ACCR

25 January 2023

Safeguard Mechanism (Crediting) Amendment Bill 2022

ACCR Submission

ABOUT ACCR

The Australasian Centre for Corporate Responsibility (ACCR) is a not-for-profit, philanthropically-funded research organisation, based in Australia. ACCR monitors the environmental, social and governance (ESG) practices and performance of Australian-listed companies, including climate change, human rights, and labour rights. We undertake research and highlight emerging areas of business risk through private and public engagement. For more information, follow ACCR on Facebook, Twitter and LinkedIn.

Contact: Alex Hillman, Lead Analyst | [redacted]

Contents

Introduction

Fixing the Safeguard Mechanism (SGM) is critical to Australia meeting its legislated 2030 emission reduction target and 2050 net zero goal.

If the SGM is to meaningfully address the pollution of Australia's top emitters, and achieve real emission reductions, it must:

- Guarantee that all headroom is removed
- Increase its ambition to align with the efforts of the rest of Australia's economy
- Decouple industrial emission reductions from the land sector, which is out of step internationally, and
- Remove the unnecessary shielding for trade exposed facilities.

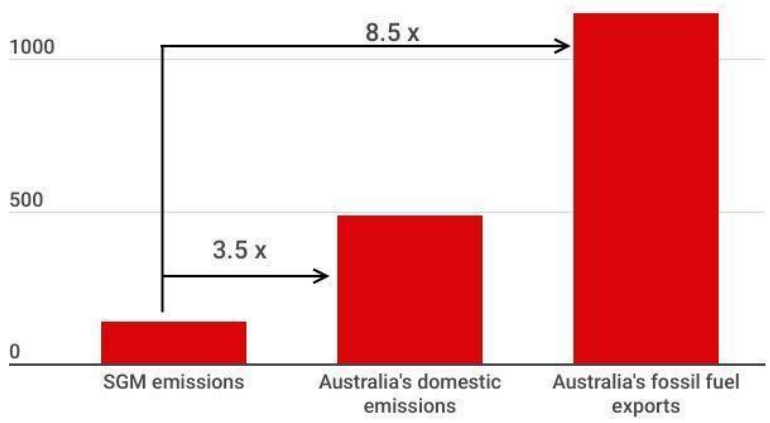
Companies and their industry associations have protested even the modest impact that the proposed SGM changes will have. This submission rebuts some of the least defensible of these claims.

However, the SGM is not a comprehensive policy for managing Australia's excessive contribution to climate change, which is predominantly due to the fossil fuels that we extract and export. The emissions from using the fossil fuels that we extract should be dealt with separately to the SGM. For Labor's climate policy suite to be complete, additional mechanisms are required to cease the continued growth of Australia's coal, oil and gas sectors.

Fixing the Safeguard Mechanism is critical but insufficient

Australia's greatest contribution to dangerous climate change is our exported fossil fuels (Figure 1). The SGM does not manage these emissions, and other policies are required to address this issue.

Figure 1: Emissions covered by the SGM, Australia's domestic emissions and Australia's exported fossil fuel emissions ($MtCO_2e$)



Australia's climate policy has improved significantly over the last 12 months. We now have a legislated carbon budget covering until 2030 and a net zero goal for 2050.

The role of the SGM within this policy framework is to constrain scope 1 emissions from a subset of industrial facilities. This set of emissions is likely to be the largest 'sector' of emissions in Australia within the next 1-2 years.[1] As such, it is critical that the SGM is reformed so that it effectively reduces emissions.

The SGM is not however sufficient to meet Australia's targets on its own, let alone to meet Australia's fair share of global emissions reductions.

The SGM does not cover domestic sources of emissions, such as the 22 $MtCO_2e$ of Australia's industrial emissions from smaller facilities[2], or emissions from other sectors of Australia's economy, such as the agricultural or transport sectors.

More importantly, Australia's main contribution to global climate change is from the fossil fuels that we export - emissions from the use of our exported fossil fuels are more than double[3] domestic emissions. The International Energy Agency and many others have concluded that there is no room for any additional fossil fuel developments, if we want to maintain a safe climate.[4]

In 2022, the Intergovernmental Panel on Climate Change released its Sixth Assessment Report, with the Working Group Two Contribution stating, "Any further delay in concerted anticipatory global action on adaptation and mitigation will miss a brief and rapidly closing window of opportunity to secure a liveable and sustainable future for all."[5] Every country needs to stop developing new fossil fuels and we need to do that immediately. Australia needs to decide whether to support a safe climate, or develop our fossil fuels - we cannot do both.

