

Climate Change Authority Review of the
Carbon Farming Initiative Legislation & the
Emissions Reduction Fund

submission

October 2017





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About the Carbon Market Institute

The Carbon Market Institute is at the centre of climate change policy and business in Australia. We're dedicated to helping business seize opportunities in rapidly evolving carbon markets. Independent and objective we're the peak industry body for climate change and business. We believe that market based solutions are the most efficient policy mechanism to address the challenge of climate change.

We share knowledge and facilitate connections between business, policy makers and thought leaders to drive the evolution of carbon markets towards a significant and positive impact on climate change. Engaging leaders, shaping policy and driving action, we're connecting insights and catalysing opportunities in the transition to a low carbon economy. **Our corporate members include:**



Guiding Principles

The recommendations in this Submission build on the following key principles:

- **Australia's national emissions reduction target should be in line with the global response** to the threat of climate change to keep temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 degrees Celsius.
- **A market-based approach to emissions reduction** provides an effective, efficient framework to meet emissions reduction goals and challenges at lowest cost.
- Australia's **policy suite should be comprehensive and enduring** to create a stable and predictable policy landscape for business; climate policies should be reviewed at predetermined intervals in line with UNFCCC commitments and evolving market conditions.
- Policies designed **to reduce emissions from large emitters should be aligned with the trajectory required** to meet current and future targets which are likely to be set at more ambitious levels.
- To meet emissions reduction targets at lowest cost to the economy, **Australia should open opportunities to link and trade with international markets.**



Executive Summary

The Climate Change Authority is undertaking a review of the Carbon Farming Initiative, as it is required to do every three years by the Australian Government's *Carbon Credits (Carbon Farming Initiative) Act 2011* (CFI Act). The CFI Act states that the review must cover the operation of the CFI Act, its regulations and other instruments made under the Act such as methodology determinations (known as methods) (Appendix A).

The Authority has released an August 2017 consultation paper detailing the focus and process for the review. The CCA review should be a key input into the national climate policy review being led by the Department of Environment and Energy. Through the National Climate Policy Review, the Government should ensure that the Emissions Reduction Fund (ERF) and the Carbon Farming Initiative Legislation have the flexibility to endure and evolve over time; support Australia's national emissions reduction targets; ensure Australia is able to meet its international obligations under the Paris Agreement; recognise the strategic importance of the land sector in meeting Australia's Nationally Determined Contribution; and support the development of Australia's national carbon farming industry.

It is critical also, that the CCA and the Government through its review, examine how existing policies can be implemented to ensure the effectiveness, stability and predictability of the domestic policy framework over the long term and under successive governments, and outline a pathway that can support Australia's economic transition to a zero-carbon economy.

CMI undertakes extensive consultation with national carbon farming industry participants which forms the basis of input to this submission; including with business, research institutions, representative bodies, as well as state and federal governments. Input has been received specifically through:

- Convening these stakeholders at a National Carbon Farming Industry Summit (August 2017);
- Surveying Industry Summit attendees; and
- One-on-one consultations nationally.

This Submission is underpinned by the Institute's broader policy position that has been developed using insights from CMI's annual Australian Climate Policy Survey (2016); CMI's corporate member policy and land sector working groups; extensive consultations with CMI members and international carbon market experts; and discussions held at the 2nd Asia Pacific Carbon Market Workshop (2017), the ERF Practitioners workshop and 4th Australasian Emissions Reduction Summit (2017).

This Submission provides options, considerations and recommendations for the Climate Change Authority and the Australian Government to consider, built on five broad pillars:

- Meeting Nationally Determined Contribution (NDC)
- Optimising Policy Frameworks & Market Design;
- Unlocking Finance & Investment;
- Quantifying Co-Benefits and Creating Markets; and
- Building Capacity & Communicating Benefits.

We have not detailed responses to specific questions (listed in Appendix C of the August 2017 Consultation Paper), rather we have outlined high level principles and recommendations that should be considered in determining the way in which the ERF and CFI Legislation might endure as a key policy framework for future governments, and support the growth of Australia's national carbon farming industry. This Submission outlines a summary of policy options, considerations and recommendations, and a more detailed discussion on each of these key points. **This document represents a**



synthesis of member views and is not representative of any individual or CMI member company position.

Summary of Policy Options, Considerations & Recommendations

The below statements set out CMI's key positions in reviewing the CFI Legislation and the ERF. These statements are expanded upon in the later sections of this Submission.

Meeting Australia's NDC Obligations

1. The Government should clarify the role and contribution of the ERF and Safeguard Mechanism (as a potential driver of demand for domestic credits) in meeting Australia's 2030 emissions reduction targets and international obligations under the Paris Agreement.
2. As the land sector is of strategic importance in meeting Australia's Nationally Determined Contribution (NDC) under the Paris Agreement, the Government should work collaboratively with State Governments and a broad range of industry stakeholders to scale-up Australia's national carbon farming industry to meet its 2030 emissions reduction target.
3. The Government should work with the carbon farming sector to ensure ongoing market integrity, build confidence in best practice ERF activities and provide greater protections for landholders by contributing funding and support for the effective administration of a voluntary Code of Conduct for ERF Participants.

Optimising Policy Frameworks & Market Design

Domestic

4. The Government should commit to an allocation of more R&D funding for ERF method development, ensuring new and existing methods are accessible for landholders, and attractive for investment.
5. The Government should explore different models to engage with industry in the development of new ERF methods, working closely with industry to update, streamline and expand existing methods.
6. The Government should clarify how voluntary market activity and additional sources of private sector demand for carbon units credited under the ERF can be created.

International

7. The Government should explore how methods developed under the ERF can align with best practice, international standards and other carbon offset markets.
8. The Government should engage in Article 6 Rulebook negotiations, and international carbon market-linkage discussions to identify the potential export of ACCUs into other markets, and how to secure high quality international abatement for the purposes of meeting 2030 reduction targets at lowest cost.
9. The Government should confirm the use, eligibility requirements and proportion of international units that may be used for compliance under the Safeguard Mechanism, to ensure the ongoing viability of, and demand for domestic offsets continues.



10. The Government should research and model the factors affecting availability, and future supply and demand for domestic and international units as new rules around international trade in carbon emerge and countries implement their commitments made under the Paris Agreement.

Unlocking Finance & Investment

11. The Government should commit a quantum of additional funding allocation to the ERF that is required to ensure the continuity of the domestic carbon offset industry until the time it transitions to a market driven by demand under the Safeguard Mechanism.
12. The Government work with project developers to develop flexible business models for aggregation of projects to encourage private sector finance and investment in large scale domestic abatement projects.

Quantifying Co-Benefits & Creating Markets

13. The Government should explore and develop new metrics to more accurately quantify co-benefits of carbon farming projects under the ERF – such as biodiversity, water quality, conservation and community benefits – and align these metrics with international standards and best practice.
14. The Government should work with the carbon farming sector and State Governments to consider opportunities for public/private collaboration around innovation in environmental markets and the quantification of co-benefits.

Building Capacity & Communicating Benefits

15. The Government should invest in targeted ERF outreach and capacity building in remote rural communities, and with safeguard covered entities to build greater understanding of the benefits of participating in carbon farming.
16. The Government should provide more clarity around the rights of eligible interest holders in the development and registration of ERF and carbon farming projects.



