bp Australia Pty Ltd
A.B.N. 53 004 085 616
717 Bourke Street
Docklands Victoria 3008
Australia

20 September 2022

bp Australia response to the Safeguard Mechanism reforms consultation paper

bp welcomes the opportunity to respond to the Department of Climate Change, Energy, Environment and Water's (DCCEEW) consultation paper on options to reform the Safeguard Mechanism.

bp believes market-based policy to be the most effective and efficient way to reduce greenhouse gas emissions and has previously joined other business voices to call for reforms of the Safeguard Mechanism to provide incentives for large emitters to reduce their emission in support of Australia's emission reduction targets and the goals of the Paris Agreement. We now welcome the opportunity to contribute to the effective design of the mechanism to achieve these outcomes.

About bp

bp's purpose is to reimagine energy for people and our planet. Our ambition is to become a net-zero company by 2050 or sooner; and to help the world get there, too. Globally bp aims to be net-zero across our operations (scope 1 & 2), in our oil and gas production (scope 3) and for the energy products we sell (life-cycle emissions intensity). For each of these we have also set short-term targets (2025) and medium-term aims (2030). You can read more about our net-zero plans and progress in our Net-Zero ambition report released earlier this year.

Globally we are aiming to be a different company by 2030:

- reducing our oil and gas production by around 40% by 2030 and lowering emissions, while keeping up cash flow by high-grading our hydrocarbon portfolio and growing bioenergy;
- investing in low carbon energy to rapidly scale up in solar and offshore wind, and develop new opportunities in carbon capture and low carbon hydrogen.
- providing 100,000 EV charging points and opening more than 1,000 new strategic convenience sites.
- doubling down on five transition growth businesses, planning for more than 40% of the capital we invest to be in bioenergy, convenience, EV charging, renewables, and hydrogen by 2025.

bp is not acting alone with many of our partners and customers here in Australia and globally also committed to supporting progress towards a net-zero future.

We believe that ambitious climate policies will be essential to enable the world to meet the Paris climate goals. bp welcomes well-designed, stable, and long-term policy frameworks to incentivize and support the necessary investments in low carbon solutions.

Reform objectives and policy principles

Here in Australia some of our assets are, or will be if developed, safeguard facilities. Many of our customers also operate safeguard facilities spanning many sectors like mining, freight and logistics, chemicals, and manufacturing. This means much of our local business will be impacted by the reforms, for example, our local business includes:

- LNG production with a share in Northwest Shelf and other gas reserves
- Liquid fuels supply, including to mining, freight and aviation
- Renewable energy with a 50 per cent ownership of LightSource bp the largest solar developer and operator in Australia, and alongside equity participation, our recent announcement to take operatorship of the Asian Renewable Energy Hub in the Pilbara with plans to supply renewable energy and low carbon hydrogen to domestic and export customers.
- Exploring renewable fuels and green hydrogen production at our Kwinana site and another green hydrogen project Geri in the mid-west of Western Australia.
- Carbon Capture and Storage, with the recent award of a GHG Assessment Permit in the Carnarvon Basin which has potential to support the decarbonization of our own assets and the creation of a large-scale, multi-user hub.
- Providing decarbonized transport solutions like electrification and hydrogen for mobility.
- Low carbon trading team, that sources and trades a range of carbon offsets and compliance units for our own use and for our customers.

Consistent with our global and local business, bp welcomes well designed policy that provides emission reduction incentives to large emitters in support of Australia's emissions reduction targets. bp supports the objectives and policy principles set out in the consultation paper to guide the safeguard reforms.

Phases and need for longer-term policy

bp notes the proposal in the discussion paper to have two phases in the period to 2030. bp recommends that the safeguard mechanism is designed to be enduring, providing incentives beyond 2030.

