



Climate Council of Australia

Submission to: Senate Standing Committee on Environment and Communications- Inquiry into the Safeguard Mechanism (Crediting) Amendment Bill 2022

Addressed to: Committee Secretary, Senate Standing Committee on Environment and Communications, PO Box 6100 Parliament House, Canberra, ACT 2600

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25 January 2023

About the Climate Council

Climate Council is Australia's own independent, evidence-based organisation on climate science, impacts and solutions.

We connect decision-makers, the public and the media to catalyse action at scale, elevate climate stories in the news and shape the conversation on climate consequences and action, at home and abroad.

We advocate for climate policies and solutions that can rapidly drive down emissions, based on the most up-to-date climate science and information.

We do this in partnership with our incredible community: thousands of generous, passionate supporters and donors, who have backed us every step of the way since they crowd-funded our beginning as a non-profit organisation in 2013.

To find out more about the Climate Council's work, visit www.climatecouncil.org.au.

1. Introduction and context

The world has already warmed by around 1.2°C and Australia is suffering significant losses from climate change, with worse on the way. Extreme weather events – such as bushfires, floods, heatwaves and droughts – are happening more often, and are more severe. To avoid the worst climate impacts, global emissions must halve this decade with net zero reached in the early 2040s.

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.¹

While Australia is a wealthy, high emitting country, we also have immense renewable energy resources. This means we have both a responsibility and the ability to cut emissions faster. Australia should aim to reduce our emissions by 75 per cent (below 2005 levels) by 2030, and reach net zero emissions by 2035.

Australia cannot meet, or improve on, our legislated emissions reduction targets and make real progress on tackling harmful climate change if we do not get the Safeguard Mechanism right. Strengthening this policy is essential to ensure Australia's biggest emitters pull their weight in the national effort to reduce harmful pollution.

The companies regulated by the Safeguard Mechanism represent some of Australia's largest and most profitable corporations - many of whom are multinationals based offshore who have a history of avoiding their tax, environmental and other obligations to the Australian community.² Collectively, facilities regulated by the Safeguard Mechanism account for 28 percent of Australia's national emissions.³ Since the mechanism commenced in 2016, they have produced almost 712 million tonnes of harmful CO₂-equivalent emissions - equivalent to 1.4 times Australia's total emissions in the year to March 2022.⁴

¹ Climate Council (2021), From Paris to Glasgow: A World on the Move. Accessed: <https://www.climatecouncil.org.au/resources/paris-glasgow-world-move/>

² Climate Council (2022), Introducing the Dirty Dozen. Accessed: <https://www.climatecouncil.org.au/resources/dirty-dozen/>

³ Department of Climate Change, Energy, the Environment and Water (2023), Safeguard Mechanism Reforms Position Paper. Accessed: <https://consult.dcceew.gov.au/safeguard-mechanism-reform-consultation-paper>

⁴ Clean Energy Regulator (multiple dates), Safeguard data. Accessed: <https://www.cleanenergyregulator.gov.au/NGER/The-safeguard-mechanism/safeguard-data> ; Department of Climate Change, Energy, the Environment and Water (2022), Australia's greenhouse gas emissions: March 2022 quarterly update. Accessed: <https://www.dcceew.gov.au/about/news/australias-greenhouse-gas-emissions-march-2022->

These big emitters must pull their weight in the national effort to drive down Australia's emissions. For key industrial producers in industries like steel and aluminium, concrete and fertilisers, that means transforming how they operate so that they can thrive in a zero emissions world. There is no question that this will require significant investment - in new power sources, technologies, and research and development for production processes which do not yet exist today. Businesses must step up to this challenge with real investment, or risk losing market share and a social licence to operate as Australia and our global trading partners rapidly decarbonise. Australia's governments and our investment markets will also have a role to play in supporting this transition through unlocking and directing more capital to where it is most needed to drive this change.

Climate Council acknowledges that the primary settings for strengthening the Safeguard Mechanism will be delivered through the *National Greenhouse and Energy Reporting (Safeguard Mechanism) Amendment (Reforms) Rules 2023*, which are not the subject of this inquiry. However, settings and ministerial powers established by the *Safeguard Mechanism (Crediting) Amendment Bill 2022* have the potential to determine the effective operation of these Rules and the broader policy framework for regulating Australia's biggest industrial emitters. That is why it is essential the Senate uses the opportunity in front of it to strengthen this Bill, and ensure that the Safeguard Mechanism prioritises genuine emissions reduction.

