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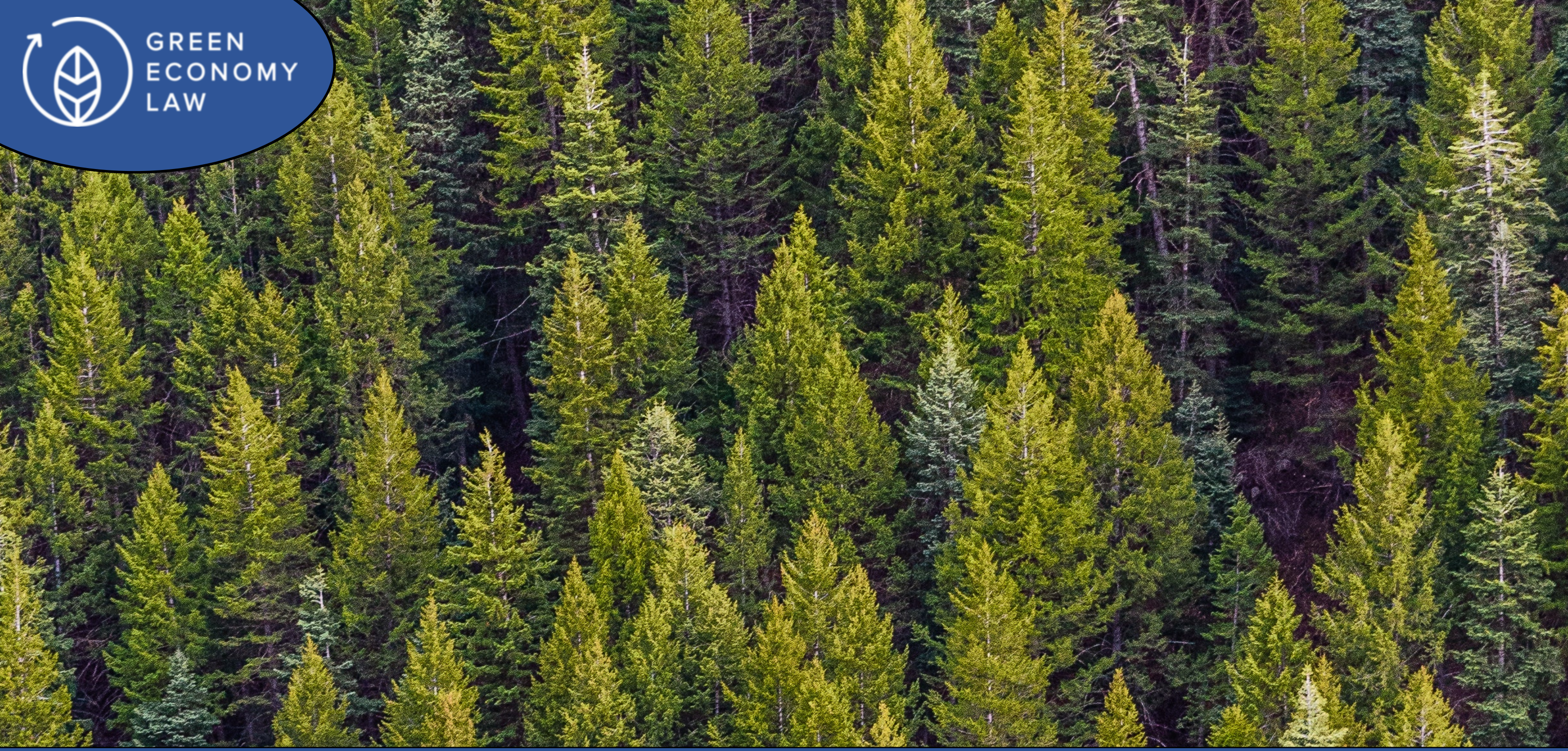
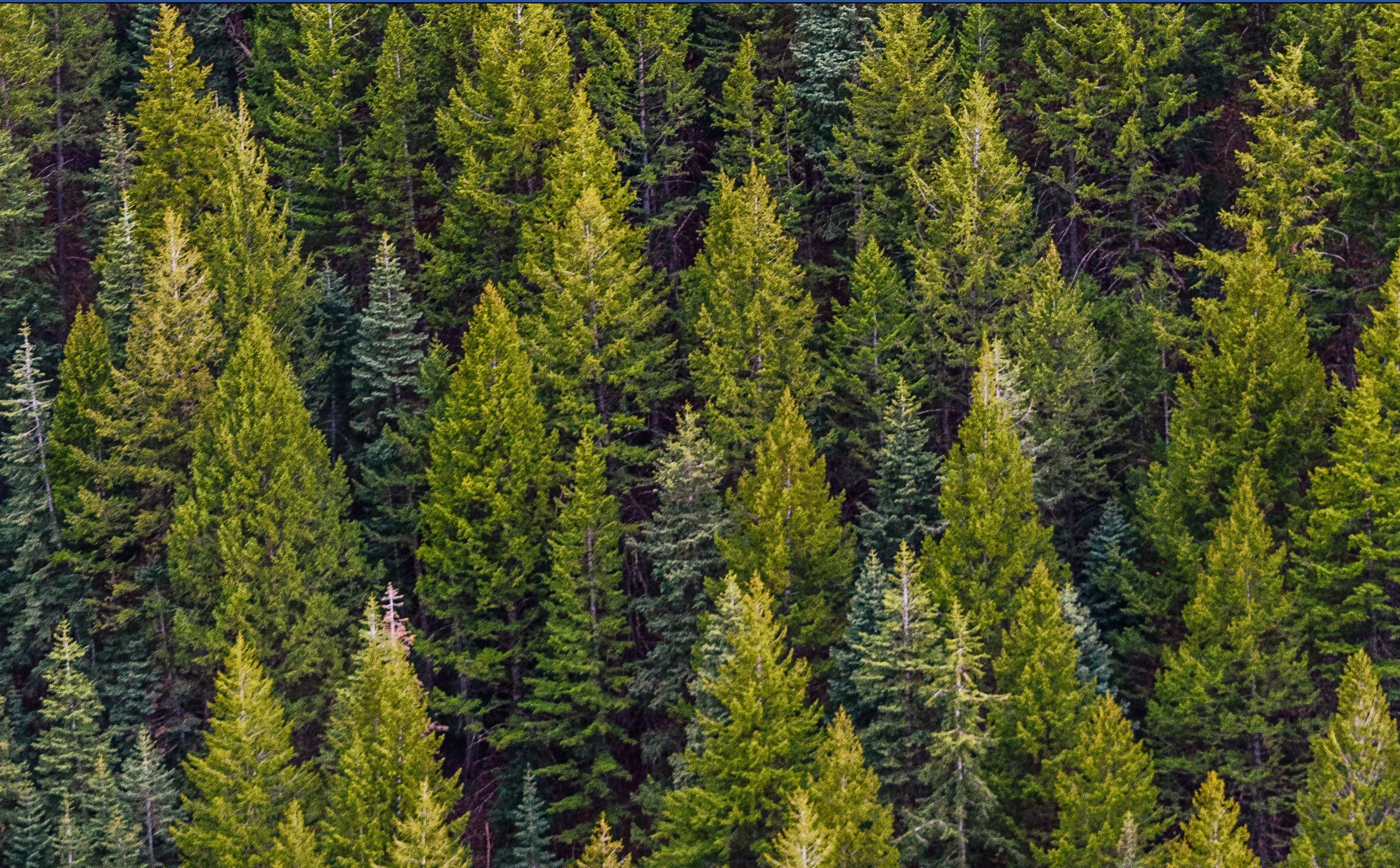


