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Australian Government
Department of Climate Change, Energy, the Environment and Water
Safeguard Mechanism Taskforce
By email: Safeguard.Mechanism@industry.gov.au

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AGL Response to Safeguard Mechanism Reform Consultation

AGL Energy (**AGL**) welcomes the opportunity to comment on the Safeguard Mechanism Reform (**Consultation Paper**).

AGL is a leading integrated essential service provider, with a proud 185-year history of innovation and a passionate belief in progress – human and technological. We deliver 4.2 million gas, electricity, and telecommunications services to our residential, small, and large business, and wholesale customers across Australia. We operate Australia’s largest electricity generation portfolio, with an operated generation capacity of 11,208 MW, which accounts for approximately 20% of the total generation capacity within Australia’s National Electricity Market (NEM). We have the largest renewables and storage portfolio of any ASX-listed company, having invested \$4.8 billion over two decades in renewable and firming generation.

As Australia’s largest electricity generator, AGL is also Australia’s largest greenhouse gas emitter. Our operated scope 1 emissions account for approximately 8% of Australia’s total emissions, over 95% of which come from the combustion of coal for the generation of electricity for our customers. As the global community responds to the risks of climate change, AGL Energy recognises the large part that we must play in the transition to a low carbon economy.

In 2015, AGL committed via its Greenhouse Gas Policy not to extend the life of its coal-fired power plants. As we work towards the full closure of these plants and the Australian economy transitions towards full decarbonisation, we have also made further commitments in pursuit of a 2050 net zero target.

AGL now offers customers the option of carbon neutral prices across all of its products, providing viable carbon-neutral supply options for households, business, and wholesale customers. AGL is also continuing to invest in new sources of electricity supply both through direct investment and offtake agreements.

The emissions reduction imperative

AGL accepts the science on climate change and supports policy action to meet Australia’s commitments under the Paris Agreement, including the commitments by the Commonwealth and State Governments to reach net zero emissions by 2050. We strongly support the strengthening of the Safeguard Mechanism to meaningfully contribute to these climate targets and to meet Australia’s overall emissions reduction task.



By 2050, we believe that Australia has the opportunity to be carbon neutral and an energy superpower. This will be realised by Australia generating low-cost power using zero emissions wind and solar resources, backed up by technologies like batteries, hydro power, gas, and hydrogen.

Economy-wide policies to set guideposts for the transition to a net zero economy are an important component of realising this objective. In addition to a national emissions budget and a legislated long-term emissions reduction trajectory, policies that provide targets for Australia's largest emitters provide more clarity on expectations of the future operating environment and allow businesses, governments, customers, and communities to plan for the future.

Emissions reduction targets for large emitters under the Safeguard will also support an increased level of coordination between government policy action and voluntary private sector action to maximise the efficiency of abatement. Certainty of long-term policy settings provides a more stable environment for the deployment of capital to support economies and communities through transition.

At the same time, substantial reductions in emissions and a shift away from current dependence on fossil fuels represents a major shift across the entire economy, with very large transitional costs required to replace existing products, services, technologies, and infrastructure with zero-emissions alternatives. The policy decisions taken in setting the parameters of the Safeguard will determine the future direction of some of the largest contributors to Australia's economy, and therefore the operation of the mechanism must be considered closely to ensure the emissions task is achieved efficiently and in a way that minimises broader impacts.

Although the transition to a low-emissions economy brings significant challenges, many of which will require significant capital support, with well-designed policies these challenges present an enormous opportunity for investment, with the potential to promote a more productive, inclusive economy with healthy, connected communities, underpinned by affordable and sustainable products and services.

To maximise the potential benefits of the energy transition, the right balance needs to be struck in addressing core domestic economic challenges, creating jobs, and boosting growth – but in a way that also takes into account the key challenge of building a cleaner, more sustainable, and more resilient economy for the future.

The role of the Safeguard Mechanism

In order to strengthen the operation of the Safeguard Mechanism, decisions must be made on several critical design options, which are well covered in the Consultation Paper. For many of these design choices, the preferred option to both reduce emissions and to maximise the efficiency of the scheme is not immediately clear, with competing options clearly involving trade-offs principally between equity of emissions reduction targets and efficient cost of abatement.

