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ERF Rort Risk

Submission for the Review of the Carbon Credits (Carbon Farming Initiative—Facilities) Methodology Determination 2015

The Statement of Activity Intent and the essential equipment adjustment of the ERF Facilities Method are essential for ensuring the integrity of the ERF. Removing or weakening either risks rewarding emissions reductions that would have happened anyway or extending the life of old coal power stations and ultimately increasing emissions.

Submission

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Summary

The Australia Institute is pleased to have the opportunity to respond to the Review of the Carbon Credits (Carbon Farming Initiative—Facilities) Methodology Determination 2015.

Australia's emissions are continuing to increase despite our commitment to significantly reduce emissions under the Paris Agreement. The Climate Solutions Fund, formally the Emissions Reduction Fund (the ERF) is the central pillar of the Australian Government's climate policy and the only component designed to directly reduce emissions.

This review was allegedly prompted by a request from the then Environment Minister following lobbying from the owner of the Vales Point coal power station with the purpose of finding "ways coal fired Power stations can earn credits under the method."

The credibility of the ERF rests on the integrity of the abatement activities is supports.

The *Statement of Activity Intent* and the *essential equipment adjustment* requirements under the facilities method are essential to safeguarding the Integrity Standards of the ERF. However, the Emissions Reduction Assurance Committee's (ERAC) Consultation Paper discusses removing or weakening both of these standards.

The *Statement of Activity Intent* includes penalties for false and misleading information under the Criminal Code. If this is removed, it removes the main deterrent for unscrupulous participants to rort the scheme by claiming projects are additional when this is seriously in question.

Without this deterrent, and the *essential equipment* adjustment, there is a serious risk that large amounts of taxpayers' money intended for reducing emissions will be given to the owners of coal power stations for upgrades and repairs that would have occurred anyway if the owner was committed to extending the unit's operating life.

The principles underpinning the Government's direct action policy is to purchase abatement through the ERF while ensuring there is a national net benefit by capping emissions of facilities through the complementary Safeguards Mechanism. By the same principle, amending the facilities method could contribute to extending the lifetimes of coal fired power stations.

Increasing the proportion of time these power stations are operating throughout the year and extending their life could result in large increases in emissions that could dwarf any emissions savings that result from marginal improvements to the emissions intensity of these power stations.

If there is a genuine policy concern to reduce emissions from coal power stations without extending their life, there are far better ways to achieve this than weakening these essential safeguards. Coal power stations could be required to make upgrades to improve their efficiency and reduce emissions though more rigorous emissions standards. This would be simpler, have virtually no cost to Australian taxpayers, and carry no risk of increasing emissions by extending the operating life of power stations. It would also free up more ERF funding for projects in other sectors with a clear and genuine additionality.

The Australia Institute strongly recommends that the *Statement of Activity Intent* and the *essential equipment adjustment* remain and are not weakened in any way.

This includes that that signatories to the Statement of Activity Intent remain subject to the penalties under the Corporations Act 2001 and the Criminal Code for false or misleading information or omitting any material fact or information.

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Introduction

There is a serious risk that projects proposed by large emitting facilities to participate in the Emissions Reduction Fund will contribute to increasing rather than reducing emissions. This is particularly the case where the project involves repairing or upgrading coal or gas power stations.

The Facilities Method is part of the Climate Solutions Fund, formerly the Emissions Reduction Fund. For the sake of consistency with the Consultation Paper, we will refer to the fund by its former name, the Emissions Reduction Fund (ERF).

The ERF is the central climate change policy of the Australian Government and its sole mechanism for directly reducing emissions. The ERF is a scheme that allows organisations and individuals to earn Australian Carbon Credit Units (ACCUs) for activities that reduce emissions or sequester carbon. The scheme allows a broad range of activities across many sectors of the economy including agriculture, energy and energy efficiency, waste and industry. The Government purchases these ACCU's from participants through a reverse auction. The ACCU's can also be retained or sold on the open market.

