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bp Australia response to the Safeguard Mechanism reform position paper

bp welcomes the opportunity to respond to the Department of Climate Change, Energy, Environment and Water's (DCCEEW) position paper setting out the proposed detailed design of reform to the Safeguard Mechanism. This follows our previous submissions on the discussion paper, draft legislation, and to the senate inquiry.

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), 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 on our aims here.

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

- Reducing our oil and gas production by 25-30% 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 clean hydrogen.
- Switching on 100,000 EV charging points and opening more than 1,000 new strategic convenience sites worldwide.
- Doubling down on five transition growth businesses: bioenergy, convenience, EV charging, renewables, and hydrogen by 2025.
- We remain absolutely committed to our net zero targets.

In Australia, we are developing projects consistent with our global strategy:

- We've recently taken operatorship of the Australian Renewable Energy Hub in the Pilbara, which will provide green electrons and green hydrogen to help decarbonise our local customers and to provide hydrogen for export.
- We're transitioning our Kwinana refinery site into a clean energy hub, in FEED on the Kwinana Renewable Fuels project and exploring hydrogen production as part of H2Kwinana.
- We are also working on another hydrogen project – GERI at Oakajee in the mid-west of Western Australia.
- We own 50% of Lightsource bp with a major renewable generation portfolio here in Australia.

- We're working with partners to explore the possibility of a CCS hub off the coast of Western Australia.
- And are rolling out electric vehicle charge points and exploring options with partners to decarbonise heavy transport, including hydrogen refueling.
- We also have substantial gas interests in Western Australia through Northwest Shelf and Browse and are working on ways to decarbonise these operations.

Some of our assets are, or will be if developed, safeguard entities. Many of our customers are also safeguard entities spanning many sectors like mining, freight and logistics, chemicals, and manufacturing. This means much of our local business will be impacted by the reforms. This provides bp with a unique perspective because while we expect to face declining baselines for our large emitting assets, the reforms will also improve the business case for our Australian based low carbon projects that form part of our global growth strategy.

bp reiterates that we believe market-based policy to be the most effective and efficient way to reduce greenhouse gas emissions. We welcome the position paper and are broadly supportive of the proposed design. We understand the reforms need to be considered as a package given the interconnectedness of different design elements. We believe the proposal can provide material investment signals across a large segment of the economy as one of a broader suite of policies that will be needed.

We set out below some comments on the proposed reform and hope they will be helpful as the reforms are finalized.

Overall ambition and decline rates

We acknowledge the Government's intention to design the reforms so that safeguard entities in aggregate achieve their proportional share of the economy-wide target. We believe this ambition will provide a material incentive for covered entities to reduce emissions.

Our expectation is many safeguard entities will rely on the deployment of technologies such as renewable power at scale, low carbon hydrogen, biofuels and carbon capture and storage to reduce their own emissions. It will be essential the mechanism is designed to provide appropriate incentives for deployment of these technologies at a scale and pace consistent with the overall ambition to net-zero.

We note the aggregate ambition proposed for the safeguard is a significant contribution given many sources of covered emissions are hard to abate and for some facilities available technologies are unlikely to deliver emission reductions in line with the proposed decline rate. The proposed flexible compliance options including the trading of Safeguard mechanism credits (SMCs) and continued access to Australian Carbon Credit Units (ACCUs) will be essential to achieving the proposed ambition.

Baselines

We welcome the proposal to retain production adjusted baselines which will allow baselines to automatically adjust with output. We are comfortable the built in buffer and ability to adjust the baseline trajectory at review points will ensure absolute emissions are reduced over time.

We acknowledge the proposed hybrid baseline approach provides a reasonable compromise, balancing the varied views of stakeholders. We agree the proposal will remove any headroom and allow incentives to flow from the first year.

We note the proposal will mean some facilities face a decline rate that is higher than the average decline of 4.9%, highlighting the importance of many other design elements in ensuring these are manageable, such as crediting and trading of SMCs, continued access to ACCUs, and other flexibility like limited borrowing.

We note the significant amount of policy work still to be completed to allow entities to set their baselines and the very short timeframe before the reforms are intended to take effect. We urge the government to progress at pace work to review the production variables and determine the defaults that will form the basis of the baselines. We recommend the review of production variables should:

- test and ensure incentives flow (for example, provide incentives to deploy Carbon Capture and Storage in setting baselines for reservoir emissions)
- avoid unintended consequences (for example, avoid different incentives for fuel switching for electricity generation depending on whether its own generation or provided by a third party); and
- draw as much as possible on available data.

We encourage the department to continue its close consultation with industry in progressing this work. We note some flexibility might be needed regarding the timeline for setting baselines considering the capacity of industry and their third-party service providers to complete this work, while also engaging in the substantial ongoing policy work.

