

DEVELOPING MARKET MECHANISMS: CANADA'S RESPONSES TO CLIMATE CHANGE

A look at the climate change regulatory framework being contemplated at federal and provincial levels

By Jason Kroft, Ruth Elnekave and Cora Zeeman; *Stikeman Elliott LLP*

The challenge of climate change has produced many distinct policy and legislative responses in jurisdictions across Canada and the United States. Federal, regional, provincial and state initiatives seek to reduce greenhouse-gas (GHG) emissions through market mechanisms and technological innovation.

Emissions trading, or “cap and trade,” is a key market mechanism that is expected to significantly contribute to North America’s efforts to reduce GHG emissions. While neither the US nor the Canadian federal governments have introduced a regulatory framework for cap and trade, each has identified it as its preferred approach at the present time. At the provincial, state and regional level, existing and proposed cap and trade systems are playing an increasingly

considerable role. Our view is that, in some form, cap and trade will continue to be an important focus of most climate change policy responses.

Part I: Canadian Federal Policy

Canada’s federal government has recently emphasized its desire to harmonize its climate change initiatives with the anticipated US regulatory regime, creating a continent-wide cap and trade system. The federal government’s climate change policies, outlined in *Turning the Corner: An Action Plan to Reduce Greenhouse Gases and Air Pollution* (2007), have been fine-tuned following renewed engagement by the Obama administration with climate change issues. Canadian Environment Minister Jim Prentice recently noted that his government is in the process of

creating a cap and trade system “capable and worthy of integration into an eventual North American carbon market” that is “harmonized, consistent and free from conflict”. The federal government advocates harmonization for a number of reasons, including the shared physical environment and integrated economies of Canada and the US, Canada’s major role in North America’s energy equation and the risk of tariffs on Canadian exports.

GHG Reduction Target

Under the original *Turning the Corner* framework, Canada had proposed a 20-percent reduction in emission “intensity” (i.e., a limit on emissions per unit of economic output) from 2006 levels by 2020. However, in December 2009, the federal government announced that it is adopting an absolute target in order to facilitate continent-wide cap and trade. In addition, the government has revised its reduction target to 17 percent from 2005 levels by 2020 to match America’s pledge in the UN Framework Convention on Climate Change (UNFCCC), noting in its own UNFCCC pledge that it has done so “to be aligned with the final economy-wide emissions target of the United States in enacted legislation.”

However, the federal government has yet to legislate its commitment. Bill C-311, the *Climate Change Accountability Act*, was introduced as an opposition private member’s Bill in February 2009. If passed, the Bill would commit the federal government to GHG emission reductions of 25 percent below 1990 levels by 2020 and by 80 percent by 2050. It would also evidence to its North American counterparts its dedication to a continental approach to emission reduction. While Bill C-311 passed second reading in the House of Commons, however, it was not passed into law prior to the United Nations Climate Change Conference in Copenhagen. A final vote on the Bill is expected in 2010. Further, if passed, a constitutional challenge could be made with respect to what some might consider a federal intrusion into areas of provincial authority.

Cap and Trade

Under the *Turning the Corner* framework, certain industries – including electricity generation produced by combustion, oil and gas, pulp and paper, iron and steel, iron ore pelletizing, smelting and refining, cement, lime, potash, and chemicals and fertilizers – are to be regulated by a federal cap and trade system. However, while Minister Prentice recently indicated that the government “is in the process” of creating a domestic cap and trade system, as a result of the government’s plan to harmonize its approach

with that of the United States, further details on the design and structure of such a regime will likely not be announced until equivalent legislation is passed south of the border.

