



# Consultation on exposure draft amendments to the Safeguard Mechanism, September 2018

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## Introduction

Since 1959, the Australian Petroleum Production & Exploration Association (APPEA) has been the peak national body representing the upstream oil and gas exploration and production industry. APPEA has 59 member companies that explore for and produce Australia's oil and gas. In addition, APPEA's more than 130 associate member companies provide a wide range of goods and services for the industry. Further information about APPEA can be found on our website, at [www.appea.com.au](http://www.appea.com.au).

APPEA welcomes the opportunity to comment on the *Exposure Draft Amendments to the Safeguard Mechanism* (the Amendments), released on 21 July 2018. This submission follows our February 2018 submission to the *Emissions Reduction Fund Safeguard Mechanism Consultation Paper*<sup>1</sup> (The Consultation Paper) and our ongoing involvement in the development and review of the Emissions Reduction Fund Safeguard Mechanism (ERF-SM).

APPEA has been engaged in the greenhouse policy debate since the 1990s and has participated in every major consideration of national climate change policy in Australia since that time. APPEA is committed to working with governments as they develop policy responses to climate change.

In addition to the APPEA submission, APPEA members have made individual submissions to the Consultation Paper. This response should be read in conjunction with submissions from individual APPEA members.

APPEA's submission addresses specific aspects of the Consultation Paper, focussing on those areas that are particularly important for the upstream oil and gas industry.

APPEA supports a national climate change policy that reduces greenhouse gas emissions at least cost and facilitates investment decisions consistent with an international price on carbon.

## Proposed approach for improving the Safeguard Mechanism: comments on specific sections of the Consultation Paper

The sections below offer comments on specific sections of the draft amendments. In addition to these comments, APPEA would welcome the opportunity to meet with the Department to discuss these comments and to 'workshop', amongst other things, the development of 'prescribed production variables' and 'default emissions-intensity' values for calculating baselines.

### Transitioning to calculated baselines

APPEA welcomes the addition of the transitional calculated baseline criteria in the amendments. This will allow all project proponents to apply for adjustments to the baselines that better reflect the business conditions prevailing during the period between 2017-18 and 2019-2020. APPEA notes that on page 29 under section 26A(2) the eligibility criteria reads:

*A calculated-emissions baseline determination commencing on or after 1 July 2018 has never been made in relation to the facility.*

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<sup>1</sup> Available at [www.environment.gov.au/submissions/emissions-reduction/operation-erf-safeguard-mechanism/australian-petroleum-production-and-exploration-association.pdf](http://www.environment.gov.au/submissions/emissions-reduction/operation-erf-safeguard-mechanism/australian-petroleum-production-and-exploration-association.pdf).



This removed the ability of those facilities from applying for a calculated baseline that may have applied for a calculated emissions baseline commencing 1 July 2018 (with 2018-19 as the high forecast production year) under existing criteria as the deadline for this application was 30 July 2018. This could potentially mean those facilities would no longer be eligible to apply under the transitional calculated baseline criteria. APPEA believes this is not the intention of the criteria.

APPEA recommends this section be amended to appropriately apply under the transitional calculated baseline criteria.

APPEA notes the amendments on page 28 under section 25(9) in the inherent emissions variability criteria state:

*The calculated-emissions baseline determination to which the application relates is to commence on a 1 July up to and including 1 July 2024.*

APPEA has previously flagged concerns that, given the industry will continue to experience inherent emissions variability as an operational factor even beyond 2025, this baseline adjustment measure should be made an enduring feature of the mechanism. While APPEA welcomes the maintenance of these provisions after extensive consultations in 2014 and 2015, and endorsed again in the 2018 consultation, it remains the case that the provisions:

- Have limits on their application:
  - To make use of these provisions, the relevant facility must satisfy all of the criteria set out in section 25(3) and, under section 25(4), the provisions only apply when the facility's covered emissions in respect of the first financial year to be covered by the calculated-emissions baseline determination have exceeded, or are reasonably expected to exceed, the baseline emissions number which would otherwise apply to the facility in that financial year.
  - In addition, under section 25(7) the provisions are not available if a benchmark-emissions baseline determination (considered further below) has been made in relation to the facility.
    - This is notwithstanding the fact that the criteria to which section 25 relates – the inherent emissions variability arising because of the properties of the natural resource or natural gas reserve – will not “disappear” if a benchmark-emissions baseline determination is made.
- Are only in place for a limited period of time:
  - Under section 25(9) the calculated-emissions baseline determination to which the application relates is to commence on a 1 July up to and including 1 July 2024 and therefore does not apply after that time.
    - This is notwithstanding the fact that the criteria to which section 25 relates – the inherent emissions variability arising because of the properties of the natural resource or natural gas reserve – will not “disappear” after 1 July 2024.
    - Indeed, as was explained in 2015 during the consultation period for the Rule, and during the consultation period for the 2017 Review, there are a number of examples of natural gas projects that will experience an increase in emissions as a direct result of production moving into a new reservoir which has different properties from the existing reservoir, and that this change is known now and will take place after 1 July 2024.



