

20 September 2022

Department of Industry, Science and Resources
Safeguard Mechanism Taskforce
By email: safeguard.mechanism@industry.gov.au

Dear Safeguard Mechanism Taskforce

SAFEGUARD MECHANISM REFORM: CONSULTATION PAPER

Set out below are the comments made on behalf of the National Environmental Law Association (NELA) regarding the Department of Industry, Science and Resource's (**Department**) *Safeguard Mechanism Reform: Consultation Paper (Consultation)*.

About NELA

1. NELA is a peak body for advancing Australian environmental law. We are Australia's only national, multidisciplinary, member-based association focused on environmental law and sustainability. NELA serves the needs of practitioners in law, planning, natural resources and environmental science and management. NELA obtains and exchanges information on issues relevant to environmental law and policy.
2. One of NELA's objectives is to provide a forum for and otherwise assist in the discussion, consideration and advancement of environmental law among the legal profession and the wider community.

Executive summary

3. NELA wishes to begin by emphasising the extraordinary urgency of the imperative to mitigate climate change. The decade of delay in this policy arena in Australia, combined with dire projections in the most recent reports of the Intergovernmental Panel on Climate Change, and Australians' lived experiences of catastrophic and compounding extreme events in recent years, all point to the urgent need for the Australian Government to act decisively, immediately and with a high level of ambition, to reduce emissions to zero across all sectors of the economy, in every part of the continent, as soon as possible.
4. With that in mind, NELA also supports past recommendations by the Climate Change Authority (Authority), that an 'enhanced safeguard mechanism' is a 'pragmatic and durable way of reducing emissions across a range of industrial, manufacturing and resource sectors'. We acknowledge that there is much ground to be made up in Australia's transition to net zero carbon.

5. Over the long term, we support the implementation of the broader and more ambitious Roadmap for Climate Reform¹, set out in the report of the same name by the Environmental Defenders Office. However, in the context of the narrower focus for this consultation process, we make the following submissions:
- NELA submits that prescriptive and ambitious baselines will be crucial, and new facilities in particular should be required to meet the highest possible standards, right from the outset.
 - Baselines for all medium-to-high emitting facilities should be reduced in a predictable way over time, and clearly and consistently enforced.
 - NELA expresses qualified support for the introduction of a Safeguard Mechanism Credit. A crediting scheme of this kind may be extremely useful but, if it is to be established, it should be supported by the highest integrity standards and rigorous approaches to scrutiny and accountability.

Submissions on Consultation

Removing headroom, setting baselines for new facilities, and revising baselines over time

6. NELA strongly supports the need to remove the existing headroom in baselines so that crediting, trading and a clear policy trajectory for strong climate mitigation, commences immediately. The Department has specifically requested feedback on two particular options for resetting baselines to remove ‘headroom’: (a) benchmark (industry average) or (b) site-specific emissions-intensity values.
7. The Department has also requested feedback on how baselines should be set for new facilities: (a) best practice or (b) benchmark (industry average). We are not technical experts on the various mechanisms that have been proposed, but we provide brief feedback on these considerations before turning to the question of integrity.

Remove headroom by applying an industry-average baseline (but impose an inflated standard of ambition for industries with a high proportion of ‘laggards’ such as coal fired power generators, to push the ‘industry average’ closer to a ‘best practice’ standard).

8. Given that the Australian Government is proposing to introduce credits ‘for facilities that emit less than their baseline’, the level of ambition in the baseline must be high, to ensure that incentives are only awarded for real emissions reductions. Facilities that are operating at a better-than-industry-average should not bear the same costs and impacts that laggards face in the transition to a decarbonised economy; and NELA opposes the introduction of uniform scaling, as described in Box 3.3 on p 14. We acknowledge the Department’s advice, in its consultation paper, that an industry-average approach is more transparent, would hold all facilities in an industry to the same standard, and would leave least-emissions intensive producers relatively better off (p 14). On that basis, NELA supports an approach that removes headroom by – at least at first – adopting an industry average approach to setting baselines.
9. That said, NELA is concerned that relying solely on the ‘industry average’ may compromise emission reductions in industries with a weak industry average – that is, where the weight of ambition for emission reductions is low. Facilities that operate in long-life, ageing and slow-to-innovate industries, such as coal- and gas-fired power generation, may face reduced incentives to rapidly cut emissions, particularly if facilities benefit from a lower industry-wide standard. This risks creating a perverse incentive for a whole industry to move slowly on emissions reductions.

¹ Environmental Defenders Office, ‘A Roadmap for Climate Reform’ <https://www.edo.org.au/publication/a-roadmap-for-climate-reform/>

10. To avoid this scenario, NELA recommends that the Department investigate supplementing the industry average standard with a mechanism to inflate that standard in certain (transparent, predictable) circumstances – pushing it closer towards a best practice standard if the industry average is insufficiently ambitious.