New facilities

We accept that new investments should be made within the context of Australia's legislated emission reduction targets and be consistent with a global transition net zero. We anticipate investors will increasingly look to future proof their new investments by designing and operating them to minimize emissions and agree that policy should provide incentives to support this. Australia's industry development objectives include a strong focus on establishing new industries and growing its role in manufacturing and value-added products. It is important the safeguard mechanism does not unduly disadvantage or discourage these new entrants or expansions, some of which will be essential to the global transition but may not (at least initially) be emission free.

We acknowledge with an absolute economywide target and set emissions budget new entrants may require incumbent facilities to reduce their emissions faster than they otherwise would. However, policy should encourage adjustments to our economy which might include displacement of higher emitting incumbent facilities with lower emitting new facilities over time.

We are encouraged that government proposes to treat all new entrants the same. We do not accept commentary from others that new entrant fossil fuel facilities should be treated differently from other emitters. For example, bp's energy outlook illustrates the growing demand for critical minerals, other inputs like green steel, and biofuels in support of the transition which may require new facilities under the safeguard mechanism. Similarly, our analysis illustrates the important role that gas will play in supporting the energy transition, not just here in Australia but in supporting emissions reductions of our trading partners. Gas can displace coal, it can provide the firming needed to support greater penetration of renewable electricity, and it can be used to support hard to abate sectors, for example, in the production of low emissions hydrogen. While demand for gas is expected to decline over time, our energy outlook indicates continued investment is needed to meet the continued demand even as the world transition net zero. Policy should focus on providing the right incentives to ensure gas (like other outputs) is produced and used (including in other countries) with lower emissions.

bp is open to exploring the government's proposal to apply the principle of 'global best practice, adjusted for Australian context' when setting the baseline for new facilities. We again urge the government to progress the work needed to develop a workable framework at pace.

We understand the proposal to apply international best practice at existing facilities if they begin producing new products to avoid any competitive disadvantages to green field facilities looking to produce the same product. In principle bp supports this approach, however, further consideration is needed to ensure incentives are not undermined for existing facilities to invest in new plant and equipment to reduce their emissions even where this would move them from one production variable to another.

High integrity compliance options

Access to high integrity but flexible compliance options will be essential for driving the emission reduction incentives under the reformed safeguard mechanism.

Crediting and trading of SMCs

Crediting of emissions performance below the safeguard baseline and the ability to trade those credits is essential to the reformed mechanism in driving incentives to reduce emissions. It encourages entities to reduce their emissions beyond what is required by their baseline if it is cost-effective to do so. This supports efficiency across safeguard entities, with the market determining the lowest cost abatement pathway for the sector as a whole. The integrity of the SMCs is assured by the aggregate ambition and decline of the mechanism, supported by the strong compliance and administrative arrangements proposed. We urge the parliament to pass legislation to give effect to this element of the reforms.

Access to ACCUs

The ongoing access to ACCUs will also be essential, as this provides an opportunity to level the incentives to reduce emissions between the safeguard mechanism and the rest of the economy. Given differences in cost of abatement between different sectors, it is appropriate that some parts of the economy will reduce their emissions faster or slower than the economy wide target. Access to ACCUs allows for emissions reductions to occur where they are most efficient, with aggregate baselines determining the share of the national target that safeguard entities are responsible for (the burden).

It is very important for the integrity of the safeguard mechanism and Australia's national target that ACCUs continue to represent genuine additional abatement. bp is encouraged by the findings and recommendations of the Independent Review of ACCUs and looks forward to working with government in their implementation to ensure the ongoing integrity of ACCUs.

bp reiterates our view that the level of ambition in the proposed reforms is significant and will provide material incentives for emission reductions by safeguard entities, both directly at their facilities as well as in other sectors of the economy via the use of ACCUs.

Cost containment

bp acknowledges the government's proposal to offer ACCUs it has acquired to safeguard entities at the cost containment price. We reiterate our preference is for the market to determine the price and outcomes under the safeguard mechanism; and for any cost containment to be designed for exceptional circumstances and not in a way that drives the market for extended periods of time.

With this in mind, we encourage government to provide greater clarity around how the price for the cost containment was determined. We understand that different safeguard entities will have different abatement cost curves and expectations about incentives needed to achieve net-zero. We do note however that the cost containment price proposed in the initial year, is lower than bp's internal cost of carbon used to support its investment decisions (bp's carbon price assumptions align with a USD100 (real 2022) carbon price in 2030). We also note many other public analyses that indicate a higher price than the cost containment would be needed to support the deployment of abatement technology consistent with a pathway to net-zero by 2050.

