

Environment and Communications
Legislation Committee
Senate Inquiry: Safeguard
Mechanism (Crediting) Amendment
Bill 2022 [Provisions]

submission

January 2023





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The Carbon Market Institute (**CMI**) welcomes the opportunity to provide this submission to support the Senate Inquiry into the Safeguard Mechanism (Crediting) Amendment Bill 2022 [Provisions] (**Senate Inquiry**) which was referred to the Environment and Communications Legislation Committee on 1 December 2022 for inquiry and report by 2 March 2023.

CMI is an independent member-based institute that promotes the use of market-based solutions and supports best practice in decarbonisation to limit warming to 1.5°C. CMI's 150 strong membership includes organisations from across the entire carbon value chain, including primary producers, carbon service providers, legal and financial institutions, technology firms and emissions intensive companies.

CMI's Board annually updates the CMI Advocacy Policy Positions in consultation with, but independent of, members. Our positions include supporting policies aligned with Australia's fair share of effort to achieve the high-ambition Paris Agreement goal to limit warming to 1.5°C, evolving Australia's carbon markets to guide investment and opportunities in the transition, and ensuring rigorous governance, integrity and disclosure on carbon crediting.¹ CMI also administers the Australian Carbon Industry Code of Conduct, which was established in 2018 to promote and steward consumer protection and market integrity.²

The positions put forward in this submission are CMI's view, independent of members, and do not represent any CMI individual, member company or industry sector.

Strategic outlook

At the outset, CMI wishes to reiterate our support for the Government's plan to transition the Safeguard Mechanism into a declining baseline and credit scheme (hereafter, the '**enhanced Safeguard Mechanism**'). Since 2018, we have advocated for Safeguard baselines to be tightened to drive industrial decarbonisation and support Australia's Nationally Determined Contribution (NDC) targets under the Paris Agreement.³

¹ CMI 2021, 'Advocacy Policy Position Statement 2021', <https://carbonmarketinstitute.org/app/uploads/2021/12/CMI-Advocacy-Policy-PositionsUpdated-Dec-2021-004.pdf>.

² More information can be found on the Code website: <https://carbonmarketinstitute.org/code/>.

³ See: 3 See: CMI 2018, 'Climate Change Authority: NGER Legislation Review Submission', <https://carbonmarketinstitute.org/app/uploads/2018/09/CMI-Submission-2018-CCA-Review-of-NGER-Legislation.pdf>; CMI 2018, 'Exposure Draft Amendments: Safeguard Mechanism Rule Consultation', <https://carbonmarketinstitute.org/app/uploads/2018/12/CMI-Submission-2018-Consultation-on-Safeguard-Rule-Amendments.pdf>; CMI 2019, 'Climate Change Authority Review: Meeting the Paris Agreement Submission', https://carbonmarketinstitute.org/app/uploads/2021/06/CCA-Submission-Sept_2019.pdf; CMI 2020, 'Australian Government response to the Expert Panel Review (King Review): CMI Position' <https://carbonmarketinstitute.org/app/uploads/2021/06/CMI-Position-Statement-Expert-Panel-King-Review.pdf>; CMI 2021, 'Australian Government Discussion Paper: King Review Safeguard Crediting Mechanism Submission', <https://carbonmarketinstitute.org/app/uploads/2021/10/Safeguard-Crediting-Mechanism-CMI-Submission-FINAL-Oct-2021-1.pdf>; CMI 2021, 'CMI Policy Advocacy Position Statement 2021', <https://carbonmarketinstitute.org/app/uploads/2021/12/CMI-Advocacy-Policy-Positions-Updated-Dec-2021-004.pdf>; CMI 2022,



CMI encourages the Senate Inquiry to consider the Safeguard Mechanism (Crediting) Amendment Bill (hereafter, '**SMC Bill**') and related regulatory changes with a view to ensuring the enhanced Safeguard Mechanism drives industrial decarbonisation in an efficient and orderly manner. This will assist the long-term competitiveness of Australian industry in a carbon-constrained global economy, whilst supporting the regions and communities whose livelihoods hinge on a well-managed industrial transition.

