Carbon Monitor

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New Zealand ETS Responses and Updates on Forestry and ETS

Billed as the world's first all sectors all gases system the NZETS has been under intense scrutiny for the last month, particularly by the farming and forestry sector at a number of regional meetings.

In the main centre's a two day presentation by officials often raised more questions than they answered especially from those who have spent the last five years denying the inevitable.

Not unexpectedly a few entities received rude shocks. Those who had doggedly reduced their emissions profiles since 2000 as 'good citizens' found the reference point has suddenly become 2005 and their efforts have now turned into a rod for their own backs.

Industry constantly complained that they are marginal 'at risk' and the protocol will cripple them and they would move 'off shore'

Anyone expecting to see a working ETS is going to subject to a whole lot of arbitrary decisions. Not unlike risk management, those though at most peril from the policy received the highest priority and those left at the end with no more credits to grandparent simply received nothing.

EU Price Update

The Dec08 firmed over the 22 Euro mark in recent trading. This compares with the projected value of the New Zealand Unit (NZU) at less than 8 Euro!

www.pointcarbon.com

Roger Dickie Promotes Forest Carbon Sink Credits

An existing post 1989 400 ha Douglas Fir forest currently part of the Roger Dickie portfolio is earmarked as New Zealand's first Carbon Farm.

The concept will be based on selling the carbon credits that accrue from 1st Jan next year. If after 50 years the marginal cost wood is better then the credits could be repurchased and clearfell the trees. The long term intention would be to carry this forest on for more than 100 years, selling the credits all the way.

Commentary

Introducing this project to the PFSI and choosing selective logging would provide another option not dependent on credit sales giving a credit and wood income stream combined. Ed

Any investment in this type of offering will be subject to a registered prospectus and should be made on such a prospectus.

Forest Briefing on NZETS – Should you Opt In or Out?

At recent briefings on the NZETS and particularly forestry, raised some interesting questions.

Opt in or Opt Out – the question based on the proposal foresters have to choose to receive the credits and liabilities.

Discussion was quite brisk on this concept and the conclusion foresters wanted the credits even if they did not trade them. They were concerned as to the costs of the measurement activities around the credits.

Commentary

Firstly, no one including the current government can bind or predict future government's policy. So if the Government retains the credits you may not receive them at harvest – and may have to PAY!

The wall of wood from 2020 onwards and more radical emissions limits will place significant pressure for compliance and therefore cost on the Government and Taxpayer.

Recall the fishing quotas in the past – you had them – they persisted, you didn't and they were gone and you had to purchase them!

So what about the activities and penalties?

Bryan Smith of MAF stated a single inventory some time in the period 2008-2012 extrapolating forwards and backwards for the carbon content of the forest in 2012 and 2008 would provide the NET change in carbon – the source of the credits.

Even if this was wrong, and you have not traded the penalty is based on shortfall, you have not sold any credits so any penalty is multiplied by the shortfall. There is no shortfall, hence no penalty (if they follow tax principles as stated)

And the cost?

In the early part of the decade EITG ran a pilot program measuring a number of forest compartments in the South Island. We gained good experience on the cost and methodologies involved in the process.

Some of the results are on our web site http://www.eitg.co.nz/pcp.htm

In essence, the activities over and above a normal inventory are minimal, with STANDPAK inventory integrating with the CCHANGE carbon model.

So we suggest the actual costs are minimal and well worth the certainty of ownership of the credits!

One issue not canvassed by the briefing is the uncertainties in the process, particularly as inventory is based on sampling and PSP plots. We urge foresters to consider this when deciding whether to trade or not.

Forestry & ETS - Single Age Class Risks

In the briefing it became very clear foresters with one age class should not sell their credits due to the market risk.

It also became clear no single forest group has a 'normal forest' that would internally manage carbon.

As we have always said a carbon pool both nationally and internationally is the only way to manage risk both for the buyer and seller of credits.

Commentary - Impact on Liquidity of Opt In and No Trading

Where this is leading to is a recommendation that all foresters should opt in for the credits even if they have no intention of trading them.

If you have an inventory (and you only need one in the five years 2008-2012) verifying carbon is inexpensive and straightforward.

Then when you need the credits at harvest you have them in YOUR name. This resolves the issues of the government allocation at some later date.

The outcome is going to severely impact the liquidity of the ETS. Proposals indicate 22mt of the pre 1990 deforestation windfall credits will be the first credits into the market in early 2008.

These would be used up rapidly by the end of 2008 based on a total of 460mt total emissions (2008-2012), less half for agriculture leaving 230mt over 5 years for fuels, electricity and the other emitters. With a demand of nearly 50mt per year and supply of 22mt we see a significant liquidity problem without Kyoto Forest Credits being traded.

This suggests that there is a significant design flaw in the process, namely forest owners see too much risk in either ignoring credits and leaving them with Government to trade or trading them with the harvest liability. Either way in our view work needs to be done to convince forest owners their risk is manageable.

Tax Treatment of NZETS

A discussion paper on the taxation treatment has been issued by IRD. Submissions were required by 28th October for forestry and 30 November for general tax issues.

CM view is CONSIDERABLE RISK EXISTS FOR FORESTERS IN THE PROPOSED TAX TREATMENT

One of the taxation proposals in effect taxes forest investors on the VALUE of the NZU credits whether they are sold or not! This means if you say have $150k worth of credits (not sold and banked for harvest as discussed) then you receive a tax bill of $50k with NO INCOME.

This represents a critical threat to the forest industry and forest investment. In the example above over a 28 year rotation investors would have to pay taxes of $1.4m as well as the normal forest contributions such as rates etc IN CASH.

The IRR and attractiveness of forest investment will in our view COLLAPSE!

Our submission to IRD was as follows:

GST – that the NZU units are GST zero rated as timing of supply alone is a minefield. Our view is that this is a financial instrument and likely to be traded just like a share, future or interest rate swap.

It is not a service or a good in any stretch of the definitions. The likely outcome of GST application is arguments with Inland Revenue Inspectors intent on

collecting penalties based on timing disputes.
In terms of general taxation of the credit revenue the paper offers the option of taxation in the period of receipt of the revenue and deduction of associated expenses.

This view is based on the uncertainty of the harvest date and therefore the crystallisation of the liability.

We disagree and suggest that harvest date is established and from that point you know that the liability will also emerge on that date.

Simply therefore we recommend in your submissions you support the option where the credit income is recognised in the year that the liabilities at harvest are also created and offset the two against each other. Meantime the contingent liability at harvest offsets the asset income on the balance sheet.

This is our view for the submissions only and should not be taken as accounting or legal advice! You should SEEK YOUR OWN INDEPENDENT TAXATION AND LEGAL ADVICE on these issues and tax issues generally.

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'Carbon Monitor' is a client service of EITG.
EITG develops, facilitates and engineers Carbon Mitigation projects and strategies.

EITG corporate advisory provides high-level briefings and advice on building robust responses to emerging regulatory structures.

EITG Carbon Pool provides forest owners with a robust platform to access local and international markets while dealing with harvest and other liabilities.

EITG provides trading platforms and strategies based on extensive mitigation and avoidance platforms under JI and CDM, with matched offset packages for emitters.

EITG is part of an international consortium with representation in Asia/Pacific, UK, USA and South Africa

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