



**WARREN FORESTRY**

Forest Investment Excellence

## **Newsletter for Partnerships, Landowners & Statutory Supervisor**

### **The ETS:**

#### **Lease Deal Falls Over - Time to Swap it for a 'Free Lunch Lite'**

**Dear All,**

**April 2013**

Last year I told you I was leaning towards advising all our partnerships and landowners to quit the Emissions Trading Scheme. Well although there has been another distracting interlude, the 'prevaricating around the bush' is over. I'm positive now we should quit, while we can make a little out of doing so, as explained below. Yes, it miraculously looks like we can have a free lunch after all, but only one lunch not annual blow outs!

Before I explain recent events I will explain how we exit at a profit given we have incurred legal & management costs but not found a way to safely sell our carbon credits (which are still coming to us each year). Currently the price of NZ carbon credits, called NZUs is about \$2. Each of our partnerships and landowners has between 12,000 and 24,000 of them to date (2008 to 2012). If we sell them and stay in the ETS we will have to repurchase them at harvest (or for any forest loss), yet we have no idea at what price, nor what rule changes will occur along the way to harvest. The most threatening is that we may have to purchase enough to represent the full harvest carbon rather than just the number we have received. That is the sort of rule a Green Party influenced government may impose. On the other hand they may impose carbon liabilities on dairy farming and manipulate the price up. There are speculators betting on that currently which is why NZUs are \$2 not 20c.

Anyway the point is, we have exhausted all ideas on how we can manage the ETS for a profit, other than joining in the speculation game.

But for forests it is a voluntary scheme so we can leave it. To do so we give back our NZUs to the government and there is no longer any liability or responsibility relating to the ETS. However the government has allowed NZ emitters such as coal, oil and gas users to account for their emissions with cheap European carbon credits called EURs, as well as NZUs. This is the reason the NZU price has collapsed, and the government is content with that as they do not want a high price on carbon emissions for economic and political reasons. It does mean however, when we leave we can give back EURs to the government instead of NZUs. And why would we do that? Because they are 15c and NZUs are \$2.00, so we can pocket \$1.85 by doing what is called a 'swap'! I only found this out late last year and I still find it incredible. We need to take this opportunity because it will probably vanish in due course. The government says it will end in 2015, but there is an election before then so who knows!

Wait there is more: Once we leave and cash out, we can re-join if we think it worthwhile. (I'm not making this up)

So for those of you interested I will explain what happened to the leasing proposal we were going to take up. Skip this bit if you don't care. It's nothing to do with forests, more about lawyers.

As you may recall we entered a deal whereby a company called NZ Forest Leasing would take over our ETS registration and get our NZUs, in exchange for a modest annual rental (again, all perfectly legal). They make money from trading carbon credits and the current rules meant they would be solely responsible for returning them at harvest. Each forest stand would exit the ETS just before harvest and no liability would remain. So we trade risk for certainty and a fixed modest income and they get NZUs to speculate with. All very good as long as the contract is bullet proof, failsafe and several other overused terms like that. However we were unable to agree on a key term in the lease, indeed an essential one I contented. This term was to protect against changes to the law exposing the landowners and partnerships to liability for NZUs. Under current interpretations of the ETS laws, if NZFL went bust the government could not look to us for the NZUs issued on our forests since NZFL would have received them not us. But what if that interpretation changed or the law was changed, perhaps by a new government, keener than the current one to make the ETS more water tight? NZFL's preferred term was really only an indemnity, which is inadequate ultimately if they fold. Regrettably the lawyers could not agree on terms so I eventually went back to NZFL, explaining that from the start we were clear we could not accept NZU risk. I asked for the following clause, or similar:

**'ETS Change:** If as a result of legislative change, Government policy or Court decisions, the ETS laws or rules change to significantly alter the parties' positions, which fundamentally are for the Lessor's part, that they are exchanging their right to and responsibility for Units for a fixed annual sum in order to avoid any Unit liability risk from the ETS at harvest, and for the Lessee's part to have full entitlement to all units the Forest has and will generate until harvest, to hold them, sell them, securitize or deal with them however they wish in exchange for a fixed annual sum, then either party may invoke this clause and terminate the lease, however before doing so the parties, always acting in good faith must use their best endeavours to find a means to overcome the adverse affect of such change and continue the lease in its current terms.....'

Not so onerous a clause I thought. Yet to them it was, so they called the deal off. Perhaps they cancelled for other reasons. They said none of many clients had asked for such a term which surprises me as it means they are all taking a risk. It is perhaps a small risk but one with the possibility of large consequences. Good luck to them but it is very clear to me neither our partnerships nor the landowners want to take risks with carbon credits so we could not proceed without at least a similar term.

Accordingly I believe we should get out of the ETS while we can do so profitably. We have incurred legal and management costs, plus forest measurement costs required by the ETS. Yet we should still have about one year's contributions paid for by the ETS. There is no great hurry but before the next election we should be out.

If the ETS changes favourably after that, I will let you know. Actually that is quite possible ..... but irrelevant for now ..... so I'll stop right here!

**Charles Etherington**  
**Warren Forestry Ltd**  
**Manager**

**PS:** I can now send out the budget for this year, as we know roughly what income we should get from the carbon credit swap deal and the costs we have incurred. However we will need a resolution at the AGM to exit the ETS, as well as landowner consent. AGMs will be called soon. We await the 2012 Audited Accounts currently but they should be to hand soon. This year the Accounts contain the Annual Report.

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