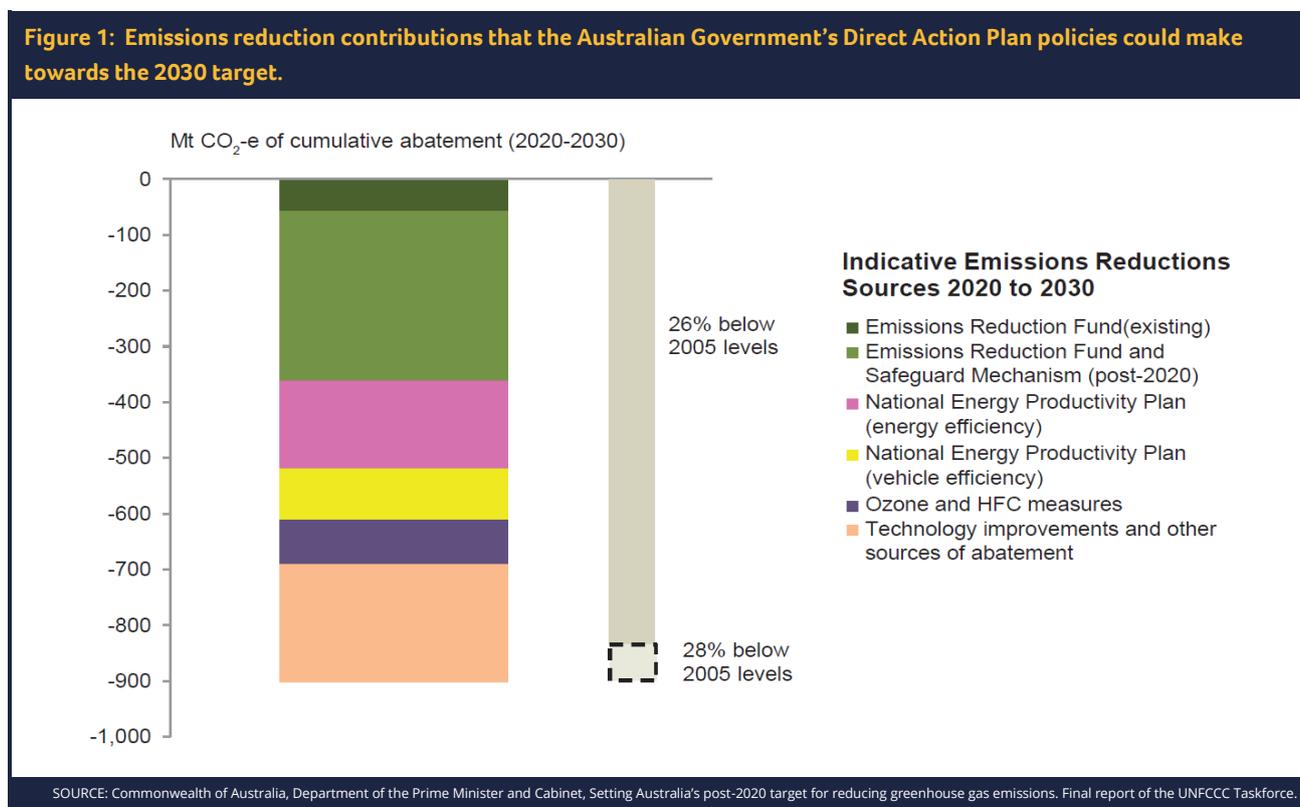
Meeting Australia’s NDC Obligations

1 The Government should clarify the role and contribution of the ERF and Safeguard Mechanism (as a potential driver of demand for domestic abatement) in meeting Australia’s 2030 emissions reduction targets and international obligations under the Paris Agreement.

As part of its Nationally Determined Contribution (NDC) submitted under the Paris Agreement, the Australian Government has committed to an emissions reduction target of 26 to 28 per cent below 2005 levels by 2030. As outlined in the NDC, Australia plans to meet this target through a combination of policies including:

- The Emissions Reduction Fund;
- The Safeguard Mechanism;
- Renewable Energy Target (23 per cent of Australia’s electricity by 2020);
- National Climate Resilience and Adaptation Strategy;
- National Energy Productivity Plan (40 per cent improvement between 2015 and 2030);
- Improvements in the efficiency of light and heavy vehicles and
- Enhanced management of synthetic GHG emissions under ozone protection laws & Montreal Protocol.

Particularly with regard to the development of the domestic abatement industry, the Emissions Reduction Fund and the Safeguard Mechanism must act as key policy frameworks to support the scaling up of land sector abatement to meet our national 2030 target. The contribution of each of the above policies to reducing Australia’s emissions is illustrated in Figure 1, below.





Emissions Reduction Fund

The Emission Reduction Fund is a well-designed, well-governed domestic offset scheme that is currently supported by government funding of contracted abatement. However, the funds available for the ERF may only support one or two more auctions. It is critical that the Government consider the appropriate quantum of future funding allocations to the ERF, required to ensure the continuity of the domestic carbon offset industry until the time it transitions to a market driven by demand, by companies captured under the Safeguard Mechanism.

With the tightening of Safeguard Mechanism baselines will come a need for a strong viable domestic carbon offset supply to help meet emissions exceedance, so there must be continuity of credits issued under the ERF. With a finite pool of funding left for the next few ERF auctions, the Government must identify the appropriate quantum of additional ERF funding required until there is a liquid secondary market, and it transitions to a market driven by demand under the Safeguard Mechanism.

The global demand for carbon offsets is set to increase as over 90 countries have indicated they will use markets to achieve their UN emission reduction targets. As the market provisions of the Paris Agreement get bedded down and domestic carbon markets are established in our region, an international market of significance could open up for the export of Australian carbon credit units. If we enhance and grow the supply of domestic carbon credits, Australia could be well positioned to use domestic credits to meet the required proportion of Australia's 2030 target. Furthermore, if through the global stocktake, NDC ambition is increased, then the ERF and land sector abatement (if invested in properly), could be used to support a deepened emissions reduction response to our international obligations under the Paris Agreement.

Safeguard Mechanism

It is critical that, as Australia's climate policy suite evolves, the Government implements a policy mechanism that places a clear limit on absolute emissions across the economy, and that this mechanism actively drives down emissions over time. From extensive consultation undertaken by CMI, it is clear that in a business as usual scenario, the Government's existing climate policy suite does not effectively constrain or reduce emissions in a way that will enable Australia to meet its 2030 targets.

The Government's Safeguard Mechanism is capable of limiting and reducing emissions without legislative change (through the adjustment of baselines), and should be the primary policy to do the heavy lifting to drive down absolute emissions to 2030 and beyond.

The evolution and adjustment of baselines under the Safeguard Mechanism will provide an important market signal to drive long-term investment in the development of a secure supply of domestic abatement. When declining safeguard baseline trajectories are made clear (or at least the conditions and criteria for how baselines might decline), private sector demand for domestic credits will likely kick in, and ramp up to meet increasing emissions exceedance liabilities over time. This may also obviate the need for any significant top up of ERF funding as the ERF transitions from public funding to a source of private sector demand under the Safeguard Mechanism.



