



Minister for Agriculture and Food Security

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Mr Tony Zappia MP
Chair
House of Representatives Standing Committee
on Climate Change, Environment and the Arts
Parliament House
PO Box 6021
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Dear Mr Zappia,

CARBON CREDITS (CARBON FARMING INITIATIVE) BILL 2010

On behalf of the Victorian Government, I welcome the opportunity to provide comments on the *Carbon Credits (Carbon Farming Initiative) Bill 2011*. These comments below are supplementary to those made by the Victorian Government in its original submission to the Australian Government on the Carbon Farming Initiative (CFI) stakeholder consultation paper, draft exposure legislation and methodology guidelines. The original submission is attached.

The Victorian Government places a high priority on the competitiveness and productivity of the agricultural sector, and its contribution to the Victorian and national economies. As such, it would be opposed to the future granting of any offset credits for activities such as destocking, or any policy actions which give rise to perverse incentives that could adversely affect the economy, communities and the environment.

The Victorian Government acknowledges a number of improvements in the proposed legislation compared to the draft exposure legislation, stakeholder consultation paper and methodology guidelines. In particular, the Victorian Government welcomes the changes to the additionality criteria, especially exclusion of financial additionality.

However, the government still has significant concerns with the CFI legislation, with many of these concerns canvassed in the original submission remaining relevant. Additional comments on the key remaining concerns and changes to the CFI as outlined in the Bill are attached.

The Victorian Government is keen to continue the process of engagement in the development of this important policy initiative.

Yours sincerely

Peter Walsh MLA
Minister for Agriculture and Food Security

Encl.

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**VICTORIAN GOVERNMENT'S ADDITIONAL COMMENTS ON THE CARBON CREDITS
(CARBON FARMING INITIATIVE) BILL 2011**

The Victorian government welcomes the opportunity to provide comments on the Carbon Credits (Carbon Farming Initiative) Bill 2011. These comments are supplementary to those made in the Victorian Government's original submission to the Australian Government on the Carbon Farming Initiative (CFI) stakeholder consultation paper, draft exposure legislation and methodology guidelines (attached).

The Victorian Government places a high priority on the competitiveness and productivity of the agricultural sector, and its contribution to the Victorian and national economies. The Victorian Government also wishes to ensure that the CFI complements rather than conflicts with existing State-based policies and programs aimed at improving the environment and land management practices, both on public and private land. As such, it would be opposed to the future granting of any offset credits for activities such as destocking, or any policy actions which give rise to perverse incentives that could adversely affect the economy, communities and the environment.

The Victorian Government acknowledges a number of improvements in the proposed legislation compared to the draft exposure legislation, stakeholder consultation paper and methodology guidelines. In particular the Government welcomes the changes to the additionality criteria, especially exclusion of financial additionality.

However, the Victorian Government still has significant concerns with the CFI legislation, with many of these concerns canvassed in the original submission remaining relevant. One particular area of concern is the continuing lack of clarity on what implications the CFI project approval process will have for State-based natural resource management programs. Additional comments on the key remaining concerns and changes to the CFI as outlined in the Bill are as follows.

Comments on changes to the CFI Bill

Additionality

The Victorian Government welcomes the changes to the CFI which provide more flexibility in the application of the additionality criteria. The main changes include a focus on determining "common practice" on an industry or regional basis rather than on a project basis, and the removal of any "financial additionality" requirement. These changes remove barriers to the inclusion of project activities which increase agricultural productivity or business profitability. These changes may also reduce compliance costs for businesses and potentially enhance the range and scope of

eligible offset activities, which in turn could promote greater innovation and productivity in the agriculture sector.

These changes could also help ensure that private landholders that may receive some funding from the State Government for the production of other environmental services such as habitat and biodiversity are not excluded from the CFI.

However, more detail on what constitutes the "not common practice" criterion which is the new proposed threshold for additionality, is required.

Crediting and reporting periods

The Victorian Government acknowledges changes to the crediting period and reporting requirements. The increase in crediting period to seven years (20 years for avoided deforestation), is potentially useful since the benefits of abatement activities are often felt over a longer period of time. Likewise changes to the reporting period to enable project proponents to choose a reporting period between 12 months and 5 years enhances flexibility in the system.

Methodology approvals process

The Victorian Government is also pleased that the methodology approval process has been streamlined, with the possibility of applicants being able to request that commercially sensitive information be kept out of the public domain. This is important to preserve the integrity of intellectual property and not diminish the incentives for innovators to undertake improved practices. Other welcome changes have also been made which add transparency, flexibility and timeliness of the decision making process. A new procedure has been developed to allow for project proponents to change projects' methodology during the life of the project. Further, proposals for new methodologies now only have to be open to public comment for 40 days rather than the previous 60 day period. This will likely make the process more timely. The Government is also required to publish reasons for its decisions regarding methodologies, which will assist transparency.

Public land

The Victorian Government also notes that public land will be able to be used for carbon projects under the CFI Bill, an aspect that the Government was seeking clarification on its earlier submission. However, it is still seeking further clarification as to what reforestation or revegetation activities are deemed additional in public land management. Further clarification is needed regarding the role of State based native title agreements. While the legislation indicates it will allow indigenous people to participate in the CFI, there does not yet appear to be any formal recognition of State based native title agreements in the Bill.

Prescribed burning

The Victorian Government supports changes in relation to prescribed burning such that credits do not have to be relinquished if project managers undertake prescribed burning or establish fire breaks. This is important for effective and efficient fire management strategies by State Governments.

Key remaining concerns

The Victorian Government has a number of remaining concerns with the CFI legislation, as reflected in its original submission.

Administrative burdens

Notwithstanding some flexibility in areas such as reporting timelines, the Victorian Government still considers that the scheme, overall, is complicated and costly for landowners in terms of compliance costs, including reporting, verification and other transaction costs.

Demand side issues

The CFI is also essentially a supply side proposal which would benefit from greater consideration of demand issues to ensure a robust and viable offset market. A well functioning, adequately sized offset market would also enable governments to learn lessons on how best to design and operate a larger, future market and facilitate learning experiences for businesses associated with participating and trading in a voluntary offset market. The Victorian Government believes that the Commonwealth should examine ways in which the demand for offsets can be stimulated efficiently and effectively.

Leakage

The Victorian Government has ongoing concerns with the treatment of leakage, despite the legislation removing the assessment of leakage on a project by project basis. The Victorian Government believes that issues which are beyond a landholder's direct control, such as increased production in other parts of the economy, should not impact on a landholder's ability to generate offsets. Leakage principles should not extend to changes in production external to a farm business.

The CFI should be complementary to farm productivity and not provide perverse incentives for farmers to reduce or not optimise the productivity and profitability of their core business.

Perverse incentives for communities/biodiversity/water

The Victorian Government believes that it is important to identify and manage carefully any unintended perverse outcomes of the CFI in relation to agricultural land, water availability and biodiversity.

