

**Submission to
Garnaut Climate Change Review
Issues Paper 6
Emissions Trading Scheme Discussion Paper**

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Submission

Garnaut Climate Change Review Issues Paper 6 Emissions Trading Scheme Discussion Paper.

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Introduction

This submission has been written in response to the request for comment on Issues Paper 6 released as part of the Garnaut Climate Change Review.

New Forests Pty Limited is a Sydney-based forestry asset management and advisory services business. We support investment by institutional investors (e.g. super funds, pension funds, insurance companies, foundations) in the forestry sector and manage those investments on behalf of our clients. We have a specialized business which focuses on forestry investments that are exposed to environmental markets and can deliver additional returns from carbon credits, biodiversity conservation, renewable energy development and other environmental attributes.

Investors are increasingly interested in finding investments that will contribute to solutions to climate change, land and water degradation and biodiversity conservation. Forestry investments can be unique in contributing to all three of these challenges. Our role is to source investments and manage those investments to generate returns to the investors from these emerging opportunities.

Accordingly, New Forests supports the development of an Australian Emissions Trading Scheme and welcomes the opportunity to participate in consultation on the design of the scheme. We 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.

Submission outline

Given that New Forests operates primarily within the forestry sector, this submission is focussed on issues relating to forestry. In particular, our discussion of the forestry sector is limited to the growing and management of forests (plantations and native forests) and excludes issues relating to the timber and paper processing sub-sector.

Given the broad scope of the Discussion Paper this submission does not include detailed comments on the technical issues of carbon accounting for forestry projects (some of which were covered in an earlier submission on Issues Paper 1). The comments within are grouped under 5 headings:

- Separation of agriculture and forestry sectors
- Treatment of sub-sectors within forestry
- Coverage versus offsets
- Reforestation offset projects
- Permit design

Separation of agriculture and forestry sectors

The discussion paper repeatedly refers to the Agriculture and Forestry sectors as if they are effectively a single unit, and are afforded similar treatment under the scheme design. New Forests believes that while there are some similarities between the sectors, such as a large number of (relatively) small-scale participants, there are significant differences between the activity types within the two sectors that require differential treatment in order to achieve appropriate outcomes.

First and foremost activity within the forestry sector (including native forest and plantations) results in significant net sequestration of carbon from the atmosphere, producing renewable products with low embodied energy. In contrast activity within the agriculture sector is primarily a source of emissions.

Secondly, while the claim is generally made that there are substantial unresolved issues relating to estimation of abatement within the agriculture sector (and we agree with this claim), there are parts of the forestry sector (discussed further below) where there are existing methodologies that can be immediately implemented within the Australian ETS. There is considerable expertise within Australia and internationally in relation to quantification and verification of carbon sequestration in reforestation projects.

To link the implementation of agriculture and forestry sectors within the Australian ETS will delay the inclusion of reforestation projects, and therefore reduce the mitigation potential of this activity type.

Treatment of sub-sectors within forestry

Much of the argument presented above for separating the treatment of agriculture and forestry sectors is also relevant when considering treatment of individual components of the forestry sector. There are existing methodologies for quantification and verification of sequestration in plantations whereas there are not similarly well developed and tested methodologies for the native forest sector. There is therefore an opportunity to include the plantation sector in the Australian ETS at the commencement of the scheme, whereas it is unlikely that methodological issues can be resolved in time to include the native forest sector at the same time.

Further, the fact that the Australian Government has elected not to include forest management (Article 3.4) in meeting its commitments under the Kyoto Protocol for the first commitment period would suggest that inclusion of the native forest sector into the Australian ETS prior to 2013 would raise an issue of conflict.

New Forests believes that any delay in inclusion of reforestation projects into the ETS will adversely impact on the many project proponents who are developing (or have already developed) forestry projects in anticipation of the introduction of the ETS. Given the timeframe between project development and actual abatement (which happens over the 10 to 20 years after establishment) a delay in providing certainty in rulesets for inclusion of reforestation projects will also reduce further investment in these project types and therefore reduce the mitigation benefit that forestry can provide in the short to medium term.

Coverage versus offsets

The discussion paper indicates that ETS design will ensure that coverage is as broad as possible. New Forests believes that the forest sector should not be covered under the ETS (at least in the short to medium term), but should instead be able to participate in the ETS through the provision of offset credits.

The main argument against coverage relates to the distribution of forest ownership across many small and medium sized businesses (as well as a limited number of large organisations). In particular:

- The small to medium growers do not necessarily have the financial and/or technical resources to participate in an ETS in a cost effective manner. Transaction costs for small

growers are likely to be disproportionately high. Methodologies and systems are not yet sufficiently developed enough to reduce the transaction costs to an acceptable level for small and medium sized forest growers.

