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Safeguard and Industrial Policy Team
Department of Industry, Science, Energy and Resources
<https://consult.industry.gov.au/climate-change/safeguard-crediting-mechanism-discussion-paper/>

5 October 2021

Dear Minister

Re: Discussion Paper: King Review Safeguard Crediting Mechanism

The Australian Aluminium Council (the Council) welcomes the opportunity to provide feedback to the Department of Industry, Science, Energy and Resources (the Department) on the Discussion Paper: King Review Safeguard Crediting Mechanism (the Paper).

The Council represents Australia's bauxite mining, alumina refining, aluminium smelting and downstream processing industries. The Australian aluminium industry has been operating in Australia since 1955, and over the decades has been a significant contributor to the Australian economy. Alongside many decades of economic contribution, the industry is globally comparatively young and well maintained. The industry includes five large (>10 Mt per annum) bauxite mines plus several smaller producers which collectively produce over 100 Mt per annum making Australia the world's largest producer of bauxite. The six alumina refineries produce around 20 Mt per annum of alumina and Australia is the world's largest exporter of alumina. There are four aluminium smelters; in addition to downstream processing including more than 20 extrusion presses and Australia is the sixth largest global producer of aluminium. Aluminium is Australia's highest earning manufacturing export. The industry directly employs more than 17,000 people, including 4,000 full time equivalent contractors. The industry also indirectly supports around 60,000 families in regional Australia.

The Council appreciates the Government's willingness to support an increased range of measures, aimed at bringing forward low-cost abatement; particularly in the industrial sector. For large energy users this willingness is important as is developing and continuing a dialogue with industry, in order to ensure that barriers to achieving abatement are removed.

The 2019 King Review recommended that the Government establish a 'below-baseline crediting arrangement' for large facilities using the existing National Greenhouse and Energy Reporting (NGER) Scheme and Safeguard Mechanism architecture. In support of this, the Government committed \$279.9 million to establish the crediting mechanism and support investment in transformative abatement projects, through the 2021-22 Budget. The Council notes that it is the Government's intent to develop detailed policy design to be set in subordinate legislation before 1 July 2022.

As noted in the Paper, the Safeguard Mechanism already provides a strong incentive for businesses to prevent their emissions from rising above baseline levels. There are also opportunities for facilities covered by the Safeguard Mechanism can make use of the Emissions Reduction Fund (ERF). The Council notes that its members have pursued projects under the ERF's Industrial Electricity and Fuel Efficiency Method, with the largest of the 11 projects under this method being one of the Council's members (RTA Gove Pty Limited). However, as noted by the Council in recent submissions¹ to the Emissions Reduction Assurance Committee (ERAC), this ERF method is currently complex and cumbersome, providing a disincentive to its use. The Council understands ERAC is currently reviewing an alternative industrial and commercial emissions reduction method.

The intent of the proposed Safeguard Crediting Mechanism (the Mechanism) is to enable 'below-baseline' abatement opportunities that are not being realised under the Safeguard Mechanism or the ERF. In considering its response to the detailed design principles outlined in the Paper, the Council notes that ultimately for each facility the ability to use the proposed Mechanism, or any other mechanism, will come down to the current level of emissions compared to the baseline; the available technology options for emissions reduction; the cost of implementation compared to any potential benefit; and the technical and process risks associated with implementation. Therefore, the Council's comments on the Paper are general in nature, as each Member would need to assess this complexity for each facility and each project.

When considering the detailed design proposed in the Paper, the Council also considered the context in which this scheme might operate. The purpose appears to be to bring forward transformative abatement projects within existing industry. In this context, to bring forward transformative abatement; the technology must exist today but not yet be commercially deployable; requiring some additional incentive. Transformative abatement, by its nature is likely to be challenging, complex and capital intensive to implement. There may be multiple policy pathways to incentivise transformative abatement; for example, accelerated depreciation, ARENA funding; some of which may be simpler than the proposed Mechanism, others that may be complementary to it. In aligning the Mechanism with the ERF and NGER schemes, the parameters under consideration naturally align with these schemes – and as a result the Mechanism will need to be well designed to ensure it does not suffer from the same challenges as the Facilities Method, or indeed ERF in general, in terms of constraining the ability for industry to access support for transformative abatement. The scale of funding of transformative change, needs to be commensurate with the size of the challenge and capital required. The Council and its members are interested in a continued dialogue with the Government; on what is the best way to bring forward transformative abatement opportunities as quickly and simply as possible to deliver a low-emissions aluminium value chain in Australia, recognising that any policy mechanisms put in place will need to ensure continued integrity of any Government funding.

