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A new era of climate policy: Australia's Safeguard Mechanism reforms

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Introduction

Australia has a fraught history when it comes to climate policy and politics. Australia briefly had a Carbon Pollution Reduction Scheme (CPRS), which was a cap-and-trade emissions scheme. However, the Liberal Party repealed the CPRS in 2014 when it won the federal election. The Liberal Party then introduced the Safeguard Mechanism in 2016, however this policy failed to significantly drive down Australia's emissions.[1] This led to over 10 years of Australian climate policy limbo as major political parties could not agree on a more effective emissions reductions policy. However, nearly a decade on, Australia is in the midst of the most significant and ambitious climate reforms. The keystone is the strengthening of the Safeguard Mechanism.

The Safeguard Mechanism sets emissions baselines for facilities that emit more than 100,000 tonnes of carbon dioxide equivalent (CO_2-e) per year, with the aim of ensuring that emissions from these facilities do not increase over time. The mechanism faced criticism because of the "headroom" existing between actual emissions and generous emissions limits. This "headroom" has allowed business-as-usual operations and aggregate emissions from Safeguard facilities to grow.[2]

The passing of the Safeguard Mechanism (Crediting) Amendment Bill 2023 (Bill) on 30 March 2023 creates a more ambitious framework designed to actually reduce emissions and to achieve Australia's climate targets. The current Federal Government has committed to reducing national emissions to 43% below 2005 levels by 2030, and to achieving net zero emissions by 2050. These targets are prescribed under the Climate Change Act 2022 (Cth) (Climate Change Act).[3] The Bill amends the legislation that currently regulates Safeguard Mechanism facilities, such as the National Greenhouse and Energy Reporting Act 2007 (Cth) (NGER Act), among other legislative instruments.

In short, the Bill imposes a "hard cap" on emissions which sets a limit on total net safeguard emissions for financial years between 1 July 2020 and 30 June 2030. It also introduces a "pollution trigger" to ensure that new projects likely to result in an increase in emissions of a Safeguard facility are notified to the Minister and Climate Change Authority, and potentially released for public consultation. The reforms also require facilities to decrease emissions below their baseline by 4.9% each year until 2030, although some exceptions will be made for emissions-intensive trade-exposed facilities (EITE). Facilities will be incentivised to reduce their emissions through the imposition of penalties on excess emissions and by earning tradeable credits for any emissions below their baseline.

What is the Safeguard Mechanism and why is it being reformed?

The Safeguard Mechanism applies to the covered scope 1 emissions of facilities that emit more than 100,000 tonnes of CO_2-e per year.[4] Covered scope 1 emissions are direct emissions from processes such as fuel combustion, waste disposal and industrial processes. The Safeguard Mechanism does not apply to a facility's scope 2 emissions (the indirect consumption of an energy commodity)[5] or scope 3 emissions (upstream or downstream emissions generated as a consequence of the activities of a facility, but outside the control of a facility's business).[6] Currently the Safeguard Mechanism applies to 215 facilities from a broad range of industries, including mining, oil and gas and manufacturing.

These 215 facilities have a "baseline" which is a volumetric emissions limit. Facilities must keep their net-emissions below their baseline. The term "net-emissions" is used because it means gross emissions minus any offset emissions through, for example, the purchase of Australian carbon credit units (ACCUs). Facilities must record and report their net emissions levels under the NGER Act.

The existing Safeguard Mechanism has been criticised for being ineffective due to the leeway it gives emitters to exceed their baselines without penalty. For example, the Australian Centre for Corporate Responsibility reported that:

> [i]n FY17, the first year of reporting, the approximately 200 covered facilities emitted 131MtCO_2-e. In the latest reported year, FY21, the 212 covered facilities emitted 137 MtCO_2-e.[7]

The current Federal Minister for Climate and Energy acknowledged this in late 2022 saying that the safeguards "have failed and emissions have gone up from facilities covered by the safeguard mechanism".[8] Further, facilities covered by the Safeguard Mechanism produced 28% of national emissions in 2020–21.[9] To achieve ambitious emissions reductions targets legislated under the Climate Change Act, Safeguard facilities must reduce their emissions.

What are the reforms and what do they mean for emitters?

There are several key elements of the reforms that emitters should be aware of. This article addresses each in turn below.