As discussed above, bp is considering several Australian low carbon investments that have long-lives. These significant investments involve billions of dollars of capital and rely on economics that reach far into the future. To support these kinds of investments, which are essential to achieving the deep cuts in emissions required, Australia needs policy stability and predictability over the medium to long-term.

bp can understand the desire to have a transition phase for the first few years of declining baseline. This allows the new settings, including the crediting below baselines and trading, to be tested without risk of carrying forward any unintended outcomes.

Beyond the initial phase, bp's recommendation is that the mechanism is designed to be enduring with phase 2 extending beyond 2030. This would still allow for regular review and for scheduled adjustments as required by the design, but also give business confidence to make the necessary investments in capital-intensive emission reduction projects and initiatives.

Safeguard Mechanism's share of the national abatement task

Facilities covered by the Safeguard mechanism should contribute an appropriate share to Australia's economy-wide emissions reduction targets. Given the limited coverage of the safeguard mechanism, its share will need to be determined in the context of emissions reductions expected from other sectors of the economy.

bp considers economy-wide carbon pricing is the most effective and efficient way to reduce emissions, but understands the Australian government intends to take a more sectoral (sector by sector) approach to reducing emissions. In taking this approach, bp suggests the government establish a framework for considering the contribution of different sectors across the economy. The principles set out for the design of the safeguard could also be relevant for designing a suite of policy measures to reduce emissions across different sectors.

bp expects all sectors of the economy will contribute to Australia's emissions reduction targets and ideally face similar incentives to reduce emissions. This would help to ensure, even where different policies are applied, that emission reductions across the economy is equitable and efficient. Given differences in cost of abatement between different sectors, it is likely some will reduce their emissions faster or slower than the economy wide targets. A proportionate split is unlikely to be the most equitable or efficient split.

bp acknowledges the use of offsets (ACCUs) provides an opportunity to level the incentive between the safeguard sector and other sectors of the economy. This allows for emissions reductions to occur where they are most efficient. With offsets, the safeguard mechanism's share of the national task does not necessarily mean those emissions reductions occur in that sector, but rather determines the share of the national task that safeguard entities are expected to pay for (its burden).

While the ambition of the mechanism should have regard to Australia's 2030 target and the whole of economy carbon budget over the period to 2030, this doesn't necessarily require a strict point target or carbon budget for the mechanism, particularly if this would undermine the efficiency or effectiveness of the mechanism. bp would welcome further consideration by government of this important design choice and any tradeoffs it might have with other design elements.

Coverage of the safeguard mechanism

While bp understands the government's intention is to keep the threshold for inclusion of a facility within the safeguard mechanism at 100,000t CO_2e, bp recommends government consider expanding coverage over time by lowering the threshold.

To achieve Australia's emission reduction targets, all sources of emissions will need to be subject to some form of emission reduction policy. By widening the coverage of the safeguard,

government can use the same architecture to drive emission reductions across more of the economy, limiting the need to design separate policies. By including more emissions sources within the same policy, the market can drive efficiencies and determine where emissions reductions are best achieved (rather than government trying to emulate this in the design of different policies).

We anticipate some competitive distortions with maintaining the current threshold, with some facilities above the threshold and their competitors below the threshold simply as a function of size rather than emissions performance. Expanding coverage could address some of these concerns.

Lowering the threshold over time, say consistent with the decline rate of baselines, could address concerns of facilities dropping out of the mechanism as their baselines or emissions decline in response to the incentives provided by the mechanism.

We acknowledge expanding coverage would require additional work to establish baselines. We also accept that some lead time would be warranted for facilities to prepare for coverage. However, many emitters (below the safeguard mechanism threshold) already report their emissions under the National Greenhouse and Energy Reporting Scheme, which does provide a solid basis for expanding the coverage. Given lead times, it would be useful for government to signal now intention to expand coverage and provide timelines for this.

Importantly, clarity is needed on how emissions reductions will be achieved in the electricity sector and the interaction between that policy and the safeguard mechanism. Given electrification is likely to be a prominent abatement option for many safeguard facilities, a sensible policy framework is needed that drives emission reductions in the electricity sector while at the same time provides incentives for the electricity sector and electrification to play its full part in decarbonizing the operational emissions of safeguard entities.

