AUSTRALIAN CONSERVATION FOUNDATION

Environmental Justice Australia

Emissions Reduction Fund submissions
Safeguard Mechanism Branch
Department of the Environment
By Email: emissions-reduction-submissions@environment.gov.au

27 April 2015

Dear Safeguard Mechanism Branch,

Thank you for the opportunity to participate in ERF safeguard mechanism development process. Please find attached a joint submission from the Australian Conservation Foundation (ACF) and Environmental Justice Australia (Envirojustice) in response to the Department's consultation paper released on 26 March 2015.

Whilst we remain very critical of the ERF, which is in our view an inefficient means of reducing greenhouse gas emissions, we recognise that as significant public money is now to be spent under the policy, it is important that a robust safeguard mechanism is in place to ensure that public funds expended actually achieve emissions reductions and not merely emissions displacement.

From the limited detail provided in the consultation paper we are particularly concerned that the proposed mechanism will not be broad enough and will not provide enough of a constraint on the entities that it does regulate. Consequently there will be no meaningful guarantee that emissions savings paid for by the government will not simply be shifted to other parts of the economy. We are also concerned that the proposed sectoral baseline for electricity generators is inconsistent with the scheme set out in the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) and therefore will be invalid.

In summary we make the following recommendations for changes to the scheme outlined in the consultation paper:

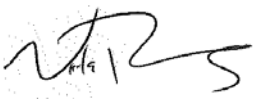
- The safeguard mechanism should be used as a foundation for the structural adjustment that needs to occur right across the economy rather than simply imposing a nominal limit on certain facilities whilst providing for overall growth in emissions across the economy.
- Coverage of the safeguard mechanism should be expanded to all facilities that are currently required to report under the NGER Act.
- The proposal to permit additional sector specific emissions growth for mining, oil and gas operations should not be accepted.
- The baseline for a designated large facility should be set at the lowest level of emissions during the five year period, which is the level at which the facility has demonstrated it is capable of operating. Alternatively it should be set at the level of emissions immediately prior to the enactment of the ERF to ensure that there is no increase in emissions which will offset ERF projects.
- Multi year averaging should not be permitted by the rules and facilities should be required to stay within their baseline each and every year.

- If new high emission investments are to be permitted they should be limited to facilities that displace current emissions to ensure that there is actually an emission reduction and they are not in fact in addition to business as usual.
- Any new facility should be subject to a baseline that is no greater than the emission level anticipated in other regulatory approvals.
- The proposed sectoral baseline for electricity generators should not be accepted and individual caps should be imposed on electricity generators from the outset.
- The Government should also consult with community on the details of the safeguard mechanism and the content of any rules or regulations to implement it.

Finally, we are particularly concerned that there is no plan to consult with the community on the detailed design of the scheme and the final content of the legislative rules and regulations. The community should have a role in this process. The evident bias in the discussion paper toward responding to fossil fuel industry concerns at the expense of good public outcomes means that the safeguard mechanism, as it is currently proposed, is likely to fail to deliver any meaningful outcomes.

Please don't hesitate to contact us if you would like to follow up on any of the matters raised in this submission and we are happy for this submission to be made public.

Yours sincerely



Victoria McKenzie-McHarg
Climate Change Manager
Australian Conservation Foundation

Nicola Rivers
Director of Advocacy and Research
Lawyer
Environmental Justice Australia

Emission Reduction Fund: Safeguard Mechanism Consultation Paper (March 2015)
Submission
Australian Conservation Foundation & Environmental Justice Australia

Introduction

The Emission Reduction Fund ('ERF') is a short term policy that purports to contribute toward the 2020 emission reduction target. Not only is it fundamentally inconsistent with the principles of sustainable development, particularly the polluter pays principle, the ACF and Envirojustice are concerned that the policy is not an efficient means of reducing GHG emissions. The ERF will make at best only a limited contribution to achieving the 2020 target and it will do nothing for the structural adjustment needed to achieve the more significant reductions that are required.

