

Carbon Farming Initiative Review

Submission to the Climate Change Authority in response to the Issues Paper (17 Oct 2014)

Fares Rural Pty Ltd

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Background

Fares Rural Pty Ltd (“Fares Rural”) is a carbon abatement project developer and participant in the Carbon Farming Initiative (“CFI”). Fares Rural both owns and manages permanent carbon sequestration projects (reforestation) operated under two different sequestration methodologies.

Projects are located in South and Western Australia and are established between 2009 and 2013. As such our experience relates to how the CFI operates across two States and interacts with State law.

Fares Rural has close hands-on experience of the operation of the areas of the CFI covering sequestration since the scheme’s development and commencement. Fares Rural has successfully registered projects and generated Australian Carbon Credit Units from these projects. Therefore in making this submission, our comments are drawn from experience in marrying the commercial realities of project development and Scheme compliance.

Key messages

- The CFI has been well run to date, with a high standard of integrity for sequestration projects.
- Streamlining is welcome, but not at the expense of abatement integrity.
- The proposed “Once-Only” contract rule under the ERF is illogical and would seriously curtail new investment in any projects partially relying on revenue from abatement.
- For the CFI to meet its objectives, and for Australia to transition to a cleaner economy, it is essential that the value of abatement per tonne of CO₂-e is not slashed as a result of changes to the way the CFI is run.

Q.1. To what extent has the CFI met the objects of its Act over its first two years of operation?

A. The role of a carbon market and the need for the CFI.

The modest level of implementation of reforestation projects to date reflects the market conditions resulting from political uncertainty, despite a very good CFI scheme being in existence. It is the view of Fares Rural that if there was greater certainty around the medium to long term economic value of carbon abatement projects then a much greater level of investment would be made in new projects. Reviewing the effectiveness of the CFI in isolation from broader Government policy on carbon pricing is a weakness of the review and excludes important considerations.

Fares Rural's reforestation projects provide an example of how the CFI can meet the objectives of its Act. Fares Rural's reforestation projects are integrated into the agricultural landscape and provide many benefits to landowners and society in addition to the removal of carbon dioxide from the atmosphere. Without the CFI and subsequent markets for the resulting credits, none of the plantings would have been instigated.

B. Scheme Operation

Fares Rural believes that the CFI is a comprehensive and, in the main, well designed scheme which provides a sound mechanism for the generation of verified abatement actions.

The CFI is professionally managed by the Clean Energy Regulator, and the processes employed are fair, predictable and well organised.

The integrity of the offsets generated through sequestration methodologies is very high. There is no doubt that all the claimed carbon abatement by Fares Rural represents real and direct carbon dioxide removal from the atmosphere. This is in fact underestimated by virtue of various conservative aspects of the methodologies.

By way of criticism, the strict and complex compliance and auditing requirements of the CFI process have the effect of deterring potential project proponents. The combination of market uncertainty and high compliance requirements bars small projects from participating. This in turn means that they do not benefit from the incentives available to help get their projects off the ground.

We note that, while we are very confident of the very high standards of integrity of the reported abatement from forestry projects applying the current CFI sequestration methodologies, we cannot comment on other types of activities which are covered by the CFI.

Q.2. Will the recent and proposed changes to the CFI's governance arrangements improve the performance of the scheme? What other changes should be made and why?

A. Impact on abatement integrity

We are concerned about the governance system allowing inclusion of new activity-wide methodologies from new sectors if these are so generic that non-genuine abatement is able to be credited.

While we acknowledge that the DOIC was slow and overly particular, there was no doubt that the integrity of abatement claimed in the resulting sequestration methodologies was very high.

We are concerned that allowing ministerial endorsement of methodologies outside of the advice of the ERAC will open the possibility of results that are in individual's interests, rather than the National interest, such as through the use of lobbyists by vested sectorial bodies. In particular the use of baselines, how baselines are calculated, and any potential gaming that might arise all have the potential to undermine the credibility of the Carbon Farming Initiative.

The integrity and value of the CFI as a whole will be lost if the bar for participation is reduced too low. Oversupply of easily-generated credits has had devastating effects on the schemes in Europe and New Zealand. The result is

- Drastic loss of value per unit in the market;
- Resulting loss of investment in genuine offsets activities and technologies;
- Lack of transition of the economy to a future with lower emissions; and
- Increased compliance cost for businesses, but with no real benefit to the atmosphere.

To help prevent non-genuine abatement being credited, we believe that a mechanism for addressing weaknesses in methodologies which become apparent in time should be built into the governance system.

Recommendation:

A review process of methodologies, on a three-yearly cycle for example, would provide a mechanism for protecting the integrity of the scheme as a whole.

