200 - 2006 West 10th Avenue
Vancouver, BC V6J 2B3
www.wcel.org

tel: 604.684.7378
fax: 604.684.1312
toll free: 1.800.330.WCEL (in BC)
email: admin@wcel.org

December 3, 2010

Ministry of Environment
C/o cindybertram@shaw.ca
Victoria, BC

***** BY EMAIL ONLY *****

Dear Sirs/Mesdames:

Re: Consultation on Carbon Trading Regulations

Thank you for the opportunity to comment on the Emissions Trading Regulations ("ETR") and Carbon Trade Offsets Regulation ("CTOR") consultations papers. This letter provides our comments on these proposed Regulations. While we applaud the BC government for taking a leadership role on seeking to reduce greenhouse gases, we are concerned that some aspects of the Regulations, as proposed, may undermine their effectiveness.

1. Emissions Trading Regulation

In general we are impressed by the level of thought and consideration which has gone into the development of the ETR (and the WCI Design upon which it is based). Subject to the following concerns, we believe that the mechanisms required for an effective carbon pricing mechanism are present.

That being said, we have specific comments and concerns regarding:

- The Sources to be covered by the Regulation;
- The percentage of compliance credits to be awarded for free as opposed to auctioned;
- The design of Early Reduction Allowances; and
- The potential for a glut of compliance credits, driving down the carbon price to levels that are not useful, due to the range and number of compliance options provided.

We will address each of these points in turn. In addition, we will discuss ways in which the concept of a feebate might be incorporated into the ETR model to more simply address some of the problems that free compliance unit allocations are intended to address, while improving the effectiveness of the regime in driving emissions reductions.

1.1. Sources to be Covered

We believe that to the extent possible all industrial GHG emissions sources should be covered by either the regulation or the carbon tax. Consequently we believe that all of the emissions sources listed on page 5 of the ETR Consultation Paper should be included as emissions sources. In particular, we note that the Climate Action Team, in its report, highlighted the need to regulate all industrial emissions by 2012.

Given the role of the sector in climate change, any perception that this sector is being "let off lightly" undermines the credibility of the entire ETR.

In addition, we are concerned that emissions from forestry are not listed as a covered source. While we recognize that forestry was not included as an emissions source under the Kyoto Protocol, most estimates that include these emissions suggest that it is one of the larger sources of emissions in BC (4.6% of BC's total emissions in 2008).[1]

Moreover, since industrial forestry is being looked to as a source of carbon offsets, it would be inconsistent to recognize emissions taken from the atmosphere by forestry operations while exempting emissions caused by the same operations.

Assuming that the goal is to reduce BC's overall contribution to GHG emissions, and not merely to comply with the Kyoto Protocol and/or protect the forest industry, industrial forestry emissions should be included.

1.2 Awarded vs. Auctioned Compliance Credits

We strongly urge moving immediately to auctioning the substantial majority of compliance credits and moving as quickly as possible to auctioning 100% of compliance credits.

As is clear from the substantial consideration given in the ETR Consultation Paper to how to appropriately allocate free compliance credits, the inclusion of free credits inevitably involves direct manipulation of the carbon market, while giving away a valuable public asset to industry free of charge.[2] By contrast, the auction involves less opportunity for government interference in the market, is more transparent, and obtains a significant source of revenue for the public that can be used to fund other climate change mitigation and adaptation to the impacts of climate change.

The rationale for giving away credits for free is presumably based on the perception that it is somehow unfair to industrial users who have been able until now to emit carbon for free to suddenly have to pay for it. We disagree with this premise – these emissions are contributing to compromising the integrity of the global atmosphere, and these industrial users have never had a right to do that. Indeed, what is unfair is that they have been able to emit emissions for free until now.

A second rationale is that requiring BC companies to pay for these emissions will put them at a competitive disadvantage relative to other jurisdictions which are not pricing carbon, requiring government, in the words of the ETR Consultation Paper, to "compensate" them. This is, of course, an inherent risk associated with pricing carbon when other jurisdictions are not, and introducing mechanisms that have the effect of reducing the price associated with carbon for some users is entirely inconsistent with the purpose of carbon pricing.

