

## THE CARBON FARMING INITIATIVE - TOO LITTLE, TOO SOON?

by Michael Power<sup>1</sup>

### Introduction

Since the federal election in August 2010, the Australian Government's Department of Climate Change and Energy Efficiency (DCCEE) has been working on the design of a new federal climate change law: the Carbon Farming Initiative (CFI). The CFI is the latest in a string of climate change mitigation initiatives. The CFI will provide landowners with tradable credits in return for carbon offset activities that reduce atmospheric concentrations of greenhouse gases.

DCCEE is currently in the latter stages of a rapid consultation process with stakeholders on the design of the CFI, which had been announced as a Labor election commitment in August 2010. A Consultation Paper was released on 22 November 2010, and submissions closed on 21 January 2011.<sup>2</sup> Draft legislation was released for public comment on 4 January 2011.<sup>3</sup> The fact that draft legislation was released before submissions closed is indicative of the urgency with which the CFI is being developed.<sup>4</sup> The Bill was introduced to the Australian Parliament on 24 March 2011 and was referred to the House of Representatives' Climate Change, Environment and the Arts Committee, and the Senate's Environment and Communications Legislation Committee for review.

The Australian Network of Environment Defenders' Offices (ANEDO) has already advised environmental groups on the draft legislation, prepared a submission on the Consultation Paper and draft legislation, and will continue to liaise with DCCEE on the design of the CFI. ANEDO has some serious concerns about the CFI as currently proposed and recommendations for how the scheme could be improved. This article outlines some of these concerns and suggestions, based on ANEDO's submission to DCCEE.

The scheme faces an uncertain political future. Unless the Coalition supports the Bill, it will require the support of the Greens MP Adam Bandt, and independent MPs Tony Windsor, Rob Oakeshott and Andrew Wilkie, and the cross-benchers in the Senate. The CFI is therefore very much subject to change over the coming months.

### Background

The CFI is a voluntary carbon offset scheme for the agricultural sector. Farmers will be able to earn offset credits by conducting eligible offset activities. Those credits can then be sold on domestic and international carbon markets.

To participate in the CFI, a project proponent must be accredited as a recognised offsets entity.<sup>5</sup> That offsets entity may be the owner of the land, or a company appointed by the landowner. The landowner may transfer their carbon sequestration rights in the land to that company. It is envisaged in the Consultation Paper that farmers and landholders may wish to transfer these rights and/or the management of their offsets project to a 'carbon aggregator' company, similar to a managed investment scheme well known in the forestry industry.

Eligible offset activities would be approved on a case-by-case basis by the Carbon Credits Administrator,<sup>6</sup> who is responsible for administering the CFI. The Carbon Credits Administrator must not approve an eligible offset activity unless it meets a list of specified requirements.<sup>7</sup> Those requirements, which are set out in cl 25(4) of the Bill, include a requirement that

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<sup>2</sup> DCCEE, *Design of the Carbon Farming Initiative: Consultation Paper (November 2010) (Consultation Paper)*.

<sup>3</sup> *Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth)*.

<sup>4</sup> The Government hopes to have the CFI in place by 1 July 2011.

<sup>5</sup> *Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth)* cl 25(4)(f), Pt 4.

<sup>6</sup> *Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth)* cl 25.

<sup>7</sup> *Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth)* cl 25.

the activity pass the 'additionality test', that it obtain all regulatory approvals, that it be carried out by a recognised offsets entity, and that it be covered by an approved methodology determination.<sup>8</sup>

The requirement for a methodology determination is particularly important. Methodologies apply to a particular type of offsets activity, and prescribe the eligibility requirements and carbon counting method for that activity.<sup>9</sup> They therefore effectively determine which activities are eligible for credits under the CFI. A methodology can be developed by anybody, but to take effect it must be approved by an independent committee of experts: the Domestic Offsets Integrity Committee (DOIC).<sup>10</sup> DCCEE has released *Draft Guidelines for Submitting Methodologies* (Draft Guidelines) to govern that process.<sup>11</sup>

