



Australian Government
**Department of Climate Change
and Energy Efficiency**

DESIGN OF THE CARBON FARMING INITIATIVE

CONSULTATION PAPER

thinkchange



Published by the Department of Climate Change and Energy Efficiency

www.climatechange.gov.au

© Commonwealth of Australia 2010

This work is copyright.

Apart from any use as permitted under the Copyright Act 1968, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Commonwealth Copyright Administration, Attorney General's Department, National Circuit, Barton ACT 2600 or posted at www.ag.gov.au/cca

This document is made available to seek feedback on the Carbon Farming Initiative. Material in this document should not be taken to indicate the Commonwealth's commitment to a particular policy or course of action.

The Commonwealth does not make any representations or warranties that it will implement any or all of the options, preferred positions or dispositions set out in this document. Material in this document is made available for general information only and on the understanding that the Commonwealth is not providing professional advice. Different solutions and outcomes may apply in individual circumstances. Before relying on any material contained in this document, readers should obtain professional advice suitable to their particular circumstances. While reasonable efforts have been made to ensure the accuracy, completeness and reliability of the material contained in this document, to the extent permitted by law, the Commonwealth provides no express or implied warranties and makes no representations that the information contained in this document is accurate, complete or reliable, and expressly disclaims liability for any loss, however caused and whether due to negligence or otherwise, arising directly or indirectly from the use of, inferences drawn, deductions made, or acts done in reliance on, this document or the information contained in it, by any person.

INFORMATION FOR RESPONDENTS

This paper is a first step in a dialogue with stakeholders about the Carbon Farming Initiative. Further information about the Carbon Farming Initiative will be made available as the consultation progresses to address issues raised.

Key Dates

22 November 2010	Consultation paper available on the Commonwealth Department of Climate Change and Energy Efficiency Website
4 February 2011	Submissions on consultation paper due

Submission Guidelines

These guidelines outline the requirements for submissions on this consultation paper:

1. Submissions are invited from all interested stakeholders;
2. Where possible submissions should be lodged electronically to the email address below, preferably using the template provided on the Department of Climate Change and Energy Efficiency website in Microsoft Word or other text based formats. Alternatively, submissions may be sent to the postal address below to arrive by the due date;
3. **Submissions will not be treated as confidential** and may be made publicly available. If a submission (or extracts of a submission) is to be kept confidential, please indicate this in the submission; and
4. All submissions are due **close of business 4 February 2011**. The Government may not be able to consider late submissions.

Submissions should be sent to:

Email:	CFI@climatechange.gov.au
Address:	Emerging Policy Section, Land Division Department of Climate Change and Energy Efficiency GPO Box 854 CANBERRA ACT 2601

Contact details

Copies of this paper and submission template are available on the Department's website at <http://www.climatechange.gov.au/government/submissions.aspx>

Hard copies are available on request via telephone: 02 6159 7294 or email CFI@climatechange.gov.au.



Contents

1. Introduction	5
2. Background to crediting schemes	5
3. Scheme design principles	6
4. Coverage.....	6
5. Demand for Carbon Farming Initiative credits	7
6. Regional communities, water, biodiversity	8
7. Integrity standards.....	9
7.1 Additionality	10
7.2 Permanence	11
7.3 Leakage.....	14
8. Scheme processes.....	15
9. Methodology approval	20

1. Introduction

On 14 August 2010, the Prime Minister announced an election commitment to establish the Carbon Farming Initiative (CFI) to give farmers, forest growers and landholders access to domestic voluntary and international carbon markets. This will begin to unlock the abatement opportunities in the land sector which currently make up 23 percent of Australia's emissions.

The Carbon Farming Initiative will include:

- A carbon crediting mechanism ('the scheme');
- Funding to fast track the development of methodologies for offset projects, including on-farm demonstration of biochar; and
- Information and tools to help farmers and landholders benefit from carbon markets.

The Australian Government will develop legislation for the scheme to provide long-term certainty to participants. To underpin the environmental integrity and market value of carbon credits, abatement will need to meet internationally consistent integrity standards.

The Government recognises the importance of certainty regarding the rules for crediting and selling carbon offsets and is working towards scheme commencement on 1 July 2011.

This consultation paper is the first step in a dialogue with stakeholders about the CFI. It describes and seeks stakeholder feedback on a range of options in relation to the design of the scheme. A number of the concepts outlined in the paper are based on the reforestation and offset provisions included in the Carbon Pollution Reduction Scheme (CPRS) Bill (2010), and reflect the outcomes of previous consultation with industry stakeholders, scientists, state and territory officials, Aboriginal and Torres Strait Islander and environmental groups, and other members of the public.

Information about methodology development will be made available on the Department of Climate Change and Energy Efficiency web site.

Information and tools to help farmers benefit from carbon markets will be available on the Department of Agriculture, Forestry and Fisheries website.

For those unfamiliar with greenhouse gas abatement and crediting schemes please read **Appendix A** which includes examples of what this might mean for farmers and landholders. Further information on the options to implement the CFI and what it might mean for farmers and landholders will be provided during the consultation process to clarify the issues and address queries raised by stakeholders.

2. Background to crediting schemes

There are a number of offset standards and offsets crediting mechanisms currently in operation including the Clean Development Mechanism under the Kyoto Protocol, the Voluntary Carbon Standard, the Chicago Climate Exchange, the New South Wales and Australian Capital Territory Greenhouse Gas Reduction Scheme (GGAS), the offset component of the Regional Greenhouse Gas Initiative (which operates in 10 northeast and mid-Atlantic states in the United States) and the Alberta Offset System.



The proposals outlined in this consultation paper build on Australia's decade-long practical experience in implementing offsets programs such as the Greenhouse Friendly and GGAS, as well as the forestry and offsets components of the CPRS. The Government recognises, however, that only the Alberta Offsets Scheme covers a broad range of agricultural offsets and that many of the issues unique to the sector have yet to be fully explored.

3. Scheme design principles

The principles that will guide design of the scheme are:

- Ensuring environmental integrity – credits that represent genuine and additional emissions abatement will have a higher market value and help address climate change; and
- Enabling broad participation – clear and simple rules will keep administrative costs low and ensure that farmers and Aboriginal and Torres Strait Islander and other land owners and managers can benefit from the scheme.

4. Coverage

The scheme could enable crediting of land sector abatement, whether or not it is recognised towards Australia's international emissions reduction targets.

