Policy and Law Reform

Environment Defenders Office

The Carbon Farming Initiative — will it work for you?

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Introduction

The Federal Government has recently introduced legislation for the Carbon Farming Initiative (**CFI**) into Parliament: the Carbon Credits (Carbon Farming Initiative) Bill 2011 (**CFI Bill**). The CFI is an offset scheme aimed at reducing the agricultural sector's carbon footprint. The Government hopes to have the scheme up and running by July 2011.

There are two reasons you should care about the CFI. First, because the Multi-Party Climate Change Committee (**MPCCC**) has indicated that the CFI will be the only climate change law applying to emissions from the agricultural and forestry sectors, as they will be excluded from the forthcoming carbon price being separately proposed by the Government. The CFI will therefore be crucial to unlocking the enormous potential for greenhouse gas abatement in these sectors. Second, because if you own or manage rural land, you might be able to claim CFI credits for greenhouse gas abatement and make a profit.

The Environment Defenders Office (Victoria) Ltd (**EDO**) has prepared this issues paper to help you understand this proposed law, to help you work out how it could be improved, and to assist you in advocating for those improvements. Please call our office if you would like further information or assistance in this regard.

About the CFI

What is the CFI?

The CFI is a voluntary carbon offset scheme for the agriculture, land and forestry sectors. Landholders will be able to earn 'offset credits' by conducting eligible offset activities. Those credits can then be sold on domestic and international carbon markets.

Who may participate?

To participate in the CFI, a project proponent must first be accredited as a 'recognised offsets entity'. The recognised offsets entity might be the owner of the land, the manager of the land, or a company specialising in offset projects — whoever can demonstrate that they have responsibility for the offsets project and the right to the carbon abatement generated by it. The Consultation Paper envisages that landowners could transfer their carbon rights to 'offset aggregators' — companies which finance and manage a number of eligible offsets activities at one time.

What activities are eligible?

At present, there is no set list of what types of activities are eligible. A type of offset activity (for example, reforestation) becomes eligible under the CFI when a methodology for that activity is made by the Minister and endorsed by the Domestic Offsets Integrity Committee (**DOIC**). The DOIC is a committee of scientists, policymakers and lawyers appointed by the Government. Anyone can submit a methodology for approval, but the Department of Climate Change and Energy Efficiency (**DCCEE**) is currently developing some key methodologies. These include soil carbon sequestration, biochar, reforestation, forest management, avoided deforestation, savannah fire management, landfill gas recovery, manure management, and management of methane emissions from livestock.

What environmental safeguards apply?

Each individual project needs to be approved as an 'eligible offsets project' by the Carbon Credits Administrator (**the Administrator**), who is responsible for administering the CFI. The Administrator may only approve an eligible offset project if it meets the requirements in cl 27 of the Bill, including:

- **Additionality** — the greenhouse gas abatement must be new and additional to activity which would have occurred anyway (s 27(4)(d)). This is determined by a 'positive list' of projects created under cl 41 of the Bill;
- **Native forests** — the project does not involve the clearing or harvesting of native forest, or use material obtained as a result of such clearing or harvesting (s 27(4)(j));
- **Excluded projects** — the Minister may declare that certain types of projects are ineligible, if there is a significant risk that they will have a significant adverse impact on water availability, biodiversity conservation, employment, or the local community (ss 27(4)(m), 56);
- **Regulatory approval** — all regulatory approvals (e.g. planning approvals, environmental approvals) have been obtained for the project.

Similar safeguards are included in other parts of the Act:

- **Measurability** —the greenhouse gas abatement achieved by the project must be capable of measurement and verification (cl 133(1)(b));
- **Scientific credibility** — the methodologies should be consistent with relevant scientific results published in peer-reviewed scientific literature (cl 133(1)(d));
- **Permanence** — greenhouse gas sequestered in carbon sinks must not be released at a later date, once credits have been issued (cll 16, 17, 90, 91, Pt 8).

How does one get credits?

Once an eligible offsets project has been approved, the project proponent must prepare and submit offset reports to the Carbon Credits Administrator at set intervals, which can be between one and five years. Australian Carbon Credit Units (ACCUs) will be issued based on that report. Those ACCUs can then be sold on international and domestic carbon markets.