Setting baselines

Getting the baseline setting right is essential for the effective functioning of the mechanism. It is the aggregation of the baselines that determines the overall ambition of the mechanism (and the contribution to Australia's emission reduction targets). To be effective the baselines need to provide incentives to reduce emissions.

With trade between entities, bp expects it will be the market that determines what emissions reductions occur with the marginal cost of abatement being the same across the mechanism. bp notes, careful consideration is needed, however, because the baselines will also determine the distribution of costs between safeguard entities.

Below we provide our views on the baseline options discussed in the consultation paper, but first some overarching comments and views.

Safeguard entities won't be starting from scratch, so, bp considers baselines will need to reflect that some have already invested in emission reductions while others may not have. bp anticipates new entrants and expansions, so encourages baseline setting arrangements that provide the right incentives for low emissions growth.

If not designed carefully baselines can introduce competitive distortions between businesses that produce the same or similar products. bp's preference is the mechanism would advantage those that can produce with less emissions.

bp notes, to date there has been a lot of flexibility and tailored arrangements for setting safeguard mechanism baselines which has introduced a lot of complexity to the rules. But as the mechanism moves to providing incentives to reduce emissions, it will be preferable to remove much of this complexity. bp considers, this will be important for the proper functioning of the incentives now central to the mechanism.

While bp encourages the government to build upon the existing baseline setting arrangements where possible, these must be reviewed to ensure they remain fit for purpose and provide incentives as intended. For example, bp understands that existing baseline arrangements have the perverse effect of providing no incentive to electrify using renewable electricity supplied offsite, because the baseline would also be reduced to reflect the facility is no longer producing electricity. Similarly, existing arrangements remove the incentive to deploy CCS to reduce reservoir emissions in the production of gas, because any emissions captured directly reduce the baseline.

The consultation paper raises many different baseline setting options which bp considers do need to be assessed in combination to understand how the whole will work. bp encourages the government to further support the policy debate with some worked examples and data that illustrate the combined impact and interrelated tradeoffs.

Fixed (absolute) versus production-adjusted (intensity) baselines

bp agrees with the consultation paper that both production- adjusted (intensity) and fixed (absolute) baselines can provide incentives to reduce emissions and can be calibrated to achieve the desired emission reduction outcome.

bp also agrees with the arguments for retaining the production-adjusted baselines set out in the consultation paper, namely that these work to decouple economic growth from emissions growth, are better suited to sectors that have difficulties passing on costs (like many under the safeguard mechanism) and that they automatically adjust to declining output. bp also see's value in production-adjusted baselines for accommodating new entrants and expansions.

Finally keeping production-adjusted baselines could help facilitate a smooth transition, given the limited time to re-establish baselines for the target start date of 1 July 2023. Where possible building on existing arrangements seems sensible.

Dealing with headroom

bp agrees it is important to have confidence there will be aggregate scarcity within the mechanism, as this will drive the incentives to reduce emissions. It will also support the credibility of the mechanism and credits generated within. bp also agrees that it is aggregate scarcity that matters, which does not require each facility to face a shortfall. Also, with intertemporal flexibility as proposed, it will be aggregate scarcity over time, rather than in a particular year, that drives the emissions reduction outcomes.

bp notes when assessing scarcity, care should be given to using a single historical year (particularly one that was impacted by a pandemic) as a reference. This is unlikely to be a good estimate for future emissions expected in the absence of the incentive (which is what will drive scarcity).

Industry average versus site specific factors

bp agrees with the consultation paper that both options have potential to provide incentives to reduce emissions and that the choice is much more about the distribution of costs. bp does not expect consensus on this design aspect with those currently using a site-specific approach likely to prefer site specific and those using industry average approach preferring those models. bp notes that in practice these options can be implemented in a variety of ways, so to help build consensus bp recommends government prepare clear straw proposals so that the relative merits and tradeoffs can be better assessed and understood.

bp's priority is for baseline setting to provide strong incentives to reduce emissions and to be simple in support of the effective function of the market.

