Carbon Market Institute

Submission - Emissions Reduction Fund: Safeguard Mechanism

April 2015

ABOUT THE CARBON MARKET INSTITUTE

The Carbon Market Institute (CMI) is an independent membership-based not-for-profit organisation. Our aim is to assist Australian businesses in meeting the challenges and opportunities associated with market-based approaches to emissions reduction and the transition to a low carbon economy.

As the peak body for carbon market participants, CMI has established an important role in the evolution of the carbon market in Australia. The Institute facilitates the networks, knowledge exchange and commercial interaction amongst key government policy makers and regulators, industry, financiers and investors, professional services companies and technology solution providers.

CMI membership represents a broad range of professionals, organisations and industry. Our members include leading professional service providers, NGERs reporting entities, secondary market participants, offset providers, academia and international organisations. Individuals within the CMI membership base are some of Australia's most respected carbon market innovators and leaders.

BACKGROUND

CMI's submission on the safeguard mechanism was developed from consultation with CMI members through dedicated Policy Working Groups and one-on-one meetings with members, and builds on earlier consultations with CMI members and meetings with the Minister for the Environment, Department of the Environment, and the Clean Energy Regulator and participation in the Safeguard Mechanism Reference Group and the ERF Expert Reference Group. In addition CMI played an active role in communicating member's views to the Government, the Federal opposition, the Greens and the Senate cross bench in the development of the amendments of the Carbon Farming Initiative Amendment Bill 2014.

The submission draws on CMI's submissions to the Emissions Reduction Fund Terms of Reference, Green and White Papers and the Carbon Farming Initiative Amendment Bill 2014.

CMI recognises it has a diverse membership base and while the submission reflects the broad view of members, no comments or viewpoints are attributed to any individual or organisation.

TIMELINE

- April 2013 – First CMI Direct Action Working Group with a focus on constructive input to the then Opposition's proposed plan.
- 14 August 2013 – Presented options to then Shadow Minister for Climate Action to consider in the design and implementation of the proposed Emissions Reduction Fund.
- October 2013 – CMI Direct Action Working Group review of the Emissions Reduction Fund Terms of Reference with a focus on design features.
- 24 October 2013 – Workshop with Environment Minister Greg Hunt.
- 12 November 2013 – CMI workshop with the Department of the Environment's Emissions Reduction Fund Taskforce.
- 21 February 2014 - CMI Submission to the Emissions Reduction Fund Green Paper
- 1 July 2014 - CMI Submission to the Inquiry into the Carbon Farming Initiative Amendment Bill 2014.
- September 2014 - CMI consultation with Senate cross-bench regarding the passage of the CFI Amendment Bill 2014.
- March 2015 - CMI Members Policy Working Group with UNFCCC Taskforce within the Department of Prime Minister and Cabinet and the Safeguard Mechanism Taskforce.

1. EXECUTIVE SUMMARY

The Carbon Market Institute aims to work with the government of the day to communicate members' views on how the government's policy can be implemented so that it can meet international emissions reduction goals and best reflect a market based approach to emissions reduction. As such this submission is based on responding to the Government's safeguard mechanism policy and does not cover the options for alternate climate change policies.

In framing our submission on the safeguard mechanism design and rules, we have taken into account the following key principles and options for implementation:

1.1. Key issues and principles

- The objectives of the safeguard mechanism need to be clearly defined to reflect Australia's intensifying emissions reduction task, limit emissions growth across the economy and meet emissions reduction targets under international obligations.
- The rules and objectives of the safeguard mechanism should be set at the outset so they ensure a long-term, stable and predictable policy landscape for business.
- To cost effectively meet current and future targets, the safeguard mechanism should operate as a market-based mechanism.
- The safeguard mechanism should become the primary means to limit emissions growth across the Australian economy and lead to the transition from predominantly public sector funding to private sector funding of emissions abatement.
- To meet emissions reduction targets at lowest cost to the economy, the design of Australia's national scheme should keep open opportunities to link and trade with other international markets.
- The proposed design of the safeguard mechanism should align with one of the stated principles of the Emissions Reduction Fund: streamlined administration.
- Bipartisan agreement in climate policy is necessary to alleviate uncertainty for business.