The ERF Facilities Method was created in 2015 and updated (varied) in March 2016. This method is specifically for large emitting facilities including industrial facilities and power stations. Projects that register must be at a facility that reports under the National Greenhouse and Energy Reporting scheme. Eligible projects can receive Australian Carbon Credit Units for emissions reduction for a 7-year period.

Earlier this year, in response to lobbying from Delta Energy, the owner of Vales Point coal power station, the then Environment Minister reportedly asked the body responsible for ensuring the integrity of activities under the scheme, the Emissions Reduction Assurance Committee (ERAC) to Review the Facilities Method, with the aim looking for "ways coal-fired power stations can earn credits" through the ERF.[1]

Upgrading coal or gas power stations can, in some cases marginally improves the amount of emissions per unit of production (known as the *emissions intensity*). However, these same measures can also allow plants to operate for a greater proportion of time over a given year and/or extend their operating life. Even a small increase in the amount of time a coal power

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[1] Stephanie Marsh (2019) *Coal-fired power station lobbied Environment Minister for help, FOI documents reveal*, https://www.abc.net.au/news/2019-04-02/coal-fired-power-station-lobbied-environment-minister-foi-reveal/10960544

plant operates annually, or any extension of its operating life can lead to a large increase in emissions, potentially dwarfing any saving resulting from the reduced emissions intensity.

The key safeguards against this are the *offsets integrity standards* overseen by the Emissions Reduction Assurance Committee (the Committee), a statutory committee established under the *Carbon Credits (Carbon Farming Initiative) Act 2011* (the Act), and any changes to the method must comply with these standards.

This submission focuses on suggestions in the Consultation Paper to discard or change two of the most important requirements of the method for safeguarding the integrity standards. These measures are the Statement of Activity Intent as outlined S.3.2.1 of the Consultation paper, and the essential equipment adjustment discussed in S.3.2.3. We believe these requirements in particularly crucial to maintaining the Integrity Standards of the Facilities Method of the ERF.

Context of the review

It is important to understand why this review is taking place. The review is squarely aimed at finding ways for coal power stations to access funding under the ERF.

The Review was initiated by the then Environment Minister Melissa Price in response to lobbying by the owners Vales Point coal power station (Sunset International, trading as Delta Electricity) following the rejection of their attempt to receive government funding for an upgrade of their power station through the ERF.

Documents released under Freedom of Information legislation show that the Minister requested a review be undertaken by ERAC "to cover the ways coal fired Power stations can earn credits under the method and seek advice on any changes that could be made to the method to improve its clarity and intent."[2]

The Review Consultation Paper largely reflects the concerns raised by Delta Electricity with the Department of Environment and Energy, proposing changes to the rules contained in the Carbon Credits (Carbon Farming Initiative – Facilities and Minor Corrections) Methodology Determination Variation 2016, which we will refer to as the "Facilities Method."

The review includes discussion of potential changes to the specific rules in the Facilities Method that were a barrier to Delta Electricity gaining approval for their proposal for ERF funding for the upgrade of the Vales Point Power Station.

Delta Electricity registered a project to replace some turbine blades at the Vales Point Power Station under the Facilities Method of the Emissions Reduction Fund in August 2018 with the intention of gaining ACCU's on the basis that the replacement of the blades was an energy efficiency measure which would also reduce carbon emissions.

However, the Clean Energy Regulator (CER) which is the authority that administers the ERF rejected Delta's application to participate in scheme on the basis that the blade replacement was replacing "essential equipment" under the Facilities Method and as such cannot generate ACCUs unless the facility generates electricity at below the grid average emissions intensity of the National Electricity Market (NEM) of 0.82 tonnes CO_2 per MWh. As Vales Point power plant is an old and relatively emissions intensive power station (0.85 tonnes CO_2 per MWh), and the blade replacement would only increase its efficiency by around 1.1%, this would leave the plant above the average emissions intensity of the grid. The definition of "essential equipment" is that "*the generating unit would not physically be*

[2] FOI 190104 - Final Document Pack - 120319 – Redacted, Document 41, https://www.scribd.com/document/404009420/FOI-190104-Final-Document-Pack-120319-Redacted

able to generate electricity without it', and coal turbines indisputably require turbine blades to operate.