Potential eligible abatement activities include:

- Reforestation and revegetation;
- Reduced methane emissions from livestock;
- Reduced fertiliser emissions;
- Manure management;
- Reduced emissions or increased sequestration in agricultural soils (soil carbon);
- Savanna fire management;
- Avoided deforestation;
- Burning of stubble/crop residue;
- Reduced emissions from rice cultivation; and
- Reduced emissions from landfill waste deposited before 1 July 2011.

The scheme will deliver on the election commitment, as well as provide a source of domestic offsets under the National Carbon Offset Standard (NCOS). The NCOS was designed to complement the CPRS and establish rules for companies to become carbon neutral or to sell carbon neutral products. It provided for domestic offsets to be generated from abatement that is not counted towards Australia's Kyoto Protocol target. Rather than establishing separate administrative arrangements to enable crediting for this 'non-Kyoto' abatement, this abatement will be credited under the scheme.



Credits representing non-Kyoto abatement (non-Kyoto CFI credits) would, however, need to be distinguished from CFI credits that are issued for Kyoto-recognised abatement (Kyoto CFI credits), so they may be readily identified by compliance and voluntary market buyers.¹

The demand and therefore the price of Kyoto CFI credits is likely to be higher than for non-Kyoto CFI credits, which could only be traded in voluntary markets.

A significant advantage of administering all eligible domestic abatement under the same scheme is that farmers will be able to bring forward projects, without having to first determine whether or not the abatement is recognised towards Australia's Kyoto Protocol target. This would be determined by the scheme administrator, with the assistance of the Department of Climate Change and Energy Efficiency. A 'one-stop shop' approach would also reduce overall administrative costs for scheme participants and the Government.

Stakeholders are invited to comment on the coverage of the Carbon Farming Initiative, and in particular the proposal to administer NCOS eligible domestic offsets under the Carbon Farming Initiative.

5. Demand for Carbon Farming Initiative credits

Demand for Carbon Farming Initiative credits is expected to come from both international and voluntary markets. The tax treatment of CFI credits is explained at **Appendix B**.

International

The international buyers for CFI credits may include governments that have obligations under the Kyoto Protocol, companies with emissions obligations under national or regional emissions trading schemes, such as the European Union Emissions Trading Scheme, and organisations voluntarily offsetting their emissions.

Specially marked "Kyoto" CFI credits would be issued for abatement that is recognised under Australia's Kyoto Protocol target. Credits for abatement that occurs prior to the end of the first Kyoto Protocol commitment period (2008-2012) could be exchanged for Kyoto Protocol units held by the Government – either Assigned Amount Units or Emissions Reduction Units – and could be exported to other Kyoto Protocol registries. The Government would make the necessary arrangements to facilitate the continued export of CFI credits as arrangements for the post-2012 period become more certain.

Carbon Farming Initiative credits could also be sold directly into international voluntary markets. This can be achieved by cancelling units in Australia's registry on behalf of international buyers. The Government could also explore options for linking the Australian National Registry of Emissions Units to other voluntary registries to enable direct international transfers of CFI credits.

¹ The term "CFI credits" refers to all CFI credits, whether or not they represent abatement that is recognised under the Kyoto Protocol.

Domestic

Domestic buyers of CFI credits could include companies that may have offsetting obligations under state government regulations, and organisations, companies and individuals voluntarily offsetting their emissions, for example to achieve carbon neutrality.

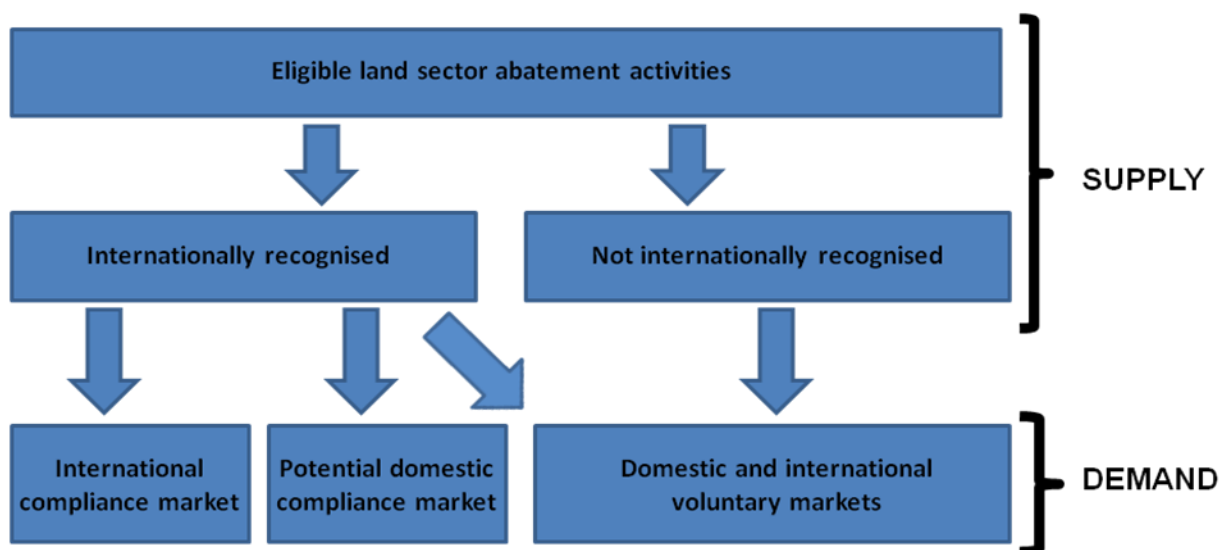
All CFI credits would be recognised as eligible under the NCOS for use by Australian businesses seeking to voluntarily offset their emissions or become carbon neutral. The NCOS will be amended to this effect in the context of its first review which is to commence in late 2010.

The Government would ensure that CFI credits that are voluntarily surrendered are not double counted (once towards Australia's international target and again by the offset buyer) by cancelling an equivalent number of Australian Assigned Amount Units in the Commonwealth's holding account.

Whether or not CFI credits can be used to meet carbon liabilities under a domestic carbon pricing mechanism is a matter for future Government decision-making, following consideration of a carbon price by the Multi-Party Climate Change Committee.

The diagram below illustrates the markets for the different CFI credits.

Diagram 1: Markets for Carbon Farming Initiative credits



6. Regional communities, water, biodiversity

Many land sector abatement activities are expected to produce benefits for farm productivity, biodiversity and natural resource management. For example, environmental plantings can connect existing areas of habitat, help manage salinity and improve water quality; and increasing soil carbon can improve farm productivity.

