



## Climate Council of Australia

Submission to: Department of Climate Change, Energy, Environment and Water - Safeguard Mechanism Review

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## About the Climate Council

The Climate Council is an independent non-profit organisation funded by donations by the public. Our mission is to provide authoritative, expert advice to the Australian public on climate change and solutions based on the most up-to-date science available.

To find out more about the Climate Council's work, visit [www.climatecouncil.org.au](http://www.climatecouncil.org.au).

# 1. Introduction and context

We thank the Federal Government and Department of Climate Change, Energy, Environment and Water for this opportunity to help strengthen the Safeguard Mechanism to enable dramatic emissions reductions this decade. Our submission is based around three key principles for the reform of the Safeguard Mechanism. These are:

1. To build confidence in the scheme, it must demonstrate the highest levels of integrity, transparency and accountability.
2. To realise deep emissions reductions this decade and realise the scheme's potential, baselines must be set to enable the highest possible ambition.
3. To avoid locking in high emissions and to maintain social licence and political feasibility, the scheme must avoid placing any ceiling on future ambition.

Australia plays an outsized role in driving the global climate crisis. On a per person basis, we are the most polluting nation in the developed world - even before considering the impact of our globally significant fossil fuel exports.<sup>1</sup> Reflecting the urgency of the global climate crisis and Australia's role in it, the Climate Council recommends that Australia set its sights on reducing greenhouse gas emissions to 75% below 2005 by 2030.<sup>2</sup>

**A reformed Safeguard Mechanism must not create any barriers to the Federal Government lifting its ambition in future years.** When the Federal Government improves our Nationally Determined Contribution commitment through the Paris Agreement - as it will need to do in future - the emissions reduction effort to be delivered through this mechanism must increase in tandem.

Climate change is accelerating with deadly consequences for Australians through worsening extremes like floods, heatwaves and bushfires. To tackle this existential threat to Australia's way of life, emissions must go down, so **achieving absolute emissions reduction is the key measure of success for a reformed Safeguard Mechanism.**

The facilities covered by the safeguard mechanism have played an outsized role in ensuring Australia's emissions stay high in recent times. While reported emissions from most other sectors have either held steady or

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<sup>1</sup> "From Paris to Glasgow: A World on the Move," n.d.

<sup>2</sup> Climate Council, "Aim High, Go Fast: Why Emissions Need to Plummet This Decade," April 15, 2021, <https://www.climatecouncil.org.au/resources/net-zero-emissions-plummet-decade/>.

decreased, emissions from facilities covered by the safeguard mechanism have increased by around 25%. As Australians face a seemingly never-ending series of events linked to the climate crisis, **it's about time that these big polluters took steps to reduce their impact on Australian lives, livelihoods and the places we love.**

The Safeguard Mechanism, in its current form, is not set up to deliver emissions reduction. While the scheme may have been enacted to avoid emissions increases from Australia's largest emitters, the reality is that over the first five years of its operation emissions from covered facilities - our largest industrial emitters across all sectors, including coal and gas producers, manufacturing, mining and transport - have trended upward. At the same time, the annual quantity of Australian Carbon Credit Units surrendered under the scheme has gone backward. As such, while the scheme could play a valuable role in reducing Australia's greenhouse gas emissions, realising this potential will be challenging. The recommendations provided in this Climate Council submission would turn the Safeguard Mechanism into a robust, credible and effective lever for strong emissions reduction, if implemented as a package.

Given the scale of the emissions reduction task facing Australia, we also urge the Federal Government to consider taking further steps alongside this reform process to encourage and incentivise genuine investment in clean technologies by Australia's major industrial emitters. In particular, we encourage the Government to consider implementing a mechanism similar to the *Energy Efficiency Opportunities Act 2006*, which required major energy users to identify and evaluate practical opportunities to achieve energy efficiency. Running a scheme such as this alongside funding mechanisms available through the National Reconstruction Fund, the Powering the Regions Fund and other state and territory funding sources would provide practical support and incentives for major industrial emitters to invest in the genuine technology improvements which can drive down their emissions. Integrating these policy levers to create an emissions reduction clearing house would provide very substantial benefits to industry, positively bolstering the government's use of direct regulatory levers through the Safeguard Mechanism. For more details, please refer to the Climate Council's ['PowerUp: 10 climate gamechangers'](#).

We look forward to engaging further with the Government, Department and Parliament through the process of redesigning the Safeguard Mechanism to make it a tool that drives Australia's largest industrial facilities to decarbonise. The Safeguard Mechanism can help to ensure clean, resilient, future-proof industries employing Australians for generations to come, if we get it right.

## Recommendations

The Climate Council's recommendations are summarised below; further discussion and supporting data on each is outlined through this submission. A scheme that ensures that Australia's biggest polluters take responsibility for the consequences that their operations have on the global climate must meet the minimum standards outlined below.

### Recommendation 1

A schedule of progressive decreases to the designated large facility threshold should be included in the Safeguard Mechanism Rule to send a clear and long-term signal for investments that are being made today. This would ensure the Safeguard Mechanism is able to track the reduction efforts of major emitters all the way to net zero.

### Recommendation 2

There is no good reason for the continued exclusion of large gas-fired electricity generators from the Safeguard Mechanism. Consideration should be given to bringing these facilities within the scheme, or implementing alternative but equivalently rigorous mechanisms for incentivising emissions reduction in this sector.

### Recommendation 3

To ensure Australia can meet its Nationally Determined Contribution, and the targets outlined in the *Climate Change Act 2022*, cumulative covered emissions from facilities bound by the Safeguard Mechanism should be no higher than 89 million tonnes (CO<sub>2</sub>e) in 2030. This must be an absolute cap for Australia to achieve the emissions reduction now written into law, meaning there is no clear mechanism for accommodating new high emissions projects. Failure to do this will force other sectors to pick up the slack of the industrial sector's low ambition.