Based on those Draft Guidelines, and the Consultation Paper, the Government is proposing that the CFI will cover both *emissions avoidance offsets projects*<sup>12</sup> (including avoided deforestation, reduced methane emissions from livestock, reduced fertiliser emissions, manure management, reduced emissions from rice cultivation and reduced emissions from landfill waste) and *sequestration offsets projects*<sup>13</sup> (including reforestation and soil carbon sequestration).<sup>14</sup>

Once an eligible offsets project has been approved, the project proponent must report to the Carbon Credits Administrator annually, in accordance with the relevant methodology.<sup>15</sup> Australian Carbon Credit Units (ACCUs) will be issued based on that report.<sup>16</sup>

ACCUs are tradable personal property.<sup>17</sup> It is expected that they can be traded on voluntary and domestic markets in Australia and overseas. Different markets will have different eligibility criteria and certain credits will not be tradable on certain markets. For example, in some cases ACCUs can be earned for offset activities which are not eligible activities under the Kyoto Protocol. These will be distinguished from credits tradable under the Kyoto Protocol, and are likely to have a lower value than Kyoto ACCUs.<sup>18</sup>

## **Regulatory framework**

An offsets scheme like the CFI, however well-conceived, is a fundamentally insufficient regulatory response to climate change. Although voluntary offsets schemes can play a valuable role as part of a broader suite of climate change laws, without a carbon price or some similar comprehensive disincentive to emit they are ineffective and potentially self-defeating.

Because offsets work on a project-by-project basis, rather than an economy-wide basis, they are unable to guarantee net emissions reductions. The Consultation Paper seems to recognise this problem when it deals with 'carbon leakage'.<sup>19</sup> There is nothing in the CFI to prevent the same person claiming CFI credits for an eligible offset activity in one place, but increasing their emissions by an even greater amount in another place. Therefore, a farmer could claim CFI credits for reforestation on one part of their farm, while clearing an even greater amount of forest on another part.<sup>20</sup> The carbon leakage provisions in the draft Bill would not prevent this: they only capture increases in emissions which occur '*as a consequence*' of the

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<sup>8</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 25.

<sup>9</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 100.

<sup>10</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 100(4).

<sup>11</sup> DCCEE, *Draft Guidelines for Submitting Methodologies* (January 2011) (*Draft Methodology Guidelines*).

<sup>12</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 5.

<sup>13</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 5.

<sup>14</sup> Consultation Paper 6; Draft Guidelines 1–2.

<sup>15</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cll 67–9.

<sup>16</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cll 11–18.

<sup>17</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 142.

<sup>18</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) Pt 11, Div 3, cf Div 4.

<sup>19</sup> Consultation Paper 10, 14.

<sup>20</sup> Louis Chiam, 'Abatements and Offsets: Legal Issues in Reducing Emissions and Developing Offsets Projects' (2008) 27 *Australian Resources and Energy Law Journal* 105, 118.

eligible offset project.<sup>21</sup> It is therefore possible for a project proponent to receive CFI credits for a net increase in their emissions. This project focus, inherent in all offsets schemes, is in contradistinction to the focus on corporate groups and net emissions used in the National Greenhouse and Energy Reporting Scheme<sup>22</sup> and the proposed CPRS.<sup>23</sup>

Even where a project proponent does achieve a net reduction in emissions from their own activities, an offsets scheme like the CFI cannot ensure that emissions will be reduced across the entire economy. When a landowner creates CFI credits and sells them to another party, the other party can increase their emissions accordingly. From this perspective, the CFI simply shifts the source of pollution.<sup>24</sup> Under an economy-wide cap-and-trade scheme this shifting is justified, because although one party may be allowed to increase their emissions, they are required to pay for it, and overall emissions must still be reduced. However, without that cap, there is no guarantee of overall greenhouse gas reductions, and offsets simply legitimate a failure to reduce greenhouse gas emissions.