How to strengthen the scheme

The Australian Network of Environment Defenders Offices (ANEDO) has already made a submission on the CFI2[1], and will be making a submission to the upcoming Parliamentary Inquiries into the CFI Bill. In summary, our key concerns and recommendations for the CFI Bill are:

1. Using a carbon offsets trading scheme for the land sector is problematic
2. To be successful, the CFI needs to be complemented by a strong carbon price.
3. The additionality test must be strengthened.
4. The provisions to ensure that offset projects are scientifically credible must be strengthened.
5. The provisions to prevent negative environmental side-effects must be strengthened.
6. Greater priority must be given to offset projects that improve biodiversity (through a fund, for example).
7. Crediting periods should be shortened to three years, to allow initial mistakes in the scheme to be corrected.

These seven recommendations are expanded upon below.

1. Using a carbon offsets trading scheme for the land sector is problematic

The Government's decision to implement a carbon offset trading scheme to drive abatement in the land sector (rather than a carbon price, or a carbon abatement fund, or direct regulation) raises some inherent problems.

First, on their own, carbon offsets schemes are unable to guarantee net emissions reductions. This is because they work on a project-by-project basis, rather than an economy-wide basis. A well-designed offset scheme can guarantee that an offset has succeeded in reducing greenhouse gas at that location, but it cannot guarantee that abatement is not cancelled out by an increase in emissions elsewhere. This is the problem of 'carbon leakage'. If, for example, a farmer reduces their emissions by reducing the number of cattle they keep, there is nothing to say that other farmers will not increase the number of cattle they keep to make up for that shortfall in supply. The Bill recognises this problem in requiring methodologies to account for increases in carbon caused by the project[2]. But in practice, it is difficult if not impossible to identify such increases. Only an economy-wide cap or price on carbon can ensure that emissions reductions are not negated by increases elsewhere.

Second, carbon offsets schemes can be unfair. To begin with, they reward people who take abatement action for the first time, rather than 'early movers' who are already reducing greenhouse gas. A good offsets scheme necessarily involves an 'additionality' requirement (see below). But that requirement means that people who are already undertaking abatement projects are unable to demonstrate that their actions are new or additional, and are ineligible for credits. Moreover, offset schemes often involve paying people not to pollute. Giving credits for avoided emissions activities (like avoided deforestation, for example) effectively involves paying people not to pollute. This violates the 'polluter pays' principle. It is also unsound regulatory practice — this is not the way that governments usually prevent pollution, and for good reason.

Third, a poorly designed offset scheme will spread its problems far and wide if tradable credits are used. Every time an ACCU is created and sold to a polluting company, that company has an excuse not to reduce their emissions. This becomes hugely problematic if ACCUs do not represent real and genuine abatement. If an ACCU is issued for an offsets project that is scientifically unsound, or is reversed, then the polluting company who purchases that ACCU is nonetheless entitled to increase their emissions. In this way, the CFI will effectively 'export' any deficiencies into other trading schemes, including a domestic carbon price.

1. The full list of submissions is on the DCCEE website: http://www.climatechange.gov.au/government/submissions/carbon-farming-initiative.aspx.
2. Carbon Credits (Carbon Farming Initiative) Bill 2011 cl 133(1)(e)

For these reasons, a carbon offset trading scheme is a relatively unattractive option for the land sector. That is particularly true if the Government does not have any other laws in place to drive abatement in the sector (which is currently the case). By comparison, some of these weaknesses can be avoided by imposing negative incentives on carbon pollution in this sector, or by establishing a fund (like the Climate Change and Ecosystem Protection Fund recently proposed by the Australian Conservation Foundation (**ACF**)) for abatement activities.

However, this debate may very well be moot, as the Government appears determined to pass the CFI into law, and is likely to be able to get it passed through Parliament. The rest of this paper therefore focuses on ways to improve the CFI.

2. To be successful, the CFI must be complemented by a strong carbon price

A domestic compliance market for carbon credits (i.e. an Australian emissions trading scheme) is likely to be a major source of demand for ACCUs. Without a strong carbon price the price of ACCUs is likely to be quite low, and it is unlikely that farmers will use the CFI. The stronger the carbon price, the higher the price of ACCUs — this is so under the initial fixed-price phase, and after the transition to full emissions trading. The fourth Update Paper published by the Garnaut Climate Change Review, *Transforming Rural Land Use*, also makes this point, stating that unless the initial carbon price is quite high, primary producers will not have sufficient incentive to take up abatement projects under the CFI.

