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Carbon Security or Carbon Whimsy?

By: Nigel Bankes

Document commented on: [Alberta's Proposed Technology Innovation and Emissions Reduction System: Discussion Document, July 2019](#)

This Discussion Document contains the Government of Alberta's proposal to replace the current Carbon Competitiveness Incentive Regulation, [Alta Reg 255/2017](#), (CCIR) with a Technology Innovation and Emissions Reduction (TIER) system for Alberta's large final emitters (LFEs). If promulgated, the TIER system will effectively return us to the model of the Specified Gas Emitters Regulation, [Alta Reg 139/2007](#) (SGER) first introduced by the Stelmach government in 2007, and then repealed and replaced by the Notley government's CCIR effective January 1, 2018. Both the SGER and the CCIR are greenhouse gas (GHG) mitigation measures; both are emissions intensity schemes rather than cap and trade schemes; both require increased carbon efficiency over time (i.e. reduced carbon emissions per unit of output); both schemes offer covered entities access to flexibility mechanisms (including payments into a fund) to allow them to meet their targets in the most efficient manner; both impose a liability only on excess emissions over the target rather than on all emissions but still provide a pricing signal; both are designed to protect trade exposed sectors; and both focus on LFEs.

The principal difference between the old SGER and the current CCIR is that under the SGER the baseline against which the emissions intensity target was established was determined on a facility-by-facility basis. Under the CCIR the target is based on best-in-class performers (typically the top quartile) in the sector. The scheme is also known as an output-based allocation (OBA) model. The principal advantage of the CCIR approach from a GHG mitigation perspective is that it creates an incentive to commission new facilities that make the top quartile. Under the SGER approach there is no such incentive since an emitter's baseline is established against its own performance in its first few years of operations. The new emitter may be the most carbon intensive emitter in its class, but so long as it improves its emissions intensity over time in accordance with the ratchet factor established by the regulations, it will escape any emissions liability and indeed may earn emission performance credits that it can sell to others. The TIER system will return us to the SGER model and this perverse incentive unless modifications are introduced to address this issue.

There are three parts to this post. The first part summarizes the discussion of the TIER System in the United Conservative Party's (UCP) [election platform](#). The second part summarizes the discussion document, and the third part offers some comments.

The TIER System as Described in the UCP Election Platform

Recall that the Notley government adopted two main measures to give effect to an economy wide price on carbon. One measure was the Climate Leadership Regulation, [Alta Reg 175/2016](#) (CLR) adopted under the terms of the *Climate Leadership Act*, [SA 2016, c C-16.9](#). This established a price on carbon for end users including gas at the pump and at the burner tip. Until the repeal of the authorizing statute “immediately at the beginning of the day on May 30, 2019” by [Bill 1, An Act to Repeal the Carbon Tax](#), the CLR implemented an effective price of carbon on multiple products at the rate of \$30/tonne at the time of its repeal. As a result of the repeal the current price on carbon outside the CCIR (and products created by covered emitters) is zero. It will remain at zero until the federal government applies its ‘backstop’ legislation: *Greenhouse Gas Pollution Pricing Act*, [SC 2018, c 12, s 186](#) (GGPPA). This is scheduled to happen effective [January 1, 2020](#). The federal carbon price is currently \$20 rising to \$30 on April 1, 2020. The second measure of the Notley government (as discussed above) was the CCIR which established a price on carbon for LFEs (also currently resting at \$30/tonne).

The UCP was elected on a platform that addressed both aspects of the Notley carbon pricing scheme. As is well known, the platform addressed the first element by the simple expedient of repeal:

Bill 1: The Carbon Tax Repeal Act will scrap the NDP’s \$1.4 billion tax on everything....

The platform also promised that the new government, if elected, would:

Challenge the constitutionality of the Trudeau carbon tax by filing a judicial reference to the Court of Appeal, while continuing to support similar challenges by the governments of Saskatchewan and Ontario.

The Kenney government has delivered on both of these commitments, although in the case of the latter, challenges lie ahead insofar as a majority of judges from both the Saskatchewan and Ontario Courts of Appeal have since rendered decisions upholding the federal government’s GHG pricing regime: *Reference re Greenhouse Gas Pollution Pricing Act*, [2019 SKCA 40 \(CanLII\)](#), and *Reference re Greenhouse Gas Pollution Pricing Act*, [2019 ONCA 544 \(CanLII\)](#).

