



Real action on climate change

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Dear Sir or Madam

RE: NATIONAL CARBON OFFSET STANDARD DISCUSSION PAPER

We welcome the opportunity to comment on the recently released National Carbon Offset Standard Discussion Paper.

The Sandbag Climate Campaign is a London based Non-Governmental Organisation established to improve the way in which emissions trading is working, and to enable civil society the opportunity to engage in the debate around emissions trading and its actual operation. Since our establishment in September 2008 Sandbag has recruited a sizeable number of supporters from across the world, including numerous interested parties in Australia.

In preparing this submission we have consulted with a number of parties in Australia, the European Union and the United States of America. As damaging emissions know no boundaries we too believe that the establishment of meaningful emissions trading schemes, and the subsequent monitoring and debate on these schemes, should be a collective effort from concerned members of the public across the world. Sandbag seeks to provide a platform for local, regional, national and international debate.

Sandbag was set up to improve the way in which emissions trading is working, helping to reduce the threat of climate change. We do this in different ways:

- By lobbying to make sure the rules that dictate future levels of pollution are in line with what the science of climate change tells us;
- By campaigning to reduce current pollution levels, including seeking to cancel the legal permits currently in circulation;
- By increasing public awareness of the scheme, scrutinising how it is operating and making information more easily accessible.

Currently Sandbag is concentrating on the following specific issues:

- Campaigning for a rapid decarbonisation of the global power sector in order that global emissions peak and decline well within a decade;
- Seeking the voluntary retirement of excess permits that were distributed for free within the EU ETS

- including tax incentives for entities that do so;
- Developing policy around the interaction of voluntary abatement measures and emissions trading schemes, to ensure civil society is informed and engaged in the utilisation of emissions trading schemes to transition to a low carbon economy.

In the near term, on behalf of our members and civil society in general, we will be seeking to engage with both the United Kingdom and European Union Governments on various issues related to EU Emissions Trading and the post-Kyoto Framework.

We would likewise welcome the opportunity to work with the Australian Government on policy development, with the common view that meaningful emissions reduction is not only desirable, but essential.

In conjunction with our lobbying and policy related activities we will continue to seek meaningful dialogue with concerned organisations, community groups and individuals around the globe.

If you have any queries in regarding this submission, or would like further information on the content of our submission, please contact Jeremy Burke at Jeremy@sandbag.org.uk

Kind regards

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MANAGING DIRECTOR

SANDBAG CLIMATE CAMPAIGN



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SUBMISSION TO THE DEPARTMENT OF CLIMATE CHANGE
IN RESPONSE TO THE NATIONAL CARBON OFFSET STANDARD (December 2008)

1. Basis of Submission

While we acknowledge that the National Carbon Offset Standard ('Standard') Discussion Paper seeks comment in respect of the specific design of the Standard in the context of the proposed Carbon Pollution Reduction Scheme ('CPRS' or 'Scheme') we believe that any Offset Standard needs to be viewed in the context of Voluntary Abatement as a whole.

In our submission we present an initial discussion on identified issues relating to Scheme design and then propose a collection of measures that we recommend be implemented to adequately and transparently alleviate the undesirable elements of the currently proposed Scheme.

2. Scheme Design Issues

1. Fallacy of Composition

The Discussion Paper correctly notes that the Scheme, as currently proposed, suffers from the Fallacy of Composition, in that what is true for the individual is not true for the group. However, we believe that this should be regarded as an (unintended) consequence of the Scheme construction, not as a desirable or acceptable outcome.

In fact, given the ability for the Fallacy of Composition to decrease community level abatement, we believe that policy and Scheme design should deliberately and specifically seek to minimise the negative and destructive outcome that the Fallacy describes. What is needed is an open discussion resulting in transparent policy on this issue.

Our submission seeks to outline potential policy that can achieve a reduction in this regard. While by no means definitive or exhaustive in nature our suggestions are solely to raise the issues in the Scheme (as proposed) and we welcome and encourage further debate on how best to design and implement appropriate policy on this matter.