Some stakeholders, however, are concerned about the possible adverse impact of abatement projects for water and food production. For economic reasons reforestation is more likely to occur on marginal than on productive agricultural land, for example to manage salinity, provide shelter for animals or wind breaks against erosion. This is because, generally, ongoing returns for agricultural production would be significantly higher than once-off returns for increasing carbon storage.

To address community concerns about the potential impacts of carbon offset projects, the Government is considering requiring projects to have obtained all regulatory approvals and met regulatory requirements from all levels of government before they receive final approval under the scheme. This would promote compliance with Commonwealth, state and local government planning, environmental and water requirements, and give buyers confidence in the environmental integrity of the scheme.

A further option is to require project proponents to consider relevant regional natural resource management plans. Whilst not all regional plans are at the same level of development, such a requirement could provide a vehicle for regional communities to discuss and make decisions about land use planning and priorities. This requirement could help to improve alignment with other natural resource management policies and programs such as the Green Corridors Plan election commitment and investments under Caring for Our Country.

Finally, the scheme could prevent approval of abatement projects that involve, or make use of material derived from, the destruction of native forests, for example projects involving the conversion of native forests into biochar. Projects that involve uses of native forests that are consistent with keeping the forests healthy and intact, for example harvesting bush foods and selective thinning, would be permitted.

The Government could monitor the implications of the scheme for regional communities and will introduce further restrictions on abatement projects as necessary, including additional water requirements, if there is evidence that projects are likely to have a material and adverse impact on the allocation of prime agricultural land, water availability or biodiversity. The scheme will be reviewed regularly, with the first review planned for 2014.

Stakeholders are invited to comment on this approach to addressing potential risks in relation to prime agricultural land, water availability and biodiversity, and to suggest alternative options.

7. Integrity standards

The environmental integrity of the scheme will directly affect consumer confidence and the amount that buyers are willing to pay for Carbon Farming Initiative credits.

For these reasons, it is important to ensure that all abatement credited under the Carbon Farming Initiative meets internationally recognised standards, which are designed to ensure that abatement is real and verifiable. Under the NCOS, only offset credits that meet these standards are recognised as suitable for the purpose of carbon neutrality. They include:

- **Additional** – a project must result in abatement that would not have occurred in the absence of the scheme. There would be no reduction in emissions as a result of the Carbon Farming Initiative if the project activity would have occurred in the normal course of business.
- **Permanent** – permanence is an important characteristic of any offset project that involves the removal of carbon from the atmosphere and its long-term storage in plants, soil or other carbon sinks. There would be no real abatement if carbon



were to be stored and subsequently released to the atmosphere. For practical purposes, biological carbon stores would be generally considered permanent if they were maintained (on a net basis) for at least 100 years.

- **Avoidance of leakage** – the project must not cause material increases in emissions elsewhere, which nullify or replace the abatement that would otherwise result from the project.
- **Measurable and verifiable** – emissions abatement must be able to be accurately measured or estimated to ensure each offset credit represents one tonne of carbon dioxide equivalent (CO₂-e) of emissions reduction or removal. Measurement and monitoring systems must be consistent over time and enable abatement estimates to be audited. Projects should be verified by an independent, qualified third party.
- **Conservative** – conservative assumptions, numerical values and procedures should be used to ensure that abatement and other claims are not over-estimated. Every CFI credit must be equivalent to at least one tonne of carbon dioxide abatement.
- **Internationally consistent** – estimation methods must be consistent with (not necessarily the same as) the National Greenhouse Accounts, where relevant, and internationally agreed methodologies and reporting practices adopted by the United Nations Framework Convention on Climate Change.
- **Supported by peer-reviewed science** – scientific evidence must be peer-reviewed, or if based on peer-reviewed science there must be independent and expert opinion validating the application of the approach or model in the relevant circumstances. Peer-reviewed science is scientific evidence that has been subject to independent review and critique by scientific peers prior to publication in scientific journals.

These standards would be reflected in the scheme legislation. The legislation would require decision-making by the scheme administrator (the ‘administrator’) and advice from the Domestic Offsets Integrity Committee, the independent expert panel that would assess methodologies for use under the scheme, to be in accordance with these standards (see section 9).

7.1 Additionality

Assessing whether abatement is additional to business as usual – whether the project would have occurred in the absence of the scheme – can be time consuming, costly and subjective.

To reduce participation costs whilst maintaining environmental integrity, the scheme could provide for streamlined assessment of additionality in the manner outlined below. Further, the Government has provided funding to develop methodologies as part of the Carbon Farming Initiative. This will include development of approaches to baseline setting that will make it easier for project proponents to demonstrate that their projects are additional.

Activities which achieve abatement and clearly do not result in material increases in agricultural productivity or business profitability would be identified in the regulations through a ‘positive’ list that would be deemed additional without further assessment.



Activities that could be included on such a list include not-for harvest, carbon sink forests, on-farm tree planting or capture and flaring of methane from livestock manure or landfill facilities.

Landscape conservation or restoration that has been funded under previous or existing government programs and secured, for example with a covenant or contract, could not be considered additional even if environmental covenants or contracts protecting these areas are removed or cancelled. Similarly, activities that require ongoing funding, such as feral camel management and savanna fire management, would likely be considered once government funding ceases.

If an activity is on a positive list or depends on revenue from the sale of credits, participation in future government conservation and natural resource management programs including grants, covenanting and stewardship programs would not, of itself, result in ineligibility for participation in the Carbon Farming Initiative.

The majority of agricultural activities increase productivity. Approaches to assessing additionality, which are consistent with integrity principles outlined in section 7, will be explored as part of the program of work to develop offset methodologies for use under the Carbon Farming Initiative.

Activities that are mandated under Commonwealth, state, territory or local government regulations could not be approved as these form part of business-as-usual.

Stakeholders are invited to comment on this approach to assessing additionality and whether alternative approaches should be considered.

7.2 Permanence

Carbon that is removed from the atmosphere and stored in the landscape can be re-released to the atmosphere, reversing the abatement benefit. Biological carbon stores are generally considered permanent if they are held for at least 100 years.