The Victorian Government notes that the CFI bill proposes the following to help address such perverse outcomes and encourage "win-wins": a co-benefits index to allow project proponents to rate, market and obtain a premium for co-benefits; a requirement that project proponents publish details of their project's alignment with State resource management plans; and the establishment of a "negative" list which would exclude projects with significant risk of significant adverse impacts on water availability, biodiversity, employment or the local community.

While the Government welcomes the need to carefully manage externalities and any perverse outcomes from CFI projects, it would like clarification from the Australian Government as to the implications of these arrangements for State based natural resource management plans. Further, the Victorian Government would like to point out that care needs to be taken in determining what standards should be met in terms of the co-benefits identified. In addition, in dealing with any perverse outcomes from the scheme, it will be important to avoid investor uncertainty and adding unduly to compliance and other cost burdens for businesses. In relation to the exclusion of projects, the Victorian Government would like clarification regarding what is meant by "significant" adverse impacts on water availability, biodiversity, employment or the local community.

Permanence

The Victorian Government is of the view that the permanence arrangements in the Bill are a major constraint for biosequestration projects, although it recognises the advantages of maintaining sequestration in biological sinks over the long term. The Victorian Government suggests that permanency arrangements should be improved by treating biosequestration in a flexible manner, allowing for temporary sequestration to be valued through mechanisms such as "rental income". This can help to slow cumulative warming of the climate and, in effect, buys time for other sequestration or abatement activities to be adopted.

Risk of reversal buffer

While accepting the value of a risk of reversal buffer, the Victorian Government considers that a flat percentage buffer (currently specified at 5%) across all biosequestration projects appears to be overly simplistic. A risk based assessment of projects, or broad categories of projects with different risk of reversal buffers, would be more appropriate. Thus, projects with a greater risk should attract a higher risk of reversal buffer.

**THE CARBON FARMING INITIATIVE
CONSULTATION PAPER**

VICTORIAN GOVERNMENT SUBMISSION

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Introduction

This paper has been prepared on behalf of the Victorian Government as an input into the Australian Department of Climate Change and Energy Efficiency's proposed Carbon Farming Initiative (hereafter CFI) Consultation Paper, draft legislation and methodology guidelines.

The Consultation Paper seeks comment on a number of specific issues associated with the development and implementation of the proposed initiative.

This submission outlines the Victorian Government's views and suggested areas for further consideration. The Victorian Government welcomes the opportunity for additional consultation on any of the key design issues outlined below.

Voluntary offset carbon markets such as the CFI can potentially provide farmers with the opportunity to earn additional revenue, an opportunity only accorded to the agricultural sector in Australia. Further, the voluntary nature of such an offset market means that only those businesses that see benefits from participating may do so.

However, the Victorian Government has a number of significant concerns with the design of the proposed CFI which may act as disincentives for primary producers to participate in the scheme. It strongly believes that the scheme as currently designed is unnecessarily complicated, costly for landowners to verify compliance, carries significant deadweight administrative costs in terms of on-farm auditing and may entrench perverse incentives restricting landowners from maximising productivity and profitability from increasingly scarce agricultural land resources.

Moreover, the CFI does not adequately define the nature of the product to be traded. It is also essentially a supply-side proposal which would benefit from greater consideration of issues related to the demand for carbon offsets.

The Victorian Government is also concerned that the CFI should not cause uncertainty for business due to its complexity. It is important that the CFI can drive real emission reductions whilst providing investment certainty for farmers and other landholders.

The Victorian Government has placed a policy priority on a competitive and vibrant agriculture sector. An important component of that policy is that governments do not introduce policies which artificially distort markets either for agricultural land use or impose barriers on food and fibre productivity and output. CFI should complement, not detract from, productive primary production enterprises. As such, the Victorian Government is strongly opposed to the granting of any offset credits for activities such as destocking.

In this context, while the Victorian Government believes that any real and significant reductions in greenhouse gas emissions, alongside other co-benefits such as enhancing agricultural productivity, biodiversity and salinity management, could occur under the CFI, it will be important to manage perverse outcomes that may adversely affect communities and/or the environment.

More specifically, key areas of concern to the Victorian Government include the treatment of additionality, leakage and methodology approval under the CFI. The Victorian Government believes that, in the first instance, methodologies should be simple and flexible to maximise market participation and ensure emission reductions at minimal cost can be achieved.

Specific Issues

- The CFI should enhance and complement farm productivity and profitability outcomes.
- Additionality principles should be flexible in the early years to ensure they do not unnecessarily restrict market participation.
- The principle of permanence should be more flexible to recognise the value of temporary sequestration.
- Clarification is needed on how existing Victorian programs can complement the CFI.
- Offsets generated on public land should be considered as part of the CFI.
- The risk of reversal buffer should reflect more accurately the potential risks of emissions reversal across different types of agricultural activities.
- Perverse incentives discouraging planned burning for fire reduction purposes should be removed from the CFI.
- Clarification is needed on the standards for co-benefits linked to carbon offsets.
- Leakage principles should not extend to changes in production external to a farm business.
- Leakage principles should not create perverse incentives for landowners to reduce or not take up opportunities to boost productivity.
- Care should be taken to avoid methodology approval processes which give rise to perverse outcomes that are against the community interest.
- Support structural adjustment by promoting innovation in the agriculture industry.

1. Definition of “Project”

There are many references to “projects” throughout the consultation paper and draft legislation, but they do not specify exactly what a project entails.

The CFI Consultation Paper outlines that agriculture and forestry offsets can be generated by individual landholders or by broader collections of landholders, usually represented by a carbon offset aggregator that manages project application and administration requirements. The ability to pool landholders for emission reduction projects is advantageous as it enables many smaller landholders to participate in the carbon offset market by minimising transaction costs.

Further discussion with Australian Government officers indicates the intention is to allow both individual landholders and larger collections of landholders to participate in the CFI as “projects”. It was also indicated that the key principle for determining what constitutes a project is ownership of carbon rights and only one entity will be able to hold the carbon rights for each CFI project regardless of whether one or multiple landholders are involved.

As such, the Victorian Government suggests that clarification is needed over what constitutes a project including the role of aggregators, how projects with multiple landholders will work, including if projects can occur across multiple land titles, and whether there will be any threshold for participation.

There also appears to be some inconsistency in the *Draft Methodology Guidelines* in the treatment of project emissions. The Guidelines indicate all “*direct and indirect emissions sources and sinks within the project proponent's control would form the project boundary. This would include emissions from electricity consumption*”. The Guidelines also state however that “*emissions sources and sinks that would result in net reductions or removals under abatement projects applying the draft methodology, but are ineligible for crediting, must be excluded from the project boundary*” (p 10).

This raises two problems:

(a) there appears to be a one-sided treatment of non-eligible emissions. Reductions in electricity or fuel use associated with a project cannot be credited as offsets but the amount of credits received can be reduced if electricity or fuel use increases; and
(b) the need for project proponents to account for indirect emissions such as electricity consumption is problematic where the project proponent is a carbon aggregator, who may not be directly managing the land and may have limited ability to control all other activities at a project site.