1.2. Key design features and options for implementation of the safeguard mechanism

The following points relate to options for the design features and rules of the safeguard mechanism so that they meet the key principles outlined above.

- **Coverage**
  - The threshold for coverage of entities under the safeguard mechanism should be determined by modelling of the emissions abatement profile and trajectory to meet international targets.
- **Baselines**
  - Designed effectively, baselines set under the safeguard mechanism, could be a way to effectively cap emissions growth of covered entities.

- Through the safeguard mechanism, the Government should have the ability to adjust and tighten allocated baselines over time to limit emissions growth and meet potentially more ambitious future emissions targets.
- A process needs to be established to identify how baselines may change over time to provide business more certainty on possible future compliance obligations.

- **Linkage with the ERF crediting and purchasing and development of the secondary market**
  - Linkage between the crediting and purchasing elements of the ERF and the operation of the safeguard mechanism should be made clear.
  - The final design of the safeguard mechanism should allow for a secondary market in carbon credits to evolve, facilitating trading between entities participating in the ERF and/or covered under the safeguard mechanism.

- **Compliance**
  - The penalty for companies exceeding their baseline should provide a significant incentive to stay below allocated baselines.
  - The make-good provision for companies exceeding their baseline should provide maximum flexibility to purchase eligible units – either ACCUs or international units.

2. KEY ISSUES AND PRINCIPLES FRAMING CMI'S SUBMISSION

- **The objectives of the safeguard mechanism need to be clearly defined to reflect Australia's intensifying emissions reduction task, limit emissions growth across the economy and meet emissions reduction targets under international obligations.**

The primary objective of the ERF as outlined in the Government's explanatory memorandum to the Carbon Credits (Carbon Farming Initiative) Amendment Bill 2014 is "to help Australia meet its international obligations under the United Nations Framework Convention on Climate Change" (UNFCCC). This is also the first object of the amended Carbon Credits (Carbon Farming Initiative) Act 2011.

The objectives of the ERF and safeguard mechanism, as described in the consultation paper, are inconsistent with the CFI Amendment Bill. The safeguard mechanism consultation paper states the objective of the ERF is to "cut emissions to five per cent below 2000 levels by 2020" and that the safeguard mechanism objective is to "avoid displacing emissions reduction under ERF with rises elsewhere in economy". Stated this way, the safeguard mechanism is only required while publicly funded abatement contracts remain in force. These objectives in the consultation paper both relate to Australia's commitment under the UNFCCC for the pre-2020 period, with neither accounting for emissions reductions required in the post-2020 period.

Australia is due to outline its post-2020 emissions reduction goals as part of the UNFCCC Intended Nationally Determined Contribution (INDC) process in mid-2015. Given the ambitious targets announced by Australia's key trading partners, namely China, the US and Europe, Australia will likely need to propose a target that is an increase on the 2020 target.

By not considering any post-2020 targets in defining the objectives of the safeguard mechanism, as is the case in the consultation paper, Australia will shortly be in a position of having announced a new post-2020 emissions reduction target without the flagship policy objective's aligned to achieving it. If the safeguard mechanism is to be enduring, the objectives and the rules governing the implementation need to be set so the mechanism plays a primary role in effectively limiting emissions growth and meeting future emissions targets in the post 2020 period.

Through the consultation period for the safeguard mechanism, there is an opportunity to ensure the initial scheme is designed so it is an enduring mechanism to limit emissions growth that provides long-term policy certainty. The abatement challenge to 2020 is significant and limiting emissions growth in the period 2020-2030 also needs to be considered as a central part of the initial policy framework.