Our organisations are particularly concerned that the corresponding safeguard mechanism proposes to not just facilitate additional investment in polluting activities but will potentially operate to encourage that investment prior to 2020. Although the safeguard mechanism is not designed to reduce emissions, it is nevertheless a wasted opportunity not to concurrently provide an additional incentive and market for longer term investment in low emissions technologies that will provide a means of delivering the required emissions savings and of mitigating the costs of climate change for Australians.

The overarching purpose of the safeguard mechanism is set out in the white paper which states that "[The safeguard mechanism] will ensure that emissions reductions paid for by the Emissions Reduction Fund are not displaced by a significant rise in emissions elsewhere in the economy."[1] It is worth noting that the safeguard mechanism will now be implemented one year after the time proposed in the white paper, and consequently that the first year of ERF expenditure will enjoy no safeguard whatsoever. Furthermore it may result in emissions intensive activity being brought forward to avoid being part of the future cap.[2]

In principle the idea of having a mechanism to ensure that emissions savings purchased by the ERF are not displaced by increases in emissions elsewhere is worthwhile. Conceptually at least a broad based capping of emissions has the additional potential to form the basis for subsequent initiatives to actually reduce emissions. Unfortunately the very general outline of what the Government is proposing in the consultation paper will at best do very little to prevent emission growth elsewhere in the economy, or to establish a basis for future emissions savings. It is difficult to see how capping the emissions for the 140 highest polluters that account for only 'around half' of Australia's emissions will actually safeguard against emissions displacement.[3] To the best of our

[1] Emission Reduction Fund White Paper p12.
[2] The Emission Reduction Fund White Paper p51 and the EM to the Carbon Farming Initiative Amendment Bill 2014 p7 both state that the safeguard mechanism will begin on 1 July 2015. Senate amendments that set out the framework commence on 1 July 2016, however it is not clear why this delay was required for the commencement of the safeguard mechanism.
[3] Consultation paper p3.

knowledge there is no evidence, and certainly none is presented in the consultation paper, to suggest that these 140 polluters are the most likely to increase their emissions as a consequence of any emissions savings that may be achieved through ERF funded projects.

There are ultimately two key decisions to be made by the safeguard rules which will determine the effectiveness of the scheme:

- The threshold for becoming a designated large facility; and
- The method for calculating the baseline for a designated large facility.

The remainder of the scheme is effectively the implementation of these two underpinning decisions.

Given the very general nature of the information presented in the consultation paper and the absence of any detail on how the proposed scheme will be implemented it is hard to make conclusive comments on the operation of the mechanism. However from what is set out in the consultation paper the outcomes that will be achieved from the proposed safeguard mechanism appear to be:

- There will be no cap on total emissions.
- Overall emissions can continue to grow both because of the absence of any restriction (either economic or regulatory) on around half the economy and because of the capacity for new and expanded high emission facilities.
- A group of defined large emitters will be subject to some nominal emission constraints through the introduction of emission baselines.
- Covered polluters will be able to maintain their emissions at the highest level of emissions for the facility in the last five years. Consequently there will be the capacity for overall growth in emissions compared with current emissions (although to what degree is not known).
- There may be a very modest market from ACCUs from covered emitters' need to offset emissions exceedances.
- In theory any growth in demand for ACCUs and consequently any increase in their value will mean that the total emissions saving able to be purchased by the ERF will decline (noting that in any case it appears that the ERF will not be fully subscribed at anticipated prices[4]).
- Under the sector wide model for electricity generators there will be no restriction or incentive for any single facility to control their emissions.

The range of mechanisms that are canvassed to allow for the increase of emissions, combined with the evident reluctance to enforce the minimal obligations created by the safeguard

[4] See for example http://www.businessspectator.com.au/news/2014/6/12/policy-politics/emissions-reduction-fund-be-undersupplied-reputex.

mechanism only increase our concern that the mechanism will actually achieve little, if anything at all.

Coverage of the safeguard mechanism

Perhaps the most significant decision is at what point emitters become captured by the safeguard. The obvious shortcoming of the proposed minimum baseline is that half the economy will remain completely unregulated and therefore susceptible / available to offset any reductions generated through ERF funds.