Encouraging the use of ACCUs in a carbon trading scheme does pose a risk if too many ACCUs are generated. This would reduce the actual emissions reductions required under the carbon price, and reduce the revenue derived from the scheme. However, this risk could be resolved by putting a cap on the amount of ACCUs (and other offsets) that can be used in the carbon price scheme that the MPCCC is currently developing — a measure also recommended by the Garnaut Review.

Suggested solutions:

- the carbon price should start high to stimulate demand for ACCUs;
- the use of ACCUs and other offsets under the carbon price law should be capped;
- to combat 'leakage', the government must explore other ways of imposing a price on carbon pollution in this sector.

3. The additionality test must be strengthened

Additionality is one of the most important integrity standards in the CFI. Without it, ACCUs will be rewarded for abatement that was already going to happen. This causes two problems:

- the CFI fails to create new greenhouse gas abatement, and gives away ACCUs for nothing;
- those ACCUs are sold to polluters who can justify a failure to reduce their emissions, raising the risk that the ACCUs will lead to a net increase in emissions.

It is therefore very concerning that the additionality test in the Bill does not, in fact, guarantee additionality. Section 41 allows the Minister to add abatement activities which are not already common practice in a region to a 'positive list'. All projects which involve those activities are therefore deemed to be 'additional'. The problem with this approach is that additionality cannot be worked out in advance. Whether a project is additional — that is, whether it was already going to happen without the CFI — is a question of fact to be determined on a case-by-case basis. The 'positive list' approach makes it very likely, if not certain, that projects which are not additional will receive credits.

The Government chose this 'streamlined' additionality test out of concern that assessing additionality on a case-by-case basis would cost project applicants too much time and money, and deter participation in the CFI. It is indeed important to encourage participation in the CFI by keeping transaction costs low. However, it is possible to introduce a case-by-case additionality test without inhibiting participation in the scheme. For example, project proponents could be required to self-assess additionality (by signing a statutory declaration, exposing them to criminal penalties if they lie) and the DCCEE could audit every 20th project to ensure compliance.

Finally, the unfairness to 'early movers' who are already conducting abatement activities that the additionality test causes (discussed above) could be ameliorated by other incentives or payments to these early movers. The Government should

consider establishing a fund to pay these early movers for the biodiversity and carbon reduction benefits that they are already delivering, and finance the continuation of these projects. This will remove any perverse incentives to abandon these activities that might otherwise arise.

Suggested solutions:

- additionality should be assessed on a case-by-case basis, according to a simple test of 'would the abatement have occurred in the absence of the CFI';
- if that test turns out to inhibit participation, the Government could adopt 'light-touch' assessment methods;
- positive incentives (for example, a fund) should be provided to 'early movers' to ensure fairness and remove perverse incentives to cease existing abatement projects.

4. Eligible offset activities must be scientifically credible

As recognised by the Garnaut Climate Change Review, many of the proposed eligible offset activities listed in the Consultation Paper are scientifically untested and largely theoretical. For example, soil carbon sequestration — which is scientifically unproven and highly variable in its capacity to sequester carbon — is proposed to be included in the scheme. This is a big problem, because if ACCUs do not represent genuine abatement, the polluters who buy them will nonetheless be able to justify increasing their own emissions.

The decision as to which offset activities are eligible under the CFI lies with the Minister. Under section 106, the Minister must follow the advice of the DOIC and must ensure that the methodology for an eligible offset activity is consistent with the offset integrity standards. Those standards provide that the methodology 'should be supported by relevant scientific results published in peer-reviewed literature', and that 'estimates, projections or assumptions' must be conservatively made.

Suggested solution: These standards could be improved by providing that:

- a methodology, and the activity supported by the methodology, must be supported by peer-reviewed scientific literature before a methodology determination can be made;
- the decision to approve an eligible offset activity as scientifically credible must also be conservatively made; and
- failure to satisfy one or both of those requirements will render a methodology invalid.

5. It is still possible for eligible offset projects to have a negative environmental impact

The Bill already includes a number of measures designed to ensure that eligible offsets projects do not have negative impacts on the local environment:

- eligible offset projects must not involve native forest clearing, or use material obtained from it (s 27(4)(j));
- the Minister can exclude certain types of projects from the scheme, if there is a significant risk that those projects will have a significant adverse impact on water availability, biodiversity conservation, employment, or the local community (s 56); and
- a project's consistency with the relevant regional natural resource management plan must be stated in the application for a project (s 23(1)(g)) and the public register of eligible offsets projects (s 168(1)).