Further clarity on the reasons for this approach is sought, and consideration of the impact of the accounting approach to project design is required. Articulation of the treatment of leakage for eligible and non-eligible emissions sources and sinks would also be appropriate.

Recommendations:

That the Australian Government clearly define what constitutes a CFI project, and makes explicit that projects can involve pooling of individual landowners.

That the Australian Government provide further clarity on the inclusion and exclusion of eligible and ineligible emissions sources and sinks to be included in the 'project boundary'.

That the Draft Guidelines provide some guidance as to differences in methodology approaches, if necessary, for landholders and aggregators.

2. Additionality

Additionality is an internationally recognised principle, integral to the development of robust and credible carbon offsets and one of the key principles underpinning the Australian Government's CFI proposal. In essence, it aims to ensure that any emissions reduction credited in an offset market are for activities that would not otherwise have occurred – i.e. activities that are not business-as-usual.

Victoria is concerned, however, that the way additionality is framed in the CFI consultation paper could potentially lead to exclusion of some significant offset projects or produce perverse and unintended consequences. What is needed is greater flexibility and simplicity in the application of additionality.

The Victorian Government does however consider that the concept of a 'positive list' which readily identifies activities which achieve abatement and do not result in material increases to emissions, enabling them to be deemed as additional without further assessment has merit. This could help to reduce cost for landholders and could encourage participation in the offset market.

Another way to reduce costs for both landholders and government would be to create a 'memory' in the system so that when the same type of project crops up, whether on the positive list or not, the additionality status is immediately recognised. This would reduce some of the administrative burden for government.

There are a number of reasons for a more flexible definition of additionality and ways in which this can be achieved, which could enhance the range of activities eligible for offsets. Specific concerns about the treatment of additionality are discussed further below.

2.1 Risks of a small market

Victoria suggests that it is important to have a broad offset market in the early years, to enable as many farmers as possible to capitalise on revenue earning opportunities and to build capacity in the sector. This view is supported by ACIL Tasman's 'Australian agriculture as a provider of carbon offsets' (2010) discussion paper which argues that "in the initial stages of developing an offsets market, where capacity building is a priority along with achieving a net reduction in emissions, it may be

worthwhile erring toward a liberal additionality test rather than risk constraining offset development through a heavy handed additionality policy.”¹

Victoria is concerned that onerous requirements of additionality could result in few benefits to farmers and a thin market, with few offsets. A well-functioning, adequately sized offset market would also enable governments to learn lessons on how best to design and operate a larger, future market, and allow participants learning experiences associated with participating and trading in a voluntary offset market.

The Consultation Paper is silent on whether there are any caps or limits on the export of offsets. By explicitly excluding any limits or caps on the amount of offsets that can be exported to international markets, the Australian Government could help to increase the depth of the domestic offset market and stimulate investment into Australia’s rural economy. This is an area worthy of further discussion with the Australian Government.

2.2 Unlocking emissions reduction potential

A flexible standard of additionality could allow for additional abatement as the carbon price signal provided by the CFI drives uptake of new practices. This is particularly beneficial for practices that are in the early stages of development, where production benefits are not yet clear enough to drive practice change.

In the case of agriculture, farmers have a strong track record of improving productivity while reducing emissions. In fact, most changes to agricultural activities which reduce greenhouse gas emissions also increase productivity. This could be considered business-as-usual from a narrow additionality perspective and therefore rule out such activities from the CFI. This puts future productivity gains and emissions reductions at risk and could limit future research and development on options to reduce agricultural emissions.

Indeed, in the case of agriculture, most research so far on agricultural mitigation has focussed on win-win options, as farmers are most likely to adopt options that also increase productivity. For example, adding whole cottonseed to the diet of dairy cattle can improve milk yield and profitability while decreasing methane emissions, especially when there is poorer quality pasture available. A strict treatment of additionality might rule out such opportunities from offset markets despite the benefit of reduced emissions.

There are many new practices in farming that have been demonstrated to deliver enhanced returns for farmers as well as potentially reducing greenhouse gas emissions. However, a number of have not been widely adopted due to a lack of information, difficulties accessing up-front capital, and costs of system change amongst other reasons. Allowing these practices to earn credits from the CFI may help to drive practice change and enhance structural adjustment in the agriculture industry.

¹ ACIL Tasman, (2010) ‘Australian Agriculture as a provider of carbon offsets,’ pp 39

The Victorian Government places a very high priority on a growing, productive and profitable agriculture sector. It is strongly opposed to any possible awarding of offset credits associated with destocking. Such incentives would be inconsistent with the important role that agricultural production plays in the Victorian and national economies. Moreover, awarding credits for destocking could encourage leakage as stocking rates increase elsewhere in the economy.

The Victorian Government recognises that the provisions in the *Draft Methodology Guidelines* allow for a more flexible treatment of additionality of projects on the non-positive list of activities including accounting for barriers to adoption such as information gaps, and capital market barriers. Barriers to adoption of new practices can change over time and it will be important for the Australian Government to take into account changing circumstances.

Recommendation:

The Australian Government be flexible when it comes to determining additionality criteria, and avoids possible perverse outcomes associated with offset markets.

2.3 State Government Carbon Offset Programs

The language in the discussion of additionality in the CFI consultation paper and the proposed additionality test in the draft CFI legislation leaves the status of government funded offsets programs unclear.

The Victorian Government has engaged in a number of carbon offsetting programs in recent years. The Victorian Government Vehicle Fleet Offset Program (VFOP) is a good example of such programs. Administered by the Victorian Department of Sustainability and Environment (DSE), this program has been buying carbon offsets to lower the net environmental impacts of the Government's vehicle fleet since 2001.

The main features of the VFOP program are summarised below:

- DSE purchases approximately 30,000 tonnes of carbon offsets annually to offset part of the Victorian Government fleet's emissions;
- offsets are purchased through contracts with established carbon offset providers (carbon aggregators);
- most of the carbon offsets are sourced from biodiverse environmental plantings (an offset that produces multiple benefits, including biodiversity); and
- the required carbon accounting outcomes for the program have changed as the voluntary market has matured. Prior to 2008, third party verification was required. In 2008, the offsets purchased needed to be accredited under the Australian Government's previous Greenhouse Friendly program or the NSW GGAS scheme. The offset purchase in 2010 required suppliers to commit to complying with a future Australian Government offset standard relatively consistent with the CPRS approach.

While programs like the VFOP are Government-funded programs, they are specifically designed to purchase carbon offsets; they source their offsets mainly from

private land; they are designed to meet national offset standards; and they clearly are a voluntary action by Government that goes beyond "business as usual" Government activity.

The Victorian Government notes the importance of allowing State Government policies and programs that support carbon sequestration either through voluntary action or complementary measures to participate in, or alongside, the CFI.

There should be scope for recognition of emissions reduction and/or sequestration services from farmers purchased under this sort of State scheme to transition into the CFI. Failure to recognise such programs which adhere to CFI criteria would not only defeat the purpose of such programs from State Government's perspective but also potentially remove State Government as a buyer of emissions reduction and/or sequestration services from farmers.