Australia needs to consciously manage emissions from fossil fuel projects. A logical first step is to focus on the approval of projects to develop new fossil fuels, which would be 'new entrants' in SGM parlance. While acknowledging that the SGM has a role influencing the business case of a new entrant, it only deals with scope 1 emissions, which are typically a small portion of the lifecycle emissions of a fossil fuel development. As such the SGM is unlikely to place a significant constraint on fossil fuel new entrants without much more substantial changes than are currently being considered.

The weight of scientific consensus shows that new fossil fuel projects are incompatible with a safe climate. In the absence of a ban, a climate trigger implemented through a Federal Environmental Protection Authority, or the Environmental Protection and Biodiversity Conservation Act 1999 (EPBC), could ensure that new fossil fuel projects are appropriately assessed.

[1] Reputex, 'The Economic Impact of the ALP's Powering Australian Plan', 2021, p8, https://www.reputex.com/research-insights/report-the-economic-impact-of-the-alps-powering-australia-plan/
[2] Calculated by ACCR based on FY21 Clean Energy Regulator information
[3] Moss, Jeremy, 'Australia: an emission super-power', UNSW, p5, https://climatejustice.co/wp-content/uploads/2020/07/Australia-_-an-emissions-super-power.pdf
[4] ACCR, Appeal against the NWS Extension, pp14-17, https://www.accr.org.au/downloads/accr_nws-extension_full.pdf
[5] Climate Change 2022: Impacts, Adaptation and Vulnerability. Working Group II Contribution to the IPCC Sixth Assessment Report

Ambition

Australia's emission target is referenced to 2005 emissions. Since 2005, Australia's scope 1 industrial emissions have increased whilst the rest of the economy has decarbonised. The SGM should be calibrated so that industrial facilities 'catch up' with the emissions reduction of the rest of the economy.

The Safeguard Reform has framed the emissions reduction task for the SGM in a misleading manner. The initial consultation document posits that the SGM will meet its share of Australia's 2030 target if it reduces emissions as fast as the rest of Australia from FY21. Yet Australia's target is not based on a 2021 baseline - it uses a 2005 baseline, and industrial emissions have increased since 2005.

Based on Reputex modelling of 2005 emissions, the emissions covered by the SGM emitted 117 $MtCO_2e$ in 2005.[6] Emissions from this category of facilities reached 137 $MtCO_2e$ by FY21, representing a 17% increase. Meanwhile, the Australian economy as a whole has reduced emissions by 21% over the same period. With industry having increased emissions so significantly, steeper reductions are required just to catch up.

To be consistent with Australia's legislated, economy-wide target, the industrial sector's fair share of emissions reduction should be a 43% reduction between 2005 and 2030. Based on FY21 emission levels of 137 $MtCO_2e$, this would require annual reductions of 10 $MtCO_2e$, or 7.3% of FY21 emission levels.

The trade protection measures for a subset of facilities and unfettered use of offsets to meet facility baselines also weaken the SGM's ambition. These are discussed below.

Corporate claims

Submissions by some industry associations and major polluters in response to the Safeguard Mechanism Consultation Paper in 2022 included claims that sought to justify weakening or delaying the emissions reductions possible through the Mechanism, by retaining headroom, delaying implementation, and supporting less ambitious baselines. These positions, if adopted, would weaken the intended Safeguard Mechanism reforms.

Delay

Several entities argued in their submissions to delay emissions reductions being required through the scheme. For example, APPEA requested further examination of costs before the emissions reduction ambition of the Mechanism is finalised, and labelled the proposed timeline 'ambitious'. Woodside also called for a sectoral analysis first. The Minerals Council of Australia (MCA) claimed "decline rates for emissions should be calibrated with the availability of technologies", while BHP attempted to assert there could be 10-20 years before current technology could be implemented, stating "that the form and scale of most new investment in the next 5-10 years will be determined by technical and financial studies carried out in the previous 5-10 years."

[6] Reputex, 'The Economic Impact of the ALP's Powering Australian Plan', 2021, p8, https://www.reputex.com/research-insights/report-the-economic-impact-of-the-alps-powering-australia-plan/

All these assertions are clearly designed to delay the implementation of the policy, its rules and responsibility for emissions reductions. This is inappropriate and misaligned with the public climate policy statements from these very companies and their industry associations.