#### **Recommendation 4**

To ensure that the reformed scheme delivers the abatement necessary to reach the Federal Government's 2030 emissions reduction target as a minimum, absolute emissions reduction goals should be set at regular intervals between scheme commencement in 2023 and this target date. Mechanisms should be inserted into the legislation which trigger a review and proportional tightening of all facility baselines if the scheme as a whole fails to meet the absolute emissions reduction goals for a given period.

#### **Recommendation 5**

There should be no carve-outs or caps on ambition for whole categories of scheme participants or individual facilities. To do so would unfairly force other facilities or sectors to do more. Any use of flexibility mechanisms like additional crediting and multi-year reporting diminishes the overall integrity of the Safeguard Mechanism and should therefore be avoided.

#### **Recommendation 6**

In the rare instance where additional flexibility is required for a sector, or facility this should occur through flexibility with access to the ACCU market, rather than adjustments to baselines.

#### **Recommendation 7**

Facility-specific production variables should be removed from the scheme. This will incentivise production at less emissions intensive facilities, and disincentivise production at emissions intensive facilities. Done right, this will also provide the necessary triggers for private investment in emissions reductions at facilities where it is most overdue.

#### **Recommendation 8**

Production variables should be set at the standard of best in class, and linearly decline on an annual basis.

## **Recommendation 9**

To ensure that the scheme contains sufficient incentives to reduce the consumption of coal, oil and gas, limitations should be placed on the use of credits, both Safeguard Mechanism Credits (SMCs) and Australian Carbon Credit Units (ACCUs). This includes:

- A requirement to use SMCs before accessing ACCUs;
- A total percentage limit on the use of ACCUs;
- No use of international carbon credits.

Land-based offsets are no substitute for cutting emissions at source. Limiting the use of crediting and offsets other than those credits created within the scheme is essential to drive genuine, absolute emissions reduction in the years to 2030 and beyond.

## **Recommendation 10**

There should be limited ability to bank credits under the scheme, particularly in the early stages, and no ability to borrow. Credits generated in one year should be cancelled if they are not surrendered within two years.

## **Recommendation 11**

There should be a legislated review of credit creation and use in year three to ensure that this component of the scheme is, and remains, fit-for purpose in delivering at least Australia's legislated 2030 ambition.

## **2. Scope of the scheme**

The Safeguard Mechanism applies to facilities that report under the *National Greenhouse and Energy Reporting Act 2007* (Cth) (*NGER Act*). The binding requirements of the Safeguard Mechanism are determined by two factors: sectoral coverage and the designated large facility threshold. Specifically, the scheme only applies to facilities that emit more than 100,000 tonnes of greenhouse gas emissions in a given year from energy production, industrial processes or waste ('covered emissions') from their own facilities.

For the reasons set out below, the Climate Council has determined that there would be minimal benefit in adjusting either the sectoral coverage of the Safeguard Mechanism or the designated large facility threshold at this time. However, there is a clear need to ensure a sustained pathway to net zero for covered facilities so that they remain accountable for emissions reduction even as these drop below the current threshold over time. Some consideration should be given to whether to bring large gas-fired electricity generators into the scheme over time.

## Sectoral coverage

As with the broader *NGER Act*, the Safeguard Mechanism is not intended to capture all of Australia's greenhouse gas emissions. The scheme currently excludes agriculture and land clearing. It also effectively excludes the electricity sector. As shown in Table 1, this latter exclusion means that emissions from nine out of ten of Australia's biggest emitters - all coal-fired power stations - are excluded from the scheme.

The Safeguard Mechanism is enabled by the *NGER Act* and inherits many of the enabling act's limitations. For example, agriculture and land clearing emissions were originally excluded from the operation of that Act from the date of passage; it is limited to emissions from energy, industrial processes and waste. As such, while emissions from certain on farm operations like diesel use might be included if they were to reach relevant thresholds, emissions from livestock, land-clearing or fertiliser application will not. The stated rationale for this was because robust measurement methods didn't exist to assess emissions from these sectors. While this may longer be the case today, there are principled reasons to maintain the Safeguard Mechanism's focus on energy and other industrial emissions. The solutions required to reduce emissions in our industrial facilities are often of the same nature as one another, while the solutions to driving down agricultural emissions and land clearing are fundamentally different.<sup>3</sup> As such, we would prefer that alternative schemes be used to drive emissions reduction in the agriculture and land sectors.

Generators providing electricity to one of Australia's five largest grids<sup>4</sup> are technically included in the scheme, though covered by a single baseline

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<sup>3</sup> For more details, see, Climate Council, "Agriculture's Contribution to Australia's Greenhouse Gas Emissions," June 15, 2021, <https://www.climatecouncil.org.au/resources/australia-agriculture-climate-change-emissions-methane/>.

<sup>4</sup> The National Electricity Market, South West Interconnected System, North West Interconnected System, Darwin – Katherine Interconnected System and Mount – Isa Cloncurry network.



which applies to all facilities cumulatively. This baseline is set at the historic high point for the sector. In 2009 emissions from covered electricity generating facilities were 198 MtCO<sub>2</sub>e. With the share of renewable energy increasing by 20% over that time - and coal generation falling by the same amount - there is no realistic prospect of covered electricity generating facilities exceeding this baseline. In the (impossible) event that emissions in this sector exceed 198 MtCO<sub>2</sub>e in a year, facilities would be bound by the Safeguard Mechanism's normal operation from the following year.

