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Australian Government
**Department of Climate Change, Energy,
the Environment and Water**

Mr Nicholas Craft
Acting Committee Secretary
Environment and Communication Legislation Committee
Email: ec.sen@aph.gov.au

Dear Mr Craft

Thank you for your letter of 2 December 2022 to Mr David Fredericks PSM inviting the Department of Climate Change, Energy, the Environment and Water (the Department) to provide a submission to the Environment and Communications Legislation Committee inquiry of the *Safeguard Mechanism (Crediting) Amendment Bill 2022* (the Bill). We welcome this opportunity to provide a submission.

The Bill acts on Australia's climate targets and supports the Powering Australia plan

The Australian Government has increased the ambition of Australia's 2030 emission reduction target to 43 per cent below 2005 levels by 2030, and affirmed Australia's commitment to net zero emissions by 2050. Parliament has enshrined these targets in law through the *Climate Change Act 2022*. This target was developed collaboratively with and welcomed by businesses, industry organisations, investor groups, trade unions and civil society groups and complements the ambitious targets already established by state and territory governments.

Enshrining targets into law sends a clear signal that the time for action on climate change is now. It provides policy certainty for stakeholders across all sectors of the economy, stimulating greater investment and employment in the transition to a net zero economy by 2050. The Investor Group on Climate Change (IGCC) has estimated there is potential for \$131 billion in new technology and jobs in Australia by 2030¹.

Powering Australia is the Government's plan to meet these targets and to support industries and communities through the energy transition—including by building on the existing Safeguard Mechanism to reduce industrial sector emissions. Other elements of the Powering Australia plan are also underway, including the \$20 billion investment in Rewiring the Nation, the \$1.9 billion Powering the Regions Fund (PRF) and developing the National Electric Vehicle Strategy.

The Government is currently seeking feedback on design of the PRF. The PRF will provide dedicated funding to support decarbonisation by trade-exposed facilities covered by the Safeguard Mechanism and all Safeguard facilities will have preferential access to other streams of the PRF.

Facilities covered by the Safeguard Mechanism are expected (under the position paper currently out for consultation) to deliver a proportional share of the national 2030 target. This will put Australian

¹ <https://igcc.org.au/new-government-opportunity-2022/>

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industry on a path to net zero, which will be necessary to remain competitive as the world decarbonises. This Bill makes provision for this to be achieved in the most efficient and cost-effective way, by enabling the trade of Safeguard Mechanism Credits, which will be credited to those facilities able to reduce emissions below their regulated baseline and sell them to facilities with higher cost abatement options.

Reforms to the Safeguard Mechanism build on existing frameworks

The Safeguard Mechanism has been in place since 2016. It provides a legislated framework that limits the emissions of around 215 large industrial facilities—covering around 28 per cent of national emissions. Emissions limits for individual facilities are known as baselines. The sum of all facilities' baselines provides the overall emissions constraint for the scheme. Building on this framework will promote policy certainty and stability and enable timely implementation of the Safeguard reforms. The Government aims to deliver its climate targets in a cost-effective way that shares the effort across the economy. The Safeguard Mechanism reforms have been guided by the principles of being effective, equitable, efficient, and simple.

Many businesses that operate facilities covered by the Safeguard Mechanism have made long-term climate commitments that match or surpass Australia's climate targets. The Safeguard reforms will provide a supportive policy framework for industry to meet these commitments, with the right signals to drive investments in emissions reductions, and flexibility so that businesses find the lowest cost abatement, wherever it occurs.

The proposed changes include reducing Safeguard Mechanism baselines and enabling facilities covered by the Safeguard Mechanism (referred to in the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) as designated large facilities and referred to here as Safeguard facilities) that stay below their baselines to generate tradable credits, known as Safeguard Mechanism Credits. The main purpose of the Bill is to enable the crediting element of the reforms.

The Bill establishes a crediting framework to support industry to reduce emissions in a cost-effective way

The Bill's amendments enable Safeguard facilities that keep their emissions below their baseline to generate tradable credits, termed Safeguard Mechanism Credits (SMCs).

The Bill amends the NGER Act and *Australian National Registry of Emissions Units Act 2011* (ANREU Act) to establish the framework for creating SMCs, covering how credits are issued, purchased, and included in Australia's National Registry of Emissions Units. A SMC corresponds to a tonne carbon dioxide equivalent of emissions, and the number issued is the amount of emissions below a facility's baseline. The Bill enables SMCs to be traded and used by other Safeguard facilities to reduce their net emissions.

