

CMI Carbon Farming Contracts – Guidance Note

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1 Introduction

1.1 This guidance note, which was procured by the Carbon Market Institute and prepared by Norton Rose Fulbright Australia, is intended to be used by owners or lessees of land (**Landholders**), carbon project developers and entities providing services to Landholders or carbon project developers in connection with the establishment and operation of carbon projects. It:

- (1) provides an introduction to carbon projects and Australia’s carbon crediting scheme (**ACCU Scheme**);
- (2) offers a brief explanation of important concepts under the ACCU Scheme;

- (3) summarises the two primary types of carbon project contracts entered into with Landholders; and
 - (4) annexes and provides example contract clauses for the two primary types of carbon project contracts.
- 1.2 This document is provided as a guide only. Norton Rose Fulbright Australia takes no responsibility for providing legal advice. CMI takes no responsibility for the accuracy of the document. **It is recommended that parties obtain their own legal advice in relation to participation in the ACCU Scheme and before entering into a carbon project contract. It is also recommended that parties obtain legal advice on the appropriateness of the example contract clauses in the context of its carbon farming activities.**
 - 1.3 Parties are recommended to undertake appropriate due diligence in connection with the other party (or parties). Further, the Landholder should undertake appropriate due diligence (including with appropriate external legal and financial advice) of the proposed project type to ensure that the project is fit for purpose, having regard to the attributes of the land and the Landholder's long term aspirations for the land.
 - 1.4 This guidance note and the example contract clauses have primarily been prepared for application to carbon sequestration projects, rather than reduction or avoidance projects. However, the clauses could be applied to reduction or avoidance projects, with appropriate modification.
 - 1.5 Some of the example contract clauses may not be appropriate for use for carbon sequestration projects to be undertaken on land where native title has been extinguished i.e. the example contract clauses may not be appropriate if the project land is, or may be, subject to a native title determination under the *Native Title Act 1993 (Cth)*.¹ In this circumstance, it may be appropriate for the parties being the Landholder, Service Provider/Project Developer and the Native Title holders (or persons claiming to hold native title) to enter into a tripartite agreement that documents the rights and obligations of the respective parties in relation to the project and the conditions pursuant to which the Native Title holders (or persons claiming to hold native title) provide their consent for the project to be undertaken on the land. This could be in the form of an Indigenous Land Use Agreement. Please refer to:
 - (1) *'Australian Carbon Industry Code of Conduct'* published by the Carbon Market Institute;
 - (2) *'Seeking free, prior and informed consent from Indigenous communities for carbon projects'* guidance published by the Indigenous Carbon Industry Network; and
 - (3) *'Native title, legal right and eligible interest-holder consent guidance'* published by the Clean Energy Regulator, for further guidance.
 - 1.6 It is recommended that Parties obtain legal advice in relation to whether native title has been extinguished with respect to the Project Land.

¹ Extinguishment is a term defined and used in the *Native Title Act 1993*. It means the permanent extinguishment of native title rights and interests, which cannot be revived under Australian law. Generally, native title will have been extinguished over land that was the subject of a valid grant of a freehold estate on or before 23 December 1996. This is because the grant of a freehold estate is considered inconsistent with the continued enjoyment of native title. There are exceptions to this rule and specialist advice should be sought with respect to whether native title has been extinguished on the land on which the carbon sequestration project is proposed to be undertaken.

- 1.7 It is CMI's intention to support, in partnership with relevant Indigenous Australian carbon and land organisations, the development of a second set of example contract clauses for projects to be undertaken on land that is, or may be, subject to a native title determination.

2 The ACCU Scheme

- 2.1 The *Carbon Credits (Carbon Farming Initiative) Act 2011 (CFI Act)*² establishes the ACCU Scheme (previously referred to as the Carbon Farming Initiative or Emissions Reduction Fund). The ACCU Scheme credits registered projects with one Australian Carbon Credit Unit (**ACCU**) for every tonne of CO₂ equivalent avoided or sequestered as a result of the project.
- 2.2 ACCUs may be offered for sale to the Australian Government or other entities and may be used for compliance purposes (for example, to offset emissions exceedances under the Safeguard Mechanism) or voluntary purposes (for example, participation in Climate Active or to achieve carbon neutrality). The CFI Act is regulated by the Clean Energy Regulator (**Regulator**).
- 2.3 Projects registered under the CFI Act must be undertaken in accordance with an approved methodology determination (**Methodology**). The Methodology sets out the eligibility rules for a project and other requirements that apply to the project such as monitoring and reporting obligations.