- Government can play a potentially useful role in helping support demand for offsets under the CFI and thereby enable farmers to see net benefits from reducing greenhouse gas emissions, particularly in the early years of establishment of a domestic carbon market.

Recommendation:

That the Australian Government clarify the use of the term 'Government programs' in the CFI.

That the Australian Government consider including State Government programs that can assure voluntary action be included as part of the CFI.

That the Australian Government make clear that State and Territory Governments can purchase or drive offsets through its own policies.

2.4 Multiple Benefits / Ecomarkets approaches

Victoria recognises that a range of environmental benefits can often be jointly generated alongside carbon sequestration in a cost effective manner. Victoria's ecoMarkets program has demonstrated that investments in environmental goods and services (such as river, terrestrial and catchment benefits) can be more cost effective when outcomes are produced together than when produced separately (see Attachment A).

An integrated market for carbon and co-benefits represents the next generation of eco-markets. Governments at all levels are beginning to recognise that an opportunity exists to leverage the carbon sequestration market to achieve greater efficiency in government expenditure on environmental regeneration and rehabilitation activities.

Given that many environmental benefits of a biodiverse planting do not have a price without government intervention (e.g. biodiversity), opportunities will emerge for States and Territories, NGOs and private individuals, to 'purchase' the non-carbon environmental benefits co-produced with carbon, where the carbon may be purchased by a third party. This is a similar proposition to a farmer selling wheat grown on a plot of land also used for soil carbon sequestration. It is important that the CFI does not block these emerging opportunities.

Joint purchase can represent a win-win proposition, delivering a greater return for landholders and improved cost-effectiveness for governments. Government may not ordinarily fund the project 'but for' the demand for carbon (which co-delivers the cost-effective non-carbon environmental benefits), and the status of the carbon as additional should therefore be unaffected by the Government's joint purchase. The carbon component of these projects must be regarded as additional in order for the broader range of environmental benefits (e.g. biodiversity) to be realised.

The CFI needs to be sufficiently flexible to permit this co-purchase without invalidating the additionality of the carbon sequestered. This will incentivise landholders to deliver non-carbon related environmental benefits while delivering greenhouse gas abatement when planting carbon. Should the positive benefits from the production of carbon alongside other goods not be priced, producers are underestimating the true benefits of activities that produce carbon alongside other goods in their investment decisions.

The Victorian Government supports the inclusion of 'the establishment of mixed-species or non-commercial plantings designed to maximise carbon sequestration' alongside other projects with multiple benefits on the 'positive list', as suggested in the *Draft Guidelines for Submitting Methodologies*.

Recommendation:

That the CFI be sufficiently flexible to enable third-parties to purchase the non-carbon environmental benefits jointly produced with carbon bought by another buyer, without invalidating the additionality of the carbon.

2.5 Carbon Projects on Public Land

The consultation paper does not indicate whether carbon projects on public land will be able to participate in the CFI.

The Australian Government's position on this issue has varied in recent years.

Several years ago Victorian agencies explored the possibility of having reforestation / landscape rehabilitation projects on specific areas of public land accredited by the Australian Government's previous Greenhouse Friendly program. The intention was to use the carbon market to help leverage investment in strategic parts of public land requiring reforestation / rehabilitation.

Australian Government advice at the time indicated such projects would not be accredited. This was reportedly because such projects were not considered "additional", because the projects were occurring on public land (and hence considered part of Government's normal public land management responsibilities).

The Australian Government's position shifted with the subsequent Carbon Pollution Reduction Scheme (CPRS) proposal. The CPRS allowed Kyoto-compliant reforestation projects on public land to be "opted in" to the Scheme to act as a source of carbon credits. Victoria recently introduced new legislation (Victoria's Climate Change Act 2010) to facilitate development of carbon projects on public land, in line with the CPRS proposal.

Introduction of the CPRS has now been deferred, but the Australian Government has chosen to proceed with implementation of many aspects of the forestry component of the original CPRS proposal through the CFI.

The CFI aims to cover both Kyoto- compliant and non-Kyoto compliant types of forest carbon offsets. Public land can usefully complement private land in this area. While most forest carbon generation on private land in Victoria is likely to be Kyoto-compliant, most forest carbon on public land is likely to be non-Kyoto compliant (ie. carbon generated not through reforestation but rather through revegetation and native forest management). Inclusion of public land in the CFI would provide an opportunity to further develop the carbon market's capacity to deal in domestic non-Kyoto forestry offsets and broaden the range of offset products available.

The basic principle, that public land should in certain circumstances be able to participate in the CFI, appears to have been recognised in the draft CFI legislation. Clause 25(4) of the exposure draft sets out the requirements for the 'Declaration of an eligible project' and allows for the project areas to be on Crown land, provided that written consent has been received from the lands Minister of the State or Territory.

Inclusion of carbon projects on public land may raise the question of additionality – i.e. to what extent such activities can be attributed to a carbon price. Victoria believes the previous argument that carbon projects on public land cannot be eligible in principle because they are considered part of normal Government land management responsibilities is oversimplified, unrealistic and requires further review.

There should be capacity within the new CFI accreditation framework to approve carbon offset projects on public land on the basis of more specific, agreed and transparent project criteria, either as part of, or separate to the Australian Government's proposed "positive listing" mechanism. Victoria would be happy to work with the Australian Government and other jurisdictions further on this issue.

Recommendation:

That the Australian Government work with the States and Territories to ensure that the proposed regulations, which will provide a "positive listing" of eligible CFI projects, gives appropriate recognition to potential carbon abatement or sequestration projects on public land.

3. Permanence

Permanence will be a major issue for bio-sequestration projects, as the consultation paper raises. The Victorian Government acknowledges the importance of ensuring that reductions in emissions make a difference to the overall abatement task but recognises the difficulty of maintaining sequestration in biological sinks over the long-term.

The Victorian Government points to an approach to address permanence as outlined in the ACIL Tasman work. In its report, ACIL Tasman suggested permanency should be treated in a flexible manner, allowing for temporary sequestration to be valued

through a mechanism such as “rental income” for temporary sequestration². Temporary sequestration, ACIL Tasman argues, has value in that it can help slow cumulative warming and in effect buys time for other sequestration or abatement activities to be adopted.

While the Victorian Government acknowledges the ACIL Tasman approach would likely attract a discount to the price of permanent carbon abatement, such products expand the options available to promote greater abatement.

Recommendation:

The Australian Government consider allowing projects with shorter ‘permanency’ timeframes to enable greater participation by farmers and expand the abatement product mix.

3.1 Risk of reversal buffer

The Victorian Government recognises the potential benefits of a risk of reversal buffer, however a flat percentage buffer (currently specified at 5 per cent) across all bio-sequestration projects seems overly simplistic. A risk based assessment of projects, or broad categories of projects with different risk of reversal buffers, may be more appropriate. In other words, projects which have a greater risk should attract a higher risk of reversal buffer that incorporates this higher risk. Certainly for soil carbon projects, a larger buffer may be appropriate to protect the integrity of the scheme.

