

Goodmans^{LLP} Update

Cleantech in Canada 2019: Recent Developments

Growing Recognition of the Climate Emergency

In June 2019, Canada's federal House of Commons passed a motion (186 to 63 votes) to declare a national climate emergency. This declaration followed reporting from Environment and Climate Change Canada (ECCC) that past and future warming from climate change in Canada is approximately double the global average and may be "effectively irreversible".¹ The damage caused to Canadians by climate change, while projected to grow, is already significant; annually, chronic exposure to greenhouse gas (GHG) emissions and accompanying pollution contributes to the deaths of over 7,000 Canadians² and the weather effects of climate change impose billions in costs on Canadian communities and businesses.³

The reality of the climate emergency is increasingly recognized globally. In May 2019, the Parliament of the United Kingdom declared a climate emergency, and in June 2019, all but four members of the European Union (EU), namely Poland, Czech Republic, Hungary and Estonia, voted in favour of the EU adopting measures to ensure a transition to carbon neutrality by 2050.⁴ The members of the Carbon Neutrality Coalition, which, as of September 27, 2019, include 19 countries and 32 major cities across four continents, have pledged to become emissions neutral by 2050.⁵ Canada is among the countries, and Toronto and Vancouver are among the cities, which are members of this coalition.

As global temperatures continue to rise and the world becomes increasingly focused on solutions, an increasing number of jurisdictions (led by Canada) are implementing or plan to implement a carbon tax or emission trading system.⁶ As the Canadian experience has shown, however, political opposition to carbon pricing can interfere with or delay implementation, even in jurisdictions where a significant portion of the population supports strong action against climate change.

Federal Pricing Act: Federal Carbon Levy and OBPS

As detailed in our January 7, 2019 Update, *Federal and Ontario Updates on Climate Change and Clean Growth Plans*, the federal Output-Based Pricing System (OBPS), which is part of the *Greenhouse Gas Pollution Pricing Act* ("**Federal Pricing Act**"), is designed to create a price incentive for large industrial emitters to reduce their GHG emissions while also promoting innovation and maintaining competitiveness. On June 28, 2019, the federal government released the [regulations](#) implementing the OBPS.

¹See the full text of the report: https://www.nrcan.gc.ca/sites/www.nrcan.gc.ca/files/energy/Climate-change/pdf/CCCR_FULLREPORT-EN-FINAL.pdf.

² See the full text of the report of the Lancet: <http://www.lancetcountdown.org/media/1418/2018-lancet-countdown-policy-brief-canada.pdf>.

³ See the 2015 report commissioned by the Insurance Bureau of Canada: <http://assets.IBC.ca/Documents/Studies/IBC-The-Economic-Impacts.pdf>.

⁴The goal of carbon neutrality by 2050 originates in a report of the Intergovernmental Panel on Climate Change (IPCC), which highlighted the climate change impacts that will likely arise unless global warming is limited to 1.5°C instead of 2°C. See the full text of the IPCC report: https://report.ipcc.ch/sr15/pdf/sr15_spm_final.pdf.

⁵ See the Declaration of the Carbon Neutrality Coalition: <https://www.carbon-neutrality.global/wp-content/uploads/2018/09/CNC-Declaration-final.pdf>.

⁶ See the full text of the "State and Trends of Carbon Pricing 2019" report of the World Bank: <http://documents.worldbank.org/curated/en/191801559846379845/pdf/State-and-Trends-of-Carbon-Pricing-2019.pdf>.

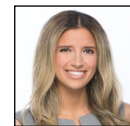
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By way of background, the *Federal Pricing Act* has two parts:

- Part 1 establishes a charge on the fossil fuels used by households and businesses (“**Federal Carbon Levy**”).
- Part 2 applies the OBPS, which will be administered by ECCC and Canada Revenue Agency, to emissions-intensive, trade-exposed industrial facilities which generate substantial GHG emissions.

The *Federal Pricing Act* operates as a backstop, applying only in provinces where the Governor-in-Council concludes GHG emissions are not priced at the minimum standards established by the *Federal Pricing Act*.