3 Carbon Sequestration Projects

- 3.1 Carbon projects can encompass land management activities that sequester carbon dioxide (**CO₂**) in soil or vegetation on land or in oceans and wetlands. The land which will be subject to the land management activities is referred to as the 'Project Area'.
- 3.2 There are a diverse range of Methodologies that relate to sequestering CO₂ in soil or vegetation.
- 3.3 To be registered as an eligible offsets project under the CFI Act, the project must satisfy certain requirements including meeting any applicable additionality requirements, being undertaken on Torrens system land or Crown land and meeting any eligibility requirements specified in subordinate legislation (i.e. in the CFI Rule and the applicable Methodology).³
- 3.4 There are risks involved in undertaking carbon sequestration projects, and it is recommended that technical advice on the proposed Methodology be obtained before deciding to undertake a project.

4 What does it mean to be "Project Proponent"?

- 4.1 Every project registered under the CFI Act must have a project proponent (**Project Proponent**). A Project Proponent is the entity responsible for carrying out a project and having the legal right to carry out a project. The Regulator considers that an entity has the legal right to carry out a project when they can demonstrate that they hold the following rights for the duration of the project's 'crediting period':
- (1) the right to carry out the project activities on the project area; and
 - (2) the lawful and exclusive right to be issued all ACCUs that may be generated as a result of the project.⁴

² Together with the *Carbon Credits (Carbon Farming Initiative) Rule 2015 (CFI Rule)*.

³ See section 27(4) of the CFI Act for full list of requirements.

⁴ For further guidance see [Legal right \(cleanenergyregulator.gov.au\)](http://cleanenergyregulator.gov.au).

- 4.2 The Regulator's recognition of an entity as Project Proponent of a Project does not confer on that entity the legal right to carry out the Project i.e. it is not determinative of that entity being a Project Proponent. The Project Proponent is the entity who, at law, holds the legal right to carry out a project.
- 4.3 Ordinarily, the legal right will be held by the owner of the land. However, it is possible to transfer legal right through a contract. If an entity other than the landowner is intending to act as Project Proponent of the Project, they should undertake appropriate due diligence to ensure the landowner is able to transfer full legal right to them.
- 4.4 A Project Proponent can be an individual, body corporate, trust, corporation, body politic or local governing body. Provided that the Project Proponent holds the legal right to carry out the project, the Project Proponent can be anybody, for example, the owner of the land, the lessee of the land, a carbon project developer, etc.
- 4.5 A Project Proponent must also pass a fit and proper person test.⁵
- 4.6 The Project Proponent has legal obligations under the CFI Act and the relevant Methodology. Failure to comply with these obligations can, in some circumstances, result in pecuniary penalties. As such, there is a financial risk associated with acting as Project Proponent of a project.
- 4.7 Carbon project contracts should be drafted to ensure that whichever party is acting as Project Proponent can meet its legal obligations under the CFI Act with respect to the project. If a Project Proponent loses legal right to undertake the project, there is a risk that the project may be revoked by the Regulator. Revocation of a carbon sequestration project could lead to a requirement on the Project Proponent to relinquish ACCUs to the Regulator.
- 4.8 Depending on the status of the land upon which the project will be undertaken, consideration may also need to be given to any implications arising under the *Native Title Act 1993*.⁶ Further expert advice should be sought if native title has not been extinguished over the land on which a project is proposed to be undertaken.

