BCA Submission to Draft 'National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015'

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Working to achieve economic, social and environmental goals that will benefit Australians now and into the future
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About this submission

This submission is the Business Council’s response to the recently released Draft *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* and regulations.

The Business Council’s comments on the safeguard mechanism rule and regulations are made from the perspective that Australia’s policy response to the risks associated with climate change should be workable, at lowest possible cost, economically responsible, not make Australian industries uncompetitive, particularly if competitor nations do not take equivalent actions, and provide the foundations for a durable, long-term policy framework that is responsive to international negotiations.

The Business Council appreciates the consultations on the safeguard mechanism to date, and changes made to improve the operation of the safeguard mechanism as a result of this consultation. However, we are concerned that the short time available to consider the draft rule and regulations provides limited opportunities to identify potential unintended consequences as a result of the drafting.

The government has advised that the safeguard mechanism is not designed to either reduce emissions (that is the role of the Emissions Reduction Fund) or raise revenue, rather, it is to ‘ensure that emissions reductions purchased through the Emissions Reduction Fund are not displaced by a significant rise in emissions elsewhere in the economy’.¹

The government has made clear its intention that the Emissions Reduction Fund and safeguard mechanism are ‘designed to allow businesses to continue ordinary operations without penalty’.

Noting the government’s intentions, the Business Council recommends:

- establishing an opt-in entity level baseline setting process
- ensuring resource projects have the option to seek baseline variations in relation to resource variability for the life of the project
- revisiting the data collection and auditing requirements associated with baseline setting, including removing the requirement for emissions intensity data as part of this process, so as to substantially reduce the excessive administrative burden and associated high costs, which are not in line with the government’s broader deregulation agenda
- simplifying the baseline setting process for significant expansions and new projects in the period to 1 July 2020, such that estimated baselines are set on the basis of the first six months of operational data or longer if appropriate to the ramp up time of a project

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• removing the requirement for ongoing emissions intensity improvements where facilities seek multiple baseline resets as a result of increases in production

• revisiting with the industry, the impact of the draft rules in relation to expansion on gas pipeline infrastructure to ensure there are not unintended consequences.

The Business Council also takes this opportunity to ask the government to reconsider its decision deferring the inclusion of international permits until after the 2017–18 review of the safeguard mechanism. Credible and verifiable international permits should be included in the suite of compliance options when the safeguard mechanism becomes operational in 2016.

The Business Council also recommends that the government take the opportunity to broaden the scope of exemptions under the National Greenhouse Energy Reporting (NGER) Act to include recognition of force majeure events, such as adverse weather, industrial action, equipment failure and changes to government policy or regulation, as exceptional circumstances that may be subject to an exemption declaration.

This submission also raises a number of issues to be taken into consideration in the government’s forthcoming process to establish best practice benchmarks.

**Matters requiring further consideration**

**Consideration of entity level baselines**

The safeguard mechanism rule and regulations now provide an opt-in provision for a national approach in the transport industry.

Such an approach provides multi-site facilities to be effectively managed in an integrated manner to ensure the emissions baseline is not exceeded.

Such an arrangement should also be available to companies with multiple facilities over the emissions threshold. Managing emissions from the multiple facilities within a baseline developed along similar lines as the opt-in transport approach will provide these companies with a more cost-effective way in which to reduce the risk of exceeding the baseline.

Such an approach will reduce the administrative burden associated with the multi-year compliance approach and baseline resetting, for both the company and the Clean Energy Regulator, while still ensuring the desired outcome in terms of emissions management.

**Inherent emissions variability associated with the extraction of natural resources**

The draft rule limits to 2025 the use of the baseline resetting, as a consequence of declining resource grade, pressure and ease of extraction. This appears to be an arbitrary date, with no recognition that resource projects are long term in nature and extraction may go beyond 2025.

The Business Council recommends this rule be amended to provide facilities with the option to seek a reset for the life of the project.
Data and auditing requirements

Baselines

The safeguard mechanism regulations in relation to setting baselines and seeking baseline variations require the collection, disaggregation and auditing of a substantial amount of data in relation to production, production variables and apportionment of emissions.

Draft rule 28 requires provision of audited forecasts for production volume, emissions volume and emissions intensities, broken down by product, and then requires further breakdowns by greenhouse gas type.

This data collection process is complex, time consuming and high cost. It also appears there may well be difficulties in attaining audits in a cost-effective manner.

The likely costs associated with this data collection and audit process will far outweigh any risk of facilities over-estimating emissions or otherwise ‘gaming’ the system, particularly given that estimates must be accompanied by previous estimates and environmental impact statement documents, and will be compared against them.

These factors do not appear to have been taken into consideration in the drafting of the rule and there does not appear to have been any effort to address the administrative and cost burden implicit in the draft rules. In an example provided by a BCA member, the cost of apportioning and auditing was in excess of $400,000.

The Business Council is of the view that there should be a redrafting of the rule to provide a simplified approach and reduce costs. A preferred option is that the application for a calculated-emissions baseline determination should require submission of an absolute emissions forecast for the facility, rather than forecasts of production levels for production variables and forecasts of emissions intensities for those production variables.

Significant expansions and new projects to 1 July 2020

To provide a more accurate forecast, reduce the cost to business and reduce complexity associated with the task, the baseline estimations for significant expansions and new facilities prior to 1 July 2020 should be made only once a minimum of 6 months’ worth of operational data is available, or a longer period where a project has a significant ramp-up period.

Managing incremental production growth using an emissions intensity measure

Under the safeguard mechanism rule, where a facility exceeds its baseline and does so with an improvement in the emissions intensity, it may seek a variation to its baseline for that year.