The *Federal Pricing Act* came into force on June 21, 2018.⁷ The Federal Carbon Levy came into effect in Ontario, New Brunswick, Saskatchewan, and Manitoba in April 2019, and in Nunavut and Yukon in July 2019. The OBPS came into effect in Ontario, Manitoba, New Brunswick, Prince Edward Island and Saskatchewan in January 2019,⁸ and in Yukon and Nunavut in July 2019. The *Federal Pricing Act* will apply in Alberta in January 2020.

Federal Carbon Levy

The Federal Carbon Levy applies to gasoline, diesel fuel and natural gas, as well as combustible waste. The applicable rates of charge are set out in Schedule 2 to the *Federal Pricing Act*. The rates for 2019 represent a price of \$20 per tonne of CO₂ equivalent (CO₂e) emitted by the combustion of each fuel. The rates will increase annually by \$10 per tonne, up to \$50 per tonne in 2022.

OBPS

Under the OBPS, the government will set an emissions threshold per unit of output for each sector. Companies that emit below their annual limit will receive credits and those that exceed the threshold must either buy credits from other companies or pay an additional charge.

Participation: Mandatory and Voluntary

The federal OBPS is **mandatory** for facilities that:

- are located in a jurisdiction where the OBPS applies;
- have reported 50,000 tonnes of CO₂e or more in 2014 or a subsequent year to the [Greenhouse Gas Reporting Program](#) (which requires facilities that emit 10,000 tonnes or more of CO₂e per year to report to ECCC); and
- carry out a covered activity in certain specified sectors.

The list of covered activities is set out in Schedule 1 of the OBPS regulations. The list includes certain activities relating to oil and gas production, mineral processing, chemicals production, pharmaceutical production, iron and steel, mining and ore processing, food processing, pulp and paper, automotive assembly and electricity generation, among others.

The regulations also allow for voluntary participation in the OBPS. Facilities that carry out a covered activity with annual emissions between 10,000 and 50,000 tonnes of CO₂e per year, and facilities with more than 10,000 tonnes of CO₂e per year in sectors not listed under Schedule 1 but at significant risk of carbon leakage and competitiveness impacts from carbon pollution pricing, may also apply to opt in to the OBPS. Once a qualifying facility chooses to participate, it will be subject to the OBPS regime, and will not be subject to the Federal Carbon Levy.

⁷See our January 23, 2018 Update, [Feds Announce Proposed Carbon Pricing System as Part of Pan-Canadian Clean Growth Plan](#).

⁸In Saskatchewan, the federal OBPS applies only to facilities engaged in electricity generation and to natural gas transmission lines.

Pricing Standards

Facilities subject to the federal OBPS are required to pay compensation for the portion, if any, of their GHG emissions that exceed their applicable emissions limit, based on a sector specific output-based standard. The annual facility emissions limit is determined by multiplying the facility's production by the applicable output-based standard.

The output-based standard is generally set at 80% of the national, production-weighted average emissions intensity of a specific industrial activity. The production-weighted average emissions intensity is calculated as the total emissions of a given industrial activity (or grouping of facilities carrying out the same listed activity) divided by the total production of that sector. In calculating the emissions of a given industrial activity, data is considered from all relevant Canadian facilities that emitted at least 50 kilotonnes of CO₂e from 2014 to 2016.

For certain sectors at particular risk of “carbon leakage” (i.e., the flight of production to less strictly regulated jurisdictions), the output-based standard is set at 90% or 95% (thereby increasing the threshold of allowable emissions relative to the 80% standard). These “at-risk” sectors include various petrochemical-related industries, iron and steel, and cement, among others.

The only exception to the foregoing approach is with respect to electricity generation, which has explicitly defined output-based standards. These standards will generally decline on a linear basis (to zero for the 2030 compliance period) for all solid fuel generation facilities and any new gas generation facilities in jurisdictions subject to the federal OBPS.

Compensation and Credits; Compliance Flexibility

A facility subject to the federal OBPS that emits less than its annual emissions limit will receive surplus credits. A facility subject to the OBPS that exceeds its annual emissions limit must pay compensation at a price of \$20 per tonne of CO₂e in 2019, rising by \$10 per tonne annually to \$50 per tonne of CO₂e in 2022. The price is expected to flatten after 2022 but may then be reassessed. Compensation for excess emissions must be paid by a certain deadline (generally, December 15 of the subsequent calendar year), failing which compensation due is multiplied by a factor of four.