2. Breadth of Scheme coverage versus Depth of Scheme coverage

The current Scheme proposal is designed to have broad sectoral coverage, with an estimated 75% of Australian emissions being covered. This coverage should lead to emissions targets being met at a lower cost, but not least cost due to the limited depth of the Scheme coverage. By limiting the depth of scheme participants to upstream installations the cost reduction ability of the scheme is severely limited.

The challenge therefore is how to achieve downstream emission abatement when the scheme only applies to



upstream installations. Essentially the issue stems from trying to limit demand for emissions, but only including supply side market participants in the chosen reduction mechanism.

By limiting the number of CPRS participants (to around 1,000) the Scheme is undeniably easier to administer and regulate however it is potentially limited in its capacity to achieve least cost abatement. Therefore, any Voluntary or Offset Standard should be appropriately framed to ensure that these opportunities are not squandered but instead are encouraged.

As with the Fallacy of Composition this essentially mechanical failing can be alleviated through appropriate policy responses.

It is only through a combination of policy mechanisms will the lowest cost abatement measures be obtained in a rapid fashion. Policy needs to specifically:

- Recognise the voluntary actions being deliberately taken by individuals and companies not covered by the Scheme
- Provide a structure to encourage further voluntary actions

The policy needs to reflect community support for a transition to a low carbon economy, rather than focus on mitigating the financial impact of a carbon price (via the currently proposed tax cuts flagged in the White Paper).

We see appropriate recognition of voluntary abatement and the introduction of Emissions Reduction Credits as two mechanisms that can easily greatly assist in ensuring downstream participants (specifically civil society and non-covered businesses) are engaged and rewarded in their abatement activities.

3. Mandatory versus Voluntary Action

The Discussion Paper refers to ‘voluntary action that occurs beyond that imposed by the mandatory or compliance market’ [p2]. However, with the currently proposed CPRS the only mandatory action required will on the part of covered installations to ensure they surrender a number of permits equal to their annual emissions under the Scheme. As non-covered parties have no direct obligation to respond to the CPRS any other action, either in response to the CPRS pricing of carbon or a desire to contribute to our collective abatement (the greater good) is by definition voluntary.

Of course action in response to a carbon price is what drives abatement, thus the distinction between action taken for economic reasons in response to the current (or expected future) carbon price needs to be separated from action that is not an ‘economically rational’ response to carbon pricing. It is these voluntary actions that will achieve rapid lower cost abatement.

As we will discuss in further detail only 2 of 17 negative cost abatement opportunities identified by McKinsey & Company in their Version 2 of the Global Greenhouse Gas Abatement Cost Curve appear to relate to covered installations. So given that 15 of 17 opportunities are (a) not already being implemented and (b) not directly covered by the CPRS, it is hard to see how an indirect emissions cost will be adequate to initiation action (particularly in the early days if targets are unambitious resulting in low prices - as has been illustrated in the EU ETS). This is particularly the case when one considers other cost components that impact goods and services pricing to a greater degree than a carbon price would, e.g. foreign exchange rates and oil price on petrol costs.

By recognising both the opportunities available from cheap and negative cost abatement and the limitation of



the proposed CPRS it is possible to move beyond simply relying on a market based solution (that resigns non-covered sectors to passive price respondents) and frame meaningful, easily implementable policies.

4. The Voluntary Abatement Opportunity

The opportunity for individuals and non-covered businesses to reduce emissions in a manner greater than that which is economically rational under a CPRS price signal is significant. Rather than concentrate on the numerous opportunities we focus specifically on the rationale for devising positive policy to unlock these opportunities. We also consider the opportunities available from Negative cost abatement, which would be economically rational regardless of any carbon pricing mechanism.