It is not clear why 100 kilotonnes has been determined to be the appropriate threshold at which safeguard obligations should begin to apply. Currently the *National Greenhouse and Energy Reporting Act 2007* (NGER Act)[5] reporting obligations begin at 25 kilotonnes for a facility and 50 kilotonnes for facilities operated by a single group of related entities. Section 13 of the NGER Act relevantly provides:

Thresholds

*(1) A controlling corporation's group meets a **threshold** for a financial year if in that year:*

(a) the total amount of greenhouse gases emitted from the operation of facilities under the operational control of entities that are members of the group has a carbon dioxide equivalence of:
…

(iii) the year is a later financial year [after 2009-10] —50 kilotonnes or more; or

(b) the total amount of energy produced from the operation of facilities under the operational control of entities that are members of the group is:
…

(iii) if the year is a later financial year [after 2009-10]—200 terajoules or more; or

(c) the total amount of energy consumed from the operation of facilities under the operational control of entities that are members of the group is:
…

(iii) if the year is a later financial year [after 2009-10]—200 terajoules or more; or

[5] References to sections of the NGER Act are as they will be following the commencement of amendments made by the *Carbon Farming Initiative Amendment Act 2014*.

(d) an entity that is a member of the group has operational control of a facility the operation of which during the year causes:

(i) emission of greenhouse gases that have a carbon dioxide equivalence of 25 kilotonnes or more; or

(ii) production of energy of 100 terajoules or more; or

(iii) consumption of energy of 100 terajoules or more.

There is no reason why the safeguard rules could not simply adopt the limits applied by the definition of facility currently applied by the NGER Act as the limits for a designated large facility. This would have the obvious benefit of significantly improving the effectiveness of the scheme and utilising the existing regulatory framework for entities that are already required to report their emissions. There is no apparent policy reason not to apply a baseline cap on these emitters. The additional regulatory burden would be at most very modest and the practical emission prevention benefit of ensuring that these facilities do not displace the emission savings from ERF projects would be significant. Additionally it would reduce competitive disadvantage between covered and non covered facilities (as articulated in the context of sector coverage[6]) and reduce the capacity for avoidance measures to be taken by emitters.

Any emissions saving that are achieved between now and 2020 will just be the beginning of a much more significant economy wide transition that needs to occur if we are to mitigate the worst impacts of climate change. The narrow coverage of the safeguard mechanism misses an important opportunity to begin the structural adjustment and signal to the broader economy that practices have to change.

It is also noteworthy that there is no indication of a general anti-avoidance provision such as was found in section 29 of the *Clean Energy Act 2011* (repealed) being included as part of the scheme. Such a measure is an important safeguard to ensure that the limitations created in regulatory schemes such as this can be effectively applied.

Mining, Oil and Gas

The consultation paper on pages 8 and 9 discusses an additional mechanism to allow for increased emissions within the mining, oil and gas sectors. The mining, oil and gas sectors make up a significant part of Australia's emissions. Allowing for increased baselines in these industries in the manner described in the consultation paper will not just require administrative complexity and the exercise of significant executive discretion to determine whether the general criteria (which will need to be considerably more prescriptive in the rules themselves) set out on page 8 have been met, it will remove what would otherwise be an important driver of technological innovation to reduce emissions.

As for any industry there will be a range of factors that can have an impact on emissions. Recognising a factor in one industry will no doubt lead to further debate about other industries

[6] Consultation paper p3.

also being able to access additional individual assessments to increase their emissions. The proposed scheme is already very generous and it would undermine the scheme to allow for additional emissions beyond the generally applicable baselines, for which there can be no certainty that they would have otherwise occurred.

Recommendations

- The safeguard mechanism should be used as a foundation for the structural adjustment that needs to occur right across the economy rather than simply imposing a nominal limit on certain facilities whilst providing for overall growth in emissions across the economy.

- Coverage of the safeguard mechanism should be expanded to all facilities that are currently required to report under the NGER Act.

- The proposal to permit additional sector specific emissions growth for mining, oil and gas operations should not be accepted.

