# Submission Template

## Design of the Carbon Farming Initiative

### Overview
This submission template should be used to provide comments on the consultation paper outlining the proposed design of the Carbon Farming Initiative.

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### Confidentiality
All submissions will be treated as public documents, unless the author of the submission clearly indicates the contrary by marking all or part of the submission as 'confidential'. Public submissions may be published in full on the Department of Climate Change and Energy Efficiency website, including any personal information of authors and/or other third parties contained in the submission. If any part of the submission should be treated as confidential then please provide two versions of the submission, one with the confidential information removed for publication.

A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

Do you want this submission to be treated as confidential?  □ Yes  □ No

### Submission Instructions
Submissions should be made by **close of business 21 January 2011**. The Department reserves the right not to consider late submissions.

Where possible, submissions should be lodged electronically, preferably in Microsoft Word or other text based formats, via the email address – CFI@climatechange.gov.au.

Submissions may alternatively be sent to the postal address below to arrive by the due date.

Emerging Policy Section, Land Division  
Department of Climate Change and Energy Efficiency  
GPO Box 854  
CANBERRA ACT 2601
## Scheme design principles

- Westpac believes that the introduction of the Carbon Farming Initiative (CFI) represents an important first step in the establishment of an effective carbon price signal across the Australian economy. Westpac is a major supplier of financial services to the Australian agricultural industry and is therefore eager to encourage opportunities which will support the sector.

- Westpac supports the scheme design principles of environmental integrity and enabling broad participation.

- In reviewing the discussion paper and the supporting draft legislation, Westpac has also identified the following key issues which we believe should also be embedded in scheme design considerations:

  1. Certainty of cash flow for carbon projects
  2. Certainty around security implications for landowners; and
  3. Certainty of liability for all eligible interests.

These three dimensions form the basis of Westpac’s comments on specific provisions within the Carbon Farming Initiative (CFI) framework.

## Scheme coverage

- Westpac supports the development of a market and crediting framework which recognises the role of land sector abatement in meeting Australia’s national emission reduction commitments.

- The Australian agricultural sector is one of the most efficient and well-managed in the world. Australian farmers, given the volatility of climatic conditions and the natural landscape have become highly experienced at land and water management practices. They continue to innovate in terms of land management practices, with due consideration towards sustainable and environment best practice.

- Government policy needs to support and further this position, in both examining the impacts of changing climatic conditions and implementing supporting market-based policy frameworks. As such, Westpac supports recent announcements by the Government promoting carbon farming for the Australian agricultural sector.

- Westpac supports greater alignment between the National Carbon Offset Standard (NCOS) and the ability of Australian communities to generate international and national carbon credits.
Sale of units

- Westpac notes that Kyoto-compliant carbon credits will only be issued for abatement achieved in the period 2008-2012. Given the proposed timeframe for implementation of the Carbon Farming Initiative, this would allow for a very limited period of time in which new projects can be established and achieve significant abatement eligible for the crediting of Kyoto-Kyoto compliant carbon credits.

- Westpac recognises that international uncertainty around the post-2012 market will make it difficult for the Government to clarify the post-2012 credit issuance regime in the immediate term, but would strongly encourage the government to make the appropriate arrangements necessary to clarify the continued export of CFI credits for the post-2012 period as soon as is possible. Failure to do so would undermine the early growth of the domestic carbon offset market by adversely impacting the commercial viability of many carbon farming projects where the return period for capital invested extends beyond 2012.

- Where appropriate, Westpac would encourage the approval of crediting periods for longer than three years. Westpac notes that the limiting of crediting periods to three years may have considerable implications for cash flow certainty and could subsequently limit the opportunities for financing carbon farming projects.

Regional Communities, Water and Biodiversity

- Westpac supports the need for the Carbon Farming Initiative to appropriately balance broader environmental, economic and community concerns. However, the current requirements to secure State and Territory endorsement and approval may result in a lengthy process for obtaining final approval under the scheme. These extended periods of approval will expose project sponsors to risks that may influence their choice of projects. Projects of a complex nature but with long term substantial benefits are likely to be overlooked in favour of simpler projects with a shorter approval process.

