Pembina Institute Comments on Environment Canada's *Notice of intent to regulate greenhouse gas emissions by Large Final Emitters*, published in the *Canada Gazette Part I*, July 16, 2005

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General comments

The large final emitter (LFE) system is an essential and major element of the Government of Canada's April 2005 plan to implement the Kyoto Protocol, *Moving Forward on Climate Change: A Plan for Honouring our Kyoto Commitment* ("2005 Plan"). The Government first committed to implement the LFE system in its previous *Climate Change Plan for Canada* (November 2002), but a lack of Cabinet decision-making on the system for a lengthy period caused considerable delays in its development. Given that the Kyoto commitment period (2008–12) begins in not much more than two years' time, and that Canada needs be able to demonstrate major progress in implementing the LFE system to the international community before the Montreal climate conference at the end of 2005 (COP-11), there is no further room for delay.

The 2005 Plan acknowledges that "early implementation of the LFE system is important, since without it there is much less financial incentive for companies to seek out opportunities to reduce emissions from their operations" (p.16). Specifically, to be able to plan how to meet their obligations, companies urgently need to have a clear idea of the targets they will face. This requires the Government, as soon as possible, to (i) put in place the legislative framework for regulating emissions and (ii) formally publish draft LFE regulations that will specify enforceable targets. The 2005 Plan states that the Canadian Environmental Protection Act 1999 (CEPA) is its "preferred option for implementing the LFE system" (p.17) and that draft LFE regulations are "expected" to be published "in fall 2005" (p.18).

The Pembina Institute welcomes these statements of the urgency of implementing the LFE system, is pleased that Environment Canada has published the *Notice of intent to regulate greenhouse gas emissions by Large Final Emitters* ("Notice") and is grateful for this opportunity to comment on it. The Pembina Institute also applauds the Minister of the Environment for having now also formally proposed the addition of greenhouse gases to Schedule I of CEPA (*Canada Gazette Part I*, September 3, 2005), which is a pre-condition for adopting LFE regulations.

The Pembina Institute remains, however, deeply disappointed with the unjustifiably small amount of reductions in annual emissions proposed for the LFE system (36 Mt during the Kyoto commitment period) and continues to believe that the credibility of the Plan depends critically on this amount being increased. We note that the House of Commons Standing Committee on Environment and Sustainable Development recently recommended that the amount of reductions in annual emissions to be delivered by the LFE system be increased to 55 Mt.[2]

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[2] Standing Committee on the Environment and Sustainable Development. 2005. *Finding the Energy to Act: Reducing Canada's Greenhouse Gas Emissions*, p.44; http://www.parl.gc.ca/infocomdoc/38/1/parlbus/commbus/house/ENVI/report/RP1875334/envirp07/envirp07-e.pdf.

The 2005 Plan commits to undertake "detailed implementation of the LFE system… in partnership with… environmental groups" (p.17). The Pembina Institute believes that equity and the public credibility of the LFE system require that ENGOs be consulted on all aspects of the system's development on an equal footing to industry. At the same time, consultations must be undertaken in an efficient manner that ensures there are no further delays in the system's implementation.

Detailed comments

Legislative authority

The Notice describes as a "working assumption" (p.2489) the use of CEPA 1999 as the legislative basis for the LFE system. Almost three years since the Government committed to implement an LFE system with a regulatory backstop, a definitive decision on the choice of legislative instrument is long overdue. The ambivalent language must be replaced by a clear decision.

Timelines for publication of draft LFE regulations

It is regrettable that the Notice suggests that only "part of the regulatory package" be published in the Canada Gazette Part I "no later than early 2006" (p.2492). This is a significant retreat from the expectation expressed just a few months ago in the 2005 Plan that the regulation would be published "in fall 2005." To maintain credibility and to honour its original commitment made to Canadians, the Government should do everything possible to restore the fall 2005 timeline. Similarly, it is disappointing that only "preliminary" rather than full discussions on the regulation with provinces were to begin "in summer 2005" (p.2493).