In response to these claims, ACCR makes the following points:

- Climate change and the need to reduce emissions is not a new area of focus for these large companies and their industry associations. There has been plenty of time for companies to consider and determine their strategies in line with market, shareholder and management requirements.
- Many companies, such as Fortescue Metals Group[7], have set more ambitious targets and timelines for emissions reductions than is prescribed by the Safeguard Mechanism or the government's pre-election target. It is appropriate that the government continues to require and encourage rapid emissions reductions.
- Australia has implemented the Climate Change Act (2022), which legislates a carbon budget to 2030 and establishes a 2050 net zero target. We now have a fixed (or maximum) limit on total emissions, which means that if any source of emissions increases, some other source needs to decrease. Similarly, if any source or sector reduces emissions more slowly, then other source(s) or sector(s) will need to decline more rapidly.
- When Australian businesses lobby to postpone or delay emissions reductions, they are actually asking for other parts of the Australian economy to shoulder more of the burden.

New entrants

Gas industry representatives are making public assertions around new entrants being at risk of being disadvantaged by this scheme, or "presenting barriers to entry for new industries and industry participants".[8] These statements appear designed to avoid any requirement for best practice technology to be utilised by major new polluting projects. APPEA in its 2022 submission recommended that the "baseline setting approach adopted for new facilities is consistent with the approach adopted for existing facilities". Woodside also stated that it supports an industry average benchmark for new entrants. It also sought to delay any adjustment of required decline rates back to Phase 2 of the scheme to avoid "penalising new entrants from Phase 1".

ACCR previously noted that new facilities should receive smaller baselines since they have access to more efficient technology. The emissions intensities used to determine baselines for new facilities should be reduced as technology improves.

Considering the recent consultation paper's recommendation to apply international best-practice,[9] these intensities should be based on the top decile of facilities installed in the last decade. Consideration could be given to setting best practice baselines for future-facing commodities such as lithium hydroxide or copper more generously than for fossil fuels such as coal mines or LNG facilities.

[7] FMG, 'Climate Change and Energy', https://www.fmgl.com.au/workingresponsibly/climate-change-and-energy
[8] Sydney Morning Herald, 12 January 2023, https://www.smh.com.au/politics/federal/senate-showdown-looms-as-bowen-demands-coalition-support-for-climate-reform-20230111-p5cbur.html
[9] DCCEEW, 'Safeguard Mechanism Reforms: Position Paper, January 2023, p27, https://storage.googleapis.com/files-au-climate/climate-au/p/prj23cd662ff4387d8c254ae/public_assets/Safeguard%20Mechanism%20Reforms%20Position%20Paper.pdf

Trade exposure

Several claims have been made by the MCA, Woodside and APPEA around the need for economic support for trade exposed industries, implying that all forms of assistance should be provided. The MCA asserted that not all facilities that are trade exposed will be able to meet the bill's EITEs definition, and those facilities may also require assistance through the transition. Our response to those claims is outlined below.

Managing trade exposure

Emissions Intensive Trade Exposed (EITE) industries should not get preferential treatment under the SGM. If such preferential treatment is granted, it should favour commodities that have a sustained and significant role in a net zero economy and do not introduce perverse incentives to delay emissions reductions.

An argument for giving preferential treatment to EITE industries is that they may face higher costs to reduce emissions, and may be 'less able to manage those costs because the price of its products are set in global markets' (i.e. are trade exposed).[10] It has been suggested that if production is shifted overseas, the overseas producers may cause more emissions than if production occurred within Australia ('carbon leakage').[11]

ACCR's submission to the SGM Consultation reform covered trade exposure extensively, and noted that:

- The 'default' baseline shielding is already a generous trade protection measure;
- Fears of carbon leakage are normally based on modelling forecasts, whilst retrospective empirical analysis shows carbon leakage to be less than originally expected; and
- Several of the claims made by industry, that previous efforts to price carbon would stifle investment, have turned out to be inaccurate, and Australia became the world's biggest LNG exporter whilst carbon pricing was under discussion or in place.

Our position remains that, if trade protection is granted, it should not be used to support industries that do not have a sustained role in a net zero carbon economy.

