Australian Government
Clean Energy Regulator

April 2024

Dear < executive officer >

Safeguard Reforms - New emission reductions obligations

I am writing to you concerning the Clean Energy Regulator's role in implementing reforms to the Safeguard Mechanism, and the importance of taking the strategic opportunities and risks that your organisations will be presented with into account in your business and decarbonisation planning in the years ahead.

The Safeguard Mechanism is the Australian Government's policy for reducing emissions at large facilities. It applies to facilities that emit more than 100,000 tCO_2-e of on-site (scope 1) emissions in a financial year and covers businesses across a range of industry sectors including electricity generation, mining, oil and gas extraction, manufacturing, transport, and waste.

The 2022-23 Safeguard Mechanism reporting period saw covered emissions from Safeguard entities increase slightly from 137.5 million to 138.7 million tonnes of CO_2-e and 44 facilities were required to surrender Australian Carbon Credit Units (ACCUs) to ensure they remained below their baseline emissions target. In total 1,218,000 ACCUs were surrendered. Further data relating to the operation of the Mechanism can be found at Reports and data.

I am very pleased to report that 100% compliance was achieved in 2022-23, which is the final year before Safeguard Mechanisms reforms come into full effect in 2023-24. I thank all industry players for your active engagement and participation in ensuring the large industrial sector plays its role in meeting Australia's emission reduction targets.

Implication of Safeguard Mechanisms Reforms

As you are aware, the Safeguard Mechanism scheme sets annual emissions limits—known as baselines—for the on-site emissions of regulated facilities. Under the reformed Safeguard Mechanism, these baselines will decline, predictably and gradually, on a trajectory consistent with achieving Australia's emission reduction targets of 43% below 2005 levels by 2030 and net zero by 2050. The 2023-24 financial year is the first that is subject to the new arrangements and includes a 4.9% baseline decline factor.

In total, Safeguard facilities will be required to reduce net emissions by more than 200 million tonnes by 2030. It is important that your organisation understands the implications of the reformed Safeguard Mechanism and is acting early to meet its compliance strategy.

As baselines decline your organisation will be more likely to be required to find options to reduce emissions or source ACCUs or Safeguard Mechanism Credits (SMCs) that will be made available to those facilities that operate below their baseline.

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As baselines tighten, it is expected that demand for both ACCUs and SMCs will increase and, consequently, it is possible that the market will tighten. Those organisations that have acted early to implement on-site emissions reduction activities, where available, and secure supply of ACCUs or SMCs to meet residual obligations, will be well positioned to manage their obligations.

Reducing emissions

While purchasing ACCUs and SMCs to address annual emission exceedances is an option, purchasing increasing volumes of credits at potentially higher prices is unlikely to be a sustainable long-term option for most business models.

Many Safeguard facilities are planning projects that will deliver improved emissions-intensity levels over the long and short-term. Early implementation of these projects will give certainty about the possible emissions reduction capacity of individual facilities, and therefore the reduced need to purchase carbon credits. These projects also have the potential to create an additional revenue stream (where emissions reductions result in a facility being eligible for SMCs for every tonne of CO_2-e it is below its baseline) and may deliver improved operational costs.

Early action on these projects is key, as in many cases implementation and realisation of the desired emission reduction may have long lead times, complex approval requirements or difficult workforce/ supply chain considerations.

An additional collective challenge for industry is to invest in accelerating research, development and adoption of new technologies that are yet to be fully economic. The government provides a range of programs and incentives including specific funding available to assist Safeguard entities under the Government's Powering Australia Plan.

Meeting the government's 2030 and 2050 targets is a very significant national endeavour that cannot be achieved through offsite abatement in the form of carbon credits alone. As I am sure you are aware there is a technology gap and a step change in the range and cost of emission reduction technologies is required.

As a consequence, I encourage you to work to identify and bring forward emission reduction strategies that have a clear economic case as quickly as possible and also to be pro-active in supporting emerging technologies.

Flexibility

In the event that you have firm plans to reduce emissions, the Safeguard Mechanism includes flexibility through multi-year reporting periods which will allow organisations to implement strategies to meet the new Safeguard obligations in manageable increments. Organisations can also manage short-term spikes in emissions in one year by borrowing baseline from the following compliance year (to be paid back with interest in the following compliance period).