The federal OBPS enables certain flexibility for compliance in addition to the payment of monetary penalties. Credits can be sold between facilities or banked for future use. The regulations under the *Federal Pricing Act* also contemplate a variety of other mechanisms for compensation that may be enacted, such as offset programs.

The Ontario Landscape

Ontario Emission Performance Standards Regime

On July 4, 2019, the Ontario government released the [regulations](#) implementing industrial emission performance standards (EPS).

Participation: Mandatory and Voluntary

The EPS applies to facilities in the same sectors that fall under the scope of the federal OBPS. The main components of the EPS are:

- mandatory participation for facilities listed in the sectors in Schedule 2 to the EPS regulations, with emissions of 50,000 tonnes of CO₂e per year or more (the “**Mandatory Threshold**”);
- voluntary participation for facilities with emissions between 10,000 tonnes of CO₂e per year and the Mandatory Threshold, and which satisfy the other requirements to participate in the EPS;
- a lower threshold on a megawatt hour basis for the electricity sector; and
- complementary amendments to the *Greenhouse Gas Emissions: Quantification, Reporting and Verification* regulation under the Ontario *Environmental Protection Act* to align the verification threshold with the Mandatory Threshold for the EPS program.

Emissions Standards; Many Varying Standards

Annual emissions limits for facilities covered by the EPS are determined in accordance with the “GHG Emissions Performance Standards and Methodology for the Determination of the Total Annual Emissions Limit” (the “**Provincial Methodology**”), which is published by the Ontario Ministry of the Environment, Conservation and Parks.

The Provincial Methodology prescribes various standards for calculating a facility’s annual emissions limit, depending on the industry in question. The different standards that can apply include sector-specific, facility-specific and historical performance standards, as well as a standard based on energy use (i.e., how much fuel is used instead of how much GHG is emitted). Electricity generation, thermal energy and cogeneration are each subject to different specific standards.

The Provincial Methodology also distinguishes between fixed process emissions, which are generally the result of chemical or physical reactions unrelated to combustion (“**Fixed Process**”), and non-fixed process emissions such as combustion (e.g., GHG from the burning of fuel), fugitive (e.g., equipment leaks and unintentional losses) and on-site mobile sources (“**Non-Fixed Process**”) of facilities. Specifically, most Non-Fixed Process emissions are subject to a “stringency factor” of less than 100% and, therefore, an increased reduction of these emissions is required as compared to Fixed Process emissions. The table below summarizes the stringency factors (SF) prescribed by the Provincial Methodology based on industrial activity emissions type.

Industrial Activity	Emission Type	2019 SF	2020 SF	2021 SF	2022 SF
All Industrial Activities	Fixed Process	100%	100%	100%	100%
Generating Electricity Using Fossil Fuels	Non-Fixed Process	100%	100%	100%	100%
Transmitting Natural Gas	Non-Fixed Process	95%	90%	85%	80%
All Other Industrial Activities	Non-Fixed Process	98%	96%	94%	92%

Compensation and Credits; Compliance Flexibility

The EPS establishes two types of compliance instruments: emissions performance units (EPUs) and excess emissions units (EEUs). Each EPU or EEU represents one tonne of CO₂e. A facility subject to the EPS that exceeds its annual emissions limit must purchase EPUs from the government. The cost of EPUs will be \$20 per unit in 2020, \$30 in 2021, \$40 in 2022 and \$50 in 2023. A facility subject to the EPS that emits less than its annual emissions limit will receive EEUs correspondingly. Generally, EEUs must be removed from a facility’s account before any EPUs can be removed. However, the EPS permits certain compliance flexibility. EEUs can be banked for up to five years to address future compliance obligations. Alternatively, subject to certain notice requirements, EEUs may be transferred between facilities that are covered by the EPS.

Non-Applicability

The EPS regulations apply retroactively to January 2019 and are intended to serve as an alternative to the federal OBPS. However, the EPS regulations only apply to the extent that Ontario is not subject to the OBPS. For now, and unless the federal Governor-in-Council decides to remove Ontario from the OBPS or the decision of the Court of Appeal for Ontario (the “**ONCA**”) in the constitutional reference (discussed further below) is overturned by the Supreme Court of Canada (the “**Supreme Court**”), the OBPS (not the EPS⁹) applies in Ontario.