CMI appreciates that many of the key design elements of the enhanced Safeguard Mechanism will be determined in the subordinate legislation and will provide further commentary on the government's design proposal in our response to the draft Safeguard Rules consultation. However, we wish to foreground this submission to the Senate Inquiry by highlighting the value of a market-based approach to industrial decarbonisation.

Properly calibrated, a market-based design will allow the enhanced Safeguard Mechanism to balance the compliance driver of declining baselines with incentives to invest in at-point decarbonisation, as well as sufficient flexibility so that liable entities can manage compliance obligations over time. For example, investments in decarbonising production processes often have significant lead times. While waiting for upgrades to come online, a market-based design allows facilities to meet declining baselines and support the national abatement task by purchasing carbon credits. This market flexibility is particularly important for hard-to-abate sectors who have little alternative in the short to medium term, while technology and financial hurdles present barriers to reducing emissions at source.

It is also worth noting that the enhanced Safeguard Mechanism will operate in a broader ecosystem of public policy and private sector drivers to invest in at-point decarbonisation. These include pressure from investors and customers, maturing public climate risk management and disclosure frameworks – such as the one Treasury is currently consulting on⁴ – as well as Commonwealth and State industry initiatives.⁵ The Climate Change Authority's annual review will provide another important accountability measure to ensure the national policy suite ultimately supports Australia's NDCs and net zero 2050 target.

Against the backdrop of a decade of climate change policy uncertainty, CMI considers it critical that the enhanced Safeguard Mechanism creates a carbon pricing signal that strengthens and scales over time, delivering industrial decarbonisation to support Australia's ratcheting NDCs and the transition of the broader economy.

CMI is broadly supportive of the amendments proposed in the SMC Bill to primary legislation: the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) and *Carbon Credits (Carbon Farming Initiative) Act 2011* (CFI Act). We consider that its primary objective – to introduce the 'Safeguard Mechanism Credit' (**SMC**) and provide for its legal treatment and financial regulation in a similar manner to the Australian Carbon Credit Unit (**ACCU**) – will support the establishment of an effective and efficient compliance market.

We also support amendments in the SMC Bill that strengthen ministerial accountability to protect the integrity, durability, and ambition of the enhanced Safeguard Mechanism.

⁴ 'Climate Change Authority Review into the use of international offsets under Commonwealth programs submission', <https://carbonmarketinstitute.org/app/uploads/2022/04/CCA-Review-of-international-offsets-CMI-Submission-April-2022.pdf>.

⁵ See: Treasury, 'Climate-related financial disclosure', <https://treasury.gov.au/consultation/c2022-314397>.

⁵ Further commentary on the role of climate risk disclosure frameworks as a decarbonisation investment driver can be found in CMI's submission: CMI 2022, 'Treasury Exposure Draft Legislation – Treasury Law Amendment (Measures for Consultation) Bill 2022: sustainability standards submission', <https://carbonmarketinstitute.org/app/uploads/2023/01/2022121.pdf>.



To further support scheme integrity and ambition, we recommend that the amendment that would allow the government to transfer a proportion of SMCs into a holding account should be removed.

CMI also recommends that consideration be given to further amendments through the SMC Bill that would support scaling the scheme and broadening its coverage in the future to support Australia's increasing climate ambition.