Partnership with provinces and territories

The Pembina Institute believes that the Government of Canada must retain the final say in setting the "broad policy outcomes and objectives of the LFE system" (p.2489) – most notably the overall amount of emission reductions to be delivered by the system. The federal government is in a different position to provinces and territories, with the former having a legal responsibility to comply with the Kyoto Protocol, while the latter do not. Furthermore, some provincial governments' willingness to contribute adequately to Kyoto implementation is in serious doubt. No encouragement should therefore be given to the notion that provinces and territories have a veto on this point. The Government must clearly state that its mandate to meet its international obligations supersedes provincial and territorial jurisdictions.

The Pembina Institute supports the Government's view that "a key objective [of any equivalency agreement] would be to ensure national consistency of the mandatory emission intensity targets" and that "national consistency is necessary to protect competitiveness among Canadian industry by avoiding a patchwork of different regulations being applied to the same industry sectors and to ensure an effective emission trading system" (p.2492). However, the Pembina Institute believes that on a practical level equivalency agreements could only be acceptable only if (i) the public has a clear assurance that enforcement by a province would be of equal quality to enforcement by the Government and (ii) there is a single national electronic tracking system for compliance units and a single national emissions reporting system, to facilitate a transparent and efficient emissions trading system.

Emissions intensity targets

The Pembina Institute remains opposed to the use of intensity, rather than absolute emissions, targets. Intensity targets result in an unacceptable transfer of liability for higher-than-expected production to government, are disconnected from the environmental goal and international legal requirement of a reduction in absolute emissions, are inconsistent with other "LFE systems" emerging in other important jurisdictions (notably the EU), and are a source of economic inefficiency because they make the marginal

cost of increased emissions vary depending on whether the cause of increased emissions is increased production or increased intensity.

The Pembina Institute is also opposed to the blanket exemption of fixed process emissions as it takes no account of the polluter-pays and ability-to-pay principles.

The Pembina Institute believes that a sectoral reduction target of no more than 12% is unacceptably low. In particular it cannot be justified on economic grounds. The upstream oil and gas sector, with its high profitability and abundant profitable emission reduction opportunities, provides a particularly obvious example where a 12% target could be considerably toughened without significant economic impact, while from a polluter-pays perspective, the same sector's dramatic emissions growth calls for much tougher targets.

A particularly important additional point regarding targets is the following. Given that the Government has chosen to measure emission reductions starting from business-as-usual levels, third parties and the public will have no way of understanding the environmental implications of targets – or of holding the Government accountable by verifying whether they add up to the total amount of reductions to which the Government committed in the 2005 Plan – unless business-as-usual projections are published for both emissions and production in 2010 for each activity that has a distinct target under the LFE regulation. This information must therefore be published, at the latest, at the same time as the proposed numerical targets.

BATEA-based targets

The Pembina Institute considers the introduction of the BATEA concept into the LFE system to be unfortunate, especially in the absence of the polluter-pays and ability-to-pay principles. This results in targets being tied to what is technically feasible without considering what is financially feasible (ability-to-pay) or the proportion of their emissions for which polluters should have to take responsibility (polluter-pays) – which is all that should matter when there is full flexibility to use emissions trading to go beyond what is technically feasible. BATEA-based targets are also a major concern because the amount of emission reductions from individual companies and from the LFE system as a whole could vary greatly depending on how BATEA is interpreted. BATEA-based targets for new large facilities and facilities undergoing major transformations or expansions will only be acceptable if (i) those targets are set at a lower intensity level than targets for existing comparable facilities, and (ii) they can be tightened after a reasonable time has elapsed. On point (i), the Notice's phrase "new facilities may have greater greenhouse gas emission mitigation potential than existing facilities" (p.2494) seems to imply that BATEA targets will be set at a lower intensity level than targets for existing comparable facilities, but the Notice does not make this entirely clear. On point (ii), the Pembina Insitute believes that the Notice's suggestion that BATEA targets be locked in "for at least 10 years" (p.2495) is unwise and unacceptable, because (a) it can be expected to be interpreted by some in industry as an invitation to push for targets being locked in for a much longer period, such as the full life of a facility, and (b) it goes potentially far beyond former Prime Minister Chrétien's original commitment to the Canadian Association of Petroleum Producers, to lock in BATEA targets for "up to 10 years." Lock-in of targets "for at least 10 years" could turn out to be a major barrier to the ability of future governments to ratchet down targets rapidly enough to meet the environmental imperative and future international obligations. The Government must quickly place tight limits on the interpretation of "at least 10 years."