In the US, there have been a number of recent efforts to pass cap and trade legislation. On June 26, 2009, the House of Representatives passed the *American Clean Energy and Security Act* (also known as the Waxman-Markey Bill), which promotes the development of clean energy resources and energy efficiency and requires cuts in GHG emissions through a cap and trade system. On September 30, 2009, the US Senate introduced its own climate change Bill, the *Clean Energy Jobs and American Power Act* (also known as the Kerry-Boxer Bill), which also proposes to establish a GHG emission cap and trade system. Finally, one of numerous currently competing legislative proposals in the Senate is a bipartisan Bill sponsored by Senators Kerry, Lieberman and Graham that includes a cap and trade program and is favoured by the White House. Whether and when any of this legislation will be passed is unclear, however, as senators from energy-producing states express concern about potential competitive disadvantage and increasingly advocate such alternatives to cap and trade as a carbon tax, greater focus on alternative energy, stronger EPA regulation and a “cap and dividend” scheme.

Offsets. Building upon the *Turning the Corner* framework, Canada’s federal government is now contemplating the creation of an offset system that will allow for the creation of offset credits through projects that avoid or sequester emissions (each corresponding to one metric ton of CO₂ equivalent, or “CO₂e”) that can be used by regulated emitters for compliance purposes, traded or banked for future use under a cap and trade system. To be eligible for offset credits, projects must achieve real, incremental, quantifiable, verifiable and unique GHG emission reductions. Project developers will be required to obtain third-party verification and certification of reductions in order to obtain offset credits.

Emission Reporting. As a first step in creating a cap and trade regime, each participating jurisdiction must compile an inventory of GHG emissions. In 2009, the federal government, by notice of the Minister of the Environment pursuant to the *Canadian Environmental Protection Act, 1999* (CEPA), required mandatory annual reporting of GHG emissions by facilities that emit over 50,000 metric tons of CO₂e per year. Similarly, as of 2010, the US EPA will begin tracking GHG emissions over 25,000 metric tons of CO₂e per year.

Other Regulatory Measures

The cornerstone of the federal government's response to climate change is a focus on technology and innovation. Since 2007, the federal government has invested in a range of "ecoAction" programs that promote the use of clean technologies. Furthermore, Canada's 2009 Economic Action Plan included billions of dollars in spending on initiatives such as

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the Clean Energy Fund and the Green Infrastructure Fund, which are similar to measures proposed in the US Waxman-Markey and Kerry-Boxer Bills.

In further support of its GHG emission reduction efforts, on December 7, 2009 Environment Canada published the draft *Passenger Automobile and Light Truck Greenhouse Gas Emissions Regulation*, which is based on proposed US federal fuel standards. Developed under CEPA, this draft regulation would establish progressively more rigorous limits on GHG emissions from new passenger automobiles and light trucks in Canada, beginning with the 2011 model year, with an expected 20-percent improvement in the average GHG-emission performance between the 2007 and 2016 model years.

Part II: Regional

In addition to federal climate change initiatives, Canadian provinces and US states are involved in several regional initiatives.

At the 2001 Conference of New England Governors and Eastern Canadian Premiers (including Québec and

the Maritime provinces), the Climate Change Action Plan was announced. This plan commits participants in the region to reduce GHG emissions to 1990 levels by 2010, 10 percent below 1990 levels by 2020 and by 75 to 85 percent in the long term. This initiative led to the legally binding 2005 Regional Greenhouse Gas Initiative (RGGI), North America's first mandatory cap and trade program. RGGI regulates power plants in the US Northeast. Ontario, Québec and the Atlantic provinces are observers of the RGGI.

In 2007, six states and the province of Manitoba established the Midwest Greenhouse Gas Reduction Accord. Under the accord, members have agreed to establish regional emission-reduction targets, including a long-term target of 60 to 80 percent below 2007 levels, and develop a cap and trade system that would link to those of other jurisdictions.

The Western Climate Initiative (WCI) was also established in 2007. Members include British Columbia, Manitoba, Ontario and Québec and seven US states. Fourteen other North American jurisdictions, including Nova Scotia and Saskatchewan, participate as observers. WCI members have set a regional GHG emission reduction target of 15 percent below 2005 levels by 2020, and each has committed to adopting a reduction target at least as stringent as the regional target. The WCI is working toward the establishment of a cap and trade program by 2015. Each member is responsible for taking the necessary steps toward implementation, including enacting the appropriate legislation. As discussed below, each of the four Canadian members has announced or enacted cap- and trade-enabling legislation.