There are also alternative approaches to managing this risk such as using a ‘portfolio’ of projects, across a large area, which can minimise this risk. By using multiple projects across different areas, the risk of much of the carbon being lost in one event, such as a bushfire, is limited.

The use of a portfolio approach, as advocated by ACIL Tasman (2010), could reduce the risks of reversal by “bundling” abatement projects (using different methodologies) and therefore spreading risk. The ACIL Tasman report highlights that for a given level of risk, a higher level of abatement can be attributed to a portfolio of abatement activities, compared to assessing the same projects on a case by case basis. See Box 1.

Recommendation:

The Australian Government considers applying different risk of reversal buffers to different projects.

4. Leakage

There are various types of leakage, including where production is reduced in one location but increased in another, meaning no net change in emissions, or where actions on farm to reduce emissions give rise to increased emissions on the same farm.

² ACIL Tasman, (2010) op. cit. pp 37

The Victorian Government believes that issues which are beyond a landholder's direct control, such as increased production elsewhere, should not impact on a landholder's ability to generate offsets.

The Victorian Government is concerned that any increases in Australia's gross agricultural emissions could be seen as enough evidence to indicate leakage is occurring, thus excluding agricultural activities from being eligible to generate offset credits.

Box 1. Example of increasing incentives from pooling risk across a portfolio

Consider the case of a farm behaviour change being assessed for a carbon credit. The assessors recognise substantial uncertainty in the level of carbon that might be captured and conclude that the distribution of plausible outcomes is approximately a Normal distribution, with a mean of 7.9 tonnes and a standard deviation of 3 tonnes. They adopt a project focus, in which a safe lower bound is interpreted as the 1 percentile outcome – a level of accredited abatement that will be delivered 99 per cent of the time. This results in credit being issued for 1 tonne of carbon abatement, even though the expected abatement is 7.9 tonnes. Incentives are very weak.

What now if we could pool 100 such measures, spread across different forms of behaviour change, different farms, regions, rainfall patterns, production systems – even countries. Purely for simplicity, assume all offer the same distribution of possible outcomes.

If assessed case by case, the assessors would conclude that each offers safe abatement of 1 tonne and would issue credits for 100 tonnes of carbon.

However, if instead they looked at the distribution of the portfolio of 100 initiatives, again using the 1 percentile safety rule, they would reach a very different conclusion – because the “Central Limit Theorem” applies to the distribution. The 1 percentile of the portfolio is 718 tonnes, not 100 tonnes. Each farm contributes 7.18 tonnes, not 1 tonne, to the safe lower bound performance of the portfolio, and could receive credit for over seven times the abatement that would be recognised in a project-by-project assessment process. The whole climate change initiative gains from the greatly enhanced, and now much less biased, incentives to deliver abatement and sequestration.

The remaining upside – the gap between the 718 tonnes credit and the expected contribution of 790 tonnes, and the 540 per cent chance that the actual outcome could be greater again, could then be tapped by issuing options over this upside – to be exercisable if and when the assessment rules are changed to reflect new information. Any or all of more stringent verification requirements, larger portfolios, greater uncertainty on individual initiatives and scope for including in the portfolio some measures whose outcomes are negatively correlated (self-hedging), would serve to strengthen the point made by this example. There is no requirement for all initiatives to be identically distributed.

Source: ACIL Tasman (2010), 'Australian Agriculture as a provider of carbon offsets' pp xvii

There are other sources of leakage on farm, however, that could warrant attention, such as the potential for leakage due to positive outcomes from emission reduction activity. For example, a farmer may take action to improve their soil carbon levels, which requires greater use of fertiliser. The increase in fertiliser usage gives rise to nitrous oxide emissions. The increased emissions from fertiliser usage may then wipe out any gains from increased soil carbon levels.

Enhancements to agricultural productivity resulting from the CFI should be embraced as a positive. It would be possible in such instances to require landholders to have a whole farm systems audit to determine any impacts on net emissions, but such an approach could be burdensome and discourage participation in the initiative. Governments could consider subsidising the cost of such audits in the short term to encourage participation and allow for learning experiences to grow.

- The CFI should be complementary to farm productivity and not provide perverse incentives for farmers that reduce or fail to optimise the productivity and profitability of their core business.

Recommendations:

The Australian Government should exclude external (off farm) production changes from its assessment of leakage.

The Australian Government could consider modelling (even on a trial basis) leakage on a farm systems basis to examine the sort of issues raised in relation to the soil carbon example above.

5. Scheme Processes

The Victorian Government considers that there are a number of procedural issues that require clarification.

5.1 Co-benefits

Victoria strongly supports policies that provide an incentive for other benefits arising from emissions reductions and biosequestration activities. However, there have been some concerns regarding misleading and overstated claims in relation to other benefits of carbon sequestration, some of which have been noted by the ACCC.

Providing information on the other benefits from carbon offsetting activities is particularly relevant to the voluntary market, where buyers may be prepared to pay a premium for social and environmental co-benefits. A framework that responds to concerns regarding misleading claims on co-benefits and ensures transparency of claims is needed.

The CFI proposal provides this to some extent by requiring that claims included in the database should be supported by evidence made available for public scrutiny. However, care should be taken in determining what standards should be met in terms of both the actual co-benefits and the information provided before claims are included in the database, and the resources required to ensure these standards are met. Without

some form of verification and monitoring, including such claims on a Government database could perpetuate existing issues with misleading or overstated claims, and even worsen the issue by suggesting that the claims had been endorsed by the Government.

The Victorian Government is also concerned about how projects with co-benefits will be identified and sold at a premium price. Clarification is needed as to whether it will be entirely up to carbon brokers, or the offset holders to promote their offsets as having co-benefits and use this to justify a higher price, or whether the Australian Government will take a role in identifying and promoting these offsets. We would envisage that an assessment of the potential market for these co-benefits would be conducted by the Australian Government.

Additionally, the examples of co-benefits given, such as youth employment, seem rather tangential to the overall aim of the CFI. The Victorian Government seeks clarification about any restrictions relating to what can be classified as a co-benefit, and whether claims of co-benefits would need to meet a similar level of integrity to the offset itself.

As noted in the CFI consultation paper, governments are working on developing methods to assess or value co-benefits, and Victoria has been actively involved in this process through the Ecosystem Markets Task Group. Victoria would recommend that co-benefits should only be in the offsets database if they meet a standard approved by the Australian Government, the requirements of which may vary depending on the co-benefits being claimed. The Australian Government should work with State and Territory Governments and the private sector in the development of these standards. Operators would still be able to make claims outside of the standards elsewhere, which would be subject to the Trade Practices Act 1974. It will be important to monitor the effectiveness of the Trade Practices Act in ensuring the integrity of any co-benefits.

Another point of concern relates to the relinquishment requirement if carbon stores are destroyed or not re-established, or in the case that participants may want to withdraw from the scheme. Discussions with Australian Government officers indicated that this requirement would not extend to the 'co-benefits' associated with a carbon offset purchase. This could create a situation where carbon credits with co-benefits are sold at a premium, only for the proponent to withdraw from the scheme and relinquish cheaper carbon credits with no associated co-benefits. This strengthens the argument for a standard on co-benefits to be in place, and also indicates that consideration of a 'like-for-like' relinquishment requirement to be put in place.