⁹Except for certain registration requirements that apply as of January 2019.

Next Steps

The continued application of the federal OBPS may be affected by the outcome of the upcoming federal election (discussed further below). For now, industrial emitters in the designated provinces, including Ontario, are subject to the *Federal Pricing Act* and, if applicable, the OBPS.

Developments in Alberta

Alberta is the leading GHG emitter among Canadian provinces, and the home of significant oil and natural gas extraction and production centres. The provincial government of Alberta is led by the United Conservative Party (UCP), which was elected in April 2019 after promising, among other things, to scrap the carbon tax that had been put in place by the prior government (the “**Alberta Levy**”).

Repeal of Alberta Levy and Consequent Application of Federal Pricing Act

The UCP repealed the Alberta Levy as its first legislative act. The repeal was made effective as of May 30, 2019. As a result, the federal government announced that Alberta will be subject to the backstop under the *Federal Pricing Act*. Consequently, the Federal Carbon Levy and federal OBPS are scheduled to take effect in Alberta on January 1, 2020. In response, Alberta filed a reference case with the Alberta Court of Appeal (the “**ABCA**”) challenging the constitutional validity of the *Federal Pricing Act*. The ABCA will consider the issue afresh, but will have the benefit of the reasons laid out in the decisions of the Ontario and Saskatchewan courts.¹⁰

Cancellation of Reform to Electricity Sector

In July 2019, the UCP cancelled the planned overhaul of Alberta’s energy system, thus providing that electricity generators in Alberta will continue to be paid only for the electricity they produce instead of being paid on the basis of capacity. Several Canadian provinces use a capacity-based system, including Ontario since 2004.

The UCP states that maintaining an energy-only (i.e., not capacity-based) system will benefit Albertans, who will only be charged for electricity that is used instead of paying for electricity capacity regardless of how much is used. Critics of the government’s decision maintain that, if generators are not incentivized on a capacity basis, they will not invest in clean energy generation. There is also a concern that, if generators are not incented to install capacity, they will not build enough and there may be insufficient electricity available to satisfy peak demand. This is an issue of significant interest for the cleantech sector.

Federal Conservative Party Position

In anticipation of the federal Canadian election scheduled to take place on October 21, 2019, in June 2019, the Conservative Party of Canada (CPC) released a policy document entitled *A Real Plan to Protect Our Environment* (the “**CPC Climate Plan**”). Although vague in many respects, it is clear that the CPC Climate Plan would involve the repeal of the *Federal Pricing Act*, thereby eliminating the Federal Carbon Levy and terminating the OBPS.

In the place of the OBPS, the CPC Climate Plan refers to new and different GHG emissions standards that would apply to major emitters. Emitters who exceed these standards would be required to make certain “investments” in research and development of emissions-reducing technology relating to their industry. Notably, however, the CPC Climate Plan is silent with respect to:

- the methodology by which the emissions standards would be set; and
- the quantum of the “investments” that would be required to be made by emitters who exceed the emissions standards.

¹⁰ See our May 16, 2019 Update, *Saskatchewan Court of Appeal Rules Federal Carbon Price is Constitutionally Valid*.

The CPC Climate Plan would make other changes of importance, including cancellation of the proposed Clean Fuel Standard (CFS), which is currently scheduled to come into effect in January 2022. The CFS is designed to incent the innovation and adoption of clean technologies in the oil and gas sector and the development and use of low-carbon fuels throughout the economy. Some stakeholders believe the changes proposed in the CPC Climate Plan would result in substantially higher emissions than under the *Federal Pricing Act* and other policies implemented by the Liberal government.¹¹

The CPC has also promised to remove the GST from home heating and energy bills, which it believes will save the average Canadian household \$107 per year.¹² While modest in its expected impact, this change would appear to represent an additional subsidy of home heating fuels and to reduce the economic incentives to either conserve or replace GHG emitting heating equipment with non-emitting alternatives.

