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Department of Climate Change, Energy, the Environment and Water (DCCEEW)
https://consult.dcceew.gov.au/safeguard-mechanism-ebit-and-dpup
4 April 2024

Dear Minister Bowen

Re: Safeguard Mechanism: Draft EBIT Guidelines and calculating the Default Prescribed Unit Price

The Australian Aluminium Council (the Council) represents Australia's bauxite mining, alumina refining, aluminium smelting and downstream processing industries. The industry includes six bauxite mines, six alumina refineries and four aluminium smelters; in addition to downstream processing including more than 20 extrusion presses. The Council welcomes the opportunity to provide feedback to the Draft Earnings Before Interest and Tax (EBIT) Guidelines and calculating the Default Prescribed Unit Price which supports the implementation of the Safeguard Mechanism. Most of Australia's large bauxite mines, all six alumina refineries plus all four aluminium smelters are covered facilities under the Safeguard Mechanism. The Council anticipates that at a number of these facilities will qualify for reduced decline rates under the trade-exposed baseline-adjusted (TEBA) framework and notes the importance of these guidance documents in this context.

Draft Earnings Before Interest and Tax (EBIT) Guidelines

The Council recognises that there is an Australian Accounting Standard for EBIT. However, of Australia's alumina refineries and aluminium smelters, eight are joint venture partnerships and some are also tolling facilities. Joint venture partners have different EBITs for the same facility and tolling entities don't have an EBIT. The Council welcomes the inclusion of consideration of these joint ventures in the EBIT Guidelines.

The Council notes that the Guidelines have a separate Explanatory Memoranda. This is cumbersome and could be streamlined in the publication of the final versions.

The Council notes that some Members have responded directly to the EBIT Guidelines.

Default Prescribed Unit Price (DPUP)

The Council notes that the Default Prescribed Unit Price will be published on the department's website by 30 June each year from 2024 for the purposes of the relevant calculations and that it does not have any other operation or regulatory significance.

The DPUP Discussion Paper outlines a number of possible processes which could be used to determine the DPUP:

1. To use spot price data to calculate the Default Prescribed Unit Price.

2. The department will determine a comprehensive source of spot price data each year and publish the names of companies that provide the data in accordance with relevant licensing agreements.
3. That an estimate of prices at the end of the compliance year be made using an average of the previous three months of spot price data.

In considering its response to these options the Council believes that the DPUP should best reflect the price that a facility will be exposed to if they were required to purchase credits to determine they are eligible for TEBA. Although forecasts for both covered emissions and EBIT are likely to be updated for a Safeguard facility on a regular basis during the year, most facilities will not be able to definitively conclude if they will be eligible for TEBA and what amended ERC they will receive until after the DPUP has been published and the financial year has concluded. For facilities that may be eligible for TEBA, due to a limited margin between carbon cost and EBIT, each year, they would be unlikely be in the position to purchase more credits than they know that they need and take advantage of lower pricing during the reporting year.

Additionally, to drive liquidity in the spot market it may be worth applying a "penalty" to the DPUP formula such that the DPUP is the average spot price plus a margin – something of the order of 5%. This may encourage further trading activity to avoid the DPUP becoming the default carbon price.

Option 1: The Council agrees that spot pricing would be more representative than long term contracts but recognises that this needs to incorporate a time period.

Option 2: The Council does not oppose this but believes this should include the pricing for all eligible units including SMCs.

Option 3: The Council is concerned that the use of the last 3 months' data does not represent a full year's trading and is potentially subject to market manipulation to drive the price up or down of the DPUP. It would be more robust to use a longer averaging period to avoid the risk of attempted market manipulation. The Council recognises the challenges with publishing timely data but believes this could be addressed through either the use of a longer period (e.g. the first 11 months of the year) or an April – March 12 month average (which would have a 3 month lag but be more representative of a full year's trading).

While the price of units are expected to rise over time with peak pricing in the lead up to the surrender deadline, as has been seen in recent years there are many factors that impact the carbon price as has been seen in recent years, therefore, we suggest that there is flexibility in the methodology. For example, both the average from the previous 12 month period and the 3 month average should be calculated and the highest of the two selected, in order to best represent the value which a TEBA facility could be exposed to.

The Council would be happy to discuss the contents of this letter with your Office or the Department at any time.

Kind regards,

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