Department of Climate Change, Energy, the Environment and Water

Safeguard Mechanism Rules: Consultation on proposed design

submission

February 2023

Carbon Market Institute

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The Carbon Market Institute (**CMI**) welcomes this opportunity to provide feedback to the Department of Climate Change, Energy, the Environment and Water (**DCCEEW**) on the Safeguard Mechanism reform: Consultation on proposed design (**Safeguard Rules Consultation**), which opened on 10 January 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

CMI supports the Government's reform agenda to transition the Safeguard Mechanism into a declining baseline and credit scheme (hereafter, the '**enhanced Safeguard Mechanism**'). Since 2018, CMI has advocated for the Safeguard Mechanism to be amended to reduce industrial emissions and drive emission reductions in other parts of the economy as well as supporting achievement of Australia's Nationally Determined Contribution (NDC) targets under the Paris Agreement.[3]

[1] Carbon Market Institute (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: CMI 2018, 'Climate Change Authority: NGER Legislation Review Submission'; CMI 2018, 'Exposure Draft Amendments: Safeguard Mechanism Rule Consultation'; CMI 2019, 'Climate Change Authority Review: Meeting the Paris Agreement Submission'; CMI 2020, 'Australian Government response to the Expert Panel Review (King Review): CMI Position'; CMI 2021, 'Australian Government Discussion Paper: King Review Safeguard Crediting Mechanism Submission'; CMI 2021, 'CMI Policy Advocacy Position Statement 2021'; and CMI 2022, 'Climate Change Authority Review into the use of international offsets under Commonwealth programs submission'.

CMI recognises that the enhanced Safeguard Mechanism is a very significant but by itself insufficient step forward to establishing an effective climate change policy framework to guide the transition of Australia's economy towards net zero emissions.

CMI maintains that an emissions trading system with broader economic coverage, like the former Carbon Pricing Mechanism, is the most efficient and effective use of carbon markets to drive decarbonisation. Against the backdrop of a decade of climate change policy uncertainty, however, we recognise the potential of the enhanced Safeguard Mechanism to significantly accelerate Australia's efforts to mitigate climate change instead of allowing direct industrial emissions to continue to grow.

With some amendments, we consider the enhanced Safeguard Mechanism can provide a strong foundation that can be scaled to support ratcheting ambition – to realise Australia's legislated climate target and longer-term commitments under the Paris Agreement.

It is also important to recognise that the enhanced Safeguard Mechanism alone does not constitute a complete industrial decarbonisation plan. Rather, it will operate within an ecosystem of broader investment drivers, all of which are important if Australia is to reach its net zero target. Among these drivers are consumer and capital market pressures, as well as complementary federal, state, and international policies, including:

- The Government's policy to mandate climate-related financial disclosures for Australian businesses, which will provide investors with greater transparency to scrutinise company decisions and risk management, reinforcing decarbonisation drivers at Safeguard-covered facilities;[4]
- The Government's $1.9 billion federal Powering the Regions Fund (**PRF**), which includes a $600 million 'Safeguard Transformation Stream' to support emissions-intensive, trade-exposed (**EITE**) facilities to decarbonise and meet compliance;
- State-based funding initiatives, such as the NSW Government's recent announcement of $855,000 for research, development and deployment of deep decarbonisation technology to support local industrial facilities to decarbonise;[5]
- The federal Net Zero Economy Taskforce, which is looking at progress and gaps towards a coordinated regional economic transition;[6]
- The United Nations Framework Convention on Climate Change (UNFCCC) Paris Agreement and its five-yearly cycle of global stocktakes and ratchets for NDCs, with the first global stocktake to take place at COP28 later this year and 2035 NDCs due by COP30 in 2025; and
- International policy drivers, including the European Union's Carbon Border Adjustment Mechanism (**CBAM**) and United States' Inflation Reduction Act (IRA), both of which may have implications for Australian industry's competitiveness in a carbon-constrained global economy.

To guide the broader structural transition of Australia's industrial sector to realise a net-zero emissions economy, the Government will need to develop a range of additional complementary measures alongside the enhanced Safeguard Mechanism.

[4] See more in CMI's submission: CMI 2023, 'Treasury: Climate-related financial disclosure Consultation paper submission', https://carbonmarketinstitute.org/app/uploads/2023/02/Carbon-Market-Institute_TSY-consultation_climate-related-financial-disclosure-framework.pdf.
[5] See: NSW Government 2023, 'Media release: Matt Kean, Treasurer and Minister for Energy', 2 February, https://www.energy.nsw.gov.au/news/nsw-partners-big-manufacturers-slash-emissions.
[6] See: Department of Prime Minister and Cabinet 2023, 'Net Zero Economy Taskforce', https://www.pmc.gov.au/domestic-policy/climate-change-energy-environment-and-adaptation/net-zero-economy-taskforce.

CMI's **10 Key Recommendations** for the Government are summarised below:

1. Regulate the carbon budget proposed for covered facilities through the Safeguard Rules, to guide the application of flexibility measures and assessment of new entrants.
2. Scale the covered facility baseline decline rate after 2030 to support ratcheting climate ambition.
3. Progressively lower the coverage threshold for the enhanced Safeguard Mechanism to 25,000 tCO_2-e scope 1 emissions.
4. Develop a National Carbon Market Strategy to guide expansion of the enhanced Safeguard Mechanism over time.
5. Maintain facilities' ability to meet baselines using ACCU offsets in the initial design but bring forward to 2026-27 review by a year to assess preliminary but real world at-point decarbonisation investments, as well as use of ACCUs, SMCs and other flexibility measures.
6. Monitor the proposed cost containment reserve and government ACCU purchasing to avoid unintended outcomes such as unduly inhibiting at source decarbonisation investments, creating unnecessary costs for taxpayers or other disincentive.
7. Review SMC banking arrangements in the initial milestone review to support investment certainty beyond 2030 and bring forward long-term investment decisions.
8. Expedite the development of a CBAM as a durable solution to prevent carbon leakage, and consider early commencement for high-exposure sectors, such as cement and steel.
9. Clarify the governance arrangements for setting international best practice benchmarks for new entrants under the enhanced Safeguard Mechanism and extend new entrant treatment to significant expansions at existing facilities, to ensure that these developments do not jeopardise the scheme's abatement task.
10. Develop additional complementary governance arrangements, institutions, and regulatory frameworks to address structural economic transition, including establishing an independent transition authority, requiring public transition plans as part of mandatory climate reporting and instituting a more rigorous assessment framework for emissions-intensive developments.

These **Key Recommendations** are elaborated over the page. We provide detailed responses to the design elements proposed in the Safeguard Mechanism Reforms Position Paper (**Consultation Paper**) in the **Attachment**.

Should you have any questions or wish to discuss CMI's submission in greater detail, please contact Gabriella Warden (Manager, Research and Government Relations) at gabriella.warden@carbonmarketinstitue.org.

Yours sincerely

Kurt J Winter

Kurt Winter
Director, Corporate Transition

Key Recommendations

CMI has carefully considered the design proposal outlined in the Consultation Paper. The 10 broad recommendations below are geared at improving the enhanced Safeguard Mechanism's performance in terms of driving industrial decarbonisation – which we maintain must be the primary goal of the reforms – while supporting emission reduction in other economic sectors and the achievement of Australia's legislated climate targets and ratcheting NDCs.

1. **Regulate the carbon budget proposed for covered facilities through the Safeguard Rules, to guide the application of flexibility measures and assessment of new entrants.**

CMI considers that the proposed proportionate carbon budget of 1,233 Mt CO2-e emissions for the period 2021-30 should be prescribed in the final Safeguard Rules as an additional regulatory guardrail.

Regulating the carbon budget would provide a useful reference point for the administration of the scheme, particularly in the context of covered facilities seeking flexibility with respect to their individual baselines and the setting of baselines for new facilities entering the scheme. While we appreciate that some legislative checks and balances have been incorporated into the Safeguard Mechanism (Crediting) Amendment Bill 2022, these are directed at the Minister's accountability. Prescribing the carbon budget in the Safeguard Rules would provide an additional guardrail to ensure the Clean Energy Regulator is directed to administer the scheme with integrity.

The carbon budget could be regulated within the scheme as a maximum limit on emissions permitted in the setting of baselines across the 2021-30 period. New entrant baselines could then be set having regard to the residual aggregate emissions that remain within that budget. While CMI understands that a buffer has been incorporated into the scheme to account for some expansions and new entrants, we anticipate that approaching the question of new entrant baselines by reference to the carbon budget would provide greater confidence in the scheme's ability to achieve the level of abatement necessary to support Australia's economy-wide climate targets.