- **The rules and objectives of the safeguard mechanism should be set at the outset so they ensure a long-term, stable and predictable policy landscape for business.**

The design of the safeguard mechanism should be conducive to the Government's goal of creating a stable and predictable policy landscape in which business can make new investments, as stated in the consultation paper. As currently described, the safeguard mechanism is linked to the crediting and purchasing elements of the ERF, a policy with the objective to achieve Australia's 2020

emissions reduction target. Focusing the design of the safeguard mechanism on Australia's 2020 target without considering our future emissions reduction targets sets Australia on course for further policy uncertainty as we will be forced to revisit the policy suite in the near future to achieve our post-2020 target.

Business needs policy certainty regarding future compliance obligations to ensure they are not competitively disadvantaged in the period 2020-2030 as the emissions reduction task intensifies.

By restricting the objectives of the ERF and safeguard mechanism to the pre-2020 period, the prospect of increased public funding required to meet future targets is increased. The safeguard mechanism should incorporate long term design features, such as how baselines will adjust and potentially decline over time, and demonstrate how the mechanism will become the primary means to limit emissions growth in the economy. Otherwise, the crediting and purchasing elements of the ERF may be required to continue as the primary basis for reducing emissions beyond 2020 which may increase the call on the Government budget to very high levels.

- **To cost effectively meet current and future targets, safeguard mechanism should operate as a market-based mechanism.**

CMI believes a market-based approach is the most cost effective means to reduce emissions. Globally, 39 national and 23 sub-national jurisdictions representing 52 per cent of global GDP have implemented or are scheduled to implement market-based policy instruments to meet their emissions reduction targets[1]. This is supported by over 1,000 businesses and investors who have signalled their support for carbon pricing[2].

Consistent with the Coalition's position before and after the September 2013 Federal election, the ERF and safeguard mechanism will involve a market-based approach. Market mechanisms allow the greatest reduction in emissions at the least cost and are crucial to efficient carbon price discovery.

The full transition of the safeguard mechanism into a market-based scheme such as a baseline-and-credit mechanism will be necessary to defray the future public cost of funding emissions reduction. In a baseline and credit scheme, a forward emissions baseline against which performance is measured is established. If actual emissions for covered entities are below this baseline, the difference between the two represents a reduction in emissions, and would be eligible for credits. Conversely, emissions above the baseline represent excess emissions and can be penalised[3]. Covered entities can offset their liability by reducing emissions below the baseline or purchasing offset units from others who have been issued credits, or a combination. Consistent with the baseline and credit model, the safeguard mechanism should ultimately operate to both credit emissions reductions and penalise excess emissions for emitting below or above allocated baselines respectively.

[1] States and Trends of Carbon Pricing. World Bank Group. May 2014, Washington DC, USA.
[2] 73 Countries and Over 1,000 Businesses Speak Out in support of a Price on Carbon. World Bank, 22 September 2014 (http://www.worldbank.org/en/news/feature/2014/09/22/governments-businesses-support-carbon-pricing)
[3] Coverage, Additionality and Baselines - Lessons from the Carbon Farming Initiative and other schemes, April 2014. Climate Change Authority, Australian Government.

A market based approach, such as a bassline and credit scheme, involves pricing carbon. Designed effectively, a baseline and credit mechanism puts a price on carbon which provides a signal for business to make investment decisions and most efficiently reduce emissions[4]. Globally, many companies consider carbon pricing to be the most effective and efficient means to reduce emissions[5]. Many Australian businesses factor an internal carbon price in investment decisions to assess their exposure under future policy scenarios. In a national business survey CMI found that the majority of respondents believe Australia will be economically disadvantaged if we do not price carbon in line with our international partners[6].

The final design of the safeguard mechanism should allow for the development of a secondary market, facilitating trading between entities participating in the ERF, covered under a safeguard mechanism or as part of a voluntary market. It is critical to consider the development of the secondary market in the initial design of the safeguard mechanism. The consultation papers' proposed exemptions for exceeding emissions baselines should not undermine the development of the secondary market by reducing demand for offsets.