CMI positions

CMI's positions on key provisions of the SMC Bill and recommendations for further consideration are detailed for the Senate Committee's consideration below:

1. CMI recognises the SMC as an important market-based driver for at-point industrial decarbonisation under the enhanced Safeguard Mechanism and supports amendments outlined in the SMC Bill that will provide for their introduction and consistent treatment as ACCUs.⁶

Established as a tradeable credit for below-baseline emissions within a reporting year under the scheme, the value of SMCs is two-fold:

- SMCs will incentivise facilities to decarbonise their operations by creating market value for below-baseline emissions reductions, complementing the compliance driver of declining baselines. The ability for facilities to bank SMCs for future use, subject to appropriate limitations that will be detailed in the subordinate *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (Safeguard Rules), will also support more timely investment decisions.⁷
- SMCs will provide further flexibility for liable companies, enabling them to procure SMCs sourced from the in-house decarbonisation efforts of other industrial companies to meet their declining baselines. As the integrity of the SMC is assured through the design parameters of the enhanced Safeguard Mechanism, the trade in SMCs will not impact the overall abatement task attributed to the scheme. Rather it will facilitate greater economic efficiency in realising that task.

2. CMI recognises and supports legislative checks and balances that have been incorporated into the SMC Bill to ensure the integrity, durability, and ambition of the enhanced Safeguard Mechanism.

These additional administrative checks and balances outlined in the SMC Bill include:

- The requirement that aggregate net covered emissions from facilities covered by the Safeguard Mechanism must decline, reflected in amendments to the second object of the NGER Act,⁸

⁶ CMI highlighted our support for the proposed introduction of the SMC in our submissions to the Government's first Safeguard Mechanism consultation paper in August 2022 (https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf) and exposure draft of the SMC Bill in November 2022 (https://carbonmarketinstitute.org/app/uploads/2022/11/20221101_CMI-submission_Safeguard-Mechanism-Reform-consultation-on-draft-legislation.pdf).

⁷ The Government is currently consulting on its draft Safeguard Mechanism Rules package, which proposes unlimited banking of SMCs in the initial phase up to 2030; see: <https://consult.dcceew.gov.au/safeguard-mechanism-reform-consult-on-design>.

⁸ The second object of the *National Greenhouse and Energy Reporting Act 2007* (Cth) is to ensure that the Act contributes to Australia's greenhouse gas emissions reduction targets.



- The requirement that the Minister only make or amend Safeguard Rules such that they remain consistent with this second object of the NGER Act; and
- Amendments to ensure that penalties for non-compliance are calculated in a way that reflects their climate impact.

These checks and balances can, contingent on appropriate resourcing and implementation, ensure that baselines under enhanced Safeguard Mechanism continue to decline in a way that supports Australia's legislated NDC and net-zero 2050 targets now, and under future successive governments.

CMI notes that the Climate Change Authority's strengthened role to track and advise on Australia's progress against the NDC and 2050 net zero targets in annual reports, legislated in the *Climate Change Act 2022*, will provide another layer of scrutiny to ensure baseline decline under the enhanced Safeguard Mechanism is sufficiently ambitious.

3. CMI recommends that Section 22XND, which would allow the government to transfer a proportion of SMCs into a holding account, is removed from the SMC Bill to prevent it from undermining scheme integrity in the future.

Beyond enabling direct provision of SMCs to facilities, potentially as a form of support for emissions-intensive trade-exposed (EITE) sectors, CMI considers it unclear what purpose it would serve. CMI therefore recommends removing this provision to prevent unintended market consequences from its use down the track under successive governments.

As outlined in CMI's submissions on both the first Safeguard Mechanism consultation and the exposure draft of the SMC Bill, direct provision of SMCs – along with other 'in-scheme' forms of support – may dilute scheme-wide carbon pricing decarbonisation drivers and are therefore suboptimal ways to support EITE facilities with liability costs.⁹

Given that the Government has not indicated any intent to rely upon this avenue, instead proposing an alternative, two-tiered model of support for EITE facilities. CMI considers that this flexibility measure should be removed from the SMC Bill, to mitigate risks of its use in future.

CMI intends to engage more closely on the Government's preferred approach to supporting EITE facilities in context of its draft Safeguard Rules consultation. Nevertheless, we would highlight CMI's supports for the Government's intention in the medium term to explore the potential of a carbon border adjustment mechanism (CBAM) and other methods of addressing carbon leakage risks.¹⁰ This future-facing approach to supporting the long-term competitiveness of Australian industry and preventing carbon leakage will be more effective and durable than direct provision of SMCs or other in-scheme, short-term ways of supporting EITE facilities.