2	As the land sector is of strategic importance in meeting Australia's Nationally Determined Contribution (NDC) under the Paris Agreement, the Government should work collaboratively with State Governments and a broad range of industry stakeholders to scale-up Australia's national carbon farming industry to meet its 2030 emissions reduction target.
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The Land sector in Australia holds particular strategic importance with respect to the overall domestic emissions reduction task. Carbon farming projects on agricultural land, have added importance in terms of the opportunities for sustainable agricultural practices and increased economic activity, but also in terms of their significant emissions reduction potential. 93% of respondents from CMI's 2017 Carbon Farming Industry Survey agreed or strongly agreed that substantial growth in domestic land sector abatement is required for Australia to meet its 2030 emissions reduction targets; and that State Governments collaboratively have a key role to play in promoting and facilitating the uptake of carbon farming (supported by 89% of CMI's 2017 Carbon Farming Industry Survey respondents). Below, are seven considerations that the Government should explore in order to maximise the potential for the land sector to deliver large volumes of abatement.

Emissions Reductions

Land sector projects can provide low cost options for emissions reductions from agricultural activities, as well as storing considerable amounts of carbon in the landscape. To date, 153 million tonnes of abatement is already under contract in the land sector, supported by the Government's ERF.

Increasing Farm Productivity

Carbon farming projects on agricultural land have been able to deliver productivity benefits for farming operations, with measures taken to reduce emissions that are implemented alongside traditional agricultural enterprises.

Risk Management

Agriculture is particularly vulnerable to variations in climatic conditions. Land sector projects that deliver carbon benefits have also been able to deliver risk management outcomes associated to climate variability and impacts on crop and livestock production

Degraded & Unproductive Land

Emissions reduction projects have been important sources of income on degraded land, providing new use and benefits from re-vegetation and better soil management.

Co-Benefits

Emissions reductions projects have been able to deliver multiple environmental benefits, in addition to providing new opportunities for economic development, social/cultural benefits and jobs for rural communities.

Sub-national Opportunities

The ERF has underpinned a strong domestic market, but there remain significant opportunities for State Governments to take action and help facilitate land sector investment to deliver positive outcomes for communities and landscapes.

Voluntary Markets

The land sector is an important source of credits for organisations looking to voluntarily offset their emissions, as they are able to achieve and communicate multiple benefits that align with their corporate strategies.



3	The Government should work with the carbon farming sector to ensure ongoing market integrity, build confidence in best practice ERF activities and provide greater protections for landholders by contributing funding and support for the effective administration of a voluntary Code of Conduct for ERF Participants.
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Australia’s carbon farming industry, underpinned by a well-designed, well-governed offset scheme (ERF) and legislation (Carbon Farming Initiative Act 2014) is still a relatively nascent industry with significant amounts of abatement contracted under the ERF spread across a small group of aggregators and producers. In order for the ERF to continue to deliver successful outcomes as it scales up to meet future demand, it is important that additional market-based frameworks are put in place to support market activity, and predominantly encourage best practice carbon farming activity as the industry grows.

As discussed in the CCA Review’s discussion paper, the Carbon Market Institute is collaborating with industry representatives to develop a voluntary Code of Conduct (the Code). CMI has established a Carbon Project Developers Council with the primary aim of developing the Code. The Code will act as a framework to establish and maintain a viable emissions reduction and sequestration industry that operates under the principle of shared stewardship of the industry, and the broader environment – in conjunction with the three arms of government: Minister, Department and Regulator.

The Code will aim to define industry best practice for carbon offset project developers, agents and advisers and represents the minimum standards that all signatories agree to meet. These would include clear guidelines and procedures for achieving best practice for various stages of project implementation, including engagement procedures and appropriate timelines for various stakeholder engagement and disclosure. There would also be documentation outlining best practice for managing and accounting for co-benefits.

The Code will be applicable to operations under all ERF methods, and to project developers, aggregators, agents, and advisers who provide advice to clients regarding implementation of carbon projects under the federal Emissions Reduction Fund on their property or within their business practice.

If operationalised, this Code of Conduct will be important to a broad range of stakeholders who will rely on it to provide assurance that industry participants are fulfilling all their obligations in relation to operating under the enabling legislation, and that the industry as a whole is seeking to adopt specific standards of conduct as a self-regulatory tool for continual improvement.

Such a Code of Conduct would complement and broaden the ERF policy instrument; improve actual and perceived robustness of activities, emissions reductions and participants under the ERF and its methods; and give additional assurance of the industry’s credibility.

The Code would be instrumental in reducing project and investment risk and build capacity through the promotion of improved management and condition of landscapes; creation of significant environmental and social benefits; and providing protections and increased education for landholders who enter into abatement contracts with producers and aggregators.

Due to the current size of the industry, the number of abatement producers, there is insufficient funding capacity and resourcing from participants to fully manage the setup and ongoing administration of the code. It is in the Government’s interest to invest in this type of industry risk mitigation and capacity-building activity, and so we recommend that the Minister, Department and Clean Energy Regulator consider its role in co-funding with industry participants the establishment and ongoing administration of the Code.



Optimising Policy Frameworks & Market Design

Domestic

4

The Government should commit to an allocation of more R&D funding for ERF method development, ensuring new and existing methods are accessible for landholders, and attractive for investment.

There is an opportunity to leverage Australia's capacity to generate large scale emission reductions from the land sector by ensuring new and existing methods for land sector abatement are ready and viable for landholders and ERF project developers. It is important for the Government to build on existing R&D around method development, to ensure that new and existing ERF methods provide the necessary conditions to scale up land sector abatement. Opportunities for identifying specific methods should be prioritised and potentially fast tracked, allowing for large scale development of emissions reduction projects in the land sector.

Industry groups in the land sector such as The National Farmers Federation, Meat and Livestock Australia, Dairy Australia and Rangelands NRM have all indicated a strong interest in developing the emissions reductions potential of their respective sectors, and have highlighted an interest from their stakeholders participating in the ERF given the right conditions and available methods. Indeed, 84% of CMI's 2017 Carbon Farming Industry Survey respondents agree that ERF method R&D is critical for ensuring mitigation options are cost effective and accessible for farmers in Australia and indeed the land sector as a whole; particularly for those existing and new methods that can increase farm productivity and generate carbon credits.

The Government should prioritise R&D funding and resources for changes to existing methods or new methods that will facilitate the highest uptake among the land and agriculture sectors and deliver the greatest volumes of abatement. Consideration should be given to lead times from method development to project implementation, and through to credit generation. It is important for the Government to provide clear and transparent information pertaining to method development and prioritisation, and to provide all relevant stakeholders with the opportunity to have input into the research and development process.

5

The Government should explore different models to engage with industry in the development of new ERF methods, and work closely with industry to update, streamline and expand existing methods.

Currently, there are a limited number of methods that have been adopted and used by farmers, landholders and indigenous groups to implement projects under the ERF. Consultations with stakeholders have indicated that more industry input on method development would translate to new types of cost-effective carbon farming projects, more implementation and more innovation.

Under the Carbon Farming Initiative, the development of abatement methods occurred with strong input from the private sector. This ground-up approach leveraged the expertise within the abatement industry to identify opportunities for emissions reduction and prioritisation of method development in an efficient and effective manner. Under the ERF, method development and prioritisation is led principally by the Department of Environment and Energy. The Government should formalise a process for further engagement with relevant industry bodies and land sector groups to alleviate some of the barriers that currently exist with respect to ERF methods.

The Government should clarify the changes to prioritising ERF method development and governance processes so that there are more options for new methods that are more participant-led, and that there is transparency and stakeholder engagement ahead of any method changes.