5 Approvals and Consents

- 5.1 A project may be declared to be an eligible offsets project under the CFI Act subject to conditions requiring regulatory approvals or consents from eligible interest holders to be obtained.
- 5.2 Regulatory approvals include approvals, licences or permits required for the project under Commonwealth, State or Territory laws relating to land use or development, the environment or water.
- 5.3 Eligible interest holders are specified entities that have an interest in the project land and include banks (where there is a mortgage in place), the Crown Land Minister if the project is on Crown land and registered native title body corporates if there is a native title determination in place for the land.
- 5.4 Regulatory approvals or eligible interest holder consents must be obtained by the Project Proponent before the end of the first reporting period for the project.⁷

⁵ See section 60 of the CFI Act for the fit and proper person test.

⁶ Further guidance can be found in the Regulator's guidance: <https://www.cleanenergyregulator.gov.au/DocumentAssets/Pages/Native-title-legal-right-and-eligible-interest-holder-consent-guidance.aspx>

⁷ It is noted that recommendation 11 of the Chubb Review was "The CFI Act should be amended to remove the option to conditionally register ACCU projects on Native Title lands (as defined in the CFI Act) prior to

6 Crediting Period, Monitoring, Reporting and Verification

- 6.1 Each project registered under the CFI Act has a crediting period. The crediting period for a project determines the number of years for which ACCUs can be issued for the project. Typically, the crediting period for a project which involves the sequestering of CO₂ in soil or vegetation is 25 years⁸.
- 6.2 The Project Proponent will have certain obligations during the crediting period to monitor, report on and verify the amount of carbon being sequestered as a result of the project's activities. The Methodology, in conjunction with the CFI Act and CFI Rule, sets out the monitoring, reporting and verification requirements for a project.
- 6.3 In brief, the crediting period is split into a number of reporting periods. For a sequestration project, the reporting period must be no less than 6 months and no greater than 5 years in length. An offset report must be submitted to the Regulator for each reporting period. If an application for a certificate of entitlement is submitted to the Regulator with the offset report then the Regulator will issue ACCUs equivalent to the amount of abatement achieved for that reporting period (provided all the requirements specified in the CFI Act and CFI Rule relating to ACCU issuance have been satisfied). The ACCUs will be issued by the Regulator into the Australian National Registry of Emissions Units account of the Project Proponent.
- 6.4 A project is also required to undergo third party independent audits during the crediting period. When a project is registered, the Regulator issues the Project Proponent with an audit schedule. This consists of an initial audit for the first reporting period and a minimum of two subsequent audits for other reporting periods. Audits must be undertaken by auditors registered under the *National Greenhouse and Energy Reporting Regulations 2008*.

7 What is a "Permanence Period" and the Implications of a "Significant Reversal"?

- 7.1 The Project Proponent of a sequestration project is required (under the CFI Act) to ensure that the carbon which is taken out of the atmosphere (as a result of the project) is stored for a period of time and not released back into the atmosphere. The release of carbon back into the atmosphere is referred to as a 'reversal'.
- 7.2 Every sequestration project will have a nominated period of time during which there cannot be a 'Significant Reversal' in relation to the Project.⁹ This period of time is referred to as the project's 'Permanence Period'. The Permanence Period can be either 25 or 100 years and the Project Proponent can nominate which period they want to have applied to the project. A project's Permanence Period is different to a project's crediting period and is not required to be the same duration.
- 7.3 During the Permanence Period, if there is a Significant Reversal of the project's carbon sequestration, which results in the project having less carbon stock available than already claimed in the form of ACCUs, the Regulator can require the Project Proponent to relinquish (i.e. give back) a specified number of ACCUs to account for the reversal.
- 7.4 The CFI Act does not require the Project Proponent to relinquish ACCUs if the reversal was caused by a natural disturbance (defined under the CFI Act as flood, bushfire, drought,

obtaining consent, in alignment with the principles of Free, Prior and Informed Consent (FPIC).” The Government has indicated that it accepts all recommendations of the Chubb Review.

⁸ Methodologies can set out different lengths for the crediting period.

⁹ 'Significant reversal' is defined in sections 81 and 82 of the CFI Rule and encompasses a reversal of the removal of CO₂ from the atmosphere that is caused, or likely to have been caused, by a natural disturbance and the reversal exceeds 5% of the total project area or the reversal is caused, or likely to have been caused, by third party action and the reversal exceeds 5% of the total project area or 50 hectares (whichever is smaller).

pest attack and disease), or the actions of a third party (where those actions were not within the reasonable control of the Project Proponent) provided the Project Proponent took reasonable steps to mitigate the reversal.