The only lasting solution to dangerous climate change is for Australia's emissions to genuinely go down. This can occur by driving the transformation of our existing heavy industries, and ensuring we do not add fuel to the fire by continuing to open new coal, oil and gas facilities. Without the right settings for the Safeguard Mechanism, Australia will simply see more pollution-as-usual from our biggest emitters, leading to more harmful climate change that will threaten lives and livelihoods across the nation and the globe.

Summary of recommendations

In this submission, Climate Council has discussed essential improvements to the Australian Government's proposed policy settings for the Safeguard Mechanism as outlined in the Department of Climate Change, Energy, the Environment and Water Position Paper of 10 January 2023.

We have also outlined specific opportunities to strengthen the *Safeguard Mechanism (Crediting) Amendment Bill 2022* to give effect to these improvements. Further context and discussion of these recommendations is provided throughout this submission.

Policy recommendations

Climate Council recommends the draft Safeguard Mechanism settings released by the Australian Government be updated to clarify that:

- Safeguard Mechanism-regulated facilities must demonstrate practical steps and/or investments in train to genuinely reduce emissions *before* being able to purchase SMCs or ACCUs to meet their determined baselines;
- Facilities must use some SMCs to account for any remaining emissions before purchasing ACCUs, given their more direct equivalence to the type of emissions produced within the scheme;
- Unlimited use of ACCUs will not be a permanent feature of the scheme. Climate Council recommends that over time, use of ACCUs be progressively phased down to a set percentage of a facility's total baseline. Differential percentages would be expected to apply based on the sector a facility operates within and therefore the available technology options for achieving genuine emissions reduction;
- Any new coal, oil and gas facilities entering the Safeguard Mechanism after 1 July 2023 will be required to meet their baselines *without* the use of ACCUs - i.e. using only a combination of best-practice technologies and SMCs.

Bill recommendations

Climate Council recommends the *Safeguard Mechanism (Crediting) Amendment Bill 2022* be amended to make further updates to several sections of the *National Greenhouse and Energy Reporting Act 2007* - and any necessary consequential sections - to achieve the following objectives:

1. *Section 21* - require covered facilities to make reports to the Regulator about their emissions reduced and removed through onsite projects and/or

active investment in research and development and pilots of technology changes to achieve this in future.

2. *Sections 22XK and Section 22XM* -

- require covered facilities to surrender SMCs alongside ACCUs when doing so for the purpose of reducing net emissions;
- expressly state that the total share of prescribed carbon units able to be surrendered against a facility's obligations can be determined by the Minister via regulation;
- clarify that any coal, oil or gas facilities entering the mechanism after 1 July 2023 may only surrender SMCs for the purpose of reducing their net emissions.

2. Role of carbon credits and offsets in the Safeguard Mechanism

The *Safeguard Mechanism (Crediting) Amendment Bill 2022* is primarily concerned with one discrete element of the Safeguard Mechanism: the creation of Safeguard Mechanism Credits (SMCs) as a new component of existing scheme settings.

The Bill seeks to amend the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) and *Australian National Registry of Emissions Units Act 2011* (ANREU Act) to establish the framework for creating SMCs. Bill provisions cover how credits are issued, purchased, and included in Australia's National Registry of Emissions Units.

These credits will correspond to one tonne of carbon dioxide equivalent emissions, and will be automatically created when a facility regulated by the Safeguard Mechanism has emissions below its determined baseline. SMCs are intended to be able to be traded and used by other facilities with emissions above their determined baselines, to reduce their net emissions.

In line with the carbon mitigation hierarchy, the Climate Council recommends that all facilities regulated by the Safeguard Mechanism demonstrate genuine efforts to avoid and reduce emissions before relying on credits and/or offsets to meet their regulated baselines.

However, we recognise that there will be instances where high emitting facilities are not able to fully avoid harmful emissions - such as in sectors like cement and steel where alternative production processes and technologies are not yet well developed, but the products are essential. In such instances, where facilities are taking all available steps to reduce emissions and progress towards business transformation, it is appropriate they should be able to access credits representing an equivalent quantity and quality of emissions reduction, to account for any remaining emissions above their baseline.