In terms of community desire for voluntary measures we note that the Discussion Paper indicates that voluntary offsets in 2007 were around 0.5 per cent of Australia's emissions. Given this is 10% of Australia's unconditional reduction below 2000 levels by 2020 it is hardly small, nor inconsequential.

1. Negative cost abatement opportunities

As previously noted of the 17 identified negative cost abatement opportunities in the McKinsey & Company Version 2 of the Global GHG Abatement Cost curves only two (Small Hydro and Electricity from landfill gas) appear to be available directly by covered sectors. These are also relatively small from a tCo2e perspective and the level of negative cost (i.e. they are closer to zero cost than significantly negative).

The greatest identified opportunities fall overwhelmingly to uncovered sectors. The fact that these are not currently being pursued indicates a low likelihood of implementation even with a carbon pricing mechanism. For example, switching lighting from incandescent to LED in a residential setting has a negative abatement cost of circa €90 per tCO2e. Government intervention to obtain these valuable emission abatement opportunities appears warranted.

Other examples of negative or low cost abatement (under A\$25) identified by McKinsey and Company include:

- Residential electronics
- Insulation retrofit (commercial and residential)
- Residential appliances
- Cars full hybrid
- Building efficiency new build
- Cars plug-in hybrid
- Solar PV

Without 'picking winners' from a technology perspective the opportunity exists for the Australian Government to specifically target and support the uptake of solutions that have low or negative costs. This is even more so when it is apparent that consumers (for a variety of reasons including split-incentives and inadequate information) are not implementing or likely to implement these measures.



2. Behavioural Change

Included within the updated McKinsey cost curve is an estimate of abatement available, on a global basis, from behavioural change. While achieving abatement from behavioural change is inherently difficult McKinsey specifically note that it ‘would depend heavily on whether, and to what extent, policy makers establish effective incentives’. Despite the difficulties the rewards are extensive. McKinsey estimate that behavioural change could provide abatement equal to nearly $\frac{1}{3}$ that of Energy Efficiency and $\frac{1}{3}$ that of Low carbon energy supply¹. This is too great an opportunity to not focus on in a targeted and meaningful manner.

3. The case for Government action

We, and numerous others, have identified specific low or negative abatement cost opportunities that should be pursued in a rapid manner, with appropriate government support.

A further disincentive to change, particularly at the household level, may be the significant up-front capital costs that a number of opportunities have (e.g. switching to a more fuel efficient car). McKinsey note that opportunities with the lowest capital intensity may be favoured over ones with the lowest cost per emission reduction over time.

Government support, through either up-front rebates or on-going subsidies, can play a meaningful role in enabling the implementation of these opportunities. A good example is that of Solar PV for which meaningful well structured policies (that do not cannibalise appropriate renewable energy targets) can both promote the purchase and ongoing utilisation of solar power to contribute to Australia’s emission reduction.

4. Voluntary Action Standard

We would like to see developed, either as part of the Offset Standard or separately, an appropriate standard on Voluntary Action, which links to the CPRS. This would be a key part of the CPRS and would explicitly include appropriate mechanisms to recognise and reward voluntary action to reduce emissions.

The crucial element to ensuring voluntary action is recognised in the context of the CPRS is a mechanism whereby voluntary abatement (over and above that reasonably assumed to result from the carbon price signal) interacts with the CPRS. In this regard we support the work being completed by the Voluntary Carbon Markets Association (‘VCMA’) and their Voluntary Domestic Abatement Scheme model. Specifically we support the cancellation of AAUs and AEU’s for covered sector voluntary abatement.

Rather than adjusting caps five years in advance we would propose a more dynamic mechanism that appropriately recognises the desire for immediate abatement from the voluntary action undertaken.

