The New Federal Carbon Pricing Policy — Roadmap To A Pan-Canadian Energy Strategy?

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Earlier this month the Federal Government took two major steps towards the implementation of its climate change policy — ratification of the Paris Agreement and a proposed pan-Canadian benchmark for carbon pricing to be implemented by 2018. These changes both address prior commitments and raise outstanding legal and policy issues.

Background to the New Federal Carbon Pricing Policy

At the 2015 United Nations Climate Change Conference in Paris, France ("COP21"), that resulted in the Paris Agreement, Canada committed to a 2030 target of a 30 per cent reduction below 2005 levels of emissions. In the March 3, 2016 First Ministers' Meeting in Vancouver, British Columbia, the First Ministers resolved in a Vancouver Declaration on Clean Growth and Climate Change (the "Vancouver Declaration"), to develop a concrete plan to achieve Canada's international commitments that includes federal action through a Pan-Canadian Framework for Clean Growth and Climate Change, to be implement ed by early 2017. Working groups were set up in four areas, including carbon pricing mechanisms, to provide reports by September 2016. The First Ministers also agreed to meet in the Fall of 2016 to review progress on their Canadian Energy Strategy. The Working Group on Carbon Pricing Mechanisms produced its report. The Government of Canada adopted the Pan-Canadian Approach to Pricing Carbon Pollution.

The Federal Carbon Pricing Policy

In its October, 2016 announcement, the Federal Government supports the following principles of the Working Group on Carbon Pricing Mechanisms:

- carbon pricing should be a central component of the Pan-Canadian Framework;
- the approach should be flexible and recognize carbon pricing policies already implemented or in development by provinces and territories;
- carbon pricing should be applied to a broad set of emission sources across the economy;

- carbon pricing policies should be introduced in a timely manner to minimize investment into assets that could become stranded and maximize cumulative emission reductions;
- carbon price increases should occur in a predictable and gradual way to limit economic impacts;
- reporting on carbon pricing policies should be consistent, regular, transparent and verifiable;
- carbon pricing policies should minimize impacts on competition a nd carbon leakage, particularly for trade-exposed sectors; and
- carbon pricing policies should include revenue recycling to avoid a disproportionate burden on vulnerable groups and Indigenous peoples.

The federal benchmark includes the following elements:

1. Timelines: all jurisdictions will have carbon pricing by 2018.
2. Common scope. Pricing will be applied to a common and broad set of sources to ensure effectiveness and minimize interprovincial competitiveness effects. At a minimum, carbon pricing should apply to substantively the same sources as British Columbia's carbon tax.
3. Flexibility between two systems. Provinces and territories will have the flexibility to choose how they implement carbon pricing by (i) an explicit price-based system (as in British Columbia and Alberta), or (ii) a cap-and-trade system (as in Ontario and Québec).
4. Legislated benchmarks with incremental stringency. For jurisdictions with an explicit price-based system, the initial price will be a minimum $10 per tonne of carbon pollution in 2018 and will rise $10 a year to reach $50 per tonne in 2022.

   a. For Provinces with cap-and-trade the number of available pollution permits will decrease every year, based on both: (i) a 2030 target equal to or greater than Canada's 30 per cent reduction target; and (ii) annual cap cuts through to 2022 that correspond, at a minimum, to the projected emissions reductions resulting from the carbon price set per year in price-based systems.
5. Revenues. Revenues realized remain in provinces and territories of origin to be used according to their needs, including addressing impacts on vulnerable populations and sectors and supporting climate change and clean growth goals.
6. Equivalency and application of the federal policy. The Federal Government will introduce an explicit price-based carbon pricing system that will apply in jurisdictions that do not meet the benchmark. The federal system will be consistent with the above principles and will return revenues to the jurisdiction of origin.
7. Reporting. Provinces and territories are expected to provide regular, transparent and verifiable reports on the outcomes and impacts of carbon pricing policies.
8. Review. The framework will be reviewed in five years (2022) to ensure that it is effective and to confirm future price increases. The review will account for actions of other countries in response to carbon pricing and permits or credits imported from other countries.

Implications

The Government of Canada's clear message is that an economy-wide carbon pricing is the most efficient way to reduce greenhouse gas emissions. The assumption is that pricing pollution will drive innovative solutions to provide low-carbon choices for consumers and businesses, clean growth and the creation of jobs for the middle class to support the transition to a low-carbon economy. The federal policy is also based on the fact that British Columbia, Alberta, Ontario and Québec, representing over 80 per cent of the Canadian population, have already introduced carbon pricing and the same principles should apply to the remaining 20 per cent.

While a laudable effort on the part of the Federal Government to take on leadership on climate change issues, given the controversies in the context of energy development projects, several potential concerns are flagged as set out below.