Prior to the creation of Safeguard Mechanism Credits, facilities operating within the Safeguard Mechanism with annual emissions above their regulated baseline have been required to purchase Australian Carbon Credit Units (ACCUs) to account for these excess emissions. In practice, such purchases were rarely required due to artificially high baselines and considerable flexibility in their application by the former Liberal National Government.

Disappointingly, the draft policy settings released by the Australian Government in January 2023 propose to allow Safeguard Mechanism-regulated facilities to use any available combination of SMCs and ACCUs to offset their full baseline liabilities.⁵ This would mean there is no requirement for facilities to take - or demonstrate they have taken - steps to avoid and reduce emissions to meet their baselines, before being able to access carbon credits and offsets for the full liability.

With the spot price for ACCUs sitting at approximately \$37 a unit in January 2023,⁶ fully offsetting Safeguard Mechanism liabilities with ACCUs would likely be considerably cheaper for facilities than undertaking genuine business transformation, particularly in the short term. For example, analysis by the federal Parliamentary Library indicates that the cost of buying ACCUs to comply with new Safeguard Mechanism requirements for Australia's large mining and gas companies could be less than 0.1 percent of these companies' significant profits.⁷

The science is clear that the 2020s are the critical decade for action to tackle harmful climate change by reducing Australia's emissions.⁸ That is why it is essential that our largest polluters are incentivised to commence the genuine decarbonisation of their operations as soon as possible.

Land systems can make an important contribution to mitigating climate change by removing carbon dioxide from the atmosphere or avoiding emissions of carbon dioxide to the atmosphere.

Avoiding clearing of old growth, carbon-rich vegetation and protecting regrowth vegetation are the most effective approaches to mitigating climate change using land systems. Maintaining and restoring carbon-rich vegetation has many other benefits, including the protection of biodiversity, the maintenance of water quality, and the enhancement of long-term soil carbon storage.

Other approaches to land based mitigation can also be useful. These include improved land management to protect soil carbon, development of sustainable bioenergy systems, and protection of carbon stored in coastal ecosystems ("blue carbon").

⁵ Department of Climate Change, Energy and Water (2023)

⁶ Jarden (2023), ACCU Platform. Accessed: <https://accus.com.au/>

⁷ Sydney Morning Herald (2022), Cost of carbon credits would be 'coins down the couch' for coal, gas companies. Accessed: <https://www.smh.com.au/politics/federal/cost-of-carbon-credits-would-be-coins-down-the-couch-for-coal-gas-companies-20221006-p5bnl4.html>

⁸ Climate Council (2021), Aim High, Go Fast: Why Australia's emissions must plummet this decade. Accessed: <https://www.climatecouncil.org.au/resources/net-zero-emissions-plummet-decade/>

Continuing to burn fossil fuels while assuming that these emissions are being offset by increasing land carbon is counterproductive. However, sequestering carbon in land systems is still very useful. The challenge is to *both* reduce fossil fuel emissions deeply *and* rapidly return back to the land as much as possible of the atmospheric carbon that originated from the land.

Allowing facilities in the Safeguard Mechanism to use offsets to write off all of their emissions as a permanent feature of the scheme will send a market signal which is inconsistent with these objectives. It will incentivise Australia's heavy industry to engage in carbon accounting to cover up pollution-as-usual activity as cheaply as possible, instead of investing in genuine business transformation and high quality biodiversity initiatives. If this issue is not fixed, big industrial emitters - particularly those in Australia's fossil fuel sector - will continue to make record profits while worsening climate change, which is supercharging the floods and fires that have ravaged communities across Australia and the world in recent years.

Climate Council recognises that access to offsets will be necessary in the initial phase of reformed scheme arrangements commencing from 1 July 2023, to give businesses time to implement and develop new technologies and business processes while still meeting their regulated baselines. However, it is essential that the Government sends a clear message that unlimited offsetting will not be a permanent feature of the scheme, so that Australia's largest emitters are incentivised to commence genuine transformation of their businesses as soon as possible.