The investment in domestic abatement through the ERF should continue to provide an opportunity for Kyoto-compliant credits to be generated and traded in the primary and secondary markets established under the scheme and potentially traded internationally.

Designed effectively, the safeguard mechanism could translate to being a baseline and credit mechanism that meets emissions reduction goals and become the primary long term approach to manage emissions growth.

- **The safeguard mechanism should become the primary means to limit emissions growth across the Australian economy and lead to the transition from predominantly public sector funding to private sector funding of emissions abatement.**

The safeguard mechanism rules should be set so it is an enduring mechanism that provides long-term policy certainty and a market-based approach to meet emissions targets at least cost to the economy. Funding the emissions reductions to meet the 5% 2020 emissions reduction target and the post-2020 target - which under UNFCCC rules must be more ambitious - will involve significant investment from both the public and private sector[7]. Initially, the Government is committed to using public funds, through the ERF, to achieve emissions reduction.

If in the initial years of the operation of the safeguard mechanism, baselines are set at too high a level, emissions reductions under the safeguard will be minimal and few companies will be required to incur a financial compliance obligation. However, even if baselines were initially set at the levels indicated in the consultation paper, over time baselines can still be set to decline against historical high points or business as usual levels.

[4] Market-based Approaches to Emissions Reductions: Australia's Key Trading Partners. CMI Briefing Note - July 2014, Carbon Market Institute
[5] Pricing Carbon, The World Bank (http://www.worldbank.org/en/programs/pricing-carbon)
[6] 2014 Australian Emissions Reduction Survey, Carbon Market Institute
[7] 2014 Australian Emissions Reduction Survey, Carbon Market Institute

If allocated baselines for entities covered under the safeguard mechanism are tightened over time, it transfers the 'heavy lifting' to meet emissions reduction targets to covered entities, rather than the tax payer funded ERF. The cost for emissions reduction is transferred to those who are required to buy the credits. Over time the safeguard mechanism can become the primary means to manage emissions growth.

The $2.5bn ERF can make an important contribution to of the emissions reduction task over the short term, however limiting emissions growth in the period 2020-2030 also needs to be considered as a central part of the initial policy framework. If the crediting and purchasing elements of the ERF continues as the primary basis for reducing emissions beyond 2020, the call on the Government budget may increase to very high levels. Therefore the transition into a market-based scheme, using the safeguard mechanism or other market-based approaches, will be necessary to defray the ongoing, indefinite public cost of funding emissions reduction.

- **To meet emissions reduction targets at lowest cost to the economy, the design of Australia's national scheme should keep open opportunities to link and trade with other international markets.**

Any market based climate policy approach adopted in Australia should evolve in parallel with developments in other international markets, particularly with key trading partners. The rules of the safeguard mechanism should take into account and include the prospect for the international fungibility of ACCUs so as to enable linkages with other markets to be developed over time. Similarly the use of international units to meet compliance under the safeguard mechanism should be available to those entities that exceed their baseline. This would benefit, for example, companies that have compliance obligations under the safeguard mechanism that could potentially manage exposure in a cost effective manner using a range of trading and hedging strategies such as the use of international offset units to meet any liability, particularly so for large multi-national companies with operations in Australia.

Many multinational Australian businesses operate in jurisdictions with a market-based mechanism. In a recent CMI survey of 245 major Australian businesses, 80 per cent of respondents consider climate policy developments in other countries to have a major influence on the Australian economy.

There is a range of new market linkages being established between compliance markets in national and sub- national jurisdictions, increasing the demand for verified carbon credits. The development and expansion of abatement projects under the ERF could enable the potential export of ACCUs to international markets, stimulating the Australian carbon market.

- **The proposed design of the safeguard mechanism should align with one of the stated principles of the Emissions Reduction Fund: streamlined administration.**

While the Government's intention to set baselines for covered entities using historical NGERs data for the period 2009-10 to 2013-14 may simplify reporting obligations for business, the processes for assessing and applying 'individual assessment' of baselines, new investments and expansions, multi-

year averaging and exceptional circumstances for baselines exceedance are administratively complex.