Carbon Pricing

A practical guide for Canadian businesses and institutions



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Introduction

Carbon pricing is a market mechanism that places an explicit cost on carbon and other greenhouse gas (GHG) emissions.[1]

By pricing what would otherwise be an unaccounted for negative externality,[2] affected parties are incentivized to reduce pollution by adopting low-emission practices and products, particularly clean energy technologies ("cleantech").[3] Cleantech and other green economy solution providers benefit from increased demand and products sales, providing them greater capital with which to scale operations and decrease per-unit production costs in a positively-reinforcing cycle.

Because carbon pricing is a market-based policy answer to the quandary of how governments can efficiently incentivize GHG emission reduction, it's garnered broad support from some of the world's most celebrated economists.[4]

Carbon pricing typically takes one of two systemic forms: cap and trade or carbon taxation.

Cap and Trade

Cap and trade system administrators limit the amount of GHG emissions covered parties can emit during a set period (*e.g.,* annually). Parties who exceed their emission limit (cap) can either (a) pay for those emissions at the applicable pricing rate; or (b) purchase credits from parties emitting below their cap.[5] Where purchasing available credits is more cost-efficient than paying for emissions at the applicable rate, parties are incentivized to purchase credits, which reward sellers for decreasing their respective emissions.

For example, if Company A has an annual emissions cap of one (1) tonne of carbon, and it emitted 1.1 tonnes in the last year, the company will have to either pay for that 0.1 tonne overage at the applicable rate or purchase a credit equivalent to 0.1 tonne of carbon from Company B. Company B, which also has an annual one (1) tonne cap, but which only emitted 0.9 tonnes, has earned the right to sell its allowance spread as a credit.

Cap and trade system benefits include their flexibility and ability to financially reward parties that lower their emissions. However, the principal drawback of cap and trade is that administration and compliance requirements are relatively complicated, potentially leaving room for fraud and creative accounting. Another drawback is that operating carbon credit auctions and monitoring compliance can entail significant administrative costs.

Carbon Taxation

A carbon tax (or fee) is a levy applied to transactions involving fossil fuels (*e.g.,* gasoline, natural gas) based on applicable fuels' GHG emission content.

Carbon taxation is typically favoured for being straightforward and easy to understand, with relatively minor administrative requirements and little room for shenanigans. The primary complaint, however, regarding carbon taxation is that it imposes additional costs without apparent near-term benefits for even the most climate-friendly parties unless a program features a dividend or rebate component.[6]

It is important to note that the term "carbon tax" can be misleading. For example, because the Canadian federal backstop fuel charge does not raise federal government revenue, but rather, distributes proceeds back to residents of affected provinces through Climate Action Incentive (CAI) rebates, courts have repeatedly stated that it is not a tax but a "regulatory charge".[7] Nonetheless, such systems typically function *like* a tax.

Carbon Pricing in Canada

More than a decade before national carbon pricing, Canada's provinces began pricing their emissions by various means.

- **2007**: Alberta implemented its *Specified Gas Emitters Regulation* (SGER) to regulate industrial emissions,[8] and Quebec adopted an energy sector carbon tax.[9]

- **2008**: British Columbia adopted North America's first economy-wide carbon tax.[10]

- **2013**: Quebec adopted a provincial cap and trade program. It was later linked with California's equivalent program.[11]

- **2018**: Ontario implemented its cap and trade program, which was linked with the Quebec and California programs. Before the year's end though, Doug Ford's Progressive Conservative party won a majority government and the program was unceremoniously scrapped.[12]

Following the Liberal Party of Canada's 2015 electoral victory, the federal government worked with Canada's provincial and territorial governments to develop the *Pan-Canadian Framework on Clean Energy and Climate Change* in 2016.[13] The framework established a working plan for Canada's various governments to collaboratively reduce GHG emissions in accordance with our newly-established Paris Agreement commitment.[14]

Delivering on a core goal of the *Pan-Canadian Framework,* Canada's legislature passed the federal *Greenhouse Gas Pollution Pricing Act* (GGPPA) in 2018.[15]

The *Greenhouse Gas Pollution Pricing Act*

The GGPPA established carbon pricing standards for Canadian provinces and territories, including a rising baseline price per tonne of carbon (currently $50.00 per tonne).[16] Should jurisdictions fail or refuse to implement their own compliant carbon pricing system, they will be subject to a federal backstop system consisting of two component programs: the fuel charge and the Output-Based Pricing System ("OBPS").