The risk of reversal is unique to sequestration activities and needs to be addressed to ensure the value of credits issued for these projects. On the other hand, the Government recognises the difficulties involved in making very long-lasting decisions about land use and the value of preserving future land use flexibility. The Government is therefore considering the following approach to permanence:

- a) scheme participants would be able to withdraw voluntarily from the scheme and associated permanence obligations at any time as long as they relinquish credits already received for abatement;
- b) a risk of reversal buffer to insure the scheme as a whole against re-release of carbon that is not otherwise covered by compliance and penalty provisions;
- c) an obligation to relinquish credits if carbon stores are destroyed and not re-established; and



- d) a carbon maintenance obligation that would require future landowners to maintain carbon stocks if the project is not properly transferred and the proponent becomes insolvent, goes into receivership or dies.

Further, proponents of projects involving environmental plantings that provide important biodiversity benefits could seek to protect these through conservation covenants or by transferring these plantings to conservation organisations or governments, for example for inclusion in the National Reserve System. Participation in conservation programs and activities as well as the Carbon Farming Initiative may assist landowners with the future costs of managing these plantings.

This approach could ensure the environmental integrity of abatement and allow for higher returns on bio-sequestration projects than other offset schemes which issue temporary credits for bio-sequestration or apply very large risk buffers.

Risk of reversal buffer

The purpose of the 'risk of reversal buffer' is to insure the scheme against losses of carbon in the period whilst carbon stores are being re-established following bushfire, drought, disease and pest attack, and against deliberate wrong-doing which has not otherwise been addressed under the scheme.

The Government is considering applying a risk buffer of five per cent of the carbon sequestered by the project to all bio-sequestration projects. A uniform approach will be simple to administer and is justified because there is limited data to enable project or activity level risks to be accurately and easily quantified. As more information becomes available, the risk of reversal buffer could also be adjusted to reflect project level risks or risks for a particular activity.

A buffer is required because carbon stores can take a long time to recover and compliance provisions will not be completely effective in addressing carbon losses. For example, a person who inherits land that has already been cleared of a scheme forest would be subject to a carbon maintenance obligation, but this would not require them to re-establish the forest.

A modest buffer of five per cent is justified because there are other permanence provisions in the legislation that will help to ensure that carbon stores are restored or an equivalent number of units relinquished.

As a result of their contribution to the risk buffer, project proponents would not have to relinquish credits if carbon stores were re-released to the atmosphere as a result of a natural disturbance, such as bushfire.

However, project proponents would have to take the necessary steps to ensure that carbon stores were re-established. In many cases, environmental plantings are likely to regenerate with only modest intervention by the project proponent. However, other types of bio-sequestration projects may require more action by the proponent to re-establish carbon stores.

Further, project proponents would not receive any further credits until carbon stores are re-established and reach previously reported levels.

For these reasons, the application of a five per cent risk of reversal buffer will have a marginal impact on incentives to manage the risk of natural disturbances such as bushfire



and pest attack. Indeed, some project proponents are expected to take out private insurance to cover outstanding risks including loss of income whilst carbon stores are being re-established and the cost of re-establishing carbon stores.

To help evaluate the adequacy of the buffer over time, the administrator would report annually on the number of units withheld and the amount of carbon losses reported (both annually and cumulatively). Any increase in the buffer would apply prospectively to new projects and existing projects from the commencement of a new crediting period (see *crediting periods* below).

Relinquishment obligation for bio-sequestration

Project proponents would be permitted to cancel their project and relinquish credits at any time, for example because they wish to sell or use the land for an alternative use. Credits would also have to be relinquished if the project is terminated by the administrator, carbon stores are destroyed other than through natural disturbance, or a project proponent did not take the necessary steps to re-establish carbon stores following a natural disturbance.

The project proponent would be subject to civil penalties for failure to relinquish credits. Failure to relinquish credits would also trigger the application of a carbon maintenance obligation in relation to the land.

Carbon maintenance obligation

The carbon maintenance obligation would apply if the project is not properly transferred and the proponent dies, becomes insolvent, or does not relinquish credits as required. The obligation would require future land owners not to engage in conduct that would destroy carbon stores that existed at the time the obligation was applied. Landowners would not be required to re-establish carbon stores that were destroyed prior to the application of the obligation.

The carbon maintenance obligation would apply automatically if there was an unmet obligation to relinquish units. It would be lifted with respect to any areas for which obligations to relinquish units were met, for example because of successful or partially successful compliance action against a previous project owner.

Project proponents would have two options when selling property that underpins a CFI bio-sequestration project. They could transfer the project to the purchaser who would become the new project proponent, responsible for reporting on the project and eligible to receive credits. Alternatively they may terminate the project, relinquish units and sell the land free of the project.

Property may sometimes transfer to new owners without their consent to the transfer of the project, for example because land is inherited or a lease is terminated. In these circumstances, the new owner would take the land subject to the carbon maintenance obligation and would not be allowed to destroy existing carbon stores. Accordingly, state and Commonwealth governments could become subject to carbon maintenance obligations following the expiry of long term leases.

Civil penalties would apply for non-compliance with the obligation. The legislation would also enable the administrator to seek injunctions preventing destruction of carbon stores or to require the land owner to take actions to restore carbon stores that they had destroyed.



Scheme obligations would need to be noted on land title. This note would not give the Commonwealth Government an interest in the land, and is intended only to ensure that future interest holders in the land are given notice of scheme obligations.

Avoided deforestation

The risk of reversal in avoided deforestation projects is particularly high if credits representing the full amount of carbon sequestered in the forest are issued immediately after the project is approved. Further, these stocks would take a very long time to recover if they were destroyed. For this reason, the scheme could provide for credits for avoided deforestation projects to be issued on a pro-rata basis over a longer period, for example twenty years. Under these arrangements, project proponents would receive a stream of credits over the crediting period, which would be similar to land stewardship payments. These crediting arrangements may not be necessary where permanence is ensured through additional mechanisms such as the application of a conservation covenant or transfer of land to the National Reserve System.

Stakeholders are invited to comment on the proposed approaches to permanence, and, specifically whether:

- a five percent risk of reversal buffer is appropriate;
- the same risk buffer should apply to all projects or activities; and
- the twenty year crediting period for avoided deforestation is appropriate and in what circumstances.

7.3 Leakage

Some abatement activities can result in increases in emissions.

To prevent over-crediting, material increases in emissions that are directly attributable to the abatement activity would need to be estimated and deducted from project abatement. For example, improvements in soil carbon can involve increases in nitrous oxide from fertiliser use. Further, projects can displace economic activity and therefore increase emissions outside the project boundaries. For example, reductions in deforestation in one area may be offset by increases in deforestation in other areas if the market demand for timber remains the same.