Further, offsetting greenhouse gas emissions is no substitute for preventing or mitigating greenhouse gas emissions in the first place. Climate change regulation should follow a hierarchy, similar to that found in existing environmental protection legislation.<sup>25</sup> Greenhouse gas emissions should first of all be avoided; if that is not possible, they should be reduced; and if that is not possible, they should be offset. This is particularly so for offsets which involve carbon sequestration. Sequestration is an end-of-the-pipe solution. It is a band-aid which attempts to suppress the symptoms of the problem, rather than fix it at its roots. Further, it often involves great scientific uncertainty as to how much emissions are actually reduced, and how permanent those reductions are.<sup>26</sup>

With these limitations in mind, it is important that the Government turn its mind to the purpose that the CFI is intended to serve as part of Australia's broader regulatory response to climate change. It is concerning that neither the Consultation Paper, the draft legislation or the draft methodology make clear what place the CFI has in a broader mosaic of climate change law. Even more concerning is the lack of attention devoted to the fundamental question of what the CFI is actually trying to achieve. The Government's key purpose in introducing the CFI is said to be to 'provide new opportunities for Australian farmers and landholders to participate in lucrative international markets for carbon credits.'<sup>27</sup> Many features of the scheme seem to indicate that this objective overrides the objective of reducing atmospheric concentrations of greenhouse gas emissions. The 'objects and purposes' section of the draft legislation does nothing to resolve this uncertainty.<sup>28</sup>

## Coverage

The types of conduct which are likely to be eligible offset activities are in some respects inequitable and unworkable.

## Ongoing conservation and management

To begin with, ongoing conservation and management of land will not be an eligible offset activity. The requirement of 'additionality' (discussed in more detail below) is such that only new projects are eligible for credits.<sup>29</sup> This precludes people who are already engaged in conservation activities from accessing benefits under the scheme, rewarding would-be polluters instead. For example, under the *Victorian Conservation Trust Act 1972* (Vic) a landowner can enter a 'conservation

21 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 102.

22 *National Greenhouse and Energy Reporting Scheme Act 2007* (Cth) s 8.

23 Carbon Pollution Reduction Scheme Bill 2010 (Cth) cl 5.

24 Uncommon Goods: on Environmental Virtues and Voluntary Carbon Offsets' (2010) 123 *Harvard Law Review* 2065; Soumitra Gosh, 'Licence to Pollute', *The Guardian*, 18 October 2006.

25 See for e.g., the hierarchy for native vegetation offsets in the Victoria Planning Provisions cl 15.09, and the 'waste management hierarchy' in Environment Protection Act 1970 (Vic) s 11; Zero Waste SA Act 2004 (SA) s 3(2).

26 David Powlson et al, 'Soil carbon sequestration to mitigate climate change: a critical re-examination to identify the true and the false' (2011) 62(1) *European Journal of Soil Science* 42; Rolf Sommer and Eddy de Pauw, 'Organic carbon in soils of Central Asia – status quo and potentials for sequestration' (2011) 338(1/2) *Plant & Soil* 273; Cornelis van Kooten, 'Biological carbon sequestration and carbon trading re-visited' (2009) 95 *Climatic Change* 449.

27 [www.al.org.au/federal-government/news/carbon-farming-initiative](http://www.al.org.au/federal-government/news/carbon-farming-initiative).

28 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 3.

29 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 39.

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covenant': a legally binding commitment to conserve and manage that land in perpetuity.<sup>30</sup> A person who protects trees on land that is subject to a covenant will probably not be eligible for credits for avoided deforestation, since that activity is already required by law, and does not go beyond the common practice on that land.<sup>31</sup>

From the point of view of climate change mitigation this is entirely justified: after all, conservation of that land will not produce additional material reductions in atmospheric greenhouse gases. However, from the point of those who are already voluntarily protecting vegetation, it is inequitable. There is no obvious way to avoid that inequity without undermining the environmental effectiveness of the scheme. It appears to be an unavoidable side-effect of offsets schemes like the CFI.

## Avoided emissions and avoided deforestation

The likely inclusion of 'emissions avoidance' activities in the list of eligible offset activities is also problematic. Emissions avoidance activities include things like reducing fertiliser use, where the proponent agrees not to pollute in return for CFI credits. Making such activities eligible for CFI credits effectively involves paying people not to pollute. This is inconsistent with the polluter pays principle — a well-recognised component of a wide range of international and Australian laws,<sup>32</sup> a sound guide to good regulatory practice, and a principle of basic fairness.