New facilities

11. NELA strongly supports the introduction of a requirement that all new facilities meet the best practice baseline for the particular industry to which the new facility belongs. As noted above, the task of reducing emissions is urgent and the necessary timeline for decarbonisation is extremely short. It would be inappropriate to allow new facilities to begin operation at an ‘industry average’ standard when the baseline requirements should be consistently and decisively reducing that average standard. Best practice, at the time at which a facility ‘comes online’, ought to be expected to become industry average over a relatively short period of time. Perhaps most importantly, while there is an argument to provide a transition process for existing facilities, which are already part-way through their operating life, new facilities have no such argument. There is no reason why a new facility cannot be designed and developed to achieve the best possible mitigation outcomes as we rapidly transition to a zero carbon economy.

Fixed or production-adjusted baselines

12. The Department’s consultation paper also sought feedback on whether fixed or production-adjusted baselines are to be preferred. NELA supports the continuation of production-adjusted baselines, on the proviso that baselines be set at a standard (and reduced in a way) that actively incentivises innovation and improvements in emissions from every facility. That is, NELA does not adopt the argument that growing a strong economy is an equivalent imperative to mitigating climate change, nor that economic growth should be considered a crucial consideration in determining our ambition when setting baselines for emissions reductions. The fundamental nature of the challenges that we face demand something more than the economic-environmental-social balance that has undermined so much of environmental law over past decades. More compelling is the case for production-adjusted baselines continuing to operate to reduce emissions intensity, even in periods of economic downturn (p 11, Consultation Paper).
13. We highlight the risk that facility operators in certain sectors may capitalise on a production-adjusted baseline to increase output as a way of reducing the ‘intensity’ of their operations overall. We are particularly wary of this opportunity for high-emitting facilities in fossil fuel electricity generation, given the current context of extraordinarily high energy prices, which provides an incentive to maximise production and thus may reduce incentives to address climate emissions. We also note the old adage in environmental management that ‘dilution is the solution to pollution’ and its application to diluting emissions by increasing production and thus undermining progress on emissions targets. Given the trajectory of climate impacts that we risk facing in the short, medium and long terms, we urge the Australian Government to ensure that high-emitting industries cannot ‘dilute’ the potential to breach emissions baselines by increasing production (and thus, both profits and emissions).

Practice and process: the need for integrity

14. NELA sees value in revising the Safeguard Mechanism to create a new legal instrument: a ‘Safeguard Mechanism Credit’ (SMC). By allowing facilities that beat their baselines to receive SMCs, which they can then sell to high-emissions facilities that have not met their baseline, the revised Safeguard Mechanism scheme could be more readily applied, immediately, to all facilities and operators, including Australia’s heaviest emitters. The 215 heaviest emitters currently collectively emit just over a quarter of Australia’s domestic emissions (Clean Energy Regulator 2022), and more comprehensive coverage will ensure that future tightening of the scheme’s rules,

including adjustments to baselines, will have real, and meaningful implications for Australia's national emissions.

15. However, NELA is concerned that other examples of credits or offsets in the Australian economy have been the subject of controversy and significant integrity shortfalls (particularly carbon offsets generated under the national Emission Reduction Fund (**ERF**) – also overseen by the Clean Energy Regulator). The task of rapidly decarbonising all sectors of the Australian economy is too important and too urgent to be mired in the kinds of controversies that have emerged in relation to carbon offsetting under the ERF. If the Clean Energy Regulator is to create and administer a SMC scheme, NELA urges the Department, in the strongest possible terms, to ensure that that scheme is set up with the highest integrity standards, clear timeframes within which the scheme will be independently reviewed, and mechanisms for triggering reform if shortfalls or weaknesses in the scheme are identified.
16. To ensure a high-integrity approach to the proposed SMCs, NELA supports the recommendations made by the Climate Council in its Power Up report² including:
 - Imposing a tight limit on the number of carbon credits that a facility can purchase to meet its obligations – ensuring that the scheme is oriented towards ‘achieving absolute emissions reduction rather than simply facilitating large-scale carbon offsetting’.
 - Avoiding any perverse incentives or regressive subsidies, instead encouraging ‘facilities to achieve the greatest possible emissions reductions, both within the current reporting period and over the longer term’.
 - Considering ‘a mechanism similar to the former *Energy Efficiency Opportunities Act*. This program compelled major energy users to audit their operations for opportunities to reduce demand. It would deliver outsized benefits if paired with a government funded clearing house for information about emissions reduction opportunities and grant funding for facilities covered by the Safeguard Mechanism’.
17. More generally, on the topic of integrity, we understand that industries have had the opportunity to negotiate baselines with the Clean Energy Regulator in the past, rather than having those baselines determined by a combination of rigorous, verified estimates of particular facilities’ emissions, and the application of a code or standard industry-wide calculation process. This is a significant concern. In some cases, at least, we understand that the negotiation process has resulted in dramatically-inflated baselines that far-exceed annual estimated emissions (ACF 2022; see acf.org.au/what-is-the-safeguard-mechanism). A recent ACF investigation also demonstrated that, in some cases, the Clean Energy Regulator has adjusted a facility’s baseline temporarily to avoid companies that have breached their baselines from suffering consequences or penalties.
18. NELA submits that, however baselines are set under a revised Safeguard Mechanism, these kinds of opaque, negotiated arrangements and ad hoc exemptions must not be allowed to occur. Regulated operations must be subject to continuing reporting obligations and transparent calculations of annual estimated emissions (made publicly available), so that baselines can be set in a way that is consistent with those estimates, scrutinised, and tightened over time. The ACF investigation found that the Clean Energy Regulator had never penalised a company for exceeding the baseline. For the revised Safeguard Mechanism to be effective, baselines must certainly be appropriate, and strong integrity mechanisms will assist with that. However, in addition, penalties and other consequences for their breach must be strictly enforced.