The UCP platform was somewhat more nuanced with respect to the CCIRs. The platform introduced its discussion of the CCIRs and the proposed TIER Fund by acknowledging that:

The world is grappling with the tension between our need for the carbon-based energy industry and a consensus that its emissions are directly contributing to climate change. The United Conservatives are committed to responsible energy development and that includes action to mitigate greenhouse emissions and reduce their contribution to climate change.

We need a sensible approach to reducing greenhouse gas emissions. (at 34)

What then was the case for change to the CCIR element of the Notley Climate Leadership Plan? Was it not a “sensible approach to reducing greenhouse gas emissions” that addressed such issues as the competitiveness concerns of trade exposed industries while addressing the moral hazard issues associated with a facility-specific baseline model? The UCP platform asserted that the CCIR “had become just another ‘cash cow’ for government” and had “introduced significant uncertainty into the marketplace, which has hurt Alberta’s economy.”

Having identified ‘the problems’ with the CCIR, the platform indicated that:

The United Conservatives believe that restoring an updated version of [the SGER model] will produce better environmental and fiscal results than the CCIR introduced by the NDP. We can reassure investors while generating real emissions reductions by implementing an improved system for larger emitters. (at 34)

The platform then went on to describe the main elements of the TIER proposal:

- Coverage would remain unchanged at 100,000 tonnes CO₂e per year except that electricity generating facilities which would be subject to as good as best gas performance standard.
- The intensity target would require reduced emissions intensity by facility by 10% at the rate of 1% per year based on average emissions between 2016 and 2018.
- Flexibility in achieving targets would still be available: emissions performance credits, offsets and payments into the fund.
- There would be a reduced carbon (fund) price of \$20/tonne (with no stated schedule for increases)
- Establish the TIER Fund.
- The first \$100 million per year and 50% of all incremental revenues to be used for “new and cleaner Alberta-based technologies that reduce carbon emissions even further ...”.
- The balance of the funds to be used to reduce the deficit as well as a specific allocation of \$20 million per year to the “energy ‘war room’ that will share the truth about Alberta’s resource sector.”
- Effective January 1, 2020. (at 34-35)

The platform did not set an overall target for GHG emission reductions in Alberta either absolutely or as against a business as usual scenario. Nor did it discuss the implications for emission reductions of reducing the carbon price signal from \$30/tonne to \$20/tonne.

The Discussion Document

In introducing the document, *Jason Nixon, Minister of Environment and Parks pronounced that:*

TIER is a realistic and effective approach to addressing climate change that will reduce emissions and reassure investors. Hearing stakeholder perspectives as we design TIER will make sure the program meets the needs of Alberta’s environment and economy. This system is the centrepiece of our government’s new provincial climate strategy, to be released this fall, which will focus on innovative and practical solutions instead of

punishing Albertans with a punitive tax on heating their homes and driving their kids to soccer. ([Government of Alberta Press Release, July 9, 2019](#))

The document has 12 sections. Section 1 provides an overview and context. It largely follows the main elements of the TIER system as described in the UCP platform above. It describes the TIER system (at 1) as “a realistic plan for reducing emissions without overregulating and slowing the economy.” It also foreshadows a concern that the Government will examine ways to protect those emitting less than covered facilities (100,000 tonnes CO₂e) from the federal fuel charge.

Section 2 describes the purposes of the document. Section 3 outlines the principles of the TIER system: increased competitiveness; encourage innovation; and continuous improvement. Section 4 outlines the principles of engagement: transparent; solutions-focused; and meaningful. Section 5 describes the engagement approach. The engagement identifies four classes of persons: (1) senior industry representatives; (2) industry stakeholders (further described as covered facilities and industry associations), (3) individual Albertans, and (4) “other interested parties”. The emphasis on industry seems to privilege both engagement with industry and the input of industry – I return to this point below. Section 6 lists some 10 matters that are out of scope for the TIER engagement process. The exclusion list does *not* include the question of why the province is abandoning the CCIR and reverting to a facility-based baseline approach. This might suggest an opening to continue to make the case for the CCIR but that seems unlikely given the overall tenor of the document.