**Table 1: Australia's 10 largest emitters and their Safeguard Mechanism limits**

Rank	Name	Emissions in 2020-21	Facility safeguard?
#1	Loy Yang A (Brown Coal Power Station)	19.15 MtCO <sub>2</sub> e	No
#2	Bayswater (Black Coal Power Station)	12.76 MtCO <sub>2</sub> e	No
#3	Eraring (Black Coal Power Station)	12.71 MtCO <sub>2</sub> e	No
#4	Yallourn (Brown Coal Power Station)	11.07 MtCO <sub>2</sub> e	No
#5	Tarong (Black Coal Power Station)	10.64 MtCO <sub>2</sub> e	No
#6	Loy Yang B (Brown Coal Power Station)	9.70 MtCO <sub>2</sub> e	No
#7	Mt Piper (Black Coal Power Station)	7.08 MtCO <sub>2</sub> e	No
#8	Liddell (Black Coal Power Station)	7.02 MtCO <sub>2</sub> e	No
#9	Stanwell (Black Coal Power Station)	6.92 MtCO <sub>2</sub> e	No
#10	North West Shelf (Liquefied Gas Export)	6.78 MtCO <sub>2</sub> e	Yes

While the original rationale for functionally excluding electricity from the Safeguard Mechanism is questionable, adding Australia's fleet of coal generators to the scheme is likely to be detrimental to scheme integrity for the simple reason that these power stations are likely to close far sooner than those dates that have been publicly announced by their operators. While there is uncertainty as to the timing, it is plausible that Australia's entire fleet of coal-fired power stations could close before the end of 2030.<sup>5</sup>

<sup>5</sup> The most ambitious scenarios contained in AEMO's Integrated System Plan - Hydrogen Superpower and the Strong Electrification sensitivity - both have zero generation from coal in the 2031 financial year. Further, Western Australia has announced that its two state-owned coal fired power stations will close by 2030. The last remaining coal-fired power station - Bluewaters in Collie - has no fuel supply agreement beyond 2030 and has been struggling to prove its financial viability for a number of years. See: Australian Energy Market Operator, "2022 Integrated System Plan," 2022, <https://aemo.com.au/energy-systems/major-publications/integrated-system-plan-isp/2022-integrated-system-plan-isp>; WA Government, "State-Owned Coal Power Stations to Be Retired

Whether or not this extraordinary rate of change occurs, the transformation in Australia's largest grids will inevitably occur at a very rapid pace. Including coal fired electricity generators in the mechanism now would therefore risk skewing the overall setting of absolute reduction targets and baselines in a way that would be detrimental to its long-term effectiveness.

That said, there are 44 large gas-fired power stations that would qualify for the Safeguard Mechanism if it were not for the sectoral baseline applying to all electricity facilities. These facilities, which each produced in excess of 100,000 tonnes of greenhouse gas in the 2021 financial year, are highly unlikely to experience the same pressure to close as coal. Cumulatively, these facilities emitted over 14 MtCO<sub>2</sub>e in 2021 alone. Consideration should be given to how these facilities can be incentivised to reduce their emissions, whether through the Safeguard Mechanism or otherwise. In an era of fossil fuel super-profits and market manipulation from these fossil fuel operators,<sup>6</sup> it is unreasonable that these generators should be freed of all obligations to reduce their emissions.

Electricity generation that is not associated with one of Australia's five largest grids - including on-site electricity generation at mines and other facilities - is covered by the scheme and should remain so.

## Designated large facility threshold

Binding commitments for facilities under the Safeguard Mechanism apply when the facility emits more covered emissions than the designated large facility threshold. The threshold is set in the *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015 (Cth) (Safeguard Mechanism Rule)*. Currently, section 8 of the *Safeguard Mechanism Rule* sets the threshold at 100,000 tonnes CO<sub>2</sub>e of reported covered emissions per year.

The Climate Council believes there is limited benefit to lowering the designated large facility threshold at this time in order to capture more, and more types, of economic activity. However, provision should be made for emissions limits to continue to apply to covered facilities as they reduce

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by 2030 with Move towards Renewable Energy," June 20, 2022, <https://www.wa.gov.au/government/announcements/state-owned-coal-power-stations-be-retired-2030-move-towards-renewable-energy>; Josh Zimmerman, "Synergy Contract with Collie Coal Plant Won't Be Renewed," The West Australian, June 20, 2022, <https://thewest.com.au/business/energy/bluewater-power-station-synergy-wont-renew-contract-with-collie-coal-plant-c-7201639>.

<sup>6</sup> Australian Competition and Consumer Commission, "ACCC Updates on Recent Electricity Market Challenges," Text, Australian Competition and Consumer Commission, June 20, 2022, <https://www.accc.gov.au/media-release/accc-updates-on-recent-electricity-market-challenges>.

their emissions all the way to zero. This will ensure covered facilities maintain a consistent reduction pathway and avoid Australia's emissions reduction efforts stalling in the years beyond 2030.

The original purpose of the *NGER Act* was to place emissions reporting obligations on corporate groups that emit more than 25,000 tonnes CO<sub>2</sub>e of covered emissions per year. In the 2021 financial year, 413 of Australia's largest corporations were required to do so. Cumulatively, these companies were responsible for 315 million tonnes - or just under two thirds - of Australia's greenhouse gas emissions in that year. Most, though not all, emissions reported under the *NGER Act* will be from individual facilities that could be covered by lowering the threshold at which facilities are required to report.

Recognising that the general obligation to report under the *NGER Act* applies to corporate groups rather than individual facilities, the 315 million tonnes of greenhouse gas emissions reported under the Act - with its lower threshold of 25,000 tCO<sub>2</sub>e - is not substantially more than the total emissions notionally covered by the scheme already. In the same year, grid-connected electricity generators emitted 155 MtCO<sub>2</sub>e and other facilities covered by facility-level baselines emitted 137 MtCO<sub>2</sub>e for a total of 292 MtCO<sub>2</sub>e.

If the treatment of sectors like agriculture and electricity remains unchanged, lowering the Safeguard Mechanism threshold from 100,000 tonnes to 25,000 tonnes would deliver only a relatively minor additional benefit. Very likely, this would result in less than 20 million tonnes of additional annual greenhouse gas emissions being captured by the scheme - and expand the coverage of the scheme by around 10%.

However, if the Safeguard Mechanism works as intended, the quantum of emissions that fall out of the scheme will grow substantially over time as designated large facilities reduce their emissions and fall below the threshold. The updated scheme design should therefore ensure that covered facilities continue to be captured as they progressively reduce their emissions all the way to net zero.

To ensure that long-term business signals are sent for major infrastructure projects being built today, the Climate Council proposes that future reductions to the designated large facility threshold be included in the rule today. An example of this, which lowers the designated large facility threshold linearly in half-decade increments is contained in Table 2.