If the system is to protect BC industries at the outset this should not be done through free compliance credits, but through a reapportionment of the income from auctions back into the industry on a rationale basis other than current emissions levels. See "A Feebate approach" below for further discussion of this approach.

---

1 BC Greenhouse Gas Inventory Report 2008, at http://www.env.gov.bc.ca/cas/mitigation/ghg_inventory/pdf/pir-2008-full-report.pdf, last accessed December 3, 2010.

2 Perhaps not surprisingly, while we are opposed to free allocations, we are particularly opposed to any grandfathering based approach, which awards historically high emitters over those who have historically had a lower emissions profile.

Meanwhile, the ETR Consultation Paper's discussion of how to remedy the problems associated with free allocations (ie. how to not unfairly prejudice new entrants, how to take back free allocations from businesses that close, etc.), and the, by contrast, comparatively simple and transparent rules around the conduct of auctions make it clear that this is a far more transparent and desirable approach.

1.3 Design of Early Reduction Allowances

We have reviewed a draft of submissions on the ETR by the Pembina Institute which argues persuasively against offering Early Reduction Allowances (ERAs). That being said, we not necessarily opposed to recognizing early action taken by companies prior to the ETR coming into force. However, we disagree entirely with the proposal to recognize such early action by issuing ERAs over and beyond the province's first annual allocation budget. If ERAs are issued for free to recognize early action then they should be taken out of the annual budget, just as any other compliance credit would be.

The ETR Consultation Paper explains:

> This would not increase the net emissions of GHGs to the atmosphere under the emissions trading system, as ERAs would be issued in quantity no greater than realized emission reductions.[3]

Essentially the ETR Consultation Paper is arguing that had the industrial operations waited to take action until 2012, their emissions would have been included in the annual budget, and the overall annual budget would have been higher. Consequently, so the argument goes, there is no problem with effectively increasing the budget to recognize this early action.

With respect, this argument is flawed, on several grounds. First, these early actor reductions are emissions reductions which occurred not due to the ETR, but due to corporation social responsibility, carbon pricing associated with the carbon tax, risk management or some other reason. In the design of carbon offsets, it is well recognized that emissions reductions that would have occurred anyway (the concept of additionality). The ETR Consultation Paper is effectively giving offset credit to projects which not just only might occur anyway, but which actually did occur anyway.

Even were that not the case, the idea that such emissions reductions, whether voluntary or for some other reason, should be used as a rationale to increase the emissions levels required in 2012 is deeply objectionable, particularly when BC is nowhere close to achieving the government's interim targets for GHG emissions.

Finally, the ETR Consultation Paper provides no discussion, or even recognition, of the risk that substantial numbers of ERAs might affect the functioning of the carbon market, driving down prices, as discussed below in Glut of Compliance Credits.

If early action is to be recognized, this should occur either through an allowance of compliance credits taken from the annual budget or, better still, through cash rebates from auctioned compliance credits.

1.4 Glut of Compliance Units

A traditional cap and trade model sets a cap for a given emission that industry must achieve, and a market mechanism whereby industry as a whole (according to economic theory) can figure out how best to achieve that cap. As a result, government can have some confidence that the target will be met, since there is flexibility in who meets the target and how, but not flexibility in the target itself.

The attempt in most of the GHG cap and trade systems to include offsets alongside compliance credits introduces an additional design complexity, since the target is no longer fixed. Indeed, as proposed, the

---

[3] ETR Consultation Paper, above, p. 12.

emissions trading system proposed in the ETR Consultation Paper could raise the cap significantly for the heavy emitters targeted by the cap and trade system. The maximum amount of emissions allowed under the ETR as proposed would be:

Max Emissions =	Annual Budget (based on 2012 Estimated Emissions)	+	Allowed Offsets (Up to 49% of Total Emissions Reductions under WCI)	+	Early Reduction Allocations (based on reductions from 2008-2011)

Although details remain to be worked out, it is clear that the "cap" under the proposed system could actually be significantly higher than 2012 levels. We understand that the province has equated the 49% of total emissions reductions amounts to roughly 5% of an industry's compliance. Combined with the ERAs granted, there is the potential that the ETR will actually allow for significant increases in emissions in the short term. .