⁹ CMI acknowledges that the currently proposed model of support for critically cost-impacted EITE facilities includes a variable baseline decline rate for critically cost-impacted EITE facilities. This constitutes 'in-scheme' support. However, due to the low volume of trade exposed, baseline adjusted (TEBA) qualifying facilities expected in the initial years of the enhanced Safeguard Mechanism, and as this measure appears to be a stopgap solution while the Government explores more durable means of preventing carbon leakage, CMI considers the risk of significant in-scheme carbon price distortion to be low. CMI will elaborate on this point in our response to consultation on the government's draft Safeguard Mechanism Rules package. See: Department of Climate Change, Energy, the Environment and Water (DCCEEW) 2023, 'Safeguard Mechanism reform: Consultation on proposed design', <https://consult.dcceew.gov.au/safeguard-mechanism-reform-consult-on-design>.

¹⁰ Footnote on sub and response to the rule media release



4. CMI reiterates the need for the enhanced Safeguard Mechanism to create a carbon pricing signal that strengthens and scales over time to accelerate industrial, and economy-wide decarbonisation. We encourage further consideration be given to additional amendments in the SMC Bill that could support scaling the scheme in the future and/or increasing coverage to support Australia's ratcheting NDCs.

As outlined in our response to the first Safeguard Mechanism consultation, CMI considers that the enhanced Safeguard Mechanism should be implemented such that scheme coverage expands in a phased approach, beginning in 2025. This will allow the government to scale Australia's climate ambition beyond the 43 per cent 2030 NDC when it submits the 2035 NDC in 2025, and subsequent NDCs thereafter.

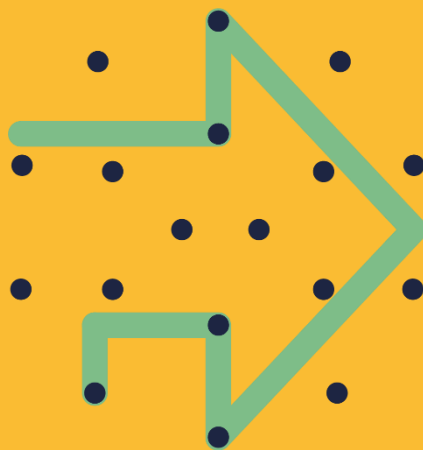
CMI reiterates that an economy-wide carbon pricing mechanism is the most efficient means of using markets to drive decarbonisation. However, the enhanced Safeguard Mechanism is a necessary starting point. To increase opportunities for scheme expansion in the future, CMI recommends consideration be given to introducing additional amendments into the SMC Bill.

For example, the SMC Bill proposes amendments to the NGER Act that would allow facilities to continue generating SMCs for five years after falling below the 100,000 tCO₂-e coverage threshold. One option to explore could be incentivising below-threshold facilities to reduce their direct emissions by allowing them to 'opt in' to the scheme and generate SMCs. This would provide an incentive-based means of increasing scheme coverage that would also increase SMC supply for hard-to-abate industrial sectors. At the same time, this could test the potential for dropping the 100,000 tCO₂-e threshold for mandatory inclusion in future phases of the enhanced Safeguard Mechanism..

CMI is available to provide further evidence and discussion as part of a panel at a public hearing in support of this Senate Inquiry and would welcome this opportunity. In the meantime, please direct any questions about CMI's submission to **Gabriella Warden**, Manager, Research and Government Relations, at gabriella.warden@carbonmarketinstitute.org.

Yours sincerely,

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The Carbon Market Institute is at the centre of climate change policy and business in Australia. Independent and non-partisan, we bring business, policy makers and thought leaders together to drive the evolution of carbon markets towards a significant and positive impact on climate change.

Engaging leaders, shaping policy and driving action, we're helping business to seize opportunities in the transition to a low carbon economy.



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