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This newsletter was prepared by members of the Energy and Emissions Trading and Climate Change Groups at Stikeman Elliott.

Ottawa unveils carbon-offset system

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On June 10, 2009, the Government of Canada announced the release of two draft “Program Guides” for the creation of Canada’s Offset System for Greenhouse Gases (Offset System). The Offset System is an important step in the creation of a carbon market in Canada, establishing tradable credits for greenhouse gas (GHG) reductions that will work in conjunction with the planned federal GHG regulatory regime. Under that regime, the Government will place a cap on GHG emissions and allow firms that do not meet set targets to buy credits from those with a surplus as an alternative to reducing their emissions. The creation of a carbon market is part of the Government’s commitment to reducing total GHG emissions by 20% below 2006 levels by 2020.

The *Program Rules and Guidance for Project Proponents* provides the rules, requirements and processes for offset credit creation, addressing registration of eligible projects right through to the issuance of credits and requirements after issuance. The *Program Rules for Verification and Guidance for Verification Bodies* sets out the rules for processes to verify the eligible GHG reductions or removals achieved from a registered project. The two Program Guides, together with the *Guide for Protocol Developers* (released August 2008), form the basis of Canada’s Offset System.

The draft Program Guides are available on the Environment Canada website and were announced in the June 13, 2009 *Canada Gazette*. They are open for a **60-day public comment period ending August 12, 2009**. After the comment period, final versions of the Guides will be prepared for expected release in the fall of 2009.

Overview

The Offset System will be a voluntary program administered under the *Canadian Environmental Protection Act, 1999*. Overall responsibility for the design and operation of the system will be granted to the Minister of the Environment, including establishment of the Offset System program rules; approving protocols used to quantify GHG reductions; registration of projects; and issuance of offset credits to eligible projects.

Each offset credit developed under the Offset System will represent one tonne of GHG (CO₂ equivalent) that has been reduced or removed. Credits will be both tradable and bankable, and the system will include a procedure for tracking all offset credits from issuance to retirement.

Key Elements

Program Rules and Guidance for Project Proponents

Registration

- > A proponent can apply to register a single project or an aggregated or bundled project.
- > The registration period is effective for eight years. An offset project may apply for re-registration one time only, for a second eight-year period, and registration periods must be contiguous (an exception to this rule is agricultural and forestry sink projects, which may register for three and five registration periods respectively).

Eligibility

- > In order to be eligible to receive offset credits, projects must be within the scope of the Offset System and achieve quantifiable, real, incremental, verifiable and unique GHG reductions.
- > Offset credits will only be available to projects that lead to reductions in Canada.

Claiming Offset Credits

- > Offset credits will only be issued after an eligible verification body has verified the project proponent's GHG reduction claim.
- > The Minister of Environment is responsible for the certification and issuance of all credits. Issued credits will be deposited in the project proponent's account in the tracking system.

Program Rules and Verification and Guidance for Verification Bodies

Verification Body Eligibility

- > Verification activities for projects in the Offset System must be conducted by an accredited verification body.

Verification Standard

- > All credit verifications for the Offset System must be conducted in accordance with the National Standard of Canada CAN/CSA-ISO 14064-3, *Specification with Guidance for the Validation and Verification of Greenhouse Gas Assertion*.

Conflict of Interest Assessment

- > To ensure that verification is conducted by a third-party verifier, the proposed verification body must complete a conflict of interest assessment prior to agreeing with a project proponent to act as a verifier.

What's Next

The Government has indicated that it will continue to monitor developments in the U.S. before finalizing certain aspects of the Offset System (such as project eligibility criteria), so as not to disadvantage Canadian project proponents. However, the manner in which the Offset System will interact with other carbon trading programs, including the Western Climate Initiative, British Columbia's carbon trading system, proposed systems being developed in Ontario and Quebec, and even a future North American program, remains unclear.

On a broader scale, Canada will surely continue to keep a close eye on U.S. policy and legislative developments relating to cap-and-trade. The Hon. Jim Prentice, Minister of the Environment, has stated that as Canada's economy is deeply integrated with that of the U.S., with which we share the same environmental space, the two countries must work toward the same climate change objectives.

The author wishes to thank Annie Pyke, Student-at-law at Stikeman Elliott, for her valuable contribution.

Ontario MoE releases proposed minimum setback requirements for wind energy

On June 9, 2009, the Ontario Ministry of the Environment released the “Proposed Content for the Renewable Energy Approval Regulation under the *Environmental Protection Act*” (the “Proposal”). The intent of the Proposal is to standardize requirements applicable to developers of renewable energy projects across the province. One such proposed requirement would oblige developers to locate renewable energy projects at a minimum setback distance from “receptors”, such as dwellings, to ensure that noise levels do not exceed a certain threshold at any receptor.

Although setbacks requirements would apply to wind, solar, hydro, biogas, and biomass projects, the standardization of setback distances is specifically intended to target wind projects. At present wind developers are subject to multiple setback distance requirements as dictated by municipal governments. The Proposal would require that wind projects are set back a minimum of 550 metres from any receptor. A higher standard would be imposed depending on factors such as: (1) the number of turbines in the proposed development; (2) any existing or approved turbines in the area; and (3) the sound level rating of the turbines selected for the development. The Proposal also provides for a minimum setback from roads, railways, and side and rear lot lines that is equal to the turbine hub height plus the length of the blade.