2. **Scale the covered facility baseline decline rate after 2030 to support ratcheting climate ambition.**

CMI recognises that the 4.9 percent annual decline rate proposed in the Consultation Paper is at the mid-to-high-ambition end of the 3.5 to 6 percent range the Government originally consulted on in August 2022.[7]

As with Australia's 43 percent 2030 NDC,[8] CMI maintains that the enhanced Safeguard Mechanism's initial decline rate and share of abatement – which the Consultation Paper proposes at 4.9 percent and 205 million tonnes by 2030, respectively – must represent a floor, not a ceiling, on what the industrial sector can deliver.[9]

[7] CMI had originally recommended an initial 5.6 percent decline rate for the enhanced Safeguard Mechanism. See: CMI 2022, 'Safeguard Mechanism Reform – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 4, 6.

[8] While recognising the 43 percent 2030 NDC as a progression on the previous Government's 26-28 percent 2030 NDC, CMI continues to advocate for Australia to target a minimum 50 percent reduction in emissions, based on 2005 levels, by 2030. See: CMI 2021, 'CMI Policy Advocacy Position Statement 2021', https://carbonmarketinstitute.org/app/uploads/2021/12/CMI-Advocacy-Policy-Positions-Updated-Dec-2021-004.pdf.

[9] CMI made this point in our submission to the first round of consultation on the Safeguard Mechanism reforms. See: CMI 2022, 'Safeguard Mechanism Reform: First consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 4, 6-7.

We recommend that the Government 'ratchet up' decline rates from 2030, signal its intent to steepen the 4.9 percent decline rate in future phases to guide facilities to make appropriate investment decisions that support planning and compliance beyond 2030.

Noting that Australia's new 2030 NDC target of 43 percent reductions in emissions is a significant improvement but still inconsistent with limiting global warming to 1.5°C, which would require at least 50 percent reductions, the Government will need to develop a 2035 NDC (due in 2025) that represents a significant uplift in ambition.[10] This is required not only to demonstrate that Australia is contributing our 'fair share' of action on climate change,[11] but to steer the Australian economy onto a pathway towards achieving and surpassing the bipartisan net zero 2050 target.[12] As Australia's climate targets increase to meet our fair share of effort, the Government may also need to recalibrate the Safeguard Mechanism's decline rate to ensure that the scheme continues to deliver its proposed proportionate share of abatement. Covered facility upgrades to reduce emissions intensity at industrial facilities will have significant lead times, requiring investment decisions to be made well in advance.

By signalling its intention early to increase the decline rate and thereby the scheme-wide investment signal to decarbonise over time, to support Australia's obligations under the Paris Agreement, the Government can help guide longer-term investment planning at these industrial facilities.

CMI supports the proposed hybrid approach to baseline setting as an elegant solution that balances the competing circumstances of different facilities through the transition from site-specific values to industry average benchmarks. While we previously recommended a site-specific approach to setting and declining baselines,[13] we recognise that the hybrid approach will mean that facilities with below industry average emissions-intensity values would experience a steeper decline rate on their baselines than the scheme-wide indicative 4.9 percent towards 2030. Moreover, those initially below-average performers would have between 2023-24 to 2029-30 to make investments to reduce their emissions intensity by the time the scheme fully transitions to industry average benchmarks. By giving advance notice of its intent to further steepen decline rates under the enhanced Safeguard Mechanism beyond 2030, the Government can better support facility operators to make these longer-term planning, investment – and ultimately transition – decisions.

3. Progressively lower the coverage threshold for the enhanced Safeguard Mechanism to 25,000 tCO2-e scope 1 emissions.

CMI recommends that the Government begin dropping the threshold for coverage under the enhanced Safeguard Mechanism from 100,000 tCO_2-e scope 1 emissions to 25,000 tCO_2-e[14]

[10] Climate Action Tracker rates Australia's 43 percent 2030 NDC as 'insufficient' to limit global warming to 1.5°C and not aligned with Australia's 'fair share' of action on climate change. See: Climate Action Tracker 2022, 'Australia', https://climateactiontracker.org/countries/australia/.

[11] According to the United Nations Framework Convention on Climate Change (UNFCCC) principle of 'common but differentiated responsibilities' (CBDR), countries have different levels of responsibility for taking action to address climate change that should reflect their historic contributions to human-induced climate change and their capacity to respond. See: UNFCCC 2021, 'The Explainer: The Paris Agreement', https://unfccc.int/blog/the-explainer-the-paris-agreement.

[12] The Government's own 2022 emissions projections model that currently committed policy actions will fall short of the 2030 NDC by 3 percent. There is also a significant gap between policy ambition and achieving the bipartisan net zero 2050 target. See: Department of Climate Change, Energy, the Environment and Water (DCCEEW) 2022, 'Australia's emissions projections 2022', https://www.dcceew.gov.au/sites/default/files/documents/australias-emissions-projections-2022.pdf, p. 3.

[13] CMI 2022, 'Safeguard Mechanism Reforms – First Consultation', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 2, 6-7.

[14] 25,000 tCO_2-e would align with the threshold for reporting under the *National Greenhouse and Energy Reporting Act 2007* (NGER Act), ensuring the enhanced Safeguard Mechanism would be extended to facilities with compliance reporting capabilities.

To test and signal advance notice of this, the Government could allow below-threshold facilities to 'opt in' to the scheme to generate below-baseline Safeguard Mechanism Credits (**SMCs**) from 1 July 2023 under declining baselines.[15] This would provide an incentive-based means of increasing scheme coverage while increasing SMC supply for hard-to-abate industrial sub-sectors.[16]

CMI also recommends that the Government ensure that existing facilities captured by the enhanced Safeguard Mechanism do not automatically 'drop out' of the scheme when they reduce scope 1 emissions below 100,000 tCO_2-e. Adopting this recommendation would reinforce the anti-avoidance measures proposed in the Consultation Paper that would prevent facilities from breaking up into several lower-emitting entities to avoid coverage. Making it clear that existing facilities will remain covered even if they reduce their emissions below 100,000 tCO_2-e would ensure the Government is fulfilling its commitment to "deliver a strong investment signal and a clear trajectory to net zero in 2050".[17] CMI considers that the proposed incentive of generating SMCs for five years after they fall below the coverage threshold is insufficient without ensuring there is a continuing, complementary compliance driver.

If the Government proposes to allow facilities to drop out of the scheme, certainty should be provided that their associated scope 1 emissions are subtracted from the 1,233 $MtCO_2$-e 2021-30 carbon budget allocated to the enhanced Safeguard Mechanism to ensure that additional emissions are not available for new entrants and existing facilities to 'use up'.

4. Develop a National Carbon Market Strategy to guide the expansion of the scheme over time, ideally towards an economy-wide carbon price.

CMI recommends the Government explore expanding the coverage of the enhanced Safeguard Mechanism from 2030 to bring in more facilities and a greater portion of economy-wide emissions. A National Carbon Market Strategy, as recommended by the Climate Change Authority (CCA), should guide this process.[18]

The CCA recommended a National Carbon Market Strategy that:

- makes Australia's carbon price more visible and understandable, to embed decarbonisation in everyday decision-making;
- upholds the integrity of offsets – in both the ways they are generated and the ways they are used – to build confidence and trust in Australia's approach;
- clarifies the role of domestic and international units in the mix of voluntary action and compliance mechanisms to help smooth and accelerate Australia's decarbonisation;
- ensures Australia's institutional and regulatory infrastructure is fit for participation in Article 6 [of the Paris Agreement];

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[15] CMI notes that the introduction of below-baseline SMCs into the enhanced Safeguard Mechanism, and therefore the Government's ability to adopt this recommendation, is contingent on the passage of the Safeguard Mechanism (Crediting) Amendment Bill 2022 – which is currently subject to a Senate Inquiry – through both houses.

[16] CMI has advocated this point in: CMI 2023, 'Senate Inquiry: Safeguard Mechanism (Crediting) Amendment Bill 2022 [Provisions], https://carbonmarketinstitute.org/app/uploads/2023/02/Carbon-Market-Institute-submission-to-Senate-Inquiry-on-SMC-Bill.pdf, p. 6.

[17] DCCEEW 2023, 'Safeguard Mechanism Reforms Position Paper', https://storage.googleapis.com/files-au-climate/climate-au/p/prj23cd662ff4387d8c254ae/public_assets/Safeguard%20Mechanism%20Reforms%20Position%20Paper.pdf, p. 1.