To overcome some of these policy challenges, we support the reference to key objectives and policy principles to guide scheme development and agree with the four key principles highlighted in the Consultation Paper that seek to deliver an outcome that is effective, equitable, efficient, and simple.

However, first among these principles must be the objective that emissions reductions are actually realised by covered facilities on an overall basis, and in line with a carbon budget that is consistent with Australia's requirement to contribute to the objectives of the Paris Agreement. Policy decisions

that would have the effect of delaying emissions reductions or reducing targets on individual emitters, must therefore be picked up by other scheme participants or other sectors of the economy.

Our key messages

Setting the Safeguard up for an enduring function

One of the key steps to drive emissions reductions, especially in the early stages of the revised Safeguard, is the removal of 'headroom'¹ from overall targets, which requires careful setting of baselines across all facilities in order to deliver scheme-wide abatement. Meaningful baseline setting and removal of headroom are fundamental to the enduring function of the Safeguard Mechanism. Allowing headroom or direct provision of Safeguard Mechanism Credits (SMCs) to particular facilities could delay action on emissions reductions and also erode the value of SMCs, as each SMC would not represent a true cost of abatement. It could also place a larger decarbonisation burden on other sectors or facilities that were unable to access SMCs because of a particular baseline methodology, despite there being overall headroom across the scheme. All of these impacts would be highly detrimental to the operation of the scheme.

While we are broadly supportive of a simple, low maintenance scheme where SMCs are automatically awarded for emissions reductions achieved, for the scheme to have real integrity, information and data on baselines and emissions reductions should be transparent and available to the public. In the current Safeguard Mechanism, there are instances where facilities are able to withhold baseline information under commercial claims. In our view, this is incompatible with an equitable scheme where all participants are seen to be taking on their fair share of emissions reductions.

Impact of scheme design on ACCU market integrity

If the scheme is well-designed, SMCs will reflect the true cost of carbon abatement, providing a strong price signal and encouraging investment in new, decarbonised technologies.

ACCU market integrity should be considered in the setting of facility baselines. ACCUs are experiencing a period of high demand due to both mandatory ERF and voluntary contracts. The Safeguard Mechanism should support ACCU markets by generating competitively priced SMCs rather than contributing to ACCU market volatility by offering a low-cost, ineffective unit of compliance.

Ineffective setting of baselines could also delay action on climate change. If there is oversupply of SMCs early on through poor scheme design, this will force stronger action in later years and mitigation timeframes will get tighter.

The responsibilities of EITEs in an effective Safeguard Mechanism

Under the current scheme, emissions-intensive trade-exposed facilities (EITEs) make up 78% of covered emissions and 56% of facilities. Allowing for complex, individually tailored treatment of each EITE would be complicated, expensive, and inefficient. We note that for some facilities and in

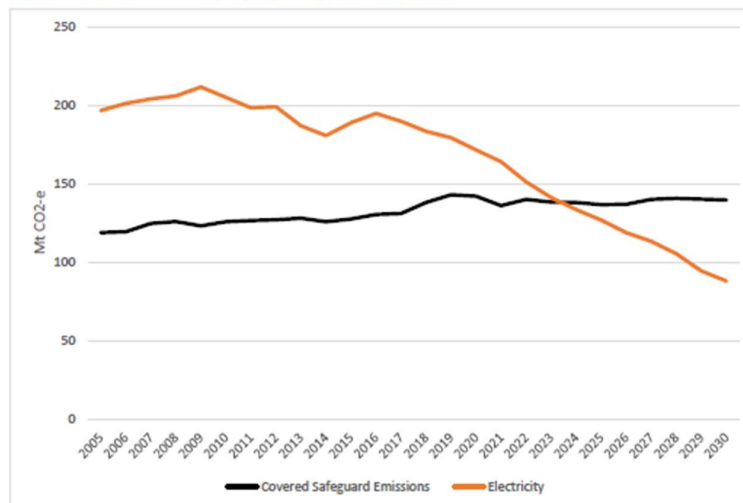
¹ In this context, headroom refers to the gap between existing aggregate baselines (180 Mt CO₂-e in FY21) and actual emissions from covered facilities (137 Mt CO₂-e in FY21).

particular some EITEs, decarbonisation pathways while maintaining full production are not clear. However, this should not necessarily justify exemption from the scheme – if EITEs are unable to access a viable decarbonisation pathway, further discussions should take place regarding appropriate support mechanisms that could drive technological innovation to contribute to the overall decarbonisation load or directly support continued production for a defined period.