- Westpac believes that it may be appropriate to have one administrator to oversee the approval process, particularly for short-term emission reduction projects with minimal long-term community impact. This would also serve to accelerate and simplify the provision of finance for projects. Large, high profile projects, however, would clearly still need to go through a comprehensive planning and development approval process. For these projects, Westpac believes it would be appropriate for the Government to provide additional support and expertise to local and state planning authorities to support efficient decision-making outcomes.
Integrity standards

- Westpac supports the application of robust integrity standards to Australian carbon offset credits, which meet or exceed international standards. High standards will increase appetite for credits produced which will in turn lead to the creation of more value.

- Westpac supports the proposal that “Projects should be verified by an independent, qualified third party” as registered under the National Greenhouse and Energy and Energy Reporting System, (NGERS). In addition, auditors must hold indemnity and liability insurance similar to valuers. This will ensure that buyers and financiers are confident in relying on third party verification as part of the formal due diligence process.

- Further, a verification renewal schedule should be established for each type of offset activity. This will ensure that managers and financiers are aware of milestone points at which to review projects.

Additionality

- Westpac notes the importance of a robust and systematic approach to assessing ‘additionality’ for each project. This will be important, not only in meeting crediting and project approval requirements, but also in determining the end market value of the carbon credit issued to the methodology more broadly and the specific project.

- Westpac also supports Government steps to ensure process simplicity and streamlining for determining additionality to avoid unpredictable or inconsistent outcomes to project assessment.

- Westpac has some concern over the statement “Some projects may cease to be additional during their lifetime, for example because the project activity may become common practice.” Where an investment is made to generate a revenue stream from credits issued over a prescribed period of time, changing the revenue streams of the project in this manner and over the proscribed crediting period (three years) may adversely impact the ability to secure finance. Financiers, both equity and debt, would be reluctant to support projects if there is risk of revenue from credit generation ceasing or significantly reducing during the minimum return period for the capital invested.

- In circumstances where the Government does feel it is appropriate to re-evaluate the additionality of approved methodologies, the Government should strongly signal well in advance that credits will no longer be eligible from a particular methodology and extreme care should be taken to ensure that existing projects are not adversely impacted financially in the immediate term. This will help to address ongoing concerns over the impact of short term regulatory changes to the commercial viability of the carbon farming market.
Permanence

**Implications for financiers**

- Westpac notes that ensuring that permanence of schemes for up to 100 years has implications for financiers and mortgage documents. The discussion paper notes that “Scheme obligations would need to be noted on land title”. Scheme obligations would also need to be noted on mortgages along with a covenant outlining maintenance obligations (and corresponding costs). Subsequently, there are a number of implications:

  o Credits could be paid pro-rata over the life of the project and these credits directed to the mortgagee and used for maintenance in mortgagee repossession cases.
  o Where revenue from credits is paid to the land owner in a lump sum by the project developer upon project approval, the mortgagee would be forced to reduce the loan to value ratio to ensure sufficient funds for project maintenance when in possession prior to liquidation.
  o Consideration must also be given as to whether the project reduces the saleability of a property by the mortgagee. If the sale potential is reduced, property valuation may decline and/or loan to value ratio may be reduced to provide sufficient margin for the new owner to reverse the project and pay back any credits (relinquishment).
  o In all cases, where an existing mortgage is involved there will be large volumes of mortgage changes to include covenants and possibly implement new loan to value ratios (in some cases requiring a cash injection from the property owner).

- Westpac believes it may be appropriate that the Department of Climate Change and Energy Efficiency engage with the Australian Bankers’ Association to explore an industry-wide response.

**Implications for ‘green’ claims under the Trade Practices Act**

- Additionally, greater clarification is sought on the impact of issues of permanence on carbon offsetting claims by the purchaser. The current draft focuses on the process for terminating participation under the program and liabilities under the scheme should abatement activities be reversed. However it is unclear on the impact on the purchaser of these credits particularly in relation to green claims under the Trade Practices Act (TPA).

- Specific offset projects may be selected by an organisation for reputational or brand value, for instant links to the organisation’s operations because of the location or nature of a project. These links can form an important component of an organisation’s communication activities. Where these offsets are damaged, for instance by fire or the termination of the project, there is the potential for reputational damage. Furthermore there is the potential for questions of misleading claims under the TPA if an organisation is claiming carbon neutrality, for instance under NCOS, but the offsets purchased now have a carbon liability attached to them.

- It is recommended that further drafts provide greater clarification on the relationship between the Carbon Farming Initiative, the National Carbon Offset Scheme and how subsequent claims may be treated under the TPA in these scenarios.
Leakage

- Westpac notes the challenges involved in establishing a consistent and streamlined approach to assessing leakage across different methodologies and projects proposals.