Part III: Provinces

The development of climate change policy and legislative frameworks has gained momentum in provinces across the country. In some instances, provinces have indicated that they will work together on climate change, as evidenced by the June 2008 memorandum of understanding between Québec and Ontario to collaborate on a regional cap and trade scheme, and a memorandum of understanding on carbon capture and storage between Alberta,

Saskatchewan and Manitoba. However, other than the cap and trade regimes under development by WCI members, provincial regimes are generally not harmonized with each other or with the federal plan.

As discussed below, Alberta has Canada's only regulatory emissions trading market, in which carbon is priced at C\$15 per metric ton based on the province's administrative penalty for not meeting emissions targets. While market-based systems outside of Alberta are in their infancy (for example, activity on the Montreal Climate Exchange is minimal, and many companies not subject to legislated caps are hesitant to invest resources amid regulatory uncertainty), regulatory regimes being developed across the country will, over time, provide needed price signals to the broader Canadian marketplace.

While space does not permit us to consider all provincial initiatives, the following sections review the key steps toward market-based mechanisms that have been taken in British Columbia, Alberta, Manitoba, Ontario and Québec.

British Columbia

GHG Emission Reduction Target

With the enactment of its commitment to reduce the province's GHG emissions by 33 percent (by 2020) and 80 percent (by 2050) against a 2007 baseline in the *Greenhouse Gas Reduction Targets Act* (GGRTA) in early 2008, British Columbia took a major step toward achieving its emission-reduction targets. The province's *Climate Action Plan*, released in mid-2008, is the province's road map for achieving these goals.

Cap and Trade

British Columbia's Bill 18, which would create the *Greenhouse Gas Reduction (Cap and Trade) Act*, is intended to help meet the province's WCI obligations through the creation of a cap and trade system. Although key provisions of the proposed legislation are not yet in force, it will (when implemented) require facilities in designated sectors to acquire government-issued allowances – each corresponding to a right to emit one tonne of CO₂e – for each compliance period. Facilities with emissions exceeding those permitted by their assigned number of allowances would have several compliance options, including purchasing allowance units from other British Columbia facilities, purchasing “Recognized Compliance Units” (i.e., units from another recognized system such as the WCI), acquiring offset credits or paying an administrative penalty.

Offsets. The *Emission Offset Regulations* under the GGRTA, which received Royal Assent in late 2008, establish rules for the recognition of GHG reductions and removals generated from various projects as emission offsets for purposes of fulfilling the government's commitment under the GGRTA to achieve carbon neutrality in the public sector by 2010. Key requirements for recognition include the verification of GHG emission reductions, which must not have been previously recognized by another GHG emission-reduction program, and ownership of the offsets by the Pacific Carbon Trust, a Crown corporation established to help the province meet its emission-reduction goals.

Emission Reporting. A GHG reporting regulation that came into force on January 1, 2010, requires British Columbia facilities emitting over 10,000 metric tons of GHG annually to file a report, beginning with the 2010 calendar year.

Other Regulatory Measures

A number of other emission-reduction measures have been implemented in BC, including the adoption of California's strict vehicle emission standards for cars and light-duty trucks (to take effect only when the equivalent California standards have been implemented), legislation mandating renewable fuel content in gasoline and diesel, and a revenue-neutral carbon tax applying to practically all fossil fuels in the province.

Alberta

GHG Emission Reduction Target

Alberta is the only Canadian jurisdiction with an intensity-based emission reduction target (now that the federal government is moving to an absolute target). Alberta has committed to reduce GHG emissions by 20 million metric tons by 2010, 50 million metric tons by 2020 and 14 percent from 2005 levels by 2050.