The Council's specific comments on the stakeholder questions posed in the Paper are outlined in the order presented in the Paper. The Council does note that the discussion paper lacks formal definitions of the proposed terms set out in the Paper. Without these detailed definitions, the Council has had to interpret the Department's intent. Proposals such as "transformative statements" cannot be assessed without clearly defining the relevant terms so their impact can be evaluated. While the Council has tried to respond to specific design elements raised in the Paper, it is worth noting that these are not independent. It will be the cumulative impact of scheme design, particularly around complexity and accessibility of participation, which is likely to be the deciding factor in scheme success.

Design Principles

The Council supports the four proposed design principles; as another path by which additional industrial abatement may be incentivised. However, the Council notes that there is an incongruence between Principles 1 and 2 – where Principle 1 is encouraging "transformational", and Principle 2 is seeking "low cost". It is the experience of the Council that transformational emissions reduction is rarely low cost.

¹ <https://aluminium.org.au/wp-content/uploads/2021/08/210817-Aluminium-ERAC-ICER.pdf> and <https://aluminium.org.au/wp-content/uploads/2021/03/210319-Aluminium-ERAC-IEFE.pdf>

Pilot Phase

The Council supports the use of a pilot phase, to test the Mechanism design and impacts, starting on 1 July 2022 to align with the current reporting timeframes. A pilot phase which operates for two to three years, but where eligible projects continued to have a longer crediting period beyond that period would be appropriate. The Council notes that given the short timeframe for the pilot and the longer time frame for crediting, the Council would be interested in a continued discussion with the Department about how any pilot transitions into a longer term scheme. As an example, consideration should be given to how new projects, which may not be ready on 1 July 2022 and therefore not able to participate in the pilot, could opt in or register during the course of the pilot; without affecting the scheme integrity.

Crediting

Reference Levels

The Council recognises the challenge in setting an appropriate reference emissions intensity for crediting and agrees that forecasts, industry averages and historic averages all present different challenges.

Industrial processes by their nature are highly variable. This makes the use of a single recent period problematic, and therefore the Council would support the use of an average of two or three years, to consider a wider range of operational circumstances; with appropriate governance to prevent non-additional abatement being eligible. The Council believes the exception to this, should be where the facility can point to a specific project or production during this time which has resulted in a material (perhaps >5%) and permanent step change in emissions during this averaging period; which would mean that a different shorter averaging period for this facility may be more appropriate. There should be a process by which, a facility can apply for this variation in the reference emission period; with appropriate justification.

Additionally, it is worth noting that project timelines are unlikely to completely align exactly with the start and end of financial years; which may mean financial year baselines are not the perfect solution for part year projects. Consideration should therefore be given to allowing an alternative time frame to the July – June NGER year as the baseline intensity and as the basis of crediting, when appropriate. Project implementation is not instantaneous, and it would be preferred to be able to have some flexibility in setting a representative baseline period, nominating an installation and commissioning period and the start date on which implementation is complete and full abatement will start occurring.

Consideration should also be given to how large multi-stage projects would work under this framework. Being able to define and measure abatement to a smaller equipment specific boundary would have the benefit of being able to quantify the abatement benefit and project success more clearly. It may also prevent instability from other process improvements and significant commissioning activities occurring in parallel from counteracting the project.

The Council supports adjustments being made to reference levels where the facility moves to a new method, there is a change to global warming potentials or the NGER method changes. A similar materiality threshold of 5% and a permanent change is appropriate.

