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Supreme Court of Canada Rules on Carbon Pricing, Paving Way for Offset Credit Regulations

The Supreme Court of Canada (SCC) has released its highly anticipated decision on the constitutional validity of the federal framework for carbon pricing under the *Greenhouse Gas Pollution Pricing Act* (GGPPA), which became law in 2018. In a split decision on March 25, 2021, the majority of the SCC found the GGPPA to be valid federal legislation (authorized under the national concern branch of the federal Peace, Order and Good Government (POGG) power) and upheld the fuel charge imposed under the GGPPA as a regulatory charge rather than a disguised tax.

With somewhat less fanfare, on March 6, 2021, the federal government published draft regulations that will implement the federal offset credit system contemplated under the GGPPA's Output-Based Pricing System (OBPS). Draft regulations were also published in Québec on March 3, 2021, primarily to simplify the existing offset credits of the Québec carbon market.

Summaries of these developments are set out below.

The Federal Carbon Backstop: SCC Finds a New Matter of National Concern

Under the GGPPA, any provinces and territories failing to implement sufficiently stringent carbon pricing mechanisms are subject to the "backstop" of the federal carbon pricing regime, consisting of

- a regulatory charge on fuel (the Carbon Levy);¹ and
- the OBPS, which applies to facilities undertaking prescribed activities, with greenhouse gas (GHG) emissions exceeding a regulatory threshold (Covered Facilities), although voluntary participation is open to facilities with emissions of at least 10,000 tonnes per year.²

In keeping with the established approach to determining whether legislation falls within the national concern branch of the POGG power, the SCC majority first identified the true subject matter, or "pith and substance," of the GGPPA to be "establishing minimum national standards of GHG price stringency to reduce GHG emissions."³

The SCC majority then applied a three-part test to determine whether this is a matter of national concern. First, the SCC majority was satisfied that this is a matter of concern to Canada as a whole, finding the reduction of GHG emissions through minimum national standards of GHG price stringency to be a critical response to the existential threat of climate change.

The SCC majority found that the GGPPA was distinct from matters of provincial concern, noting that GHG emissions are primarily extraprovincial and international in character and implication, and that provinces and territories are constitutionally incapable of establishing a binding national GHG "pricing floor." Failure of any province or territory to act, or refuse to cooperate, would have grave consequences for the remaining provinces and territories. The SCC majority further held that recognizing the subject of the GGPPA as a national concern would have minimal impact on provincial jurisdiction.

The validity of the Carbon Levy was also upheld, on the grounds that it serves to influence behaviour by providing incentives, a long-recognized regulatory purpose. Although the debate whether the GGPPA is valid federal legislation is now behind us, we expect future challenges regarding the application, or lack thereof, of the federal backstop. There has been significant variation in the stringency of the provincial/territorial regimes that have been approved by the federal government as alternatives to the GGPPA. This inconsistent approach may well be the subject of future applications for judicial review.

Proposed Federal Offset Regulations

With the constitutional validity of the GGPPA confirmed, attention will now shift to a key component of the OBPS set out in the recently proposed draft *Greenhouse Gas Offset Credit System Regulations (Canada)* (the Offset Regs), open for public consultation until May 5, 2021.

Under the OBPS, if a Covered Facility's emissions exceed the applicable output-based standard, an excess emissions charge is applicable, which can be satisfied by (i) making an emission charge payment; or (ii) remitting compliance units, which notably include federal offset credits. Offset credits create incentives for voluntary GHG reduction activities, by creating opportunities for revenue.

The Offset Regs propose the regulatory framework under which Environment and Climate Change Canada (ECCC) could issue federal offset credits to projects that meet eligibility criteria and are implemented in accordance with federal offset protocols. The following are of note:

- Project proponents, who must be resident in Canada, will be required to demonstrate exclusive entitlement to or ownership of the project's GHG emissions reductions.
- Projects will need to be in a single province or territory, registered with ECCC and subject to the ECCC tracking system.
- GHG reductions from offset projects must be voluntary – that is, not required by law. Project activities must also not be subject to any other carbon pricing system; nor may project emission reductions be used to receive credits under another carbon pricing system.
- Activities called for in an offset project must be “additional” to the baseline, business-as-usual, scenario for the project activity.
- Offset project proponents will be required to deposit a percentage of issued credits into the integrity account, which will comprise a pool of credits acting as a form of insurance for the environmental integrity of the federal offset system.