Emission baselines

The idea of setting a baseline at the highest, rather than lowest, level of emissions seems to be at odds with the underlying purpose of having a baseline. The whole purpose of an emissions baseline is to set the operating level for a facility beyond which it cannot exceed. Doing so at a level potentially above what a facility is currently operating at, by definition allows for an unnecessary growth in emissions and will not ensure that business as usual emissions are capped. The baseline should be set at the lowest level during the five year period, which is the level at which the facility has demonstrated it is capable of operating. Alternatively at the very least it should be set at the level of current emissions prior to the enactment of the ERF to ensure that there is no increase in emissions which will offset ERF projects. Although the emissions of a facility may vary from year to year, this is most likely to be a product of demand and profitability rather than anything innate in the facility or activity that cannot be adjusted for, consequently there is no need to accept the asserted need for a highest of five year baseline.

Multi year periods – 22XG(5)(6)

The proposal set out at pages 16 and 17 of the consultation paper for multi year averaging periods creates the very real risk that additional increases in emissions will be permitted. While it may appear that emissions across years would equal out, (as an increase in a given year must be offset by savings in future years) the reality is that it will not be possible to know what the future emissions for a facility would otherwise be. A facility may be planning to decrease its emissions in future years as a result of a natural cycle or because of a natural decline in profitability from a particular operation. Similarly it may be that circumstances beyond the companies control change in the later years and consequently that fewer emissions are and would have been, generated

anyway. In these circumstances the increase in the initial year will not be offset by a reduction that would not otherwise have occurred.

Recommendations

- The baseline for a designated large facility should be set at the lowest level of emissions during the five year period, which is the level at which the facility has demonstrated it is capable of operating. Alternatively it should be set at the level of emissions immediately prior to the enactment of the ERF to ensure that there is no increase in emissions which will offset ERF projects.

- Multi year averaging should not be permitted by the rules and facilities should be required to stay within their baseline each and every year.

Expansions and new investments

In the context of a mechanism that is designed to ensure that purchased emissions savings are not offset by growth in emissions elsewhere in the economy, it is difficult to see how this aim can be reconciled with allowing for the expansion of emissions. Perhaps most problematic is that it may have the effect of locking in future emissions at the opportunity cost of alternative low emission technologies.

It is not clear why a distinction has been drawn between pre and post 2020 investments. Without doubt it is preferable to have a fixed date to avoid debating when the investment took place, however in the context of a policy designed to achieve the 2020 emissions reduction target it is not clear why the delineation point is not the commencement of the safeguard itself rather than four years after it has been in operation. The risk is that a consequence of the 2020 date will be to bring forward investment hampering the achievement of the 2020 targets and further locking in emission growth.

If new high emission investments are to be permitted they should be limited to facilities that displace current emissions to ensure that there is actually an emission reduction and they are not in fact in addition to business as usual. This approach is best illustrated in the Victorian Civil and Administrative Tribunal decision in *Dual Gas Pty Ltd & Ors v Environment Protection Authority* (includes Summary) (Red Dot) [2012] VCAT 308. In effect VCAT allowed the construction of the new fossil fuel based power generating facility on the condition that an equivalent amount of higher emission intensive generation capacity in Victoria is retired. This is a workable model that could be adopted particularly in the electricity sector but also more broadly across the economy both for new investments and significant expansions.

In setting a baseline for a new investment or significant expansion there are a number of particularly problematic issues. Firstly the three year model for determining a baseline provides an incentive for a high level of emissions in early years to ensure that there is capacity for future

emissions.[7] Secondly there should be no capacity to increase the emissions effectively approved as part of the regulator approvals process for the facility. This would fundamentally undermine the integrity of the approval process and further offset the benefit of any ERF funded project. There is no basis for accepting an increase in these circumstances and emitters should be bound by their prior representations.[8]

Recommendations

- If new high emission investments are to be permitted they should be limited to facilities that displace current emissions to ensure that there is actually an emission reduction and they are not in fact in addition to business as usual.
- Any new facility should be subject to a baseline that is no greater than the emission level anticipated in other regulatory approvals.

Electricity Sector

The proposed sector wide cap is problematic for a number of reasons. It provides no real incentive for individual emitters to constrain their emissions and there is no sanction if the sector cap is breached, as moving to individual caps provides no means of addressing the sector wide exceedance. Further the proposal that any subsequent individual cap only apply to facilities at above average intensity undermines the whole premise of the safeguard mechanism.