Under the proposed arrangements in the consultation paper there would be a significantly increased role of the Clean Energy Regulator to manage on a case by case basis the assessments and applications for exemptions.

- **Bipartisan agreement in climate policy is necessary to alleviate uncertainty for business.**

It is critical that the design and implementation of the safeguard mechanism and Australia's broader climate policies have bipartisan support so that industry, the market and investors can invest in emissions reduction with an increased level of certainty. This is essential to achieving the Government's goal of creating a stable and predictable policy landscape in which business can make new investments.

3. KEY DESIGN FEATURES AND OPTIONS FOR IMPLEMENTATION OF THE SAFEGUARD MECHANISM

3.1. Coverage

The safeguard mechanism could be applied to either a very broad range of companies/sectors or to a relatively narrow set. If all NGER reporting entities were covered under the safeguard mechanism, the scheme would extend to over 1100 companies[8]. The Issues Paper outlines coverage at 100,000 tCO_2e which would cover approximately 140 companies.

- **The threshold for coverage of entities under the safeguard mechanism should be based on modelling of the emissions abatement profile and trajectory to meet international targets and initially include a significant proportion of Australia's largest greenhouse gas emitting companies.**

Aligning the emissions reductions required under the safeguard mechanism to Australia's emissions reduction targets is essential to meet the objectives of the mechanism (see Section 2 of this submission).

To determine what the contribution required of the safeguard mechanism to reduce emissions in line with international targets should involve detailed modelling. The extent of the coverage of NGER reporting entities and the threshold for participating in the scheme should then be determined based on the modelling and calibrated against this abatement task. Calibrating the coverage of the safeguard mechanism against the abatement challenge is crucial for ensuring the threshold is set correctly.

The emissions reductions under the safeguard mechanism will complement the emissions reductions purchased under the ERF contracts. So the modelling to determine the threshold for coverage should initially take into account the contracted abatement purchased at the ERF auctions.

Based on the modelling, one option could be to apply the baselines to the companies who were liable under the Carbon Pricing Mechanism (CPM) or a subset of these companies. In a recent CMI survey of 245 major Australian businesses, 86 per cent supported extending coverage of the safeguard mechanism to companies liable under the CPM or further, to all NGER reporting companies[9].

Another option would be to stage the coverage of the safeguard mechanism so that it would initially apply to a subset of industry – for example, those that exceed 100,000 tonnes of CO_2e a year – and gradually lower the thresholds based on regularly modelling updates on how emission reductions are tracking against international targets.

[8] Extract of NGER Register 2012-13, Clean Energy Regulator
[9] 2014 Australian Emissions Reduction Survey, Carbon Market Institute

3.2. Baselines

- **Designed effectively, baselines set under the safeguard mechanism, could be a way to effectively cap emissions growth of covered entities.**

Under the initial coverage of the safeguard mechanism, it is unclear what quantum of emissions will be captured. It will be possible however to model the upper limit of the emissions profile if covered entities operated at the five year historical high point of emissions as outlined in the consultation paper. Baselines should be set to address any discrepancy between the modelled emissions profile and that required to meet emissions reduction targets. Setting baselines according to the emissions abatement task, calibrated against internationally agreed targets, will help to effectively limit emissions growth across the economy and distribute the task of reducing emissions across covered entities.

In some circumstances, such as where companies have a number of large facilities, it may be appropriate to consider aggregating emissions and setting baselines at the group or company level. Setting baselines at this level can in some cases result in a lower baseline than the sum of individual facilities and are simpler for companies to manage. Baselines set at group or company level are not appropriate for all companies, however for some they are likely to be more effective at reducing emissions and more cost efficient for business to manage.