Despite relentless lobbying by Delta Electricity of the CER directly and the Department of Environment and Energy (to complain about the decision), the CER held firm on its decision.

The Minister, in response to the lobbying, then sought advice on her powers to influence to this decision and was advised that she could not overrule the CER. She was also advised that she could not change the method if the ERAC advised that that it was inconsistent with the offsets integrity standards under the CFI Act.[3]

Unable to change the CER decision, the Minister ordered the Review in order to find "ways coal-fired power stations can earn credits under the method and seek advice on any changes that could be made to the method to improve its clarity and intent".[4]

The Consultation Paper reflects the purpose of the review to enable coal power stations access credits under the ERF by examining ways to remove barriers.

In particular, firstly, it seeks to remove or water down the Statement of Activity Intent (see section 3.2.1 of the Consultation Paper) which requires company officers to sign a declaration, subject to penalties under the Criminal Code, that the emissions reduction will be additional.

Secondly, Section 3.3.2 asks:

> Whether the impact of replacing essential equipment at electricity generators that may extend their operating life is sufficiently and appropriately addressed in the Facilities Method.

This is the very issue that prevented Vales Point Power Station gaining approval from the CER to access the scheme.

[3] FOI 190104 - Final Document Pack - 120319 – Redacted. FOI 190104 Document 7A, Document 36 https://www.scribd.com/document/404009420/FOI-190104-Final-Document-Pack-120319-Redacted

[4] FOI 190104 - Final Document Pack - 120319 – Redacted, Document 41, Email from John Short to Ministers office, December 8, 2018 4.44 pm https://www.scribd.com/document/404009420/FOI-190104-Final-Document-Pack-120319-Redacted

Statement of Activity Intent

3.2.1 Statement of activity intent

The Committee welcomes views on:

Whether the requirement for a statement of activity intent is appropriate and sufficient to ensure that a proposed project is additional; whether there are other measures that could be used to supplement or replace this statement; and whether there are other changes to refine the scope of the method to improve its usability: [Consultation Paper P.7]

As mentioned above, under the Act, ERF methods must comply with a set of offset integrity standards. The purpose of the Integrity Standards of the ERF is to ensure that the abatement is “genuine and additional.”

The Integrity Standards of the Scheme are contained in S.133 of the Act. S.133(1)a and stipulates that to be eligible for the scheme, abatement must be unlikely to occur in the absence of the incentives provided by the scheme. S.133(1)g of the Act requires that any estimate, projection or assumptions in the determination are conservative. The combined effect of these provisions is to require a high level of certainty as to the additionality of the proposed activity or project. The ERAC is required to make recommendations consistent with these and the other Integrity Standards contained in S.133.

Nonadditional

If abatement measures are not genuine and additional, large amounts of public money could be given to private companies without achieving additional abatement and it threatens the broader credibility of the ERF.

Registering projects for offsets requires the Chief Financial Officer of the applicant’s company to sign a Statement of Activity Intent declaring that the abatement activities for the project would not be (or would not have been) implemented without the scheme. Giving false or misleading information, or omitting material information is a serious offence and carries penalties under the Criminal Code.

The Statement of Activity Intent is an essential safeguard against the registering of projects that would result in these types of perverse outcomes. It is essential that the Statement is not weakened. If it is not clear that the abatement will be additional, the project should not go ahead.

It is also entirely appropriate that giving false or misleading information remains sanctioned under Criminal Code. Giving false and misleading information in order to receive large amounts of public money is a serious offense. Without the sanction there is no legal deterrent to abuse of the scheme.

