

# Newsletter for Partnerships, Landowners & Statutory Supervisor

June 2012

## The Emissions Trading Scheme is Ultimately .....Unworkable

Dear All,

I am leaning towards advising all of our partnerships to quit the ETS. This would most likely be later this year.

The two main reasons are *uncertainty* and *risk*. It is likely the government is going to change the ETS rules which will be intolerable for a lot of forest owners as the changes will be adverse, but the further uncertainty is the last straw. Forests are a long term investment so the uncertainty of this ETS does not fit. Secondly, the partially rigged carbon credit market it provides means most growers have to speculate, exposing them to considerable risk. The ways around this are not practical and anyway, the rules might change.

Fortunately, to date it has not cost us much (about \$20 per unit or \$9 per hectare) but in due course it will do, and perhaps for nothing in return.

This change of view requires some explanation, as about two years ago I advised joining because it looked like we were in for a significant 'free lunch'. I know, silly me. So what is the story?

In brief, it goes as follows:

1. Originally it appeared the ETS would enable us to claim and sell a good portion of carbon credits and not have to return them at harvest. The ETS rules, which came after the Act have not allowed this except to a small extent for our forests planted from 1999 to 2003; The government may now change the rules, which could prevent even this;
2. We and many others have been hoping an alternative rule change will allow us to sell the average number of credits a rotational forest contains, and never have to buy them back so long as the forest land remains forest land indefinitely. That could be agreed for many of our plantations. (This is called 'averaging', and is simple and sensible). However it now seems the government will not allow it except perhaps for small new plantations;
3. We cannot take any risks with carbon credits on your behalf. Taking a risk (i.e. selling them) could pay off nicely but it may instead lose you plenty at harvest, so it is out of the question. In any case, quite reasonably, the Statutory Supervisor would not allow it; and the landowners do not want to risk it, which is perfectly understandable; (Please note, none of the prospectuses made any forecast of carbon credit income. *That was a good decision!*)
4. Even if there was no risk currently from selling some credits, the government has proved entirely unreliable and unpredictable. I don't think they have a clue what they will do next. The ETS has proved to be entirely political, and all about appearances rather than substance. It has been about pleasing the EU and marketing our Clean Green image, although also trying to profit from our plantation forests' age class profile. But now the EU is in a mess its carbon trading scheme is too. Japan, Canada & Russia have left. Some countries are talking about a carbon tax instead or going their own way with non Kyoto ETs. Which way NZ will go is unknown but regular changes to our ETS are very likely, and that does not fit with long term forest investors like us;
5. Why not stay in the ETS and just accumulate credits and wait and see what happens, as we might one day get something from it? Firstly, the government is considering making credits

expire unless you sell or use them within each five year period, and the first one ends at the end of this year; and secondly they have now ruled that if you have more than 100ha you must undertake extremely detailed measurement by the end of this year that will cost our partnerships about \$35,000! That would only be worth it if we could safely sell credits. But we cannot, as explained above.

Therefore, either we stay in and spend money while we wait for that free lunch, always perhaps just out of our grasp, or get out and forget the whole bad experience. Perhaps some other scheme will replace the ETS one day and we forest owners will at last get some credit for the environmental services forests deliver free. (*Hope springs eternal*).

I should add that I have taken advice on this from New Zealand's leading expert on the ETS and he agrees we should give up by the end of the year unless there is a miraculous change of rules. We shall see. In the meantime, there is a company that buys credits and 'guarantees' they need not be returned at harvest by the forest owner, so I am making enquiries. I expect they will go bust at some point, possibly leaving a mess, or the government will make a rule change to thwart them and make landowners liable for credits not repaid. (*Yes, I have become a cynic now*)

The good news is that there is money in the current budgets for ETS measurement & management time, we will not spend if we quit so then a surplus would carry over to next year. We still will do some measurements this year though, as we need to for normal silvicultural reasons. Though at nowhere near the cost the ETS was imposing.

Finally I should apologise to you as previously I said I was sure there would be a way to gain from the ETS without compromising our growing asset. I was wrong.

**Regards**

**Charles Etherington  
Warren Forestry Ltd**

**PS: I have just read over 11 years of reports & newsletters I have sent out on carbon credits and the ETS. I regret I did not listen to myself, as for a long time I was skeptical about carbon credits!**

**Here are some extracts:**

**2001** " , the more I study the details the more I have to agree with many other forest owners that we might be better off declining direct ownership of carbon credits. .... it may be better if the government deals with the whole country's ledger ..... After all 'carbon credits' are an inter-governmental creation so it is a mistake to see them as belonging to anyone ..... We deserve credit for them but maybe not credits."

