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## THE ENVIRONMENT – THE INDUSTRY

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Our federal government seems to have paid heed to H L Mencken's warning that "a plan to save humanity is almost always a false front for the urge to rule". They frequently and vehemently state their intention to commit our nation to meeting its greenhouse gas target of 108% of 1990 levels. However, they aren't willing to ratify the Kyoto Protocol. They believe that were we to ratify the Protocol, Australia would suffer a loss of sovereignty over our environment and thus, by default, our industries.

Hopefully, this decision will prove to be the right one and we will see a flow of funds to low emitting industries rather than a river of karmic debt heading our way. Certainly there are a number of schemes being put forward and partially funded by various levels of government for encouraging new technology, and the federal government has nominated technology development as one of its five key areas under the terms of the US-Australia Climate Action Partnership.

The problem is that our federal government is opposed to any form of explicit or implicit carbon tax. So it's hard to see where the driver will come for the uptake of all this fabulous technology. At some point, the 108% cap is going to have to become real. By this I mean that there has to be a punishment, and one that hurts, for exceeding it.

So far, most of the initiatives are targeted at the supply side. Presumably, demand is to be coaxed out by 'market forces'. However, markets don't develop out of the ether. I can appreciate that cleaner coal technologies may supplant old, dirtier processes because they lower the maintenance costs and extend the useful life of existing plants. I would expect that a vaccine that stopped ruminants from burping up great stomach loads of methane with every meal would be popular if it also piled on the kilos. But it's really hard to see what "market forces" would act to create a demand for carbon dioxide sequestered in trees, saltbush and pumped underground. Put simply, when it's still free to emit carbon dioxide, why would anyone pay someone not to do it?

In a recent speech in London, Australian Environment Minister David Kemp said "we will be aiming to build on Australia's competitive strengths with a lower greenhouse signature". The corollary, that this is achievable only if processes with high greenhouse signatures are actively discouraged, has become unmentionable. It's a rational and logical conclusion given Australia's circumstances and the stated intention of our government, but one that is rarely acknowledged.

The lack of a firm policy on managing the demand side of the equation is likely to stifle investment in greenhouse abating technology. Many of these technologies are developed by companies seeking to attract venture capital. However, the absence of regulations makes it difficult to turn their GHG abatement attribute into an asset in the form of a tradeable environmental offset instrument.

Projects that can use regulation to turn their GHG attributes into an instrument are much better placed. Their ability to create and monetise this asset means that the financial risk of the project can be better managed and crafting an exit strategy for capital is at least possible.

Compare two technologies, both looking for funding. The first is a state of the art bio-digestor project in NSW which takes chook poo and turns it into power to keep the chooks warm and 'process' them for consumption. This technology is remarkably efficient at transforming the calorific power of chicken litter into power. But it doesn't come cheap and, based on a project life

of 10-15 years, the cost of producing each MWh of power is around \$55-60. Compare this to the cost of power purchased from the NSW pool at around \$33 per MWh.

The second is in the Northern Territory and entails administering an anti-methanogenic vaccine to cattle. Because they're not wasting calories burping and farting, the cattle also put on condition. It's variable, but essentially the value of the weight gain offsets the cost of producing and administering the vaccine.

Clearly, both projects are developing technology which will help Australia meet its 108% cap. But the benefit each derives through regulatory intervention is vastly different.

The chook-poo developer can choose to augment the project's revenue stream by producing Renewable Energy Certificates (RECs), Green Power Rights (GPRs) and maybe even NSW Abatement Certificates (NACs)<sup>1</sup>. Currently, GPRs can be sold for around \$8 per MWh and RECs for around \$36. The market for NACs has yet to take off because the legislation is still pending, but around \$7-10 per tonne of carbon dioxide equivalent (CO2-e) abated is probably reasonable. Significantly, the demand for the RECs and NACs products, and indeed their very existence, is fed by a regulatory impost on electricity retailers. The GPRs are to satisfy the appetite of electricity consumers for Green Power, which is a voluntary initiative. So, without regulation, the most the project would attract would be the NSW electricity pool price and perhaps \$8 per MWh for the GPR. A total of \$41, \$8 of which is dependent on a capricious market built on altruism. The REC market is a thin, nascent market, but if you are prepared to cross spreads, it is possible to access forwards, swaps and options out to at least 2-3 years. This illustrates the two-fold effect of this regulation. It increases the revenue of the project and also assists in the development of a secondary market in which financial risks can be hedged.

The anti-methanogenic project is not quite so lucky. It will have to fend for itself unless it can attract some form of direct subsidy. A carbon tax levied on agriculture is unlikely, as it would be both politically unpopular and difficult to implement fairly. Agricultural greenhouse gas emissions, unlike those from stationary energy generation are diffuse and thus difficult to measure.

There will be a market for this technology, but it will be in a market where there are sticks as well as carrots. This is why so many in the environment business sector are lobbying for the ratification by Australia of the Kyoto Protocol. They know that once the Protocol is brought into force that, if Australia were to ratify, our government would have little option but to extend the net of regulation over a wider range of high emitting industries. But under the current situation, where we sit with the US outside the Kyoto net, it would require a government with suicidal political intentions to do what's required."

<sup>1</sup> *This is still under discussion, but it is likely that projects that produce RECs will be prohibited from also producing NACs*

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#### *About the Author*

Louise Drolz is the Manager, Environmental Markets, for Tullett & Tokyo Liberty, Sydney and the environmental markets columnist for Australia's Ethical Investor magazine. Louise joined Tulletts in August 1999, bringing with her more than two decades of experience in Australian business including eight years trading options for the HSBC Group. Louise has a Bachelor of Business from Kuring-gai CAE, Sydney, majoring in Accountancy and Finance. Louise can be contacted on +61 2 9240 5539 or [ldrolz@tullib.com.au](mailto:ldrolz@tullib.com.au)

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