As it can be difficult to estimate leakage that occurs beyond the boundaries of project or individual farm, this issue would also be examined through the program of work to develop offset methodologies for use under the Carbon Farming Initiative.

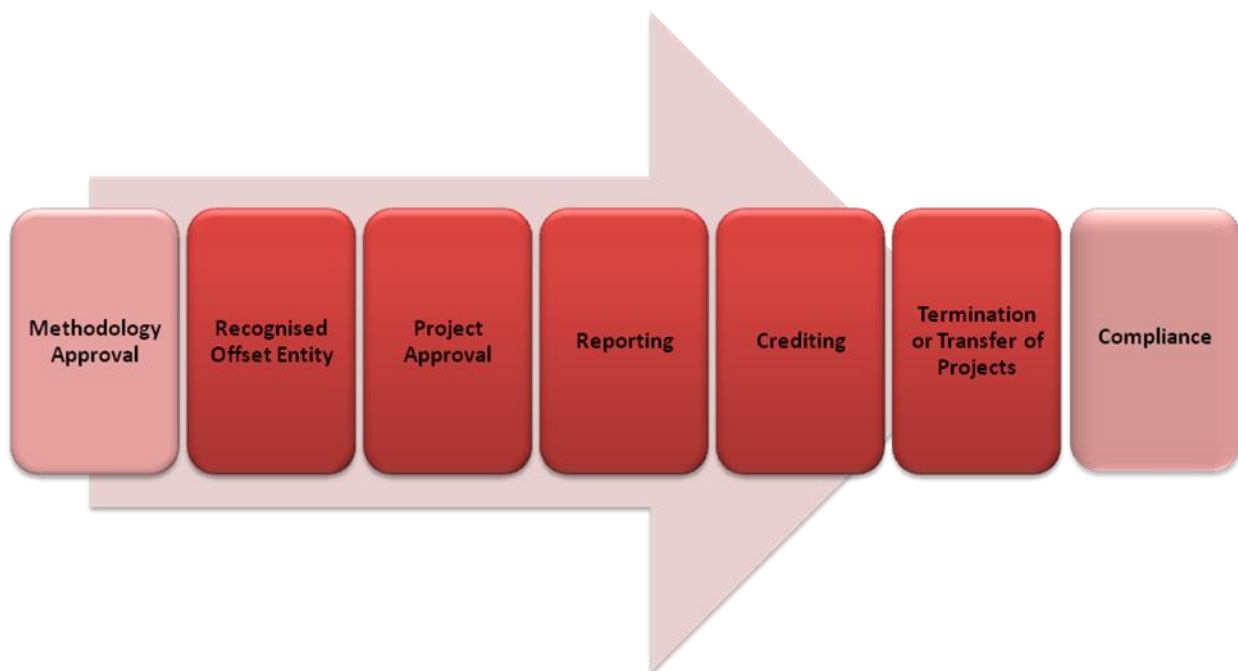
Stakeholder views are sought on approaches to addressing leakage.



8. Scheme processes

The following diagram illustrates possible components of the scheme.

Diagram 2: Scheme processes



Recognised entity

To reduce the risk of fraud undermining the credibility of the scheme, the scheme could allow only recognised offset entities to participate in the scheme. The key requirement for recognition would be that the entity or offset project proponent passes a ‘fit and proper’ person test.

To provide flexibility, the scheme could allow farmers or landholders to appoint an agent to report on the project on their behalf. The farmer or landholder would still receive the credits and have to relinquish credits if carbon stores were destroyed and not re-established.

Project approval

Projects would need to be approved by the administrator before they could generate Carbon Farming Initiative credits.

The scheme could enable the administrator to only approve projects that are undertaken in Australia in accordance with an approved offset methodology (discussed below) and that meet any other criteria that would be specified in the legislation.

The declaration of an eligible project, issued following the assessment of the project application, would need to indicate Kyoto-applicable and non-Kyoto parts of the project and the applicable methodology for the crediting period.

For a bio-sequestration project, the proponent would also have to demonstrate that they have the right to the carbon in the soil and/or vegetation, for example because they have a lease or own the land. This is to ensure that offset credits are issued to the right person.



The project proponent would also have to demonstrate that they have obtained the consent of all persons who have a registered interest in the project land to include that land in the scheme. This would help to protect the interests of those who may be subject to a carbon maintenance obligation (see *carbon maintenance obligation* above). Further, the project proponent would need to ensure that a note is placed on the land title to alert future purchasers to the potential for carbon maintenance obligations.

Indigenous held land

The scheme would provide new economic opportunities for Aboriginal and Torres Strait Islander land holders.

In many cases Indigenous land could be treated similarly to other land, for example, Aboriginal and Torres Strait Islander owners of a freehold title could demonstrate that they have the right to carbon in a similar manner as other landholders. However, some Indigenous lands are not readily comparable to freehold title (eg Crown reserves), and there may be uncertainty in these cases as to the capacity of Indigenous people to participate in the scheme.

In addition, concerns have been raised about whether exclusive possession native title includes the right to benefit from carbon or to manage vegetation for the purpose of carbon sequestration. Any uncertainty about this could lead to difficulties for such native title holders gaining approval for scheme bio-sequestration projects.

Stakeholders are invited to comment on whether they consider it would be useful for the legislation to confirm that exclusive native title holders and other categories of Indigenous land have rights to benefit from, and manage land for, carbon storage.

Database of offset projects

To provide transparency, the scheme could include information about eligible projects on a publicly accessible database of offset projects. Mandatory information would include a detailed description of the project, the methodology applied, the name of the project proponent, the location of the project, and the number of credits issued to date.

The database of offset projects would assist prospective purchasers of land to understand their potential future responsibilities. Prospective land buyers, seeing a note on the title about the Carbon Farming Initiative, could check the database for information about the project, including the number of carbon credits that had already been issued.

Co-benefits

The scheme could allow optional information to be included on the database about the biodiversity and other co-benefits associated with the project, to assist offset buyers who have a preference for such projects. Claims included on the database about the co-benefits of the offset project would need to be supported by evidence made available for public scrutiny. The provisions of the *Trade Practices Act 1974* in relation to misleading and deceptive conduct would also apply.

Governments are working to develop a method for assessing and rating or accrediting the value of co-benefits associated with abatement projects. Proponents of bio-diverse



abatement projects could advertise co-benefits associated with their projects in order to sell their credits at a premium price. Other co-benefits that could be listed against the project include Indigenous or youth employment and benefits for water quality, erosion control or management of salinity.