The better way to prevent greenhouse gas emissions — from a regulatory, budgetary and equitable point of view — is to use a *negative* incentive.<sup>33</sup> Therefore, the best way to stop deforestation, for example, is to count it as an emission which carries a carbon price.<sup>34</sup> It may be that an emissions trading scheme or other form of carbon price are not appropriate ways to deal with agricultural emissions, due to the difficulties in measuring them, the large number of diverse individuals who would have to be made liable, and the fact that agricultural emissions depend on many factors not all of which are anthropogenic in nature.<sup>35</sup> However, absent an emissions trading scheme, other forms of negative incentives to reduce emissions should be applied.

Using positive incentives to avoid emissions may preclude the imposition of a carbon price at a later date. It is not yet clear how the CFI will interact with a future carbon price, but it seems unlikely that avoided deforestation will simultaneously be an eligible offset activity eligible for credits, and a recognised source of emissions subject to a carbon price. Including it in the CFI therefore appears to obstruct the inclusion of emissions from deforestation in any future carbon price law.

There are also significant methodological and technical issues that make the measurement of 'abatement' and proof of 'additionality' difficult (if not impossible) for avoided emissions projects. In the case of avoided deforestation, for example, it will be difficult to accurately determine as a matter of fact whether or not the landowner was ever going to clear the forest in question. It will be possible for landowners to exploit this, and claim CFI credits for not clearing forests that they were never going to clear anyway.

The question becomes even more complex when applied to the messy additionality mechanism in cl 39 of the draft legislation. The additionality test under cl 39 requires, *inter alia*, that a project 'is not required to be carried out by or under a law of the Commonwealth, a State or a Territory'. This begs the question: when does a law 'require' that a person

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30 *Victorian Conservation Trust Act 1972* (Vic) s 3A.

31 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 39.

32 Rio Declaration on Environment and Development, A/CONF.151/26 (Vol I) (1992) Principle 16; Intergovernmental Agreement on the Environment (1992) cl 3.5.4; Sands P, *Principles of International Environmental Law* (Cambridge University Press, 2003) p 253; *National Environment Protection Council Act 1994* (Cth) Schedule 1 cl 3.5.4; *Environment Protection Act 1970* (Vic) s 1F(2); *Protection of the Environment Administration Act 1991* (NSW) s 6(2)(d)(i).

33 See the advice given by the federal Department of Treasury on the effectiveness of 'direct action' climate regulation which relies on positive incentives: Department of Treasury, Treasury Incoming Government Brief — Red Book — Redacted — Part 2 (2010) 26.

34 See, eg, *Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 11 December 1997 (1998) 37 ILM 22 (entered into force 16 February 2005) (Kyoto Protocol) art 3(3).

35 Hugh Sandler and Helen King, *Agriculture and Emissions Trading: the impossible dream?* (Discussion Paper No 102, 2008); Steven Geroe, 'Exclusion of agriculture from the (prospective) CPRS — good policy or good politics? A discussion of legal and policy options in the context of current political developments' (2010) 27 *Environment and Planning Law Journal* 202.

not clear a forest? In Victoria, for example, it is not illegal to clear native vegetation, so long as the person has a permit to do so.<sup>36</sup> Does that mean that in order to prove additionality, a project proponent would have to obtain a permit to clear the forest, then apply for CFI credits for not following through with the clearance? Or is it enough that the project proponent shows that they could obtain a permit if they wanted to? Similar problems arise in trying to determine whether, under the second limb of the additionality test in cl 39(2)(d)(i) 'there are reasonable grounds to believe that the project is not likely to be financially viable without the prospect of revenue derived from the sale of Australian carbon credit units issued in relation to the project.'<sup>37</sup> When is not clearing a forest 'financially viable'? What does it even mean to say that conserving forests is 'financially viable'?

For these reasons, it is better to use a negative incentive than a positive incentive to encourage people to avoid greenhouse gas emissions. This is particularly the case for avoided deforestation. Comparable offset schemes like the New South Wales Greenhouse Gas Abatement Scheme, the European Union Emissions Trading Scheme and the CDM have not recognised avoided deforestation as an eligible offset activity.<sup>38</sup> Doing so in the CFI is a mistake.

