

18 January 2008

Garnaut Review Secretariat  
Level 2, 1 Treasury Place  
East Melbourne VIC 3002

Dear Sir/Madam,

**Submission to Garnaut Climate Change Review Issues Paper 1**

**Climate Change: Land use – Agriculture and Forestry**

The submission attached has been written in response to the request for comment on the document “Climate Change: Land Use – Agriculture and Forestry” issued by the Garnaut Climate Change Review.

JF Infrastructure Pty Limited is a Sydney-based infrastructure funds management business, which represents predominantly institutional investors such as the Australian Industry Super funds in direct investment in three main areas of infrastructure investment – Economic, Social and Environmental Infrastructure.

Within the environmental investment area, JF Infrastructure currently is the Investment Manager to the Australian and New Zealand Sustainable Forestry Investors (ASFI/NZSFI) which are unlisted wholesale investment funds focused on timberland assets.

ASFI/NZFI’s core investment thesis which was designed over 4 years ago is to generate:

1. financial returns through acquiring land holdings and interests in land in Australia and New Zealand to derive value from the underlying timberland assets; and
2. enhanced returns by implementing value-adding strategies through carbon credit sales, adapting the land for renewable energy (e.g. wind farm rentals, sale of forest residue for bio-energy etc), bio-diversity, conservation and salinity credits.

For the Investor’s portfolio diversification benefits are generated:

1. by the inclusion of timberland assets to optimise risk adjusted portfolio returns, and
2. as a hedge for the portfolio against the introduction of a transparent price signal for CO<sub>2</sub> emissions having a negative impact upon the portfolio’s investments, particularly in the listed equities allocation as global economies move toward being increasingly carbon constrained..

JF Infrastructure was established by the James Fielding Group in 2003 to originate and establish a suite of infrastructure funds and mandates and to manage those on behalf of institutional investors. JF Infrastructure’s CEO, Alan O’Sullivan, and then James Fielding Group CEO, Greg Paramor (now Mirvac Group Managing Director), founded JF Infrastructure to capture the synergies between the property sector and the infrastructure sector. JF Infrastructure today has a professional staff of 16 with combined experience of over 125 years in infrastructure, funds management, capital markets and property matters and expertise in all aspects of infrastructure. JFI is now an independent 50/50 joint venture company involving the Mirvac Group (Mircvac) and Leighton Holdings Limited

(Leighton). Because of this strategic relationship, JFI has access to a suite of both Mirvac and Leighton projects, resources and competencies.

Mirvac is a leading ASX-listed, integrated real estate group with more than \$22.2 billion of activities under control across the real estate, funds management and hotel management spectrum.

Leighton is the parent company of Australia's largest project development and construction contracting group.

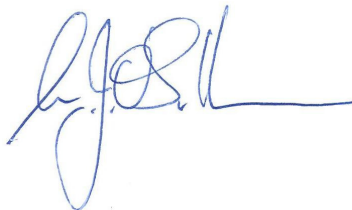
JF Infrastructure is planning the launch of new environmental investment products in addition to ASFI/NZSFI which will focus on renewable energy, water and waste management to the wholesale institutional markets in 2008.

Accordingly JF Infrastructure supports the development of market based policies, such as an Australian Emissions Trading Scheme, to ensure transparent pricing of environmental externalities and welcomes the opportunity to participate in consultation on the design of such policy.

We strongly believe that the sequestration of carbon in forests is an important component in enabling Australia to achieve emission reduction targets, and that the scheme design should encourage investment in this sector to the greatest extent. We would be happy to provide additional feedback on any of the elements in this submission.

Yours faithfully,

**JF Infrastructure Pty Limited**



Michael O'Sullivan  
Investment Manager – Environmental

### **Issue 3.1 – Adaptation in the Agriculture and Forestry Sector**

#### Questions for Consideration

How might these adaptation challenges be addressed?