Leveraging the private sector expertise in the development of methods is important for identifying the most efficient and effective means to generate abatement. Furthermore, industry-led method development will assist in prioritising methods most useful to industry and therefore most widely adopted.

In addition, it is essential that the method development, priority identification of new methods and method review process is transparent. Any changes to current methods should be undertaken through appropriate stakeholder engagement to ensure industry views are incorporated and timeframes to elicit feedback are appropriate.

6

The Government should clarify how voluntary market activity and additional sources of private sector demand for carbon units credited under the ERF can be created.

In addition to an evolving Safeguard Mechanism that increases demand for credits created under the ERF, other sources of private sector demand should be investigated. The voluntary market presents one such opportunity for further emissions reductions coming from outside the Government's primary policy mechanisms, and there is a role for the Government in supporting this uptake by business. Through activities carried out under the Services Agreement with the Department of Environment and Energy, CMI has evidenced an increasing interest and appetite from organisations looking to better understand the voluntary carbon market, specifically the National Carbon Offset Standard (NCOS) and Carbon Neutral Program (CNP) and the Gold Standard.

Despite varying levels of understanding and engagement, organisations have shown considerable interest in accessing the benefits associated with voluntarily reducing emissions, and understanding what the different options are to progress voluntary action. This was highlighted in September 2016, when CMI ran a series of national promotional workshops in Melbourne, Sydney, Brisbane, Adelaide and Perth. The workshops were attended by over 230 individuals from various organisations. In addition to this, there has been an overwhelmingly positive response to the development of other market education materials such as the Guide to Going Carbon Neutral, Carbon Neutral Case Studies of certified organisations, and the development of an online portal, the Australian Carbon Marketplace.

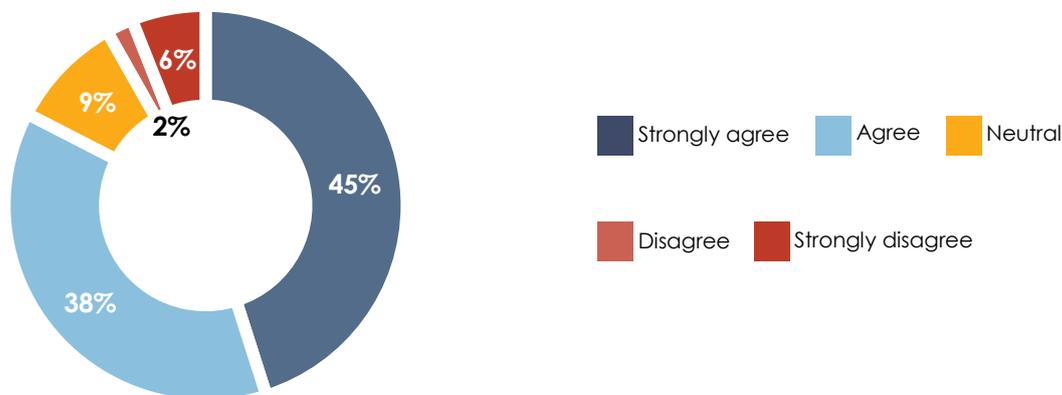
It is important that efforts are continued to further increase uptake of the voluntary purchase of carbon offsets and emissions reduction activities. The Government's NCOS currently certifies 30 organisations and 15 products and services as carbon neutral, with a number of other organisations reportedly close to becoming certified in the near future. Carbon neutrality, offsetting and the benefits of becoming carbon neutral are still relatively unknown to many, therefore it is important that there is a continuation and ongoing commitment to market education around voluntary market activity and the Government's NCOS and other voluntary standards.

A further option for stimulating private sector demand for ACCUs is through the incorporation of offsetting requirements in environmental and planning approval legislation. Requirements for emissions from major infrastructure projects have previously been explored at the state level¹. By introducing requirements for emissions from major projects to be offset by domestic abatement, investment in local projects could be catalysed. Such projects could deliver a range of additional social, economic and environmental benefits to the project region.

¹ Environmental Assessment Guidelines. Preparation of Management Plans Under Part IV of the Environmental Protection Act 1986. Environmental Protection Authority, Government of Western Australia. August 2015.



Figure 2: In addition to Government purchasing, it is important there are other sources of private sector demand for carbon units credited under the ERF.



SOURCE: Australian Climate Policy Survey 2016, Carbon Market Institute

The Clean Energy Target as a source of demand for ERF credits

One possible way to achieve cross party and industry acceptance of coal fired generation under the proposed Clean Energy Target (CET) by requiring coal fired generators to offset their emissions using carbon credits from Emission Reduction Fund (ERF) projects. This may be the solution to link climate and energy policies and drive down absolute emissions in line with Australia’s 2030 Paris Agreement targets.

An economy wide, market-based approach to emissions reductions, an explicit carbon price signal, and internationally linked emissions markets are required to drive investment in new generation, and efficiently transition to a net-zero emissions economy. If coal fired generation is to continue as a core part of the energy mix in the medium-term through the CET, then carbon emissions from those facilities need to be offset using ACCUs so that Australia can reduce its absolute emissions across the economy. The cost of offsetting emissions over the life of any new asset could be built into the capital cost of the plant through a carbon price (cost), which the majority of investors are now factoring in anyway.

ERF credits can be fungible into the CET and tools like the World Bank’s Mitigation Action Assessment Protocol enable the conversion and fungibility of MWh to tCO₂e (ACCUs) with rigor. Under Finkel’s CET design, this could bring coal fired generators under a CET benchmark threshold by reducing the generator’s emissions profile. This requirement to offset emissions would then address the key issue of reducing emissions as well as providing a much-needed private sector market for the domestic carbon offset industry. This requirement on coal fired generation, along with an enhanced Safeguard Mechanism that has baselines that decline over time, will create a sustainable private market demand for credits generated under the ERF, obviating the need for significant ongoing public funding of ERF auctions.

The offsets used for such a framework would likely be sourced from regional and rural Australia - where the majority of ERF land sector projects exist - creating additional economic activity and jobs in rural communities and contributing to the scaling up of a national carbon farming industry across Australia.



International

7

The Government should explore how methods developed under the ERF can align with best practice, international standards and other carbon offset markets.

International carbon markets are going to evolve under the framework of the Paris Agreement. The suite of emissions reduction project methods developed under the Carbon Farming Initiative and ERF represent carbon abatement and emissions avoidance projects that could be aligned with international standards and form part of a suite of project types that could have applicability in other jurisdictions. Eligible mitigation actions in future international markets or bilateral/regional markets are expected to have at least the following characteristics:

- **Net Mitigation Contribution:** Which refers to the extent to which a mitigation action counts against a host country's efforts to reducing their domestic emissions, to assure that there is no double counting.
- **Sustainable development contribution:** Mitigation actions should, in addition to contributing to a net mitigation of greenhouse gas emissions, support sustainable development, as outlined by the Paris Agreement's Article 6. This will also be important for ensuring that carbon abatement activities contribute to achieving the UN's Sustainable Development Goals.
- **Credibility and integrity:** Mitigation actions should represent real, permanent and additional reductions, and be subject to robust monitoring, reporting and verification (MRV).

The Government should build connections with the private sector as it engages in international/bilateral/regional fora so that it can be part of the rule-making process about eligible mitigation actions. Importantly, decisions about 'eligibility' are not just being discussed at the international level under the UNFCCC, but also on a bilateral/regional basis. It is important that Australian business has a 'window' into the different dialogues about eligible mitigation actions, so that it is 'link-ready' and well positioned to access and benefit from international markets in the future.

