

Canada moves forward on domestic emissions trading market

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On March 10, 2008, the Government of Canada released much anticipated details of its *Regulatory Framework for Industrial Greenhouse Gas Emissions*, part of its *Turning the Corner* climate change plan first announced in April 2007. The framework document and accompanying policy documents (the Framework) set out mandatory intensity-based (*i.e.*, per unit of production) reduction targets, details of certain compliance mechanisms, and new measures to address Canada's leading industrial greenhouse gas (GHG) emitting sectors: electricity and oil and gas. A significant aspect of the Government's announcement is its emphasis on carbon capture and storage (CCS) technology as a key solution to reduce emissions – not surprising in light of the \$250 million for CCS announced in the Government's February Budget Plan.

Under the Framework, the Government intends to establish a market price for carbon and set up a compliance-based emissions trading market. Sixteen major industrial sectors would be required to reduce their emissions intensity by 18% from 2006 levels by 2010, with 2% continuous improvement in each subsequent year. The Government says it will reduce Canada's GHG emissions by 20% (approximately 165 megatonnes (Mt)) from 2006 levels by 2020. These targets will not make Canada compliant with its obligations under the Kyoto Protocol.

The Government plans to transition from an emission-intensity based target system to a fixed emissions cap system in the 2020-2025 period. It has indicated that in determining the level of the cap, particular consideration will be given to climate change-related regulatory developments in the U.S., with the aim of establishing a North America-wide emissions trading system.

In addition to emissions trading between regulated companies, the Framework also elaborates on some of the voluntary reduction compliance mechanisms available to meet the targets. These include:

- > *Domestic offset system*: credits would be issued for incremental, real, verified domestic reductions or removals of GHG emissions. Functional details of the system, including verification of reductions and issuance and use of offset credits, are set out in the Framework. The Government has also indicated that consideration would be given to reductions originating in the U.S. once the U.S. has a regulatory system in place and compliance-based cross-border emissions trading is feasible.
- > *Credit for Early Action Program*: companies that took verified early action to reduce emissions would be eligible for a one-time allocation of 15 Mt in bankable, tradable credits. In addition, firms with eligible reductions above

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that amount would be allocated credits based on each firm's proportional contribution to the total emission reduction achieved. To qualify, reductions must have been the result of an incremental process change or facility improvement (*i.e.*, they cannot have been the result of business as usual conditions).

- > *Technology Fund*: companies would be able to contribute to a fund that would invest in a range of clean technology development projects in exchange for credits that could initially be used to comply with up to 70% of their regulatory obligations. This contribution rate would decline through 2018, at which time this mechanism would be phased out and replaced by other measures, including internal abatement actions and carbon trading. Contributions to other funds that meet the necessary requirements could potentially also be recognized under this compliance mechanism (*e.g.*, provincial funds).

Additions to the April 2007 framework include:

- > *Pre-certified Investments*: companies would also have the compliance option of investing directly in pre-certified large-scale projects (*e.g.*, CCS projects). As an added incentive for participation, firms in the oil sands, electricity, chemicals, fertilizers and petroleum refining sectors could be credited for their investments up to 100% of their regulatory obligation through 2018 (in contrast to the limited, declining contribution limit under the Technology Fund mechanism).
- > Oil sands upgraders, in-situ plants (*i.e.*, on-site soil remediation facilities) and coal-fired electricity plants that come into operation in 2012 or later would be obliged to comply with targets described as "tough" by the Government, which will provide incentive for facilities to be built carbon-capture ready. These targets are expected to generate an additional 30 Mt in reductions in 2020.
- > The electricity sector, Canada's top emitting industrial sector, would face an 18% reduction target at the facility level and a task force will be established to work with the provinces and industry to explore ways to meet an additional 25-30 Mt reduction goal from the electricity sector by 2020.

The Government calls the Framework "one of the toughest regulatory regimes in the world to cut GHG emissions", but reaction has been mixed. Certain affected industries expressed cautious approval of the Framework, while federal opposition parties and environmental groups were critical of its use of intensity-based targets (rather than absolute reductions) and its emphasis on CCS technology rather than energy efficiency, or more proven technologies. Ontario and Quebec expressed disappointment over the lack of recognition for companies that have taken early measures to cut emissions. Further, some said that provincial green plans and provincially-driven efforts to establish an inter-provincial cap-and-trade system (perhaps linked with the U.S.) would have a more immediate impact than the Framework.

Business and environmental groups alike have repeatedly called for a uniform approach to carbon regulation in Canada. Industry has expressed concern that the growing regulatory patchwork of federal and provincial schemes, if not harmonized, will result in increased costs, confusion, and decreased investment. While British Columbia, Quebec and Alberta already have regulatory schemes in place, the draft federal GHG regulations are expected in fall 2008. The final federal regulations are expected to be released in fall 2009, with the GHG provisions of the regulations coming into force on January 1, 2010. However, experts predict that the new U.S. administration will establish a national cap-and-trade system and that Canada will be forced to follow suit. Accordingly, while the Government is moving forward with its plans, the state of carbon regulation in Canada remains in flux. ■

CCS a cornerstone of Alberta's climate strategy

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The Alberta government recently announced an updated climate change strategy in its January 2008 policy document, entitled "*Alberta's 2008 Climate Strategy: Responsibility/Leadership/Action*". The strategy calls for province-wide emissions reduction targets from current levels. Alberta is proposing cutting 20 million tonnes of greenhouse gas (GHG) emissions by 2010, 50 million tonnes by 2020 and 200 million tonnes by 2050, relative to anticipated economic growth. The strategy calls for the fostering and leveraging of carbon capture and storage technology (CCS) to account for approximately 70% of the ultimate reductions, with conservation and efficiency efforts and the adoption of greener practices accounting for the remainder. Other points of interest in the strategy

include the development of an Energy Efficiency Act, the development of protocols for facilities that emit over 50,000 tonnes of greenhouse gases to report their emissions, and the continued development of a carbon offset market in the Province.