The rule also allows for the same facility to request such a variation in future years; however, the variation will only be allowed if there is a further improvement in the emissions intensity.
Achieving successive improvements in emissions intensity will not always be possible, particularly where a facility is already at best practice. This rule will therefore have the perverse outcome of limiting production in more efficient facilities and incentivising production growth in less emissions-efficient plant. The rule should be redrafted to address this anomaly.

One option is to require facilities seeking a variation to the baseline, using the emissions intensity test as a result of increased production, to continually benchmark their emissions intensity against the emission intensity in the same year as when the historical baseline for absolute emissions was set. This will ensure that emissions intensity will always be an improvement on pre-investment levels, but will not expose potentially trade-exposed industries to being penalized for minor fluctuations in emissions intensity, or be required to have continuous improvement, where this may not be possible. This could be relatively easily achieved by amending the definition of ‘baseline intensity comparison year’ and removing sub clause (d).

**Gas pipeline expansions**

The differentiation of incremental and major expansions, when applied to gas pipelines, appears to have unintended consequences:

- under the 20 per cent criteria major expansion rule, a pipeline may be incentivised to overbuild its expansion, exposing the pipeline to market risk, or delay its expansion until 20 per cent can be achieved, negatively impacting supply to customers. Both are sub economic events that will lead to higher costs.

- where two different pipelines of different size are competing for the same market, one pipeline may receive an additional cost over another if its expansion is less than 20 per cent (and the other expands by >20 per cent), thereby lessening competition.

In these circumstances, the safeguard mechanism would impose additional costs on customers who, in the case of pipelines, are likely to be utilising natural gas in low-emission applications as a substitute for more carbon-intensive fuels. Given this likely impact, it is important that the government revisit the draft rules and consult with the industry to determine an approach to prevent such outcomes.

**Publishing of data**

The safeguard mechanism rule requires the provision and publishing of a range of business data, including facility level production data. The Business Council has serious concerns with regard to publishing the range of data now being collected. Data at this level is much more likely to be commercially sensitive and uniquely identifiable.

While the regulator may need access to the data at the facility level for the purposes of compliance and setting baselines, the safeguard mechanism rule and regulations should be amended so that potentially commercially sensitive data is not published.
Expansion of exemption declarations

The NGER Act will include a small number of exemptions based on exceptional circumstances. While the government has not been inclined to expand this list, the Business Council is of the view that this approach should be revisited.

Subsection 22XE(4)(b) of the NGER Act, when it comes into operation in 2016, will allow the Safeguard Rule to specify other circumstances, besides natural disaster and criminal activity, that are taken to be exceptional circumstances for the purposes of an exemption declaration.

The Business Council recommends that the exceptional circumstances be expanded to cover events commonly recognised in commercial practice as events outside the operator’s control, which could have a significant impact on a facility’s greenhouse gas emissions. The Safeguard Rule should provide for recognition of force majeure events, such as adverse weather, industrial action, equipment failure and changes to government policy or regulation, as exceptional circumstances that may be subject to an exemption declaration.

Benchmarks and best practice

New facilities and major expansions post 1 July 2020 will be required to meet some form of benchmark emissions standard.

The details of the benchmark are not included in the current draft rules as the process to identify the benchmarks is yet to be undertaken.

As the Business Council has previously argued, the identification of best practice benchmarks is a highly contested process both locally and internationally, with difficulties in identifying appropriate comparators. Processes to identify best practice are complex and time-consuming, as well as open to litigation.

Similarly, industry averages may not be a useful predictor of business-as-usual, especially where you have varied production techniques, small numbers of firms, significant firm size variation or production infrastructure with substantial age variation.

In the case of resource extraction, significant variability in the quality of the resource can impact emissions intensity and result in significant variation from ‘industry’ best practice.

The safeguard mechanism should not, in effect, impose an additional cost on new facilities that acts as a de facto carbon cost.

Setting a baseline for a new facility should also be considered in the context that proponents of new projects (and major expansions) already have a strong incentive to maximise energy efficiency, and hence reduce greenhouse gas emissions, by virtue of increasing energy costs. They also have to comply with a range of planning and environmental legislation, all of which mean new facilities are largely being designed with an eye to the best approach available at the time.
For significant expansions and new entrants, rather than relying on some theoretical concept of best practice or use of a comparator site that does not share the same characteristics, consideration should be given to approaches such as:

- determining a new facility baseline post five years of actual operation, allowing for the facility to be both established and operating under normal conditions, prior to the determination of a baseline.

- establishing a process where project proponents provide evidence that they have included consideration of managing and minimising greenhouse gas emissions, as the project has been developed. Evidence could include the project planning approvals process, environmental assessment, and other relevant information.

Given the importance of getting this approach right, so that there is both environmental integrity and also a process that does not dissuade new project proponents, this is a matter where further consultation is required.

It is also important that the consultation process and setting of benchmarks be completed in a timely manner so that new project proponents, and those planning industry expansion, are able to factor these benchmarks into their post-2020 planning.

**Access to international greenhouse gas emissions offsets**

Action to address the risks associated with climate change are important. As businesses seek to comply with policies and regulations designed to reduce greenhouse gas emissions, it is important that they have the opportunity to do so effectively and efficiently. It is important business can meet any compliance obligations at least cost.

The government has indicated that it will consider the use of international greenhouse gas emissions offsets as part of the 2017–18 review of the safeguard mechanism.

This is a disappointing decision, as it limits the opportunities available to business to manage costs of complying with the safeguard mechanism rules.

In previous submissions, the Business Council has highlighted the importance of access to credible and verifiable international offsets to help manage the cost of compliance and meet target obligations.

As the safeguard regulations are being finalised, the opportunity should be taken to provide access to credible offsets, which are currently available at low prices, to help manage the cost of the implementation of the safeguard mechanism and provide business with the flexibility to manage any liability, should it occur, in a cost effective manner.