Even if this initial rise in emissions does not occur – presumably not due to the "cap" per se but to the associated carbon of carbon – what is the potential impact of the resulting excess in the required compliance credits on the price of carbon? This issue should have been discussed in the ETR Consultation Paper and economic modeling should have been done and reviewed. We are concerned that the resulting drop in the price of carbon could take the price down below the price currently being paid through the carbon tax.

These problems may be further exacerbated by the generous rules for banking compliance units and using them in subsequent years. This means that any overallocations from early years in the program may significantly delay the real reductions that the ETR is supposed to accomplish.

Europe's carbon market, at one time viewed as a success story, has more recently struggled with a collapse in carbon price brought on by an over-availability of carbon credits. This problem should be addressed in a BC model, and it is disturbing that the ETR Consultation Paper does not discuss this issue at all.

We are disturbed that the ETR Consultation Paper appears not to even recognize this as a possible issue, or to discuss the economic modeling or other factors which should inform a decision about the appropriate level of offsets that should be allowed under the ETR Consultation Paper. We suspect that allowing the use of offsets to achieve more than 10-20% of required compliance units will begin to undermine the price signals, but call on the government to conduct the modeling required to confirm this.

To this end, we would recommend that:

- The Annual Budget should be set below 2012 emissions levels on the assumption that some emitters will achieve compliance through offsets, rather than through compliance credits.
- Compliance units should be auctioned, with few or no free allocations, with a reserve price based on the carbon tax.
- A percentage of compliance credits should initially be held back to monitor the price, and only be released if required.
- Allowed offsets should be much more limited than the 49% maximum contemplated by the WCI – probably representing no more than 10-20% of the reductions.
- Compliance units and offsets should not a definite and finite life-span.
- Compliance units should have a minimum price tied to the price set by the carbon tax.
- The government should obtain economic advice on the impact of oversupply on the price under the ETR system and how to avoid a collapse in carbon price.

1.5 A feebate approach

Much of the ETR Consultation Paper is concerned with how to fairly allocate free compliance units. As discussed above, this is based upon the perception that it is necessary to "compensate industries that compete for business in a global market place and where their competitors do not face the same carbon compliance costs."

It is fairly clear from the Consultation Paper that there is no fair way. Each approach favours some operators over others, and involves giving away valuable public assets (the atmosphere) for free. Free allocations make the system less market based and there is a significant likelihood that they will compromise its effectiveness. Further market manipulations are then required to ensure that new players – presumably including the innovative new companies that we hope carbon pricing will give rise to – are not shut out by having to complete against companies which received their allocations for free (and therefore are partially insulated against the carbon price).

The solution, we believe, is to auction all or substantially all of the compliance units, but to use some or all of the funds raised through the auction to address industrial competiveness through a rebate. This model is similar to the feebate systems which have been developed to great effect in Europe and elsewhere, and other proposals for frameworks to addresss greenhouse gases have proposed using fee repayments in this way to help regulated industries remain competitive with unregulated competitors.[4]

Under a feebate system, fees are collected on the basis of pollution levels, but then rebated to the industry on the basis of some other criteria – often the output levels. This means that high emitters pay a lot, but receive proportionally less back through the rebate. Conversely, low emitters pay little, but may actually receive more back than they paid.