[18] Climate Change Authority 2022, '2022 Review of International Offsets', https://www.climatechangeauthority.gov.au/sites/default/files/2022-08/Review%20of%20International%20Offsets%20-%20Report%20-%20August%202022.pdf.

- builds understanding of the approach domestically and with other nations; and
- enhances links between carbon markets and international trade and measurement standards, to underpin Australia's engagement in the development of a robust, liquid, high integrity, trusted and effective global carbon market.[19]

We consider that expansion of the enhanced Safeguard Mechanism could create additional efficiencies. As noted above, economy-wide emissions trading systems are the most efficient and effective use of carbon markets to drive decarbonisation.[20] Expanding the scheme would also support the achievement of Australia's eventual 2035 NDC and ensure the initial share of abatement apportioned to the enhanced Safeguard Mechanism is a floor, not a ceiling.

Ideally, a first National Carbon Market Strategy should be published in 2024 to give advance notice for investment decisions. To ensure coordination across the economy, the National Carbon Market Strategy should feed into forward-planning for Australia's five-yearly NDCs.

As well as guiding implementation and phasing of dropping the coverage threshold to 25,000 tCO_2-e, the National Carbon Market Strategy should contemplate scaling coverage of the enhanced Safeguard Mechanism into adjacent sectors and the broader economy.

By way of example, the electricity generation sector could be brought into the enhanced Safeguard Mechanism to drive continued decarbonisation after 2030, when the 82 percent Renewable Energy Target (RET) concludes. In CMI's 2022 Australian Business Climate Survey, 72 per cent of respondents indicated that additional policy instruments are required to drive clean energy investment and 76 per cent indicated that the RET should be reformed to accelerate decarbonisation.[21]

If the Government intends to maintain its sectoral approach for electricity, CMI urges greater clarity to be provided on its approach to driving continued decarbonisation of the grid beyond 2030. This is particularly pertinent, given that electric vehicle uptake is a central plank of its current approach to reducing emissions in the transport sector under the National Electric Vehicle Strategy, which ultimately depends on the continued growth of renewables the electricity mix to achieve decarbonisation.[22]

5. Maintain facilities' ability to meet baselines using ACCU offsets in the initial design but bring forward to 2026-27 review by a year to assess preliminary but real world at-point decarbonisation investments, as well as use of ACCUs, SMCs and other flexibility measures.

CMI cautiously supports the currently proposed model of the enhanced Safeguard Mechanism that would maintain facilities' flexibility to meet their baselines by 'offsetting' using ACCUs without restriction, alongside the ability to trade in 'below baseline' SMCs.

[19] Climate Change Authority 2022, '2022 Review of International Offsets', https://www.climatechangeauthority.gov.au/sites/default/files/2022-08/Review%20of%20International%20Offsets%20-%20Report%20-%20August%202022.pdf, p. 41.
[20] See CMI 2018 , 'Climate Change Authority: NGER Legislation Review Submission.
[21] See further CMI, Australian Business Climate Survey (2022), Available at https://carbonmarketinstitute.org/app/uploads/2022/10/Australian-Business-Climate-Survey-2022_FINAL.pdf..
[22] Australian Labor Party (ALP) 2021, 'Powering Australia Plan', p. 6 (accessed via: Analysis & Policy Observatory: https://apo.org.au/sites/default/files/resource-files/2021-12/apo-nid317333.pdf).

The primary purpose of the enhanced Safeguard Mechanism is to create a strengthening investment driver to guide decarbonisation of industrial processes. CMI maintains that the main design element to drive this change is a strong and ratcheting baseline decline rate,[23] supported by funding and incentives such as those provided by the PRF and introduction of SMCs.[24]

The flexibility to meet baselines by surrendering ACCUs should be maintained in the initial design of the enhanced Safeguard Mechanism to ensure that facilities, particularly those in hard-to-abate sub-sectors where there is no immediate technology solution for at-point decarbonisation, are able to comply. For other facilities, there will be a material lead time for investments in at-point decarbonisation solutions to be deployed to reduce at-source emissions. In part, this is a consequence of more than 10 years of investment uncertainty.

Driving industrial decarbonisation should be the primary purpose of the enhanced Safeguard Mechanism, thereby strengthening Australia's competitiveness in a carbon-constrained global economy. All design elements, including the baseline decline rate and flexibility measures, should be calibrated to send a strong investment signal towards prioritising at-point decarbonisation at covered facilities.

However, in circumstances where technology solutions are not yet available or commercially viable, it is entirely appropriate that business take responsibility for a growing part of their emissions and invest in ACCUs to drive emission reductions in other parts of the economy in this transition. CMI supports the findings and recommendations of the Independent Review of ACCUs, led by Professor Chubb (**Chubb Review**), to build further integrity and transparency in the ACCU framework, as well as further initiatives for transparency to support investor and community confidence in the ACCU framework.[25]

As investment cycles begin to reflect the market signal that the enhanced Safeguard Mechanism will provide, we recommend the Government review ACCU and SMC use, and other flexibility measures, to ensure the scheme is driving adequate investment in at-point decarbonisation. This could be signalled for review in the 2026-27 review, which should be brought forward to 2025-26.

Market interventions that introduce limits on offsetting or remove other flexibility provisions, such as SMC banking and borrowing, should be introduced only if robust evidence suggests that they are hindering at-source decarbonisation for those sub-sectors with available solutions. In the absence of published Government modelling on the impact of the current design in driving at-source decarbonisation, it is difficult to make a robust assessment of whether interventions, such as limits to offset use, are justified in the initial phase of the scheme. Nevertheless, we note that there is broad experience in overseas markets of quantitative offset limits in carbon pricing systems.[26]

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[23] See more on the importance of a strong baseline decline rate: Australian National University Institute of Climate, Energy and Disaster Solutions (ANU ICEDS) 2022, 'Submission to Safeguard Mechanism reform consultation', (F Jotzo, E Aisbett and A Macintosh), https://iceds.anu.edu.au/files/Submission%20on%20Safeguard%20Mechanism%20reform%20consultation%20by%20the%20ANU%20Institute%20for%20Climate%2C%20Energy%20%26%20Disaster%20Solutions%20%28ICEDS%29.pdf, pp. 10-11.

[24] CMI notes that the introduction of the SMC is contingent on the passing of the Safeguard Mechanism (Crediting) Amendment Bill 2022, which is currently the subject of Senate Inquiry that must be resolved before it can continue its passage through the Senate.

[25] For more information on the Chubb Review, see CMI's submission: CMI 2022, 'Australian Government Independent Review of ACCUs submission', https://carbonmarketinstitute.org/app/uploads/2022/10/FINAL-CMI-ACCU-Review-submission.pdf.

[26] Research by the International Carbon Action Partnership (ICAP) shows that restrictions on the use of offsetting is a common feature among carbon pricing schemes in other countries. See: ICAP 2023, 'Offset use across Emissions Trading Systems', https://icapcarbonaction.com/system/files/document/ICAP%20offsets%20paper_vfin.pdf, pp. 30-35.

If limits to offsetting are considered, CMI encourages the scheduled review to explore alternative approaches than scheme-wide percentage limits. For example, ACCU vintage restrictions such as a rolling eligibility window to align with SMC banking restrictions.[27] If introduced, CMI considers that it would be appropriate for ACCU vintage restrictions to also apply to the cost containment measure. That is, the Government should be required to retire and remove ACCUs from the cost containment measure when their vintage surpasses its eligibility window.

We note that limits may need to be sub-sector specific, to account for facilities in hard-to-abate sub-sectors where there are no alternatives to offsetting, to – in extreme cases – avoid situations where they are not able to comply and are forced to pay penalties. Sector-specific limits on use of ACCUs would be a more appropriate, fit-for-purpose means of limiting offset use as opposed to an arbitrary, scheme-wide percentage limit.

6. **Monitor the proposed cost containment reserve and government ACCU purchasing to avoid unintended outcomes such as unduly inhibiting at source decarbonisation investments, creating unnecessary costs for taxpayers or other disincentive.**

CMI has reservations about the proposed cost containment reserve, which would allow facilities with no alternative to source ACCUs from a government holding account, with prices beginning at $75/tonne in 2023-24 and increasing by 2 percent plus CPI annually. CMI appreciates that this measure would provide facilities with certainty that they could access this measure in extreme cases where the only other alternative would be non-compliance and penalty.