Alberta was the first province to take action against GHG emissions; introducing a legislative regime in the spring of 2007. Under the regime, facilities with yearly GHG emissions over 100,000 tonnes are obliged to make annual emissions intensity reductions. The regime provided the foundation for Canada's first mandatory carbon trading market, commencing July 1, 2007. The Alberta government is still developing the rules of this market and hopes to have a system in place later this spring. In the interim, trading for compliance is already occurring. An offset system, including certain approved protocols and a registry, is already up and running in the Province. Offsets are considered to be a key compliance option for regulated entities under the Alberta regime.

In addition, CCS is receiving significant attention in Alberta as in other provinces and at the federal level. A number of large industrial emitters in Canada perceive significant opportunities for CCS in Western Canada and, through an alliance called ICO2N, have expressed a willingness to invest in CCS and use the Western Canadian Sedimentary Basin's estimated capacity to store emissions. Given its potential capacity to generate emissions credits (and its potential assistance in petroleum recovery), CCS may prove to be of significant importance in the development of emissions trading, both in Alberta and federally. ■

B.C.'s green plan combines carbon trading and carbon tax

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In November 2007, the British Columbia (B.C.) Legislature enacted initial legislation respecting the reduction of greenhouse gas (GHG) emissions. The *Greenhouse Gas Reduction Targets Act*, which came into force on January 1, 2008, establishes targets of a 33% reduction below 2007 GHG emission levels by 2020, and an 80% reduction below 2007 emission levels by 2050. It also requires that realistic, economically viable interim targets for 2012 and 2016 be established by the Minister of Environment by the end of 2008, and that the provincial government itself become carbon neutral by 2010.

The B.C. government has also announced that additional legislation will be introduced this year to regulate emissions from different sectors. The proposed legislation would establish a cap-and-trade system for large emitters, which would include firm caps on the allowable emissions from large sources, and provide for participation in emissions trading systems. The new legislation would also adopt California tailpipe standards for new vehicles, introduce low-carbon standards for fuels, and provide authority for the regulation and capture of landfill gases.

In February 2008, the B.C. government introduced a provincial budget that included Canada's first broad-reaching carbon tax. The tax, which will come into effect on July 1, 2008, will apply to virtually all fossil fuels, including gasoline, diesel, natural gas, home-heating fuel and coal. It will be phased in over a five-year period at rates based initially on \$10 per tonne of carbon emissions and escalating to \$30 per tonne by 2012. The carbon tax rate for gasoline will be 2.41 cents per litre effective July 1, 2008 and will increase to 7.24 cents per litre by July 1, 2012. For natural gas, the initial carbon tax rate will be 49.88 cents per gigajoule, increasing to 149.64 cents per gigajoule by 2012. According to the B.C. Minister of Finance, the tax is "revenue neutral" since all revenues will be returned to individual taxpayers and businesses in the form of reductions in other taxes.

B.C.'s Premier Campbell has also been aggressively promoting the development of cross-border cap-and-trade emissions trading. Along with Manitoba, B.C. is a member of the Western Climate Initiative, an alliance of U.S. states that seeks to establish a common cap on GHG emissions and implement a regional emissions trading scheme. The Premier also signed on to the International Carbon Action Partnership at its launch in Lisbon last fall. ■

Proposed launch date for trading of CO₂e futures in Canada

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The Montreal Climate Exchange (MCEX) recently announced that, subject to regulatory approval, on May 30, 2008 it plans to launch trading of its first environmental product, namely futures contracts on Canada carbon dioxide equivalent (CO₂e) units. The MCEX set the launch date after the federal government's March 10, 2008 release of further details of its greenhouse gas emissions regulations.

It is expected that the emissions reductions credits and offset credits under the federal government's proposed greenhouse gas regulatory scheme will be the two sources for futures contracts on Canada CO₂e units. Units of each of these two types of domestic credits (which will represent an equivalent emission of one metric tonne of CO₂e) will be the underlying interest of the CO₂e futures contracts traded on the MCEX.

The MCEX was created in 2006 through a joint venture between Montreal Exchange and the Chicago Climate Exchange. The MCEX aims to become the leading market for publicly-traded environmental products in Canada. In October 2007, the MCEX filed an application with its lead regulator, the Autorité des marchés financiers (AMF), requesting approval of market rules designed to govern the trading of MCEX environmental products on its electronic trading platform SOLA®. A decision on its AMF application is expected in the near future.

The MCEX has cited World Bank estimates to the effect that the world market for carbon amounts to about US\$100 billion and that trading activity on public carbon markets has grown rapidly in recent years to reach US\$30 billion in 2006. ■

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