These measures are a step in the right direction, but they are not enough. Native forests have been adequately protected, but other negative impacts could still be allowed under the Bill. A more general safeguard is required.

Suggested solution: to ensure that offsets projects have positive environmental impacts:

- eligible offsets projects must not be approved unless they are 'environmentally sustainable' or have a 'net positive environmental impact';
- the Government should consider introducing a 'Carbon Abatement and Biodiversity Code' to guide the application of that test, and maximise both carbon reduction and biodiversity outcomes.

6. Offset projects that enhance biodiversity need to be prioritised

There are lots of potential offsets projects that can reduce carbon and improve biodiversity outcomes at the same time. However, at present the Bill does not give clear priority to supporting these projects, as compared to offsets projects that have a neutral or negative impact on biodiversity.

Some provisions have already been made in this regard. The Government has promised to develop a co-benefits index to measure these positive biodiversity and community benefits, and project proponents will be able to include details of these on the public register of offset projects. This information might allow ACCUs for these projects to be sold at a premium. However, further action is required to ensure that projects which enhance biodiversity are 'first cab off the rank'.

Suggested solution: establish a fund to provide additional funding to projects which improve biodiversity — for example, the Climate Change and Ecosystem Protection Fund proposed by the Australian Conservation Foundation.

7. Longer crediting periods 'lock in' mistakes, and undermine the 2014 review

After consulting with stakeholders on the Consultation Paper and the draft legislation, the Government amended the Bill to extend crediting periods from three to seven years. Even longer crediting periods can be provided by regulation (for example, the government intends a crediting period of 15 years for reforestation). This is important because during a crediting period, the methodology and risk of reversal buffer for an offsets project can't be changed. In other words, the amount of credits per unit of carbon abatement which is awarded is fixed for seven years. If new scientific evidence comes to light, or the risk of reversal (due to natural disasters, for example) changes during that time, no changes to the credits for these projects can be made. This ties the hands of the Government, despite the considerable uncertainty surrounding the CFI market. The Government has committed to reviewing the CFI in 2014 to take account of the uncertainty that the scheme is likely to involve. But by lengthening these crediting periods, the Government is tying its hands and limiting its ability to respond to the review.

Suggested solution: maintain crediting periods at three years, as originally proposed.

How you can get involved

The DCCEE has been working on the design of the CFI since the August 2010 federal election, when Labor promised to introduce the initiative. The formal consultation process for the CFI has come to an end, and the Government has introduced the Bill into Parliament. The EDO understands that the Government hopes to have the CFI in place by July 2011.

However, changes to the Bill may still be made. The Government does not have a majority in either house of Parliament, and the Bill faces an uncertain political future. Members of Parliament may be receptive to arguments and submissions made in the coming weeks.

You can make a submission to the Inquiry being conducted by the Senate Standing Committee on Environment and Communications Legislation, details of which can be found on the Senate website. Submissions are due by **Friday 8 AprIL 2011**.

You can also make a submission to the Inquiry being conducted by the House of Representatives' Climate Change, Environment and the Arts Committee, details of which can be found on their website. Submissions are due by **Wednesday 13 April 2011**.

Ask us for advice or assistance

TThe EDO can provide legal assistance to groups and individuals with public interest environmental law issues. Our lawyers may be able to help you to engage in the development of the CFI and understand the CFI better through phone advice or a workshop in your local area. If you would like assistance please contact us and we will let you know whether we can help.

Call us on **(03) 8341 3100 (metropolitan)** or **1300 336 842 (regional)**.

About the Environment Defenders Office (Victoria) Ltd

The Environment Defenders Office (Victoria) Ltd ('EDO') is a Community Legal Centre specialising in public interest environment law. We support, empower and advocate for individuals and groups in Victoria who want to use the law and legal system to protect the environment. We are dedicated to a community that values and protects a healthy environment and support this vision through the provision of information, advocacy and advice.

In addition to Victorian-based activities, the EDO is a member of a national network of EDOs working collectively to protect Australia's environment through public interest planning and environmental law.

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While all care has been taken in preparing this publication, it is not a substitute for legal advice in individual cases. For any specific questions, seek legal advice.

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