To address these issues, Climate Council recommends the draft Safeguard Mechanism settings released by the Australian Government in January 2023 be updated to clarify that:

- Safeguard Mechanism-regulated facilities must demonstrate practical steps and/or investments in train to genuinely reduce emissions - which may include research and development and pilot projects - before being able to purchase SMCs or ACCUs to meet their determined baselines;
- Facilities must use some SMCs to account for any remaining emissions before purchasing ACCUs, as these represent the most directly equivalent type of emissions reduction to emissions produced within the scheme;
- Unlimited use of ACCUs will not be a permanent feature of the scheme. Climate Council recommends that over time, use of ACCUs be progressively phased down to a set percentage of a facility's total

baseline. Differential percentages would be expected to apply based on the sector a facility operates within and therefore the available technology options for achieving genuine emissions reduction. The initial review of Safeguard Mechanism settings would be an appropriate point to commence a measured phase down of offset use - Climate Council recommends this is brought forward to commence as soon as possible after 1 July 2025;

- Any new coal, oil and gas facilities entering the Safeguard Mechanism after 1 July 2023 will be required to meet their baselines *without* the use of ACCUs - i.e. using only a combination of best-practice technologies if these are available and SMCs.

Key international expert bodies such as the International Energy Agency and the United Nations have been clear that the world cannot proceed with any new fossil fuel projects if we are to have the chance of holding global warming to 1.5 degrees. Allowing such new projects to proceed under pollution-as-usual business models masked by unlimited use of offsets will further accelerate the climate crisis - both within Australia and around the world. With more than 100 potential coal, oil and gas projects in the development pipeline in Australia today,⁹ we need a fundamental shift in how these projects are assessed and what is required of them, to ensure we are not opening the door to even more climate harm.

The following section identifies opportunities to implement aspects of these recommendations through the *Safeguard Mechanism (Crediting) Amendment Bill 2022*.

⁹ Department of Industry, Science and Resources (2022), Resources and Energy Major Projects 2022. Accessed: <https://www.industry.gov.au/publications/resources-and-energy-major-projects-2022>

3. Opportunities to strengthen the Bill

The *Safeguard Mechanism (Crediting) Amendment Bill 2023* presents a range of opportunities to strengthen the proposed Safeguard Mechanism settings through sensible amendments.

In this submission, Climate Council has focused on identifying specific sections of the Bill where such improvements could be inserted; detailed discussion would be required with legislative drafters and the Government on the specific form of words to best achieve the intent in each case. We would be happy to provide further advice and input on this drafting as the Parliament progresses consideration of this Bill.

Schedule 1, Part 1 - Amendment of the National Greenhouse and Energy Reporting Act 2007

Section 21 of the NGER Act lays out a range of requirements for 'reports relating to greenhouse gas projects: reduction of greenhouse gas emissions and removals of greenhouse gases' (p.43). This section of the Act allows facilities to identify emissions reduction achieved through onsite projects which reduce or remove greenhouse gas emissions.

To ensure that facilities regulated by the Safeguard Mechanism are taking genuine efforts to avoid and reduce their emissions - rather than simply relying on credits and offsets - the current Bill should be updated to amend the NGER Act such that facilities are required to make a report to the Regulator about their:

- emissions reduced and removed through onsite projects; and/or
- investments in research and development, pilot projects and other initiatives which will lead to genuine emissions reduction in future.

This could be undertaken as a standalone amendment, or paired with further language and consequential amendments throughout the bill to stipulate that regulated facilities may not access offset arrangements for greenhouse gas emissions under section 22 (see below) unless they have also made a report on investments in genuine emissions reductions and removals under Section 21.

The scope of such reporting could include both investment in business transformation using existing technologies - for example, switching to cleaner energy sources; and investments in research and development and pilot projects to advance new technologies - such as entirely new chemical or production processes.

Australia's largest emitters claim that they are taking genuine steps to reduce their emissions, in addition to accessing offsets. If this is the case, facilities should not face any difficulty in demonstrating this to the Regulator as part of accounting for compliance with their annual baselines.

Section 22XK of the NGER Act (p.71) deals with the calculation of net emissions for a facility that is regulated by the Safeguard Mechanism. It states:

"For the purposes of this Act, the net emissions number for a facility for a period is the number of tonnes of carbon dioxide equivalence of the total amount of covered emissions of greenhouse gases from the operation of the facility during the period.

Reduction—surrender of prescribed carbon units.

If:

(a) a number of prescribed carbon units are surrendered on a particular occasion; and

(b) the notice surrendering the units contains a statement to the effect that the units are being surrendered for the purpose of reducing the net emissions number for a facility for a period;

the net emissions number for the facility for the period is reduced (but not below zero) by the number of prescribed carbon units surrendered.