Sections 7 (Regulatory Coverage), 8 (Benchmarking) and 9 (Emissions Scope) form the heart of the document. These sections are usefully presented insofar as they offer a comparison on important variables as between the proposed TIER scheme and the CCIR scheme.

Perhaps the key issue in Section 7, Regulatory Coverage, is the proposed opt-in scheme. Under the CCIR rules, an LFE emitting less than 100,000 tonnes CO₂e may elect to opt-in to the CCIR if it meets one of two conditions: (1) it competes directly against a covered facility, or (2) it emits more than 50,000 tonnes CO₂e and belongs to a high emissions-intensive, trade-exposed (EITE) sector. The TIER system proposes to expand the opt-in possibilities. The first will remain the same, but the threshold for opting in under the second option will be reduced to 10,000 tonnes CO₂e. The principal reason for wanting to opt-in is to gain an exemption from paying the levy on any fuel inputs into the opted-in facility.

Section 8, Benchmarking, outlines how facility specific baselines will be determined. Perhaps the most significant point is section 8.3, which addresses the best-in-class issue. Here the document recognizes that the CCIR scheme incents best-in-class facilities and that a facility specific system will not do so. In response, the discussion paper indicates that: “The Government of Alberta is considering methods to reward best-in-class facilities under the TIER system. This could include retaining product benchmarks as an option to allow best-in-class facilities to earn emissions performance credits.” It is entirely unclear what might be the scope of this further consideration. Is the government considering abandoning the facility-by-facility approach entirely? As noted above, that seems unlikely. Or is it considering running the two schemes in parallel and permitting LFEs to opt for the scheme that is most favourable to it? If the latter, the

moral hazard problems associated with SGER scheme remain. Section 8.4 may address this issue when it indicates that:

... the Government of Alberta is seeking input on how new facilities can be incentivized to invest in the best available technology under the TIER system. This could include product benchmarks, which would provide an emissions intensity target for new facilities. If facilities outperform those benchmarks, they could earn emissions performance credits immediately. The Government of Alberta is also seeking input on treatment of facilities that have undergone significant expansion or change.

One wonders how these different paths will fit together. Multiple paths signal regulatory complexity – not regulatory simplicity and efficiency.

Section 9 on Emissions Scope deals with a number of technical matters, including indirect emissions, industrial process emission, biomass emissions, formation CO₂ emissions and fugitive emissions.

Section 10 (Conventional Oil and Gas Facilities Below Emissions Threshold) expands on the comment made in Section 1 (overview and context) and invites discussion as to how to allow small conventional oil and gas facilities additional opt-in possibilities so as to avoid the application of the federal fuel charge. There is a long list of items here that would need to be addressed and therefore, much as with the “multiple paths” discussed above in relation to section 8, this smells of regulatory complexity – not regulatory simplicity and efficiency.

Section 11 deals with Revenue Recycling and seeks input as to how “to most effectively” use that portion of the TIER system fund revenues that will be dedicated to clean technology, efficiency and innovation, etc.

Section 12 deals with reporting and compliance. There is little change here as between the current CCIR and the proposed TIER scheme but two matters deserve attention. First, under the current CCIR scheme there are limits on the extent to which a facility can avail itself of offsets and emissions performance credits (see CCIR, section 19). The Discussion Paper takes no position on this but seeks feedback. The second matter is s 13.2.3, ‘Tier Fund Price’ – almost buried at the end of the document. Here, and with little fanfare, the Discussion Paper fails to repeat the promise of the UCP Platform (a reduced fund price of \$20/tonne) and instead simply indicates that “The Government of Alberta is seeking input on TIER Fund price.”

Section 13 addresses “Compliance Cost Containment” which is principally concerned with the exceptional relief that may be available to EITE facilities. The document seeks discussion on the current provisions in the CCIR and the need for a special relief mechanism going forward.

Commentary

I address five questions by way of comment: (1) where is the government’s overall carbon policy? (2) has the government made the case for change to the LFE system? (3) will the proposed scheme result in more or less complexity? (4) will the proposed scheme result in an

increase or a decrease in the application of federal carbon pricing rules in Alberta? and (5) is this a discussion document for industry or for all Albertans?

Where is the Government's Overall Carbon Policy?