The proposed mechanism to manage trade exposed industries introduces several perverse incentives:

- It is not time bound, that is if a facility is trade protected for one year, it receives a benefit that is retained for all future years. This means that a facility that stops being trade exposed will continue to benefit from shielding that it should no longer receive.
- The mechanism is based on the carbon costs that a facility would face, rather than useful economic output - which perversely rewards those facilities with high emissions.
- The mechanism to determine what is trade exposed makes no reference to what other countries are doing. If other countries impose carbon prices, then any carbon price that Australian producers face will not be a competitive disadvantage that requires shielding.

[10] DCCEEW, 2021, 'Safeguard Mechanism reform consultation factsheet - Emissions-intensive, trade-exposed facilities', https://storage.googleapis.com/converlens-au-industry/industry/p/prj2135e8da0cf17d76c70fc/public_assets/DCCEEW-Fact-sheet-EITEs.pdf
[11] DCCEEW, 2021, 'Safeguard Mechanism reform consultation factsheet - Emissions-intensive, trade-exposed facilities', https://storage.googleapis.com/converlens-au-industry/industry/p/prj2135e8da0cf17d76c70fc/public_assets/DCCEEW-Fact-sheet-EITEs.pdf

Offsets and other credits

The unlimited use of land-based offsets is poor science and poor policy. It is out of step with international practice. Safeguard Mechanism Credits can make the SGM more efficient as long as headroom is removed from baselines.

Safeguard Mechanism Credits may not work with the proposed baselines

The introduction of Safeguard Mechanism Credits (SMCs) has the potential to reduce compliance costs. They will allow facilities that can reduce emissions more easily than other facilities to implement these reductions and trade the benefit with facilities where reducing emissions is more difficult. Since the creation and transfer of SMCs does not impact the sum of all facility baselines, they neither increase or decrease the ambition of the mechanism - but they do make it more efficient.

What has prevented SMCs from being created to date is the 'headroom' in the baselines. Where the sum of all the baselines is low enough that action needs to be taken to reduce emissions, then SMCs allow the action to be taken where it is the most cost effective. An SMC's value will, in a perfect market, be the cost of reducing those emissions. To date, baselines have had significant headroom, so a hypothetical SMC created today would be nearly worthless.

The draft Rule introduces a mechanism whereby baselines transition from historic facility-specific emissions intensities to industry-average emissions intensities by 2030. Facilities will need to apply for the facility-specific emissions intensities, but if they do not do this, they will be allocated best-practice emissions intensities. The best-practice emissions intensities have not been set and there is a risk that this may not be done, or at least not done in accordance with the 'international best practice' policy intent. This introduces a risk that facilities will have some flexibility to elect to have a higher baseline than is intended by the government. This would result in SMCs being created for little or no cost, with their value being driven by facilities banking them for future use. This will delay emissions reductions, meaning that the SGM facilities will contribute less than expected to Australia's emissions reduction task over this critical decade. This weakens the SGM and we strongly recommend that this is remedied.

Australian Carbon Credit Units

ACCR's submission to the SGM Consultation reform covered the use of ACCUs, and noted that:

- Offsets were limited to 5% of a liable entities' obligation under Clean Energy Act and there does not appear to have been any considered rationale for changing this limit. It should be reinstated in the SGM.
- Land sector abatement is finite and should be reserved to sequester emissions from previous land sector degradation. We need a policy framework set up to deliver emissions reductions in the land sector *or* the industrial sector, whereas emissions reductions are required in *both*.
- Most ACCUs are from the land sector, which means that they are moving carbon from one part of the short term cycle (i.e. the atmosphere) to another part of the short term cycle (e.g. vegetation) which is subject to permanence risks, especially in a changing climate. Fossil fuel reserves are a different

part of the carbon cycle and are, by definition, stable for millenia. Treating them as equivalent is a scientifically flawed proposition.