In the realm of international law, different considerations may apply. International REDD+<sup>39</sup> initiatives can play an important role in developing countries that have significant forestry pressures and less regulation of land clearing. In that context, paying landholders not to clear vegetation is the best available option, because many developing countries do not regulate to prohibit vegetation clearing, and developed countries can't regulate for them. REDD+ is therefore the only way to stop deforestation. It is also consistent with the 'polluter pays' principle, because the vast majority of anthropogenic greenhouse gases emissions have historically come from developed countries, rather than developing countries. Domestically, however, these considerations do not apply, and governments' choice between negative and positive incentives to avoid clearing is unfettered.

## Integrity standards

As recognised in the Consultation Paper, the commercial viability of CFI credits depends upon their environmental integrity.<sup>40</sup> If potential purchasers of CFI credits do not have faith that the credits represent real greenhouse gas reductions, then their value will decline and the market for them will collapse. This integrity challenge has proved problematic in voluntary carbon markets in the past, attracting the attention of environmental groups and regulators alike,<sup>41</sup> including the Australian Competition and Consumer Commission.<sup>42</sup>

To ensure that ACCUs under the CFI represent real and permanent greenhouse gas reductions, the CFI relies on a set of principles called 'integrity standards' which are outlined in the Consultation Paper. These integrity standards are, in principle, sound. Additionality, permanence, avoidance of leakage, measurability and verifiability, conservatism, international consistency and support from peer-reviewed science are all important principles for an environmentally sound outcome.<sup>43</sup> However, in several respects, the implementation of these principles in the draft legislation is deeply problematic.

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36 See cl 52.17 of the Victorian Planning Provisions, which are given effect in planning schemes by the Planning and Environment Act 1987 (Vic).

37 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 39.

38 Louis Chiam, 'Abatements and Offsets: Legal Issues in Reducing Emissions and Developing Offset Projects' (2008) 27 *Australian Resources and Energy Law Journal* 105, 118–9.

39 REDD+ is a shorthand for 'Reducing Emissions from Deforestation and Forest Degradation' which covers activities creating a financial value for the carbon stored in forests, offering incentives for developing countries to reduce emissions from forested lands and invest in low-carbon paths to sustainable development. REDD+ includes the role of conservation, sustainable management of forests and enhancement of forest carbon stocks: [www.un-redd.org/AboutREDD/tabid/582/Default.aspx](http://www.un-redd.org/AboutREDD/tabid/582/Default.aspx)

40 Consultation Paper 9.

41 Charles Schmidt, 'Carbon Offsets: Growing Pains in a Growing Market' (2009) 117(2) *Environmental Health Perspectives* 62, 64; David Victor and Michael Wara, 'A Realistic Policy on International Carbon Offsets' (Working Paper, Stanford Law School, April 2008); Government Accountability Office, *The U.S. Voluntary Market is Growing, but Quality Assurance Poses Challenges for Market Participants* (August 2008).

42 The ACCC has developed a publication on *Carbon claims and the Trade Practices Act* (2008) to inform businesses of their obligations in this regard. ACCC has previously taken enforcement action against Saab for misleading claims of carbon neutrality: *Australian Competition and Consumer Commission v GM Holden Ltd* [2008] FCA 1428 (18 September 2008).

43 Consultation Paper 9–10.

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## Additionality

Additionality requires that the offset activity must result in abatement that would not otherwise have occurred. In the draft CFI legislation, an activity must pass the additionality test in cl 39 before it can be approved as an eligible offset project.<sup>44</sup> There are two tests of additionality in s 39: a general test in s 39(2), and a 'fast-track' test in s 39(1).

The fast-track test is a serious problem. It allows certain offset activities to be deemed additional, if the DOIC advises that they be included in the regulations.<sup>45</sup> The DOIC must '*have regard to*' whether the activity would pass the additionality test, and any other matters it thinks relevant.<sup>46</sup> Therefore, whether or not an offset activity is additional is only one factor to be considered, and the DOIC must only '*have regard to*' it. There is therefore no certainty that offset activities approved under this section are actually additional. This undermines the environmental and commercial integrity of these offset projects and the ACCUs that they generate.