Under this model (adapted for an emissions trading system), consider an industry with three main players, which collectively pay $1 million in auctions for compliance units (for emissions of 25,000 tonnes collectively), of which $750,000 will be paid in rebates.[5]

Business A	Business B	Business C	Total
Emits 10,000 tonnes GHG emissions requiring compliance units	Emits 2,500 tonnes GHG emissions requiring compliance units	Emits 12,500 tonnes GHG emissions requiring compliance units	25,000 tonnes GHG emissions requiring compliance units
Pays $400,000 in auctions for Compliance Units	Pays $100,000 in auctions for Compliance Units	Pays $500,000 in auctions for Compliance Units	$1 million paid for compliance units (at $40/tonne)
Production of Business A is 100,000 tonnes	Production of Business B is 50,000 tonnes	Production of Business C is 150,000 tonnes	Total production is 300,000 tonnes
Receives $250,000 in rebate	Receives $125,000 in rebate	Receives $375,000 in rebate	Rebate of $750,000 or 2.5 $/tonne
Cost of compliance is $150,000 or $1.5/tonne	Receives $25,000 due to efficiency	Cost of compliance is $125,000 or $.83/tonne	Industry cost of compliance is $250,000 or $.83/tonne

This example illustrates how offering a rebate of some of the fees mitigates the costs of compliance for the industry as a whole, while creating an additional incentive for each company to improve its emissions

[4] For example, while not referred to as a "feebate", a version was included in the approach modeled the Pembina Institute and the David Suzuki Foundation in Climate Leadership, Economic Prosperity, available at http://pubs.pembina.org/reports/climate-leadership-report-en.pdf, last accessed December 2, 2010.

[5] We are not necessarily advocating the rebate of ¾ of fees charged to respective industries. This example is intended merely to illustrate that a very high level of protection for an industry can be achieved while still retaining significant price incentives to reduce GHG emissions.

intensity. Such a system favours those players in an industry that have reduced their emissions intensity, and gives them a competitive advantage over those who have less efficient processes.

Such an approach would keep many of the benefits of auctioning emissions, including transparency and an ability for new entrants to obtain compliance units. However, it protects the international competitiveness of the industry as a whole, without undermining (and in fact, while enhancing) the financial incentives for each industry to improve its emissions profile.

There is some complexity introduced by the introduction of offsets into the system, but this complexity could be addressed in the design of the system.

2.0 Cap and Trade Offsets Regulation

The CTOR Consultation Paper, like the ETR Consultation Paper, is relatively comprehensive in terms of scope. We agree that offsets from projects in BC should be carefully and closely regulated by the BC government. The recommendations below are aimed at ensuring that offsets result in real reductions, do not cause environmental harm or have negative impacts with respect to Aboriginal Title and Rights, and do not undermine the carbon pricing mechanism created by the ETR.

Specifically we will comment on:

- The purpose of the regulation;
- The definition offsets under the regulation;
- The concept of additionality;
- Permanence;
- Additional eligibility criteria; and
- Consequences of non-compliance.

Further, to help ensure that the cap and trade system sends a strong carbon price signal and creates certainty about the level of reductions that are required from large emitters in BC, we recommend a limit on the percentage of offsets used to meet the cap in the range of 10-20%, as noted above in our comments on the ETR Consultation Paper.

2.1 Purpose and application of the proposed regulation

The purpose section set out in the CTOR Consultation Paper does not address what should be one of the fundamental purposes of the regulation: ensuring that any greenhouse gas reductions or removals recognized as offsets have a real, additional and lasting climate benefit.

2.2 Definition of an offset under the proposed regulation

We agree that clear ownership by the project developer is an essential requirement for offsets. However, the Consultation Paper suggests that project developers will resolve entitlement issues through contractual arrangements setting out the rights and responsibilities of all parties involved in the project. However, the Consultation Paper suggests that project developers will resolve entitlement issues through contractual arrangements setting out the rights and responsibilities of all parties involved in the project, which will be problematic in some cases. With respect to offset projects based on greenhouse gas removals and storage in biological sinks, for example, contractual arrangements may be inadequate to resolve entitlement issues, particularly on Crown lands where Aboriginal Title and Rights are at issue and/or where the existing tenure system is silent with respect to rights of carbon ownership. Relying on contractual arrangements without an adequate legal framework for carbon ownership in these cases will

not resolve underlying uncertainties about ownership, and will not ensure that Aboriginal Title and Rights are honourably addressed.