We recommend that the Government clearly outline the conditions under which a facility may access the cost containment reserve in the upfront design of the enhanced Safeguard Mechanism. This would help ensure that facilities are incentivised to invest in decarbonisation rather than rely on the measure – which should be a last resort only, rather than an investment guide.

The cost containment reserve should be a focus of the 2026-27 (or ideally earlier – see Key Recommendation 5) review, and the Government may need to consider significantly increasing the price or retiring the measure in future phases. In this case, the Government could consider alternative approaches to protecting against market price volatility, such as the European Union ETS's Market Stability Reserve, which triggers a release (or relinquishment) of units into the market under certain conditions.[28] This could provide a market-wide approach to reducing the risks of market volatility as an alternative to supporting liable entities on an individual basis, which would be less open to gaming or misuse than under the cost containment reserve proposal.

For more information on the opportunities and risks associated with permitting offsetting within a carbon pricing scheme, also see: International Bank for Reconstruction and Development & The World Bank 2016, 'Emissions Trading in Practice: A handbook on design and implementation', https://openknowledge.worldbank.org/bitstream/handle/10986/23874/ETP.pdf, pp. 84-85.

[27] CMI recommends and comments on the use of rolling vintages for international offsets used under Climate Active in: CMI 2022, 'Climate Change Authority Review into the use of international offsets under Commonwealth programs', https://carbonmarketinstitute.org/app/uploads/2022/04/CCA-Review-of-international-offsets-CMI-Submission-April-2022.pdf, pp. 12-13.

[28] The Market Stability Reserve was introduced into the EU ETS in 2019 to improve the system's response to price volatility and market shocks, including economic downturns. See more: European Commission, 'Climate Action: Market Stability Reserve', https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/market-stability-reserve_en.

Without clear guardrails around access and careful monitoring, CMI considers that cost containment measure may dilute the enhanced Safeguard Mechanism's long-term carbon pricing signal and put a cap on investment in at-source decarbonisation.

It may also lead to other perverse, unintended outcomes, such as setting up an unlimited taxpayer liability. This could occur if the Government's carbon abatement contracts (CACs) accrue insufficient supply, and if the market price of ACCUs exceeds the point-in-time cost containment reserve price. Under these circumstances, the Government may need to procure market-price ACCUs to populate the measure – leaving taxpayers to foot a growing shortfall bill to subsidise facility compliance.

CMI also cautions the Government against pooling ACCUs delivered through existing contracts under historical deemed surrender arrangements into the cost containment reserve. If ACCUs delivered to the Government under these contracts are pooled in the cost containment reserve, CMI considers there is a risk that the abatement associated with these ACCUs could be used to support facility abatement activity twice. That is, this abatement would be used once by the facility delivering ACCUs to the Government under deemed surrender, and then a second time by another facility accessing the cost containment reserve in the future. CMI's full position on deemed surrender proposed grandfathering arrangements are elaborated on in the Attachment (pp. 21-22).

The National Carbon Market Strategy, as recommended above, could clarify the Government's intended role in ACCU purchases in the future and the associated governance framework that will facilitate this to ensure public confidence and trust. This will be particularly important as Australia's carbon crediting scheme transitions from a taxpayer-funded ACCU market towards one with greater private sector engagement.

CMI recognises the enhanced Safeguard Mechanism and PRF as part of this but notes that the ACCU market will likely require continued additional government support. Options for managing this transition include:

- Targeting PRF grant funding towards ACCU purchases in emerging abatement and removal technologies to help commercialise these methods and unlock new markets and further market growth (alongside reverse auctions);
- Committing dividends from the fixed carbon abatement contract exit arrangements to the PRF to top up funding to support the continued growth of the ACCU market and other PRF functions.

7. Review SMC banking arrangements in the initial milestone review to support investment certainty beyond 2030 and bring forward long-term investment decisions.

In its initial scheduled milestone review of the scheme, CMI encourages the Government to review enabling banking of SMCs beyond 2030 to support investment decisions in production upgrades that need to be made now. Permitting banking of SMCs beyond 2030 for those SMCs generated from 2028-29 onwards could be beneficial in supporting investment decisions that would implement production upgrades from the latter years of the decade being worthwhile.

CMI acknowledges that preventing banking of SMCs generated before 2030 may support liquidity and trade of SMCs among facilities, rather than continued banking, however notes that having restricted inter-phase banking could mitigate these risks while allowing investment decisions to flow into production upgrades. For example, allowing the banking of SMCs generated in 2028-29 and 2029-30 into the post-2030 phase of the enhanced Safeguard Mechanism. The review would also consider the development of rules under Article 6 about use of credits between NDC periods.

8. Expedite the development of a carbon border adjustment mechanism (CBAM) as a durable solution to prevent carbon leakage, and consider early commencement for high-exposure sectors, such as cement and steel.

CMI supports the Government's current proposal for the treatment of emissions intensive, trade exposed (EITE) facilities, contingent on its commitment to expediting a more durable solution to preventing carbon leakage.

We urge the Government to publish its timeline and forward workplan for exploring and implementing a durable solution to carbon leakage – including the potential of a carbon border adjustment mechanism (CBAM). CMI recommends that work on this begins in July 2023, alongside the enhanced Safeguard Mechanism. This work could be undertaken by the Government as part of the National Carbon Market Strategy (Key Recommendation 4). Implementation should also contemplate early commencement for high-exposure sub-sectors such as cement and steel.

The timely introduction of a CBAM could be particularly helpful as a form of support to prevent offshoring of heavily trade-exposed sub-sectors, for example cement and steel.[29] In considering a CBAM, Australia should observe the experience of the European Union, which has identified sectoral priorities for its CBAM which is slated to commence for steel, cement, aluminium, fertiliser and electricity in October 2023.[30] Australia could also explore opportunities for collaboration with Europe.[31]

CMI considers that the trade exposed, baseline adjusted (TEBA) proposal that facilities for which the cost impact exceeds 3 percent of revenue can apply for should be an interim measure only. As highlighted in our first submission, differential decline rates are a suboptimal form of EITE support that carry longer-term risks of diluting the scheme-wide carbon pricing driver or increasing the burden on non-EITE facilities.[32] We stress that without a timely plan to phase out TEBA arrangements for a more durable framework for preventing carbon leakage, this could have significant impacts on the scheme-wide carbon pricing driver that would affect the integrity of the scheme. This is because as baselines decline, all facilities will incur growing compliance costs and the EITE cohort experiencing a cost impact metric over 3 percent of revenue will grow and be eligible to apply for TEBA designation – eroding the overall scheme decline rate and its abatement outcomes.

The Government should also put guardrails in place to ensure its Safeguard Transformation Stream under the Powering the Regions Fund supports not only EITE compliance but leads to decarbonisation of production

[29] For example, Australian steelmaker BlueScope is investigating commercialising 'green' steel, but has warned of manufacturing offshoring risks under the enhanced Safeguard Mechanism after investing in relining its coking coal-fired blast furnace. See: ABC News 2023, 'BlueScope Steel boss warns safeguard mechanism changes could impact sovereign manufacturing', https://www.abc.net.au/news/2023-02-20/bluescope-steel-defends-blast-furnace-reline/101998036.

[30] European Commission 2022, 'EU carbon border adjustment mechanism', https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/698889/EPRS_BRI(2022)698889_EN.pdf, p. 2.

[31] For example, Ai Group has suggested that an Australian CBAM could lead to the formation of a 'carbon club' with Europe that could soften the impacts for EITE facilities in hard-hit sub-sectors by enabling a 'trade neutral' arrangements with Europe, under its CBAM. See: Australian Financial Review (AFR) 2022, 'Australia should join global 'carbon club' to soften safeguard blow', https://www.afr.com/policy/energy-and-climate/australia-should-join-global-carbon-club-to-soften-safeguard-blow-20220928-p5blmk.

[32] CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 8-9, 17.

processes; this is the most effective, durable outcomes for protecting Australian industry's competitiveness in a carbon-constrained global economy.

Here, we note that while the Safeguard Transformation Stream is geared at supporting EITEs specifically and is currently proposed as a competitive grants program, the broader Industrial Decarbonisation Stream could explore more targeted financing approaches that directly result in industrial decarbonisation and transformational, step-changing upgrades, such as carbon contract for difference[33] or production subsidies.

CMI also recommends careful consideration of the eligibility of coal and gas projects receiving funding, even if they constitute EITE, to ensure this does not represent a subsidy towards the extended operation of fossil fuels. The Safeguard Transformation Stream must be focused on supporting transformative decarbonisation initiatives that align with economic structural adjustment towards away from high emission industries and towards net zero.