There already appears to be appears to be some additionality abuses, such as the South African mining company Gold Fields, which received ERF support to fuel switch from diesel to gas, an investment it maintained it would have made regardless, noting it would have to hedge gas prices.[5] If there are already abuses, further weakening the safeguards would only open the door to further exploiting the methodology.

The two case studies given in the Consultation Paper demonstrate that the Statement of Activity Intent is a necessary and appropriate safeguard for the integrity standards of the ERF. Both cases are clear examples of projects that should not be eligible for the scheme because the circumstances show that it is far from clear that they would be genuinely additional. As such, the company officers would not have been able to sign the Statement of Activity Intent which would protect the integrity standards of the scheme as intended.

In case study number 1, the company happened not to be aware of the opportunity and an engineering consultant happened to become aware of it and offer to undertake the work and receive the ACCU's. This appears to be a very particular scenario that would be likely to be outweighed by the risks of other projects that were not genuinely additional going ahead if the Statement of Activity Intent was weakened or removed.

Net increase in emissions

In the case of the Facilities Method, there is the additional risk that the scheme could result in large increases in emissions.

Coal power stations require repairs, particularly old ones. These are part of the normal cost of operating such facilities. While these repairs may marginally increase efficiency and reduce the emissions intensity, they can also increase the amount of time the power station operates over the year and/or extend the life of the power plant.

Even a small extension of the life of a coal power station or increase in the amount of time the power station operates over the year is likely to dwarf any marginal emission savings from improvements to the efficiency of the plant that reduce its emissions intensity. This means that the net effect of and upgrade or repair to the power station which is receiving taxpayer's money to reduce emissions could significantly increase emissions.

[5] Morton (February 2019) *Emissions reduction fund to pay for fossil fuel plant that would be built anyway*, https://www.theguardian.com/environment/2019/feb/25/emissions-reduction-fund-to-pay-for-fossil-fuel-plant-that-would-be-built-anyway

For instance, if the proposed upgrade of the Vales Point Power Station increased its efficiency by around 1.1 percent as reported[6], anything greater than a 1.1 percent increase in the plants annual operation over a 12 month period resulting from the upgrade would result in additional emissions. Just a 5 percent increase in the annual capacity factor would could increase emissions by around 4.5 times the abatement resulting from the reduced emissions intensity. If the upgrade extended the life of the plant by just one year, it would increase emissions by over 300 times the annual emissions savings.

As such, unless the Integrity Standards of the ERF are strictly maintained and enforced, there is an unacceptable risk that the Method will amount to a taxpayer subsidy enabling polluting power stations in Australia to increase their net emissions.

[6] McDonald-Smith (March 2019) *Coal baron says public cash for Vales Point station upgrade stacks up*, https://www.afr.com/business/energy/electricity/st-baker-says-vales-point-upgrade-stacks-up-even-under-labor-targets-20190327-p5180u

Replacing essential equipment at electricity generators

3.2.3 Replacing essential equipment at electricity generators

> The Committee welcomes views on:
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> Whether the impact of replacing essential equipment at electricity generators that may extend their operating life is sufficiently and appropriately addressed in the Facilities Method. [Consultation Paper P.12]

The treatment of upgrades involving “essential components” at power stations, prevents power stations from accessing credits unless the upgrade lowers their emissions intensity to below the grid average.

This requirement is an essential safeguard against giving credits to upgrades and repairs that will extend the life of coal power stations, which could result in additional emissions potentially far in excess of any emissions savings achieved by the improved efficiency of the plant.

This requirement was the reason that Clean Energy Regulator rejected the Delta Electricity’s application to access credits for replacing the turbines blade on units of the Vales Point Power Plant.

Turbine blades are undoubtedly “essential equipment” under the method which defines essential equipment as being equipment that *“the generating unit would not physically be able to generate electricity without it”*.