Enabling Safeguard facilities to earn tradable credits when they are over-performing on their individual emissions limit will encourage facilities with low-cost abatement opportunities to do more. This also helps businesses for which on-site abatement is more difficult—they can purchase credits from other Safeguard facilities if it is cheaper than reducing their own emissions on site. This lowers the overall costs to the economy of meeting Australia's climate goals, while delivering the same volume of abatement.

A key consideration for Safeguard reform is to drive the transformation of Australia's economy, delivering jobs and enhancing Australia's competitiveness as the world moves to net zero.

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Policy objectives of the Bill go beyond crediting

Schedule 1 to the Bill amends the NGER Act to create SMCs and apply the laws about registration, transfers and compliance obligations to SMCs that are consistent with the treatment of Australian Carbon Credit Units (ACCUs). The Bill also amends the *Income Tax Assessment Act 1997* so that SMCs receive the same tax treatment as other specified units, like ACCUs.

Schedule 2 to the Bill amends the ANREU Act to provide for SMCs to exist in the Registry and establish arrangements for SMCs in the Registry that mirror the treatment of ACCUs.

Schedule 3 to the Bill amends the *Clean Energy Regulator Act 2011* (CER Act), the NGER Act and the *Clean Energy (Consequential Amendments) Act 2011* to ensure consistent protection of information held by the Regulator.

Schedule 4 to the Bill amends the *Carbon Credits (Carbon Farming Initiative) Act 2011*. These amendments mean the Safeguard Mechanism can be considered when considering the regulatory additionality of proposed Emissions Reduction Fund offsets projects.

Subordinate legislation is being consulted on in parallel to the Bill

Many details of the design of the Safeguard Mechanism, such as how baselines are set, are contained in the *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (Safeguard Rules). A core element of the reforms to the Safeguard Mechanism will be a framework where baselines decline predictably and gradually over time. It is important to do this efficiently, so that business finds the lowest cost abatement, wherever it occurs. Doing so supports strong emissions reductions being delivered by Safeguard facilities.

The Bill provides for subordinate legislation to detail the crediting framework such as application processes, the number of SMCs to issue, how that number is worked out, conditions that may be imposed, and audit requirements. This structure is necessary because the crediting framework is closely linked to the technical details of how Safeguard baselines are determined, which are also set out by the Safeguard Rules.

Given the important role of subordinate legislation, the Bill requires the Minister to only make Safeguard Rules that are consistent with the objects of the NGER Act (Item 37 of Schedule 1). The Bill also adds to the second object of the Act a reference to ensuring that the aggregate net covered emissions from the operation of facilities covered by the Safeguard Mechanism decline (Item 1 of Schedule 1).

So that the detail in subordinate legislation can be considered alongside the introduction of the Bill, on 10 January 2023 the Department released for comment:

- draft *National Greenhouse and Energy Reporting (Safeguard Mechanism) Amendment (Reforms) Rules 2023* (that amend the Safeguard Rules)
- draft *Carbon Credits (Carbon Farming Initiative) Amendment (No. 2) Rules 2023*
- draft *Australian National Registry of Emissions Units Rules 2023*.

The draft subordinate legislation is available on the Department's website at <https://consult.dcccew.gov.au/safeguard-mechanism-reform-consult-on-design>. Feedback is open until 24 February 2023. The consultation package includes a Position Paper on the Government's proposed design of the overall Safeguard Mechanism reforms.

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Draft technical amendments to the *National Greenhouse and Energy Report Regulations 2008* and the *Australian National Registry of Emissions Units Regulations 2011* required to implement the reforms will also be released by the end of January 2023, for consultation.

Under the reforms to the Safeguard Mechanism, all baselines will adjust with production. This approach builds on elements of the Safeguard Mechanism's existing design, including production variables and industry average emissions intensities. These design elements have been developed in close consultation with a broad range of stakeholders and implemented through previous changes to the Safeguard Rules.

Relevant pieces of subordinate legislation, including the Safeguard Rules, are disallowable under the *Legislation Act 2003*, providing Parliament with oversight of these instruments.