Given JF Infrastructure's (hereafter JFI) experience in developing an institutional investment product that addresses the challenges and opportunities associated with LULUCF which is primarily a climate change mitigation measure, JFI intends to only address the issues raised in respect of mitigation.

What other factors affect the implementation of adaptation measure in the agriculture and forestry sectors?

JFI intends to only address the issues raised in respect of mitigation.

How should responsibilities be shared in dealing with adaptation?

JFI intends to only address the issues raised in respect of mitigation.

### **Issue 3.2 – Mitigation options for Agriculture and Forestry Sector**

#### **The Mitigation Challenge**

#### Questions for Consideration

What potential is there for mitigation in the agricultural sector in the short term? What practical options for mitigation are likely to become commercially viable in the near future?

JFI believes that;

- abatement through the creation of a bio-sequestration offset regime, for both bio-mass and soil CO<sub>2</sub> storage, modification of feedstock to reduce enteric fermentation, improved fertiliser management etc, will provide significant short and longer-term potential for mitigation in the agriculture and forestry sector. As an active participant in the field of institutional investment in carbon sinks, JFI believes that practical mitigation options in respect of forestry in particular have already been developed and tested by the early movers. These early movers including JFI have utilised the *Greenhouse Gas Benchmark Rule (Carbon Sequestration) No. 5 of 2003* precedent ruleset which has been successfully applied by the NSW Greenhouse Gas Abatement Scheme (NSW GGAS) since 1 January 2003; and
- allowing the resultant offset instruments to be included in a national Emissions Trading Scheme with appropriate incentives for early offset/abatement prior to scheme commencement will provide significant short and longer-term potential for mitigation in the agriculture and forestry sector; and

- the creation of international linkage mechanisms to allow exchange of tradeable instruments to meet demand within the broader Kyoto community will provide significant short and longer-term potential for mitigation in the agriculture and forestry sector.

What incentives, policy innovations and/or market-based mechanisms would guarantee an optimal contribution to the national mitigation effort?

JFI believes that;

- a carbon price signal is essential to the national mitigation effort and that the most efficient way to do this is via an Emissions Trading Scheme. An Emissions Trading Scheme is particularly relevant to the agriculture and forestry sector, where this transparent price signal can effect behavioural changes on both the demand and supply sides;
- Australia must set a long term emissions reduction target and provide industry with certainty to facilitate a smooth transition to achieving that target in the shorter term with the setting of a shorter term goal.

What is the best way to deal with trade exposure if policy measures are implemented to reduce emissions from the agriculture and forestry sectors?

JFI believes that on the basis that agriculture and forestry is included in any future Emissions Trading Scheme then transitional arrangements for the emissions intensive sub-sectors, which would be expected to be most severely affected by a transparent carbon price, should be considered. These arrangements would be broadly consistent with those applied to all industry sectors and consist of free permit allocations and a “safety valve” mechanism through the pre-determined transition period and be designed to create an incentive for players to move to world best production practises.

## **Mitigation Policy Options**

### Questions for Consideration

Accepting existing practical limitations, is direct inclusion in an ETS the most appropriate mechanism for encouraging mitigation in the agriculture and forestry sectors?

JFI believes that since both agriculture and forestry have significant potential to contribute to achieving any emissions targets set in both the short and long-term participation in an Emissions Trading Scheme to create offsets will ensure behavioural changes on both the demand and supply sides.

Scale will be critical and potentially the limiting factor where the potential cost of compliance will exceed any benefit derived from the abatement activity for smaller scheme participants. However, if the Emissions Trading Scheme is designed to allow smaller scheme participants to participate by voluntarily electing to participate and/or through aggregation then JFI believes that direct inclusion in an Emissions Trading Scheme is not,

as an initial measure, the most appropriate mechanism for encouraging mitigation in the agriculture and forestry sectors.

What policy mechanisms would be more appropriate for these sectors? How would these measures interact with an ETS covering other emitting sectors?

JFI believes that direct inclusion in an Emissions Trading Scheme is the most appropriate policy measure.