- 7.5 If a Project Proponent fails to comply (or is likely to fail to comply) with a relinquishment notice issued by the Regulator:
- (1) this can result in a debt becoming due to the Commonwealth, which could be up to 200% of the market value of each ACCU not relinquished; and/or
 - (2) a Carbon Maintenance Obligation may be declared for the land on which the project is being undertaken.¹⁰
- 7.6 A Carbon Maintenance Obligation requires the owner or occupier of the land (as opposed to the Project Proponent) over which the Carbon Maintenance Obligation applies to ensure that the amount of carbon sequestered in the vegetation or soil on the land is not further reduced. Failure to comply with a Carbon Maintenance Obligation may result in a pecuniary penalty. Carbon Maintenance Obligations continue to apply to land even if that land is subsequently sold to a third party.

8 Types of Landholder Agreements

- 8.1 There are various types of agreements that an entity may enter into with the owners or lessees of land (**Landholders**) for the purpose of facilitating a sequestration project being undertaken. The two most common agreements are:
- (1) a 'Project Development Agreement' where a carbon project developer is the Project Proponent of the project; and
 - (2) a 'Services Agreement' where the Landholder is the Project Proponent.
- 8.2 As detailed above at paragraph 1.5, these agreements are appropriate only where the project is to be undertaken on land where native title has been extinguished.
- 8.3 The principal differences between these two types of agreements are set out below.

Carbon Project Services Agreement

- 8.4 A 'Carbon Project Services Agreement' would usually be used if a Landholder wishes to be Project Proponent of the project but requires an entity to provide it with specialist services (**Service Provider**) which will assist with the development, implementation and management of the project.
- 8.5 As the Landholder will be the Project Proponent of the project the Landholder will retain the right to undertake the project on the project land and be issued all ACCUs generated by the project.
- 8.6 A Service Provider will typically require either a monetary fee for its services or a share of the ACCUs generated by the project. Some negotiated Carbon Project Services Agreements may require a combination of both. As the Service Provider's remuneration is, in certain circumstances, linked to the project's performance, a Carbon Project Services Agreement tends to include certain obligations on the Landholder which are aimed at ensuring that the project is not compromised by the Landholder's actions. Where the

¹⁰ A copy of the Carbon Maintenance Obligation declaration is required to be given the Project Proponent, each person who holds an eligible interest in the land, any other specified persons and the relevant land registration official.

Service Provider's remuneration is just a simple monetary fee for service these obligations on the Landholder would not be necessary or appropriate.

8.7 CMI's template Carbon Project Services Agreement (see separate document) provides a list of example contract clauses which may be included in a Carbon Project Services Agreement with a brief explanation of each clause. The intention of the example clauses is to provide guidance and assistance to Landholders and Service Providers when they are negotiating the terms of a Carbon Project Services Agreement in order to:

- (1) facilitate the parties contracting on balanced terms both in respect of revenue and benefit sharing but also risk allocation; and
- (2) enhance the parties' respective understanding of the terms of the agreement they are negotiating and the practical implications of undertaking a carbon project.

8.8 The example contract clauses are not intended to represent the only terms upon which a Landholder and Service Provider should contract with each other as it is recognised that the needs of each party and the commercial arrangements will impact on the final form of the agreement.

Carbon Project Development Agreement

8.9 A 'Carbon Project Development Agreement' is used if the Landholder would like another entity (**Project Developer**) to:

- (1) be primarily responsible for the development, implementation and management of the project; and
- (2) be the Project Proponent of the project.

8.10 As the Project Developer will be the Project Proponent of the project the Landholder will need to grant the Project Developer 'legal right', being:

- (1) the right to undertake the project activities on the project land; and
- (2) the right to be issued all ACCUs generated by the project.

8.11 The Landholder will typically receive a share of the ACCUs generated by the project (or a share of the proceeds from the sale of the ACCUs generated by the project) in consideration for granting the Project Developer the 'legal right' to the project.