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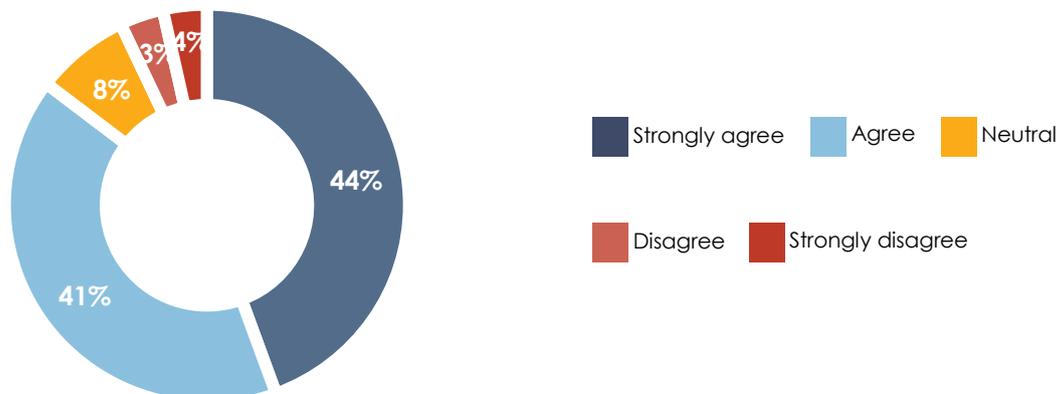
The Government should engage in Article 6 rulebook negotiations, and international carbon market-linkage discussions to identify the potential export of ACCUs into other markets, and how to secure high quality international abatement for the purposes of meeting 2030 reduction targets at lowest cost.

The policy approach adopted in Australia should evolve in parallel with developments in other international markets. Over 90 countries have identified the possible use of carbon markets in achieving their NDCs under the Paris Agreement. The design features of Australia's domestic policy suite should aim to achieve our NDC targets and aim to align with international developments to enable the development of linkages with other markets over time. Engaging with international markets can provide an opportunity to both allow entities covered under the Safeguard Mechanism to meet compliance at lowest cost and support the development of potential export markets for ACCUs.

Companies that have compliance obligations under the Safeguard Mechanism, particularly if baselines are to decline, could potentially manage their exposure cost effectively by using a range of trading and hedging strategies that involve international units. Indeed 85% of Australian Business respondents to CMI's 2016 policy survey (Figure 3, below) support Australia linking with international markets, as do 91% of CMI's 2017 Carbon Farming Industry Survey. Any use of international units for Australian compliance obligations must factor in any negative impact of the domestic offset market.



Figure 3: Australia should be part of internationally linked markets as they evolve under the Paris Agreement.

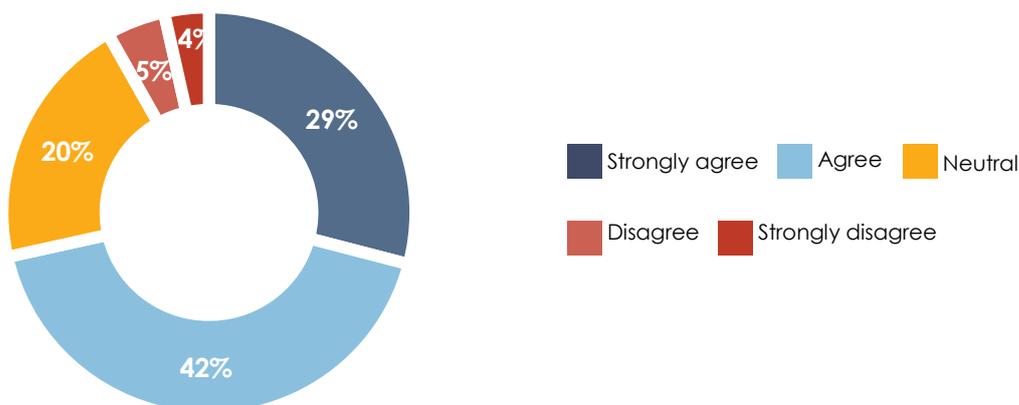


SOURCE: Australian Climate Policy Survey 2016, Carbon Market Institute

The Government should examine the pathway to open up market opportunities for the transfer and export of ACCUs into other markets. Engaging with the many countries that have outlined the use of international markets in their NDCs is an effective way to create an export market for ACCUs credited under the ERF. Export markets represent a potential additional demand for ACCUs beyond a domestic compliance policy such as the Safeguard Mechanism or Government funding of abatement. To ensure that the option of exporting ACCUs is available, it is important that the Government promote Australia’s land sector abatement methodologies as a source of high quality, robust mitigation outcomes in appropriate UNFCCC fora to ensure they are internationally recognized as acceptable methods for emissions reductions.

The Government should engage the private sector to consider how Australia’s combination of advanced methods and world-leading expertise could be leveraged to create opportunities for Australian businesses in regional markets. The majority of Australian businesses in CMI’s 2016 survey (Figure 4, below) supported the exploration of ACCU export markets.

Figure 4: The Australian Government should work to open up market opportunities for the transfer/export of credits created under the ERF into other markets.



SOURCE: Australian Climate Policy Survey 2016, Carbon Market Institute

Australia also has extensive expertise and capacity in project development and across the broader emissions reduction project development, investment and services spectrum. Many of the countries in our region are lacking such expertise as they develop their emissions reduction institutions and frameworks to meet their obligations under the Paris Agreement. In recent consultations that CMI has had with Government officials and key representatives in New Zealand, California, China and India, there is interest in Australia exporting its



Emissions Reduction Fund methods and land sector abatement methodologies, thereby advancing the development of robust, comparable and potentially fungible mitigation actions internationally. This represents a potential opportunity to export Australian expertise to assist with these processes, creating economic opportunities for Australian business. The Government could carry out a research project and/or a pilot project in a key jurisdiction to test the feasibility of exporting Australian methodologies.

To complement the ERF and Safeguard Mechanism policies, Australia should ensure it meets emissions reduction targets by engaging in international markets and emerging “carbon clubs”. After CMI’s extensive consultations with national and international stakeholders, it’s clearly of interest and advantageous for Australia to scale up engagement in discussions on the mechanics of international markets and carbon clubs, even if it chooses not to agree to link markets at the outset. Potential engagement avenues that could evolve over time include:

- Australia’s Emissions Reduction Fund methods could potentially be developed in conjunction with, and shared across jurisdictions, thereby advancing the development of robust, comparable and potentially fungible mitigation actions internationally;
- Australia could transfer to other nations its recognised expertise in design and implementation of carbon markets; national compliance schemes such as the Carbon Pricing Mechanism; experience in linking and in the development of a mature well-designed offset scheme;
- Australian business could cooperate with business and government in other jurisdictions to transfer its recognised expertise in data collection, monitoring, reporting and verification from Australia’s National Greenhouse and Energy Reporting System and the ERF; and
- Australia is located in the Asia-Pacific region, where there has been a recent proliferation of regional platforms to explore future carbon clubs, and where there is interest for Australia to engage.

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The Government should confirm the use, eligibility requirements and proportion of international units that may be used for compliance under the Safeguard Mechanism, to ensure the ongoing viability of, and demand for domestic offsets continues.