**Table 2: Example of declining designated large facility threshold schedule**

Financial years covered	Designated large facility threshold
2024 – 2029 <sup>7</sup>	100,000 tCO <sub>2</sub> e
2030 – 2034	85,000 tCO <sub>2</sub> e
2035 – 2039	70,000 tCO <sub>2</sub> e
2040 – 2044	55,000 tCO <sub>2</sub> e
2045 – 2049	40,000 tCO <sub>2</sub> e
2050 onward	25,000 tCO <sub>2</sub> e

### **Recommendation 1**

A schedule of progressive decreases to the designated large facility threshold should be included in the Safeguard Mechanism Rule to send a clear and long-term signal for investments that are being made today. This would ensure the Safeguard Mechanism is able to track the reduction efforts of major emitters all the way to net zero.

### **Recommendation 2**

There is no good reason for the continued exclusion of large gas-fired electricity generators from the Safeguard Mechanism. Consideration should be given to bringing these facilities within the scheme, or implementing alternative but equivalently rigorous mechanisms for incentivising emissions reduction in this sector.

## **3. Relative ambition**

The Climate Council believes that - at a minimum - the Safeguard Mechanism must be designed to deliver the level of greenhouse gas abatement modelled by Reputex in its pre-election work on the *Powering Australia Plan*. That is, the scheme must be designed to ensure that cumulative covered emissions from those facilities bound to the Safeguard

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<sup>7</sup> Six years are included in the first period to bring this into cycle with Australia's nationally determined contributions.

Mechanism are no higher than 89 million tonnes CO<sub>2</sub>e in 2030 and ideally lower than this.

The rationale for this is simple. Australia's Nationally Determined Contribution and the targets contained in the *Climate Change Act 2022* are based on the output of modelling performed by Reputex ahead of the 2022 Federal Election. The 2030 emissions reduction goal of 43% below 2005 levels was arrived at via Reputex's modelling of ALP policies put forward at that election. As a result, the best way to meet and - ideally - exceed this goal is to ensure that the sector delivers at least the level of abatement expected by the Reputex modelling.

Guaranteeing that the scheme delivers the required extent of abatement is complicated by two separate factors:

- a) New entrants to the scheme - these were not considered by the Reputex modelling, but have the potential to substantially derail Australia's capacity to meet these goals.
- b) The fact that production adjusted baselines are currently in place for all facilities rather than being based on absolute emissions, and it is not politically feasible to remove these.

For the Climate Council, both of these issues have the same solution. We propose that alongside individual facility baselines - set on an production adjusted basis - the reformed Safeguard Mechanism should also include a legislated, scheme-wide absolute emissions reduction target. This target would be designed to ensure that the scheme is reducing emissions in line with the share of emissions reductions modelled by Reputex as a minimum, and so ensuring Australia's Nationally Determined Contribution can be met.

Appropriately restraining emissions from new entrants to the scheme is also very important to ensuring that the Safeguard Mechanism delivers at least the abatement that underpins Australia's 2030 climate targets and preferably exceeds this. Coal and gas projects have an outsized impact on Australia's annual domestic greenhouse gas emissions, even when the majority of fossil fuel products are exported. A poorly understood reality is that the production, transport and processing of coal and gas is responsible for at least one in every seven tonnes of greenhouse gas released in Australia, even before considering the emissions from the end use of these fossil fuels.<sup>8</sup> More than half of all cumulative in-scope emissions within the Safeguard Mechanism

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<sup>8</sup> This estimate relies on official data contained in Australia's Emissions Projections 2021. Reported operational and inadvertent emissions releases from the coal and gas sector are likely very substantially under-reported in Australia. For more information, see, e.g., Climate Council, "Passing Gas: Why Renewables Are the Future," December 2020, <https://www.climatecouncil.org.au/resources/passing-gas-renewables-are-future/>.

come from facilities that have the principal purpose of extracting or processing fossil fuels.<sup>9</sup>

As of the end of last year, there were 72 new coal and 44 new gas projects planned in Australia.<sup>10</sup> Should all of these projects go ahead, they would produce a total of 1.7 billion tonnes of carbon dioxide equivalent greenhouse gas over their operating lives. This includes, at a conservative estimate, adding almost 150 million tonnes to Australia's domestic emissions through the onshore production and processing of coal and gas. To put that figure into context: the actions under the Rewiring Australia Plan are expected to avoid about 160 million tonnes of greenhouse gas emissions this decade.

Many of these projects may fail to proceed regardless of government policy. However, the figure above is conservative and only considers some of the climate impact from these projects. Examining just two large projects that unfortunately have the full support of the government in greater detail shows plans to grow coal and gas exports could potentially put Australia's domestic climate targets out of reach.

Reputex - the same consultancy that modelled the current Federal Government's pre-election policies - found that the Beetaloo Basin gas development and associated infrastructure alone could add up to 34 million tonnes to Australia's annual domestic greenhouse gas emissions.<sup>11</sup> This figure does not include emissions produced from the burning of gas overseas. If projects in the Beetaloo Basin were approved to proceed, much of the greenhouse gas emissions produced by the associated gas extraction, transport, and processing facilities and much of the domestic use of the gas would occur at facilities large enough to be within the scope of the Safeguard Mechanism.

Similarly, it has been estimated that Woodside's Pluto and Scarborough gas expansion plans in Western Australia could add another 6 million tonnes per year to Australia's domestic emissions.<sup>12</sup> Again, this is before considering the emissions that would be produced when gas from these developments is burned overseas.

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<sup>9</sup> Clean Energy Regulator data.

<sup>10</sup> The Australia Institute, "Undermining Climate Action: The Australian Way," November 2021,

<https://australiainstitute.org.au/post/australias-fossil-fuel-expansion-plans-equivalent-to-over-200-new-coal-power-stations/>.

<sup>11</sup> Reputex, "Analysis of Beetaloo Gas Basin Emissions," October 2021,

[https://www.lockthegate.org.au/reputex\\_analysis](https://www.lockthegate.org.au/reputex_analysis).