The existing provisions to accommodate natural resource variability in the mining, oil and gas sectors should be expanded and maintained as an enduring feature of the ERF-SM. The attractiveness of Australia for further investment in the oil and gas industry will be adversely affected if these provisions lapse.

#### Simplifying calculated baselines

Implemented in a considered and low-cost way, in full consultation with the industry, the introduction of an option to use prescribed production variables and default emissions-intensity values could, for some facilities, represent a lower cost option to consider in moving to a calculated baseline.

APPEA therefore welcomes the inclusion of the prescribed production variables and the default emissions intensity metrics. The comments that follow are designed to ensure the proposal is as efficient and effective as possible, for both the industry and for the government.

APPEA and the upstream oil and gas industry consider extensive ongoing consultation will be required, commencing soon, to develop, 'workshop', agree and finalise the prescribed production variables and associated default emissions-intensity values to support the move by upstream oil and gas facilities to calculated baselines, in a relatively simple and low cost way.

APPEA notes that the government intends that it publish the prescribed production variables by the first half of 2019. APPEA and its members stand ready to participate constructively in this process, and encourages consultation as soon as possible.

APPEA offers the following comments on the proposed approach set in the exposure draft:

- The choice of prescribed production variables and associated default emissions-intensity values is critical to the success of this proposal and uptake by the industry. As the Department would be aware from previous consultation processes, a wide variety of facilities exist across the industry, producing a range of products (crude oil, natural gas, condensate, LNG, liquefied petroleum gas (LPG), natural gas liquids, and so on) from a variety of reservoirs onshore and offshore that have varying characteristics and compositions and produced through a variety and usually bespoke set of facilities.
  - This means it is likely to be necessary to develop a range of production variables and associated emission intensities for a variety of reservoirs and facility components.
  - Prepared appropriately, this would result in a set of production variables and emissions intensities from which facilities could choose to match their production profile, reservoir characterises and facility configuration to ensure the baseline developed was appropriate for their circumstances.
  - If the process to develop and agree these production variables and emissions intensity is relatively simple, developing a number of variables and intensities should add little to the complexity of the approach but would result in a set of variables and intensities that is useful and relevant for the industry and consistent with the ERF-SM's policy rationale.
- Setting production variables and emissions intensity values to reflect the median or average for a sector will mean several facilities, with intensity values below the average, will see little benefit in this approach. While a facility specific approach remains open to them, they will face administrative costs to implement a facility specific approach that are not faced by facilities using the prescribed production variables and default emissions intensity values.



- The balance between an administratively simple and equitable approach will be crucial to development of a set of production variables and intensities that are useful and supported by the industry.
- The industry's experience with establishing averages of this kind (for example, under the former Jobs and Competitiveness Program) is that achieving this balance is challenging. A production weighted average may be one way to approach this challenge, but the range of intensities that exist across production variables likely to be relevant for the industry will remain challenging, and will need to be the subject of further consultation with the industry.

#### Annually updating baselines for actual production

APPEA supports the amendments to allow baselines to be updated to reflect actual production growth and change within an industry and allow for future growth in production.

While the proposed approach is supported, it is equally important this approach also allow for circumstances where variability or major change is a part of the facility's emissions profile over time, declining production is associated with an increase in emissions intensity and in situations where major shut-downs or maintenance periods affect production at particular facilities.

In particular, and as has been discussed extensively in previous consultations with the Department:

- For many oil and gas projects there will be emissions variability associated with the natural resources, anticipated before the establishment of projects, but that does not occur until several years afterward.
- Several member company projects include one or more additional resources (that is, a separate reservoir/s) that must be accessed during the life of the project to maintain production at design levels. Development of these reservoirs is, for example, fully incorporated in final investment decisions (FID), as well as in LNG supply agreements with overseas customers. In some cases, significant increases in emissions will occur from this subsequent reservoir development (for example, higher levels of CO<sub>2</sub> in the reservoir).
- The proposed approach does not appear to appropriately encompass situations where emissions are steadily growing over time (due to the inherent properties of the resource, for example, as greater impurities are found in the gas field towards the end of the field life).
- The proposed amendments also do not account for operations that are either in the exploration or initial stages or those that are past their production stage, thus have emissions that are not necessarily associated with any commercial production. APPEA would support a low production or zero production amendment that would allow project proponents that flexibility.

The annual update provisions should allow for adjustments to take into account these factors, which are not covered by existing provisions and would not be accommodated by the changes proposed in the amendments.

To accommodate this variability, APPEA recommends, to complement the annual updated production baseline, the inclusion of an option to use a multi-year rolling average of production and use the 'facility-specific intensity' value that has been approved under the calculated-baseline application which takes into consideration the impacts of gas variability.