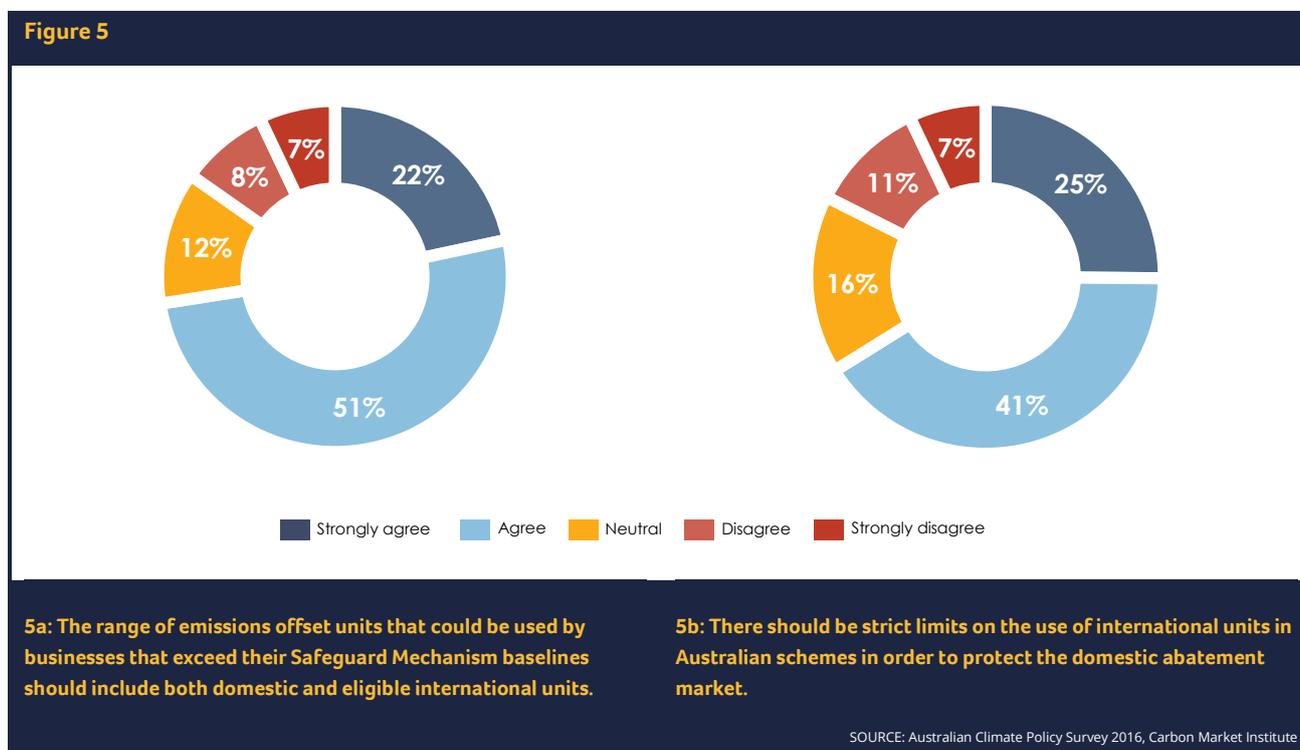
The nature of Australia’s emissions profile and its economic reliance on emissions-intensive industries, translates to some significant challenges when looking to achieve substantial emissions reductions. In achieving Australia’s emission reduction target, it will be important that entities covered by the Safeguard Mechanism have the flexibility to access low-cost, high quality abatement primarily from domestic supply, and secondarily from international sources (if they are available). This will become increasingly important as baselines under the Safeguard Mechanism become more stringent, which will raise the need for covered entities to reduce emissions cost-effectively to maintain international competitiveness.

In the post-2020 environment, there is likely to be a reduced supply of international units as countries soak up domestic credits to meet their own national commitments under the Paris Agreement. Understanding the allowable proportions of international and domestic abatement for companies to use against emissions liabilities is crucial for Australia, in order to calculate the scale of domestic abatement that will be needed to 2030.

It will be important to achieve the right balance of international abatement and domestic abatement for ensuring continuity of demand and protection of the domestic abatement sector, while ensuring abatement costs can be managed. The Government should determine how the balance of international and domestic units can be determined and what quantitative and qualitative restrictions are important for maintaining a domestic abatement industry and the international competitiveness of Australian business.



This process must incorporate consideration of the most appropriate international units; and eligibility requirements and their forward price curves - particularly in the post-2020 period (Figure 5, below). By making assumptions and mapping the forward price curves of selected international units together with the ACCU price, the Government would be more informed to then determine the range of the weighted average cost of compliance for covered entities, which would assist in identifying optimal unit balance.



Internationally sourced abatement should seek to meet the criteria and principles either defined at an international level or at a bilateral/regional/club level under either of these tracks. The Australian Government should continue to engage in international/bilateral/regional fora so that it can be part of the rule-making process. It is also important that Australian business has a ‘window’ into the dialogues about the mechanics of future global carbon markets, so that it is well positioned to benefit from these markets in the future.

Furthermore, when exploring the use of international abatement, several unit types should be considered to allow Australian business a choice of abatement options. Additionally, the Paris Agreement’s Article 6 frameworks that are currently under development (a mechanism for Sustainable Development and Mitigation Crediting (SDM), and a framework for Voluntary Cooperative Approaches) are expected to represent important sources of international units.

Providing clarity on the proportion of international units that will be allowed to supplement domestic abatement used to meet compliance will help to reduce the cost of compliance for both companies and governments to 2030. Reducing the costs of compliance may in turn, also enable the Government to raise the ambition of its emission reduction targets as Australia is expected to do under the Paris Agreement.

Moreover, as a transfer of emissions reduction units corresponds to a transfer of finance and investments, the use of international abatement has the potential of opening up new markets and new business lines for Australian businesses.

**10**

The Government should research and model the factors affecting availability, and future supply and demand for domestic and international units as new rules around international trade in carbon emerge and countries implement their commitments made under the Paris Agreement.

The Kyoto Protocol will draw to a close in 2020, and consequently the future of the underlying Clean Development Mechanism (CDM) and associated offset credits (CERs) remains unclear. Going forward, Australia will also increasingly compete with demand for international abatement from other countries to meet their NDCs, and commitments under the International Civil Aviation Organization's (ICAO) new Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

Taken together, the emergence of new sources of demand and declining supply (as countries ringfence their own domestic supply of credits to meet NDC obligations), will have strong bearing on the future price and availability of international units. The supply of units will be further impacted by the Chinese ETS – which is set to come online in late 2017 and cover approximately 5 billion tonnes of CO₂, doubling the size of the global carbon market. Once operating, the Chinese system will be the world's largest market. Considering all of the above there is no certainty that there will be an available supply of low cost international units available in the post 2020 period.