Are there any other issues to consider with the proposal to allow the Clean Energy Regulator to automatically issue tradable credits to Safeguard facilities whose emissions are below their baseline,

² Climate Council, ‘Power Up: Ten Climate Gamechangers’ (September 2022) p. 22, https://www.climatecouncil.org.au/wp-content/uploads/2022/09/CC_MVSA0319-CC-Report-Power-Up-Ten-Energy-Game-Changers_V8-FA-Low_Res_Single-Screen.pdf

with crediting and trading commencing on 1 July 2023 subject to baseline setting arrangements that remove aggregate headroom?

19. NELA concurs with the comments made by the Carbon Market Institute that SMCs should only be automatically issued if the Clean Energy Regulator can be certain that those credits represent a genuine emissions reduction. NELA notes that this is likely to depend on the design of how emissions baselines will be set under the reformed Safeguard Mechanism. For example, SMCs should not be automatically issued if the Clean Energy Regulator cannot be sure that facilities whose emissions are “below their baseline” are as a result of the facility taking additional steps to reduce their emissions. Otherwise facilities would be rewarded despite not making any extra effort to reduce emissions.
20. As pointed out by the Carbon Market Institute, the larger issue with this is that “true emission reductions from the market would be far smaller than the amount accounted for in net-terms, jeopardising Australia’s [now officially legislated] emissions reduction targets”.³

Should banking and borrowing arrangements be implemented for Safeguard Mechanism Credits?

21. If banking and borrowing arrangements are implemented, these need to be managed in a transparent and robust manner. The worst-case scenario, which the Safeguard Mechanism should be designed to avoid is emitters borrowing credits, but not paying them back.
22. The banking of credits may also lead to higher emissions in the future, which companies are only able to do as a result of relying on banked or borrowed credits. It has been commented, that allowing banked credits was a major issue in the European Union (EU) because the stockpile of banked credits grew too large. The EU subsequently moved to remove banked credits from the market.⁴ Australia should take all necessary steps to avoid a similar scenario. Therefore, whilst banking credits is arguably a necessary tool as companies begin the emissions reduction transition, the long-term vision should be for no credits to be banked so as to force emitters to continually reduce their emissions below their baseline year-on-year. NELA therefore supports the proposal for banking of credits to not be permitted beyond ‘phase 2 (2025-26 to 2029-30).
23. Alternatively, rules could be imposed that restrict the use of banked credits to a limited percentage of an emitter’s future emissions. This would incentivise emitters to bank credits for future use, but also incentivise emitters to also take other initiatives to reduce their emissions.

Further, should no new ERF projects be able to be registered at Safeguard facilities?

24. Yes, NELA agrees with this proposal. This is to avoid the risk of Safeguard facilities with registered ERF projects from generating both ACCUs and SMCs, thereby triggering double counting risks.

We would be happy to provide additional information about the issues we have raised in this submission.

Yours sincerely,

National Environmental Law Association
publications@nela.org.au | www.nela.org.au

³ Carbon Market Institute, ‘Potential futures for Australia’s Safeguard Mechanism’ (2022) <https://carbonmarketinstitute.org/app/uploads/2022/06/Potential-futures-for-Australias-Safeguard-Mechanism.pdf>.

⁴ The Conversation, ‘Australia may be heading for emissions trading between big polluters’ (2022) <https://theconversation.com/australia-may-be-heading-for-emissions-trading-between-big-polluters-188799>).