<sup>12</sup> Climate Analytics, "Warming Western Australia: How Woodside's Scarborough and Pluto Project Undermines the Paris Agreement," November 2021,

<https://climateanalytics.org/publications/2021/warming-western-australia-how-woodsides-scarborough-and-pluto-project-undermines-the-paris-agreement/>.

Delivery of these projects alone would completely derail the Government's emissions reduction agenda. None are considered in the modelling that underpinned Australia's now-legislated 43% target. Cumulatively, they could add almost as much to Australia's annual emissions in 2030 as the Safeguard Mechanism is supposed to avoid. That is, the combined 40 million tonnes of domestic greenhouse gas emissions these projects would produce each year would substantially negate the 48 million tonne reduction in greenhouse gas emissions the Safeguard Mechanism is expected to deliver in 2030. It is untenable that these projects should be able to proceed as an additional burden on Australia's climate mitigation efforts.

The Climate Council is opposed to these projects, given that each is independently a dramatic additional burden on the climate crisis. This threshold question aside, it is not clear how these projects can proceed without impeding Australia's overall effort to cut emissions by at least 43% below 2005 levels by 2030. The only way this would be possible is if space was made for the emissions produced by them from within the existing pool of emissions allocated to the Safeguard Mechanism. That is, for the scheme as a whole to still deliver on the required goal of at least 48 million tonnes of emissions reduction relative to today in 2030, other participants would need to cut their individual emissions far more deeply. It is highly unlikely that existing facilities within the Safeguard Mechanism would be willing to make disproportionately larger cuts to emissions in order to create space for these new entrants.

A related problem will occur with increases and decreases in production elsewhere in the scheme. Because facility baselines are set according to the emissions intensity of operations, rather than absolute emissions, changes to the productive output of a facility may lead to dramatic changes in absolute emissions. However, given that Australia's international emissions reduction commitments are framed in absolute terms, there is a clear need to bridge the gap between the limits that apply to facilities and assured delivery of the national goals.

The Climate Council proposes that both types of targets should be embedded within the scheme. Given the working consensus within industry that production adjusted baselines are easier to manage, facility baselines should continue to be set in this way. However, to ensure that the scheme as a whole is, and remains, on track to deliver at least its share of the minimum national emissions reduction task, triggers based on the cumulative covered emissions reduction trajectory required to meet that goal should be embedded in the legislation.

If the cumulative covered emissions from all facilities exceed these thresholds, this would trigger a review and adjustment of production

variables for all scheme participants. These would then be adjusted proportionally for future compliance periods. The intention is that if the scheme fails to meet its cumulative goal in a given period, in subsequent years calculated emissions baselines would decrease proportionally to correct this.

These triggers should be set in accordance with a linear progression from cumulative emissions in 2024 falling to 89 million tonnes per year in the 2030 financial year. These triggered revisions could occur annually or biennially and would be designed to safeguard the Safeguard Mechanism. An example set of revision thresholds, based on either annual or biennial assessment is included below in Table 3. The advantage of the biennial review is that any variation in individual years would be unlikely to affect the scheme as a whole.

**Table 3: Scheme-wide Absolute Emissions Targets for either annual, or biennial, revision**

Financial year	Scheme-wide Absolute Emissions Target	
	Annual revision threshold	Biennial revision threshold
2024	137 MtCO <sub>2</sub> e	266 MtCO <sub>2</sub> e
2025	129 MtCO <sub>2</sub> e	
2026	121 MtCO <sub>2</sub> e	234 MtCO <sub>2</sub> e
2027	113 MtCO <sub>2</sub> e	
2028	105 MtCO <sub>2</sub> e	202 MtCO <sub>2</sub> e
2029	97 MtCO <sub>2</sub> e	
2030	89 MtCO <sub>2</sub> e	<i>Next period</i>

Whether these revisions occur on an annual or biennial basis, the revision schedule and its thresholds should be legislated to provide certainty for scheme participants and make clear the Parliament’s intention for the scheme to deliver absolute emissions reduction of at least this level over time .

Importantly, given the Federal Government’s insistence that the 43% target is a “floor, not a ceiling” on Australia’s emissions reduction ambition, if the scheme outperforms these annual or biennial thresholds, there should be no adjustment to these settings.



### **Recommendation 3**

To ensure Australia can meet its Nationally Determined Contribution, and the targets outlined in the *Climate Change Act 2022*, cumulative covered emissions from facilities bound by the Safeguard Mechanism should be no higher than 89 million tonnes in 2030, *inclusive of* any new entrants. This must be an absolute cap for Australia to achieve the emissions reduction now written into law, meaning there is no clear mechanism for accommodating significant new high emissions projects. Failure to do this will force other sectors to pick up the slack of the industrial sector's low ambition.

### **Recommendation 4**

To ensure that the reformed scheme delivers the abatement necessary to reach the Federal Government's 2030 emissions reduction target, absolute emissions reduction goals should be set at regular intervals between scheme commencement in 2023 and this target date. Mechanisms should be inserted into the legislation which trigger a review and proportional tightening of all facility baselines if the scheme as a whole fails to meet the absolute emissions reduction goals for a given period.

## **4. Facility baseline setting**

To ensure the integrity of the Safeguard Mechanism, there must be limits on the range of means available to covered facilities to avoid binding limits set by the scheme. As noted in the previous section, the Climate Council is generally supportive of the continued use of baselines set on the basis of emissions intensity. Over the life of the scheme, a consensus position has been established that production adjusted variables are acceptable to most participants.

### **Flexibility arrangements**

While the Climate Council does not propose moving away from the use of production adjusted variables, other forms of flexibility within the system must be addressed to add integrity to the scheme. Facilities have access to

an unnecessary degree of additional flexibility in their ability to choose between industry-average and site-specific production variables. This has permitted operators to choose the baselines that best suit their commercial interests.

While new facilities will now largely no longer be permitted to use site-specific variables, retaining this flexibility for already registered facilities is unfair and detrimental to scheme integrity. Further, this flexibility brings no additional benefit to the scheme as a counterbalance for this lack of equity and transparency. As the scheme moves into an era where emissions reductions take on commercial value through the creation of Safeguard Mechanism Credits, this must be addressed by moving all facilities onto industry-wide production variables.