What would be the economic impacts on the agriculture and forestry sectors of a domestic ETS covering stationary energy and transport?

JFI believes that the economic impact of agriculture and forestry's exclusion from an Emissions Trading Scheme covering stationary energy and transport would be:

- increased (predominately energy/fuel related) operating costs which to the extent possible would be passed along the supply chain through to the ultimate consumer; and
- the market value of agricultural land would not incorporate the CO<sub>2</sub> sink potential and be distorted in favour of emissions sources.

## **Providing Opportunities**

Questions for Consideration

What are the opportunities available to the agriculture and forestry sectors as a result of mitigation policies?

JFI believes that due to the significant CO<sub>2</sub> sequestration potential of forestry, the substantial land mass available for plantation forestry in Australia and the sophisticated legal and financial frameworks already in place there is significant opportunity for Australia to lead in the evolving arena of plantation forestry as an environmental service provider.

How should uptake of these opportunities be maximised?

JFI believes that development of;

- a robust ruleset that encourages transparency and certainty to therefore encourage investment in new projects; and
  - linkage mechanisms for abatement/offset instruments in International markets
- are key components to ensure maximisation of the mitigation effort.

Do these opportunities create perverse outcomes and, if so, how should these be managed?

JFI believes that the policy implementation through application of specific rulesets rather than the policy itself could have the potential to create perverse outcomes. For example the application of compliance, additionality and permanence/liability rules if not designed appropriately could encourage sub-optimal market behaviour.

### ***Issue 3.3 - Practical Considerations for Including Agriculture and Forestry in an Emissions Trading Scheme***

#### **Point of Obligation**

##### Questions for Consideration

Do the economic efficiency gains from including small emitters in an ETS justify the costs of compliance?

JFI believes that an Emissions Trading Scheme should be designed to allow emitters to voluntarily elect to participate through offset projects thus encouraging self-determination of the most cost-effective means of achieving compliance.

How could transaction costs be minimised?

JFI believes that if the scheme were to allow voluntary participation through offset projects then a part of the market's response would be to determine the least cost approach.

What should be the point of obligation for agriculture and forestry industries in an ETS?

JFI believes that the point of obligation should be as early as is practicable in the supply chain and in the case of agriculture and forestry the obligation should be with the landowner.

Should a threshold for liability be applied, and how should it be defined?

JFI believes that if emitters were allowed to voluntarily elect to participate through offset projects then the market would find the natural threshold for liability which could reasonably be expected to vary over time.

## **Monitoring and Verification of Emissions and Mitigation**

### Questions for Consideration

What 'proxies' would be appropriate for the estimation of emissions in the agriculture and forestry sub-sectors?

JFI acknowledges that additional work needs to be undertaken to develop satisfactory emissions estimation techniques that are superior to the current livestock number and productivity in the agriculture sector.

JFI believes that CO<sub>2</sub> sequestration estimation techniques for forest sinks are well developed, and there is considerable technical expertise in this field in Australia. The cost associated with employing these techniques is considerable however and the use of proxies may be appropriate in developing systems that encourage participation of smaller sinks for which there is minimal detailed data. Crediting based on these systems would need to recognise the inherently greater uncertainty associated with estimates of carbon sequestration.

What systems are available that would allow for efficient and accurate monitoring of emissions at the operator level?

JFI believes that an approach that allows participants to select the most appropriate procedure for the level of participant's technical expertise, available data and type of facility/project provided the procedure were approved by the Scheme.

What are the implications if the stringency of monitoring, reporting and verification requirements vary between sectors and sub-sectors?

JFI believes that the design of monitoring, reporting and verification systems should accommodate differences in uncertainty associated with the estimation methodology, conservatism of estimates, and the consequences of errors in estimation inherent to the type of facility/project.

## **Sub-Sectoral Coverage**

### Questions for Consideration

Should all agriculture and forestry sub-sectors be included in an ETS? What sub-sectors might be better suited for inclusion?

