

Moving ahead on Large Final Emitters (LFEs)

LFE policy must be consistent with a plan that meets Canada's Kyoto target

- The Kyoto Protocol will enter into force as international law on February 16, 2005. This requires Canada to reduce its annual greenhouse gas (GHG) emissions by 238 megatonnes (Mt) below the business-as-usual level in 2010.
- Responsibility for securing (i.e., paying for) the 238 Mt of emission reductions must be shared between LFEs, other industry, governments and consumers in a way that is seen to be fair. LFEs must be assigned a proportion of the 238 Mt of reductions that is commensurate with the fact that LFEs are projected to account for 44% of Canada's GHG emissions in 2010, and that LFE emissions are rising more rapidly than Canada's total.
- If LFEs are assigned a quantity of emission reductions that is too small to be consistent with Canada meeting its Kyoto target, observers may conclude that the Government is deliberately planning to fail to comply with international law. This poses a serious threat to Canada's reputation as a law-abiding nation and responsible environmental steward.

The LFE policy must be mandatory, requiring legislation now

- Between 1990 and 2002 — the period when governments were relying on voluntary programs — Canada's industrial GHG emissions rose by 23%. Emissions from electricity generation rose 35% while emissions from the oil and gas sector rose 46%. It is well recognized that LFE emission reductions commensurate with Canada's Kyoto obligation are only achievable with a mandatory policy. This requires legislation that enables the Government to establish and effectively enforce emissions targets for LFEs.
- The Government must send a clear and irreversible signal, as soon as possible, of its determination to create the legislative framework for LFEs. This means introducing LFE legislation in parliament. Continued uncertainty hampers industry's ability to make investment decisions, delays industrial emission reductions, and makes Canada's Kyoto challenge even more difficult. If LFE legislation is not introduced very soon, there is a serious risk that there will be insufficient time to ensure the LFE policy is fully functional by January 1, 2008, when Canada must start meeting its Kyoto target.

The environmental performance of the LFE policy must be appropriate

- The *Climate Change Plan for Canada* (November 2002) assigns at least 92 Mt of emission reductions to LFEs. The 92 Mt include the following components:

a system of mandatory emissions targets and emissions trading	55 Mt
targeted measures intended to reduce LFEs' emissions intensity	~18 Mt
targeted measures intended to reduce fossil-fuelled electricity production	~19 Mt

The *Plan* assigns to LFEs the responsibility for securing the 55 Mt target, while government will pay for targeted measures to reduce emissions beyond this amount.

- It is essential that reductions achieved in one part of this three-pronged approach not be double counted in another. If the Government is to respect its commitments in the *Plan*, it must therefore either set emissions *intensity* targets for LFEs that add up to 73 (55+18) Mt, or *absolute* emissions targets for LFEs that add up to 92 (55+18+19) Mt.¹
- 92 Mt is an appropriate amount, considering that:
 - it represents 39% of the total 238 Mt Kyoto challenge, compared to LFEs' 44% share of Canada's GHG emissions in 2010
 - the national cost curves study commissioned by Natural Resources Canada in 2002² found that LFEs could reduce their emissions by 75 Mt at no net financial cost
 - a coal phase-out in Ontario could generate up to 35 Mt of reductions on its own.

¹ The reductions are relative to the business-as-usual projection underlying the *Plan*. If the projection were increased, these reductions would also have to be increased.

² M.K. Jaccard and Associates (March 7, 2002), *Construction and Analysis of Sectoral, Regional and National Cost Curves of GHG Abatement in Canada – Part IV: Final Analysis Report*. Contract No: NRCan-01-0332. See pp. 19 and 169, \$20/tonne case.

Key LFE sectors must do their fair share

- Fossil-fuelled electricity generation accounted for 34% of Canada's industrial GHG emissions in 2002, while the oil and gas sector accounted for 37%. The target of a 15% emissions intensity reduction offered to the Canadian Association of Petroleum Producers (CAPP) by former Minister Dhaliwal may have made sense two years ago but can no longer be justified:
 - This target translates into a maximum cost of only around 23 cents per barrel of oil. This was a very small burden to ask the sector to bear even at an oil price of \$C30 per barrel. It has become vanishingly small now that oil is selling for close to \$C60 per barrel.
 - Oil and gas companies that have adopted voluntary GHG targets have discovered large amounts of emission reductions that are actually profitable. BP "found that efficiency and emission reduction was good business. So while some remained locked in a debate about predicting the cost of reductions, our staff were pursuing activities that added value. In fact within the first three years we added \$650M of value, for an investment of around \$20M."³
 - Unlike the Forest Products Association of Canada, which has signed an MoU with the Government agreeing to a 15% reduction target, CAPP never accepted the 15% target.
- The electricity sector has many low-cost emission reduction opportunities, as shown by the NRCan study cited above. In addition, since over 90% of Canadian electricity is sold in Canada, much of it in regulated markets, the sector can much more easily bear cost increases than sectors more exposed to international competition.

Major transfers of liability to taxpayers must be avoided

- Canada's Kyoto target is a target for absolute emissions; LFE targets should therefore also be set in terms of absolute emissions. If emissions *intensity* targets are set for LFEs, emission increases due to higher than expected industrial production become entirely the Government's (and taxpayers') responsibility. There are plausible scenarios in which 30 Mt or more of LFE emission increases could be transferred to the Government in this way. At \$15/tonne, that represents a financial liability of \$450 million or more per year.
- A possible compromise exists between absolute and intensity targets. Targets could be set in terms of emissions intensity, but subject to a formula that would automatically tighten them if industrial production were significantly higher than expected.
- The LFE policy should not include "R&D credits" that LFEs can count towards meeting their targets when the R&D will not deliver benefits early enough to help meet Canada's Kyoto target in 2008–12. Such credits represent a further unwarranted transfer of liability from LFEs to the Government. The only rigorous way to include an incentive for R&D in the LFE policy would be to set post-2012 targets for LFEs at a level that takes full account of the emission reduction benefits of the R&D.

The offsets system must prevent double counting

A well-designed offset credits system, with both LFEs and the government eligible to purchase credits, is an appropriate component of the LFE policy that increases the likely amount of emission reductions achieved within Canada. But it is essential to prevent double counting between the offsets system and targeted measures. The offset system rules should therefore ensure that credits are only granted to projects that reduce emissions over and above the targeted measures that the Government is committed to implement under the *Climate Change Plan for Canada*.

LFE targets and compliance with targets must be transparent

Given the complex nature of emissions trading, public confidence in the LFE policy will depend critically on the fullest possible degree of transparency. Specifically, this means that individual companies' targets must be public, and their compliance with those targets transparent. This requires that the registry recording LFEs' holdings of permits and credits, and their transfer of permits and credits to the Government for compliance purposes, be open to full public access. For example, all transactions of the UK's GHG emissions trading system are published annually. Provisions similar to those in the Canadian Environmental Protection Act for notice and public comment, boards of review, and citizens' rights to pursue prosecutions, should be included in LFE legislation.

³ John Browne, CEO of BP, Speech to the Institutional Investors Group, London, November 26, 2003.