In the taxation system, rules are constantly evolved in a fair and predictable manner to simultaneously streamline compliance requirements and close loopholes that become apparent with the passage of time. A similar approach should continue to be used for methodologies under the CFI, that is, that they have the ability to evolve in a predictable and fair way.

B. Methodology development process

The current system of methodology development, based on initiation by private Project Proponents and review by DOIC, resulted in the very rigorous sequestration methodologies which are currently in use. We note that these were expensive for Project Proponents and took much longer to gain approval for than would normally be expected, due to the convoluted relationship between the Domestic Offset Integrity Committee and the then Department of Climate Change.

As an example, the Reforestation & Afforestation Methodologies have very exacting and voluminous reporting requirements which are often disproportionate to the real level of risk.

The proposed new system of methodology development results in Government-based Technical Working Groups developing methodologies which have far lower reporting and verification requirements (see the minimal reporting and verification standards required in the new Avoided Clearing of Native Regrowth draft methodology, for example).

It is important that a mechanism still exists for changes to be made to the older existing methodologies otherwise the projects operating under these are effectively penalised by a higher verification and reporting standard.

Recommendation:

Through the proposed changes to the CFI, ensure that a mechanism is retained where existing methodologies can be varied and evolved at the instigation of project proponents and with review by the ERAC. This may be through the retention of the “variation” system in the current CFI.

It will be important to continue to allow Project Proponents, as opposed to the Technical Working Group, to instigate changes. The ability for Project Proponents to instigate changes to methodologies has been removed in the proposed amendments in the Bill (i.e. by omitting Section 105 of the current Act). We believe this mechanism should be re-instated.

Alternatively, there should be an ability for Project Proponents to formally ask the Technical Working Groups to consider variations to existing methodologies developed under the current governance system, with its associated higher reporting and verification standards.

Similarly, there should be a mechanism available for project proponents to put forward variations to existing methodologies that streamline the administrative burden to reduce compliance costs (both in measurement and verification) that still maintain the integrity of the methodologies.

Q.3. Does the CFI (with the proposed changes) strike the right balance in managing risks? How could it be improved?

Currently, the CFI is very risk averse with an almost zero-risk approach in sequestration projects.

A. Reduced audit requirement sensible

Fares Rural believes that the proposed changes to auditing frequency, on a risk-based approach, as opposed to at every offsets report, are very sensible. The cost of current audit requirements is significant in sequestration projects, and immediately eliminates the viability of small projects. Under the new proposed audit regime, there remains strong incentive to submit truthful and accurate information.

B. Streamlining methodology development

In a general sense, we encourage some streamlining in the approach to development of methodologies but are concerned about the possibility of a significant lowering of the standard and a subsequent increase in the crediting of non-genuine abatement. These only serve to reduce the value of genuine abatement and undermine the scheme as a whole.

We would propose that the streamlining take a risk/scale approach. That is, if the project is small scale then a lower level of verification, reporting and audit be required (similar to personal tax returns). If the projects are generating large levels of abatement, then a higher level of assurance be required to mitigate any risks about integrity and impact.

Q.4. Do the CFI governance and other arrangements (with proposed changes) strike a good balance between the quality and quantity of emissions reductions achieved? How could they be improved?

A. Proposed “Once-only” contract rule

A major problem with the proposed Emissions Reduction Fund is the issue that “Once a project has been successful at auction, it will not be able to seek additional funding through a future auction” (page 17 of Issues Paper).

There is no justification for this proposal and it would have a significant negative impact on the economics of investment in carbon abatement projects.

This is a particularly difficult issue for sequestration projects based on reforestation which have an economic life of 25 years or more and are upfront capital intensive.

Other than the ERF, there is no clear alternative market for Kyoto-compliant credits. The inability to secure future revenues drastically reduces the ability of sequestration projects to recover the costs involved in implementing the initial planting of the forest.

This would clearly limit any new investment in reforestation activities.

We cannot see a reason why it is necessary to limit participation in future auctions. With reforestation being an activity which meets the objectives of the CFI so well, through directly removing carbon dioxide from the atmosphere, as well as providing other important benefits to the landscape, the rationale behind this rule is not clear.

This is a severe and unfair rule which will have a resounding impact on investment in carbon abatement in Australia, if implemented, and will limit the ability of the CFI and the ERF to achieve real benefits for the Australian community.

B. Kyoto versus Non-Kyoto ACCUs

Under the current CFI arrangements, Kyoto-ACCUs ultimately contribute to meeting Australia's greenhouse gas reduction target. Non-Kyoto ACCUs can also be generated through the CFI, but do not contribute to Australia's greenhouse gas targets, are less valuable, and used in alternative markets.