Assuming, and we think it is reasonable to do so, that an appropriate mechanism can be easily devised we would see the need for three complementary policy initiatives to support voluntary action (refer Figure 1):

1. Specific voluntary actions that are easily measurable in terms of emissions abatement lead to a reduction in available CPRS permits. The best example (and most widely recognised in the current debate) is Greenpower, where the ability to measure the level of uptake and reduced emissions would be simple. Under this scenario suppliers of Greenpower would estimate the projected voluntary demand for the forthcoming period. These MWhs would be converted to avoided tCO₂e and a

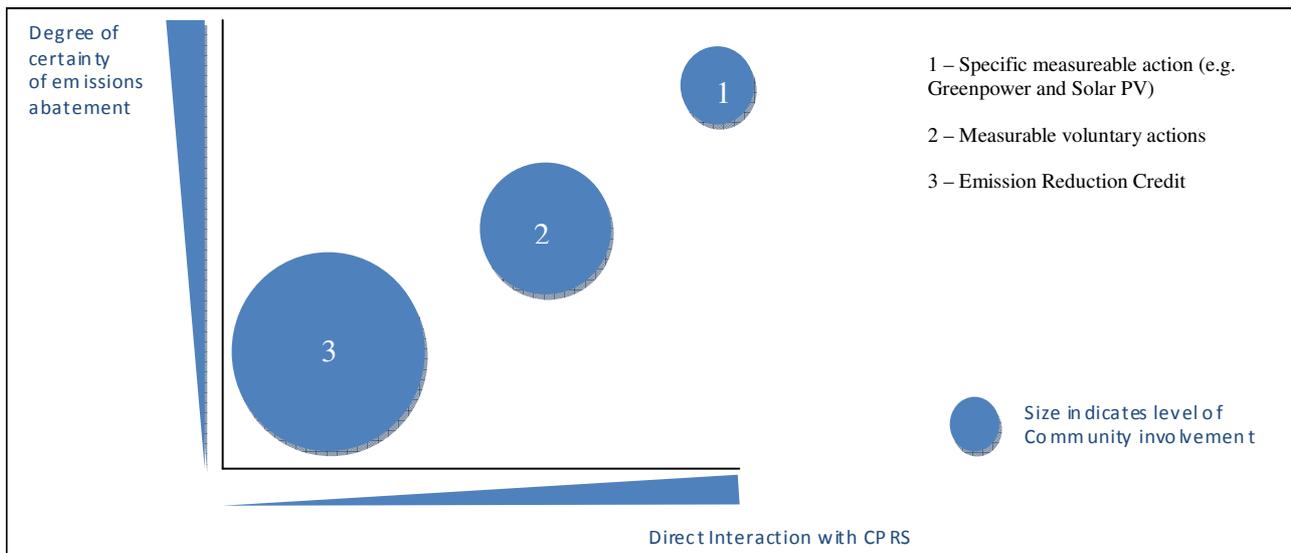
¹ McKinsey specifically calculate the impact of behavioural change after implementation of all technical levers.

commensurate number of permits removed from the quantity available for trade.

Once actual demand is determined an appropriate true up can occur, with the balance either auctioned in the next period or greater permits taken from the quantity available for trade.

This mechanism could likewise be utilised with respect of reduced power demand resulting from Solar PV being installed by individuals and businesses.

2. Voluntary actions that can be measured with a degree of accuracy are eligible for tradeable permits (in line with the VCMA model) or reduce permits from the next auction. Appropriate factors of emissions reduction could be applied depending on the level of certainty associated with achieving the desired abatement. The 'Expert Panel' proposed by the VCMA appears to be an appropriate body to determine these factors.
3. A deliberate engagement mechanism at the community level. We have termed this an 'Emission Reduction Credit', and provide further details below. In essence this will recognise immeasurable actions that contribute to emissions abatement (e.g. behavioural change) that can not be simply due to carbon pricing but must be due to a tangible desire to contribute to the greater good. If structured as we propose this would also promote further emission abatement at the community level. The cost associated with this policy would be funded via auction revenues and a reduction in the level tax cuts proposed in the White Paper².