The Bill allows for several legislative instruments, including the Safeguard Rules, the *National Greenhouse and Energy Reporting (Measurement) Determination 2008*, the *National Greenhouse and Energy Report Regulations 2008*, and legislative rules made under the ANREU Act, to apply, adopt, or incorporate matters contained in instruments or writing as in force or existing from time to time. This ensures the most up to date information, standards and measurements are available to support legislative objectives. This approach is consistent with the treatment of documents in legislative instruments made under the CFI Act and *Renewable Energy (Electricity) Act 2000*.

The Bill accounts for previous public feedback on an exposure draft

An exposure draft of the Bill was open to public consultation from 10 to 28 October 2022. Over 50 businesses, industry groups and individuals made submissions, with non-confidential submissions published on the Department's website at <https://consult.dcceew.gov.au/safeguard-mechanism-reform-consultation/submission/list>.

In response to submissions on the exposure draft, the Bill now includes an amendment to the objects of the NGER Act, and requires the Minister to be satisfied that the Safeguard Rules are consistent with the objects of the Act. The Bill adds to the second object of the Act a reference to ensuring that aggregate net covered emissions decline.

Under the NGER Act, an 'excess emissions situation' occurs if the net emissions of a facility covered by the Safeguard Mechanism exceed its baseline. The Act includes a duty to ensure that an excess emissions situation does not exist. In response to feedback that the penalty for an excess emissions situation should reflect the impact on the climate, the Bill now includes provisions that will base penalties for an excess emissions situation on both the size of the excess emissions situation and the number of days in which the excess emissions situation exists.

The exposure draft Bill provided for publication of holdings of ACCUs and SMCs in Registry accounts. Some submissions raised concerns about this provision. To address these concerns, the Bill has been updated so that legislative rules can provide for publication. This will allow for further consultation, to ensure the final settings provide for increased transparency while appropriately addressing matters raised by stakeholders.

Previous public consultation on the SMCs crediting concept was positive

The Department also sought feedback on options for reforming the Safeguard Mechanism from 22 August to 20 September 2022. Over 240 submissions were received and all non-confidential submissions are published on the Department's website at <https://consult.dcceew.gov.au/safeguard-mechanism-reform-consultation-paper/submission/list>.

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The following organisations are among those expressing public support for establishing a crediting framework as part of the Safeguard reforms:

- ANU Institute for Climate, Energy and Disaster Solutions
- Australian Industry Group
- Australian Industry Greenhouse Network
- APA Group
- Australian Petroleum Production & Exploration Association
- Association of Mining and Exploration Companies
- AusNet
- Australasian Centre for Corporate Responsibility
- Australian Chamber of Commerce and Industry
- Australian Financial Market Association
- Australian Gas Infrastructure Group Australian Hydrogen Council
- Australian Institute of Petroleum
- BP Australia
- Business Council of Australia
- City of Sydney
- Clean Energy Council
- Energetics
- Energy Efficiency Council
- Engineers Australia
- Kawasaki Heavy Industries
- Minerals Council of Australia
- Origin Energy
- Pollination
- Tasman Environmental Markets
- Team Global Express (Toll)
- Whitehaven
- Woodside Energy

SMCs are not offsets, unlike Australian Carbon Credit Units (ACCUs)

SMCs will not be carbon ‘offsets’, because they are generated within a regulated emissions limit. The integrity of SMCs arises from the regulated emissions limit, which constrains the overall emissions of Safeguard participants. Aggregate baselines form the limit—they can be calibrated to meet the desired contribution to the 2030 target.

This means that, unlike ACCUs—which are offsets—SMCs will not need to be 'additional' as defined under the *Carbon Credits (Carbon Farming Initiative) Act*.

The presence of the limit ensures that, in aggregate, Safeguard entities stay within their overall emissions budget. If one facility emits less than their baseline, they can sell a credit to another facility that emits more than its baseline. It is not necessary to know how or why a facility has reduced their emissions, or what its hypothetical business-as-usual emissions would have been.

This is a key benefit of the Safeguard Mechanism compared with an offsets scheme. It has lower administrative costs and risks—because there is no need to assess the ‘additionality’ of abatement at the project level.