Implications for the electricity sector and avoiding shifting emissions around

It is important for each sector to contribute equitably to achieve economy-wide emissions reductions; however, we recognise that each sectors faces different economic and technological challenges to achieve this task. As illustrated in the below graph, the electricity sector has made great strides to decarbonise over a period where the Safeguard Mechanism has been ineffective. This suggests that while the electricity sector is not proposed to be covered through the Safeguard Mechanism, other policy levers can be effective in reducing emissions and stimulating investment in new renewable energy projects.

Figure 6: National emissions by key segment (business as usual)



Source: RepuTex Energy, 2022; Commonwealth Emissions Projections 2021

Electrification will play an important role in reducing emissions in the industrial sector, especially for facilities that currently utilise fossil fuels as primary energy inputs. However, if the Safeguard Mechanism drives facilities to convert scope 1 emissions from the burning of fuels like natural gas to uncovered scope 2 emissions from electricity, and provides a direct SMCs for doing so, this could shift a part of the decarbonisation burden onto the electricity sector and risks carbon leakage from the Safeguard if not sufficiently monitored.

This possibility highlights the need, alongside the Safeguard Mechanism, for governments to continue to incentivise energy efficiency measures and decarbonisation of the electricity sector to achieve true, overall national emissions reductions. In this regard, we note that there are already several policies aimed at achieving this objective in the electricity sector as rapidly as possible.

Over the next three decades, substantial amounts of new large-scale renewable generation and distributed solar generation are forecast to be connected to the NEM. Aging thermal generation will be replaced by a range of variable and flexible generation technologies with lower emissions intensity to rapidly decarbonise Australia’s energy sector.



State and federal government policies aimed at meeting emissions reduction targets and climate commitments will accelerate this uptake of variable renewable generation, supporting economy-wide climate targets. In NSW, the Electricity Infrastructure Roadmap will see contracting with 12GW of new variable renewable generation prior to 2030, and in Victoria, the Renewable Energy Target to achieve 50% generation from renewable sources by 2030 is being achieved through reverse auctions. More recently, the federal government has announced an ambition to rapidly accelerate the delivery of renewable generation through a \$20bn investment program to deliver new transmission infrastructure. Policies to drive emissions reductions in the electricity sector are therefore well established.

However, the need to incentivise new renewable energy projects and a scheme to support decarbonisation of Scope 2 emissions remains an important consideration for governments alongside the operation of the Safeguard Mechanism, especially over the longer term. While the Safeguard Mechanism could incentivise investment in low-carbon technologies as businesses seek to lower process emissions, neither SMCs nor ACCUs directly incentivise new renewable energy generation.

Extending the RET beyond 2030 could be one way to lift ambition, incentivising greater buildout of renewable energy projects and providing some certainty to the LGC market, currently facing significant risk due to uncertainty post 2030.

Additional policy is required beyond the Safeguard Mechanism

Although the Safeguard covers a large proportion of Australia's total emissions, it will also be critical for additional policies to consider uncovered emissions, including from the transport, land, and uncovered industrial sectors. We support steps by the federal government to consider how emissions reductions in these sectors can also meaningfully contribute to the overall economy-wide task.

In relation to the electricity sector, numerous policies are currently under development, including the guarantee of origin scheme, renewable energy target, and energy storage targets, all of which, along with the Safeguard Mechanism, target decarbonisation in one form or another.

With a number of policy options undergoing formal and informal consultation at the moment, it will be important to consider which policy mechanism is best suited to tackle which problem or market segment and how different proposed policies may intersect or support each other in order to achieve lowest cost abatement on an economy-wide scale.