The general test of additionality in s 39(2) is also unsatisfactory. Sub-sections (2)(a)-(b) are unobjectionable, but ss (2)(c)-(d) are complex, confusing, and much longer than comparable clauses in offset schemes in other jurisdictions.<sup>47</sup> They also appear to be ineffective, in that there are cases where the confusing criteria of '*common practice*' and '*financially viable*' might be met for a project that is not truly additional. It would be much easier and far more effective to redraft sub-sections 39(2)(c)-(d) as follows:

(c) the project would not have occurred in the absence of the scheme established by this Act.

This approach is more consistent with the Clean Development Mechanism (CDM) under the Kyoto Protocol, where the concept of 'additionality' has found its fullest legal expression. The test for additionality under the CDM is simply:

CDM project activity is additional if anthropogenic emissions of greenhouse gases by sources are reduced below those that would have occurred in the absence of the registered CDM project activity.<sup>48</sup>

A similarly simple additionality test is applied by the Australian Government's Greenhouse Friendly program,<sup>49</sup> and the National Carbon Offset Standard which replaced it.<sup>50</sup> The benefit of such a simple test is that essential requirement of the test is clearly intelligible, even if its application to the facts of the case becomes more complex. If such complexity does arise, the Carbon Credits Administrator can develop further procedures for applying the test. For example, the CDM Executive Board has developed its own approach to demonstrating and assessing additionality, fleshing out the detail of how to determine 'additionality' without obscuring the core concept.<sup>51</sup>

## Permanence

Permanence requires that the greenhouse gas reductions achieved by the activity must not be subsequently reversed. Reversal might occur as a result of human agency (for example, clearing a forest for which avoided deforestation credits have been received) or natural disaster (for example, a bushfire clearing such a forest). In the draft CFI legislation, there are three key permanence mechanisms: a relinquishment requirement,<sup>52</sup> a risk of reversal buffer,<sup>53</sup> and a carbon maintenance obligation.<sup>54</sup>

44 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 25(4)(b).

45 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 39(5).

46 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 39(4).

47 For example, the Clean Development Mechanism simply requires that 'A CDM project activity is additional if anthropogenic emissions of greenhouse gases by sources are reduced below those that would have occurred in the absence of the registered CDM project activity.' 3/CM 1, Annex, paragraph 43.

48 Marrakesh Accords, (Decision 17/CP.7: 'Modalities and procedures for a clean development mechanism') [43].

49 Australian Greenhouse Office, *Guidance on Additionality for the Approval of Abatement Projects under the Greenhouse Friendly Initiative* (2007).

50 DCCCE, *National Carbon Offset Standard*, 4.

51 These are available at [cdm.unfccc.int/EB/016/eb16repan1.pdf](http://cdm.unfccc.int/EB/016/eb16repan1.pdf).

52 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 82-3.

53 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 16.

54 Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 8.

The relinquishment obligation applies when a project proponent wants to withdraw from the CFI scheme and reverse their eligible offset project. That proponent is then required to relinquish the CFI credits which they have received for that abatement.<sup>55</sup> Such an obligation is a key component of a functioning offset scheme, ensuring that offset credits represent real and lasting greenhouse gas reductions. However, the mechanism used in the CFI has two potential problems.

First, it may not be enough of a disincentive for proponents to reverse their abatement. Relinquishment does not penalise the project proponent for reversing their deeds; it merely ensures that they are not unjustly enriched by doing so. This means that the project proponent does not stand to lose anything other than transaction costs. As the price of scarce natural resources rises, the incentives to reverse eligible abatement projects will increase. Some further disincentive is therefore required. Given that the CFI is a voluntary scheme, a 'break fee' to discourage reversal, and penalties for knowingly or recklessly reversing abatement without surrendering CFI credits would be more appropriate.

Second, relinquishment may not be possible in many cases. If a proponent earns an ACCU, then sells it to a foreign company who acquits it in compliance with an emissions trading scheme in their country, only to find 10 years later that the abatement has been reversed, how will that credit be relinquished? Who will bear the risk of replacing the credit? This problem is compounded by the draft legislation providing that CFI credits are personal property — a designation with important legal consequences.<sup>56</sup> Under s 51(xxxi) of the Constitution, the Government may not acquire property except on 'just terms'.<sup>57</sup> If the Government intends to reserve the power to recall CFI credits if the abatement is reversed, it may not be wise to endow them with this constitutional protection. Moreover, designating CFI credits as personal property may also make it even harder to recover them once they have been sold to third parties. It is not clear how the Government will successfully require the relinquishment of ACCUs which have been sold to innocent third parties, especially if they are outside the jurisdiction.