We also note the proposed cost containment model will not provide a strict price cap (or cost containment) because it will rely on Government having sufficient volume of ACCUs to meet liable entity demand should market prices move to the cost containment price. As designed, there is a risk the cost containment price instead becomes price setting and drives market outcomes. We understand government has undertaken its own analysis that provides it confidence in the arrangements proposed. Government should give thought to releasing some of its own analysis to better facilitate market expectations and reduce the risk of the cost containment setting the price.

International offsets

bp understands the government does not propose to include international units initially in the safeguard mechanism reforms. bp welcomes the commitment to develop legislation to allow for high integrity international units to be included in the Australian registry and to explore the possibility for the use of international offsets for compliance under the safeguard mechanism in the future. We believe the international trade in mitigation outcomes as allowed under the Paris Agreement has potential to encourage innovation, support increased ambition, and direct finance flows in support of the transition.

Banking, borrowing and muti-year monitoring periods

bp welcomes the proposal to allow for SMCs to be banked at least until 2030. Banking means the value (price) of the SMCs will reflect the future scarcity not just scarcity in the year they are created. It provides an incentive to invest now in those technologies that will take many years to pay off. We anticipate that the review will recognize the importance of banking beyond 2030 to underpin these efficiencies in investments.

bp also welcomes the proposal to allow for limited borrowing. A limited amount of borrowing provides some flexibility and smoothing between compliance years and can increase the overall efficiency of the policy. It reduces the risk that a safeguard entity unexpectedly finds itself in exceedance and is unable to resolve this through the market. It can reduce the risk of SMCs and ACCUs being held back and short-term price spikes in the lead up to the compliance date. Experience in other carbon and environmental markets has demonstrated the importance of borrowing particularly in the early years of a market where liquidity can be greatly influenced by the uncertainty that comes with the new regulations.

Given the relative complexity of the proposed safeguard mechanism design, the limited time between when relevant information about baselines will be available to the market and the compliance date, and the likely immaturity of the market, bp recommends government reconsider applying a penalty or interest to borrowing at least in the initial years of the reforms.

bp also notes the proposal to allow for multi-year monitoring periods (MYMP) for up to five years. We agree the eligibility for these arrangements should be limited to those entities that can demonstrate a firm and credible plan to reduce cumulative emissions before the end of the MYMP. This gives confidence the abatement outcome won't be compromised. We anticipate that some abatement projects will take more than 5 years to plan and execute, with some likely taking more than 5 years to fully implement even once a final investment decision is taken. Some may only be possible toward the end of the decade, with the proposal giving those entities less than 5 years flexibility because of the hard 2030 end date. Further consultation is warranted to ensure the eligibility requirements are practical, to test if five years is adequate given known abatement project timelines, and to test the implications of extending MYMP beyond 2030 to keep flexibility equitable across different facilities.

Trade exposure and carbon leakage

bp reiterates our earlier position that consideration should be given to the risk of 'carbon leakage' to ensure the safeguard mechanism 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 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 policy to address carbon leakage, bp's preference remains that tailored treatment:

- focus on reducing the risk of carbon leakage
- maintains incentives to reduce emissions
- does not unduly burden other safeguard entities
- is fit for purpose, having regard to other settings of the mechanism
- is not static, with regular review.

bp welcomes the proposal to provide dedicated funding under the Powering the Regions fund (PRF), but as we indicated in our submission on the design of the PRF, we believe the scale of funding proposed will be insufficient to achieve the stated objectives. Beyond scale, we are encouraged that further consultation is planned with trade exposed entities on the design of the Safeguard Transformation Stream to ensure it is fit for purpose and distributed effectively.

bp does not support the proposal to provide some trade exposed entities with adjusted baselines decline rates (Trade exposed baseline adjusted facilities, TEBA) for the following reasons:

- it is not equitable, since it treats the cost an entity faces to reduce its emissions to the baseline differently to the costs another entity faces in acquiring an ACCU,
- it undermines incentives to reduce direct emissions, encouraging greater use of ACCUs since an entity can only apply if they are first in exceedance; and
- the number of entities to be eligible can be expected to grow over time as baselines decline and with that, the burden for those safeguard entities that do not qualify, making this approach unsustainable.

bp is encouraged the Government will initiate work this year to explore other policy options to address carbon leakage, including a possible carbon border adjustment. We recommend fast-tracking this work, particularly exploring alternatives to the inadequate TEBA proposal that can be implemented in the short-term.

Emissions reporting

We also reiterate our calls to ensure the emissions reporting that underpins the safeguard mechanism (NGERS) also remains 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. We are encouraged by progress underway to reflect these new biofuels in the determination for the 2023-24 reporting year. However, since these fuels are "drop-in fuels" 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. Urgent work is needed to ensure the incentives (reported emissions reductions under the 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 line with 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.