A "hard cap" on emissions

Labor's willingness to agree to the Greens' "hard cap" on emissions was a key tipping point in the Safeguard Mechanism reforms garnering enough political support to pass Parliament. The "hard cap" requires all Australian facilities that come within the mechanism's 100,000 CO_2-e threshold to collectively reduce their emissions by 205 million tonnes by 2030. Put differently, it means that collective emissions between 1 July 2020 and 30 June 2030 cannot exceed 1233 million tonnes of CO_2-e.

Prior to the Greens' amendment, the Safeguard Mechanism only required polluters to reduce their emissions by 4.9% each year. However, this still allowed for an increase in actual emissions which are then "reduced" by 4.9% through the purchase of offsets. The "hard cap" closes this loophole and ensures a real decline in emissions.

The "hard cap" on emissions is complemented by the introduction of a "pollution trigger". The trigger requires the Minister for the Environment to report to the Minister for Climate Change, the Climate Change Secretary and the Climate Change Authority on the expected scope 1 emissions from any new projects approved under the Environment Protection and Biodiversity Conservation Act 1999 (Cth) (EPBC Act). Projects that may impact on matters of national environmental significance[10] will need to be referred for approval under the EPBC Act.[11] This means that the Climate Minister has oversight of emissions from approved new projects that may affect the "hard cap". To ensure that the approval of new facilities does not result in Australia exceeding the "hard cap", the Minister has powers to consult on and amend the Safeguard Mechanism. Most likely, this will involve increasing the required decline rates for covered scope 1 emissions to ensure that Australia remains within the cap of 1233 million tonnes of CO_2-e. While 4.9% is the prescribed rate until 2030, there are mechanisms for amending this rate. For example, the Minister, after receiving advice from the Climate Secretary, must carry out public consultation on whether the National Greenhouse and Energy Reporting (Safeguard Mechanism) Amendment (Reforms) Rules 2023 should be amended to ensure that the "hard cap" is reached. If following the consultation, the Minister is satisfied that a rule change is required, then the Minister can amend the rules.[12]

Changes to baseline decline rates for existing facilities

The Safeguard Mechanism reforms affect both existing and new facilities. The reform that is most widely known about is the introduction of 4.9% annual decline rates for facilities' baselines. This means that facilities must implement measures or purchase offsets that result in net emissions decreasing by at least 4.9% year-on-year. The Federal Government foreshadowed that after 2030, the baseline decline rates will be set in five-year segments in line with Australia's commitments under the Paris Agreement.[13]

Some facility operators, who have already been proactively reducing their emissions, may feel that they are being penalised by the new annual decline rates. This is because meeting annual decline rates of 4.9% is harder if all the "low hanging fruit" steps, in terms of emissions reductions, have already been taken. This is because emissions reductions activities will only be counted towards the 4.9% emissions reduction target from when reforms take effect and not before. However, from a purely environmental perspective, facilities should not be pausing their emissions reduction efforts. This is because everyone should be doing everything possible to reduce their emissions quickly and effectively to slow the effects of climate change.

Setting baselines for new facilities

In the future there will be new facilities which meet the threshold for covered scope 1 emissions that exceed 100,000 tonnes of CO_2-e. The ability to use advanced emissions reduction technologies from the beginning of operations will need to be taken into consideration when setting baselines for these facilities. The Federal government has indicated that it will set baselines "at international best practice, adapted for an Australian context".[14] However, this terminology remains vague and further consultation is required to determine what "international best practice" means. What is clear is that new facilities will also be subject to an annual decline rate, which is consistent with the rate applied to existing facilities as adapted to account for advanced emissions reduction technologies.

Exceptions made for emissions-intensive trade-exposed industries

EITE industries will receive extra assistance to ensure that they are not affected disproportionately by the Safeguard Mechanism reforms. Approximately 80% of facilities covered by the Safeguard Mechanism are EITE industries. These facilities will be able to apply for a portion of the $1 billion in funding available under the Federal Government's "Powering the Regions" fund. The expectation is that funding will not be allocated equally and some industries, such as oil and gas, will be ineligible to receive funding.[15] The intention is that facilities will use funding to implement modern technologies that will result in genuine emissions reductions. A subset of EITE industries, which face an elevated risk of carbon leakage, can apply for a baseline decline rate of less than 4.9%. However, the minimum decline rate will be 2% each year and this concession may not be available after 2030. Australia will need to ensure that it finds an appropriate middle ground by supporting industries that have harder to abate emissions, whilst also not creating too many exceptions that risk not meeting its legislated climate targets.