It is important that the future supply and demand of international units and the subsequent price impacts as the CDM transitions in the post-2020 period be modelled. This is an important consideration for ensuring the appropriate balance of international and domestic units for compliance under Australia's domestic emissions reduction policy. Factors that are likely to play a role in affecting future supply and demand of international units include:

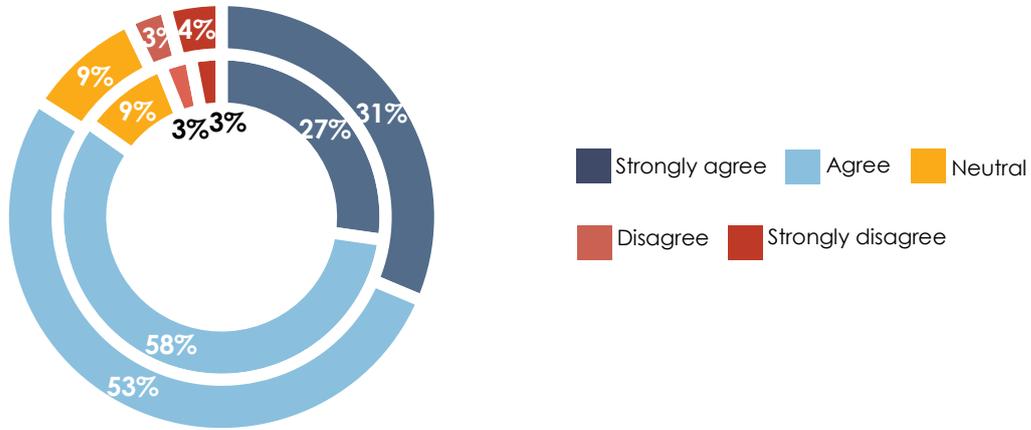
- **Scalability:** The system of transfers of international abatement must be sufficiently robust to support large scale mitigation investments in a wide range of jurisdictions. The 2 different market mechanisms under the Paris Agreement have great potential to involve all countries and to target whole sectors, rather than the project-by-project approach with the market-based mechanisms under the Kyoto Protocol. This can help governments meet the ultimate objective of the Paris Agreement.
- **Confidence:** The international system must promote confidence not only for the Parties involved and their constituents, but also for the international community. To deliver that confidence, jurisdictions must continue to develop the rules/governance structures for both tracks under Article 6.
- **Savings:** Analysis by the World Bank Group shows that current NDCs could be delivered at a potential 30% lower cost if there were full access to the international market through emissions transfers² – which in turn implies much greater ambition at the same cost. This is both significant in terms of money saved which enables governments to take on higher targets and conduct an overall greater emissions reduction.
- **Demand:** 90 governments state in their NDCs that access to carbon markets is essential. Demand is also expected to emerge from sectoral-based measures such as ICAO's CORSIA (described above).

Australian business places significant importance on the understanding of how international markets will play out post-2020, with 85% of safeguard-covered entities and 84% of total 2016 survey respondents wanting clarity on how Australia will engage in international markets through both import of international units and potential export of ACCUs into other jurisdictions.

² State & Trends of Carbon Pricing 2016 Report, World Bank Group



Figure 4: The national climate policy review should encompass issues related to international trade in carbon including: the use and eligibility of international units; the factors affecting future supply and demand for domestic and international units; the potential export of Australian Carbon Credit Units; and options to link carbon markets under the Paris Agreement. Inner series represents entities covered by the Safeguard Mechanism, outer series represents all respondents.



SOURCE: Australian Climate Policy Survey 2016, Carbon Market Institute



Unlocking Finance & Investment

11

The Government should commit a quantum of additional funding to the ERF that is required to ensure the continuity of the domestic carbon offset industry until the time it transitions to a market driven by demand under the Safeguard Mechanism.

The Government's purchasing of abatement through the ERF has played a valuable role in supporting continuity of demand for domestic abatement, in the transition from the Carbon Farming Initiative. The ERF has catalysed the development of a suite of emissions reduction projects and preserved the highly-developed expertise in the Australian offset market. Of the initial \$2.55 billion ERF, over \$2.2 billion has been contracted in the first five auctions. More than \$300 million remains in the Fund, with further auctions yet to be scheduled. With no further allocations of funding confirmed, there remains uncertainty over the future of role of government purchasing of domestic abatement under the ERF.

In addition, under the Safeguard Mechanism, there will need to be an ongoing, increasing, predictable supply of offsets that can be purchased by facilities emitting above their baseline. If, as expected, Safeguard Mechanism baselines tighten over time, there will be an increased requirement for a viable supply of domestic offsets. It is important to note that the supply of domestic abatement will directly impact the cost of compliance under the Safeguard Mechanism. If there is a shortage of domestic units, the cost for compliance will be higher than if there is adequate supply and a liquid secondary market. Therefore, ensuring the continued development of the domestic supply of carbon credits will be a critical factor in ensuring we meet the emissions reduction targets at lowest cost to the economy. 63% of CMI's 2017 Carbon Farming Industry survey agree with this sentiment, particularly that more public funding for the ERF is required until there is a private market demand for land sector abatement.

The Government should define the appropriate quantum of future funding allocations to be made to the ERF and, importantly, provide clarity on the timeframe for these allocations. This is especially important for investment certainty in domestic abatement projects and ensuring adequate future supply of ACCUs. If further ERF funding is not confirmed before remaining ERF funds are all contracted, then there will be a reduction in new project development activity and a higher likelihood that registered projects will not proceed to investment and implementation.

Under the assumption that demand for domestic units under the Safeguard Mechanism will increase in a post 2020 environment (enabling a transition to private sector funding of abatement), then ERF funds for government auctions will still be required for the years 2018 – 2020. Assuming also that the most recent (fifth) auction results are indicative of future auction volumes and funding allocations (11.25 million tonnes of contracted abatement was purchased at an average price of \$11.82 per tonne at a cost of \$133 million), the remainder of the ERF will not be sufficient to maintain abatement activity to 2020.

To ensure continuity until private sector demand can sustain market activity, the Government should allocate transitional funding of the ERF for the years 2018 – 2020. If we assume 2 auctions per year and approximately \$100 million per auction, that equates to \$200 million per year. This will mean \$600 million in new ERF funding allocations over three years.

The figure of \$200 million per year is the same figure announced by the former Environment Minister Greg Hunt when in August 2015 he stated that the Government had "allocated approximately \$200 million a year for the Emissions Reduction Fund or \$2.4 billion over the 12 years from 2018 to 2030."³

If the Safeguard Mechanism provides a strong demand for domestic offsets through baselines that were set to decline, then the funding stated by the former Environment Minister after 2020 would not be required. Demand needs to come from the Safeguard Mechanism and transfer the cost of purchasing abatement from the taxpayer to the private sector. The new funding would need to come from the consolidated budget and the allocations confirmed before all initial ERF funding has been contracted.

³ 7.30 Report <http://www.abc.net.au/7.30/content/2015/s4291521.htm>



12

The Government should work with project developers to develop flexible business models to better manage the aggregation of projects to encourage private sector finance and investment in large scale projects.

Many carbon farming projects are too small to attract large scale finance and investment, with new metrics for quantifying benefits and new models for aggregation needed. In addition, for small farm businesses, the effort required for a single method carbon farming activity is significant as a large percentage of project value is lost to overheads.

The Government could help to support the development of an efficient market interface to enable farmers to aggregate small-scale carbon farming activities to on sell – either directly or via a third party – to the offset market. Such an interface is likely to improve the efficiency in the reporting and administration of carbon farming projects. Such an interface could also support other environmental service markets, to realise the multiple environmental benefits of emissions reduction activities.



Recognising Co-Benefits & Creating Markets

13

The Government should develop new metrics to accurately quantify co-benefits of carbon farming projects under the ERF, aligning metrics with international standards and best practice.