Challenges to the *Federal Pricing Act* and Implications for the Cleantech Sector

In July 2018, the Government of Ontario announced its withdrawal from the national carbon pricing program, revoked its cap-and-trade regulation, prohibited trading of emissions allowances and cancelled seven programs to be co-funded by the federal government through the Low Carbon Economy Fund.¹³ In August 2018, Ontario announced a reference to the ONCA to challenge the constitutionality of the Federal Carbon Levy and the OBPS under the *Federal Pricing Act*.

On June 28, 2019, in a 4-1 ruling, the ONCA found the *Federal Pricing Act* to be constitutionally valid. Writing for the majority, Chief Justice Strathy explained that setting minimum national standards for GHG emissions, as the *Federal Pricing Act* does, is a valid exercise of the federal government's jurisdiction under the "national concern" branch of its peace, order, and good government (POGG) power. He wrote that "the [*Federal Pricing Act*] strikes an appropriate balance between Parliament and provincial legislatures, having regard to the critical importance of the issue of climate change caused by GHG emissions, the need to address it by collective action...and the practical inability of even a majority of the provinces to address it collectively."

Further, Chief Justice Strathy explained that because the *Federal Pricing Act* only establishes minimum standards, it respects the jurisdiction of the provinces and allows them to legislate standards that meet or exceed minimums or address other aspects of GHG regulation, such as laws addressing the causes and effects of GHG emissions in a particular province.

The sole dissenting judge, Justice Huscroft, concluded that the Federal Carbon Levy and OBPS are not valid exercises of the national concern branch of the POGG power, partly on the basis that there is "no meaningful distinction" between the cumulative effects of GHG emissions and GHG emissions *per se* (which is a matter of provincial jurisdiction). He wrote that inaction by a province is not indicative of provincial incapacity to address GHG emissions, but is instead "a reflection of legitimate political disagreement on a matter of policy."

The immediate effect of the ONCA's decision is that the *Federal Pricing Act* continues to apply to Ontario. Ontario indicated it will appeal the decision to the Supreme Court. Saskatchewan, which lost a parallel reference case before its appellate court in May 2019, already commenced an appeal to the Supreme Court that is scheduled to be heard in January 2020. While the validity of the *Federal Pricing Act* has been upheld in the two appellate court decisions, Alberta (discussed above) and Manitoba have each filed their own challenges, and New Brunswick and Quebec have announced plans to intervene in support of Saskatchewan's appeal of the *Federal Pricing Act* before the Supreme Court.¹⁴

¹¹ For an example of an analysis reaching this conclusion, see: <https://policyoptions.irpp.org/magazines/august-2019/emissions-will-rise-under-conservative-climate-plan/>.

¹² See: <https://www.conservative.ca/conservatives-to-remove-gst-from-home-heating/>.

¹³ See our January 7, 2019 Update, [Federal and Ontario Updates on Climate Change and Clean Growth Plans](#), our November 12, 2018 Update, [Cap and Trade Formally Cancelled in Ontario – Federal Carbon Pricing Regime Clarified](#), our August 7, 2018 Update, [Ontario Introduces Bill to Cancel Cap and Trade and Launches Carbon Tax Case](#) and our June 27, 2018 Update, [Going, Going, Gone – Ontario Premier-Designate Announces Cancellation of Cap and Trade; Pulls Ontario Out of August GHG Auction](#).

¹⁴ Quebec and New Brunswick have announced plans to join the Saskatchewan appeal as interveners. See: <https://nationalpost.com/news/politics/a-unified-message-provinces-move-to-synchronize-battle-plans-against-carbon-tax/>.

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These ongoing court challenges, together with the CPC's commitment to repeal the *Federal Pricing Act* if it wins the upcoming federal election, have increased the uncertainty faced by cleantech businesses seeking to capitalize on the opportunities created by the price on GHG emissions under the *Federal Pricing Act*, and have made the outcome of this election a matter of considerable importance to the cleantech sector.

The recognized need for the cleantech sector to engage more effectively in the development of policies affecting the sector has led to the formation of the [Ontario Clean Technology Industry Association](#) and to increasing activity nationally by the [Canada Cleantech Alliance](#).

For further information concerning these developments, please contact the authors or any other member of our [Cleantech Group](#).