Further responses to the questions raised in the consultation paper are included below. If you have any queries about this submission, please contact Aleks Smits (Senior Manager Policy) at asmits@agl.com.au.

Yours sincerely,

Chris Streets

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Question	Response
The Safeguard Mechanism's share of the national abatement task	
<p>1. What should the Safeguard Mechanism's share of Australia's climate targets be?</p>	<p>The Safeguard Mechanism currently covers around 28% of Australia's emissions, comprising facilities across a range of sectors. Although decarbonisation pathways for individual facilities will vary, as a starting point the aggregate emissions reduction target for the Safeguard should align with Australia's economy-wide target of 43% below 2005 levels by 2030.</p> <p>In our view, this target should be set with respect to a carbon budget over time rather than a fixed point-in-time target.</p> <p>We agree with the principle that delivery of climate targets should be structured in a way that minimises costs and shares effort across the economy – and that the Safeguard Mechanism should be grounded in the principles of being effective, equitable, efficient, and simple.</p> <p>Although in practice different sectors and facilities will reduce emissions at different rates, in our view it remains important that harder-to-abate sectors remain incentivised to reduce emissions over time.</p> <p>A complementary sectoral analysis of possible contributions to abatement may be useful to inform approaches, noting that within the Safeguard, sectors relating to the production, extraction, and mining of fossil fuels (coal, oil, and gas) are responsible for over 50% of covered emissions and are therefore critical to the overall ambition of the scheme.</p>
Fixed (absolute) versus production-adjusted (intensity) framework	
<p>2. Should we retain, and build on, the existing production-adjusted (intensity) baseline setting framework or return to a fixed (absolute) approach?</p>	<p>There are merits and challenges with both approaches. Recognising that production from covered facilities represents a material component of Australia's economy, intensity baselines may be preferable to account for changes in output over time and to assist in addressing concerns regarding carbon leakage. However, absolute baselines might provide for greater certainty about the overall abatement task.</p> <p>Regardless of approach, the key issue is that overall economy-wide targets are being met – intensity targets may therefore be acceptable as long as overall targets are being met.</p> <p>Conversely, absolute targets may provide more certainty over time, as intensity targets are likely to require regular adjustment.</p>
Setting baselines for existing and new facilities	
<p>3. Views are sought on the proposal to reset baselines in a way that removes aggregate headroom so crediting and trading can commence when baselines start to decline.</p>	<p>We strongly agree with the need to remove headroom, which is essential to the scheme function as a mechanism to reduce emissions. Consideration of the impact on carbon market integrity is important, and ideally, baselines would be designed to minimise shocks to carbon markets e.g., the sudden release of a high volume of SMCs at the start of the scheme would impact ACCU market integrity while stalling emissions reductions.</p>

4. What is the preferred approach for setting baselines for existing facilities?

Approaches may include:

- a. Option 1: setting all baselines using industry-average benchmark emissions-intensity values.
- b. Option 2: setting all baselines using facility-specific emissions-intensity values.
- c. Other proposals, noting there are many possible approaches.

There are benefits to both industry-average and facility-specific approaches, although noting the critical importance of avoiding aggregate headroom in the setting of baselines, and in order to support the objective of scheme simplicity, on balance we would support an approach that sets all baselines using industry-average benchmark emissions-intensity values, which could be more easily constructed to ensure total covered emissions meet scheme targets.

This approach would also support the objective of requiring more emissions-intensive facilities to work towards deeper reductions over time.

In future, as facilities within a sector may converge towards an average emissions-intensity, there may be merit in considering other approaches such as a best practice emissions-intensity to drive further abatement.

The alternate approach, (i.e., setting facility-specific baselines for several hundred facilities, while also ensuring that in aggregate these baselines all met the overall scheme objective) would represent an enormously complicated task, and it is not clear that this is achievable on the timelines proposed by the consultation paper.

5. What are the advantages of best practice, industry average benchmarks or alternative approaches for setting baselines for new entrants, noting that a final decision will be informed by baseline setting arrangements for existing facilities?

The challenge of new entrants or facility expansions is that these facilities represent additional emissions that have not been accounted for in the setting of existing baselines and rates of decline.

