

## “Large Final Emitters”: The Centrepiece of Canada’s Kyoto Plan

### Key points

- A system of emissions targets for major industrial facilities (“large final emitters” or “LFEs”) is the single most important policy initiative Canada needs to implement the Kyoto Protocol.
- Officials at Natural Resources Canada are now working on drafting instructions for legislation establishing the LFE system to be tabled in 2004.
- Several loopholes risk being allowed in the large final emitters system, with the result that it will deliver significantly fewer emission reductions than the government has committed to.

### Background

Major industrial facilities account for about half of Canada’s greenhouse gas emissions, and industrial emissions have risen at a faster rate than the national total. A system of emissions targets for these “large final emitters” or “LFEs” is therefore the single most important policy initiative needed to implement the Kyoto Protocol. Recognizing this, the current federal *Climate Change Plan for Canada* (November 2002) foresees a system of emissions targets and emissions trading for LFEs that will secure a 55-megatonne reduction in annual emissions — by far the biggest single component of the *Plan*.

By 2008 — the year Canada must start complying with Kyoto — several hundred industrial facilities across Canada will face regulated emissions targets. Facility owners will be able to meet their targets by reducing their own emissions or by buying emissions permits or credits in the emissions trading market, thereby compensating other emitters for achieving reductions.

While the overall idea of targets and trading is straightforward, critical decisions remain to be made on the details. The LFE system can be compared to a corporate financial system. A *financial* system that delivers real profits must be based on rigorous *financial* accounting. In the same way, a system of *emissions* targets and trading will only deliver real reductions if based on rigorous *emissions* accounting. Unfortunately, several accounting loopholes stand a real chance of being allowed in the LFE system. Any one of these loopholes will result in the system delivering significantly fewer emission reductions than the *Climate Change Plan for Canada* commits to. Since Canada’s Kyoto target is fixed, **every tonne of reductions that the LFE system fails to deliver is an extra tonne that the government — and taxpayers — will have to find elsewhere.**

New federal legislation will be needed to establish the LFE system, and Natural Resources Canada officials are now working on drafting instructions with a view to legislation being tabled in 2004 — a deadline necessary to ensure the system is in place by 2008. Promises on particular elements of the LFE system have already been made to industry. It is critical in this development phase to ensure the public interest is upheld and each of the potential loopholes is closed.

### Ten potential loopholes

**1. Increasing the “business as usual” emissions level.** The 55 megatonnes of reductions allocated to the LFE system in the *Climate Change Plan for Canada* are relative to the projected “business as usual” level of emissions in 2010. The government is in the process of revising its “business as usual” projections. Any increase will lead to a higher level of industrial emissions than foreseen in the *Plan*.

**2. Double counting other reductions allocated to industry.** The 55 megatonnes represent 15% of LFEs’ projected emissions during the Kyoto “commitment period” (2008–12). Accordingly, the government has been trying to persuade industry to accept targets of 15% below “business as usual”. But this ignores

several policy initiatives in the *Climate Change Plan for Canada* intended to secure reductions in industrial emissions *over and above* the 55 megatonnes from the LFE system. For example, the *Plan* attributes 14 megatonnes of reductions to programs including the CO<sub>2</sub> Capture and Storage Initiative in the oil and gas sector, and the Canadian Industry Program for Energy Conservation. If only 15% reduction targets are applied, those extra reductions will be double counted — once under those programs, and then a second time under the LFE system.

**3. Failing to ensure the targets add up.** Even if the government were right to focus on an overall 15% reduction target (see point #2 above), then for every company or sector that secures a target of less than 15%, there would need to be a “true-up” in the overall set of targets to ensure they still add up to 55 megatonnes. The government has already started making deals to set easier targets for some LFEs, but it has failed to identify which companies or sectors will have to make up the shortfall.

**4. Placing no limit on emission increases caused by higher production.** The government proposes to set targets for LFEs in terms of “emissions intensity,” but Canada’s Kyoto target is based solely on actual emissions. If industrial production is higher than expected, then emissions intensity targets will result in a higher level of industrial emissions than foreseen in the *Climate Change Plan for Canada*. The system therefore needs to provide for tightening of intensity targets if production is much higher than expected.

**5. Double counting reductions allocated to other sectors.** It is proposed that LFEs will be able to buy “offset” credits representing emission reductions occurring in non-LFE sectors (e.g., buildings) and use those credits to meet their targets. If this takes place, a single reduction effort could be counted twice, once under a non-LFE sector, and then a second time as an offset under the LFE system. Some offset credits can be legitimate, but granting credits for reductions already accounted for under policy initiatives specified for non-LFE sectors in the *Climate Change Plan for Canada* represents double counting.

**6. Giving credit for what would have happened anyway.** There is a risk that offset credits might be granted, at least in part, for emission reductions that would have happened anyway because they are part of “business as usual”. For example, a credit might be granted for a tree plantation that would have been established regardless of the Kyoto Protocol. If that happens, part of the 55 megatonnes will not be the reduction *below* “business as usual” it is supposed to be.

**7. Giving credit for long-term R&D.** The government has implied that LFEs might be allowed to count R&D investments towards meeting their targets, even if those investments fail to deliver benefits early enough to help meet Canada’s Kyoto target in 2008–12. This will be the case for much of the R&D being undertaken now. Counting those investments will delay achievement of the 55 megatonnes beyond 2012. We need policy initiatives to promote R&D directed at long-term emission reductions, but they can only be counted toward Canada’s Kyoto target to the extent that they deliver reductions by 2012.

**8. Allowing weaker targets now in exchange for future promises.** Similarly, the government has suggested it might set LFE targets adding up to less than 55 megatonnes in exchange for bigger reductions from certain companies after 2012.

**9. Failing to require sufficient auditing and transparency.** Just like financial accounts, emissions accounts require rigorous auditing to ensure the benefits are real. Some industry representatives argue that their emissions intensity performance should be subject to a level of confidentiality that would make it impossible for the public to have confidence that companies are really complying with the LFE system. Such a level of confidentiality is very difficult to justify. Enforcement is too important to be left to private discussions between industry and government.

**10. Accepting foreign permits and credits that do not correspond to real reductions.** The government intends to place no limits on LFEs’ use of foreign credits and permits to meet their targets. But some of these foreign units may fail to correspond to real emission reductions. For example, Russia could sell “hot air” permits that result from economic collapse in the 1990s but have no connection to efforts to address climate change. At a minimum, there needs to be full public access to the registry showing which permits and credits each company is using to comply, so that companies can be held publicly accountable.