9. Clarify the governance arrangements for the setting of international best practice benchmarks for new entrants under the enhanced Safeguard Mechanism and extend new entrant treatment to significant expansions at existing facilities, to ensure that these developments do not jeopardise the scheme's abatement task.

CMI supports the Government's proposal to apply international best practice emissions intensity values adapted for an Australian context to new entrants under the enhanced Safeguard Mechanism. Nevertheless, CMI recommends the Government clarify its approach to the following matters to ensure the new entrant requirements are fit-for-purpose:

- Extend new entrant treatment to significant expansions at existing facilities, to ensure that these developments do not lead to significant increases in scheme-wide emissions. We appreciate that the Consultation Paper indicates that a buffer, or 'reserve', would be built into the decline rate to account for uncertainty around covered emissions under the proposed production-adjusted framework. However, we consider that, where possible, additional guardrails should be built into the design to provide further assurance. If the Government maintains its current proposal, CMI recommends that it justify and provide clarity on how it will ensure that facility expansions do not lead to increases in emissions.
- Clarify and publish the processes and procedures by which international best practice benchmarks for Australian circumstances will be determined, to ensure public confidence that these will be adapted based on environmental and technical factors and not informed by facility interests and advocacy.
- As elaborated above (see Key Recommendation 1), require that new entrant should be regulated by reference to a regulated carbon budget prescribed within the Safeguard Rules, such that new entrant baselines are set having regard to the residual aggregate emissions that remain within that budget.
- Develop a complementary assessment framework for emissions-intensive development approvals (elaborated further below).

[33] Carbon Contracts for Difference (CCfD) are a form of financing support that helps counterbalance carbon price volatility that may otherwise impede investment decisions, thereby supporting the financing of decarbonisation. For an explanation of CCfDs and examples in practice, see: ENGIE Impact 2023, 'Carbon Contracts For Difference To Boost Industrial Decarbonization', https://www.engieimpact.com/insights/carbon-contracts-for-difference.

10. Develop additional complementary governance arrangements, institutions and regulatory frameworks to address structural economic transition.

CMI reiterates that while the enhanced Safeguard Mechanism provides an important investment signal for industrial decarbonisation, it is not a complete decarbonisation plan for the industrial sector and other complementary policies will therefore be required.

In part, this is because the Safeguard Mechanism only addresses scope 1 emissions of covered facilities and has not implications for the scope 3 emissions footprint of these facilities. CMI notes the growth in global efforts to account for and address Scope 3 emissions. This is particularly significant for Australia, as one of the world's top exporters of downstream emissions. If Australia is serious about its renewed commitment to supporting our Pacific Neighbourhood to mitigate and adapt to the impacts of climate change, the Government must begin contemplating an approach to managing Australia's scope 3 emissions footprint and its impact on global climate policy efforts.

More broadly, the enhanced Safeguard Mechanism is not sufficient to address the structural economic transition that will be required to support the transition away from high emission industries and towards the industries of the future that will best support a net zero emissions economy.

To address the broader policy challenge of industrial decarbonisation, CMI recommends the Government consider a range of complementary actions, including:

- Establish a more rigorous assessment framework for emissions-intensive developments in Australia by introducing a requirement for new developments to demonstrate their impact on the climate. This could be implemented by establishing a form of climate trigger into the *Environmental Protection and Biodiversity Conservation Act 1999* (EPBC Act), but not a trigger that results in an automatic ban on large-emitting projects. This could facilitate assessment of the impact of individual projects on Australia's carbon budget. This could be implemented immediately to provide further protection in the context of new entrants under the enhanced Safeguard or in the context of revised NDC commitments that will require increasing levels of ambition.
- Establish a formal transition authority with a serious remit to develop effective incentives, regulations, and workforce support programs to ensure a just transition. Working across governments, the authority could guide Australia's structural adjustment away from high-emissions industries and towards the industries of the future that will best support a net zero emissions economy. In establishing this authority, advice could be sought from the CCA, or planning could be made the remit of the Net Zero Economy Taskforce that is already established within the Department of Prime Minister and Cabinet.
- Require industrial businesses – whether listed or unlisted – to prepare public transition plans that specify targets and describe actions to achieve them through its active climate disclosure framework consultation[34] as has been mandated by the UK Government with guidance being developed by the UK Transition Plan Taskforce.[35]

[34] CMI responded to Treasury's Consultation on Climate-related Financial Disclosures, Available https://carbonmarketinstitute.org/app/uploads/2023/02/Carbon-Market-Institute_TSY-consultation_climate-related-financial-disclosure-framework.pdf.
[35] See further UK Transition Plan Taskforce, Available at https://transitiontaskforce.net/.

ATTACHMENT

1. Introduction

Sub-topic	Design proposal	CMI position
1.2. Objective and policy principles	**Consultation revealed general consensus on the policy design principles of: effective, equitable, efficient, simple**	CMI supports these principles, however reiterates our recommendation for the Government to incorporate a fifth design principle: scalability.[36] Building scalability into initial design of the enhanced Safeguard Mechanism would ensure the scheme could be 'ratcheted up' over time, as will be required to support Australia's progressively more ambitious five-year NDCs under the Paris Agreement (see Key Recommendation 3).

2. The Safeguard Mechanism's share of the national emissions reduction task

Sub-topic	Design proposal	CMI position
-	**The Safeguard Mechanism's 2030 target would be set at no more than 100 Mt in 2030 and 1,233 Mt between 2021 and 2030, representing a proportional share of the national target and delivering an estimated 205 million tonnes of abatement (relative to current trends) by the end of the decade.**	As outlined in Key Recommendation 1, CMI considers that the 1,233 Mt carbon budget for 2021-30 should be articulated in the final Safeguard Rules. This would provide certainty around the industrial sector's contribution to economy-wide abatement efforts. It would also provide greater transparency around Government decision-making by ensuring any changes to the carbon budget are on the public record and the Minister responsible for changes to subordinate legislation is accountable.

2. Setting baselines to achieve an equitable distribution of costs and benefits

Sub-topic	Design proposal	CMI position
3.1 Overarching framework	**The existing production-adjusted (intensity) baseline setting framework would be retained.** **A reserve would be built into baseline decline rate calculations to**	CMI supports maintaining a production-adjusted (intensity) framework. Importantly, this approach decouples emissions from production output and is therefore targeted at decarbonising emissions-intensive processes, rather than simply output. It also accommodates cyclical

[36] Carbon Market Institute (CMI) 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 3.

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	help ensure the 2030 target is met. The reserve would hold account for higher-than-expected production growth at new and existing facilities, and trade exposed baseline adjustments.	variability of production output at some facilities. Achieving process decarbonisation also supports the ultimate objective of supporting the international competitiveness of Australian industry in a carbon-constrained global economy. CMI supports the proposal to build a reserve into the baseline decline rate to help ensure the 2030 target is met. This is a sensible measure under a production-adjusted framework that will reduce the risks associated with possible higher-than-expected production growth. However, CMI recommends that additional guardrails be built in where possible. For example, by specifying decadal carbon budgets in the Safeguard Rules (see Key Recommendation 1) or ensuring a careful approach to new entrants and facility expansions (see Key Recommendation 9).
3.2. Setting baselines for existing facilities	**Baselines for existing facilities would be set using a hybrid model initially weighted towards the use of site-specific emissions intensity values, and transitioning to industry average emissions intensity values by 2030.**	CMI supports the Government's proposed hybrid approach to baseline setting. CMI originally advocated for a site-specific approach to setting emissions-intensity baselines under the enhanced Safeguard Mechanism to remove aggregate headroom from the scheme and allow for timely creation and trade of below-baseline SMCs for compliance.[37] However, we view the hybrid approach as an elegant solution that balances the competing circumstances of different facilities. Site-specific weighted baselines at the outset will remove headroom and equalise the impact of the scheme-wide indicative decline rate in year one, giving below-average performing facilities time to prepare as scheme transitions to an industry-average approach that will reward better performers. This creates investment drivers for

[37] CMI 2022, 'Safeguard Mechanism Reform – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 6-7.