² We note that the tax cuts as proposed do not link in any manner to emissions abatement or the costs of household mitigation or transition to a carbon constrained economy. If these assistance measures are to remain we would prefer to see them paid quarterly and specifically linked to a stated desire to reduce Australia's emissions.

All of the above initiatives would lead to a reduction in the available CPRS credits being auctioned, either in advance based on ex-ante estimates (and trued up) or ex-post based on actuals. This proposal is known in the United States (and as we understand it is active within the majority of states in the RGGI cap-and-trade scheme) as ‘off-the-top’ or ‘top-slicing’. If constructed appropriately it will be a fair and transparent solution to reward action that is not mandatory (and in many instances economically irrational) under the CPRS.

One rebuttal to our suggested policy framework mix is that allowing voluntary abatement to reduce the cap will result in increased pricing in the market. We agree that this will be the likely outcome; however any price impact is likely to enable the market to better reflect the price that would have occurred if the Voluntary Abatement action had not been taken. This therefore adheres to the polluter pays principle and allows the market to provide appropriate price discovery which would be otherwise distorted.

As an aside we note comments by Minister Wong on the 7.30 report in which she indicated cap levels could be adjusted to recognise voluntary action. We await further information in respect of this, but strongly reject the Discussion Paper comment that ‘Scheme caps will not be adjusted once announced’. Either annual Scheme caps will become more flexible (downwards only) to reflect Minister Wong’s comments or the adjustment would be 5 years hence. The latter being clearly inadequate.

5. Emission Reduction Credit

As previously outlined there are obstacles that need to be overcome to enable low cost and negative cost abatement opportunities to be realised. We also see a need to engage with community level voluntary abatement activities. As the cost of interacting with the CPRS under any Voluntary Domestic Abatement Scheme will be prohibitive to many individual household actions it is essential that a mechanism be devised that acknowledges and rewards action taken by individuals.

In this regard we have devised what we believe is an easily implementable solution to bridging the gap between the CPRS and individuals. Our proposal is by no means fully developed, is indicative in nature only and has been devised to promote discussion on how to link individual emissions abatement to a CPRS and to encourage community level engagement. We welcome further discussion and ideas on this issue.

Our proposal involves the establishment of an Emission Reduction Credit (‘ERC’s’). These Credits would be distributed to individuals within the community with the intent of providing direct incentives to households to lead emissions abatement, while simultaneously acknowledging and rewarding efforts already undertaken. They would not be CPRS permits, but instead a discount voucher to be redeemed against activities that contribute to the collective reduction of Australia’s emissions.

Funding of the ERC’s redemption would be from CPRS auction revenues, a reduction in assistance to high polluters and/or a reduction in assistance via tax cuts.

The essential elements would be:

- allocated directly to an individual (based on Medicare registration) above a pre-determined age (perhaps 16);
- redeemable against various household or community level abatement opportunities (either via Point of Sale reduction or online/paper redemption);
- non tradeable and no monetary value (other than through redemption);



- appropriate multipliers applied depending on the chosen abatement opportunity;
- able to be pooled by community groups to increase abatement efforts and community involvement in emission abatement (e.g. local sporting groups, community or faith based groups);
- able to be targeted regionally to recognise distinct abatement advantages (e.g. increasing solar hot water in northern Australia and insulation in more southern parts).

By way of example individuals could decrease the cost of purchasing efficient light bulbs, installing insulation and/or solar heating, purchasing a bike or catching public transport.

The ERC's would be created with an appropriate multiplier that determines their redemption value based on the chosen abatement opportunity. The multiplier would be based on the level of expected benefit to the community in terms of emissions abatement (the greater the benefit the greater the multiplier) and the level of extra contribution an individual would need to make to redeem the ERC (assisting to reduce high upfront capital costs).

For example installing insulation may be valued at a \$500 redemption value, public transport fares at \$200 and efficient light bulbs at \$50. Of course care would need to be taken to ensure that perverse outcomes do not take place (e.g. Incentives for more efficient refrigerators leading to overall increased energy consumption as consumers increase the size of their appliance).