Crediting periods

The scheme could allow the administrator to approve an offset project to use a particular version of a methodology for a maximum crediting period of three years, unless the regulations provide for longer crediting periods for specified activities. This is to allow for new, improved versions of methodologies in line with advances in carbon estimation.

Project proponents could apply to use a revised methodology before the end of a crediting period, and would be expected to do so if revisions resulted in higher abatement estimates.

At the start of a new crediting period, project proponents would need to demonstrate that their project meets the requirements of the relevant methodology. This will allow for continuous improvement of methodologies. Further, some projects may cease to be additional during their lifetime, for example because the project activity may become common practice. Proponents of emissions reduction projects would need to seek confirmation of the project baseline (in accordance with the relevant methodology) for any subsequent crediting period. It is not necessary to reset baselines for reforestation and revegetation projects because increases in abatement are measured from one period to the next (as the trees or vegetation grow), rather than relative to a baseline.

Permanence obligations would continue to apply to bio-sequestration projects even if these were not re-credited for a further period.

Projects could not be credited for a further period if the activity has become mandatory, which is unlikely for most land sector activities.

The risk of reversal buffer may also be adjusted in a new crediting period.

Reporting

The scheme could enable project proponents to report to the administrator annually in accordance with the relevant methodology. Proponents could report every 12 months and would be required to report at least once during the crediting period. This is to enable regular crediting while minimising participation costs for projects that generate smaller volumes of abatement, for example bio-sequestration projects in which trees or other vegetation grow very slowly.

Project proponents wishing to exchange eligible Carbon Farming Initiative credits for Kyoto units would have to submit a report and a request for exchange of units by the end of March 2013. This would allow the Government time to finalise its Kyoto Protocol accounts for the first Kyoto commitment period.

The scheme could require that all project reports be independently audited by suitably qualified persons, with the costs borne by the project proponent. To underpin the integrity of the audit process and reduce administrative costs, proponents would be required to select auditors who have met the requirements of the National Greenhouse and Energy Reporting System (NGERS) and have been listed on the Register of Greenhouse and Energy Auditors. Reporting relating to greenhouse gas emissions would need to be



consistent with NGERs requirements, including the requirement that records are kept for seven years.

The scheme could also require proponents to report relevant changes to the project, for example significant natural disturbances. Penalties would apply for obtaining credits fraudulently, for example through misreporting.

Crediting

The scheme could provide that the administrator issue Carbon Farming Initiative credits on the basis of abatement estimates in the proponent's project report, once the report has been independently audited and then approved by the administrator.

The scheme could allow Australia's registry established under the Kyoto Protocol, the Australian National Registry of Emissions Units, to be used for the purposes of issuing, transferring and cancelling Carbon Farming Initiative credits. This would allow proponents to hold Carbon Farming Initiative credits and Kyoto units in the same registry, thereby reducing account establishment costs and other administrative costs.

Credits would be uniquely identified and specify whether or not the unit is Kyoto compliant. Units would be recognised as financial products and constitute a form of personal property.

It is generally very difficult to estimate past abatement and demonstrate that abatement that has already occurred is not business-as-usual. However, for reforestation and abatement projects for which methodologies are approved prior to the proposed commencement of the scheme on 1 July 2011, the scheme could allow the first reporting period to be backdated to commence on or after 1 July 2010. This transitional arrangement would mean that projects applying an approved methodology and underway before the start of the scheme could generate credits for any part of 2010-11 in which the project was in operation.

For emissions reduction projects, the number of carbon credits issued would be equivalent to the reported abatement.

For bio-sequestration projects, the number of credits issued would be equivalent to the increase in carbon storage since the previous report, with an adjustment to account for the risk of reversal (see section 7.2 Permanence).

If carbon stores are reduced over the reporting period, the project proponent would have to indicate whether the reduction was due to natural disturbance and provide supporting evidence. If there had been a natural disturbance and the project proponent had taken the necessary steps to re-establish the carbon stores, there would be no obligation to relinquish credits because temporary losses in stored carbon would be covered by the risk of reversal buffer. No further credits would be issued until the carbon stores reached previously reported levels. This approach would provide continuing incentives to recover and increase carbon stores over time, while not penalising proponents for the impact of natural disturbances which are beyond their control.

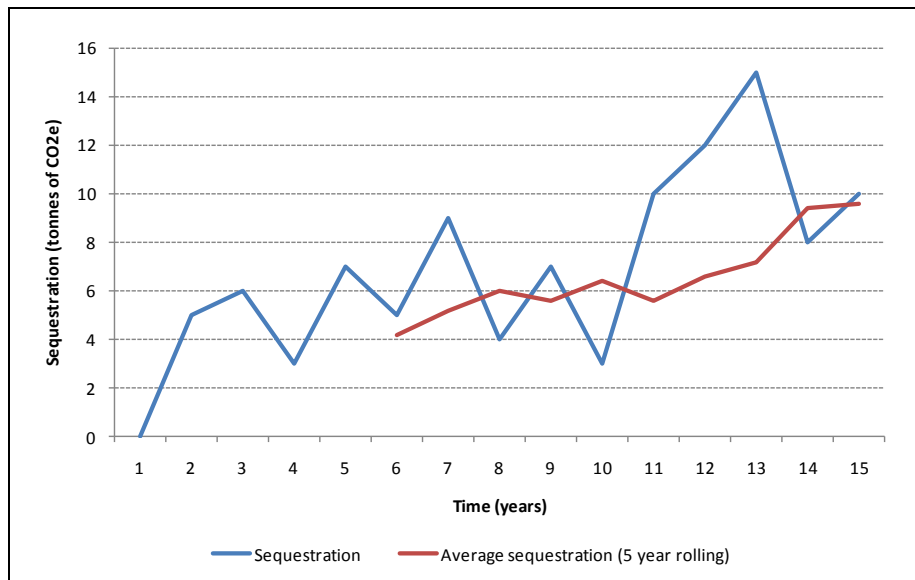
If the reduction in carbon stores was not the result of natural disturbance, the project proponent would be required to relinquish credits to cover the reduction.

For methodologies for bio-sequestration activities that are subject to significant variability, for example because of harvest cycles or natural climate variability, the scheme could



require that methods estimate long-term changes in net emissions and removals – this is sometimes referred to as ‘averaging’. If carbon stocks are subject to significant annual or intra-annual variability, using a rolling average to estimate changes in carbon storage over the longer time period provides a more realistic picture of the impact of an abatement activity, and would reduce the likelihood that project proponents would have to regularly surrender large numbers of credits. The following diagram illustrates this method of estimating changes in carbon storage.