I teach a course in energy law. I include some introductory materials on energy policy. I tell my students that a carbon policy (or a climate policy) is an energy policy and vice versa. I ask students to compare the European Union (EU) climate/energy policy documents with the climate/energy policy documents generated by successive provincial (Alberta) governments and successive federal governments. The EU's policy documents tend to be principled and detailed. They establish clear targets and a proposed range of measures to meet those targets. For a good example, see the EU's [An Energy Policy for Europe](#) (2007) and for more current documents, see [here](#). The policy articulation comes *before* legislative proposals. The EU's documents are long on text and bereft of photographs. By contrast, federal and provincial climate policy documents tend to be short on detail and short on targets (not even the Notley government had a set of overall emission reductions targets). But at least, and I think without exception, the policy formulation and articulation preceded legislative action. But here we seem to have the exact opposite – legislative action (Bill 1 and proposed new LFE regulations) with just a promise that we can expect a new provincial climate strategy in the fall with the new TIER Fund scheme as its “centerpiece”. This is indeed a world turned upside down.

Has the Government Made the Case for Change?

Industry needs certainty. It needs royalty certainty and it needs carbon price certainty. It wants to know what the schedule for increasing the price of carbon looks like into the future.

We can't and we shouldn't always give industry the level of certainty that it would like to see (because governments have broader public interest considerations to take care of) but we can at least try to send some consistent messages. One such message is that the price is only going one-way – and that way is up. In other words there will no back-sliding and there will be an increased level of ambition over time consistent with Canada's obligation under Article 4(3) of the [Paris Agreement](#) (and see the Preamble to the *GGPPA*). A second message might be a commitment not to mess with a functioning pricing scheme for LFEs like the CCIR absent proof that it is broken.

The TIER proposal is ambivalent on the first message and ignores the second. On the pricing issue, the UCP election platform actually proposed a reduction in the carbon price (from \$30/tonne to \$20/tonne). The discussion paper, as noted above, invites discussion on this point. As for the second, the UCP platform did not offer any convincing arguments that the CCIR was broken and the discussion paper does not address the issue. As for the arguments in the UCP platform (reproduced above) all that we have is the assertion that the CCIR is a “cash cow” for government, that the CCIR system introduced significant uncertainty into the marketplace, and that a return to the SGER model will reassure investors and produce better environmental and fiscal results. Neither the platform document nor the discussion paper provides evidence to support of any of these claims, or, perhaps more pertinently, that the TIER scheme will do a better job of driving down emissions intensity within the LFE group than would the CCIR.

In other words, the TIER proposal looks like change for the sake of change, or change to deliver on a poorly thought-out campaign commitment. It is whimsical. And if it is inappropriate to change royalty rates on a whim (see [my post on the royalty certainty Bill, Bill 12](#)) it is equally inappropriate to mess about with an LFE carbon pricing scheme on a whim.

Will the Proposed Scheme Result in More or Less Complexity?

At a conceptual level carbon pricing is simple and elegant. The translation of the concept, whether through a tax or levy, or through a cap and trade system, or an emission intensity scheme, is inevitably more complex. The CCIR is not an easy read; neither was the SGER before it. In carrying through a carbon pricing policy we should be looking for simplicity rather than complexity and we should try to avoid creating perverse incentives and then seeking to correct for those perversities. I think that there are at least three elements of the TIER scheme that push us in the direction of unnecessary complexity: (1) a return to facility-specific baselines rather than best-in-class baselines; (2) a suggestion that we might have elements of both types of baseline; and (3) the suggestion that we might bring coverage down (on an opt-in-basis) to as low as 10,000 tonnes CO_{2e}. As for the latter, there will always be a debate about coverage typically informed by the relative efficiency of an LFE system versus a more broadly based tax. It is apparent however that in this case, the debate over coverage is being informed not by the relative efficiency of the two schemes but principally by the goal of backing out the federal backstop measures.

Will the Proposed Scheme Result in an Increase or a Decrease in the Application of Federal Carbon Pricing Rules in Alberta?

The federal greenhouse gas pricing system is a twin-track scheme much like the Alberta scheme before the current UCP government began to dismantle it. In other words, the federal scheme has an LFE component (Part 2 of the *GGPPA*, Industrial GHG emissions, an output-based allocation scheme) and a broad-based carbon levy (Part 1 of the *GGPPA*, Fuel Charge). The federal LFE scheme, much like the current CCIR, adopts a best-in-class approach to establishing baselines rather than a facility-by-facility approach (see the recently released [Output-Based Pricing System Regulations, SOR/2019-266](#) and accompanying Regulatory Impact Assessment Statement (RIAS) indicating that in most cases the output based standard is set at 80% of the national production-weighted average emissions intensity for that activity).