- Westpac supports measures which secures both the environmental integrity of the project as well as ensuring that project costs remain commercially viable.

Scheme processes

**Becoming a recognised entity**

- Westpac is comfortable with the provisions outlined around becoming a recognised entity for participation in the Carbon Farming Initiative.

**Project approval**

- Westpac supports the provisions as outlined in the consultation paper. In particular, Westpac supports the proposal that documentary evidence be provided that the consent of all parties with a registered interest in the land be required prior to project approval.

  Ensuring that a note is attached to the land title signalling the attachment of a carbon liability is also critical for financial institutions as scheme obligations would also need to be noted on mortgages along with a covenant outlining maintenance obligations (and corresponding costs).

- Westpac would encourage further clarification of the treatment of Indigenous held land title, as there would appear to be significant new opportunities to generate revenue from land management and related carbon farming projects.

**Register of offset projects**

- Westpac strongly support the establishment of a national registry of Carbon Farming Initiative projects as detailed in the consultation paper.

  Westpac would also support promoting maximum transparency around the attachment of carbon liabilities to land title by ensuring that mandatory information requirements include explicit cross-reference to land title and the attached carbon liability (maintenance provisions).

- Westpac would support efforts to allow for further detail on the co-benefits attached to particular projects (social or environmental) to be made available on the project database.

**Crediting periods**

- Where appropriate, Westpac would encourage the approval of crediting periods for longer than three years. Westpac notes that the limiting of crediting periods to three years may have considerable implications for cash flow certainty and could subsequently limit the opportunities for
financing carbon farming projects.

- Westpac has some concern over the statement “Some projects may cease to be additional during their lifetime, for example because the project activity may become common practice.” Where an investment is made to generate a revenue stream from credits issued over a prescribed period of time, changing the revenue streams of the project in this manner and over the proscribed crediting period (three years) may adversely impact the ability to secure finance. Financiers, both equity and debt, would be reluctant to support projects if there is risk of revenue from credit generation ceasing or dramatically reducing during the minimum return period for the capital invested.

- In circumstances where the Government does feel it is appropriate to re-evaluate the additionality of approved methodologies, the Government should strongly signal well in advance that credits will no longer be eligible from a particular methodology and extreme care should be taken to ensure that existing projects are not adversely impacted financially in the immediate term. This will help to address ongoing concerns over the impact of short term regulatory changes to the commercial viability of the carbon farming market.

**Reporting**

- Westpac notes the reporting requirements attached to carbon farming projects. Westpac would support a requirement that all parties with an interest in the land title (and potentially subject to carbon liabilities) should also be notified of any relevant changes to the project, such as major natural disasters, via administrative reporting requirements.

**Crediting**

- Westpac notes and supports the statement in the discussion paper that “The scheme could ensure that these arrangements do not prevent companies from funding scheme tree planting projects through forward-sale of potential carbon sequestration”. Westpac also notes that the Government should consider how this approach will impact ability to secure finance where projects are fully or partly secured by future cash flows generated by credits.

- Westpac would support using the Australian National Registry of Emissions Units for the purposes of issuing, transferring and cancelling ACCUs.

- Westpac notes that the Bill does not directly address the implications of the Personal Property Securities Act 2009 (PPSA) and subsequent security implications. According to § 142 of the Carbon Credits (Carbon Farming Initiative) Bill 2011 an Australian carbon credit unit is designated ‘personal property’.

- Section 8 of the Personal Property Securities Act 2009 (“PPSA”) does not include Australian carbon credit units in the list of interests to which the PPSA does not apply. Accordingly we conclude that it is the intention that the PPSA will apply to Australian carbon credit units. This raises the following issues for further consideration:
  
  o Consideration will need to be given as to how lenders will take a security interest over an Australian carbon credit unit?
  
  o It is unclear how the security interest of lenders over carbon rights be recorded under the Personal Property Securities regime?
  
  o It is unclear how any transfer or transmission of an Australian carbon credit unit, including under § 143 (Transfer of Australian carbon credit units) and §144 (Transmission of Australian carbon credit units by assignment) of the Bill, will be impacted by, and will impact Personal Property Securities provisions pertaining to transfer and assignments of personal property?

- Westpac notes that within New Zealand, amendments to the Personal Property Securities Act 1999 (PPSA) in September 2008, mean that carbon credit units (New Zealand Units or NZUs) are now within the definition of ‘investment securities’ for the purposes of the PPSA. Westpac New
Zealand is therefore able to take security over NZUs by registering a security interest on the PPSR similar to the manner in which it would take security over company shares.