Recommendations:

Co-benefits should only be in the offsets database if they meet a standard approved by the Australian Government.

The Australian Government should work with State and Territory Governments and the private sector in the development of these co-benefit standards and what, if any restrictions there will be on what can be claimed as a co-benefit.

That the Australian Government consider the implications of the relinquishment requirement not being 'like-for-like' in relation to co-benefits.

5.2 Reporting

The Victorian Government is concerned about the potential for high transaction costs, including compliance and audit costs, which might limit participation by farmers and other landholders.

Data from the Alberta offset scheme in Canada suggests that costs to farmers for activities such as reporting and verification and other administrative requirements could be of the order of \$450-700 per crediting period for a project. This is in addition to transaction costs of approximately 5 cents per tonne of abatement. These costs could represent a significant proportion of any income gained from the CFI, particularly if the carbon price is low.

The Victorian Government is of the view that compliance costs for Australian farmers under the CFI would also be prohibitive, which could severely limit participation in the scheme.

- The CFI Consultation paper also states that “proponents would be required to select auditors who have met the requirement of the National Greenhouse and Energy Reporting System (NGERS) and have been listed on the register of Greenhouse and Energy Auditors.”

The Victorian Government seeks clarification as to whether the Department of Climate Change and Energy Efficiency has considered whether there are sufficient numbers of auditors for the expected number of projects. Furthermore, with a maximum crediting period of three years and a requirement to be audited at least once per crediting period, it seems possible that the costs of this could be prohibitive for small-scale offset projects.

5.3 Crediting

The Victorian Government recognises the potential benefits of using averaging approaches for bio-sequestration projects. However, it is concerned that with a maximum crediting period of three years, any benefits will not be seen for some time. Certainly this is the case for soil carbon, where DPI’s research indicates that changes in soil carbon are difficult to measure over short timeframes. Over 10 years, however, changes can be measured and verified more easily.

In such instances, it may be beneficial to allow for a longer crediting period, with regular allotment of offset credits, whilst maintaining a requirement to have the project audited several times during the period. For example, a 10 year crediting period with audits required every 1-3 years to ensure that the activities required to increase soil carbon levels are being performed. Longer crediting periods would also reduce the administrative burden for the government as well as for landholders.

In the event that the sequestration or abatement rates of a methodology are revised upwards without any change to the activities necessary to achieve this change, the Victorian Government believes that the DCCEE should apply these revised rates to existing projects. This would benefit project proponents by granting additional offset

credits against the same activity, without the need to re-apply and re-audit a project. This would also have the benefit of minimising associated transaction costs.

Another option for crediting, as suggested by ACIL Tasman in its '*Australian agriculture as a provider of carbon offsets*' discussions paper, would be to allow for immediate crediting of safe, lower bound estimates of emissions reductions, with options issued for any additional offsets to be credited for any abatement that can be verified later³. This would maximise potential value for landholders, minimise transaction costs by avoiding the need to re-apply using a different methodology, and maintain the integrity of the scheme by only crediting initially at a lower bound estimate.

Victoria is also concerned about the rolling average crediting approach. Whilst the Victorian Government broadly supports the idea of using a rolling average to credit projects which are subject to large annual fluctuations, landholders would presumably not receive any offset credits until an average value is obtained. For instance, a five year rolling average would mean that landholders would receive no credits until after the end of the fifth year.

To rectify this, a lower-bound estimate of credits could be allocated every year until the end of the first rolling average period, after which time the net position of carbon is established and crediting can continue based on the rolling average. Otherwise, the potential for no credits to be received for several years may deter some landholders from participating in the CFI.

Finally, the CFI Consultation paper states that units issued through the scheme would be recognised as financial products. ASIC Regulatory Guide 146 outlines that all natural persons who provide financial product advice to retail clients must meet training standards set out by RG 146. The Victorian Government seeks clarification as to whether or not an Australian Financial Services License would be required by the specialist service provider and/or offset aggregators to transact the units on the farmers and landowners behalf. A clear understanding of this classification and the requirements there on must be understood by the participants of the CFI.

Recommendations:

The Australian Government allows for crediting periods longer than three years in the CFI, with regular audits to ensure integrity.

The Australian Government considers granting 'options' for sequestration or abatement above safe, lower-bound estimates, which is verified after a crediting period.

The Australian Government allows for projects with rolling methodologies to be credited at safe, lower-bound estimates until an average exists.

5.4 Methodology approval

The methodology approval process as outlined in the CFI Consultation Paper and associated legislation and guidelines could become cumbersome, with the

³ ACIL Tasman, (2010) op. cit. pp 29

methodology proponent required to provide responses to queries from the DOIC and public submissions. The process whereby DOIC can query methodologies to ensure their integrity would seemingly add to the cost of having methodologies approved. In the case of aggregators, this could then be transferred back to landholders through reduced payments. There is also no indication of the procedure for an appeals process or review and re-submission in the case of a methodology application being rejected by the DOIC.

Nor is there any process for the DOIC to refer methodologies to agencies that may be better placed to assess a proponent's methodology through local knowledge or technical capability and expertise. The Victorian Government would support a provision for the DOIC to engage with other experts outside of the Committee.

Furthermore, the public submission process has a distinct first-mover disadvantage as similar methodologies could be based on the first of its kind proposed. This is a prime example of a market failure by allowing free-riders to readily engage in the market.

- This could be addressed by only releasing publicly available information, such as the peer-reviewed science being used to justify the methodology, as part of the public submission process. Where the methodologies rely wholly or solely on private research and development or information there should be no obligation to publish these as this information should really be classified as 'Commercial-in-Confidence'. The requirement not to publish private research or information could be accompanied by appropriate sunset clauses such that information eventually becomes available in the public arena.

The Victorian Government strongly supports the provision that scientific evidence supporting methodologies must be published in reputable peer reviewed scientific journals. This is a crucial measure to ensure scheme integrity.

The consultation paper also highlights that "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 private project developers."

The Victorian Government recognises the important role of public organisations in developing methodologies and would like to see the role of State Governments and other relevant public organisations in developing methodologies, explicitly highlighted by the Australian Government.

The *Draft Guidelines for Submission of Methodologies* provide significantly more detail on the process and information requirements for methodology development. An element that is missing in this detail is the process for updating methodologies once they are made into a legislative instrument. For example, if additional location-specific model inputs are developed that would allow the more wide-spread use of an existing methodology, what would the process be to get these formally approved? What changes would trigger a new consultation process?

In existing approaches to reforestation particular offsets suppliers often prefer the use of their own model to the National Carbon Accounting Toolbox. If they wish to

continue to use these models under the CFI, would this constitute an entirely new methodology, or would the framework allow for different models to be approved for use under the same methodology determination? If there are multiple methodology determinations that relate to similar activities but differ minimally in their approach to carbon accounting, this could create confusion in the offset market.