As a starting point, if an industry-average benchmark is used for calculating baselines for existing facilities, it would seem fair to apply the same standard to new facilities also.

However, new facilities do not have the same sovereign risk concerns or sunk costs as existing projects, and therefore the government may seek to apply a more rigorous emissions standard for new projects. This decision would need to be assessed based on the relative merits of encouraging new investment against the risk that new entrant facilities may impact on the ability for Australia to meet its long-term climate targets.

We note also that new-entrant facilities are likely to be subject to several other compliance obligations that relate to overall emissions profile prior to being commissioned. It may therefore be the case that the emissions intensity of new projects could be determined by regulation outside of the Safeguard Mechanism.

With regard to facilities that move above and below the threshold for compliance, we note that there should be an incentive associated with reducing emissions beyond a certain level and it may therefore be appropriate to cease all compliance with the scheme below a certain profile. The threshold could however also decline over time (for example, by 5 thousand tonnes p.a.)

Crediting and trading, domestic offsets and international units

6. Are there any other issues to consider with the proposal to allow the Clean Energy Regulator to automatically issue

It would be useful to know in advance the overall number of SMCs that will be generated as well as intentions to develop any trading

tradable credits to Safeguard facilities whose emissions are below their baseline, with crediting and trading commencing on 1 July 2023 subject to baseline setting arrangements that remove aggregate headroom?

platform for credits. Some direction on trading would be helpful, or support to develop a third-party exchange.

Enabling a well-functioning market for SMCs will reduce costs and improve scheme efficiency by increased liquidity, price discovery, and transparency.

7. Should banking and borrowing arrangements be implemented for Safeguard Mechanism Credits?

Some degree of borrowing of credits is likely to be helpful in smoothing out the cost of SMCs across compliance years, which would support the objectives of cost minimisation and efficiency.

Equally, banking of credits is likely to support scheme efficiency.

However, it is important to consider the impact on both SMC and ACCU demand and pricing in the short term. Temporal limits on banking and limits on borrowing may therefore be appropriate.

Settings should not encourage banking and borrowing of SMC credits to a level that impacts on the market for ACCUs to meet compliance, i.e., scheme settings should be such that a very high proportion of SMCs are extinguished before the demand for ACCUs increases.

8. Should Safeguard facilities no longer be able to generate ACCUs for reducing direct (scope 1) emissions unless they have an existing registered ERF project? Further, should no new ERF projects be able to be registered at Safeguard facilities?

Due to the risk of double counting, facilities should not be able to generate both ACCUs and SMCs from one activity.

While it may be possible to develop methodologies to avoid double-counting, i.e., by deducting ACCUs generated from the baseline to which SMCs are calculated, this would seem to add significant complexity to the scheme and would not materially add to the overall objective of reducing covered emissions.

Additional feedback is sought on:

- a. allowing existing ERF projects at Safeguard facilities to continue to generate credits and retaining double counting provisions to prevent a facility from generating ACCUs and SMCs;
- b. options for the treatment of deemed surrender;
- c. continuing to allow Safeguard facilities to participate in ERF projects that reduce emissions from electricity use (scope 2) emissions; and
- d. mechanisms to promote the transparency of the ACCU market, such as publishing unit holding, to assist with market decision making, supply and cost effectiveness.

Covered facilities should primarily focus on generating SMCs through abatement activities rather than other units that contribute to a reduction in emissions.

The way in which covered facilities could generate other units (e.g., ERF projects that generate ACCUs, RET projects that generate LGCs, or other energy efficiency schemes that may generate other white certificates) could be considered at a later phase of the scheme if demand emerged for this approach, and it could be shown that there was merit in meeting the overall objective of reducing emissions at lowest cost.

9. should international units be able to be used for compliance under the Safeguard Mechanism at a future time, noting that any decision would depend on the rules for international trading?

For the initial phase, it would seem sensible to limit to the scheme to ACCUs and consider the impact of bringing in other units at a later date.

In principle, we would be supportive of the possibility of inclusion of high-quality international offsets, should Article 6 be updated in future.