8.12 The Project Developer *may* require the Landholder to transfer the 'carbon rights' in the project land to them. Whilst the CFI Act does not require a Project Proponent to hold the carbon rights in the project land in order to be Project Proponent, holding the carbon rights in the project land provides greater security to the Project Developer should the project land be sold by the Landholder without the incoming Landholder entering into an agreement with the Project Developer.

8.13 Carbon rights vary from state to state but are, in essence, the legal right to commercially benefit from the carbon sequestered in trees, vegetation and soil on the land. Carbon rights are typically held by the Landholder but can usually be transferred by the Landholder to a third party (such as a Project Developer).. A carbon right constitutes an interest in land. Depending upon the relevant state/territory legislation, it may be possible for the Project Developer to register its interest in the land on the certificate of title for the land. The Project Developer's right (to commercially benefit from the carbon sequestered in trees, vegetation and soil on the land) will be enforceable against any subsequent owners of the Land.

- 8.14 Registration of the carbon right grants greater protection to the Project Developer, but is not a mandatory requirement of the ACCU Scheme. If the Project Development Agreement provides for the transfer of carbon rights to the Project Developer consideration should be given to when, and under what circumstances, the Project Developer should be required to transfer the carbon rights in the land back to the Landholder. If a Project Development Agreement does not deal with the transfer of the carbon rights back to the Landholder the Project Developer may retain carbon rights over the land after the Project Development Agreement has expired or been terminated.
- 8.15 Many of the obligations placed on the Landholder, and the rights granted to the Project Developer, within a Project Development Agreement are aimed at ensuring that the Project Developer can meet its obligations as Project Proponent of the project under the CFI Act and the relevant Methodology.
- 8.16 It is important for the Project Developer, when contracting with a Landholder, to ensure that the Landholder has an accurate understanding of the legal obligations they will be under if they enter into the Project Development Agreement. Whilst it is extremely important for a Landholder to obtain independent financial and legal advice before entering into a Project Development Agreement, this does not relieve a Project Developer who is a signatory of the CMI Code of Conduct, from their obligation to provide sufficiently accurate information to the Landholder to allow the Landholder to make an informed decision about whether to enter into a Project Development Agreement with them. This could be done by way of providing the Landholder with a plain English guide or fact sheet that addresses the Landholder's obligations under the Project Management Plan (see below) and, where appropriate, the Project Development Agreement.
- 8.17 It is helpful for a Project Development Agreement to include (as a schedule to the agreement) a 'Project Management Plan' which is prepared having regard to the requirements of the CFI Act and the relevant Methodology. The Project Management Plan should clearly set out:
- (1) the matters and activities that the Project Developer agrees to be responsible for with respect to the development, implementation and management of the project (for example: registering the project, undertaking project activities, monitoring the abatement, engaging auditors, preparing and submitting offset reports and applying for certificates of entitlement etc.);
 - (2) the matters and activities that the Landholder agrees to be responsible for with respect to the development, implementation and management of the project (for example: assisting the Project Developer in obtaining consent from Eligible Interest Holders,¹¹ maintaining fences, maintaining fire breaks etc.); and
 - (3) the actions that the Landholder cannot undertake on the project land (for example: restrictions on grazing, restrictions on clearing vegetation etc.).
- 8.18 CMI's template Carbon Project Development Agreement (see separate document) provides a list of example contract clauses which may be included in a Carbon Project Services Agreement with a brief explanation of each clause. The intention of the example clauses is to provide guidance and assistance to Landholders and Project Developers when they are negotiating the terms of a Carbon Project Development Agreement in order to:
- (1) facilitate the parties contracting on balanced terms both in respect of revenue and benefit sharing but also risk allocation; and

¹¹ An Eligible Interest Holder is, in essence, a person who holds some form of legal interest in the land on which an area based emissions avoidance project is to be carried out (for example, a bank who holds a mortgage over the land or a registered native title body corporate if the land is native title land).

- (2) enhance the parties' respective understanding of the terms of the agreement they are negotiating and the practical implications of undertaking a carbon project.
- 8.19 They are not intended to represent the only terms upon which a Landholder and Project Developer should contract with each other as it is recognised that the needs of each party and the particular commercial arrangements will impact on the final form of the agreement.