

Goodmans^{LLP} Update

Government of Canada Publishes Revised Proposal for Greenhouse Gas Offset System

On July 2, 2020, the federal government published a discussion paper entitled *Carbon Pollution Pricing: Considerations for Protocol Development in the Federal Greenhouse Offset System* (the “**Proposal**”).

This Proposal is a significant step toward the federal government’s implementation of the carbon pollution pricing scheme set out under the *Greenhouse Gas Pollution Pricing Act* (the “**Act**”).¹ The Proposal provides industry with a sample framework by which the federal government will develop greenhouse gas offset protocols, clarifies which projects are eligible for offset credits, and signals the federal government’s priorities in developing protocols for classes of projects. Parties wishing to comment on the Proposal are invited to provide written comments to Environment and Climate Change Canada (ECCC) by September 4, 2020.

Background

In 2018, the federal government enacted the Act to establish a national backstop price on greenhouse gas emissions (GHGs). The Act establishes two mechanisms in provinces and territories without comparable programs in place: (1) a regulatory charge on fuels, and (2) an emissions trading system known as the Output-Based Pricing System (the “**OBPS**”).²

Under the OBPS and its associated regulation, the *Output-Based Pricing System Regulation* (the “**Regulation**”), facilities subject to the OBPS must report their annual emissions to ECCC. If the facility’s emissions exceed a threshold set out in the Regulation, then the facility must: (i) remit an excess emissions charge per tonne of equivalent CO₂; or (ii) remit “compliance credits”, or (iii) remit some combination of the two. Compliance credits are further subdivided into three categories:

- surplus credits, which are credits received by a facility that emits less than the applicable emissions limit in a given year;
- offset credits, which represent GHG reductions arising from projects ancillary to the facility’s operation and undertaken voluntarily by the facility to reduce or avoid GHGs from sources or increase removal by sinks; or
- “recognized units”, which represent offset credits issued by a province or territory that otherwise meet the criteria set out in the Regulation.

Currently, the option to reduce excess emissions through offset credits is not available to facilities because the federal government has not brought a protocol into force. In 2019, the federal government published an initial discussion paper entitled *Carbon Pollution Pricing: Options for a Federal GHG Offset System* (the “**Discussion Paper**”). This Discussion Paper set out options to establish a federal offset credit system.

¹ The implementation of the Act was discussed in our January 7, 2019 Update, *Federal and Ontario Updates on Climate Change and Clean Growth Plans*

² The OBPS currently applies in: Ontario, New Brunswick, Manitoba, Prince Edward Island, Saskatchewan, Yukon and Nunavut.

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The Discussion Paper noted that the federal GHG offset program would operate through:

- a regulation under the Act;
- federal offset protocols, which will be guidelines that establish the approach for quantifying GHG reductions for a given project type; and
- a public registry to allow participants to register offset projects, track and issue offset credits, and share information.

The Discussion Paper also proposed that the system should be based on the following considerations:

- the proposed offset system should have Canada-wide application but prioritize provinces and territories without existing offset systems;
- GHG offset projects should occur in Canada;
- the proposed offset system should complement existing climate change policies by promoting GHG reduction projects in sectors such as agriculture and forestry;
- the proposed offset system should be as simple and cost-effective as possible to encourage participation in the proposed system; and
- the proposed offset system should build on best practices from other jurisdictions.

The Proposal's Update to the Discussion Paper

The federal government received submissions regarding its policies set out in the Discussion Paper. As discussed in more detail below, the federal government considered these public comments and published a refined road map for a federal GHG offset system in the Proposal.

In particular, the federal government refined its proposal regarding the applicability of the upcoming offset system. The Proposal clarifies that the federal GHG offset system will be national in scope, but will prioritize the development of offset projects in provinces and territories without offset programs. If a province or territory has an active protocol for a given offset project, then the federal protocol will not apply to those classes of offset projects in that province or territory. Similarly, if a province or territory subsequently publishes a protocol for an offset project, then the federal protocol will cease to apply to projects in that province or territory after a transition period of six months.

For a project in a province or territory to be exempt from the federal offset protocol, the provincial and territorial protocols must be “eligible”. The Protocol states that the provincial and territorial protocol must be capable of generating recognized units. This means the federal government will use the eligibility criteria set out in the Regulation to assess provincial and territorial protocols for offset projects.

In addition, the Proposal sets out an approach to project eligibility under the federal GHG offset system. In the Discussion Paper, the federal government proposed that GHG reductions from offset projects must exceed what would have occurred from the receipt of financial incentives under a funding program. However, the Proposal now ties project eligibility to a contractual right or ownership of federal offset credits instead of whether the project proponent received a direct financial incentive.