In the case of the Vales Point Power Station, the increase in efficiency would have been very small (reportedly 1.1%), and not enough reduce it to below the grid average of 0.82 tonnes per MWh.

The Consultation Paper acknowledges the complexity of evaluating whether any given upgrade would extend the life of a coal power plant, but acknowledges it is a serious risk and that the essential equipment adjustment is a way of protecting against this perverse outcome.

In the case of the Vales Point Power Station, the Clean Energy Regulator was unconvinced that the turbine replacement would be additional and that it would not extend the life of the power station despite very detailed representations from the company.[7] That the Delta Energy lobbyist disagreed with the decision does not mean that the commitment by the company that the upgrade would not extend its life is correct, or that the CER decision was incorrect.

Delta Energy is also seeking federal support, and has been shortlisted for a ‘coal upgrade’ for Vales Point from the Underwriting New Generation Investment (UNGI) Program.[8] While the details of the UNGI proposal are not public, the facility in question has an amazing ability to live-on following its privatisation, revaluation and the latest attempts for federal funding for upgrades.[9]

Project 2 of the case study for Section 3.2.3 of the Consultation Paper, illustrates why the essential components adjustment requirement is so essential to the integrity standards of the method. These upgrades may not be “designed or intended to extend the facility’s operating life”, however intended or not, they may have that effect as they are major investments and the longer the power plant operates, the greater the rate of return on those investments.

If there is a genuine policy concern to reduce emissions from coal power stations without extending their life, there are far better ways to achieve this. Coal power stations could be required to make upgrades to improve their efficiency and reduce emissions though more rigorous emissions standards. This would be simpler, have virtually no cost to Australian taxpayers, and carry no risk of increasing emissions by extending the operating life of power stations. It would also free up more ERF funding for projects in other sectors with a clear and unambiguous additionality.

Recommendation: The Australia Institute believes the impact of replacing essential equipment at electricity generators that may extend their operating life is sufficiently and appropriately addressed by the essential equipment adjustment in the Facilities Method and should not be weakened in any way.

[7] FOI Document email correspondence from John Short to the office of Melissa Price, Thursday December 6, 3.36pm, https://www.scribd.com/document/404009420/FOI-190104-Final-Document-Pack-120319-Redacted

[8] Department of Energy and Environment (2019) *Underwriting New Generation Investment Program* https://www.energy.gov.au/government-priorities/energy-supply/underwriting-new-generation-investments-program

[9] Long (2017) *How a power station sold for peanuts became a $730 million asset* https://www.abc.net.au/news/2017-10-24/coal-power-station-sold-for-peanuts-becomes-730-million-asset/9077582

Conclusion

Australia's emissions continue to rise in direct contradiction to the Government's commitment to the Paris Agreement and the Government's policy of a 26-28 percent reduction in emissions on 2005 levels by 2030. The Renewable Energy Target is due to expire next year, leaving the ERF as the central mechanism to achieve emissions reductions. The ERF has been given an additional lease of life from the 2019 federal budget, but now with less funding over a longer period. With reduced funding, ERAC should be looking to increase the quality and integrity of projects.

There is always the risk that loosing restrictions of government programs generates unintended consequences. Especially where the government is seeking to purchase public environmental benefits through private sector projects and the recent revelations regarding the Murray Darling Basin serve as a timely warning.

The Murray Darling Basin water infrastructure program funds private sector infrastructure that aims to use water more efficiently, in return for water rights, with the aim of returning water to the river system. However, there are widespread reports that the funds have been used to greatly expand irrigation projects leading to perverse outcomes. [10]

With less funding available for the ERF, the ERAC can't afford to water down methodologies, especially with the risks involved in dealing with coal-fired power stations like Vales Point. ERAC was correct to constrict the methodology to avoid issues around additionality and net emissions. The Australia Institute supports ERAC in maintaining its original position.

[10] 4 Corners ABC (2019) *Cash Splash* https://www.abc.net.au/4corners/cash-splash/11289412