Subject to further examination, bp is initially minded to prefer the use of industry average intensity factors as this will reward lower emissions producers, avoid penalizing early movers and can build on existing default factors (although these would need to be reviewed to make sure they are fit for purpose).

bp is also open to site specific options. bp notes that this would require a simple and equitable method for establishing these (for example, referring to the average historical emissions intensity over a period). Also, to avoid disadvantaging early movers some arrangement could be made to make sure the historical reference is appropriate. One option could be to allow for different trajectories to 2050 (apply a common percentage decay rate), so that lower emissions producers face a smaller burden compared to higher producing emitters. As discussed, further analysis on these different options is required to determine the best approach.

New entrants

bp believes the mechanism should be designed in anticipation of new entrants and expansions, and not only for existing activities but also for new activities such as renewable fuels and low carbon hydrogen that are not currently defined.

bp agrees it is important that new entrants are treated the same as expansions of existing facilities so as not to introduce unintended competitive distortions. It is also important the mechanism provide incentives for new investments to have low emissions and avoid locking-in unnecessary emissions over the long-term.

bp see's advantages in applying an industry average benchmark, so that the possibility to generate credits provides a strong incentive to make the new capacity as low emissions as possible. bp acknowledges that industry average may not be easy to establish for all new entrants, especially for first of its kind production (like our planned renewable fuels project).

Should a 'best practice' performance be required for new entrants, a process for establishing what is "best" would be needed. The same standard would need to apply to any material expansion of an existing facility. What constitutes a material expansion would need to be defined. Also, if this approach is adopted, bp suggests it would not be appropriate to apply the same decline. Instead, perhaps no decline is applied until the industry average catches up or a much flatter trajectory to 2050 (depending on how baselines are set for existing entities).

Crediting and trading, domestic offsets and international units

bp believes the crediting of performance better than the baseline and ability to trade within the mechanism is essential to underpin the move to declining baselines.

Crediting SMCs

bp is comfortable with the proposal to issue a new type of credit (SMCs) for performance better than the baseline and that this be defined separately from ACCUs. bp notes with the continued option for safeguard entities to use an ACCU for compliance, that the ACCU price will likely set the SMC price or at very least move with the SMC price (even if the SMC is not an ACCU).

While not discussed in the consultation paper, bp assumes that SMCs will otherwise have similar characteristics to an ACCU, for example, be defined as a financial product, similar tax treatment, be able to be held by third parties (not safeguard entities) etc. Early confirmation that this is the government's intent will be important, to allow businesses to plan.

The discussion paper proposes that, SMCs would only be able to be used within the safeguard mechanism (whereas ACCUs have other uses). Clarity will be needed on whether SMCs could be voluntarily cancelled. Also, a clear understanding of how the SMCs will be treated in the context of ClimateActive and CERT, where safeguard entities might also participate. On a related note, bp would encourage the various state EPA's that also have climate policy to consider how SMCs would be treated within their frameworks.

bp agrees with the proposal for the regulator to automatically issue the credits based on the emissions reporting under the mechanism. The assurance processes for the emission reporting and other data required to support the issuance will be important and may need to be strengthened.

bp does note there will be limited time between when the emission reporting is complete, and the regulator has done its assurance so that it can issue the SMCs; and then the compliance date 1 March following. Consideration could be given to any additional information (perhaps even interim data) the regulator might be able to provide to the market to facilitate better function.