It is intended that both SMCs and ACCUs can be surrendered by Safeguard facilities to reduce their net emissions. The Independent Review of the integrity of Australian Carbon Credit Units led by Professor Ian Chubb AC (Chubb Review) found the ACCU scheme arrangements are sound. The Government has accepted in-principle all 16 recommendations of the Chubb Review. The use of ACCUs in the Safeguard Mechanism provides an important option to facilities with fewer on-site abatement opportunities at any particular point in time, and lowers overall costs by providing access to cost-effective abatement from sectors outside the Safeguard Mechanism.

Overall, there will still be strong incentives under the Safeguard Mechanism for facilities to undertake emission reductions on-site, and for the industrial sector to decarbonise, even with the ability to surrender ACCUs to meet obligations.

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The Bill includes amendments that underpin integrity of the Safeguard reforms

To support the integrity of the Safeguard reforms, the Bill includes provisions to strengthen Safeguard compliance arrangements; provisions to manage interactions between the Safeguard Mechanism and the ACCU scheme; and an anti-avoidance provision.

The civil penalty for an excess emissions situation is updated by the Bill so it reflects both the number of days in exceedance *and* the quantity of excess emissions (Items 22-26 and 45 of Schedule 1). The Bill provides for the maximum civil penalty to be set in the NGER Act (rather than the NGER Regulations) to be 1 penalty unit per tonne of excess emissions per year.

Previously, Safeguard facilities could register carbon offsets projects to generate ACCUs for emissions reductions. The introduction of crediting means that the ACCU scheme will not be needed to incentivise emissions reductions at Safeguard facilities. To implement this, the *Carbon Credits (Carbon Farming Initiative) Rule 2015* has been amended so that projects that reduce the covered emissions of Safeguard facilities cannot be declared to be eligible offsets projects.

This helps to maintain the integrity of ACCU arrangements, because it addresses the possibility that an offsets project that reduces the covered emissions of a Safeguard facility might occur anyway because the Safeguard Mechanism would have incentivised the project to take place. Schedule 4 of the Bill includes an amendment to the CFI Act to enable legislative rules to be made to prevent the Clean Energy Regulator from entering into carbon abatement contracts associated with projects specified in those legislative rules. Enabled by this provision, the draft *Carbon Credits (Carbon Farming Initiative) Amendment (No. 2) Rules 2023* that are currently being consulted on would prevent the Regulator from entering into carbon abatement contracts associated with projects that reduce the covered emissions of a Safeguard facility.

When the Safeguard Mechanism was first legislated, it included a 'deemed surrender' provision (subsection 22XN(6) of the NGER Act) to allow any ACCUs delivered to the Government under contract to also be treated as being surrendered to reduce the emissions of the Safeguard facility. In other words, it was intentional that Safeguard Facilities benefited twice from having an ACCU project. They could sell it to the government and count it as an emissions reduction. This was intended to incentivise offsets projects in the industrial sector. This is no longer appropriate under the new Safeguard reforms.

The Government proposes to phase the deemed surrender arrangements out. To mitigate impacts on existing contracts, deemed surrender arrangements for existing contracts are proposed to continue for two years before they are ceased. The exposure draft amendments to the Safeguard Rules being consulted on include a provision to implement this approach. This Bill enables the Safeguard Rules to specify circumstances for which this provision does not apply, so that the phase out can be implemented.

The Bill also introduces an anti-avoidance measure to prevent a business from defining, or redefining, a facility with the intention of avoiding Safeguard Mechanism obligations (Item 46 of Schedule 1). These amendments enable the Clean Energy Regulator to overrule a business's definition of its facility, if it reasonably concludes the business was defining its facility so it would:

- not be a Safeguard facility,
- have a higher baseline number,
- have lower covered emissions, or

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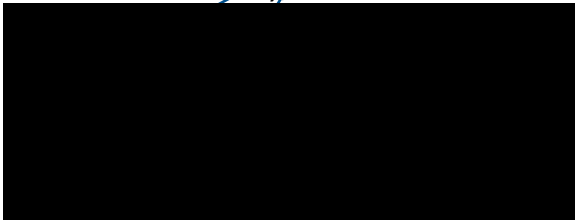
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- belong to a different industry.

I appreciate your consideration of the above information and trust it will be of assistance to the committee.

Yours sincerely,



Jo Evans PSM
Deputy Secretary
Department of Climate Change, Energy, the Environment & Water

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