Recommendations:

The Australian Government not publish any information deemed to be Commercial-in-confidence in the methodology approval process to avoid encouraging free-riders in the market, although consideration could be given to sunset clauses pertaining to commercial-in-confidence matters.

The Australian Government allow the DOIC to refer methodologies to experts where appropriate to do so.

That the Australian Government provide guidance on the processes for partial updates of methodology determinations, and what would trigger the need for public consultation.

That the Australian Government clarify whether different accounting models will be allowed under a single methodology determination.

5.5 Native Title

The Australian Government has requested further information from Victoria on its proposed approach to traditional owner participation in the CFI, and its relationship to Victoria's Native Title Settlement Framework.

The approach the Australian Government has outlined in the Carbon Farming Initiative is broadly consistent with the *Report of the Steering Committee for the Development of a Victorian Native Title Settlement Framework (December 2008) - Core Principle 33*.

Victoria's *Traditional Owner Settlement Act 2010* (TOS Act) commenced in September 2010. The first (and so far, only) Recognition and Settlement Agreement (RSA) under the TOS Act was executed with the Gunaikurnai People on 22 October 2010. For the purpose of the TOS Act, the Gunaikurnai are a "Traditional Owner Group", as well as native title-holders under the Native Title Act. As part of the RSA, the State has committed to transfer to the Gunaikurnai under "Aboriginal Title" ten Parks and Reserves. "Aboriginal Title" is a special type of estate in fee simple which is conditional upon joint management in perpetuity with the State. This is an example of what the CFI consultation paper (p.16) notes as indigenous lands that are "not readily comparable to freehold title".

It is the intention of the TOS Act that those who enter into a RSA are not disadvantaged in any way, in comparison to Traditional Owners who enter into native title agreements under the Australian Government's *Native Title Act 1993*.

The Victorian Native Title Framework and TOS Act were introduced by the previous Victorian Government. Future State policy parameters for resolving native title claims in Victoria are currently under consideration by the new State Government.

Recommendation:

That the Australian Government allow Traditional Owner Groups with Indigenous land to be eligible to benefit from, and manage land for, carbon storage under all State and Territory legislation.

6. Natural Disturbance

The consultation paper proposes that CFI landholders who lose carbon as a result of “natural disturbance” (for example, bushfires, drought and pests) would not have to surrender any carbon credits as long as the carbon stores are re-established. In such circumstances, the landholder could not claim any further credits, until their carbon reached pre-disturbance levels again. Carbon loss as a result of ‘natural disturbances’ would be covered by the pooled ‘risk of reversal’ buffers, and would not impact on the carbon estimates for the project.

Further information is required on what is meant by natural disturbance and what qualifies as a natural disturbance. If a proponent is required to report “significant natural disturbances” it is essential to know what is classified as one. For example, could drought be classified as a significant natural disturbance, and what evidence would be required to demonstrate this?

Victoria notes the draft CFI legislation defines “natural disturbance” to include a range of hazards (e.g. bushfire, flood, drought, pest attack and disease).

If events such as drought are to be included as a ‘natural disturbance’ consideration should be given to how this would be demonstrated. For example, would a state government drought declaration for one region be sufficient for all projects in that region to have faced a ‘natural disturbance’? The Victorian Government therefore seeks clarification on what will be required to demonstrate a natural disturbance has occurred.

Recommendation:

The Australian Government further clarify what is meant by “natural disturbance” and how project proponents are to demonstrate that a natural disturbance has occurred.

6.1 Planned Burning

The “natural disturbance” provision in the draft legislation does not address the specific issue of planned burning for fire reduction – burning deliberately conducted for fuel reduction purposes, as a risk management measure – and how it relates to the proposed crediting approach.

Discussions with Australian Government officers indicate it considers planned burning to be an issue that landholders should take into consideration when they opt into the CFI – i.e. they should incorporate such activity into their carbon estimates. The implication is that landholders engaging in planned burning should expect to receive a reduced level of carbon credits compared to other landholders, because of

the expected emissions impact of planned burning.

This approach raises some key issues for fire management at the State level.

The proposed approach potentially discourages effective risk management of carbon forests. This is because it penalises landholders who actively manage their forests through fuel reduction (by reducing their carbon credits “up front”), while not penalising landholders who undertake no active management (and allow fuel loads to accumulate, adding to fire risk).

Victoria acknowledges the “natural disturbance” distinction has been developed by the Australian Government to address some of the challenges Australia faces in accounting more broadly for land use, land use change and forestry (LULUCF) sector emissions as part of the current and future international carbon accounting regime.

Nevertheless, application of this approach should not produce perverse outcomes in terms of local fire management. Victoria would argue that prescribed burning, by reducing the risks of major, episodic impacts of bushfire on carbon stocks, produces a more stable and certain carbon outcome over time. The result of which should be a reduced need to draw on the risk of reversal buffer and, as such, a smaller contribution to the reversal buffer should be required (also see Section 3.1). A key issue is the length of time used to model carbon sequestration rates in a carbon forest – the longer the period of time used, the smaller the overall impact of planned burning on carbon sequestration (and conversely, the greater the potential impact of wildfire on forests not subject to planned burning).

Victoria already requires some private landholders (e.g. major commercial plantations) to manage fire risk through techniques like planned burning. Victoria already has legislation (e.g. Forests Act 1958) giving state agencies the ability to require private landholders to undertake planned burning as part of hazard reduction on their properties if fuel loads are considered high-risk, at the landholders’ own cost.

The recent Victorian Bushfires Royal Commission recommended significant increases in planned burning. Victoria is looking at developing a risk-based planned burning system, potentially covering both public and private land, as the basis of this future expansion in planned burning.

Recommendations:

If the Australian Government continues to pursue the “natural disturbance” crediting approach in the CFI, the period used for modelling carbon sequestration rates in a forest should be sufficiently long to enable the benefits of planned burning for carbon sequestration to also be factored into projections.

The risk of reversal buffer should be increased for forestry offset projects which do not have fire management plans, or reduced for projects which do.

The Australian Government should note existing Victorian regulatory requirements for hazard reduction (including planned burning) may represent a further cost landholders must consider, if participating in the CFI.

6.2 State's liability from planned burning on public land

Another issue is the question of liability where the State's own planned burning (on public land), crosses into a CFI landholder's carbon forest. From the State's perspective, it is possible it will be held legally liable for any loss of carbon from the landholder's carbon forest (as it would be for any other loss of private assets). This highlights the need for an appropriate central registry of CFI projects that can be accessed by relevant State emergency management agencies to ensure such risks are minimised.

From the CFI landholder's perspective, however, is this considered a "bushfire" that was beyond their control (hence triggering the "natural disturbance" protections to their carbon credits under the CFI?), or is it to be considered a "planned burn", which, as currently proposed, would result in a liability for the CFI landholder? This requires clarification.

Recommendations:

The Australian Government give relevant State emergency management agencies access to details of CFI projects to assist with risk management.

