Explanatory Document

Exposure draft of the *Safeguard Mechanism (Crediting) Amendment Bill 2022* and the *Carbon Credits (Carbon Farming Initiative) Amendment (Safeguard Facility Eligibility Requirements) Rules 2022*

About this document

This document explains the draft amendments set out in the exposure draft *Safeguard Mechanism (Crediting) Amendment Bill 2022* (the draft Bill) and the draft amendments set out in the exposure draft *Carbon Credits (Carbon Farming Initiative) Amendment (Safeguard Facility Eligibility Requirements) Rules 2022*.

Background

The Safeguard Mechanism and upcoming changes

The Safeguard Mechanism provides a robust, legislated framework that limits the net emissions of around 215 large industrial facilities—those with more than 100,000 tonnes carbon dioxide equivalent each year. To date, the Safeguard Mechanism has not been designed to reduce emissions. Instead, emissions limits—known as baselines—were calibrated to track business-as-usual operations.

This is changing. On 16 June 2022, Australia lodged its updated Nationally Determined Contribution under Article 4 of the Paris Agreement with the United Nations Framework Convention on Climate Change. This update confirmed Australia's commitment to achieve net zero emissions by 2050, and included a new, strengthened, 2030 target of 43 per cent below 2005 levels. The Government is reforming the Safeguard Mechanism to gradually reduce baselines to help Australia reach net zero emissions by 2050.

The Government's Powering Australia plan will reduce Australia's emissions to 43 per cent below 2005 levels by 2030. It is focused on creating jobs, cutting power bills and reducing emissions by boosting renewable energy. Under the Powering Australia plan, the Government will adopt the Business Council of Australia's recommendation to reduce emissions baselines predictably and gradually over time for facilities already covered by the Safeguard Mechanism, and provide tailored treatment for emissions-intensive trade-exposed businesses.

On 18 August 2022, the Government released a consultation paper on the design of the Safeguard Mechanism reforms. These reforms are designed to support industry to reduce emissions efficiently, so that business finds the lowest cost abatement, wherever it occurs. The proposed changes include

reducing baselines and enabling Safeguard facilities that stay below their baselines to generate tradable credits.

The amendments in the draft Bill largely concern the creation of tradeable Safeguard Mechanism credits. These credits will allow facilities with relatively low cost abatement to sell credits to facilities whose abatement options are more costly or limited. This will enable least-cost abatement to occur under the Safeguard Mechanism.

Feedback on the consultation paper highlighted the importance of these credits to facilities to help meet their obligations under the Safeguard Mechanism; and of appropriate compliance and implementation arrangements for these credits.

Stakeholders also emphasised the need to ensure appropriate interactions for Emissions Reduction Fund projects at Safeguard Mechanism facilities under the new reforms.

Through the consultations, the Government has heard that any international units would need to be of the highest integrity and would need to contribute to Australia's commitments under the Paris Agreement to be considered for future use. Some stakeholders support the future use of international units in line with these conditions, while others do not support any future use of international units for Safeguard Mechanism compliance. The Government will continue to consider the legislative framework around international credits as part of the consultation and design process for the safeguard reforms.

Related legislation

The *Climate Change Act 2022* legislates Australia's strengthened 2030 target and Australia's target to achieve net zero by 2050, and commenced on 14 September 2022. It requires an annual statement by the Minister for Climate Change to Parliament and tasks the Climate Change Authority to provide advice on Australia's progress towards meeting these targets, and on future targets.

The *Climate Change Act 2022* informs and is complemented by the *Climate Change (Consequential Amendments) Act 2022*, which embeds consideration of the emissions reduction targets and Paris Agreement into the objectives and/or functions of key agencies and government departments delivering programs and policies contributing to emissions reduction.

Other aspects of the Safeguard Mechanism reform, including the setting and reduction of baselines, will be implemented through statutory rules, including through amendment of the *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (the Safeguard Rules).

A draft version of the Safeguard Rules will be released for consultation later in 2022.

This will provide stakeholders a further opportunity to provide their views on the settings for reform of the Safeguard Mechanism.

Consultation so far

The Powering Australia plan commits to reducing Safeguard Mechanism baselines predictably and gradually, on a trajectory to net zero by 2050. The plan articulated the role of tradeable credits for companies that stay below their baselines, to encourage investment in low-emissions technology. A consultation paper outlining options for Safeguard Mechanism reforms was publically released for feedback on 18 August 2022. The dedicated consultation period ran until 20 September and included online briefing sessions and in-person roundtables and meetings.