Co-benefits are direct positive outcomes associated with carbon farming projects that are additional to the emissions avoided or carbon stored. They are the social, economic and environmental benefits that occur as a result of a project, but which have not been automatically priced into the value of that offset.

The current CFI legislation contains several provisions to ensure projects do not adversely impact on the environment or the associated communities. However, co-benefits are not explicitly defined in the legislation. The legislation does implicitly recognise the potential of co-benefits by encouraging participants to voluntarily include in the Register of Offsets Projects “particular information about the environmental benefits, or community benefits, of the project”.

There are a number of drivers that build the case for explicitly recognising co-benefits and developing new metrics to quantify and value them:

- The existence of effective and respected international standards and guidelines in the international market, providing a valuable platform for integrating co-benefits in the Australian domestic market;
- Significant potential for project developers, land owners and associated stakeholders to achieve multiple social and environmental outcomes;
- Potential for government to achieve multiple objectives such as carbon mitigation to meet their Paris Agreement targets; and
- An opportunity to engage with other industries and sectors in order to drive demand and investment in viable carbon farming projects.

Whilst co-benefits can be easily described, there is currently no market to determine the financial value of co-benefits from carbon abatement projects. Although abatement projects with certified co-benefits (for example Gold Standard projects) are able to command a premium price on the voluntary market, these currently represent a small portion of total demand. The key barrier is the lack of a framework for co-benefits valuation that is robust in scientific, regulatory and commercial terms. The Government should, therefore, explore and develop new metrics to more accurately quantify co-benefits of carbon farming projects under the ERF – such as biodiversity, water quality, conservation and other community benefits. Indeed, 86% of CMI’s 2017 Carbon Farming Industry Survey respondents agree or strongly agree there is a need for new metrics to be used and supported in the market.

Globally, there have been meaningful steps taken to develop robust metrics to value co-benefits. These metrics range from benefits linked to green job creation to improved health to improved crop yields and biodiversity. These co-benefits are highly valued in voluntary carbon markets and have allowed many international projects certified by Gold Standard, and other market participants, to fetch premium prices.

When developing a framework to quantify and value co-benefits in Australia, it is important not to ‘re-invent’ the wheel and to benefit from the lessons learned and best practice that has emerged in quantifying and valuing co-benefits in international markets.



14

The Federal and State Governments should work with the private sector to consider opportunities for public/private collaboration for innovation in environmental markets and the valuing of co-benefits.

Whilst co-benefits can be easily described, there is currently no market to determine the financial value of co-benefits from carbon abatement projects. Although abatement projects with certified co-benefits (for example Gold Standard) are able to command a premium price on the voluntary market, these currently represent a small portion of total demand. A key barrier is the lack of quantification frameworks for co-benefits valuation that is robust in scientific, regulatory and commercial terms.

In addition it is important financial organisations understand the investment opportunity in environmental markets. The financial sector requires new products and instruments that align financial metrics with environmental outcomes, leading financial benefits for land valuations and risk assessments of agricultural enterprises. Public/private collaboration can support the innovative development of environmental markets to ensure robust and accessible models to value co-benefits. Doing so would help to create additional income streams for carbon farming activities and incentivising greater participation among farmers and landholders, enhancing the resilience of the sector as a whole.



Building Capacity & Communicating Benefits

15

The Government should invest in targeted ERF outreach and capacity building in remote rural communities, in addition to safeguard covered entities to build greater understanding of the benefits of participating in carbon farming.

According to 86% of CMI's 2017 Carbon Farming Industry Survey respondents, carbon farming has the potential to substantially increase the number of direct and indirect jobs in rural and regional Australia, generating new revenue and fostering more diversified employment and skills in the process. To fully realise these opportunities, Government can help to invest in expanded and targeted funding for supply-side capacity building to ensure that rural and regional communities are informed, engaged and understand the opportunities presented by carbon farming; demand side organisations should be similarly prepared.

Building supply-side capacity to participate in ERF projects among the agricultural sector, financial services, Indigenous and regional communities is critical for the growth of the industry. It is important that there is better communication around the opportunities for ERF project activity, building greater trust and alignment with traditional agricultural industries and indigenous communities. In the case of land sector abatement, this is key for ensuring that farmers understand how carbon farming projects deliver positive environmental outcomes, and can bring productivity benefits for agricultural production. Similarly on the demand side, it is also important that ERF outreach supports safeguard covered entities that under increasing emissions liabilities (under declining safeguard baselines), will need to understand the future supply of credits and how they can connect with sources of supply in the secondary market as it evolves.

Capacity building initiatives should aim to ensuring that carbon project developers, carbon service providers, agricultural industry groups, NRM bodies and safeguard covered entities have clear and aligned messaging around the benefits of carbon farming. They should deliver effective messages on factors affecting emissions in farming systems; greenhouse gas management; opportunities for storing carbon; and the opportunities associated with participating and investing in carbon farming activities.

Capacity building and outreach could be in the form of technical workshops, professionally delivered training, mentoring programs and/or coordinated opportunities for information sharing to promote and increase knowledge and understanding around carbon farming. These initiatives should seek to deliver the appropriate technical understanding and skill level for local communities to realise the full benefits presented by new opportunities on the land; enable those in regional areas to take on board this information and disseminate to others in the field; and provide an understanding of the pathway for safeguard-covered entities to access lowest-cost domestic abatement.

The Government should also prioritise investment in research, tools and technology that reduce project complexities, thereby making ERF project implementation and investment (and the trading of credits in a secondary market) more accessible.

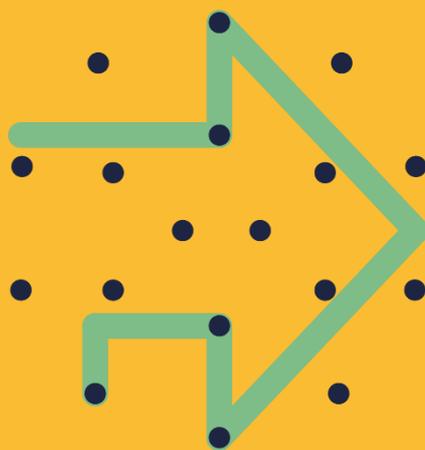


16

The Government should provide more clarity around the rights of eligible interest holders in the development and registration of ERF and carbon farming projects.

The consent of eligible interest holders is a precondition to the declaration of an eligible carbon farming project and requires consent using a specific EIHC Form. This includes consent from Native Title Holders who have a determination relating to a project area or registered title holders over land included in the project area. However, the complexities of land tenures across Australian States and different carbon farming project types makes it challenging for a one-size-fits all approach to garnering eligible interest holder consent.

The result, is negative implications and complexity regarding Native Title Holder rights, because native title holders often share land with other interest holders. The Government should continue to work in a collaborative way with industry, land councils, Native Title representative bodies and State Governments to develop detailed industry best-practice guidance around the rights of eligible interest holders, and provide sufficient clarity to support and enhance Native Title Rights with respect to carbon farming activities.



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About the Carbon Market Institute

The Carbon Market Institute is at the centre of climate change policy and business in Australia. Independent and non-partisan, we bring business, policy makers and thought leaders together to drive the evolution of carbon markets towards a significant and positive impact on climate change.

Engaging leaders, shaping policy and driving action, we're helping business to seize opportunities in the transition to a low carbon economy.



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