This approach would recognise that, while the annually updated production baseline is generally appropriate for gradual growth/decline conditions, a multi-year averaging option would assist in removing/lessening the volatility associated with circumstances where production might change significantly for any given year. This would avoid potential 'baseline swings' which could make administration and stewardship burdensome.

In addition, APPEA supports the annual (or multi-year) updating process applying to all facilities. The policy rationale for annual updates (to prevent baselines becoming out-of-date and to support business growth) applies equally to all facilities and not just to those industries deemed to be trade-exposed (noting that the ERF-SM legislative framework does not include a definition of trade-exposed industries).

#### Aligning reporting for businesses

APPEA supports the approach proposed in the Consultation Paper to provide for facilities to consistently and regularly report their production data through the National Greenhouse and Energy Reporting System (NGERS).

That said, a number of inconsistencies and shortcomings in the treatment of energy production exist in NGERS, particularly the treatment of energy transformations, which can see the same production reported multiple times as an energy transformation, providing a distorted/inflated dataset under the NGERS approach.

Addressing these inconsistencies/shortcomings to ensure NGERS data more accurately reflects energy production will be a critical element in ensuring the annual baseline adjustments are themselves accurate. APPEA would welcome the opportunity to discuss this further with the Department and to work with the Department and the Clean Energy Regulator to improve this aspect of NGERS and to ensure it is 'fit for purpose' as the basis for the updating approach proposed in the Consultation Paper<sup>2</sup>.

#### Mechanics and timing

APPEA notes the proposed approaches to updating baselines proposed by the Department.

APPEA supports the update of baselines based on actual production (setting the baseline after the compliance year).

This approach would provide greater certainty to both the facility and the Clean Energy Regulator about ERF-SM compliance. Facilities would know the emissions-intensity value used to calculate the baseline in advance and would be able to use internal production forecasts and track actual production to estimate their baseline in advance of knowing their baseline emissions number (which would be known when production data is available after the end of each compliance year).

#### New facilities post-2020

APPEA provided a submission in May 2016 on the draft *Emissions Reduction Fund: Safeguard mechanism Emissions Intensity Benchmark Guidelines* (the draft Guidelines), recommending

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<sup>2</sup> APPEA, and APPEA member companies, have raised a number of these issues in our submission to the Climate Change Authority's *Review of the National Greenhouse and Energy Reporting legislation* (see [climatechangeauthority.gov.au/call-public-input-review-national-greenhouse-and-energy-reporting-legislation](http://climatechangeauthority.gov.au/call-public-input-review-national-greenhouse-and-energy-reporting-legislation)).



against the benchmark approach proposed in the draft Guidelines, noting the ERF-SM must be designed and implemented in a way that enhances Australia's international competitiveness and does not impose costs on Australian industry, including the oil and gas industry, that are not faced by our competitors. With that in mind, APPEA recommended that emissions baselines for new facilities and major expansions be determined from actual facility emissions data, once the facility has been fully commissioned and is operating under steady state conditions.

APPEA recommends that the annual adjustment to baselines based on actual production and the use of prescribed production variable and default emissions intensities be applied to all facilities, including new facilities. Such an outcome would remove the need for a complex, costly and resource-intensive benchmarking process, ensuring all facilities are treated equitably, and in a consistent manner under the new approach proposed in this Consultation Paper.

APPEA recommends the development of benchmarks for new facilities post-2020 is replaced by the approach settled through this consultation process and that all facilities, both existing and new, be treated in the same way.

Other issues: requirement to include electricity generation as an output variable for self-generators without any grid connection or ability to import or export electricity from the facility

In a number of LNG facilities in northern and western Australia, section 5(10) of the Safeguard Mechanism Rule means that the calculated baseline application will apply *output variables* as *production variables* and include LNG production as the *primary production variable*. However, the definition of output variable in section 4, paragraph (b) requires that output variables in this case include "electricity generation".

Each of the LNG facilities located in northern and western Australia are self-generators of electricity, are not grid connected (with no plans to be so in future), and will therefore not import or export any electricity. Accordingly, all electricity generation could be appropriately attributed to the production of LNG, simplifying baseline calculations for the facility (both *calculated* and *production-adjusted* baselines). Such adjustment to the Rule could be accommodated with minor modification to either section 5(10), or the output variable definition at paragraph (b).

#### Next Steps

APPEA looks forward to further consultation with the Department to consider the comments made in this submission, to 'workshop' proposed prescribed production variables and default emissions intensity values and further discuss proposed amendments to the *National Greenhouse and Energy Reporting (Safeguard Mechanism Rule) 2015* and the *National Energy and Greenhouse Reporting Regulations 2008*.

APPEA notes the government is working toward having any changes take effect for the 2018-19 compliance year.

Beyond this consultation on the ERF-SM, APPEA looks forward to further consultation on the other issues arising from the 2017 Review of Australia's Climate Change Policies, including to pursue, as a priority, a determination of when and how international units can be used and developing a long-term emissions reduction strategy.