The consultation paper sought feedback on matters including the Safeguard Mechanism's share of the national abatement task, how Safeguard Mechanism baselines are set, crediting and trading, the role of domestic offsets and international units, treatment of emissions-intensive trade-exposed businesses, taking account of available and emerging technologies, and indicative baseline decline rates.

On Safeguard Mechanism baselines, the consultation paper sought feedback on whether baselines should be production-adjusted or be fixed as production changes. The paper raised the issue of 'headroom', where aggregate baselines currently exceed aggregarate emissions covered by the Safeguard Mechanism. The paper sought feedback on possible approaches for setting baselines for existing facilities so that aggregate headroom can be removed, and on approaches for setting baselines for new entrants.

Sections 22XL and 22XQ of the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) provide for the Safeguard Rules to specify how baselines are set. This Bill does not amend these sections, and the final policies regarding Safeguard baselines will be implemented through an amendment to the Safeguard Rules which will be released for consultation later in 2022.

The consultation paper proposed that tradeable credits would be automatically issued to Safeguard facilities whose emissions are below their baseline. It suggested that these arrangements could commence on 1 July 2023, subject to baseline-setting arrangements removing aggregate headroom. The provisions in this draft Bill will enable tradable credits, also known as Safeguard Mechanism Credits or SMCs, to be issued. These credits would each represent a tonne of emissions, and could be used by other Safeguard facilities to reduce their net emissions. This ensures facilities with emissions below their baseline level have an economic incentive to reduce their emissions even further if they have cost-effective emissions reduction opportunities.

Schedule 1 of this draft Bill adds new provisions to the NGER Act to enable the Safeguard Rules to provide for SMCs to be issued. It amends section 22XM of the NGER Act to enable Safeguard facilities to reduce their net emissions by surrendering SMCs. Schedule 2 of this draft Bill amends the ANREU Act to accommodate the inclusion of SMCs in the Registry.

The consultation paper sought feedback on 'banking' of SMCs, where SMCs created in the current year can be used for compliance in future years. It suggested that the issuance of SMCs could relate to phases, with Phase 1 operating for 2023-24 and 2024-25, and Phase 2 operating for 2025-26 to 2029-30. It suggested that there could be full banking withing phases but limits to banking from Phase 1 to Phase 2. Stakeholders provided feedback on arrangements for banking. A decision on whether to limit banking between Phase 1 and Phase 2 has not been made yet, but a provision in Schedule 1 of the Bill would amend Section 22XN of the NGER Act to enable the Safeguard Rules to provide for this should it be part of the final detailed design.

The consultation paper stated that international offsets are not proposed to be part of the initial enhanced Safeguard Mechanism and a range of views were expressed about their future inclusion in the scheme. The Government is giving ongoing consideration of a legislative framework for the possible inclusion of international offsets, which would need to be of the highest integrity and count towards Australia's Paris targets.

The consultation paper suggested that Safeguard facilities would no longer be able to generate Australian Carbon Credit Units (ACCUs) for reducing direct (scope 1) emissions unless they have an existing eligible offsets project. They could instead generate SMCs from these activities if the emissions reduction is beyond that required by the facility baseline. The draft *Carbon Credits*

(Carbon Farming Initiative) Amendment (Safeguard Facility Eligibility Requirements) Rules 2022 would implement this by preventing new eligible offsets projects from being registered if they reduce covered emissions at a Safeguard facility. Through the consultation, we heard that some facilities would prefer to continue to be able to register new offsets projects in these circumstances. For the integrity of the framework for issuing ACCUs, the Government considers it important that new projects are not registered, and instead that SMCs are generated where the reduction goes beyond the requirement of a facility's baseline.

To prevent emissions reductions from offsets projects that take place at NGER facilities from being double counted, subsection 22XK(4) of the NGER Act adds back any ACCUs attributable to carbon abatement at a Safeguard facility to that facility's net emissions number. The draft Bill includes an amendment to section 22XK of the NGER Act that will enable the Safeguard Rules to provide that ACCUs are only added back to the facility's net emissions number if they reduce the facility's Safeguard covered emissions.

In its [2018 Review of the National Greenhouse and Energy Reporting Act](), the Climate Change Authority recommended that the option for 'deemed surrender' under the Safeguard be removed (Recommendation 19). The consultation paper sought feedback on either removing deemed surrender entirely, or preventing it from being available for any new carbon abatement contracts. The draft Bill includes an amendment to section 22XN of the NGER Act so that either of these approaches could be implemented in the Safeguard Rules.