JFI believes that the agriculture and forestry sectors should ultimately be included as covered sectors but in order allow reasonable development of the necessary systems transitional arrangement whereby offset project to participate is preferred.. This would allow flexibility to potentially include a wide range of eligible project types determined by the market to encourage technical and financial innovation across the sector.

**How should economic distortions within the sectors be dealt with?**

JFI believes that potential economic distortions should be dealt with through a robust process of scheme design.

Possible distortions include:

- disproportionate effects on eligible and ineligible stands;

Adoption of a project start date for eligible projects will disproportionately disadvantage the owners of plantations planted before the start date, providing the perverse incentive to move operations to new land at the end of the current rotation. Therefore, the eligibility rules should allow for greater inclusion of forests, in accordance with the Kyoto Protocol definitions ie pre- & post-1990.

JFI believes the NZ approach to forestry whereby an emissions liability is imposed at harvest for stands planted prior to 1990 is appropriate. This harvested land cannot otherwise be included in a carbon aggregation pool according to the Kyoto Protocol definitions, and thus if the scheme is designed to impose such a liability then adequate initial compensation to landowners for the reduction in land value must be considered in the design.

- disproportionate value effects on land used for sources relative to land used for sinks

JFI believes that the value of agricultural land should be allowed to find a market equilibrium that reflects the potential uses of land and the emissions and abatement activity associated with the potential uses.

## **Phasing and Timing**

### Questions for Consideration

If a domestic ETS excludes agriculture and forestry initially, but includes them at a later point in time:

- ◆ What are the advantages/disadvantages of involving these sectors in the scheme through the inclusion of offsets, or an 'opting in' baseline and credit trading scheme?
- ◆ What sort of transitional arrangements should be incorporated in the initial design?

JFI does not support the development of a separate baseline-credit scheme with a different accounting ruleset to the formal Emissions Trading Scheme. We believe this would create a second-tier credit that would most likely be of substantially reduced quality, thereby not providing adequate incentive for market participation. The temporary crediting of Clean Development Mechanism forestry projects is such an example.

JFI believes that voluntary participation in the provision of offsets to the scheme is a key part in facilitating a transition to ultimately becoming covered sectors under the scheme at some future point in time.

## **Issue 3.4 - Recognition of Carbon Sinks and Offsets**

### **Prior Mitigation Action**

#### **Offsets and International Frameworks**

Questions for consideration

What types of carbon sink and mitigation measures should be included as offsets or within an ETS? Are there practical and cost effective monitoring solutions available for these measures?

JFI believes that scheme design should allow for as wide a range of offset project types as possible, to encourage innovation and provide the opportunity for least cost abatement. Administrative arrangements, methodologies and systems are well developed for reforestation projects (e.g. arrangements under the NSW GGAS), but there has been less emphasis on project relating to management of existing forests which also contribute to the mitigation effort.

How should positive incentives to reduce emissions or perverse incentives to increase emissions prior to inclusion in an ETS be managed?

JFI believes that perverse incentives will arise in the period between scheme announcement and scheme implementation and that an abatement start date needs to be declared, however this is less of an issue in the forestry sector since forestry offset projects involve CO<sub>2</sub> sequestration as opposed to avoided emissions.

Should offset regimes recognised under an Australian ETS be limited to those that satisfy international carbon accounting protocols?

JFI supports consistency of Australian offset regimes with international protocols subject to the overriding principle of ensuring equivalence of forestry offsets with other project type abatement credits.

JFI supports the inclusion of stored CO<sub>2</sub> of harvested wood products into estimation and accounting systems, but recognises that considerable development of the mechanisms for its application is still required.

JFI believes that the design of an Australian emissions trading scheme should be cognisant of the very high level of complexity, cost and frustration associated with accreditation of projects under the Clean Development Mechanism, and therefore should where possible apply lessons learnt in achieving a simpler system with lower transaction and compliance costs.