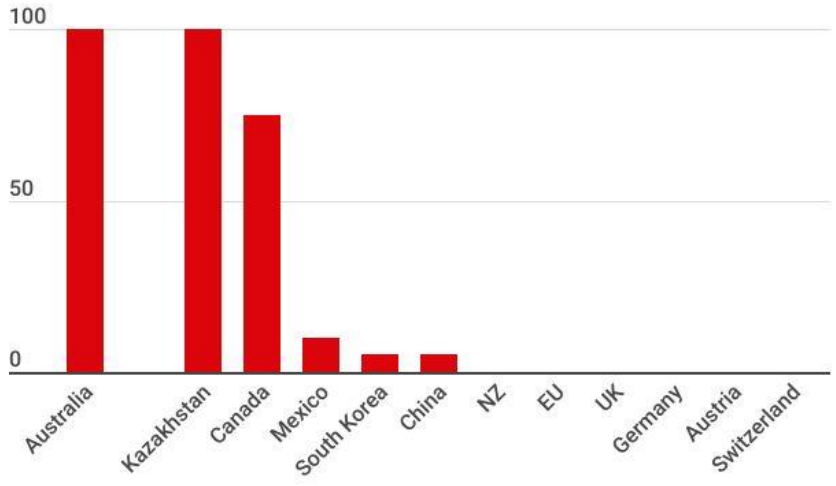
- Industry has confirmed that it can reduce emissions and many SGM covered entities have more aggressive 2030 and net zero targets than the proposed Rule changes would require.
- Long term access to offsets allows facilities to invest in high-emissions, long-life equipment that cannot be readily decarbonised later.

Unfettered access to offsets is out of step internationally

The unlimited use of offsets under the SGM is not only poor science and poor policy, it is also at odds with nearly all global standards.[12] The only other national carbon pricing schemes that allow more than 10% use of offsets are Kazakhstan and Canada[13] (Figure 2). Under schemes in other national jurisdictions, offsets use is limited to 10% or less:

- The EU ETS previously allowed limited use of Kyoto Protocol credits. This was progressively restricted, and then banned in 2021. The UK ETS has retained the ban on the use of offsets as it has established its own trading system.
- The NZ ETS originally allowed the use of Kyoto Protocol offsets until 2015. Now New Zealand emission units (NZUs) need to be surrendered for all covered emissions.[14]
- The South Korean ETS initially allowed for 10% of emissions to be met with offsets. This decreased to 5% in 2021.
- Under the Mexico ETS, up to 10% of a facility's obligation can be met with offset or early action credits.
- Under the Chinese National ETS, covered entities can use offsets up to 5% of their verified emissions.
- Austria, Switzerland and Germany's pricing schemes do not allow the use of offsets.

Figure 2: SGM limits on offset use, relative to other national carbon prices (% of liability, or emissions as applicable)



[12] All references to offset limits are from the International Carbon Action Partnership, unless otherwise stated. https://icapcarbonaction.com/en/compare
[13] IETA, 'Carbon Market Business Brief, Canada Federal Output-Based Pricing System (OBPS)', p2, https://www.ieta.org/resources/Resources/CarbonMarketBusinessBrief/2021/CarbonMarketBusinessBrief_CanadaOBPS2021.pdf
[14] Ministry for the Environment, ETS Auctions and how to buy New Zealand Emissions Units (NZUs), https://environment.govt.nz/what-government-is-doing/areas-of-work/climate-change/ets/nz-ets-market/where-to-buy-new-zealand-emissions-units/

Sub-national schemes also place limits of 10% or lower on the use of offsets, with the exception of Saitama's Target Setting Emissions Trading System, the Tokyo Cap and Trade Program which does not allow land sector offsets, and Beijing which allows up to 20% as an incentive for the low carbon transport sector. Other jurisdictions are limited as follows:

- California's Cap-and-Trade Program allows for liable entities to meet up to 4% of their obligation with offsets until 2025 and then 6% until 2030.
- The Quebec Cap and Trade system allows for 8%, with provisions to manage offsets that are later deemed to be 'illegitimate'.
- The Regional Greenhouse Gas Initiative (RGGI) allows facilities to meet up to 3.3% of their liability with offsets.
- Under Shanghai's pilot ETS, the use of credits was set at 5%, but this decreased to 3% in 2019.
- Under Shenzhen's pilot ETS, the use of credits is limited to 10% of annual compliance obligation.
- Fujian's pilot ETS allows up to 10% of the annual compliance obligation.
- Guangdong's pilot ETS allows up to 10% of the entities' annual emissions, with a scheme-wide cap of 1.5 million offsets.
- Tianjin's pilot ETS allows up to 10% of the annual compliance obligation to be met with offsets.
- Chongqing's pilot ETS allows up to 8% of a compliance obligation to be met with offsets.
- Hubei's pilot ETS use of offsets is limited to 10% of the annual initial allocation.
- Nova Scotia and Massachusett do not allow any offset use in their carbon pricing schemes.

Figure 3: SGM limits on offset use, relative to limits in sub-national carbon prices (% of liability)