2. The Safeguard Mechanism's share of the national emissions reduction task

		decarbonisation at these higher emissions-intensity facilities. CMI understands that the industry-average benchmarks used to calculate baselines between 2023-24 and 2029-30 will reflect a historical, rather than 'real-time', industry average. CMI therefore recommends that the Government update these benchmarks at regular, periodic intervals or clarify its approach to ensuring scheme integrity is not compromised (for example, through the over-crediting of SMCs in the case that previously under-performing facilities increase their performance over time). The first review of these values could occur in the scheduled review.
3.3 Implementing a hybrid model	**(a) From the commencement of Safeguard Mechanism reforms in 2023-24:** **- all facilities to be on production-adjusted baselines—reported, calculated and fixed baselines will no longer be available;** **- all facilities to use published, Government-determined production variables.** **(b) In consultation with Safeguard businesses, the Government would:** **- finalise and publish remaining production variables and industry average emissions intensity values; and** **- review existing production variable definitions to ensure a comprehensive set of suitable production variables is in place when reforms commence.** **(c) All existing facilities' site-specific emissions-intensity values would be reset using historic data.**	CMI supports the proposal to phase out reported, calculated and fixed baselines and require all facilities to be on production-adjusted baselines from 2023-24. We also support the proposed consultation process to inform finalising and publishing remaining production variables and industry average emissions intensity values. Transparency should also be provided around the facility consultation process used to inform the finalisation of production variables and industry average emissions intensity values. CMI note that consulting on and implementing this volume of work within the available time frames will require significant resourcing and progression of work. Administrative backlogs have caused roadblocks in overseas carbon pricing schemes.[38] We therefore encourage the Government to plan to avoid this situation and ensure the Clean Energy Regulator is adequately resourced to ensure baselines are checked and approved efficiently to reduce the potential of a backlog impacting the first true up period.

[38] See: Carbon Pulse 2023, 'ANALYSIS: California cap-and-trade registration backlog more than doubles in Q4 amid longer wait times', https://carbon-pulse.com/186636/.

2. The Safeguard Mechanism's share of the national emissions reduction task

	(d) Facilities would need to apply for site-specific emissions-intensity values by 30 April 2024, with the application accompanied by an audit. **The values would be calculated using the middle two values from the four most recent years of data (2018-19 to 2021-22).** **The remaining two years of data would be used to calculate a production-weighted, average emissions-intensity value(s) for the facility, noting that any emissions apportioning must be consistent with published production variable definitions.**	Finally, CMI again notes the importance of updating industry average emissions intensity values at set intervals, with reference to real-time facility performance, as the sub-sectors of industry decarbonise over time.
3.4 Setting baselines for new facilities	**New facility baselines would be based on international best practice emissions-intensity benchmarks, adapted for Australian circumstances.** **International best practice would also apply at existing Safeguard Mechanism facilities if they begin producing new products.** **New entrant arrangements would commence from 1 July 2023, consistent with broader Safeguard reforms.** **New facility baselines would be subject to an annual decline rate, consistent with baselines for existing facilities.**	As mentioned under Key Recommendation 9, CMI supports the proposed approach to setting baselines for new facilities. However, we encourage the Government to provide further transparency on how this will work in practice. This includes guardrails around the process of adapting international best practice values for an Australian context to ensure that this process is transparent and informed by unique environmental/technical considerations unique, rather than industry advocacy for special treatment. Further, CMI understands that significant work will need to be undertaken to determine international best practice and again notes the importance of adequate resourcing to perform this task. CMI appreciates potential administrative difficulties involved in treating facility expansions as new entrants. We note that if expansions were to attract new entrant treatment, definition of a 'significant expansion' would need to be built into the Safeguard Rules. However, we would appreciate clarity from the Government on how it will ensure these do not lead to significant increases in scheme-wide emissions that eat up the carbon budget. While we appreciate there is a reserve built

2. The Safeguard Mechanism's share of the national emissions reduction task

		into the decline rate to accommodate some uncertainty, we consider additional guardrails should be built into the design to provide further assurance where possible. The Government should also clarify how it will ensure that applying international best practice benchmarks to existing facilities producing new products does not create a perverse disincentive that may 'lock in' business as usual (see more above on p. 13) .

4. Flexible compliance options to lower costs

Sub-topic	Design proposal	CMI position
4.1 Crediting and trading	**Crediting and trading would commence on 1 July 2023, after passage of the Safeguard Mechanism (Crediting) Amendment Bill 2022.**	CMI supports the proposal that crediting and trading of SMCs would commence on 1 July 2023. We note that this is contingent on the passage of the Safeguard Mechanism (Crediting) Amendment Bill.[39]
4. 2 Implementation	**All Safeguard Mechanism facilities with emissions below their baseline would be able to generate credits, except landfills and facilities accessing multi-year monitoring periods, borrowing arrangements and deemed surrender provisions.** **Facilities that fall below the coverage threshold would continue to be eligible to receive credits for five years, noting that their baseline will continue to decline.**	CMI supports the proposal for all facilities to be eligible for below-baseline SMC generation, with the exception of facilities on multi-year monitoring period, borrowing arrangements and deemed surrender provisions. We also note that facilities with existing ACCU projects should also not be eligible to generate SMCs for the remaining duration of their ACCU crediting periods. With respect to landfills, CMI's comments and recommendations are on p. 30. CMI supports the proposal for facilities falling below the 100,000 tCO_2-e threshold to continue generating SMCs for five years. As articulated under Key Recommendation 3, we encourage the Government to consider

[39] CMI's positions on the Safeguard Mechanism (Crediting) Amendment Bill 2022 can be found in our submissions on the original exposure draft legislation and to the Senate Inquiry: CMI 2022, 'Safeguard Mechanism Reform – Consultation on draft legislation submission', https://carbonmarketinstitute.org/app/uploads/2022/11/20221101_CMI-submission_Safeguard-Mechanism-Reform-consultation-on-draft-legislation.pdf; CMI 2023, 'Senate Inquiry: Safeguard Mechanism (Crediting) Amendment Bill 2022 [Provisions]', https://carbonmarketinstitute.org/app/uploads/2023/02/Carbon-Market-Institute-submission-to-Senate-Inquiry-on-SMC-Bill.pdf.

4. Flexible compliance options to lower costs

		extending the incentive to generate SMCs for already below-threshold facilities by allowing them to ‘opt in’ to the scheme. This would provide an opportunity to test and prepare below-threshold facilities for future coverage under the enhanced Safeguard Mechanism, in line with CMI’s recommendation to predictably drop the coverage threshold, in phases aligned to five-year NDC cycles, to the 25,000 tCO_2-e threshold for reporting under the NGER Act.
4.3 Domestic offsets	**Safeguard Mechanism facilities would be able to continue surrendering domestic offsets—in the form of ACCUs—to meet their compliance obligations**	CMI cautiously supports the proposal to maintain facilities’ ability to meet compliance using ACCU offsets in unrestricted volumes in the initial years of the enhanced Safeguard Mechanism. This could be reviewed in the scheduled review. CMI considers that limits on ACCU offset use should be introduced only if there is robust evidence to suggest that the enhanced Safeguard Mechanism is not driving adequate industrial decarbonisation. We note that careful work would need to be conducted by the Government to inform an industrial sub-sectoral approach to applying any limits to ACCU use, given that certain sub-sectors do not currently have commercially or technically available decarbonisation solutions and would need to rely on offsetting to a higher degree. Even for facilities where there are decarbonisation solutions, maintaining the flexibility to meet compliance using ACCU offsets will be required in the early years of the enhanced Safeguard Mechanism so that facilities can meet compliance while they wait for investments in emissions-reducing production upgrades to come online. In considering limits around ACCU use under the enhanced Safeguard Mechanism, rolling vintage limits could be another way to approach this issue. CMI’s position on ACCU use is further elaborated on under Key Recommendation 5.