Recognising that the potential for the situation that demand is met by higher rather than lower intensity generation exists, as described in the consultation paper, there are a range of alternative and more effective measures that could be adopted. If effective baselines are set there is no reason to think that that higher intensity generators are less likely to meet their baselines and therefore that they will be the ones able to meet any additional demand. Further the cost of offsetting an exceedance would be cheaper for a low intensity generator giving it a competitive advantage in determining the price at which it can sell the electricity generated. Alternatively a cap based on historic emissions that incorporates a discount for emissions intensity could be applied to all generators. This would ensure that higher intensity generators meet the cap first and demand is subsequently met from lower intensity generators.

There are a range of variations available for each of these models to ensure that the situation that is intended to be avoided is avoided without removing the benefit of the safeguard mechanism which is effectively what is being proposed in the consultation paper.

[7] See consultation paper p11.
[8] See consultation paper p12.

Inconsistency with the NGER Act and invalidity of the proposed sector wide approach.

Finally, a sector wide cap appears to be inconsistent with the NGER Act framework and not within the scope of the rule making power given to the executive by the Act.

To implement the safeguard mechanism the NGER Act provides for the following matters to be determined in the rules:

- the threshold at which a facility's emissions take it from being a facility within the definition of section 9 of the NGER Act to also being within the further defined subset of facilities determined to be a designated large facility because it emits over the prescribed quantity of greenhouse gases.[9]
- The baseline for a designated large facility.[10]
- The defined circumstances where a baseline does not apply to a facility.[11]
- That a multi year period applies to a specified facility.[12]

The general rule making power to make determinations on the above matters and provide for the detail of the safeguard scheme is set out in section 22XS which relevantly provides:

> *Safeguard rules*
> *(1) The Minister may, by legislative instrument (and subject to subsection (2)), make rules (**safeguard rules**) prescribing matters:*
> *(a) required or permitted by this Act to be prescribed by the safeguard rules; or*
> *(b) necessary or convenient to be prescribed for carrying out or giving effect to the safeguard provisions.*

The object of the safeguard mechanism is to "ensure that net covered emissions of greenhouse gases from the operation of a designated large facility do not exceed the baseline applicable to the facility."[13] (emphasis added) To achieve this object the NGER Act relatively comprehensively articulates each of the fundamental elements of the safeguard scheme. The rule making power is left to fill in the details of the scheme laid out by the Act.

The scheme as set out in the NGER Act and particularly in the prohibition on emissions exceeding the determined level set out in sections 22XE and 22XF does not canvass the possibility of a sector wide cap. Section 22XF relevantly provides:

> *Duty to ensure that excess emissions situation does not exist*
> *(1) If:*
> *(a) a person is or was the responsible emitter for a facility; and*

[9] NGER Act s22XJ(1)(b).
[10] NGER Act s22XL.
[11] NGER Act s22XE(4).
[12] NGER Act s22XG(4).
[13] NGER Act s3.

(b) there is a monitoring period for the facility in relation to the person;

the person must ensure that an excess emissions situation does not exist in relation to the facility for the monitoring period at any time on or after:

(c) if the monitoring period ends at the end of a financial year— 1 March next following the financial year; or
(d) if the monitoring period ends during a financial year— 1 March next following the financial year.

A sector wide baseline is inconsistent with both the stated object to regulate designated large facilities individually rather than in sector groups and the specific provisions of the NGER Act that implement the safeguard mechanism.[14] Nowhere does the NGER Act support the capacity to introduce a 'sector wide' cap.

In effect the proposed structure of the sector wide cap would mean that there are a significant number of designated large facilities that under the express terms of the Act are subject to the prohibition on the emission of GHGs in excess of the defined level, that would no longer be subject to the individual obligation created by section 22XF. It is not within the rule making power to in effect exempt facilities other than in the circumstances provided for in section 22XE(4), which is almost certainly not applicable in these circumstances.[15]

As articulated in *Shanahan v Scott*[16] a delegated legislation making power in the terms adopted in section 22XS(1)(b) can be used for the elaboration or fulfilment of the plan outlined or sketched by the Act. However it "will not support attempts to widen the purposes of the Act, to add new and

[14] For example ss22XF, 22XL, 22XJ.