ERC's could also bridge the incentive gap between tenants and landlords by enabling both parties to pool their credits and invest in abatement opportunities in the rented premises (e.g. Solar PV and insulation). This would prevent direct Government intervention being required to solve the current split incentives problem.

ERC's are designed to be simple and easily understood by civil society. In conjunction with an appropriate public education campaign we would foresee their mass distribution as a way of clearly signalling that a collective effort is required, and that the Government will support this effort.

Beneficially they will enable individuals to indicate how they want to respond to climate change. No more focus groups or market research, individual ERC redemption would speak for itself. Using this wealth of information the Government could better direct further resources to areas where the lowest abatement cost opportunities are being neglected. For example if regions where solar hot water would be successful in reducing emissions the Government could target this through regional multiplier differences or complementary policy.

Australians will engage in discussing how to respond to climate change, rather than being concerned about inaction. Households, sporting groups, community organisations and workplaces will be abuzz with discussions on abatement opportunities that will kick start the transition to a low-carbon economy. No more negativity about what to do or guilt at a collective lack of action. The community will be incentivised and empowered to respond and engage at all levels.

We would also recommend that ERC's be created in a manner such that if they are not redeemed, by deliberate individual election, the next period CPRS cap be reduced by an appropriate amount (say 0.5 tCO₂e per ERC). This would enable members of the community who wish to see an explicit reduction in Australia's emissions able to elect for this to occur. Those which are not redeemed or requested to be cancelled could either be rolled into the next period's ERC Fund, auctioned and the proceeds used for further community level education/action or the next period CPRS cap reduced.



While we see a strong case for the establishment of ERC's, this is simply one proposed mechanism - there will no doubt be others and we welcome discussion on this.

Sandbag would be interested in working with the Government to develop measures that promote community level abatement, particularly if coupled with a greater community understanding of the CPRS and lowering Australia's emissions.

5. Specific Discussion Paper Responses

If all an entity's emissions were covered by the Scheme, would it be sufficient for the entity to participate in the Scheme to be considered carbon neutral? [p9]

While the definition of Carbon Neutral is open to various comprehension and abuse issues we reject the notion that simply complying with a legislative requirement constitutes being Carbon Neutral in any manner. Instead we see an opportunity to focus on individual, company or product level emission demand, whereby voluntary activities that 'offset' this demand could enable the claim of Carbon Neutral to be accurate. These activities would need to explicitly reduce Australia's overall emissions, utilising the Voluntary Domestic Abatement Scheme as proposed.

Should domestic offsets from uncovered sources contribute to Australia's Kyoto obligations or should an Assigned Amount Unit be cancelled to provide additionality beyond the Kyoto obligations? [p24]

If the AAU generated from an offset in an uncapped sector is used against a tonne of pollution in the capped sector then clearly it is non additional in respects of Kyoto. If however the AAU is purchased as a voluntary offset and cancelled to offset an uncapped activity then it is additional. i.e. if for example aviation were to be outside the legal cap and an individual buys an Australian AAU from either the regulated market or the voluntary uncapped market, and cancels it then it is helping Australia meet it's Kyoto target. We think tax incentives should be introduced to incentive this kind of offsetting behaviour.

Offsets from uncovered sources should result in the cancellation of equivalent Assigned Amount Units. Likewise under the proposed Voluntary Domestic Abatement Scheme AAUs, as well as CPRS permits, should be cancelled in a timely manner post calculation.

Should the national carbon offset standard be voluntary or mandatory in nature? [p27]

If any Government accreditation or Branding of offset abatement is provided then the National Carbon Offset Standard should be mandatory.

Likewise voluntary action under a Voluntary Domestic Abatement Scheme should be subject to mandatory guidelines, which may be comparable to those included in the National Carbon Offset Standard.