In addition to recommending minimum setback distances, the Proposal would require noise studies to be conducted for any project involving wind turbines with a sound power level greater than 107 decibels, regardless of number, and for any project involving more than 26 turbines within 1.5 kilometres of any receptor. These studies would form part of the new provincial approval process for renewable energy projects.

The Proposal is open for public review and comment on the Environmental Registry until July 24, 2009.

OEB confirms inherent jurisdiction to review unfairness

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In a recent Union Gas application, the Ontario Energy Board (OEB) confirmed that it retains inherent jurisdiction to review the operation of earnings share mechanisms even if the parties to a settlement agreement have not agreed to an explicit review procedure.

The issue arose in connection with the earning share mechanism that Union agreed to in its 2008 rate case. In the 2008 settlement, Union agreed to split 50/50 with ratepayers any return on equity that was more than 200 basis points over the return on equity calculated under the OEB’s cost of capital formula. The 2008 settlement also provided an “off-ramp” in the event that Union’s return on equity was more 300 basis points above the OEB’s formula; if triggered, the provision required Union to bring application for review of the earnings share mechanism.

As Union’s 2008 earnings were more than 300 basis points above the OEB’s formula, Union was required to bring a review application. As part of the application, Union agreed to a settlement under which the off-ramp provision was replaced by a commitment to share 90% of any earnings more than 300 basis points above the OEB’s formula with ratepayers. One intervenor, the Industrial Gas Users Association (IGUA), objected to the removal of the off-ramp provision because it provided Union with a “licence” to continue to over-earn without review of the reasons for the over-earning.

While recognizing IGUA’s concern, the OEB panel approved the settlement, noting that “even if the contractual right of the parties to review the plan disappears when the trigger mechanism disappears, the Board still has inherent jurisdiction to review situations it regards as unfair or unreasonable.” In the panel’s view, the 90/10 sharing mechanism was an appropriate check on Union’s ability to over-earn and provided greater regulatory certainty. In reaching this conclusion, the OEB made it clear that, while parties have considerable latitude to design and alter earnings share mechanisms, it continues to have the ultimate responsibility to ensure such mechanisms are just and reasonable.

OEB proposes cost-recovery changes to spur renewable infrastructure investment

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The Ontario Energy Board (OEB) continues to rapidly introduce changes intended to facilitate implementation of the *Green Energy and the Green Economy Act* (GEGEA). In May 2009, it issued a notice to amend the *Distribution System Code* to enhance the generation connection process, proposing measures aimed at removing the backlog of generation projects in the current queue. Earlier this month, the OEB issued a further notice to amend the *Distribution System Code* in order to reduce the costs that renewable generators pay to connect to the distribution system (this follows on similar proposed amendments to the *Transmission System Code*). Most recently, on June 10, 2009, OEB staff issued a discussion paper aimed at facilitating investment in distribution and transmission infrastructure by dramatically changing current cost recovery treatment.

The stated purpose of the discussion paper entitled *Staff Discussion on the Regulatory Treatment of Infrastructure Investment for Ontario's Electricity Transmitters and Distributors* (Discussion Paper) is to fulfill the objectives of the GEGEA by incentivizing investment in distribution and infrastructure while ensuring that the interests of ratepayers continue to be protected. The Discussion Paper draws heavily on FERC's Rule 679, *Promoting Transmission Investment through Pricing Reform*, by identifying a range of mechanisms for alternative cost treatment of infrastructure investment, some or all of which could be applied in the context of a cost of service review, a multi-year rate adjustment mechanism or a specific rate application (or in the course of approving distributors' or transmitters' infrastructure investment plans as mandated by the GEGEA). The alternative mechanisms for cost recovery identified in the Discussion Paper include recovery of costs for abandoned facilities, accelerated cost recovery, the inclusion of construction work in progress (CWIP) in rate base, accelerating depreciation and providing for incentive-based ROE.

Similarly, in accordance with FERC's view, OEB staff suggest that beyond identifying certain investments that would be presumed to qualify for alternative cost treatment, it is not appropriate to be more prescriptive. Staff suggest that establishing more prescriptive criteria would limit flexibility by pre-judging which projects are eligible for alternative treatment and limiting the ability of applicants to request a combination of alternative cost mechanisms. Accordingly, staff suggest that the Board "should exercise its discretion to allow alternative treatment on a case-by-case basis for appropriate infrastructure investments by electricity transmitters and distributors in a manner that facilitates the achievement of the Government's policy objectives as reflected in the GEGEA while protecting the interests of ratepayers".

OEB staff have outlined 26 issues for written comment. These issues include the appropriateness of the foregoing alternative cost mechanisms and whether the OEB should be more prescriptive as to which types of investments qualify for alternative treatment and which do not. Staff have asked that written comments be filed by July 7, 2009 and have outlined the framework for cost award eligibility. ■

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