The **fuel charge** is a carbon tax-style levy on 21 enumerated fossil fuels.[17] It is generally paid by fuel producers and distributors.[18] In provinces subject to the fuel charge, the federal government collects and later redistributes revenues proportionately to provinces of origin.

The majority ("approximately 90%") of redistributed funds take the form of CAI rebates paid on a per-household basis.[19] Since 2019, CAI rebates have been paid annually in connection with household income tax filings.[20] Later this year, CAI rebate payments will be made quarterly.[21]

The **OBPS** is a cap and trade program that applies to industrial facilities in select sectors emitting 50,000 tonnes or more of carbon per year, though qualifying facilities emitting 10,000 tonnes or more can opt into the program voluntarily.[22] OBPS revenues are collected by the federal government and redistributed proportionately to provinces of origin through the Output-Based Pricing System Proceeds Fund, either via direct transfer for jurisdictions that voluntarily opt into the OBPS, or through the fund's two program streams: the Decarbonization Incentive Program and the Future Electricity Fund.[23]

Because OBPS-covered facilities only pay for their above-the-cap emissions, and are exempt from the fuel charge's application, it is more emitter-friendly. The reason OBPS-covered facilities receive this advantageous treatment is to ensure that - absent a carbon border adjustment - they are not placed at a significant disadvantage as compared with international competitors in their respective industries not subject to comparable regulation.[24]

Carbon Pricing by Province

Because the GGPPA allows each province and territory to establish its own carbon pricing program to best fit the unique circumstances of its respective economy, carbon pricing across Canada is a legal patchwork. This poses challenges for businesses forced to comply with and plan for an array of different systems. However, structuring the law in this fashion was crucial to ensuring its constitutionality in the context of Canadian federalism (as discussed later in this report).

For simplicity, we can group Canadian jurisdictions into several distinct categories of carbon pricing systems.

- **Backstop Jurisdictions** subject to the full federal backstop:

- **Manitoba**
- **Nunavut**
- **The Yukon**

- **Hybrid Jurisdictions** partially subject to the federal backstop:
  - **Alberta** (federal fuel charge, provincial industrial program)
  - **Ontario** (federal fuel charge, provincial industrial program)
  - **Prince Edward Island** (provincial fuel charge, federal OBPS)
  - **Saskatchewan** (federal fuel charge, federal OBPS for select industrial sectors, provincial industrial program for most industrial sectors)

- **Cap and Trade Jurisdictions** with an economy-wide cap and trade program:
  - **Nova Scotia**
  - **Quebec**

- **Carbon Tax Jurisdictions** with an economy-wide carbon taxation system: [25]
  - **British Columbia**
  - **Northwest Territories**

- **Mirror Jurisdictions** with a fuel charge carbon taxation system as well as an industrial cap and trade system, which together mirror the federal backstop program:
  - **New Brunswick**
  - **Newfoundland and Labrador**

Supreme Court of Canada Ruling

The respective jurisdictional powers of Canada's federal and provincial governments are enumerated in sections 91 and 92 of the *Constitution Act*, *1982*.[26] The law limits each level of government's sphere of influence, giving provinces greater control over localized matters and the federal government general authority over more national concerns. In cases where one level of government unreasonably intrudes into the jurisdictional territory of another, courts can declare such action or legislation illegal for violating Canada's constitutional division of powers.[27]

In response to the GGPPA, conservative provincial governments in Alberta, Ontario, and Saskatchewan separately filed lawsuits asking the courts to strike down the law as an unconstitutional expansion of federal powers. In their respective decisions, the Ontario and Saskatchewan Courts of Appeal ultimately regarded the GGPPA as a valid exercise of federal power under Canada's constitution,[28] whereas Alberta's Court of Appeal concluded it was not.[29]

In March 2021, the Supreme Court of Canada upheld the GGPPA's constitutionality.[30] In the court's majority decision, it regarded climate change as an issue of sufficiently pressing "national concern" to justify a degree of federal intrusion into the domain of provincial authority, with such federal power rooted in s. 91's "Peace, Order, and good Government" clause.[31]

Carbon Offsets

A carbon offset is a form of credit representing greenhouse gas (GHG) emission avoidance, reduction, or sequestration (*i.e.,* removal from the atmosphere).[32] Offsets can be bought and sold by individuals, corporations, or governments with the goal of *offsetting* emissions released into the atmosphere elsewhere.