Similar issues occur with allowing inter-temporal flexibility. The existence of production adjusted baselines for all facilities already ensures that baselines are flexible. The availability of offsets (discussed further below) provides a further form of flexibility for managing short-run variability in emissions. Major emitters must be compelled to take serious action on reducing their emissions for Australia to have any chance of achieving its now-legislated emissions reduction targets. Maintaining flexibility mechanisms in the reformed scheme beyond the use of production adjusted baselines and crediting would run counter to this core objective, by providing companies with a myriad of ways to avoid making genuine reductions.

## **Emissions-intensive, trade-exposed industries**

In relation to so-called emissions-intensive, trade-exposed industries (EITEs), the government's discussion paper canvasses providing additional flexibility arrangements which would apply only to these firms. The central logic of making special allowance for EITEs is the idea of leakage - the suggestion that trade will divert to markets which do not impose restrictions or costs on emissions, and therefore place Australian companies at a competitive disadvantage. This logic was persuasive a decade ago, when few nations were taking serious action on climate change and those national and regional emissions reduction regimes that existed were still in their infancy. However, in a trend that is rapidly growing, as of 2021 more than 68 regional, national or subnational carbon prices are in effect,<sup>13</sup> covering many of the world's largest economies, key nations in our region and many markets that are competing with Australia to supply goods to the world. Furthermore, for many goods Australian firms have always been suppliers of

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<sup>13</sup> World Bank, "State and Trends of Carbon Pricing 2022," Serial (Washington, DC: World Bank, May 24, 2022), <https://doi.org/10.1596/978-1-4648-1895-0>.

choice - because of the large market share Australia provides, our geographic location close to industrial hubs in Asia and our relative geopolitical stability. Given both these factors - as well as the upcoming reality of carbon border adjustment mechanisms<sup>14</sup> - leakage is an increasingly marginal issue. Facilities engaged in international exporting generally no longer merit special treatment. If any special treatment is ultimately provided in the transition to a new set of scheme arrangements, this should be time limited and cease upon the implementation of the European Union's Carbon Border Adjustment Mechanism, currently scheduled for 2025.

As noted in the introduction to this submission, the Climate Council considers that if any support is provided to scheme participants, this should be in the form of incentives and/or co-investment linked to the implementation of new, clean technologies. This must not weaken the integrity of the Safeguard Mechanism itself through additional baseline headroom, surplus crediting or flexibility with other core policy mechanisms. The National Reconstruction Fund, Powering the Regions Fund and other Commonwealth, state and territory industry schemes provide a large and diverse funding pool which could be used for this purpose.

## **Baseline setting**

A related problem flagged in the consultation paper is the issue of headroom, with many baselines set substantially above emissions. Before the Safeguard Mechanism can be made to work to reduce greenhouse gas emissions from covered facilities, this excess capacity must be removed from the scheme. This is especially so given the government's stated intention to allow below baseline crediting through the creation of Safeguard Mechanism Certificates. Credits issued on the basis of nothing more than overly permissive baselines will lack additionality and discentivise real action to reduce emissions. Baselines must be set using accurate and up-to-date data on actual facility emissions in 2021-22, as reported in the most recent government data.

The use of industry-average emissions variables as proposed in the consultation paper will likewise result in a dampened signal to reduce emissions at covered facilities. Major polluters that are more emissions intensive per unit of production will experience diminished consequences as a result of their failure to act to improve their relative efficiency, while more efficient - yet still highly polluting - facilities that are relatively more efficient

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<sup>14</sup> For more information, see: Climate Council, "Markets Are Moving: The Economic Costs of Australia's Climate Inaction," 2021, <https://www.climatecouncil.org.au/resources/markets-moving-economic-costs-australias-climate-inaction/>.

will have no early signal to reduce their climate impact. However, as the Consultation Paper notes, the continued use of facility-specific production variables (effectively 'grandfathering') would not encourage production where it is least emissions-intensive because it would not automatically reward the least emissions-intensive producers.

As a result of the above, the Climate Council recommends that facility-specific production variables be removed from the scheme, and an alternative approach taken to the use of industry averages. That is: we recommend all facilities be bound to baselines determined in accordance with **best-in-class** production variables. This will incentivise production at the most efficient facilities in their class, while sending an increasingly strong signal to those facilities that are less efficient.

Decline rates should be applied to production variables - meaning that each year the production variables reduce in a stepwise fashion required to at least meet the 2030 goal - and match the minimum ambition required of the Safeguard Mechanism as a whole. Government assistance provided through various new and existing institutions - the National Reconstruction Fund, Powering the Regions Fund, CEFC and ARENA, as well as state and territory initiatives where possible - should be applied to emissions intensity improvements on site to ensure that these ambitions are realised.

Any carve-outs, exceptions, special dispensations or free credits will necessarily increase the relative ambition required of sectors that have not received such carve-outs. At every stage, these must be avoided.

### **Recommendation 5**

There should be no carve-outs or caps on ambition for whole categories of scheme participants or individual facilities. To do so would unfairly force other facilities or sectors to do more. Any use of flexibility mechanisms like additional crediting and multi-year reporting diminishes the overall integrity of the Safeguard Mechanism and should therefore be avoided.

### **Recommendation 6**

In the rare instance where additional flexibility is required for a sector, or facility this should occur through flexibility with access to the ACCU market, rather than adjustments to baselines.

## **Recommendation 7**

We recommend that facility-specific production variables be removed from the scheme. This will incentivise production at less emissions intensive facilities, and disincentivise production at emissions intensive facilities. Done right, this will also provide the necessary triggers required to drive private investment in emissions reductions in those facilities where it is most overdue.

## **Recommendation 8**

Production variables should be set at the standard of best in sector, and linearly decline on an annual basis.