Tailored treatment for emissions-intensive, trade-exposed (EITE) businesses

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| <p>12. Should a facility-specific comparative impact assessment that builds on existing EITEs definitions be used rather than a sector wide designation?</p> | <p>In general, EITE treatment should be exercised with a high degree of caution in order to not dilute the overall performance of the scheme.</p> <p>Although alignment between schemes is usually helpful, there may be merit in diverging from existing definitions of EITEs given the peculiar issues raised in proposed structure of the Safeguard Mechanism. For example, in principle we would support the cost-intensity-based scheme, even though it is a divergence from the RET.</p> |
| <p>13. Would additional funding opportunities effectively assist EITE facilities to adapt to declining Safeguard baselines?</p> | <p>Complementary sectoral policies should be developed once the impact on particular facilities is clear.</p> <p>In some instances, some facilities may not have a clear decarbonisation pathway – and steps to reducing emissions may involve declining production and substantial business transformation. Other sectors may well benefit from funding and support to move towards less emissions-intensive production.</p> |
| <p>14. What kinds of funding, finance or other arrangements and measures would best support EITE Safeguard facilities to reduce their emissions?</p> | <p>Access to funding and subsidies outside the Safeguard will be appropriate for some facilities, particularly those that require significant capital improvements to move towards lower emissions technologies.</p> <p>However, utilising the proposed SMC program to support EITEs does not appear to be a good option given the risk of headroom in the scheme.</p> <p>Generally, measures that would reduce the effect of the scheme of EITEs would simply create more pressure for non-EITE facilities (which are few). A better approach might be to consider industries that the government wishes to support into the future and provide this with targeted support outside of the scheme to meet their Safeguard compliance, thus preserving the operation of the Safeguard.</p> |
| <p>15. In particular, what potential design features of the Powering the Regions Fund would support covered facilities with their decarbonisation priorities?</p> | <p>Targeted support to enable decarbonisation and business transformation could comprise of a number of different elements, including workforce and skills development, supporting infrastructure, technology enablement and development, planning and licence approvals, and direct financial support.</p> <p>This is likely to be more beneficial to businesses over time than exemptions from the scheme or reductions in Safeguard liabilities.</p> <p>Industrial decarbonisation activities that also generate ACCUs would support the operation of the Safeguard on multiple fronts by reducing primary emissions and also creating additional units to meet compliance.</p> |
| <p>17. Is the direct provision of SMCs an appropriate way to mitigate cost impacts for EITE facilities?</p> | <p>Utilising the proposed SMC program to support EITEs does not appear to be a helpful design option. Our preference would be to targeted support as the direct provision of SMCs would have immediate effect on the function of the scheme – it would essentially be like providing headroom with no stimulus to invest in new technology.</p> |

18. Are differential decline rates an appropriate way to reduce the impact on EITE facilities?

In part, but the impact on non-EITE facilities may be severe. Any adjustment decline rates should be modest, with the balance of support mechanisms provided through targeted support to prevent adverse impacts on other facilities.

Over time, it may not be appropriate to apply EITE exemptions as the impact of CBAMs may impact, and the broader economy will have to cut further to meet net zero.

19. How could differential decline rates be structured so that emissions reduction and fairness outcomes are maintained?

If decline rates are more significant for non-EITE facilities, they may require additional targeted support to reduce emissions over time.

Taking account of available and emerging technologies

20. Should multi-year monitoring periods be extended to allow facilities with limited near-term abatement opportunities to manage their own abatement path?

Effective baseline setting, access to tradeable SMCs, and appropriate banking and borrowing should prevent the need for multi-year monitoring periods.

It remains important for hard-to-abate sectors to retain an incentive to reduce emission over the long-term.

Indicative baseline decline rates

23. What are the appropriate characteristics for the decline trajectory to 2030 that can deliver the Safeguard Mechanism's share of Australia's climate targets, and the process for setting baselines post-2030?

A starting point of prorata reductions for all facilities, with a linear trajectory to 2030, is a useful principle, noting that may be many good reasons for departing from this approach.

Although there are arguments for a softer start, we note that any reduction in the emissions task will need to be made up in later years, where it may be more costly.

Reductions in early years should therefore be appropriately incentivised and rewarded, working towards overall efficiency in meeting targets over the long term.