Further, **Section 22XM** of the NGER Act (p.73) specifies that ACCUs can be used to reduce the net emissions of Safeguard Mechanism-regulated facilities and allows for the safeguard rules to determine what other units can be used to reduce their net emissions. The Bill specifies that SMCs can also be used to reduce the net emissions of facilities regulated by the Safeguard Mechanism.

The Bill could further amend these sections of the NGER Act (and any necessary consequential sections) to insert clarifying provisions requiring entities to surrender SMCs alongside ACCUs for the purpose of reducing a facility's net emissions number; and stipulating that the total volume of prescribed carbon units able to be surrendered against a facility's obligations can be determined by the Minister via regulation.

This latter amendment would create a new power for the Minister to provide detailed guidance to Safeguard Mechanism facilities via regulation about the total share of ACCUs which may be surrendered to reduce their net emissions. This is important for sending a clear signal to industry that unlimited use of offsets will not be a permanent feature of the scheme. Recognising the initial need for offsets in the first phase of reform implementation, the government may not immediately exercise this power. However, its insertion into the NGER Act will provide a straightforward mechanism for commencing a managed phase-down of offset use following

the first review of scheme settings, which Climate Council recommends is undertaken as soon as possible after 1 July 2025.

It is preferable for determinations about offset use to be made by regulation rather than primary legislation because the relevant percentage share of ACCUs for appropriate use by facilities would be expected to differ over time depending on the sector of operation. Making these determinations by regulation provides more flexibility for these to be regularly updated in response to evolving industry experience with the scheme and improvements in technology than doing so in primary legislation.

Section 22XK could be further amended to specify that new facilities in the coal, oil and gas sectors entering the Safeguard Mechanism after 1 July 2023 may not surrender ACCUs for the purpose of reducing the net emissions number for that facility. This would clarify that SMCs are the only accepted credit or offset for the purpose of reducing net emissions in these industry sectors.

Collectively, these further amendments to the Bill would significantly help to address current concerns about the proposed policy settings for the Safeguard Mechanism. They would do so by:

- ensuring facilities are more accountable for undertaking projects which lead to genuine emissions reduction and removal;
- ensuring facilities make use of the most directly equivalent form of carbon crediting - being SMCs - alongside any use of ACCUs;
- giving the Minister the explicit power to make regulations restricting the use of ACCUs for the purpose of reducing net emissions so that a managed phase down of offset use can commence following the first review of Safeguard Mechanism settings from 2025; and
- clarifying that the only form of crediting new entrants in the coal, oil and gas sectors will have access to is SMCs - to drive a fundamental shift in the assessment and business models of such projects with a view to containing their further expansion.

Recommendations - Safeguard Mechanism (Crediting) Amendment Bill 2023

Climate Council recommends the Bill be amended to make further updates to the below sections of the NGER Act - and any necessary consequential sections - to achieve the following objectives:

1. *Section 21* - require covered facilities to make reports to the Regulator about their emissions reduced and removed through onsite projects and/or investment in developing new technologies that will enable this in future.

2. *Sections 22XK and Section 22XM* -

- require covered facilities to surrender SMCs alongside ACCUs when doing so for the purpose of reducing net emissions
- expressly state that the total share of prescribed carbon units able to be surrendered against a facility's obligations can be determined by the Minister via regulation
- clarify that coal, oil and gas facilities entering the mechanism after 1 July 2023 may only surrender SMCs for the purpose of reducing their net emissions.

Conclusion

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 emissions reduction** at every level. This scheme must not result in another form of carbon accounting which delivers notional emissions reductions on paper while allowing pollution-as-usual in practice - particularly for the huge coal, oil and gas corporations who are fuelling the climate crisis.

Furthermore, the scheme should ensure that any new facility which seeks to commence operations in Australia is set up to thrive as net zero increasingly becomes business as usual. This means placing **much tighter restrictions on new coal, oil and gas projects** within the Safeguard Mechanism. The only way to avoid the worst impacts of harmful climate change is for Australia's emissions to genuinely go down. This will not be achieved by allowing high polluting new facilities to start up and then simply write off their emissions on paper.

It is clear that there is much at stake in the reform of this key policy lever. We urge the Australian Government and the Parliament 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.