Intertemporal flexibility

bp supports intertemporal flexibility because this improves the efficiency of the mechanism, allowing not only for efficient emission reduction outcomes between entities but also over time.

bp supports banking of SMCs, including between phases. While we can understand the desire to test settings within a short transition phase (as proposed for phase 1), we do not see merit in limiting banking beyond this phase (banking should be permitted within phase 2 and beyond 2030). Limiting banking to within phases only, risks prices collapsing at the end of the period simply to recover again sharply at the beginning of the next phase. This kind of limit on banking undermines the incentives of the mechanism. It is also not clear how effective it would be since ACCUs can continue to be banked without limit (market will simply swap the non-bankable SMC for bankable ACCU).

bp supports the proposal to provide some limited borrowing and the possibility of multi-year monitoring periods. As discussed in the consultation paper, this allows for smoothing between years without changing the overall emissions outcomes. It gives some flexibility for the entity to align baselines with timing of their own emissions reductions.

Domestic offsets (ACCUs)

bp supports the continued use of ACCUs under the safeguard mechanism as this will allow safeguard entities to access emission reductions outside the scope of the mechanism if these can be achieved at a lower cost. The current review into the ACCUs market will be important to ensure that ACCUs continue to represent genuine emission reductions.

bp agrees it is important for the credibility of the safeguard mechanism and ACCUs that there is no double counting of emissions reductions. As proposed, a simple way to achieve this is to no longer allow for safeguard facilities to generate ACCUs for emissions covered by the baseline.

Further thought is needed to ensure the right incentives and to avoid double counting where abatement at a safeguard entity is provided by a third party. For example, where emissions are captured at the covered at the facility and the storage is provided by a CCS hub.

For those projects already registered for ACCUs, continuing with the existing arrangements that require the ACCUs to be added back to the emissions number for safeguard compliance should avoid double counting. Where those projects are registered, but, yet to issue an ACCU, further consideration could be given to issuance of ACCUs.

bp agrees with the proposal to cease entering new contracts that would allow a safeguard entity to sell ACCUs to the government and have those also count toward their safeguard compliance (deemed surrender). For existing contracts with deemed surrender, care should be taken not to set a bad precedent by retrospectively changing the value of the contract. Those entities will have made investments based on the value of the deemed surrender.

International offsets

bp supports the use of international offsets and the implementation of Article 6 by governments to achieve the goals of the Paris Agreement. The international context will continue to evolve as countries define their implementation of Article 6 and build their capabilities to allow for the trade of offsets backed by an International Traded Mitigation Outcome (ITMO) and required corresponding adjustments.

As these arrangements emerge, bp would support allowing safeguard entities to use international offsets that are consistent with the Paris agreement for compliance under the mechanism. It makes sense to anticipate this future and provide for it in the legislative architecture for the safeguard mechanism. The provisions could then be triggered at the time the eligible international offsets become available.

bp encourages the Government to accept the Climate Change Authorities recommendation to prepare a carbon market strategy that sets out how Australia intends to use international markets to achieve its emission reduction goals. Use under the safeguard mechanisms could be determined inline with that strategy.

Cost containment & price controls

While not discussed in the consultation paper, bp anticipates the potential inclusion of cost containment or price controls may be raised by other stakeholders. In general, bp prefers for the market to drive outcomes and price. If cost containment or price controls are contemplated these should be designed for exceptional circumstances and not in a way that drives the market for extended periods of time.

Tailored treatment for emissions-intensive, trade-exposed businesses

bp acknowledges that in reforming the safeguard, consideration should be given to the risk of 'carbon leakage' to ensure the policy remains effective while other countries may not yet have equivalent policy settings. bp considers, carbon leakage to be where the emission reduction goals of policies in one country are undermined by businesses moving activities and the associated GHG emissions to another country without equivalent GHG policy measures instead of implementing emission reductions. As more countries take on action to reduce their emissions, we expect the risk of carbon leakage to reduce (removing the need for tailored treatment for EITEs).