Diagram 3: Estimating changes in carbon storage



If methodologies provide for averaging, proponents would report and be credited for changes in carbon stores up to the long-term average increase in carbon stocks resulting from the abatement activity.

Arrangements would need to be made to avoid double counting of abatement. The scheme could ensure that these arrangements do not prevent companies from funding scheme tree planting projects through forward-sale of potential carbon sequestration.

Termination or transfer of projects

The scheme could enable offset projects to be terminated at any time or transferred to another recognised offset entity. This recognises the voluntary nature of participation in the scheme, as well as changes in ownership of land and changes resulting from restructuring of participating companies.

Termination of bio-sequestration projects would result in an obligation to relinquish a number of credits equivalent to those already issued for the project (see section 7.2 Permanence).

Transfer of bio-sequestration projects would have to be approved by the administrator, to ensure that potential obligations in relation to existing carbon stores are effectively transferred with the project. The administrator would not approve the transfer of the project to an ineligible entity, or one that would be unable to meet obligations such as the relinquishment of credits if required.

The scheme could provide for cancellation of projects by the administrator if the project proponent or any subsequent project owner is no longer a fit and proper person. If a bio-



sequestration project is cancelled, the project proponent (or subsequent owner) would be required to relinquish credits issued in relation to the project. To avoid this, the farmer or landholder may opt to have the project transferred to another recognised offset entity with the approval of the administrator.

Stakeholders are invited to comment on whether these administrative arrangements and processes are appropriate and workable, or whether alternative approaches should be considered.

9. Methodology approval

Carbon Farming Initiative methodologies will be developed by the Department of Climate Change and Energy Efficiency and the Department of Agriculture, Fisheries and Forestry in collaboration with industry, as well as by private project developers.

Methodologies developed by the Departments will be prioritised on the basis of scale, cost of development and potential public benefits.

The Departments may assist private methodology proponents, including by providing advice on international carbon accounting rules.

A methodology could consist of:

- a description of the abatement activities, greenhouse gases, and sources and sinks affected by a project;
- procedures for determining baseline emissions and removals for the project;
- procedures for identifying and estimating leakage;
- procedures (or the model) for estimating or measuring abatement (net of leakage) relative to the baseline;
- project monitoring requirements; and
- any additional reporting and record keeping requirements which are not specified elsewhere in legislation.

On 27 October 2010, the Government established an interim independent expert panel, the Domestic Offsets Integrity Committee ('the committee') to assess methodologies proposed for use under the Carbon Farming Initiative prior to the passage of the legislation.

Under the scheme, this committee could assess offset methodologies and provide recommendations to the Minister for Climate Change and Energy Efficiency on methodologies and positive list activities for the Carbon Farming Initiative. The Minister would approve methodologies and include activities on the positive list only after receiving advice from the committee.

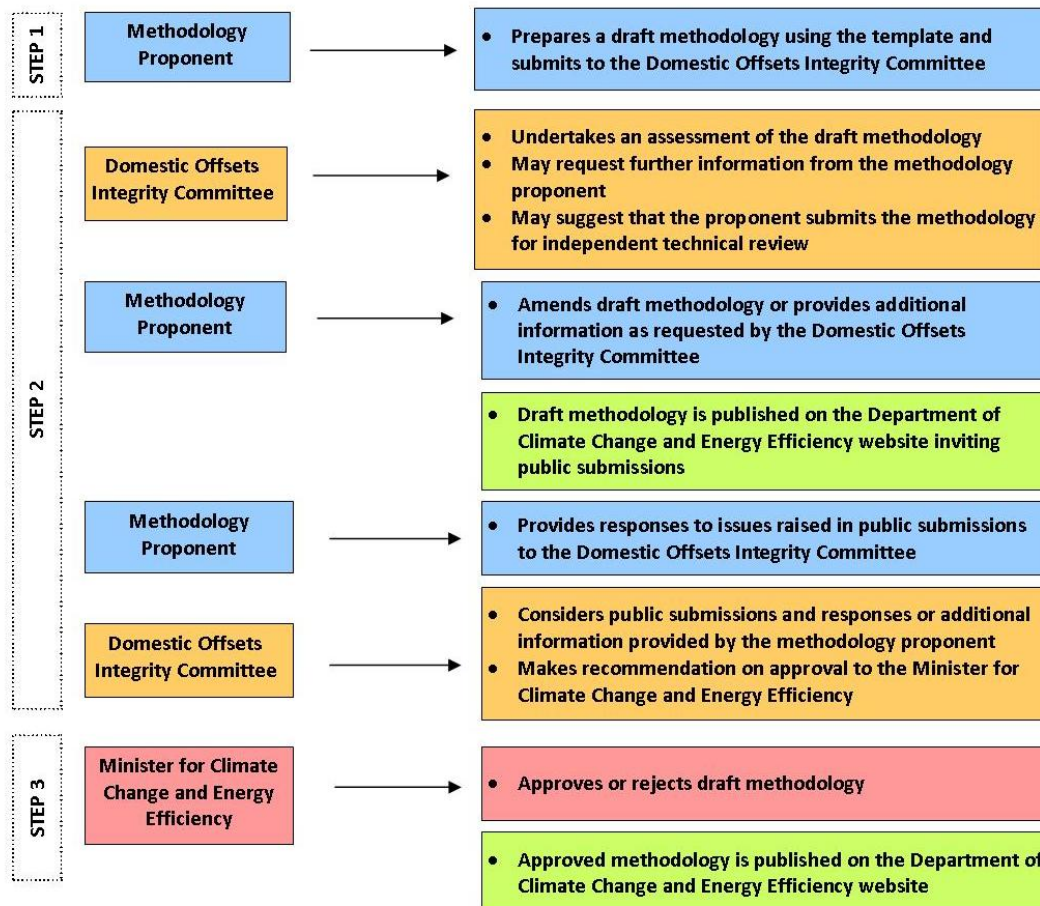
This body could transition to a committee with statutory functions and duties under the legislation.



More information on the interim committee is available on the Department of Climate Change and Energy Efficiency website.

The following diagram sets out a possible process for assessment of a methodology.

Diagram 4: Methodology assessment process



The scheme could provide that the Minister be empowered only to approve or reject the committee's recommendations and not be able to amend proposed methodologies.