Alberta, British Columbia, and Quebec are the only provinces currently boasting regulated offset programs operating in tandem with local carbon pricing systems. These offset programs function by allowing the sale certified credits for qualifying activities that sequester or reduce emissions against a baseline. For instance, the Alberta Emission Offset System allows the province to issue carbon offset credits to companies that participate in projects such as aerobic composting, carbon capture and storage, and low residual feed intake for cattle.[33]

The proposed *Federal Greenhouse Gas Offset System Regulations* (*Canada)* will govern offset credits used by OBPS participants. Credits may be generated by projects falling under an approved protocol that remove or reduce real, additional, verified, and quantifiable emissions.[34] Approved protocols currently include advanced refrigeration systems, landfill methane management, improved forest management, and enhanced soil organic carbon (regenerative agriculture).[35]

(*For more information about carbon offsets, please see our report* **Carbon Offsets: A Practical Guide for Canadian Businesses** *at https://www.greeneconomylaw.com/carbon-offsets*.)

When Conservatives Win

Conservative Party of Canada leaders have consistently vowed to repeal and replace the GGPPA if elected to national office, claiming the Liberals' regime increases consumer costs and harms Canada's economy.[36] Nonetheless, most Conservative Party proposals would actually only eliminate the GGPPA's fuel charge component while maintaining some version of the federal industrial carbon pricing regime.[37]

Of the Conservative Party's current leadership candidates, Jean Charest likewise proposes axing the fuel charge but keeping an industrial pricing system, Pierre Poilievre vociferously opposes any price on carbon, and Patrick Brown says he would consult party membership before proposing any particular policy.[38]

If a Conservative government repeals the GGPPA, then absent the introduction of a comparable law, the backstop program will cease to exist where in effect. Where applicable, provinces and territories will retain their own carbon pricing systems. Without a national minimum price on carbon though, jurisdictions may lower their applicable carbon price or simply choose not to raise it, creating chaos for businesses whose forecasts relied on a predictable rising national carbon price.

A minority Conservative government that controls the executive but lacks a majority in Parliament, however, would likely lack the votes to repeal the GGPPA. But it could effectively ruin the entire federal regime by refusing to enforce compliance against recalcitrant provinces and territories, or changing regulations under the legislation to render the system functionally useless.

Carbon Pricing-Related Services

Is your business or organization looking for help working with or understanding carbon markets and pricing? Green Economy Law Professional Corporation can help ensure all your legal bases are covered. **For more information regarding legal services, please contact the firm at 647-725-4308 or via email at info@greeneconomylaw.com.**

For those interested in learning more about the subject matter, the firm also offers a CPD-eligible online course, *Understanding Canadian Carbon Pricing*. The course will be made accessible for free upon request to all Green Economy Law clients and persons ages 22 and under.

For more information regarding courses offered by the firm, please visit https://www.greeneconomylaw.com/webinar-courses.

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[1] In addition to carbon dioxide (CO_2), carbon pricing systems often price GHGs other than CO_2. But because the vast majority of GHG emitted by humans into the atmosphere is CO_2, it typically serves as the standard GHG for purposes of carbon pricing, with other GHGs converted to "carbon dioxide equivalent". *See* GREENHOUSE GAS POLLUTION PRICING ACT: ANNUAL REPORT FOR 2022, ENVIRONMENT AND CLIMATE CHANGE CANADA (March 23, 2022) (*accessible at* https://publications.gc.ca/collections/collection_2022/eccc/En11-17-2020-eng.pdf).

[2] Will Kenton, *Externality*, INVESTOPEDIA (updated October 26, 2020) (*accessible at* https://www.investopedia.com/terms/e/externality.asp).