Cap and Trade

In April 2007, Alberta became the first jurisdiction in North America to regulate emissions from large industrial facilities. The *Specific Gas Emitters Regulation* and the *Administrative Penalty Regulation* set mandatory emission-intensity caps under which facilities that emit more than 100,000 metric tons of “specified gases” (Regulated Emitters) must improve their emission-intensity performance by 12 percent, and require payment of penalties if those caps are exceeded. Facilities may achieve compliance

by reducing their emissions, purchasing emission offsets created in Alberta or paying C\$15 per metric ton emitted over their cap into the province's Climate Change and Emissions Management Fund. In 2008, the fund received C\$82.3 million in compliance payments and as of May 6, 2009, held C\$122.4 million.

Emission Reporting. Regulated Emitters must submit annual reports on their GHG emissions. The *Specified Gas Reporting Regulation* describes who is affected by the requirement and how the information is collected, while the *Specified Gas Reporting Standard* indicates what needs to be reported and the manner for calculation of emissions.

Carbon Capture and Storage

Alberta is also heavily investing in the development of carbon capture and storage (CCS) technology. The *Carbon Capture and Storage Funding Act* provides the province with the authority to administer funding for CCS projects, which as of 2009 included retrofitting CCS into a coal-fired generating plant currently under construction, installing CCS technology on an oil sands upgrader, turning deep coal deposits into clean-burning fuel and transporting carbon dioxide from a fertilizer plant and proposed upgrader to oil fields in east-central Alberta to enhance recoveries.

Manitoba

GHG Emission Reduction Targets

Manitoba has renamed its original climate change action plan "2008 – Beyond Kyoto" and updated it to incorporate initiatives including development of a vehicle emissions standard modeled on California's, coal reduction strategies to be mandated through climate change legislation, a tax on coal emissions and enhanced CCS projects. In the same year, Manitoba enacted its commitments to reduce GHG emissions to 6 percent below 1990 levels by 2012 in its June 2008 *Climate Change and Emissions Reduction Act*.

Legislative Framework

Manitoba's *Climate Change and Emissions Reduction Act* establishes emission reduction targets and emission reporting requirements while requiring the government to prescribe California-style vehicle standards. Furthermore, on December 15, 2009, the government indicated that it will move forward in 2010 with legislation enabling the creation of a cap and trade system to fulfill its obligations under the WCI.

Bill 209, establishing the *Greenhouse Gas Emissions Reporting Act*, would require the government to publicly report Manitoba's GHG emissions on a quarterly and annual basis. The Bill was introduced on December 4, 2009 and has yet to receive a second reading in the Legislature.

Ontario

GHG Emission Reduction Target

Ontario's *Action Plan on Climate Change* calls for reductions in GHG emissions to 6 percent below 1990 levels by 2014, 15 percent by 2020 and 80 percent by 2050. As discussed below, the province has recently enacted legislation aimed at furthering this goal, although a December 8, 2009, report from the Environmental Commissioner of Ontario concluded that the province will not meet the 2014 and 2020 targets.

Cap and Trade

In December 2009, the government took a step toward meeting its stated targets with the passage of the *Environmental Protection Amendment Act (Greenhouse Gas Emissions Trading), 2009*, which lays the groundwork for implementing the province's cap and trade system (including possible linkage to the systems of other WCI jurisdictions). The amendments also provide the government with the power to create emissions allowances that can either be given away or auctioned. While much regulatory detail remains to be drafted, some indication of Ontario's plans may be found in a December 2008 discussion paper titled "A Greenhouse Gas Cap-and-trade System for Ontario" that describes the government's proposed design approaches for the system.

Emission Reporting. On December 1, 2009, Ontario established the *Greenhouse Gas Reporting Regulation*, which requires all facilities emitting over 25,000 metric tons of CO₂e per year to report their GHG emissions on an annual basis, beginning with 2010. The data that will be captured will aid in the creation of a cap and trade system.