The key question this raises is if approximately 80% of facilities are EITEs, then will a $1 billion fund suffice, or will facilities need to invest significant amounts in order to achieve baselines? On a "back of the envelope" calculation, if each EITE facility covered by the Safeguard Mechanism (~172 facilities) applies for funding then they could each receive approximately $5.8 million in funding. This is unlikely to be sufficient to cover the cost of large decarbonisation projects. It is also expected that facilities will apply for a much larger amount of funding. It is likely that the Federal Government will expect industries to invest their own money into decarbonisation projects, rather than purely relying on funding. Some uncertainty exists as to which industries are eligible for funding and whether some industries will be more likely to receive significant funding than others. Whether this depends on the type of emissions reductions activities that the funding will be put towards, or other factors remains to be seen. Ultimately, customer, shareholder, and investor pressure on facilities to be "green" will likely force companies to self-fund decarbonisation efforts.

1.1 Introduction of Safeguard Mechanism Credits

The Safeguard Mechanism reforms introduce a new type of carbon credit — the Safeguard Mechanism Credit (SMC). Facilities will automatically generate SMCs when their emissions drop below the required 4.9% emissions reductions baseline. Further, SMCs will be the only type of credit that Safeguard facilities can generate through emissions reductions activities. Previously, facilities could register emissions reduction projects and receive ACCUs. However, from 1 July 2023, this will no longer be the case. This reform ensures that there is no "double counting" of emissions reductions. This is because 1 tonne of emissions reductions should not generate both an ACCU and an SMC, as each unit represents one tonne of abated emissions.

The reforms allow unlimited "banking" of SMCs until 2030. This means that facilities who generate SMCs can use them for compliance in future years. Alternatively, facilities can sell SMCs to other facilities covered by the regime who anticipate that they will exceed their required emissions reductions baseline. SMCs are only available for use within the Safeguard Mechanism and will not be available for purchase in the carbon market more generally. At this stage, the only other type of carbon credit that facilities can use to offset excess emissions are ACCUs. The Government has ruled out the use of international carbon units for now, partially due to concerns over low integrity credits that do not represent genuine emissions reductions.

There are some criticisms over allowing unlimited usage of ACCUs to meet emissions reduction targets because it can disincentivise the need to implement more expensive technological or process improvements that result in actual emissions reductions. Indeed, ACCUs are readily available and comparatively inexpensive to the cost of implementing decarbonisation technologies, such as carbon capture and storage projects. At the time of writing an ACCU costs AUD$38.

Therefore, while the introduction of SMCs is a step in the right direction, a cap on the supply of ACCUs would further incentivise facilities to not simply offset their emissions but instead take real abatement action.

Introduction of penalties

The Safeguard Mechanism reforms introduce penalties for facilities that do not meet their baseline decline rate.[16] The penalty is intended to reflect the impact of the excess emissions on the climate. This is, for example, to take into account that some greenhouse gases (such as methane) have a more detrimental impact on climate change than others. The explanatory memorandum states that the reforms will "base penalties for an excess emissions situation on both the size of the excess emissions situation and the number of days in which the excess emissions situation exists".[17] In practical terms, this means that facilities may be liable for up to 150,000 penalty units.

At the time of writing, 1 penalty unit equates to AUD$275.[18] One penalty unit is payable for each tonne of excess CO_2-e emissions. However, given that the cost of a penalty unit is higher than the cost of an ACCU, the Federal Government states that it "does not expect any

facilities to pay civil penalties or infringement notice charges, as these will be more expensive than the cost of compliance."[19] However, it is nevertheless a sign that the government is serious about compliance with baseline decline rates. Should ACCUs and SMCs become scarce or expensive, then it ensures that there is an enforcement mechanism available for facilities that do not meet their emissions reduction targets either through abatement activities, ACCUs or SMCs.