- Small to medium growers will be disadvantaged with respect of risk management arrangements associated with the sale of carbon credits (in particular the risk from fire) due to the limited scale and geographic diversity of their operations. These growers will also be limited in their ability to enter into agreements that force an obligation over periods that span many decades.
- In many cases, particularly where plantations were established 10 to 15 years ago, there may be little additional sequestration benefit from which to generate revenue once potential liabilities from harvesting events are taken into account (depending on the treatment of carbon sequestered prior to scheme commencement), yet full coverage of the sector will impose a periodic compliance cost on these growers.

Based on these arguments, New Forests believes that forest growers should have the ability to elect whether or not to participate, based on their ability to resource the development of systems to enable accreditation, meet ongoing costs of compliance, and manage the additional risks associated with obligations arising from sale of carbon credits.

Reforestation offset projects

New Forests has a number of comments in relation to the inclusion of reforestation projects within the ETS as providers of offset credits.

The discussion paper considers the use of the National Carbon Accounting Toolbox (NCAT) in estimating carbon sequestration within forests. New Forests has significant expertise in quantifying carbon sequestration in reforestation projects, and we believe that it is not appropriate to mandate the use of the NCAT for forestry projects for the following reasons:

- While the toolbox is an excellent tool for national level accounting, our experience indicates that model outputs from the toolbox are highly sensitive to the assumptions that are made in parameterising the model, yet there are limited data to support this parameterisation process.
- The flexibility of NCAT creates the opportunity for users to manipulate the model (inadvertently or otherwise) to produce outputs that are not realistic, while its complexity increases the difficulty in auditing the model results.
- Our experience is that the model is overly conservative, and its mandatory use will therefore reduce the benefit that participants may be able to achieve with more realistic (and potentially simpler) carbon accounting models. Participants should therefore have the ability to elect whether to use the NCAT or an alternative approach (that may require scheme approval).

With respect of eligible start date for forestry offset projects New Forests believes that the ETS should use a start date of 1 January 1990. This is based on:

- This date is consistent with Kyoto Protocol, and the proposed New Zealand ETS rules.
- The use of a 3 June 2007 start date will significantly disadvantage early movers in this sector, and will provide an incentive for deforestation of existing plantations.
- The start date should be selected to provide incentive for the ongoing management of existing forest land in subsequent rotations under forestry. An early start date will increase the likelihood that the existing plantation estate will be replanted after harvest, thereby maintaining the abatement that has already occurred.

The nature of the detailed ruleset for inclusion of forestry projects will have a significant impact on the extent of investment in this sector, and therefore on the abatement that is achieved. In particular, many of the rules associated with the Greenhouse Friendly Program are overly

restrictive and discourage participation. These were discussed in an earlier submission to the Garnaut Review (February 2008) and a separate submission to the Department of the Prime Minister and Cabinet (December 2007), and include:

- The periodic review of project eligibility (including baseline assessment) and potential revision of ruleset to be applied at the time of project review. Forestry investments are inherently made on a long-term timeframe and will require greater certainty in relation to long-term eligibility than is provided by the GFP rules. The current GFP requirement for periodic review of project eligibility is not consistent with Principle 3 (credibility) as stated in the Discussion Paper.
- New Forests believes that offset providers should have a legal liability to the scheme administrator (to ensure compliance) and that buyers of offset credits should have no legal liability or obligation to maintain carbon stocks over the long term.
- The rules for eligibility of forest sink projects under Article 3.3 of the Kyoto Protocol, as implemented by the NSW Greenhouse Gas Abatement Scheme, are clear and unambiguous. In contrast, the Greenhouse Friendly rules for financial additionality are much more difficult to prove, and will require a body of determinations and precedents to be established. They introduce a degree of subjectivity into the process, and could result in identical plantations having different eligibility status under the emissions trading scheme.

New Forests believes that proponents of forestry offset projects should be required to calculate only the net change in carbon stocks – i.e. they should consider only CO₂ rather than including emissions of all greenhouse gases. The reasons for this are:

- The emissions/removals profile of forestry sequestration projects is dominated by the sequestration of atmospheric CO₂, with relatively minor contribution of emissions of non-CO₂ gases.
- The ETS will include coverage of the transport sector, so the emissions associated with fuel use (the majority of non CO₂ emissions from forestry projects) will already be included in the national accounts. To include them again within the forestry project will result in double counting. This is the logic behind the decision to not include non-CO₂ gases in forestry projects in the NZ ETS.
- The estimation of non CO₂ emissions will significantly increase the complexity of abatement calculations, due primarily to the difficulty in estimating leakage. The avoided methane emissions arising from conversion of grazing land to forests would greatly increase the project benefit, but could present the risk of double counting between sectors. The exclusion of non-CO₂ gases from the estimation of abatement within forestry projects will generally result in a conservative assessment of abatement.

Permit design

A major consideration for forest owners when deciding whether or not to participate in the ETS will relate to management of long term obligations and liabilities. One mechanism to mitigate risk associated with long term liabilities is the retention of a buffer of credits by the project proponent to meet unexpected (or planned) future reductions in carbon stock. In order for this to be possible unlimited banking of offset credits would need to be allowed.