The federal Output-Based Pricing System (OBPS) automatically applies to large emitters (50,000 tonnes CO_{2e}/year) in covered sectors in listed jurisdictions. Other facilities may opt-in to the OBPS system in accordance with the [Policy regarding voluntary participation in the OBPS](#) adopted in 2018 and section 172 of the *GGPPA*.

The federal [backgrounder](#) that announced the application of the carbon levy to Alberta stated as follows:

By repealing its carbon levy, Alberta now only partially meets the federal benchmark requirements and will join the provinces of Ontario, New Brunswick, Manitoba and Saskatchewan in being covered by the federal fuel charge.

....

The federal government will monitor any proposed changes to Alberta's large industrial emitter system, and will undertake another benchmark assessment once sufficient details about the new system for large emitters are available. The Government is also open to working with the Government of Alberta to determine the most appropriate treatment of small oil and gas facilities under the carbon-pricing regime. (emphasis added)

Evidently, the federal government is reserving its position on the question of whether or not the TIER system will, in its opinion, meet federal benchmark stringency standards. If it does not, then Alberta emitters will *want* to have Alberta listed in Part 2 of Schedule 1 of the *GGPPA* – otherwise they will not qualify to register under Part 2 of the *GGPPA* and will not be eligible to receive an exemption certificate to purchase fuel not subject to the fuel charge. Factors that will no doubt affect the federal government's assessment of the relative stringency of the TIER scheme include the choice between the best-in-class approach to benchmarking versus facility-specific benchmarking – and of course the fund price.

Is This a Discussion Document for Industry or for All Albertans?

In summarizing the Discussion Document above, I noted that the document privileges both *engagement with* industry and the *input of* industry. It is useful to quote the section on the government's "engagement approach" in its entirety:

5. Engagement Approach

The stakeholder engagement process will take place in the following stages:

- Minister-led roundtable discussions with senior industry representatives.
- A webinar where industry stakeholders will be presented with a high-level outline of the proposed TIER system and key policy considerations for which feedback is sought. Invitees will include regulated facilities, industry associations, and emission offset project developers. Stakeholders will have an opportunity to ask questions and engage in discussion.
- In-person workshop sessions with industry stakeholders in Calgary and Edmonton. Invitees will include regulated facilities and industry associations. Stakeholders will have an opportunity to ask questions and engage in discussion.

Stakeholders, individual Albertans and other interested parties also have the opportunity to provide line-by-line comments on the proposed decisions in this discussion document using the TIER Stakeholder Feedback Form. **Feedback must be submitted by Aug. 2, 2019.**

The engagement process will gather the input required to inform the development of the TIER system, including understanding the implications of various policy options on emissions reductions and industry competitiveness. The engagement process will ensure that stakeholders have the opportunity to provide input that is heard and considered by government. (emphasis added, bolding in the original).

I will refrain from a detailed textual analysis, but note how often the word ‘industry’ occurs either in conjunction with ‘stakeholder’ or ‘association’; note as well the complete absence of any reference to environmental non-governmental organizations (ENGOS) or the public (although ‘individual Albertans’ are referenced) or Indigenous communities.

It may be that this is just inadvertence, but at a time when the government is demonizing ENGOS and launching a [formal public inquiry into anti-Alberta energy campaigns](#), this seems more deliberate.

Whether inadvertent or deliberate, this is an impoverished view of deliberative democracy, a view that seems to suggest that the only opinions really worth listening to are the opinions of GHG emitters and those who have an economic interest in the flexibility mechanisms (offset developers and their clients) included in these LFE schemes. On the contrary, we *all* have an interest in provincial carbon policy, including its level of ambition and its consideration of ethical questions such as the global allocation of carbon emissions. Organizations such as the [Pembina Institute](#) have made positive and constructive contributions, based on sound and careful research, to the development of carbon policy in this province and nationally over a period of decades. I value that contribution immensely.

Thanks to my colleagues David Wright, Sharon Mascher and Martin Olszynski for their comments on an earlier draft of this post. Any remaining errors and the opinions expressed here are my responsibility.

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