## **5. Crediting and offsetting**

The Climate Council is cautiously supportive of the idea of below baseline crediting within the Safeguard Mechanism. This support is conditional on excess headroom first being removed, so that these credits are issued only for real and additional action. Further, there needs to be close and regular examination of the role that below baseline crediting may have in creating perverse incentives, particularly at the interface of the Australian Carbon Credit Unit (ACCU) and Safeguard Mechanism Credit (SMC) market. Many carbon trading schemes have been undermined by the over-abundance of “hot air” - credits with questionable links to real emissions reduction activity.<sup>15</sup> Given the Safeguard Mechanism’s central role in driving emissions reduction in line with the Federal Government’s 45% target by 2030 as a minimum, there is no time to waste on such failures.

Unfortunately, signs are not good if the market for ACCUs is any guide. Over its life, virtually all detailed independent analyses of the ACCU market have found a complex range of integrity issues within the scheme, with most of these relating to the questionable additionality of abatement activity.<sup>16</sup>

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<sup>15</sup> Jessica F. Green, “Does Carbon Pricing Reduce Emissions? A Review of Ex-Post Analyses,” *Environmental Research Letters* 16, no. 4 (March 2021): 043004, <https://doi.org/10.1088/1748-9326/abdae9>.

<sup>16</sup> Noting that many other critical failings have been published in peer reviewed literature, grey literature and canvassed in the media: see, e.g., Paul J. Burke, “Undermined by Adverse Selection: Australia’s Direct Action Abatement Subsidies,” *Economic Papers: A Journal of Applied Economics and Policy* 35, no. 3 (September 1, 2016): 216–29,

Unfortunately many of the largest integrity issues so far uncovered reside within the three most commonly used methods. The landfill gas capture and combustion, human-induced regeneration, and avoided deforestation abatement methods are collectively responsible for three quarters of all ACCUs ever issued. Many - perhaps even most - of these credits have been issued against projects that have provided very little to no environmental benefit.

Despite the obvious detrimental consequence of this - and the very public nature of the critique - virtually no action has been taken to date to address these many failings. It is hoped that the parallel Independent Review of Australian Carbon Credit Units now underway will finally begin to take these integrity and governance issues seriously. Restoring integrity to the market - through reform to both the crediting mechanism and overall market governance of - is an essential precondition to the effective operation of the Safeguard Mechanism. Unless and until these issues are addressed, there is a real risk that over-reliance by the Safeguard Mechanism on the ACCU market means it fails to deliver genuine abatement.

Further, we note that there are substantive, biophysical differences between fossil fuel emissions - which represent the bulk of emissions covered by the Safeguard Mechanism, and land sector emissions - which represents the bulk of avoided or sequestered emissions covered by the ACCU market. Treating these two kinds of emission as fungible leads to a range of problematic effects and should be avoided wherever possible.<sup>17</sup>

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<https://doi.org/10.1111/1759-3441.12138>; Tim Baxter and George Gilligan, "Verification and Australia's Emissions Reduction Fund: Integrity Undermined Through the Landfill Gas Method?," *Australian Journal of Environmental Law* 4 (2017): 1; Adam Morton, "Up in Smoke: What Did Taxpayers Get for Their \$2bn Emissions Fund?," *The Guardian*, June 2, 2018, <https://www.theguardian.com/environment/2018/jun/03/up-in-smoke-what-did-taxpayers-get-for-their-2bn-emissions-fund>; Megan C Evans, "Effective Incentives for Reforestation: Lessons from Australia's Carbon Farming Policies," *Current Opinion in Environmental Sustainability*, Environmental change issues 2018, 32 (June 1, 2018): 38–45, <https://doi.org/10.1016/j.cosust.2018.04.002>; Australian Conservation Foundation and The Australia Institute, "Questionable Integrity: Non-Additionality in the Emissions Reduction Fund's Avoided Deforestation Method," September 2021, <https://australiainstitute.org.au/report/questionable-integrity-non-additionality-in-the-emissions-reduction-funds-avoided-deforestation-method/>. Further a number of substantial criticisms have been made by Professor Andrew Macintosh - former head of the Emissions Reduction Assurance Committee. Working papers canvassing some of the relevant issues are available here: <https://law.anu.edu.au/research/publications?text=&theme=622&year%5Bvalue%5D%5Byear%5D=&nid=&author=268>.

<sup>17</sup> Wim Carton, Jens Friis Lund, and Kate Dooley, "Undoing Equivalence: Rethinking Carbon Accounting for Just Carbon Removal," *Frontiers in Climate* 3 (2021), <https://doi.org/10.3389/fclim.2021.664130>; Climate Council, "What Is Carbon Offsetting and Is It Worthwhile?," October 15, 2020,

There are real limits to the degree to which land carbon crediting can be used to hide the fact that real emissions reductions have not occurred on-site, particularly through the combustion of coal, oil and gas. Avoiding the worst impacts of climate change requires global use of these fossil fuels to steeply decline over the years to 2030. It is not possible for land carbon sequestration to compensate for a failure to reduce novel fossil fuel emissions at source.<sup>18</sup>

Recognising these limitations with ACCUs, the Climate Council recommends that in the near term - at least - facilities be required to use any available SMCs before they are permitted to use ACCUs to meet their abatement task. We note that the now repealed *Clean Energy Act 2011* (Cth) included a 5% surrender limit, which placed a ceiling on the quantum of ACCUs that could be surrendered in order to meet a facility's obligations.