Some in industry argue that new facilities are already achieving a BATEA level. If this argument is accepted, such facilities will face no emissions constraint under the LFE system, and 100% of the responsibility and liability for emissions will be transferred from industry to taxpayers or other parts of society. From a polluter-pays perspective, this is unacceptable when such facilities are adding to Canada's

emissions at the same time as the country is required to reduce them. It is especially unacceptable in the case of new oil sands facilities, which are the single most important contributor to rising emissions in Canada, and whose owners are well able to afford to offset emissions to well below actual levels (ability-to-pay perspective). Furthermore, it is likely that most new facilities could only be considered to be achieving a BATEA level under an unusually generous interpretation of BATEA. For environmental and equity reasons, the Government must make clear that BATEA is to interpreted stringently.

Given the major concerns regarding BATEA targets, the Pembina Institute believes the Government should make clear its expectations regarding the interpretation of "at least 10 years," and of the stringency of the interpretation of BATEA, and then establish and provide analytical support to a multistakeholder committee charged with examining different options for implementing the concept. This committee should be established immediately, so that companies with new facilities can have a clear idea of their targets as soon as possible, and so that the public can understand the environmental implications of references to BATEA in the draft LFE regulations. The committee's initial findings should be published no later than the draft regulations. The suggested "Technology Board" (p.2495) could play this role.

Longer-term targets

The criteria suggested for establishing longer-term targets are all welcome and should be retained. However, the Pembina Institute believes that an additional criterion should be added to reflect the polluter-pays principle: sectors' rate of change in absolute emissions and emissions intensity.

Baseline-and-credit *versus* permit-based emissions trading

The Pembina Institute is opposed to the use of a "baseline-and-credit" compliance model for the LFE system and strongly prefers a permit (allowance)-based system, as the Government originally committed to in the *Climate Change Plan for Canada*. While the two models are formally equivalent mathematically, a baseline-and-credit system sends a signal that entrenches "rights to emit" up to the level of targets. A permit system, on the other hand, sends a signal that every tonne of emissions must be covered by a permit issued by the Government on behalf of the public. A permit system therefore creates a much stronger perception that rights to emit greenhouse gases can and will be withdrawn over time, as will be necessary to achieve emission reductions of the order needed over the coming decades. In addition, a baseline-and-credit system would be inconsistent with other "LFE systems" emerging in other important jurisdictions (notably the EU). A permit system would also likely better facilitate efficient emissions trading.

Technology investment vehicles

The Pembina Institute is opposed to allowing payments into a Technology Investment Fund or other technology investment vehicle to be counted directly towards compliance with 2008–12 LFE targets because, as the 2005 Plan acknowledges, "investments in the Fund are not expected to generate emission reductions within the Kyoto 2008–2012 timeframe" (p.16). Technology investment payments therefore allow industry to borrow emission reductions from the future, financed by the Government (which is obliged to secure compensating 2008–12 vintage reductions). The best way to provide the necessary incentives for technology development would, instead, be through the establishment of appropriate long-term LFE targets and complementary policies and measures. In addition:

- If payments into the Fund or other technology investment vehicles are retained as a compliance option, the price should not be capped at $15/tonne but rather be set at a premium to the market price of compliance units in order to limit the Government's liability and create a preference for compliance options that genuinely comply with the Kyoto Protocol. (If the LFE system has a $15 price cap, it could be applied separately from the Fund.)
- The principle that "sectors should benefit from technology development funds in proportion to their contribution to these funds" (p.2498) is not acceptable because it contravenes what should

be one of the objectives of the LFE system – to encourage a shift from more-polluting to less-polluting sectors.

- The Notice weakens the 2005 Plan by opening the door to use of a variety of technology investment vehicles for compliance with LFE targets. If the technology development option is retained as part of the LFE system, the regulations should make clear that there will be only a single fund, to maximize transparency and avoid excessive complexity in ensuring rigour in the expenditure of funds.
- In particular, the Government must ensure that payments into a fund are not simply relabelled money that industry would have spent on technology anyway. In other words, rules must be included in the LFE regulations to ensure that payments into a fund are additional to business-as-usual technology investments by LFEs.