Once approved, methodologies would be made into determinations (legislative instruments) under the Carbon Farming Initiative legislation and these would be published on the Department of Climate Change and Energy Efficiency website.

The scheme could require that all recommendations made by the committee must be consistent with the integrity standards outlined in this paper.

Finally, the evidence provided to the committee by proponents of methodologies and positive list activities would need to be:

- **Complete** – claims (including the quantification of greenhouse gas emissions and removals) must be supported by evidence.
- **Verifiable** – claims must be transparently documented and reproducible, such that they are capable of being independently audited.

- **Relevant** – all information, claims and decisions should be directly relevant to proving that the integrity standards and other legislative requirements have been met.
- **Consistent** – all information, claims and decisions made should be consistent across all aspects of methodology development and assessment.
- **Accurate** – bias and uncertainties should be reduced as far as is practical. Data should be measurable or modelled in acceptable ways and should be adequate and reliable.

The committee would be able to request further information, including opinions from specified experts, if evidence provided by proponents is insufficient.

The scheme could require that the committee publish and undertake public consultation on draft methodologies before making any recommendations to the Minister. In assessing the methodology the committee would be required to consider submissions received during the consultation process, as well as the methodology proponent's responses to the submissions.

The scheme could allow the committee to publish evidence provided by the project proponent in support of the methodology. However, the project proponent could request the committee not to disclose to the public commercially sensitive information, for example proprietary model code and parameter sets. This would not prevent the committee from providing this information to the Department of Climate Change and Energy Efficiency on a confidential basis, for the purpose of developing the National Greenhouse Gas Inventory, nor prevent the department from providing this data to international inventory reviewers in an aggregated form.

Any site-specific data about carbon storage in individual forest stands that may be included in project reports provided to the administrator would not be disclosed.

To protect the interests of participants, the scheme could include in the legislation penalties for unauthorised disclosure of confidential data provided to support the assessment of draft methodologies or confidential site-specific data provided in project reports.

Stakeholders are invited to comment on whether:

- the process for assessment of methodologies is rigorous and transparent;
- the standards are appropriate; and
- the approach to disclosure of evidence represents the correct balance between the need for transparency and the need to protect proprietary information.

Appendix A

Participating in the Carbon Farming Initiative

The Carbon Farming Initiative (CFI) will be available to farmers, foresters and landholders who want to generate carbon credits.

Farmers and landholders can participate in the CFI by:

- obtaining the necessary approvals, and managing and reporting the project themselves;
- using a specialist service provider to assist with project reporting and management; or
- allowing other companies, known as offset aggregators, to undertake the offset activity on their land.

An offset aggregator is a company that manages offset projects across a number of different farms or parcels of land. The farmer or landholder, and the offset aggregators they engage, will determine their business and legal relationship.

For projects involving bio-sequestration (tree planting, revegetation etc.), the farmer will receive carbon credits and retain ultimate responsibility for meeting CFI obligations, unless the project is transferred and the carbon property rights are sold to another company or individual undertaking the project.² This is because credits for bio-sequestration projects would be issued to the person that owns the carbon property right, usually the land or lease holder.

Farmers and landholders can sell their credits through market exchanges, carbon brokers or directly to buyers.

Example 1

Farmer A chooses to undertake a project to reduce fertiliser use on his or her farm. He or she finds the relevant CFI methodology to use, becomes a recognised offsets entity and gets his/her project approved by the scheme administrator. Farmer A undertakes the project, using less fertiliser on their farm, and each year he or she completes a report, has it audited and submits it to the administrator. At the end of each year, some credits are issued into Farmer A's account in the Registry based on the amount of emissions reduced, which he or she can sell to another entity that trades in CFI credits.

Example 2

Farmer B has decided he or she wants to grow a carbon sink forest on their farm, but doesn't want to have to worry about the paperwork, so appoints an agent to look after this on their behalf. Farmer B plants the trees and looks after them. The agent takes care of the project application, reporting and auditing for a fee and all carbon credits are issued to Farmer B.

² Note that this is not possible in the Northern Territory, which does not provide for carbon property rights to be sold separately land.



Alternatively, Farmer B could sell the carbon property rights to an offset aggregator. The aggregator would group Farmer B's land together with other areas of land under a larger reforestation project. In exchange for the carbon property rights, the aggregator would manage all aspects of the project and receive the credits.



Appendix B

Income tax treatment of carbon credits

The existing income tax provisions and goods and services tax (GST) provisions would apply to the carbon credits issued under the Carbon Farming Initiative.

Income tax

For a taxpayer carrying on a business or undertaking other assessable income earning activities, the existing income tax law would recognise the cost of acquiring credits. The tax treatment and provisions that would apply in any particular case would depend on the taxpayer's activities and its purpose, both when purchasing the credit and while holding the credit. The taxpayer may acquire the credits for the following purposes:

- To meet an obligation under the Australian scheme;
- To surrender voluntarily as part of a marketing campaign;
- As part of its trading portfolio;
- Otherwise for sale at a profit.

In the first two cases the cost may be deductible but the timing of the deduction would be unclear. In the third case, where credits were bought for trading, the cost would generally be deductible on acquisition but any change over an income year in the value of credits held would be brought to account as a deduction (where the value declined) or assessable income (where the value increased). In all three cases, any proceeds on the sale of the credit would be assessable income.

In the fourth case, where the cost would not be deductible or the proceeds assessable, both would be taken into account in working out any assessable gain or deductible loss on the sale of a credit. In all cases, it would be very unlikely that a capital gain or loss would be recognised under the capital gains or losses provisions.

A credit acquired for private or domestic purposes (for example, to be surrendered voluntarily to offset the carbon footprint of the purchaser's private residence) would not be deductible under the current tax law.

GST

The supply of a credit is a taxable supply if the requirements of section 9-5 of the *Goods and Services Tax Act 1999* (GST Act) are met.

GST applies to a credit acquired from an entity outside Australia if the supply is connected with Australia and the other requirements of a taxable supply are met. If the supply of a credit to a GST registered recipient carrying on an enterprise in Australia is not connected with Australia and the credit is acquired by the recipient solely for a creditable purpose, GST does not apply.

The supply of a credit to an entity outside Australia may be GST-free under an item in the table in subsection 38-190(1) of the GST Act if it is a supply other than of goods or real property. To satisfy certain items in the table, it is a requirement that the supply of the credit is not a supply directly connected with real property. Additionally, to satisfy item 4 of the table in subsection 38-190(1) of the GST Act, it must be the supply of a right.