The distinction between Kyoto and Non-Kyoto ACCUs has been removed in the proposed amendments Bill.

It is important that only Kyoto-compliant offsets are purchased through the ERF, since (i) it would be wasteful to spend money on emissions reductions activities that don't contribute to Australia's targets (ii) the inclusion of a wider range of non-Kyoto activities would reduce the value of credits for all projects, thus reducing the viability of the scheme as a whole.

C. Other points

- We believe that some limited discretion on behalf of the Regulator would be a valuable addition to methodologies and the overall governance of the scheme.
- The risk of reversal buffer remains a very good mechanism within the scheme for sequestration projects. However, we believe that the level of 5% is too high considering the real incidence of fire and other reversal is much lower than 5% in practice. For example, research into fire frequency in low rainfall regions of rural Australia where most of the reforestation projects are located demonstrate that fire frequency reflects a 1% risk of reversal. Therefore, a loss of 5% of gross revenue through the current risk of reversal buffer represents an overinsurance.

We therefore recommend that the buffer be reduced to a level that is evidenced by data.

Q.5. Are the interactions between the CFI and other policies managed efficiently? How could interactions be improved?

We do not see the need for the current overlapping requirements for regulatory approvals, which are already required by other laws and regulations, to be checked by the regulator of the CFI scheme. It is in the project proponent's interests to ensure that the project is operated under all relevant laws and other requirements.

In the case of sequestration activities based on reforestation, there should be no hesitation in allowing a worthy project to benefit from multiple funding sources, unless they are already specifically fully funded by another public funding source. In most cases, the re-establishment of biodiverse forests throughout Australia is an expensive process which usually relies on sharing of the burden of funding widely.

Even in the case of Fares Rural's commercial reforestation projects, landowners agree to participate based on the desire to increase the forest cover on their farms as much as for financial reasons.

Reforestation is a useful and worthy activity which benefits Australia as a whole in addition to removing carbon dioxide from the atmosphere. Multiple sources of funding and benefits only help to bring these projects to fruition.

For example, securing funding for plantings that deliver environmental benefits such as catchment enhancement, salinity mitigation, landscape repair and biodiversity gains should be seen as complimentary and assist in realising what would otherwise be economically unviable projects.

Q.6. Does the operation and design of the CFI encourage 'graduation' of activities to more appropriate policy treatment if they are no longer additional? How could it be improved?

No comment. Not relevant to reforestation.

Q.7. What emissions reduction opportunities are best suited to the CFI and proposed ERF, and what is the scale of these opportunities? What implications if any does this have for their role in Australia's suite of emissions reduction measures?

A. Scale of Opportunity

In practical terms, the Carbon Farming Initiative is a series of administrative mechanisms that enable project based abatement in the landscape to be registered and carbon reductions measured and verified.

In terms of its potential to generate credits, it is instructive to examine the suite of projects that have been accredited to date under the CFI and the volume of ACCUs produced from these activities. We note that it is not possible to properly analyse the function of the CFI in the absence of understanding the impact on markets and investment of the uncertainty around Federal Carbon Policy. The CFI in itself does not create a market or provide any stimulus for investment.

Projects established to date have been solely funded by private sector capital and almost all projects are put at risk by the cessation of the Carbon Pricing Mechanism and the uncertainties created by the proposed ERF. Price, term and volume remain unknown and the combination of these factors jeopardise the economics of any future project.

Existing projects operation under the CFI will continue under the ERF as project proponents recover revenues on an opportunistic basis. Investors will be wary in participating in this market going forward until a substantial period of certainty has occurred.

Therefore analysing the scale of these opportunities remains a largely academic exercise and is not grounded in immediate market realities.

B. International Credit Types

We caution against the use of emissions reduction units from overseas. If allowed, it is very important that a mechanism is used which does not reduce the value of Australian-generated credits.

If the price of Australian-generated credits drops too low then nobody wins: It indicates that there is no real abatement of carbon dioxide occurring; there is no gradual change of practices to allow a shift to more efficient low carbon economy, and; a lot of compliance activity remains with little real long term benefit to the atmosphere.

With the current changes to the CFI and introduction of the ERF, we believe it is important to maintain the high standards of integrity which have characterised the CFI to date.

It is instructive to observe the perverse outcomes of the New Zealand ETS whereby liable parties could retire cheap Kyoto credits at a substantial discount to the price of NZUs and in turn sell freely allocated NZUs into the market converting a carbon liability into a profit centre.

Any approach that contemplates the use of international credits should function independently of the domestic market and ensure that domestic projects are quarantined from the externalities of offshore markets.