The risk of reversal buffer is another permanence mechanism with some serious problems. For a sequestration offsets project, the CFI will grant a project proponent 5% less permits than the greenhouse gas reductions which are in fact achieved.<sup>58</sup> Discounting CFI credits by 5% demonstrates a laudable commitment to the principle of 'conservatism' in quantifying emission reductions. However, the Consultation Paper seems to rely on this buffer as a mechanism to ensure permanence.<sup>59</sup> If carbon sequestration is reversed by natural disturbance (for example, a carbon sink forest burning down in a bushfire) or wilful conduct of a third party beyond the reasonable control of the proponent (for example, a deliberately lit fire), project proponents will not have to relinquish credits, unless they have failed to take reasonable steps to mitigate the effect of the natural disaster on the project.<sup>60</sup> The legislation therefore assumes that the loss of carbon reduction will be covered by the 5% risk of reversal buffer. This is an unsafe assumption. The carbon emissions caused by a natural disaster may be far greater (or far less) than 5%, particularly since natural disasters are progressively becoming larger and more common.

A far more pragmatic way of dealing with such 'acts of God' is to require the proponent to relinquish CFI credits until the sink is re-established. That approach would ensure that credits are not being traded where the carbon sequestration that the credits represent has been reversed. Although this will disadvantage proponents who are not at fault, proponents are able to manage that risk the same way that businesses usually do — by taking out insurance.

## Conservativeness

The Consultation Paper defines this integrity standard as requiring that 'conservative assumptions, numerical values and procedures should be used to ensure that abatement and other claims are not over-estimated.'<sup>61</sup> This commendable approach should be extended to the process of deciding which types of abatement activity are eligible offset activities

<sup>55</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 82–3.

<sup>56</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 142.

<sup>57</sup> *Constitution of the Commonwealth of Australia* s 51(xxxi).

<sup>58</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 16.

<sup>59</sup> Consultation Paper 12.

<sup>60</sup> Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth) cl 83.

<sup>61</sup> Consultation Paper 10.

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under the CFI. Many of the proposed offset activities listed in the Consultation Paper, such as soil carbon sequestration or reduced methane emissions from livestock, are scientifically untested and largely theoretical. Abatement activities must be proven to a high degree of scientific certainty if they are to be approved as eligible offset activities.

To some extent this is already reflected in the draft CFI legislation. Clause 124 of the draft Bill requires that 'a method specified in a methodology determination...should be consistent with relevant scientific results published in peer-reviewed literature.'<sup>62</sup> This is an important recognition that the process of approving eligible offset activities must be based on science, not politics or commerce. However, these integrity standards should be amended to include an explicit acknowledgement that a cautious and conservative approach must be adopted in approving eligible offset activities.

Further, although the establishment of DOIC as an independent expert committee charged with approving methodologies is a sound first step toward guaranteeing independent scientific rigour in the CFI, it could yet be improved by making it a committee of scientists only. At present, the DOIC includes a commercial lawyer and a representative from DCCEE.<sup>63</sup> The regulatory expertise that these members bring could prove to be a valuable asset in preparing and administering the CFI, but query whether the DOIC (whose primary function is approving eligible offset activities) needs this non-scientific skill set.

## Biodiversity

There is a danger in carbon offsets schemes that activities which have a positive impact on climate change can have negative side-effects on other aspects of the environment.<sup>64</sup> For example, offset activities like biochar carbon sequestration can involve the logging of native forests, or the degradation of other aspects of the local environment.<sup>65</sup> Offset activities might also have a negative impact on regional communities. For example, the use of land for carbon offsets might reduce the availability of agricultural land, with ramifications for food security.<sup>66</sup>

To an extent, the draft CFI legislation recognises and safeguards against this risk. Clause 25(4)(i) requires that eligible offset projects must not 'involve...the clearing or harvesting of native forest, or using material obtained as a result of the clearing or harvesting of native forest'. Further, cl 25(4)(j) requires that 'all regulatory approvals have been obtained for the project' before it is approved as an eligible offset project under the CFI. This will likely require compliance with federal and state environmental assessment laws, including planning approvals, biodiversity assessments and water licences.<sup>67</sup>

There remain, however, a number of environmentally detrimental offset projects which could fall through the cracks of these protections. Offset projects might have adverse impacts on local species of fauna or flora. They might have adverse impacts on local waterways or water supplies. They might adversely impact high conservation value areas, or types of vegetation that do not meet the definition of '*native forest*'.