4. Flexible compliance options to lower costs

4.4 Interaction with ERF	**ERF projects that reduce covered emissions at Safeguard facilities will no longer be able to be registered.** **Projects that are already registered would continue to generate and sell credits for their existing crediting period, but would not be able to enter into new contracts for Government purchase of ACCUs or extend their crediting period.** **Existing government-purchase contracts would remain in place, with 'deemed surrender' provisions grandfathered for two years from scheme commencement, then removed.**	CMI supports the proposal that Safeguard facilities will no longer be able to register new projects that reduce covered (Scope 1) emissions. However, we maintain it may be appropriate for Safeguard facilities to be able to participate in new ERF projects that reduce scope 2 emissions. We also note that should the government retain the proposal to include landfills under the enhanced Safeguard Mechanism, this may affect the commerciality of emissions reducing opportunities that have historically been incentivised through the landfill gas methodologies. CMI's full position on the proposed treatment of landfills can be found in more detail on page X. Clarity may be required around the potential for proposed projects may reduce both scope 1 and 2 emissions, noting that the enhanced Safeguard Mechanism should not lead to circumstances where non-covered emissions reductions are disincentivised as this would be a perverse outcome. While we support the retiring of deemed surrender arrangements for new ERF projects, CMI does not support the proposed two-year period proposed for grandfathering of existing deemed surrender provisions.[40] Deemed surrender provisions enable a Safeguard-covered entity with an approved ERF project and a carbon abatement contract (CAC) to sell ACCUs to the Government, reducing their facility baseline by the number of prescribed carbon units surrendered. Removing deemed surrender arrangements going forward is important to avoid 'double-counting' of certain emissions reductions in the context of the enhanced Safeguard Mechanism. *However*, removing these provisions after only two years will penalise hard to abate facilities that invested early in decarbonisation through registration of ERF projects, at the encouragement of

[40] CMI previously recommended that existing deemed surrender contracts be "appropriately grandfathered". However, we consider the two-year window to be an arbitrary, rather than appropriate, timeframe for this process. See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 14.

4. Flexible compliance options to lower costs

Government, who have more than two years left in their existing contracts.

CMI notes that the deemed surrender provisions were originally an important and legitimate aspect of the ERF and Safeguard Mechanism schemes and was intended to encourage early investment in decarbonisation. The current government proposal to discontinue the benefit of the provisions after two years, creates risks that some affected decarbonisation projects, which have long planning and implementation phases, will not continue or will be deferred. It would also penalise early-movers who utilised these provisions in good faith to secure the business case for investment in decarbonisation.

Existing deemed surrender arrangements for facilities with an existing ERF contract should continue for the duration of their existing contract. Deemed surrender provisions should not be available under any new ERF contracts entered into after January 2023. CMI maintains that rules should be established to ensure facilities generating ACCUs through existing deemed surrender arrangements are not generating SMCs for the same activities until the crediting period of the current ACCU project phases out.

CMI considers that ACCUs delivered to the Government under these continuing contracts should not be pooled into the proposed cost containment reserve as – if eventually purchased and used by a facility to meet compliance – this could lead to 'double use' of the ACCU's associated abatement for compliance by two facilities (see Key Recommendation 6).

4.5 International offsets	**International offsets are not proposed to be part of the initial reforms. The Government may consider allowing access to high integrity international offsets at some future time and will consult in**	CMI supports the proposal to consult on amending legislative framework in 2023 and looks forward to engaging in this process. However, at this stage, we also support the proposal that international offsets not be

4. Flexible compliance options to lower costs

2023 on the possibility of establishing the legislative framework for international units.

included in the initial enhanced Safeguard Mechanism.

While there is no immediate need to introduce international offsets under the enhanced Safeguard Mechanism, the legislative architecture required to import international units would take several years to set up. It is prudent to begin this process well in advance. CMI recommends that this architecture should support the future export of ACCUs, should Australia be in a position of net negative emissions that can support other countries to meet their NDCs and the global task of atmospheric carbon removal.[41]

CMI notes that any international offsets introduced into the enhanced Safeguard Mechanism in the future would need to be compliant with emerging Article 6 emissions trading rule under the Paris Agreement to avoid double counting and assure that associated abatement could count towards Australia's NDC.[42] Units would also need to meet integrity safeguards that apply to (currently, and in future following the implementation of the Chubb Review recommendations) to ACCUs, currently the legislated offsets integrity standards.

Along with unit integrity itself, CMI stresses the importance that any future Article 6 trading agreement be informed by strict guardrails to ensure mutual, equitable benefits for project host countries and prevent negative outcomes. As well as appropriate prior and informed consent processes, this would need to include consideration of a prospective partner country's ability to meet its own NDC targets.

CMI also notes that any international offsets would have to be of comparable integrity

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[41] See more on CMI's position on Australia's ability to support global carbon removal in: CMI 2022, 'Post-election briefing: 5 priorities for climate action and carbon markets', https://carbonmarketinstitute.org/app/uploads/2022/05/CMI-Post-Election-Briefing-5-priorities-for-climate-action-and-carbon-markets.pdf, p. 1.

[42] CMI's latest fact sheet updates on Articles 6.2 and 6.4 of the Paris Agreement can be downloaded here: https://carbonmarketinstitute.org/fact-sheets/.

The Intergovernmental Panel on Climate Change (IPCC) notes that carbon removal technologies will now be needed to achieve 1.5°C. See: IPCC 2022, Sixth Assessment Working Group III Report: Mitigation of Climate Change – Summary for Policymakers, https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_SummaryForPolicymakers.pdf, p. 36.

4. Flexible compliance options to lower costs

		safeguards as those that currently apply (and may in the future, following implementation of the Chubb Review recommendations) to ACCUs under the legislated Offsets Integrity Standards.
4.5 Banking and borrowing	**Unlimited banking of SMCs would be allowed to 2030. In other words, SMCs could be used for Safeguard compliance in any year to 2030, irrespective of when they are issued.**	CMI supports the proposal to allow unlimited banking of SMCs up to 2030. However, we encourage clarity on banking arrangements beyond 2030, through the initial milestone review of the scheme, to allow investment decisions to be made today.
	Borrowing of up to 10 per cent of the baseline each year would be allowed to 2030, with a 10 per cent interest rate applied in the year after borrowing occurs. **The 2026-27 Safeguard Mechanism review will consider post-2030 arrangements for banking and borrowing.**	While CMI has cautioned about borrowing, we support the Government's proposed borrowing arrangements, so long as restrictions (10 percent of baseline may be borrowed, subject to 10 percent interest in following year) are maintained. CMI considers that these restrictions are sufficient to guard against short-sighted borrowing practices that may reduce the scheme's overall effectiveness.[43]
4.6 Taking account of emerging technologies	**Five year multi-year monitoring periods (up to 2030) would be available where a facility has exceeded its baseline due to a lack of available technology, but has a firm and credible plan in place to reduce cumulative emissions before the end of the five year period.**	CMI supports the proposal to allow facilities to apply for a five-year multi-year monitoring period (MYMP), contingent a firm, credible plan to reduce cumulative emissions in the period.[44] CMI notes that it is important the requirements to demonstrate this 'firm and credible plan' must be strict enough to ensure it will achieve the cumulative emissions reductions required, but still achievable enough to encourage facilities to apply where they have technology upgrades that make them an eligible candidate.

[43] Limiting borrowing allowances is common due to risks associated with overreliance. See: International Bank for Reconstruction and Development & World Bank 2016, 'Emissions Trading in Practice: A handbook on design and implementation', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 98-100.
[44] CMI originally advocated against carrying MYMPs into the enhanced Safeguard Mechanism, however we consider that these more rigorous requirements reduce the risk that they are open to misuse and create an incentive for facilities to invest in transformational upgrades where technology is available. See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 14.

4. Flexible compliance options to lower costs

4.7 Cost containment measure	**A cost containment measure would make Government-held ACCUs available at $75 per tonne of CO2-e in 2023-24, increasing with the CPI plus 2 per cent each year.**	As mentioned above, CMI has reservations about the cost containment reserve proposal. As detailed further under Key Recommendation 6, CMI recommends the Government exercise caution with this proposal to avoid unintended or perverse outcomes down the track, and ensure it does not reduce investment in at-source decarbonisation.
4.8 Compliance costs	**Administrative dates for baseline applications and compliance would be amended and added to accommodate Safeguard Mechanism reforms.**	No comment

5. Tailored treatment for emissions-intensive, trade-exposed businesses

Sub-topic	**Design proposal**	**CMI position**
5.1 Defining EITEs	**Two categories of facilities would be given access to tailored treatment to manage competitiveness and carbon leakage risks:** **- Trade Exposed facilities, which will include all facilities undertaking a trade exposed activity;** **- Trade Exposed Baseline Adjusted facilities, which are a subset of trade-exposed facilities facing an elevated risk of carbon leakage.**	CMI supports the proposed two-tiered approach to defining EITEs, including the definition of the second category – Trade Exposed Baseline Adjusted (TEBA) – being based on cost impact.
5.2 Assistance for EITEs	**Trade Exposed facilities and Trade Exposed Baseline Adjusted facilities will have access to an initial, dedicated $600 million Safeguard Transformation Stream of the PRF; and all Safeguard Mechanism facilities will have preferential treatment for access to other PRF streams, where they are eligible, such as through additional weighting in the criteria for assessment.**	CMI supports the Government's proposed two-tiered approach to assisting EITE facilities. CMI supports the $600 million Safeguard Transformation Stream to support the first tier of EITE facilities in meeting compliance and decarbonising processes. CMI encourages the Government to provide clarity on the allocation of remaining funds among the other three funding priorities of the PRF in the May 2023 Budget..