The main problem with owning them individually could be the distortions and complications they could cause us. The transaction and accounting costs alone could consume most of the receipts ..... you might have to pay a tax to thin your forest, ..... harvesting would incur a tax which if linked to the market might exceed the credits received earlier. .... Accordingly, carbon credits have the potential to interfere with what are the clear, rational ..... sound objectives of forest owners."

**2002** "In our last newsletter I hinted that the government might keep all carbon credits itself and that we should not mind because they could be more trouble than they would be worth. Well I think that is what they are going to do ....." (*It was, but Roger Dickie changed their minds*)

**2003** "This (Kyoto) is something we should welcome as forest growers (*What were you thinking?*). It may also signal the beginning of a new trend, one that values plantations for their inherent environmental benefits as well as economic value." (*Idiot*) "So don't worry about the Kyoto Protocol etc, it has got to be good for plantation forest owners like you." (*Fool!*)

**2004** "I really find the whole thing quite amusing, although human folly (eg Kyoto & the Greens) could perhaps be seen as more tragic than worthy of a quiet chuckle. Here we are in irrelevant and isolated NZ running flat out into a truly Orwellian, Big Brother Carbon Accounting nightmare, merely to enhance our PC environmental credentials. Presumably the idea is to impress the Europeans so more come here as tourists (by fossil fuel guzzling 747) while back home their governments build more nuclear power plants. Are we not ruled by idiots?" *(Yes but we elected them)*

**2006** "New planting of pastureland may qualify for either an initial grant, or carbon credits which can be sold. That ..... proposal is very good news indeed and should encourage some new forest investment. We certainly will be looking to resume planting next year. The unhappy people are those who planted from 1990 to 2006 expecting carbon credits (e.g. Roger Dickie) and those who have old forests on easy country they want to convert to rye grass."

"Some of these (*carbon credit*) schemes may be a good thing but some will be either useless, environmentally suspect or scams. But in all cases someone other than you will be making money."

**2007** "Previously we were very sceptical about taking carbon credits, because of the expense, liabilities and the rules attached but the new policy looks favourable overall. There will be significant costs to gain credits (to be called 'NZUs') but these may be quite valuable so worth the effort & expense." *(I was deluded. I was thinking about 40% of credits would not have to be returned at harvest if replanted. The detail in the rules excluded us)*

**2009** "Partners may have noticed my considerable scepticism, bordering on cynicism concerning this topic. Well nothing much has changed since I last wrote." *(It looked like the new govt would change everything but they just diluted it)*

**2010** "Several futures are possible: Perhaps the NZUs will become more valuable than the logs at harvest, meaning you will get all our return from carbon not wood. Perhaps the scheme will only last a few more years and fade away or be cancelled, meaning you will have had a windfall. Perhaps some of your return will be carbon credits and some logs. Whatever it is, we are confident that one way or another, a good return from your investment is most likely." *(Yes, from just logs, as planned)*

"We still do not know if the ETS will be changed after 2012. Our government says there will be a carbon credit scheme for many years to come, and so do the Europeans. Japan has started one and Australia still says it will do one but they are much divided about it. The USA is against the Kyoto model but talks of doing their own ETS, but have not yet. So we can only deal with what is in front of us, which although new and uncertain, does seem positive for the JV partners overall. If we do not join, the government nationalises your credits, which we presume you do not want." *(The risk & uncertainty had not sunk in yet)*

**2011** "One option we can explore and discuss now or later is to use most of the credit money to plant more forest or buy more existing forest. That way we not only add to our assets but can grow our own replacement credits to surrender at the harvest of our older trees. Our several partnerships and the landowners could pool all credits to do this, perhaps in one large partnership of partnerships or a company. It could grow larger over time as more credits are sold and be an asset for the next generation. One day 'the carbon thing' will end, as it is designed to, and we or our descendants will own a larger forest, free of any liabilities. Sounds too good to be true, I know but using forest carbon credits to grow more forest is the safest option I think. These credits were not what we invested for, but are a product of the forest. So perhaps the wisest option is to convert them in to more forest?" *(Could work but has Ponzi features & what if the ETS goes ..... then there is the government making the rules .....)*

**2012, April** "I don't want to complain, but I wish the ETS did not exist, as so far all it has been for us is a waste of time and money, plus a considerable distraction. ....we are not able to take any risk with them. ....Even if we as investors wanted to, the Statutory Supervisor and the landowners would not let us as it exposes them to risk..... we need to have a way to realise them but still be able to guarantee those other parties the forest will be harvested as planned and the joint venture ended with a clean slate. ....may be to take out an insurance policy that guarantees to cover a carbon credit cost blow-out at harvest. ....there is a chance the government may change the rules and allow growers to have half the credits a forest earns if it is replanted in perpetuity. ....the carbon price has sunk to about \$7 due to Europe's woes and our high dollar, but the government says it will come right. May be time for a Tui!" ..... *(I think I got that one right. Hic!)*