Approaches for the treatment of emissions-intensive trade-exposed businesses, for taking account of available and emerging technologies, and for baseline decline will be implemented in the Safeguard Rules rather than provisions in the draft Bill. Feedback on the detail of these arrangements will be sought later in 2022.

Structure of the draft Bill

The draft Bill contains four schedules that amend the NGER Act, CFI Act, ANREU Act, *Clean Energy Regulator Act 2011* (CER Act) and the *Clean Energy (Consequential Amendments) Act 2011*. It includes amendments to other legislation that reference emissions units, such as legislation concerning tax treatment of the units.

To enable the issuance of SMCs, Schedule 1 amends the NGER Act to create Safeguard Mechanism Credit units and apply the laws about registration, transfers and compliance obligations to SMCs consistent with the treatment of Australian Carbon Credit Units (ACCUs) under the CFI Act.

The purpose of Schedule 2 is to amend the ANREU Act to provide for SMCs to exist in the ANREU and establish arrangements for SMCs in the Registry that mirror the treatment of ACCUs.

The purpose of Schedule 3 is to amend the CER Act and the NGER Act to ensure consistent protection of all information held by the Clean Energy Regulator, and allow the Regulator to be conferred additional functions by regulations.

Schedule 4 sets out amendments to the CFI Act that would align it with the Safeguard Mechanism reforms, so that new carbon abatement projects that reduce covered emissions at Safeguard facilities would no longer be eligible for ACCUs. These projects would generate SMCs instead.

Safeguard Mechanism (Crediting) Amendment Bill 2022

Notes on clauses

Clause 1: Short title

This clause provides for the draft Bill, when enacted, to be cited as the *Safeguard Mechanism (Crediting) Amendment Act 2022.*

Clause 2: Commencement

The table in this clause provides for the commencement of Schedules in the draft Bill, which is on the day after it receives Royal Assent. The Schedules include transitional provisions to ensure that existing processes and rights are not impacted by the commencement of the amendments.

Clause 3: Schedules

This is a machinery clause that gives effect to the provisions in the Schedules to the draft Bill according to their terms.

Schedule 1—Safeguard Mechanism Credit Units

Outline

The Schedule contains provisions to enable the issuance and purchase of SMCs. These amendments apply to the NGER Act and the *Income Tax Assessment Act.* The amendments provide that the administrative requirements for SMCs – such as how credits are registered, transferred and used for compliance obligations – are consistent with those for ACCUs.

Part 1—Amendment of the National Greenhouse and Energy Reporting Act 2007

Part 1 of Schedule 1 to the draft Bill amends the NGER Act to establish the framework for issuing SMCs. The amendments enable the Safeguard Rules to provide for the issuance of credits to persons with a Registry account and who are registered under that Act. The Rule would deal with issues such as Regulator determinations and audit requirements relating to the number of SMCs to issue. The Rule could also specify if annual audit reports are required for crediting purposes or for assessing liability under Safeguard obligations.

Section 22XM of the NGER Act specifies that ACCUs can be used to reduce the net emissions of Safeguard facilities and allows for the Safeguard Rules to determine what other units can be used to reduce the net emissions of Safeguard facilities. The draft Bill specifies that SMCs can also be used to reduce net emissions of Safeguard facilities. The draft Bill also allows for the Safeguard Rules to provide limits on the use of these units (if any). For example, limits may be desirable for the future use of international units, or limits could be desirable on banking SMCs to use for compliance in future years.

The draft Bill amends section 15B of the NGER Act to enable an entity other than a controlling corporation or responsible emitter for a designated large facility to register to report under the NGER Act. This could be used, for example, to allow facilities to continue to generate SMCs if they are no longer covered by the Safeguard Mechanism (that is, they are no longer designated large facilities). This would retain the incentive to reduce emissions even as facilities' approach the Safeguard Mechanism's coverage threshold.

The draft Bill makes it possible to transfer a percentage of all SMCs issued into a holding account. These SMCs could then be transferred to emissions-intensive trade-exposed facilities is to assist with the cost of meeting their liability or for other purposes. This is one of the potential assistance measures for emissions-intensive trade-exposed businesses that was suggested in the August 2022 Safeguard Mechanism consultation paper.

To ensure that the Safeguard Mechanism and SMCs have a high level of integrity, the draft Bill provides for the Safeguard Rules to require audits in relation to crediting or regarding NGER reports from Safeguard facilities.

The draft Bill adds provisions to the NGER Act (Subdivisions B and C of Division 4A) for relinquishment of SMCs issued as a result of false or misleading information or reporting, similar to provisions in the CFI Act.