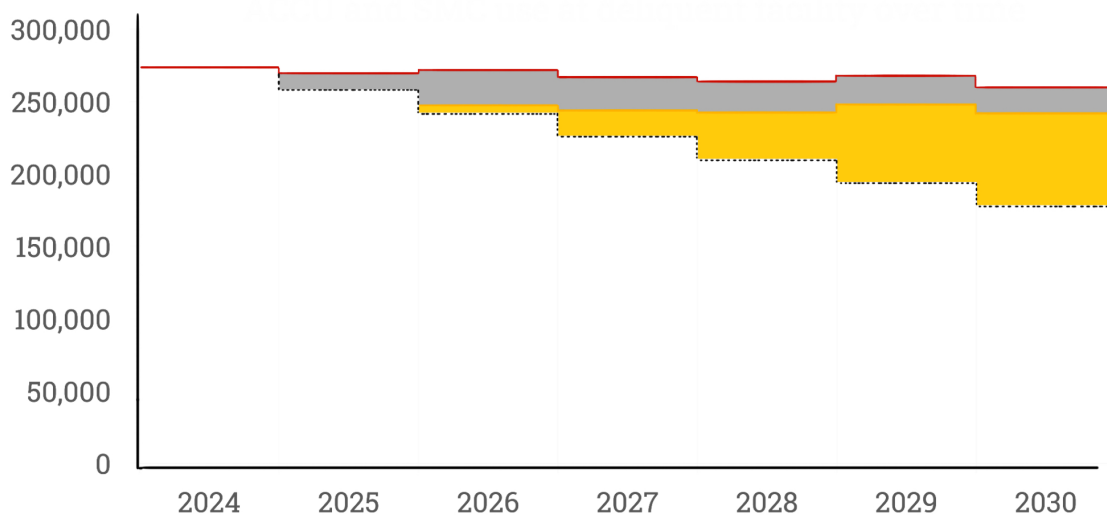
While the specific percentage used for this limit will require further consideration, a firm limit could be used to drive demand for SMCs and so ensure real emissions reductions are achieved within the scheme. This limit could be adjusted for those sectors - like aviation - where mitigation options through cleaner technologies are currently limited. An illustration of how the ACCU limit might apply over time at a facility that chooses to rely heavily on offset credits, rather than reducing emissions on site, is shown below in Figure 1.

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<https://www.climatecouncil.org.au/resources/carbon-offsetting-worthwhile/>; Climate Council, "Land Carbon: No Substitute for Action On Fossil Fuels," September 29, 2016, <https://www.climatecouncil.org.au/resources/land-carbon-report/>.

<sup>18</sup> Kate Dooley, Zebedee Nicholls, and Malte Meinshausen, "Carbon Removals from Nature Restoration Are No Substitute for Steep Emission Reductions," *One Earth* 5, no. 7 (July 15, 2022): 812–24, <https://doi.org/10.1016/j.oneear.2022.06.002>.

**Figure 1: Example chart showing ACCU and SMC use at facility that does not reduce its real emissions over time, with 10% ACCU limit (tCO<sub>2</sub>e)**



(Legend - Red line: Reported covered emissions; Grey area: Surrendered ACCUs; Yellow area: Surrendered SMCs; Dotted line: Facility baseline.)

Similar issues to the ACCU market are at play with international units, with the added complication that the Federal Government lacks any lever to ensure the environmental integrity of units. For this reason, we strongly recommend that the current prohibition on the use of international units be maintained under the reformed Safeguard Mechanism arrangements. Allowing participants access to international credits which lack integrity and are significantly cheaper than ACCUs would fundamentally undermine the integrity of the scheme and its capacity to drive genuine emissions reduction.

Noting the limited time period available for implementation and detailed modelling we recommend all use of credits within the scheme be subject to an early, independent and legislated review of the operation of the Safeguard Mechanism. International experience indicates that equivalent policy regimes have often not been calibrated correctly in their initial iteration, particularly with relation to the use of crediting and offsetting.<sup>19</sup> An independent review in year three of the scheme should therefore be undertaken to ensure that the crediting mechanisms are - and are likely to remain - fit-for-purpose while delivering Australia's 2030 climate ambitions. We recommend the renewed Climate Change Authority be tasked with undertaking this important review.

During this period of flux, with both the ACCU market and SMC market subject to change, we recommend that there be no borrowing of credits and

<sup>19</sup> Green, "Does Carbon Pricing Reduce Emissions?"



limited banking. Any unused credits should be retired two years after their creation date. That is, units created in the 2024 financial year should be retired if unused by the end of the 2026 financial year. This is to avoid the market being flooded by excess credits in the early stages of the scheme, should the headroom issues - noted above and in the consultation paper - not be appropriately addressed.

### **Recommendation 9**

To ensure that the scheme contains sufficient incentives to reduce the consumption of coal, oil and gas on-site, hard rules should be set for the use of credits, both Safeguard Mechanism Credits (SMCs) and Australian Carbon Credit Units (ACCUs). This includes:

- A requirement to use SMCs before accessing ACCUs.
- A percentage limit on the use of ACCUs.
- No international credits.

Land-based offsets are no substitute for cutting emissions at source. Limiting the use of crediting and offsets other than those credits created within the scheme is essential to drive genuine, absolute emissions reduction in the years to 2030 and beyond.

### **Recommendation 10**

There should be limited ability to bank credits under the scheme, particularly in the early stages, and no ability to borrow. Credits generated in one year should be cancelled if they are not surrendered within two years.

### **Recommendation 11**

There should be a legislated review of the credit creation and use in year three to ensure that this component of the scheme is, and remains, fit-for purpose in delivering Australia's 2030 ambition.

## Conclusion

The Climate Council is optimistic that a reformed Safeguard Mechanism can play an important role in driving the urgent emissions reduction Australia must now achieve.

However, for the Safeguard Mechanism to achieve this objective **the new settings must be calibrated to prioritise genuine, absolute emissions reduction** at every level. This scheme must not result in another form of carbon accounting which delivers notional emissions reduction on paper while allowing pollution-as-usual in practice. Key to achieving this is **removing all excess headroom** currently built into the scheme, **limiting the use of crediting and offsets**, and **dramatically scaling back the range of flexibility mechanisms** which have allowed facilities to game the system until now.

Furthermore, **facilities covered by the Safeguard Mechanism must contribute at least their proportional share of Australia's emissions reduction effort**. It is unacceptable that other parts of the Australian economy and community be asked to do more than their fair share to enable these very large emitters to do less. Equally, it would be unreasonable to expect existing facilities within the scheme to make significantly deeper cuts to emissions in order to facilitate the entry of new coal or gas facilities within the Safeguard Mechanism's overall carbon budget.

It is clear that there is much at stake in the reform of this key policy lever. We urge the Federal Government to remain focused on the enormous benefits that will be achieved through getting this right: continued prosperity in a zero emissions economy; new job and industry creation through innovation; and a safe and liveable environment for Australians - now and in the decades to come.