Regulatory Developments

In early 2008, in response to investor concerns, the Ontario Securities Commission (OSC) released Staff Notice 51-716, the product of a targeted review to determine whether reporting issuers were adequately disclosing "environmental matters." This was followed on December 18, 2009, by Staff Notice 51-717, which outlines the OSC's plans to issue guidance by December 2010 with respect to issuer compliance with environmental and corporate governance

disclosure requirements. The OSC is consulting investors, issuers, advisors and other stakeholders, and is expected to address adequate disclosure by

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reporting issuers of the financial and operational implications and risks faced as a result of climate change regulatory frameworks, including cap and trade. The disclosure guidance for public companies recently issued by the US Securities and Exchange Commission will likely have some influence on the OSC's initiative on disclosure guidance.

Québec

GHG Emission Reduction Target

In June 2006, Québec established its *2006-2012 Climate Change Action Plan*, the same year in which the province had already achieved emission reductions of over 7 percent over 1990 levels. In November 2009, the Government of Québec announced a 20 percent reduction target (over 1990 levels) to be achieved by 2020.

Cap and Trade

Québec passed Bill 42, which amends the *Environment Quality Act (EQA)*, in June 2009. Although not all of the new legislation has come in force, when fully implemented it will provide a framework for the province's cap and trade system. The legislation includes several provisions explicitly contemplating integration with regional and international cap and trade initiatives. Facilities failing to meet the reduction targets will be required to pay a fine into the province's Green Fund. Facilities will also be required to register their GHG emissions in a public registry, which would serve as a basis for calculating levels of emission allowances to be made available

from time to time. Emissions allowances will then be granted by the province in the form of emission units, offset credits, early reduction credits and any other forms to be determined by regulation. Facilities emitting less than the applicable predetermined emissions cap will be able to trade their allowances or bank them for later use or trade.

Emission Reporting. While Bill 42 gives the government the power to establish reporting thresholds by regulation, no such regulation has yet been published. However, the *Regulation respecting mandatory reporting of certain emissions of contaminants into the atmosphere*, released in 2007 and also created pursuant to the EQA, requires

reporting of GHG emissions by emitters exceeding a prescribed threshold. Under the regulation, annual reporting thresholds for GHG emissions are determined by the notice of the Minister of the Environment of Canada pursuant to CEPA (as discussed above). The 2009 threshold was 50,000 metric tons of CO₂e; no notice has as yet been published for 2010.

Other Regulatory Measures

Other key legislative measures implemented to date include Québec's *Regulation respecting greenhouse gas emissions from motor vehicles*, which sets out gradually diminishing maximum GHG emission standards and applies to all cars and light trucks from the 2010 model year onward. The regulation also establishes a system of credits and debits whereby fees for emissions in excess of the maximum standards will be payable into the province's Green Fund. Since October 2007, Québec has also applied a carbon tax amounting to 0.8 cents on every litre of gas distributed in the province and 0.9 cents for diesel fuel to energy producers. Given that the transportation sector accounts for 40 percent of Québec's emissions, these initiatives are expected to represent a significant step toward realizing the province's GHG emission-reduction target and achieving the goals of its Climate Change Action Plan.

Conclusion

Climate change regulation and harmonization in North America is still undergoing development and many policy details, including the timing of a comprehensive regulated North American response

to climate change, remain uncertain. What remains clear, however, is that businesses and their professional advisors need to be mindful of the potential

impact of climate change and the forthcoming regulatory and other implications on their business and affairs.



Jason Kroft, *Stikeman Elliott LLP*

Tel: (416) 869-5534 · Fax: (416) 947-0866 · jkroft@stikeman.com

Mr. Kroft is a partner who practises corporate/commercial law with an emphasis on structured and corporate finance, public and private asset securitization, banking and derivative products. He has developed significant experience in energy transactions, emissions trading and greenhouse gas initiatives.



Ruth Elnkave, *Stikeman Elliott LLP*

Tel: (416) 869-5563 · (416) 947-0866 · relnekave@stikeman.com

Ms. Elnkave is an associate in the Corporate Group of Stikeman Elliott's Toronto office. Her practice focuses on securities, corporate finance, mergers and acquisitions, energy and emissions trading, infrastructure and P3 work. She is a member of the Ontario Bar Association and Law Society of Upper Canada. Ruth has authored or co-authored several articles.