It is unclear if or how exemptions will be harmonized. While the principles support a flexible approach that recognizes carbon pricing policies already implemented or in development by provinces and territories, the federal policy proposes pricing that will be applied to a common and broad set of sources (based on British Columbia's carbon pricing system) to minimize interprovincial competitiveness. To the extent that jurisdictions already implementing carbon policies exempt some of the sources, it appears that they may be required to amend their carbon regimes to comply with the federal policies.

For interprovincial competitiveness and levelling the field, provinces may be seeking recognition or some form of credit for previous emission reduction actions. This is particularly so given that they will have to comply with the federal incremental stringent benchmark of $50 per tonne in 2022. The implementation of incremental stringency across board may have different impacts in different provinces as a result of the diverse economies across the country. It is possible that the federal backstop encourage s some provinces not to legislate at all now and encourage s forum shopping by investors in the meantime.

- It is unclear how the benchmark price was realized, the role of the market in setting the benchmark price, and the mechanism for enforcement where the federal policy applies.
- There is limited clarity on how two different pricing methods — carbon tax and cap-and-trade — may be consistently measured for compliance purposes. In fact, the efficacy of carbon tax to reduce emissions has been questioned. There is a view that carbon tax would have to be massive in order to change behaviour and achieve any significant emissions reductions.
- It is also unclear how imported carbon products are impacted under the federal rules, such as imported fuel. In a jurisdiction that imports fuel, the impact of carbon pricing might be less than in a province that produces fuel, leading to competitive advantages.
- In respect of international competitiveness, the federal policy may have negative impacts on emission heavy and trade sensitive industries' ability to be competitive locally and internationally. Small and mid-sized oil and gas producers have indicated that a new federal carbon cost will impact their competitiveness because energy majors can more easily price a carbon tax into the cost of their operations. Also, provinces with larger shares of Canada's international trade industries are disadvantaged over their counterparts in Canada and internationally.

- Next to be considered is the elephant in the room. There is uncertainty as to how the Federal Government's leadership on climate change will mesh with recent issues facing Canadian pipeline development, energy market access and energy regulators. This is hinted in Alberta Premier's response to the federal carbon pricing. In principle, the Government of Alberta supports a common price that ensures that no one is penalized economically. However, the Government of Alberta will not be supporting the Federal Government's proposal absent serious concurrent progress on energy infrastructure, to ensure that Alberta ha s the economic means to fund these policies. Also, Saskatchewan's Premier, Brad Wall, in his response stated that Saskatchewan, already hurting from a downturn in commodity prices, will be a less competitive place to do business because of its trade-exposed resource industries. The carbon tax will impede Saskatchewan's continuing efforts to export high quality products to global customers. Saskatchewan is investigating all options open to it to mitigate the impact of what the Premier refers to as "one of the largest national tax increases in Canadian history." In British Columbia, which has had a revenue neutral carbon tax (meaning there have been cuts to other personal taxes based on the money collected from the carbon tax) in place since 2008, Premier Christy Clarke has said she will raise the carbon tax from its current level of $30 to meet the federal benchmark when other provinces take action. Premier Clarke, who is looking to grow LNG production in the province, has been clear that B.C. will not raise its tax until other provinces "catch up" to B.C.'s carbon pricing.
- In addition to matters of policy, the new proposal raises legal issues. The Federal Government indicates that for those provinces that do not have a carbon regime, it will essentially impose one. There will likely be vigorous jurisdictional arguments emerging from the federal carbon policy. Potentially, arguments may be made on indirect taxation of provincially owned resources by the Federal Government and constitutional immunity, such as was argued in *Reference re Proposed Federal Tax on exported Natural Gas* [1982] 1 S.C.R. 1004. In that case, the question was whether a levy which the Crown in right of Canada sought to impose upon certain natural gas owned, produced, and to be exported by the Crown in right of Alberta, was ultra vires the Parliament of Canada by virtue of section 125 of the Constitution Act, 1867 which states that no lands or property belonging to Canada or any Province shall be liable to Taxation. The Supreme Court of Canada held that if the primary purpose is the raising of revenue for general federal purposes then the legislation falls under s. 91(3) and the immunity in s. 125 is engaged. If, on the other hand, the Federal Government imposes a levy primarily for regulatory purposes, or as necessarily incidental to a broader regulatory scheme, then the levy is not in pith and substance "taxation" and s. 125 does not apply.

The bridge between a Pan-Canadian Framework on Clean Growth and Climate Change and a Canadian Energy Strategy is a fundamental one that must be tackled sooner rather than later to avoid these jurisdictional tussles. The First Ministers will be reviewing progress on the Canadian Energy Strategy which remains at this stage high level statements of areas of potential cooperation. There are a number of critical issues still to be addressed to ensure the effectiveness of the alignment and equivalency of provincial and federal policies, especially as it affects provincial competiveness within and outside Canada.

Borden Ladner Gervais LLP will be monitoring these developments, including the introduction of further legislation, as they occur.

By

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