- **Through the safeguard mechanism, the Government should have the ability to adjust and tighten allocated baselines over time to limit emissions growth and meet potentially more ambitious future emissions targets.**

In the initial years of the operation of the safeguard mechanism, if baselines were set at five year historic high levels, it is likely that few companies will be incur an emission exceedance situation.

The safeguard mechanism consultation paper proposes a 'light touch' start to setting baselines and incorporates a number of avenues for proposed exemptions and exclusions. However, without a meaningful discussion of how those baselines may decline or tighten over time, business is left with a degree of uncertainty as to how the scheme will impact them in years when the national emissions abatement task requires deeper emission cuts, particularly post 2020.

Over time baselines need to be set, or allocated, to decline against business as usual. Declining baselines will be essential to meet more ambitious post 2020 targets, increasing the incentive to limit emissions growth and to invest in low carbon technologies or processes. By creating these incentives, declining baselines will ultimately allow companies covered under the safeguard mechanism to make a more significant contribution to achieving 2020 and post-2020

Fifty per cent of respondents to CMI's Australian Emissions Reduction Survey, said that safeguard mechanism baselines should be set to decline over time in line with current and future emissions targets[10].

[10] 2014 Australian Emissions Reduction Survey, Carbon Market Institute

If allocated baselines for entities covered under the safeguard mechanism are reduced over time, it transfers the 'heavy lifting' to meet emissions reduction targets to covered entities, rather than the tax payer funded ERF. The cost for emissions reduction is transferred to those who are required to buy the credits. Over time the safeguard mechanism can become the primary means to limit emissions growth across the Australian economy.

- **A process needs to be established to identify how baselines may change over time to provide business more certainty on possible future compliance obligations.**

The safeguard mechanism rules need to detail how baselines and thresholds for coverage will be set and adjusted according to changes in national emissions reduction targets.

If the allocated baselines are planned to decline against business as usual over ensuing years, businesses covered under the mechanism will need to have time to plan for the change and make investments accordingly.

Implicit in this design is the need for long term certainty on allocated baseline levels and the timing of any changes/review to the mechanism rules. Targets and thresholds could be set and adjusted according to changes in national emissions reduction targets. The review and allocation of baselines could be conducted at regular predetermined intervals by a body such as the Climate Change Authority or the Productivity Commission.

3.3. Linkage with the ERF crediting and purchasing and the development of the secondary market

- **Linkage between the crediting and purchasing elements of the ERF and the operation of the safeguard mechanism should be made clear.**

Now that the crediting and purchasing elements of the ERF have been established and are operational, it is crucial for the linkage of these elements with the operation of the safeguard mechanism to be clearly defined.

In a recent CMI survey of Australian business, the majority of companies surveyed indicated they are adopting a wait and see approach towards ERF participation[11]. One key reason for business adopting this approach is the uncertainty over the rules of the safeguard mechanism. Businesses potentially covered under the safeguard mechanism are waiting to understand their possible liability under the scheme to determine whether to invest in abatement projects or emissions reduction technologies while others need to assess the opportunities to sell abatement before making this decision.

One element that could potentially provide confusion is the setting of a baseline under the safeguard mechanism and the setting of different facilities methodology baselines under the ERF crediting and purchasing. Confusion can arise when companies may have one baseline to operate against under the safeguard mechanism where there is a compliance obligation to stay below a

[11] Voluntary Emissions Reduction Activities Survey 2015, Carbon Market Institute (in press)

baseline and another baseline that is established using a different methodology where companies can register a project, bid into the auction and generate credits.

The ERF and the safeguard mechanism can be linked through the generation of ACCUs (ERF) and the purchasing of ACCUs (make-good provision for the safeguard). Depending on the final design of the safeguard mechanism linkage with the ERF, trading in the secondary market can help manage risk and meet obligations at lowest cost. Clearly outlining the linkage between the crediting and purchasing elements of the ERF and the safeguard mechanism is critical for the development of the secondary market.