[3] *See id*. at 3 ("*A price on carbon pollution provides an incentive to reduce greenhouse gas emissions, stimulates investments in clean innovation, and encourages a competitive and prosperous economy as we transition to a low-carbon world. It creates a financial incentive for businesses and households to decide for themselves how best to reduce their emissions. Pricing carbon pollution is working. Industries are investing in energy efficiency and adopting clean technologies."*); *see also* Jason Fernando, *Cleantech*, INVESTOPEDIA (updated December 8, 20202) (*accessible at* https://www.investopedia.com/terms/c/cleantech.asp).

[4] *See The world urgently needs to expand its use of carbon prices*, THE ECONOMIST (May 23, 2020); *see also* Heather Long, *'This is not controversial': Bipartisan group of economists calls for carbon tax*, THE WASHINGTON POST (January 16, 2019).

[5] In some cap and trade systems, such as Quebec's, a limited amount of regulated offset credits can also be purchased for compliance purposes.

[6] Marina Povitkina at al., *Why are carbon taxes unfair? Disentangling public perceptions of fairness,* GLOBAL ENVIRONMENTAL CHANGE (September 2021) (*accessible at* https://www.sciencedirect.com/science/article/pii/S0959378021001357#b0240).

[7] *See* Reference re Greenhouse Gas Pollution Pricing Act, 2021 SCC 11; *see also* Reference re Greenhouse Gas Pollution Pricing Act, 2019 ONCA 544.

[8] Julia-Maria Becker, *Carbon pricing – keeping Alberta competitive since 2007,* PEMBINA INSTITUTE (*accessible at* https://www.pembina.org/blog/carbon-pricing-keeping-alberta-competitive-2007) (March 12, 2019).

[9] *Quebec imposes carbon tax on energy producers,* CTV NEWS (June 7, 2007) (*accessible at* https://www.ctvnews.ca/quebec-imposes-carbon-tax-on-energy-producers-1.244141); *see also* Ryan Urban and Chloe McElhone, *Canadian Carbon Prices & Rebates (Updated 2021),* ENERGY HUB (June 1, 2021) (*accessible at* https://www.energyhub.org/carbon-pricing/).

[10] *British Columbia's Carbon Tax,* BRITISH COLUMBIA (*accessible at* https://www2.gov.bc.ca/gov/content/environment/climate-change/clean-economy/carbon-tax).

[11] A BRIEF LOOK AT THE QUEBEC CAP-AND-TRADE-SYSTEM FOR EMISSION ALLOWANCES, QUEBEC (*accessible at* https://www.environnement.gouv.qc.ca/changements/carbone/documents-spede/in-brief.pdf).

[12] *See Archived – Cap and trade*, ONTARIO (June 2, 2016) (*accessible at* https://www.ontario.ca/page/cap-and-trade).

[13] PAN-CANADIAN FRAMEWORK ON CLEAN GROWTH AND CLIMATE CHANGE – PROGRESS REPORT, ENVIRONMENT AND CLIMATE CHANGE CANADA.

[14] In 2015, Canada agreed to reduce emissions 30% below 2005 levels as part of its Paris Agreement commitment. *See* Kathryn Harrison, *The fleeting Canadian harmony on carbon pricing,* POLICY OPTIONS (July 8, 2019) (*accessible at* https://policyoptions.irpp.org/magazines/july-2019/the-fleeting-canadian-harmony-on-carbon-pricing/). In 2021, Canada boosted this commitment to 40-45% emissions reduction below 2005 levels. *See Net-Zero Emissions by 2050*, GOVERNMENT OF CANADA (*accessible at* https://www.canada.ca/en/services/environment/weather/climatechange/climate-plan/net-zero-emissions-2050.html).

[15] GREENHOUSE GAS POLLUTION PRICING ACT: ANNUAL REPORT FOR 2019, ENVIRONMENT AND CLIMATE CHANGE CANADA.

[16] Applies to carbon or carbon equivalent. *See supra* note 1.

[17] PAN-CANADIAN APPROACH TO PRICING CARBON POLLUTION – INTERIM REPORT 2020, ENVIRONMENT AND CLIMATE CHANGE CANADA.

[18] *Id*.