[15] Subsection 22XE(4) is very prescriptive and requires not only that there be an application in a given year but that the regulator must not make an exemption declaration unless the Regulator is satisfied inter alia that:

(b) that excess is the direct result of any or all of the following:
(i) a natural disaster;
(ii) criminal activity;
(iii) circumstances that, under the safeguard rules, are taken to be exceptional circumstances for the purposes of this subsection; and

(c) the responsible emitter:
(i) has taken reasonable steps to mitigate risks of the relevant circumstance referred to in subparagraph (b)(i), (ii) or (iii) resulting in the situation described in paragraph (a); and
(ii) has done so both before and after the occurrence of the circumstance; and

(d) such other conditions (if any) as are set out in the safeguard rules are satisfied.

[16] (1957) 96 CLR 245.

different means of carrying out or to depart from the plan which the legislature has adopted to attain its ends."[17]

In *Morton v Union Steamship Co of New Zealand Ltd* it was said that:

> Regulations may be adopted for the more effective administration of the provisions actually contained in the Act, *but not regulations which vary or depart from the positive provisions made by the Act* or regulations which go outside the field of operation which the Act marks out for itself.[18] (emphasis added)

More recently in *Plaintiff M47-2012 v Director General of Security* after quoting the above passage from *Morton*, Justice Hayne said, "the question is whether the regulation in question varies or departs from (in other words alters, impairs or detracts from) the provisions of the Act.[19]

It is plain from the terms of the NGER Act that the entirety of the safeguard scheme is provided for in the Act and the rules to give effect to that scheme must operate with the parameters of the Act. A sector wide cap in the manner proposed in the consultation paper would appear to depart and substantively detract from the provisions of the Act which unequivocally set up a facility based rather than a sector based scheme to achieve the purpose of limiting the permitted level of emissions.

A possible argument that could be put in response to these issues is that consistent with the provisions of the *Acts Interpretation Act 1901* (AIA) section 23 'words in the singular number include the plural' and therefore whilst the relevant sections of the Act provide for a baseline to be applied to a facility this would, by the operation of section 23, include multiple facilities collectively. Section 2 of the AIA disapplies this rule where there is a contrary intention in the Act in question.

The NGER Act evidences a clear contrary intention and a construction that would effectively allow multiple facilities to be grouped within a sectoral baseline cannot be supported on this basis. The provisions of the NGER Act provide for the regulation of facilities as single entities and not collectively. Each corporation responsible for a facility currently covered by the NGER Act is required to individually report their greenhouse gas emissions,[20] and similarly under section 22XF will be individually responsible for ensuring that net emissions do not exceed the permitted baseline. It would fundamentally frustrate the scheme if the terms of the Act providing for the rules to determine a threshold for 'a facility' were to be read as meaning 'a group of facilities' and consequently such a construction cannot be supported by the application of s23 of the AIA.

---

[17] Ibid at 250; see also pp253-254.
[18] (1951) 83 CLR 402 at 410.
[19] *Plaintiff M47-2012 v Director General of Security* [2012] HCA 46 at [174] (Hayne J); see also at [382] per Crennan J endorsing the approach in *Morton*.
[20] NGER Act s19.

The inconsistency of a sector based cap with the facility based scheme set up in the Act would appear to render the proposed sectoral baseline invalid.

Recommendation

- The proposed sectoral baseline for electricity generators should not be accepted.

Community consultation

It is apparent from the consultation paper that in formulating the proposed mechanism the government has been and will continue to be far more concerned to consult with business than the community. It is not clear why the government would consider it appropriate that the community only be given the opportunity to comment on the very broad design of the scheme with the policy details and legislative rules to be finalised only in 'close consultation with business'.[21]

The community should be given the opportunity to participate in the development of the final policy and legislative rules that will implement the scheme. Given that the mechanism is designed to protect the expenditure of public money it is both improper and will inevitably lead to poorer outcomes if the community is not given at least an equal opportunity to participate in the process.

Recommendation

- The Government should also consult with community on the details of the safeguard mechanism and the content of any rules or regulations to implement it.

[21] Consultation paper p1.