

Consultation Paper released on the Safeguard Mechanism



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Introduction

On 26 March 2015, the Department of the Environment released a Consultation Paper on the Safeguard Mechanism (**Consultation Paper**). The Consultation Paper confirms various aspects which were set out in the White Paper² and is the precursor to the Safeguard Rules, which need to be made by 1 October 2015. At this stage, the intention is to release a draft of these rules in July 2015.

The framework for the Safeguard Mechanism was legislated through amendments to the *National Greenhouse and Energy Reporting Act 2007 (NGER Act)*, and it is due to commence on 1 July 2016. The Safeguard Mechanism is intended to ensure that emissions reductions purchased through the Emissions Reduction Fund (**ERF**)³ are not displaced by increased emissions elsewhere in the economy.

In essence, the Safeguard Mechanism operates as a “baseline and penalty” scheme. It requires entities to keep their greenhouse gas emissions below the set baseline for their covered facility, with the ability for the entity to offset any emissions over the baseline through the surrender of eligible emissions units (at this stage, only Australian Carbon Credit Units (**ACCUs**) are eligible). If an entity exceeds its baseline, it will be subject to a penalty.

The Consultation Paper deals with:

- who will be covered by the Mechanism;
- how baselines are to be established;
- the proposed rules for new investments and significant expansions;
- how emissions can be managed (i.e. compliance options); and
- the specific arrangements proposed for the electricity sector.

Coverage

As foreshadowed in the White Paper, the Consultation Paper confirms that the Safeguard Mechanism will apply to facilities with Scope 1 (direct) emissions over 100,000 tonnes CO₂-e per annum. The entity with operational control over the facility will be the liable entity. This threshold is anticipated to cover around 140 businesses.

Specific arrangements are proposed for the waste sector whereby only emissions from waste deposited after 1 July 2012 will be covered. Once these emissions exceed 100,000 tonnes CO₂-e, the landfill will be covered by the Mechanism.

¹ Norton Rose Fulbright are leading advisers to industry and Government on the design and implementation of the ERF and we would be delighted to assist you in understanding how the Safeguard Mechanism may apply to your business and with the preparation of your submission. Please contact a member of our [Climate Change team](#) to learn more about this.

² See the Norton Rose Fulbright legal update on the White Paper at www.nortonrosefulbright.com/au/knowledge/publications/115728/emissions-reduction-fund-white-paper-released

³ See www.nortonrosefulbright.com/au/knowledge/publications/122623/the-emissions-reduction-fund-has-started-how-can-you-participate



Baselines

The approach to baselines is also the same as that set out in the White Paper, namely baselines will be set based on absolute emissions. The baseline will be the highest annual amount of emissions in a five year historical period (2009/10-2013/14) (**historical period**).

For facilities that exceed the 100,000 tonne threshold by the commencement of the Mechanism, but where their emissions did not exceed this figure during the historical period, a minimum baseline of 100,000 CO₂-e is proposed to apply.

There are also arrangements proposed for dealing with the way historical emissions were reported. For example, prior to 2014/15¹ it was possible for the emissions from individual facilities to be aggregated according to vertically integrated production processes (known as VIPP). Facilities which were reported in this way, or facilities whose boundaries have changed, will be given the opportunity to “fill in the gaps” in their historical emissions reports. If this approach is not adopted, the Clean Energy Regulator (**Regulator**) will determine the emissions for each facility on a pro-rata basis using the 2014/15 data.

For other changes to emissions reporting, such as a change in the Global Warming Potential of different greenhouse gases, the Regulator will have the ability to recalculate the baseline itself.

Facilities in the mining, oil and gas sectors will have the ability to adjust their baseline using an “independent assessment” approach (explained below) in the following circumstances:

- There is a natural resource or reserve associated with the operation of a facility;
- The grade or depth of the resource or reserve will have a direct effect on the emissions performance of the facility;
- The facility has limited ability to control such emissions; and
- Facility emissions are expected to exceed their historical baseline, and the change in natural resource grade or depth, is the primary reason for this.

New Investments

New investments and significant expansions will have their own rules for establishing the baseline. The proposal is to split new investments up into facilities which exceed the 100,000 tonne threshold pre 1 July 2020, and those who exceed it after 1 July 2020.

Pre 1 July 2020 facilities

These facilities can choose the same baseline approach as for existing facilities (i.e. the highest year during the historical period) or an “independent assessment”. However, if a facility has submitted 3 annual emissions reports during the historical period where emissions were in excess of 100,000 tonnes, they must use the historical data to determine their baseline.

Independent assessment is proposed to allow the Regulator to set a baseline on the basis of expected emissions performance over a 3 year period. The 3 year period would cover the three years after the emissions first exceed 100,000 tonnes. To determine the baseline, the Regulator would ask the operator to provide their expected highest production level during this time and associated emissions intensity, and expected absolute emissions amount. An NGER auditor would provide assurance over the assumptions underpinning the estimates.

If an operator did not apply for a baseline using this approach, the Regulator could apply a default baseline of 100,000 tonnes.

The baseline determined by the Regulator would be assessed against actual performance at the end of the 3 years, and, if the highest level of production over that period was different to the forecast, the Regulator could adjust the baseline upwards.

Post 1 July 2020 facilities

This category is intended to capture facilities where there has not been a final investment decision made. For these facilities, it is considered that it would be appropriate for them to be assessed using “best practice”. The proposal is to define best practice as the average emissions intensity of production of the top 10% of Australian industry output. Where insufficient data is available domestically, international data would be used.