With regards to recognizing offsets not issued by the program authority, we would propose adding a qualifier that any offsets not issued by the program authority must meet or exceed the requirements set by the offset regulations and protocols in force in British Columbia at that time, and publicly transparent procedures must be in place to ensure that this is the case.

2.3 Additionality

Additionality is fundamental to ensuring the climate benefit of any offsets. The additionality of any offsets used in the cap and trade system should be clearly and conservatively established. In the case of establishing additionality on a project basis, it should be demonstrated by the project developer that the offset project is proceeding because of the incentives associated with the offset market, and would not otherwise go ahead.

To the extent that performance standards are used to establish additionality, these standards should be based on comprehensive data collection and verification, and updated at regular intervals. The process of establishing performance standards should be publicly transparent, and make it clear how the impact of "free riders" (i.e. non-additional reductions that would have occurred any way through activities that already meet the performance standard) is being addressed—potentially by discounting the total number of offsets available from any project by a percentage related to the expected percentage of free riders.

2.4 Permanence

The CTOR Consultation Paper would have the BC government responsible for the reversal of offset credits that are "not the result of proponent intention or negligence."

Control of the offset lies most directly with the project proponent, and the responsibility for any escape of greenhouse gases should be strict, rather than based on negligence, with very limited circumstances, if any, under which the proponent would be excused from responsibility.

To hold otherwise removes any incentive for project proponents to act any more conservatively than a basic due diligence standard would suggest. In addition, it raises the possibility of unjust enrichment, with the proponent retaining revenue from offsets which the province was forced to replace at its expense. To take this approach is not in any way unfair to the proponent, who can manage those risks through prudent behaviour[6] and through private (rather than taxpayer-based) insurance schemes.

Further, with respect to permanence it is also critical to resolve the legal issues related to carbon ownership discussed above in section 3.1, to ensure that there is an "owner" that can be responsible for ensuring the permanence of offsets.

2.5 Additional eligibility criteria

West Coast Environmental Law disagrees with the assertion in the CTOR Consultation Paper that environmental and socio-economic assessments of proposed offset projects should be optional. Offsets will be providing a government-sanctioned financial incentive for project developers, and should not be rewarding, for example, environmentally harmful practices that may not be covered by other regulations, whether because of the scale of the project or the failure of BC's laws to adequately address the cumulative environmental impacts of activities or have in place legally enforceable measures to ensure the resilience and adaptive capacity of BC's ecosystems in light of climate change. Offset protocols approved for use under the CTOR should have requirements for environmental and socio-economic assessments specific to

[6] Consistent with the principle of conservativeness.

the project type. This is likely to be the most efficient and transparent way to ensure that offset projects do not create negative environmental and socio-economic impacts.

2.6 Compliance

The CTOR Consultation Paper can be read as suggesting that there will be limited consequences for the escape of GHG emissions from an offset, even where the escape is due to "project developer intention or negligence":

If an emission reduction is reversed due to project developer intention or negligence after offsets are issued, the project developer should provide compliance units in an amount equal to the reversed reductions. The number of compliance units required to be replaced would, at a minimum, be the difference between the total offsets issued for the project and the remaining atmospheric benefit from the sequestration project after the reversal.[7] The COTR should not endorse the idea that a project developer can simply change its intention in respect of offset lands without significant and real penalty, including but not limited to a requirement to replace several times the compliance units. To hold otherwise encourages the reversal of offsets if the price of compliance units becomes sufficiently low.

3.0 Conclusion

Again, we do appreciate the clear thought and work that has gone into the ETR and COTR Consultation Papers. That being said, unless the serious and glaring problems found in both Consultation Papers are addressed, we have grave concerns that the regulations will not achieve the reductions in GHG emissions that BC requires to meet its targets. Unless the system is structured so that it creates real reductions, and a significant carbon price, the proposed trading system may actually be a step backwards from the carbon tax.

BC has provided leadership on the climate file – and we hope that the final regulations will do so again.

Sincerely,

West Coast Environmental Law

Andrew Gage (and Deborah Carlson)

[7] P. 12