New Facilities

The Council recognises that for some industries, a new facility may operate at a level substantially below the current Safeguard baselines; due to implementation of best available technology. However, this may not always apply, particularly where there are a range of site-specific variations such as would exist in a new mine which may have similar or longer haul distances than existing mines and may not meet this threshold. Additionally, in industries where there are a relatively small number of participants, then the smaller the percentage of existing facilities (e.g., top 10% or 20%), then this may represent only one facility. The Council would support a design where there are two entrance pathways into the Mechanism:

1. New facilities have immediate access to the Mechanism where they have an emission intensity of, or better than, the top 50 % of existing facilities; or

2. New facilities who do not, for reasons of natural process variation, meet this threshold may access the Mechanism after three years of setting their own reference emissions intensity.

Vintages

The Council supports the allocation of vintages consistent with application to ACCUs. This would be of particular relevance for any facility which may have more than one Mechanism project occurring. The Council would support that rather than having different rules and different credits, credits generated should in fact be ACCUs, or at least the Safeguard Mechanism Credits (SMCs) should be able to be converted to ACCUs under certain circumstances providing governance is maintained (See Genuine Abatement discussion). The Council notes the Government has allocated funding in the FY22 Budget for the purchase of SMCs but believes for the scheme to be useful beyond the pilot; SMCs should ultimately be tradable as ACCUs and are not expected to have a material impact on the ACCU market.

When considering the units generated, the Council is unclear how the change in intensity baseline will ultimately be reflected as the generation of tonnes of credits.

Crediting Periods

As noted in the Paper, the current crediting period for most ERF projects is 7 years; but the Paper implies that shorter crediting periods may be more applicable to the Mechanism as industrial sector projects could be expected to have shorter commercial pay back periods and proposes a 5 year crediting period. The Council's experience with projects under the ERF is in fact the opposite and would support a crediting period of *at least* 7 years. The Council would support not only this longer crediting period, but also more flexibility and an increase in the allowable number of contracts (limited to three under the ERF). This is to enable the full financial value of a project to be realised and to reduce the financial risks of forecasting too far ahead that have been issues with the current ERF.

Interaction with Baselines

To maintain the integrity of the Safeguard, as well as the Mechanism, the Council supports the adjustment to baselines for facilities which receive SMCs. The Council believes this should apply only to the facility which has participated in the Mechanism, and not be used to adjust the industry default value. The current Mechanism already provides a strong incentive for businesses to prevent their emissions from rising above baseline levels.

The consideration of short term and permanent adjustments to the intensity could be considered. The delay of when the abatement actually occurred and when the SMEs are issued and how that interacts with the baseline year would need to occur as to align timewise. One approach could be to adjust each year and make a permanent adjustment to the intensity using the average improvement over the crediting period.

When considering how any baseline will decline, the Council urges caution in the design detail; without the right design this could be perceived to be a significant and fundamental shift in the operation of the existing Safeguard Mechanism into a baseline and credit scheme. The Council does not believe that this is the Government's policy intent; noting that designing of only this part of a changed scheme, in the absence of detailed design of other aspects could be to the detriment of scheme integrity in the future. For example, in a baseline and credit scheme; consideration would need to be given to treatment of trade exposed industries. While this does not need to be considered in the proposed Mechanism as it stands; the potential adaptation of this policy in a future context must be considered.

Double Counting

The Council does not support the view that crediting can only occur where the relevant facility is below its Safeguard baseline. A well designed Mechanism should incentivise improvement at all facilities, including those which are currently higher than industry average. The Council believes that with a well-designed scheme, this should not result in double counting. Setting eligibility to be based on projects rather than Safeguard status would greatly simplify the scheme and entrance testing. It would provide more confidence

to facilities that are close to the baseline that might be concerned over the risk of potentially starting a project and then become ineligible for the abatement.

For sites which have more than one production variable, it is unclear how the qualification of being below the baseline could occur at the time of registration and relate to the most recent year of reporting. The final Mechanism will need to consider what would happen if other production variable performance not related to the abatement project cause the site to be above the baseline and would this invalidate the project. The Council notes that any triggers to change the validity of a projects would create business risk especially if entered into emissions contracts.

Multiyear monitoring periods (MYMP) are particularly important for the Council's bauxite mining membership, where the haul distances can be very variable, year on year. The Mechanism should be open to MYMP facilities, despite the challenges in ensuring there is no double counting.