Project proponents who receive direct financial incentives will be able to register their project if the project proponent can demonstrate that it is entitled to the GHG reductions generated by the project. In order for a proponent to demonstrate entitlement, the proponent must show that the funding agreement does not transfer the entitlement to GHG reductions to the funding program. In addition, a proponent who receives direct financial incentives for a project will not be eligible to register their project in the following two cases:

- the funding program expressly restricts the project proponent's ability to participate in another offset crediting program, or
- the funding program claims entitlement to some or all of the GHG reductions generated from the project.

The Proposal states that the purpose of this revised approach is to limit double counting of GHGs. Similarly, the Proposal also notes that a project will be ineligible if: (1) the project has been registered under another offset program, or (2) offset credits, including credits under the federal government's upcoming Clean Fuel Standard, have been issued for the GHG emissions reductions under another program.

Offset Protocol Development

The main thrust of the Proposal is to set out a framework by which the federal government will design and implement protocols for offset projects. In developing these protocols, the Proposal states that the federal government will consider the principles set out in *ISO 14064-2: Specification with Guidance at the Project Level for Quantification, Monitoring, and Reporting of Greenhouse Gas Emission Reductions or Removal Enhancements*, including:

- protocols should be designed so that the GHG source, sink, reservoir, data, and methodology should be appropriate to the intended user's needs;
- protocols should include all relevant GHG emissions and removals, as well as all relevant information to support criteria and procedures;
- protocols should enable meaningful comparisons of GHG related information;
- protocols should allow for as accurate reporting as possible, reducing bias and uncertainty as far as is practical;
- protocols should disclose sufficient and appropriate GHG-related information to allow intended users to make decisions with reasonable confidence; and
- protocols should use conservative assumptions, values and procedures to ensure that GHG reductions or removal enhancements are not over-estimated.

The federal government is proposing to adopt an “umbrella” approach to develop and obtain approval for protocol development. The Proposal explains that this approach establishes a basic set of requirements in each protocol for quantification, monitoring, and verification that would likely be consistent across Canada. In doing so, the federal government is proposing that protocols remain flexible, while avoiding the need to develop protocols for separate places, practices, and applications.

In developing protocols, the Proposal has established an approach to establish baselines. A baseline scenario is the quantity of GHG reductions achieved by a federal GHG offset project, determined by comparing the GHGs in the project scenario to GHGs that would have occurred in the absence of the project. The federal government will generally apply standardized baselines for federal offset protocols, meaning that projects falling under a protocol will be subject to quantification using the same emission factors, methodologies, and assumptions. A project-specific data approach is to be discouraged.

The Proposal also sets out the process by which the federal government will develop a protocol. Once a project type has been selected, using the methodology as described in detail below, ECCC will notify interested parties through an online notice. ECCC will then establish a protocol scoping document that includes the key elements and considerations for the protocol based on stakeholder feedback and Indigenous perspectives. Finally, the federal government will draft the protocol, publish the draft protocol in the Canada Gazette for public comment, and then finalize the protocol based on public feedback.

Projects Included in the Federal GHG Offset System

The final segment of the Protocol discusses the criteria to select classes of projects for which protocols are to be developed.. ECCC advised that the concept of “additionality”, in which GHG reductions must be “additional” to existing requirements, is fundamental to the selection of protocols for development, as informed by the United Nations Framework Convention on Climate Change. The Proposal sets out the following criteria for additionality, noting that all of the criteria will be assessed to determine whether a project type will result in additional GHG reductions:

- project activities that cause GHG reductions must not be required by federal, provincial, or territorial law or regulation, or must be able to achieve GHG reductions beyond those requirements;
- project activities that reduce GHG sources must not be covered by federal, provincial, or territorial pricing systems;
- if the activity is a new approach to reduce GHGs, then the proposed project type will be additional;

Goodmans^{LLP} Update

- where the rate at which a technology or practice has been adopted in a sector (known as the penetration rate) is deemed a good substitute to assess additionality, and the penetration rate exceeds ECCC's proposed threshold of 40 percent, then the project activities would not be considered additional; and
- supplemental barrier testing may also be conducted to determine if any financial, technical, and/or social barriers exist that could influence a project proponent's decision to carry out an offset project.

ECCC has provided a short-list of priority project types in the Proposal that the federal government will prioritize for the federal GHG offset system. The list establishes that the federal government's priorities include: (1) reducing or avoiding the use of GHG intensive refrigerants; (2) avoiding and/or reducing methane emissions from landfills by encouraging aerobic composting, anaerobic digestion, landfill methane management, and livestock manure management; (3) afforestation and reforestation projects; and (4) adopting sustainable agricultural land management activities to enhance soil carbon sequestration on agricultural lands.

Next Steps

ECCC states that it will proceed with finalizing the sub-set of priority protocols for development and prepare a set of draft regulations for publication in the fall of 2020. Parties wishing to comment on the Proposal can submit written comments by email to ECCC by September 4, 2020.

For further information, please contact any member of our [Environmental Law](#) or [Cleantech](#) Groups.