In designing tailored treatment for EITEs, bp's recomendation is that the tailored treatment:

- focus on reducing the risk of carbon leakage
- maintain incentives for EITEs to reduce emissions
- does not unduly burden non-EITE safeguard entities (prefer any adjustment to effort for EITEs to be recovered from across the economy)
- is fit for purpose, having regard to other settings of the mechanism
- is not static, with regular review in light of international progress.

bp agrees with the consultation paper that the definition of an EITE should reflect the specific design of the safeguard mechanism (which is different to the Renewable Energy Target and previous carbon pricing policies). bp would welcome further engagement on the proposal to adopt a facility specific impact assessment and suggests government work with industry to develop and assess the option in more detail.

bp supports the proposal to provide low emissions funding for EITEs. The scale and form of this funding would need to be commensurate with the task. Australia could look to the types and scale of incentives and other supports available in other countries as a guide. While there may be opportunity to leverage existing pools of funding, as indicated in the discussion paper these are unlikely to perfectly align with objectives of tailored treatment for EITEs (that is to

avoid carbon leakage). bp would support a role for government in facilitating safeguard entities to navigate the various funding pools in support of their emissions reductions.

While not our preference, bp is open to explore possible differentiated decline rates for EITEs. We see this as being akin to support provided to reduce risk of carbon leakage within other countries market mechanisms. Although we note the cost burden in the safeguard is somewhat different since carbon cost is only paid by those entities with emissions above their baseline and then only on above baseline emissions, not on all emissions like in other countries. If this approach is adopted, we suggest the additional effort required from non-EITEs to achieve the same overall emissions outcome be spread across the rest of the economy, not only those non-EITEs within the safeguard. We also note, as is the case in other countries, there will soon enough be a tension between reduced effort from EITEs and overall achievement of emissions reduction targets. Government should provide early indications on how these tensions will be resolved.

bp would encourage the Australian government to consider alternative approaches to addressing the risk of carbon leakage, such as a carbon border adjustment mechanism. While we accept these options might take some time to develop (so may not be available for tailored EITE support initially), we would support immediate efforts to explore how such mechanisms could be designed for Australia. Australia could cooperate with other like-minded countries to advance.

bp does not support the option canvassed in the consultation paper to set aside a proportion of all SMCs so that these can be provided to EITEs. This undermines the incentives to reduce emissions below baselines and effectively means below baseline entities are shouldering the EITE tailored treatment.

Indicative decline rate

As indicated in the consultation paper, the decline rate (aggregate trajectory) will depend on the decisions made on many other aspects of the design.

bp's preference is that the way the decline is applied is simple and predictable and that this is not subject frequent review and adjustment (for example, decline could be set for at least five years without adjustment).

While we are open to options that might see different entities face different trajectories (say because of different starting points), we would prefer more unform approaches (rather than say have different trajectories for different entities based on technology availability).

Preferably decline rates are known well into the future (to send a longer-term investment signal), with at least a clear framework for how these might be adjusted over time known well in advance.

Emissions reporting

While not discussed in the consultation paper, it will be important for the emissions reporting that underpins the mechanism (NGERS) to also remain fit for purpose. Importantly the emissions reporting system needs to keep pace with new emission reduction technologies. For example, many of bp's customers are interested in renewable fuels like renewable diesel

and sustainable aviation fuel but these are currently not reflected in NGERs as they are relatively new biofuels. Since these fuels are "drop in fuels" it is expected they will be distributed using the same infrastructure as their fossil alternatives and often via shared infrastructure with no way of telling the molecules apart. bp would welcome consideration by government on how to ensure the incentives (reported emissions reductions under safeguard mechanism) flow through to the customer who has paid for the renewable fuel.

Closing remarks

bp reaffirms its support for reforms to the safeguard mechanism to provide incentives for large emitters to reduce their emissions in support of Australia's emission reduction targets. We support the goals of the 2015 Paris Agreement on climate change and believe ambitious climate policies, like the safeguard mechanism reforms, will be essential to enable the world and Australia to meet these goals. We look forward to working with the government as the reforms are finalized.