The Council would support a broad definition of "transformation" to include not only the deployment of new technology but any industrial process changes which reduce emissions while not reducing production. Abatement which can be achieved by changing processes or removing process steps is as genuine as any other abatement and should be included in the scheme.

When projects are receiving ACCUs under an emissions reduction fund project, this gets added to the Scope 1 emissions of the facility at the time these are received regardless of the type of abatement (e.g., Scope 1, Scope 2 or land emissions not covered by NGER) or the timeframe the abatement was from. This can cause facilities to be above the baseline. Consideration should be given to how the rules might not disadvantage facilities that go above the baseline as a result of abatement activities and ACCUs or SMEs. This is particularly important as a number of transformative abatement opportunities relate to electrification of existing processes i.e., the conversion of Scope 1 emissions into Scope 2 emissions (including electrification with renewable alternatives).

The Council notes that the Paper confirms that the Government will separately consult on a carbon exchange rate be explored for large-scale generation certificates (LGCs). The Council believes it is important that this is also considered as part of the current range of considerations, to ensure scheme integrity.

Genuine Abatement

The Council supports the intent that each SMC must deliver a genuine tonne of abatement to provide confidence that the credits deliver the promised environmental benefit. The Council has previously raised with the Department our concerns about the additionality provisions in the ERF being too narrow and unworkable for industrial processes.

The Council therefore supports the consideration of a measured approach to address this, but which still ensures SMCs represent genuine abatement, have integrity and deliver value. The Council supports:

- The application of a buffer of 90% of the emission reductions, to remove the impact of natural process variation; or
- Transformation statements which demonstrate how the credits were created. Given the need to develop new technologies; these could link with other schemes and provide a range of co-benefits for both the project proponent and the purchaser of SMCs.

However, as previously stated, without detailed definitions, it is hard to assess the relative merits of these alternatives.

The Council does not support a minimum crediting threshold, as this would be a disincentive for small projects which may still deliver real and genuine abatement to participate. The Council does not support a time limit on the use of credits, as this could reduce the value of SMCs and limit the flexibility, which the experience of Council members has found under the ERF to be limiting.

The Council would like to see consideration of Scope 2 emissions abatement on an intensity basis included in this program and given opportunities for eligibility using this simplified process. While the Council recognises that the Safeguard is limited to Scope 1 emissions, many more project opportunities may arise from the inclusion of Scope 2 emissions. Electrification will be particularly important in the decarbonisation of major industrial processes and involve shifting emissions from Scope 1 to Scope 2. Assessment of how the crediting under the baseline framework might be inclusive of this type of project would be valuable to accelerating these initiatives.

Purchasing

The Council's views on purchasing are aligned with its views on crediting – that there should be maximum flexibility while retaining scheme integrity. The Council agrees that initially, the two primary uses for SMCs will be either for Safeguard compliance, as many facilities are part of businesses which have multiple sites; or sold to Government via auctions. However, the Council believes that over time, there will be a place for genuine abatement, such as SMCs, in the voluntary market and this would be best materialised by converting SMCs to ACCUs. This would also provide a greater understanding of future pricing, which will be essential in bringing forward the transformative abatement the scheme is targeting.

Other Issues

While the Department has articulated that a project cannot receive funding as both an ERF project and by creating SMCs, it is currently unclear whether projects which are receiving other Government funding, for example through partnerships with the Australian Renewable Energy Agency (ARENA) would still be eligible to participate in the mechanism.

The Council also notes, that while the focus of this consultation is on the proposed Safeguard Crediting Mechanism, for some industrial abatement projects; particularly those of a more innovative nature; are not a good fit for any one current policy or agency. For these large or innovative projects, a “one stop shop” could be beneficial to help provide industry the resources to navigate both existing funding and policy mechanisms and which was possibly able to amalgamate a hybrid solution of available support for projects to bring forward large scale and transformative abatement to the aluminium value chain in Australia.

The Council would like to continue to work with the Department and Clean Energy Regulator, to develop workable solutions for industry; while maintaining the durability and policy intent of the Safeguard scheme.

Yours sincerely,



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