To capture these and whatever other adverse environmental impacts might arise as a result of offset projects under the CFI, cl 25(4) should be amended to include a general requirement that eligible offset projects 'must be environmentally sustainable', or 'must not have significant adverse environmental impacts'. This approach should require the application of the precautionary principle, so that where there is a threat of serious or irreversible environmental damage, cost-effective preventative measures (including not progressing with the project) should not be postponed due to a lack of full scientific certainty.<sup>68</sup> Proponents should be required to investigate the potential adverse environmental impacts of their project, which would also help to create a better picture of the net carbon reduction achieved by a project and reduce 'carbon leakage'.

<sup>62</sup> *Draft Carbon Credits (Carbon Farming Initiative) Bill 2011 (Cth)* cl 124(1)(d).

<sup>63</sup> [www.climatechange.gov.au/government/initiatives/carbon-farming-initiative/domestic-offsets.aspx](http://www.climatechange.gov.au/government/initiatives/carbon-farming-initiative/domestic-offsets.aspx).

<sup>64</sup> Susan Galatowitsch, 'Carbon Offsets as Ecological Restorations' (2009) 17(5) *Restoration Ecology* 563, 565, 567.

<sup>65</sup> Consultation Paper 9.

<sup>66</sup> Consultation Paper 8.

<sup>67</sup> Notably, it will include the requirements of the Environment Protection and Biodiversity Conservation Act 1999 (Cth).

<sup>68</sup> For more on the application of the precautionary principle, see *Leatch v Director-General of National Parks and Wildlife Service* (1993) 81 LGERA 270 and *Telstra Corporation Ltd v Hornsby Shire Council* (2006) 146 LGERA 10.

Another way to ensure that adverse environmental side-effects are avoided would be through a biodiversity code similar to that proposed under the *Climate Change Act 2010* (Vic). The previous Victorian Government agreed to develop a Carbon Sequestration and Biodiversity Code, setting out principles for the use and management of land for carbon sequestration purposes to maximise biodiversity conservation in carbon sequestration and storage.<sup>69</sup> That Code was never developed, but the CFI could benefit from the development of a similar code. It could be introduced as subsidiary legislation, and project proponents would have to demonstrate compliance with the code as a condition of approval of their eligible offset activity under cl 25.

## Conclusion

In some respects, the CFI is a good idea which is poorly implemented. The requirements of additionality, permanence, conservatism and biodiversity conservation are all sound in principle but poorly drafted and unlikely to be effective in practice. Thankfully, these requirements are easily fixed by redrafting the draft legislation.

In other respects, the CFI was a bad idea to begin with. As convenient as the CFI may be as an extra revenue stream for the agricultural industry, a voluntary offsets scheme of this kind is unlikely to prove effective in combating climate change. The reliance on offsets and end-of-the-pipe solutions, the absence of negative incentives, and the lack of an economy-wide cap on carbon all suggest that the CFI is unlikely to reduce net greenhouse gas emissions. Indeed, once the threat of carbon leakage and the considerable scientific uncertainty involved in many proposed abatement activities is taken into account, there is a very real possibility that the CFI will lead to a net *increase* in atmospheric concentrations of greenhouse gas.

Consultations on the CFI legislation formally closed on 21 January 2011, but the CFI as currently proposed is far from a foregone conclusion. The political landscape in the Australian Parliament provides an opportunity for continued public input and advocacy, and continued change to the proposed CFI. The recommendations in this article, and in ANEDO's submission to DCCEE, provide a blueprint for how federal climate change law generally and the CFI in particular might be reformed and improved.

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<sup>69</sup> Legislative Council (Victoria), Hansard, Debate on the Climate Change Bill, 3 September 2010, 4586