- Given the above, Westpac notes that provisions will need to be made as to how the existence of a security interest over Australian carbon credit units will impact upon and need to be taken into consideration in relation to more standard security interests taken to support lending facilities.

- Westpac would support the backdating of the reporting period to 1 July 2010 for reforestation and abatement projects for which methodologies are approved prior to the proposed commencement of the scheme on 1 July 2011. This would support the early availability of credits in the scheme, particularly given the short issuance period for Kyoto credits for international markets flagged in the discussion paper (to 2012).

**Transfer or termination of projects**

- Westpac notes that any decisions regarding revocation or termination of a project should also consider including specific provisions to inform all interested parties of the decision to revoke the project, and thereby remove the liability attached to the land title.

- Consideration must be given to the implications for cases of mortgagee re-possession. This would require financiers to become “eligible entities”. One option may be that the Government consider applying an exclusion from this requirement where properties are on sold within 90-180 days of possession.

**Methodology approval**

- Westpac has no substantial feedback on the issues surrounding methodology approval, except to note that approved methodologies should be robust, promote genuine environmental outcomes, be cost effective and scalable to ensure that projects will be commercially viable.
**Taxation treatment of credits**

**A New Tax System (Goods and Services Tax) Act 1999 – Policy considerations**

- Westpac still holds significant concerns about the overall design of the CFI GST policy. We are of the view that the policy as currently designed, will result in increased complexity and uncertainty, significant compliance and funding costs, and will lead to a system which is sub-optimal for trading in an international environment.

- From a GST perspective, other jurisdictions (notably New Zealand) have simpler, lower cost treatment in relation to their emissions trading schemes. This will provide an incentive for international participants to trade out of those jurisdictions. In addition, the Trans-Tasman working group to harmonise the design of Australia’s CPRS with the New Zealand Emissions Trading Scheme had previously canvassed two options, including mutual recognition of each jurisdiction’s domestic units or full harmonisation of both of the schemes. It is very hard to envisage how either of these harmonisation options could be implemented if divergent GST treatments were to apply to the domestic units of each country.

- The proposed GST treatment will involve a great deal of complexity given the range of outcomes possible in relation to different transactions: for example spot trades could be taxable, out-of-scope or GST-free, depending on the characteristics of the buyer and seller; derivatives may be input taxed, taxable, out-of-scope or GST-free, depending on the characteristics of the buyer and seller as well as whether the particular derivative is deliverable or cash settled.

- Financial intermediaries and other traders of units and derivatives will be required to bear significant compliance costs in implementing the systems required to comply with the proposed GST treatment. Importantly, carbon market instruments will generally be accounted for in trading systems which have been designed for transactions of input taxed financial instruments such as foreign exchange. These systems will therefore generally not have the functionality to issue tax invoices or to track GST payments. Further, these systems will also need to be modified to distinguish between the various characteristics of the instruments being traded, and the characteristics of the buyers and sellers of the instrument, to be able to determine whether any particular trade is taxable, GST-free, out-of-scope or input taxed.

- At the broadest level, the policy objective of the GST is to tax final private consumption expenditure in Australia. Where supplies of units or derivatives are taxable, this creates inefficiencies by adding cash flow costs to business, requiring businesses to finance the additional GST cost until such time as it can be claimed back as an input tax credit. This issue is of particular difficulty for businesses in the current funding environment. For those entities that acquire taxable units or derivatives that are not entitled to full input tax credit recovery (such as businesses that are not registered for GST), GST will ‘stick’ with that business, and add a real cost to the acquisition of a permit.
Any additional comments

Appendix A: Participating in the Carbon Farming Initiative

- It is noted that it is possible to transfer a project and the carbon property rights by sale to another company or individual. There is some concern as to the process if the purchaser of the carbon rights goes into liquidation or abandons the project. Westpac notes that CFI obligations would then revert to the farmer or landowner even though the purchaser has on sold the credits and there is no further revenue available.

- Westpac believes there should be clear processes and procedures for project aggregators and purchasers to follow when in financial difficulty or should they abandon a project. It is noted that the farmer or landholder and the offset aggregators will determine their business and legal relationship. We believe that some of the terms and conditions of this relationship must be regulated to prevent unintended consequences for the farmer or landholder who retains ultimate responsibility for the maintenance obligation.