[19] *See Carbon pollution pricing proceeds programming and use of proceeds*, GOVERNMENT OF CANADA (accessible at https://www.canada.ca/en/environment-climate-change/services/climate-change/carbon-pollution-pricing-proceeds-programming.html).

[20] *Climate Action Incentive payment amounts for 2022-2023*, GOVERNMENT OF CANADA (*accessible at* https://www.canada.ca/en/department-finance/news/2022/03/climate-action-incentive-payment-amounts-for-2022-23.html).

[21] *Id.*
[22] *Output-Based Pricing System*, GOVERNMENT OF CANADA (accessible at https://www.canada.ca/en/environment-climate-change/services/climate-change/pricing-pollution-how-it-will-work/output-based-pricing-system.html).
[23] *See Output-Based Pricing System Proceeds Fund*, GOVERNMENT OF CANADA (*accessible at* https://www.canada.ca/en/environment-climate-change/services/climate-change/carbon-pollution-pricing-proceeds-programming/output-based-pricing-system-proceeds-fund.html).
[24] Sarah Dobson et al., *The Ground Rules for Effective OBAs: Principles for Addressing Carbon-Pricing Competitiveness Concerns Through The Use Of Output-Based Allocations,* UNIVERSITY OF CALGARY (July 6, 2017) (*accessible at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2997181); *see also Exploring Carbon Border Adjustments for Canada*, GOVERNMENT OF CANADA (2021) (*accessible at* https://www.canada.ca/en/department-finance/programs/consultations/2021/border-carbon-adjustments/exploring-border-carbon-adjustments-canada.html).
[25] Notably, under these systems industrial polluters are eligible for significant rebates should they meet certain performance standards. *See CleanBC Industrial Incentive Program*, BRITISH COLUMBIA (*accessible at* https://www2.gov.bc.ca/gov/content/environment/climate-change/industry/cleanbc-industrial-incentive-program); *see also Large Industrial Emitters*, GOVERNMENT OF NORTHWEST TERRITORIES (*accessible at* https://www.fin.gov.nt.ca/en/services/licences-taxes-and-fees/large-industrial-emitters).
[26] The *Constitution Act, 1982* consolidated and updated various laws underpinning Canada's system of government, including, most notably, *The British North America Act, 1867*.
[27] *See* SCC *supra* note 7.
[28] *See* ONCA *supra* note 7; *see also* Reference re Greenhouse Gas Pollution Pricing Act, 2019 SKCA 40 (CanLII).
[29] *See* Reference re Greenhouse Gas Pollution Pricing Act, 2020 ABCA 74 (CanLII).
[30] *See* SCC *supra* note 7.
[31] *Id*.
[32] Though they are often called "carbon offsets", applicable details regarding offsets could apply with respect to other GHGs in addition to carbon, such as methane.
[33] *Alberta Emission Offset System,* ALBERTA (*accessible at* https://www.alberta.ca/alberta-emission-offset-system.aspx).
[34] *Canada Gazette, Part I, Volume 155, Number 10: Greenhouse Gas Offset Credit System Regulations (Canada)* GOVERNMENT OF CANADA (March 6, 2021).
[35] *Id*.
[36] *See* Rachel Aiello, *Scheer acknowledges feds would put price on carbon under his plan to cap big emitters*, CTV NEWS (June 23, 2019); *see also* Joanna Smith, *Scheer vows to never support carbon tax, blames Trudeau for national unity 'crisis'*, GLOBAL NEWS (December 6, 2019); *see also* David Cochrane, Salimah Shivji, and Aaron Wherry, *Conservatives announce plan to replace Liberal carbon tax with a lower levy of their own*, CBC (April 15, 2021).
[37] *See* Aiello *supra* note 33; *see also* Cochrane *supra* note 33.
[38] Stephanie Taylor, *Jean Charest vows to repeal consumer carbon price plan if elected Conservative leader,* GLOBAL NEWS (April 26, 2022); *see also* Stuart Thomson, *Conservative leadership hopefuls reach a carbon tax consensus,* THE HUB (April 29, 2022).