There is a list of web resources below that provides more information on the mechanisms available to your Safeguard facility.

The Australian Carbon Market

Despite on-site emissions reduction efforts, it is expected that offsite carbon abatement through acquisition of ACCUs and SMCs will play an important role in many facilities' compliance strategies. For some facilities, carbon credits will be needed to meet Safeguard obligations while emissions reduction projects take effect.

For facilities operating in hard to abate industry sectors, carbon credits may be needed in the long-term, to meet net zero commitments.

Over the last year we have observed a substantial increase in the ACCU holdings by organisations likely to have a Safeguard obligation and the spot price of ACCUs stabilising between $30 - 35. However, I understand that many organisations are still formulating their compliance strategies, and so are yet to enter the carbon market to hedge against potential future ACCU need. This underpins a market view that the ACCU price is likely to rise over time.

You may wish to act early to secure supply of ACCUs. Organisations that wait until closer to the compliance deadline will potentially find it more difficult to secure the required ACCUs at a competitive price.

A run up in ACCU price, possibly caused by many buyers entering the market late in the piece could trigger the Cost Containment Mechanism. Under this mechanism, the Commonwealth may sell ACCUs directly to organisations responsible for Safeguard facilities that have exceeded their baseline for a given compliance period. The purchase price for these ACCUs is set in legislation, starting at $75 in 2023-24 and indexed in future financial years by the Consumer Price Index (CPI) plus an additional 2% per annum.

The only ACCUs available for use through the Cost Containment Measure will be sourced from ACCUs that have been delivered to the Government from 12 January 2023 onwards under Carbon Abatement Contracts. Currently there are over 1.9 million ACCUs available under the Cost Containment Measure.

Transparency

In addition to the information that has traditionally been published for Safeguard facilities, such as annual emissions, baselines, and the number of ACCUs surrendered for a facility, the Clean Energy Regulator is now also required to publish information including:

- the amount of a facility's emissions broken down by carbon dioxide, methane and nitrous oxide
- the amount of ACCUs surrendered (if any) for compliance, broken down by the method under which the ACCUs were created, and
- for Safeguard facilities that surrender ACCUs equivalent to 30% or more of their baselines, the facility's statement explaining why they haven't undertaken more on-site abatement activities.

I expect that this information will be of increasing interest to the community, investors and other key stakeholder groups.

There are resources available to assist your understanding of the Safeguard Mechanism and the carbon market. I have provided some at the end of this letter. The Safeguard section is available via email to cer-safeguardbaselines@cer.gov.au to discuss the Safeguard Mechanism and any questions you may have for the Clean Energy Regulator. I encourage your early engagement with my agency to discuss the new reforms and your proposed compliance strategies to meet the Safeguard obligations.

In closing can I reflect that the task of reducing emissions to address climate change is both an individual and collective challenge. We remain committed to facilitating the transition through robust and transparent market-based mechanisms that allow carbon abatement to be achieved at least-cost. With long lead times for investment, can I reiterate how important it is that you actively consider options for emission reductions in your strategic planning as well as ensuring you have a clear pathway to meet your compliance obligations under the reformed Safeguard Mechanism.

Yours sincerely

Mr David Parker AM
Chair and CEO
Clean Energy Regulator

Resources

What is the Safeguard Mechanism - The Safeguard Mechanism (cleanenergyregulator.gov.au)

What is the ACCU scheme - About the ACCU Scheme (cleanenergyregulator.gov.au)

What is the Renewable Energy Target scheme - Renewable Energy Target RET (cleanenergyregulator.gov.au)

Information about carbon markets - Quarterly Carbon Market Reports (cleanenergyregulator.gov.au)

Information about Powering the Regions - Powering the Regions Fund - Safeguard Transformation Stream

Subscribe to updates from the CER - Subscribe to email updates (cleanenergyregulator.gov.au)

Department of Climate Change, Energy, the Environment and Water (DCCEEW) - Safeguard Mechanism - DCCEEW