Preparing for the reforms

The passing of the Safeguard Mechanism reforms is a significant step forward in Australian climate policy. The reforms will be in effect from 1 July 2023. This means that facilities will need to act now to ensure that they are ready for the new emissions reduction requirements. This includes giving thought to how the reforms will affect their existing arrangements. For example, facility owners and operators will need to consider the following issues:

- Who will bear the additional cost of implementing emission reduction measures and complying with the revised regime — the facility owner or operator?
- What decarbonisation technologies are currently available to reduce scope 1 emissions? What is the timeframe for enabling these technologies and at what cost? Is Government funding likely to be available?
- Who is responsible for implementing the measures and accurately reporting baseline decline rates?
- Can additional costs due to the Safeguard Mechanism be passed through to customers/end users? Should facility operators or owners give any notices or make any disclosures under contracts with customers?
- Are there greenwashing risks to consider, for example is simply complying with regulatory obligations sufficient to make a green-type claim?

Given the increased ambition to actually reduce emissions and the tight timeframe between the passing of the Bill and the reforms taking effect, it is imperative that facility operators and owners turn their mind to these issues now.

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Footnotes

1. See Fig 1 in the Department of Climate Change, Energy, the Environment and Water, *Quarterly Update of Australia's Nation Greenhouse Gas Inventory: September 2022*, accessed online at www.dcceew.gov.au/climate-change/publications/national-greenhouse-gas-inventory-quarterly-update-sept-2022. Figure 1 shows that in the 2 years following the introduction of the Safeguard Mechanism in 2016, Australia's emissions rose for 2 years, before beginning to decline. Further, Fig 4 shows that emissions from stationary energy (excluding electricity), fugitive emissions and industrial processes and product use — sources of emissions that are at least partially regulated by the Safeguard Mechanism — have been rising since 2005.
2. Department of Climate Change, Energy, the Environment and Water, *Safeguard Mechanism Reforms: Consultation paper*, August 2022, accessed online at https://storage.googleapis.com/converlens-au-industry/industry/p/prj2135e8da0cf17d76c70fc/public_assets/Safeguard-Mechanism-consultation-paper.PDF.
3. At s 10.
4. It is a common misconception that the Safeguard Mechanism applies to all scope 1 emissions of facilities that exceed the 100,000 CO_2-e threshold. This is not the case and there are some exclusions. Rule 7 of the National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015 (Cth) lists the excluded scope 1 emissions.
5. For example, the use of electricity that is produced from fossil fuels such as coal or gas.
6. For example, emissions from the transportation of products produced by the facility or the use of a product by another company or person.
7. See ACCR, "Submission: Safeguard Mechanism" (20 September 2022) accessed online at www.accr.org.au/research/submission-safeguard-mechanism/ citing Labor, "Powering Australia", 2021, accessed online at www.reputex.com/wp-content/uploads/2021/12/REPUTEX_The-economic-impact-of-the-ALPs-Powering-Australia-Plan_Summary-Report-1221-2.pdf.
8. D Giannini and A Brown "Emissions safeguard has failed: Climate Change and Energy Minister Chris Bowen" *The West Australian*, 18 August 2022, accessed online at https://thewest.com.au/news/environment/climate-change-bill-hearings-to-begin-c-7918636.
9. Above n 2.
10. What constitutes a matter of national environmental significance is explained in Div 1 of Pt 3 of the EPBC Act.
11. Section 68, EPBC Act.
12. Section 22XS(1D)(e)(ii) of the Safeguard Mechanism (Crediting) Amendment Act 2023).
13. Above.

14. Department of Climate Change, Energy, the Environment and Water, "Safeguard Mechanism Reforms: Position Paper" (January 2023) accessed online at https://storage.googleapis.com/files-au-climate/climate-au/p/prj23cd662ff4387d8c254ae/public_assets/Safeguard%20Mechanism%20Reforms%20Position%20Paper.pdf.
15. Guardian Australia "Labor agrees to absolute cap on emissions to secure Greens backing for safeguard mechanism climate bill" (28 March 2023) www.theguardian.com/environment/2023/mar/27/labor-agrees-to-absolute-cap-on-emissions-to-secure-greens-backing-for-safeguard-mechanism-climate-bill.
16. See s 22XF of the Safeguard Mechanism (Crediting) Amendment Bill 2023 (Cth).
17. Safeguard Mechanism (Crediting) Amendment Bill 2023 Revised Explanatory Memorandum, accessed online on 13 June 2023 at www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6957.
18. See s 4AA of the Crimes Act 1914 (Cth).
19. Above n 14.