment, we would encourage scheme designers to centralise administrative processes as much as possible so as to reduce compliance complexity.