5. Tailored treatment for emissions-intensive, trade-exposed businesses

	Trade Exposed Baseline Adjusted facilities would be eligible to apply to the Clean Energy Regulator for a discounted decline rate set based on a scheme impact. The minimum decline rate would be two per cent each year.	In relation, CMI encourages the Government to ensure and confirm that the exit fee payments associated with the fixed carbon abatement contract exit arrangements are returned to the PRF, as a source of funding. CMI notes that the TEBA approach for the second tier of highly exposed facilities must be a short-term, interim measure only. CMI continues to encourage the Government to provide clarity on the distribution of the As elaborated in Key Recommendation 8, we encourage the Government to fast-track the development of a more durable, long-term solution to carbon leakage. In particular, we recommend the Government expedite a CBAM for highly exposed sub-sectors such as cement and steel to support the timely phase out of the TEBA designation. As elaborated above and in our initial consultation response, in-scheme modes of supporting EITE compliance can dilute scheme-wide carbon pricing signals.[45]
5.3 Applying for Trade-Exposed Baseline Adjusted Status	**Facilities would be able to apply for Trade Exposed Baseline Adjusted status based on the facility's cost impact metric exceeding the threshold.** **Costs would be determined by reference to the default certificate price published in June of each year.**	CMI supports the proposed means of applying for TEBA status. CMI again stresses, however, that this can only be a short-term, interim form of support for highly trade exposed facilities and must be phased out in a timely manner. As elaborated on under Key Recommendation 8, without a transition plan into a more durable solution, differential decline rates would have considerable impacts on scheme-wide decarbonisation drivers. This is because as baselines decline and facilities collectively incur growing compliance costs, the EITE cohort experiencing a cost impact metric over 3 percent of revenue would increase. This would erode the overall scheme decline rate, and the ability for the enhanced Safeguard Mechanism to deliver on its abatement target.

[45] See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 8-10, 17.

5. Tailored treatment for emissions-intensive, trade-exposed businesses

5.4 Exploring additional policy options to address carbon leakage	**The Government recognises strong stakeholder interest in an Australian CBAM, as well as design and implementation challenges, and will undertake a review commencing in 2023 to explore policy options to further address carbon leakage.**	CMI strongly supports the Government's commitment to exploring a CBAM or other more durable form of long-term carbon leakage prevention, as we advocated for in our initial consultation response.[46] We encourage the Government to provide detail on the plans for as soon as possible, as elaborated under Key Recommendation 8.

6. Declining baselines to deliver the target

Sub-topic	**Design proposal**	**CMI position**
-	**In general, a uniform, 4.9 per cent decline rate would apply to Safeguard Mechanism baselines each year to 2029-30. This delivers an estimated 205 million tonnes of abatement and is calibrated to meet the 1,233 Mt CO2-e emissions budget and 100 Mt CO2-e 2030 point target.** **Decline rates for 2030-31 to 2034-35 would be the subject of consultation in 2026-27 following** **Australia's required NDC update in 2025, and made by 1 July 2027.**	CMI supports the proposed 4.9 percent initial decline rate. We appreciate that this is in the mid-to-high range of the 3.5-6 percent the Government originally consulted on and is particularly strong in the context of the proposed hybrid approach that will move to industry average baselines by 2030.[47] As extrapolated under Key Recommendation 2, this decline rate should be scaled up after 2030 to support ratcheting climate ambition commensurate with Australia's Paris Agreement NDCs and fair share of global climate mitigation. CMI appreciates that the decline rate and 2030 point in time targets are complemented by an absolute carbon budget. To provide further assurance that this carbon budget will not be breached, CMI also recommends that the Government specify the scheme-wide carbon budget for 2021-30 in the final Safeguard Rules (see Key Recommendation 1).

7. Strengthening penalties

Sub-topic	**Design proposal**	**CMI position**

[46] See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, pp. 8-9.
[47] CMI had originally advocated for a 5.6 percent decline rate in the context of a site-specific, production-adjusted framework. See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 6.

7. Strengthening penalties

7.1 Civil penalty	**The civil penalty, while not expected to be imposed as it will be more expensive than the cost of compliance, would be updated so it reflects both the number of days in exceedance and the quantity of excess emissions.** **The maximum civil penalty would be set at 1 penalty unit per tonne of excess emissions per year and the infringement notice charge at one-third of the maximum civil penalty to a maximum of 150,000 penalty units. From 1 January 2023, a penalty unit will be $275.** **Decline rates for 2030-31 to 2034-35 would be the subject of consultation in 2026-27 following Australia's required NDC update in 2025, and made by 1 July 2027.**	CMI supports the tightening of penalties for non-compliance under the enhanced Safeguard Mechanism to ensure that they exceed the costs of compliance. We consider it particularly important that penalties reflect the climate impact of a given exceedance and continue to grow until a non-compliant facility has 'made good' on its exceedance by retiring equivalent SMCs and/or ACCUs.[48]
7.2 Anti-avoidance	**Anti-avoidance measures would be introduced to prevent a business from defining, or redefining, a facility with the intention of avoiding Safeguard Mechanism obligations.**	CMI supports the proposed anti-avoidance measures. We reiterate (as under Key Recommendation 3) that these could be reinforced by ensuring the facility for coverage under the enhanced Safeguard Mechanism continues to drop as covered entities reduce their emissions below the 100,000 tCO_2-e threshold for coverage.

8. Landfills

Sub-topic	**Design proposal**	**CMI position**
-	**Given the overlap with ERF projects, treatment of legacy waste and**	CMI has reservations about the proposed approach to landfills. We recommend that

[48] CMI originally advocated that penalties be tightened to be fit for purpose to deter non-compliance by being calibrated in a way that ensures they exceed the cost of procuring ACCUs, SMCs and at-source decarbonisation, and they continue to increase over time. See: CMI 2022, 'Safeguard Mechanism Reforms – First Consultation submission', https://carbonmarketinstitute.org/app/uploads/2022/09/FINAL_Safeguard-Mechanism-Reform-Submission-1.pdf, p. 8.

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existing baseline arrangements, landfills would not be eligible to generate Safeguard Mechanism Credits from 2023-24 to 2025-26.	the Government exclude landfills from the enhanced Safeguard Mechanism in the initial phase and consult with landfills and the landfill gas sector on an appropriate manner for their inclusion or alternative treatment to implement at the next phase.
Consistent with other Safeguard Mechanism facilities, landfills covered by the Safeguard Mechanism could continue existing ERF projects that reduce covered emissions and existing ERF contracts, but not register new projects that relate to covered emissions, nor extend existing crediting periods, nor enter new government contracts during this period. Deemed surrender provisions would be grandfathered for two years, then removed.	The Government should be careful to ensure that the resulting approach is not counterproductive to waste and resource recovery policy and regulation at the federal, state and territory levels. The federal National Waste Policy, for example, has a target to halve organic waste sent to landfill by 2030.[49] The Government should consider how the inclusion of large landfills as industrial facilities with declining baselines under the enhanced Safeguard Mechanism would interact with this target.
Landfill baselines would decline at the same rate as other facilities.	CMI understands that landfills are a unique facility type under the Safeguard Mechanism that is not well suited for inclusion under a declining baseline approach. Unlike other covered facilities, landfills do not produce a saleable product but provide an essential service. Landfill operators that are responsible for Safeguard compliance have little control over the waste they receive and resulting emissions.
The provision to add ACCUs issued in relation to the ERF project back to the net emissions of the facility would be amended to include only abatement of covered emissions.	The question of how to include landfills under the enhanced Safeguard Mechanism is further complicated in the context of large landfills with ERF landfill gas projects operating on site. In these instances, the landfill operator is responsible for Safeguard compliance, but a third party landfill gas operator has the rights to emissions and resulting ACCUs. CMI considers that the current proposal of signalling the intent to bring landfills into the scheme without a complete solution as to how that would work in practice risks undermining investment certainty for the sector in this intervening period. A preferable

[49] See: DCCEEW 2019, 'National Waste Policy Action Plan', https://www.dcceew.gov.au/sites/default/files/documents/national-waste-policy-action-plan-2019.pdf, pp. 26-27.

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approach would be exclude landfills until the complete solution is determined.

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