Federal offset credits will be issued only for activities for which the government has released an approved offset protocol. Such protocols will detail specific quantification requirements, an assessment of the risk of carbon leakage, as well as the expectations that must be adhered to when planning and implementing a given type of offset project. Federal offset protocols will apply in all provinces and territories other than those in which a similar protocol already exists. Four priority offset protocols are to be developed in early 2021 – namely,

- Advanced Refrigeration Systems;
- Improved Forest Management;
- Landfill Methane Management; and
- Enhanced Soil Organic Carbon.

Although the establishment of offset protocols is no guarantee that corresponding offset projects will be developed and implemented,⁴ we are hopeful that the federal protocols will be well-designed, so as to provide project proponents with effective incentives to develop a robust offset market.

Québec's Offset Regulatory Amendments

On March 3, 2021, three proposed regulations (collectively, Draft Regulations) primarily concerning offset credits were published in the *Gazette officielle du Québec* – namely,

- the draft *Regulation to amend the Regulation respecting a cap-and-trade system for greenhouse gas emission allowances*,
- the draft *Regulation respecting landfill methane reclamation and destruction projects eligible for the issuance of offset credits*; and,
- the draft *Regulation respecting halocarbon destruction projects eligible for the issuance of offset credits*

The Draft Regulations are currently undergoing public consultation until April 17, 2021.

The Québec cap-and-trade system has, nearly since its establishment almost 10 years ago, allowed offset projects to generate offset credits to the extent that such projects comply with the requirements set out in the *Regulation respecting a cap-and-trade system for greenhouse gas emission allowances* (Regulation). Currently, the Regulation is the sole instrument regulating offset credits, containing five protocols for eligible projects involving (i) the destruction of methane captured at covered manure storage facilities; (ii) the treatment or destruction of methane captured at landfill sites (Landfill Offset Projects); (iii) the destruction of ozone-depleting substances contained in insulating foam or used as refrigerants removed from refrigeration, freezer and air-conditioning appliances (Halocarbon Offset Projects); and (iv) the destruction of methane captured from targeted systems at active coal mines.

The Draft Regulations with respect to Landfill Offset Projects and to Halocarbon Offset Projects would become the responsibility of the Minister of the Environment and the Fight against Climate Change (Minister), allowing for a more simplified process of regulatory amendments. Offset projects relating to manure facilities and coal mines would remain governed by the Regulation until such protocols are replaced by ministerial regulations. Requirements relating to the issuance, replacement and cancellation of offset credits remain in the Regulation.

The Draft Regulations relating to the Landfill Offset Projects and to the Halocarbon Offset Projects impose some modifications to current rules and, once adopted, will establish the main conditions governing such offset projects, including eligibility, quantification, monitoring, project reporting, auditing and notification to the Minister. These two Draft Regulations also provide for transitional provisions for some projects that have already begun and for projects currently registered under the Regulation.

Conclusion

Carbon pricing in Canada has been subject to significant debate over the last few years, with the SCC now having the last word on the federal government's constitutional power to impose minimum carbon pricing standards on the provinces. This chapter in the regulation of GHGs has significantly reduced current uncertainty. However, the path ahead for carbon pricing and offset credits remains far from clear.

¹ The Carbon Levy is currently in effect in Ontario, Manitoba, Saskatchewan, Alberta, Nunavut and Yukon.

² The OBPS is currently in effect in Ontario, New Brunswick, Manitoba, Prince Edward Island, Saskatchewan, Yukon and Nunavut, although the federal government has confirmed its intention to discontinue the application of the OBPS in Ontario and New Brunswick.

³ A stark contrast to the broad characterization provided by the Alberta Court of Appeal, which characterized the purpose of the GGPPA to be the regulation of GHG emissions, and subsequently found both the Carbon Levy and the OBPS to be unconstitutional.

⁴ For example, relatively few offset projects have been developed under Québec's offset protocols.

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