The baseline for these facilities would reflect the highest expected production of the new facility in the first 3 years of operation above 100,000 tonnes multiplied by the relevant published best practice emissions intensity benchmark, aggregated for each relevant output. Once again, at the end of the 3 year period, the baseline could be adjusted upwards, if there was higher production than had been estimated.

Significant expansions

It proposed that significant expansions will be defined as an increase in production capacity of more than 20% that results from the installation of new plant or equipment. These facilities could chose the baseline approach proposed for new facilities, that is, an independent assessment for significant expansions exceeding the 100,000 tonne threshold before 1 July 2010 and for post 1 July 2020 facilities, the best practice benchmark approach (ie emissions intensity/production approach).

Emissions management

The Consultation Paper sets out the clear position that the Safeguard Mechanism:

- will not raise revenue
- will maximise flexibility for compliance.

The existing legislation provides the high-level framework for this flexible approach:

- Facility emissions must not exceed baselines
- Carbon offsets may be used to net off excess emissions
- Exemptions for exceptional exceedances (for example, natural disasters)
- Discretionary and graduated enforcement mechanisms culminating in civil penalties only.

Multi-year averaging

The Consultation Paper proposes that businesses have the ability to average their emissions over a number of years. If the operator of a facility expects that the facility’s emissions will exceed the annual baseline, the operator may apply to the Regulator for a multi-year monitoring period of sufficient but reasonable length to enable the operator to implement emissions reduction projects, acquire offsets or merely capture the natural variability in emissions.

The Government is considering a maximum of three years for this multi-year monitoring period.

Despite strong support from the resources sector, the Government has decided against pursuing an exemption from baseline compliance based on an emissions-intensity test. The Consultation Paper states that such a test would “complicate” the implementation of the Safeguard Mechanism and would be of “only limited benefit”.²

Carbon offsetting

The Consultation Paper confirms that ACCUs will be able to be used as eligible offsets under the Safeguard Mechanism. This can be done in two ways:

- surrendering to the Regulator
- sold to the Government under an ERF contract.

It appears that the first of these 2 options is intended to be for no value and will therefore encourage greater participation in the ERF auctions and other purchasing mechanisms under the second option.

While businesses will be able to create their own ACCUs for offsetting, they will not be able to count them twice. That is, where ACCUs are issued for abatement at a facility, those ACCUs are added back to that facility's net emissions and can then be used as an offset under the Safeguard Mechanism, reducing the net emissions at that time.

Exemptions in exceptional circumstances

While the Government is not considering exemptions for normal market dynamics, it is considering exemptions for exceptional circumstances beyond the control of businesses. The most obvious of these are natural disasters. It appears that exemptions will only be granted on application and the Regulator will need to be satisfied that business took steps to mitigate the risk of excess emissions, both before and after the exceptional event.

This appears to be similar to the obligation that the Government will impose on sellers under the Carbon Abatement Contract.

Enforcement

The Consultation Paper does not propose any additional enforcement options. Rather, it seeks to rely on those mechanisms which are set out in the existing legislation, being:

- Infringement notices
- Enforceable undertakings
- Injunctions to rectify emissions exceedance
- Civil penalties.

The amount of the proposed civil penalties has not yet been specified. By way of comparison, the current maximum civil penalty under the NGER Act is \$340,000 for a controlling corporation's failure to register and for the failure to provide an annual NGER report. The current maximum civil penalty under the *Environment Protection and Biodiversity Conservation Act 1999* (Cth), however, is \$8.5 million for a corporation and \$850,000 for an individual, for taking an 'action' under that Act that has, will have or is likely to have a significant impact on, generally, the environment, without first obtaining approval.

Note that while all of these enforcement mechanisms are civil in nature, a failure to comply with an enforcement mechanism, once imposed, may be further enforced through criminal proceedings.

Electricity generation sector

The Consultation Paper has responded to submissions made to the Green Paper and White Paper regarding the unique characteristics of the electricity sector, the requirement to interact with the Renewable Energy Target and the importance of complementing the existing energy market objectives. As such, it proposes an alternative application of the Safeguard Mechanism to the electricity generation sector.

At this stage, there is little detail on the alternative approach for the electricity generation sector other than the following 3 key differences:

1. *Sectoral baseline for grid-connected generation*

The Government is considering applying a sectorial baseline to grid-connected electricity generation that will be based on average historical emissions.

2. *Reversion to individual baselines*

Where this sectoral baseline is breached, individual facility baselines will then apply for subsequent financial years and the sectorial baseline will not be re-established. These individual baselines will be based on the average historical emissions over the same period as that used to establish the sectoral baseline.

3. *Coverage*

Where the sectoral baseline is exceeded, instead of applying individual baselines to all grid-connected generators, an alternative is to apply individual baselines to grid-connected generators that emit more than 100,000 tonnes CO₂-e and whose output is more emissions intensive than the average of the sector.

This option responds to the concern that low emissions intensity generators may otherwise choose not to supply, in order to stay below their own baseline.

Next steps

As noted above, the Consultation Paper is the precursor to the Safeguard Rules, which need to be made by 1 October 2015. At this stage, the intention is to release a draft of these rules in July 2015.

To this end, submissions on the Consultation Paper are required to be made to the Department by **midday AEST, Monday 27 April 2015** and may be made confidentially if required.