Part 2—Amendment of the Income Tax Assessment Act 1997

This Part contains amendments to the *Income Tax Assessment Act 1997* to include SMCs as specified registered emissions units, so that they receive the same tax treatment as other specified units, like ACCUs.

Part 3—Application of amendments

This Part provides that amendments in relation to notices given, and appointments made, only apply after commencement of this item.

Feedback is sought on the provisions in Schedule 1 relating to the NGER Act and *Income Tax Assessment Act 1997*.

Schedule 2—Australian National Registry of Emissions Units

The purpose of Schedule 2 to the draft Bill is to amend the ANREU Act so SMCs can be included in the Registry. The amendments would establish relevant ownership and transfer arrangements for the units, equivalent to those for existing unit types. Information about holdings and cancellations of SMCs would be published, consistent with other unit types.

Schedule 2 inserts a paragraph into the definition of 'eligible international emissions units' in the *Australian National Registry of Emissions Units Act 2011*, so that the definition includes safeguard mechanism credit units, once prescribed by legislative rules. This would mean that the *A New Tax System (Goods and Services Tax) Act 1999* will treat safeguard mechanism credit units as GST-free, like ACCUs. Specifying safeguard mechanism credit units as eligible international emissions units also means that the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* would apply to these units in the same way it does to ACCUs, and means that these units would also be financial products under the *Australian Securities and Investments Commission Act 2001* and *Corporations Act 2001*.

The amendments increase the transparency of information on unit holdings of all unit types. They require the Regulator to publish the total number of ACCUs and SMCs in each Registry account at least once per quarter. These amendments respond to advice by the Climate Change Authority to improve the transparency of the ANREU.

Feedback is sought on the provisions in Schedule 2 relating to the ANREU Act.

Schedule 3—Clean Energy Regulator

Schedule 3 to the draft Bill contains amendments to the CER Act and amendments to the *Clean Energy (Consequential Amendments) Act 2011* and the NGER Act that are consequential to those changes. These amendments implement Recommendation 14 of the Climate Change Authority's [2018 Review of the National Greenhouse and Energy Reporting Act](#).

The amendments address inconsistencies in the framework for protecting information under the CER Act and the NGER Act. These inconsistencies arose with the establishment of the Regulator in April 2012 and the transition of earlier protected information provisions in the NGER Act, the *Renewable Energy (Electricity) Act 2001* (REE Act) and the CFI Act. The result is that, currently, different protections and tests apply to pre-April 2012 information and post-April 2012 information. In particular, only information obtained after 2 April 2012 is protected information under the CER Act.

Due to overlapping secrecy provisions for information obtained under the NGER Act, the REE Act, and the CFI Act, the Schedule includes a provision to repeal some items from the *Clean Energy (Consequential Amendments) Act 2011* to ensure consistent protection, use and dissemination of information.

Feedback is sought on the provisions in Schedule 3 relating to the CER Act, the *Clean Energy (Consequential Amendments) Act 2011* and the NGER Act.

Schedule 4—Other amendments

Schedule 4 to the draft Bill contains an amendment to the CFI Act relating to carbon abatement contracts and an amendment relating to regulatory additionality.

Schedule 4 includes an amendment that would provide for legislative rules to specify types of eligible offsets projects for which the Regulator would not be able to enter into carbon abatement contracts. Legislative rules could be used to specify that the Regulator would not be able to enter into carbon abatement contracts associated with projects that reduce covered emissions at Safeguard facilities.

Under the CFI Act, a person may register an offsets project and the Regulator must consider whether the project is required to be carried out by or under a law of the Commonwealth, a State or a Territory before declaring the project to be eligible. The NGER Act is currently automatically exempt from the regulatory additionality requirement for eligible offsets projects (that is, Safeguard obligations are not considered). Schedule 4 amends the CFI Act to remove this exemption.

Feedback is sought on the provisions in Schedule 4 relating to the CFI Act.

Carbon Credits (Carbon Farming Initiative) Amendment (Safeguard Facility Eligibility Requirements) Rules 2022

This draft amendment includes a rule under paragraph 27(4)(l) of the CFI Act, which relates to eligibility requirements for eligible offsets projects.

This draft rule prevents a project from being declared to be an eligible offsets project if it would generate ACCUs that are attributable to abatement for covered emissions at a Safeguard facility. It would apply to declarations that are made on or after the day that it commences, and to declarations that are not finally determined before it commences.

Feedback is sought on the draft *Carbon Credits (Carbon Farming Initiative) Amendment (Safeguard Facility Eligibility Requirements) Rules 2022*.