Price assurance mechanism

The Pembina Institute accepts that there is a legitimate case for some form of price assurance mechanism to allow industry to manage risk. However, $15/tonne is too low a level which, if triggered, will stunt needed technology innovation by Canadian industry. In addition, the Government could bear a proportion of the price in excess of $15 less than the 100% currently envisaged, while still limiting industry's risk.

Clean energy, demand side management and cogeneration

Clean energy, demand side management and cogeneration will all be important and perhaps dominant areas of activity of the 2005 Plan's Partnership Fund. However, if credits are granted for such activities under the offsets system, they will no longer be able to be counted under the Partnership Fund. This is an extremely important area of concern given the very large amount of emission reductions that the 2005 Plan is counting on from the Parternship Fund. The Government must therefore provide, in the forthcoming final rules for the offsets system, a clear assurance that provision of offset credits for these activities will not significantly undermine the ability of the Partnership Fund to meet its objectives.

In addition, the Notice does not define "clean energy." A commitment to exclude nuclear power from the definition of clean energy should be included in the draft LFE regulations.

Minimum emission threshold

In the setting of minimum emission thresholds, particular care must be taken in the case of the upstream oil and gas sector where a large number of small facilities that might fall under a facility-level threshold are responsible for a major proportion of total emissions. The Government must therefore provide in the draft LFE regulations an assurance that the vast majority of upstream oil and gas sector emissions will be covered by the LFE system.

Electronic tracking system

The Pembina Institute believes that to meet the test of public credibility, the "electronic tracking system to act as the official record of carbon unit transactions and use of the units for compliance purposes by LFE companies" (p.2497) must be made fully accessible to the public. In the absence of compelling evidence for why a particular company's data be kept confidential, all data stored in this registry must be fully open to public inspection, as is the case, for example, with Ontario's emissions trading system for SO_2 and NOx, and with the United Kingdom's greenhouse gas emissions trading scheme. This transparency is essential for holding companies publicly to account for their use of emissions trading to meet targets, and, given that many observers consider different compliance options to be of varying environmental value, to allow precise identification of the compliance options that companies have chosen. Public confidence in emissions trading, which is already low, is likely to suffer further if parts of the system are made secret in the absence of a compelling justification.

Quantification, monitoring and reporting

Similarly, the Pembina Institute believes that LFEs' production data must not, in general, be kept confidential, and a particular company's data should not be kept confidential in the absence of compelling evidence for why its publication would be significantly harmful. There is a compelling public interest in knowing how each company has performed, prior to any purchases or sales of emissions credits, against the intensity target applying to each of its activities. The Pembina Institute urges the Minister to recognize this public interest by exercising his right to disclose this information on the grounds that the "public interest… outweighs in importance" any material financial loss or prejudice to the competitive position of the emitter (CEPA Section 53). Specifically:

- A simple assurance from the Government that a particular company has complied through some unknown mix of physical reductions and emissions trading will not meet the test of public credibility. There are several reasons why, when evaluating a company's performance on climate change, we are interested first and foremost in what the company has done to reduce its own, physical emissions, and only secondarily what offsets it has purchased.
- Canadian industry argued hard to have its climate change performance evaluated not on absolute emissions, but on emissions intensity. The Government accepted this argument. But now some in industry say that their emissions intensity is confidential because it reveals production data. It is not defensible to allow industry to be evaluated by for regulatory purposes (LFE system) on an intensity basis, but by the public only on an absolute emissions basis.

Consultations with ENGOs

The Pembina Institute is pleased to see explicit mention of additional consultations to be held with ENGOs and other stakeholders on cross-cutting issues such as implementation of BATEA standards, minimum emission thresholds, trading issues and implementation of the $15 price assurance (p.2492). However, the Pembina Institute believes that equity and the public credibility of the LFE system require that ENGOs be consulted on *all* aspects of the system's development, including numerical targets, on an equal footing to industry.

Prior policy commitments

Regarding "prior policy commitments" (p.2500), the Pembina Institute notes that while the Notice indicates that the Government has taken considerable care to meet prior commitments to industry, the Notice fails to acknowledge that the Government has chosen not to meet its commitment to Canadians, in the *Climate Change Plan for Canada*, to put in place an LFE system delivering 55 Mt of reductions in annual emissions.