The Australian Government clarify the CFI landholder's obligations in situations where it loses carbon as a result of planned burning conducted by the State.

7. Regional communities, water, biodiversity

The CFI consultation paper acknowledges concerns about unregulated expansion of carbon forestry and its potential implications for other land uses such as water, agricultural production and biodiversity. The paper suggests the Australian Government could:

- require all CFI projects to obtain all relevant State and local regulatory approvals before being accepted;
- require project proponents to consider "relevant regional natural resource management plans";
- prevent certain types of projects (eg. native forest biochar projects); and
- monitor the implications of carbon projects on regional communities.

Sections 20 and 25 of the draft CFI legislation define "regulatory approvals" to include all relevant Commonwealth, State and Territory approvals relating to the environment, land use and development and water.

The Victorian Government believes that there are potential risks associated with the CFI in relation to agricultural land, water availability and biodiversity. Indeed, it is critical that adverse externalities and perverse outcomes affecting farm businesses, communities and/or the environment are appropriately managed. The water interception potential of some biosequestration activities, for example, needs effective management. It will also be important in the CFI to avoid short term rule changes that can adversely impact on profitability and productivity, particularly when long term investment decisions by businesses are in play e.g. investments in forest plantations.

Victoria notes that these issues have been raised by the Australian Government in the CFI Consultation Paper. However, Victoria is concerned that the Australian Government's ability to introduce restrictions such as excluding projects in certain areas from participating, or applying more onerous requirements, during a crediting period, could add to already significant compliance and other costs as well as further discouraging participation in the scheme.

Moreover, the Australian Government might choose to intervene, on what grounds, and the relationship of any such future Australian Government intervention to existing State land use controls remains unexplored. Victoria is concerned that this may create uncertainty for potential investors and increase administrative costs if both the Australian Government and States have the capacity to influence the conditions for participation in the CFI, and these are not transparent or, where appropriate, coordinated.

Given it is important for there to be reasonable investment certainty for landholders, the Victorian Government recommends that any new restrictions should not apply to existing projects until the end of their crediting period, and if possible adequate notice should be given regarding the timing of introducing restrictions.

Victoria is also concerned that any new Commonwealth mechanism should not override, duplicate, or conflict with existing Victorian land use instruments, or conflict with the ability of State Governments to provide incentives to encourage activities consistent with state level priorities. Victoria seeks more clarity on what the Australian Government proposes in this regard, and how this will be implemented in the legislation.

In addition, there are benefits to be gained from pursuing policy complementarity in climate change, weather, drought, land use, agriculture and biodiversity policies to promote policy synergies and avoid duplication and perverse incentives. Victoria seeks further consultation with the Australian Government on these issues.

Recommendation:

The Australian Government clarify how it proposes to exercise its powers to add further restrictions to participation in the CFI in the future to manage perverse outcomes in a way that maximises investor confidence and ensures complementarity with State initiatives.

7.1 Natural Resource Management Plans

Carbon forestry can have positive and negative environmental and community impacts, and there are challenges in establishing a framework that minimises adverse impacts whilst still enabling actions that deliver benefits. In this context, it will be important to understand the robustness of State and Territory planning and land use systems in contributing to these multiple objectives. Difficult tradeoffs exist in the land use space, and Governments may need to take further steps to enable or discourage particular actions. A range of policy tools may be available to affect these outcomes.

In Victoria's case, there is also a range of potentially relevant "regional natural resource management plans". The most notable examples include Victoria's Sustainable Water Strategies and Regional Catchment Strategies, and Regional River Health Strategies. These types of instruments provide a strategic framework for setting regional natural resource management priorities, engaging with the community and directing investment. While they can provide an indication of broad natural resource management priorities in a region, they are not regulatory documents that would provide the type and level of information required to determine whether a given CFI project should go ahead. If such documents are to be used as part of the CFI project approval process, the onus should be on project proponents (rather than State agencies) to demonstrate that the project is consistent with regional plans.

These regional planning instruments would also indicate where in the landscape plantings should take place to maximise other environmental benefits. Examples would be: planting for salinity abatement, biologically diverse plantings that complement existing state targets, or riparian areas.

Another possible instrument for regulating CFI projects is the land use planning system. Current Victorian Planning Provisions (VPPs) have specific provisions for the establishment of timber production on private farm land. These do not, however, specifically reference plantations established for carbon purposes.

The September 2010 Victorian Parliamentary Inquiry into Soil Carbon Sequestration recommended:

"the Victorian Government investigate zoning agricultural land in Victoria to identify areas suitable for the establishment of forests to sequester carbon in soil (as well as in vegetation) in order to minimise the potential adverse impacts of forest establishment on food production and water resources and maximise the potential co-benefits" (Environment & Natural Resources Committee Report Inquiry into Soil Carbon Sequestration in Victoria, September 2010, Recommendation 5.7)

The new Victorian Government will respond to the Committee's Report in early 2011. Victoria will consult further with the Australian Government if any further reforms are proposed in this area.

Recommendations:

That the Australian Government clarify what State and local instruments will be considered relevant for the purposes of assessing the appropriateness of proposed CFI projects.

CFI approval processes should not impose additional administrative burdens on State regulatory authorities.

The Australian Government note that Victoria will respond in early 2011 to a Victorian Parliamentary Report on soil carbon sequestration

Attachment A

The Port Phillip and Westernport EcoTender is a multiple environmental outcome conservation tender on private land. In EcoTender, sites were selected on the basis of cost per unit environmental benefit, where environmental benefit was the weighted sum of the individual benefits for each of 'native vegetation', 'rivers' and 'catchment (e.g. erosion) scores. When sites are selected on the basis of their joint production of a number of outcomes, as in Ecotender, some different sites are likely to be selected to when sites are ranked on only a single outcome. For example a site that scores moderately well across all three outcomes is more likely to be selected in a multiple outcome tender and a site that scores very highly for 'native vegetation' and lower for 'river' and 'catchment' is more likely to be selected in a native vegetation tender.

The table below shows the quantity of the three environmental benefit units that would have been obtained from the same budget when the sites are ranked on the basis of each of the three individual benefit scores.

Table 1 -- Environmental benefit breakdown for single and multiple outcome tenders

<i>Ranking</i>	<i>Total EB</i>	<i>Environmental benefit breakdown</i>			<i>Percentage improvement when ranking on total EB</i>
		<i>Native Veg</i>	<i>River</i>	<i>Catchment</i>	
<i>Native Vegetation</i>	510	305	7	198	19%
<i>River Health</i>	543	230	14	299	12%
<i>Catchment Health</i>	572	260	8	304	6%
<i>EcoTender</i>	607	296	13	298	N/A

The table shows that more environmental benefit units are obtained when sites are selected on the basis of joint production. This results in a lower unit cost for environmental benefit. In a situation where different investors purchase different outcomes, this cost saving could be shared between the different investors. It should be noticed that in this example, because most of the outcomes are jointly produced, these gains will be lower than in situations where outcomes are only sometimes jointly produced (for example selecting between monocultures and environmental plantings).