- **The final design of the safeguard mechanism should allow for a secondary market to evolve, facilitating trading between entities participating in the ERF and/or covered under the safeguard mechanism.**

An active secondary market will create a demand for abatement, encourage investment in emissions reductions and provide sufficient liquidity for companies covered by the safeguard mechanism to manage their risks and make informed investment decisions.

Secondary carbon market activity can include:

- Sale/purchase of ACCUs generated under an approved methodology to the voluntary and/or international market.
- Sale/purchase of ACCUs as a make-good provision for ERF contracted parties to meet any abatement shortfall requirements.
- Sale/purchase of ACCUs generated under an approved methodology to the companies with a compliance requirement under the safeguard mechanism.
- Sale/purchase of eligible international units to the companies with a compliance requirement under the safeguard mechanism (taking into consideration a possible the threshold for international units).

The safeguard mechanism could be established as a significant demand driver for domestic abatement, if the baselines were set at a level that provides a meaningful incentive to reduce or limit emissions. Creating demand for domestic abatement through the safeguard mechanism is also a crucial element to incentivise participation in the ERF auctions.

The proposed rules to set baselines at an historical highpoint, introduce a multi-year compliance period, allow baselines to be adjusted for expansions and providing options to seek an exemption for exceeding allocated baselines all reduce the likelihood of covered entities exceeding their baselines and requiring emissions units to offset excess emissions. By creating highly flexible compliance arrangements, demand for emissions units is reduced significantly and the development of a secondary market will be limited.

The safeguard mechanism should incentivise emissions reductions in conjunction with penalising for non-compliance by enabling covered entities to earn credits for emissions reductions below their allocated baseline. This is inherently the core design feature of a 'baseline and credit' scheme which should be incorporated into the safeguard rules.

3.4. Compliance

- **The penalty for companies exceeding their baseline should provide a significant incentive to stay below allocated baselines.**

In CMI's recent survey of 245 Australian businesses, 84 per cent of respondents viewed penalties as an essential component of the safeguard mechanism. Penalties were also seen as crucial to ensuring the credibility of the safeguard mechanism as a policy to reduce emissions.

The exemptions and flexibilities regarding compliance designed into the safeguard mechanism need to be carefully considered to ensure strong incentives exist for companies to remain below their baselines and to stimulate domestic abatement.

- **The make-good provision for companies exceeding their baseline should provide maximum flexibility to purchase eligible units – either ACCUs or international units.**

The Government is not seeking to raise revenue from the implementation of the safeguard mechanism, however if baselines are set effectively, it is unlikely there will be no cost for companies covered under the mechanism that exceed their allocated baseline. To allow business to meet compliance at lowest cost, companies could 'make-good' through the purchase of a) domestically sourced standardised, carbon units – ACCUs, b) eligible international units or c) a mixture of domestic and international units.

The make-good provision requiring the purchase of ACCUs will stimulate the demand for domestic abatement but may come at a greater cost for compliance than the use of international units. Solely sourcing international units may undermine the domestic price for abatement and reduce the incentive for domestic abatement activity. A balance between domestic and international units therefore needs to be established to ensure the growth of the domestic market and that compliance can be met most cost effectively by business.

According to CMI's 2014 Australian Emissions Reduction Survey, the use of international units for compliance under the safeguard mechanism is supported by the majority of the Australian business community[12] The CFI amendment Bill 2014 stated that "It is immaterial whether a unit specified in the safeguard rules was issued in or outside Australia". The rules should spell out the eligibility criteria for the use of international units as a make good provision. Any international units used by companies to meet their make-good requirements should be sourced from credible trading systems, that is, internationally recognised and verified.

It is important however that the use of international units is appropriately limited so ensure demand for ACCUs outside the ERF. The safeguard rules should also clarify the percentage or proportion that entities exceeding their baseline could use in conjunction with domestic units.

[12] 2014 Australian Emissions Reduction Survey, Carbon Market Institute

For further information contact:

Carbon Market Institute

03 8601 1142

www.carbonmarketinstitute.org