CAPP CANADA'S OIL & NATURAL GAS PRODUCERS

To: Environment & Climate Change Canada

CAPP Comments on Federal Carbon Pricing Backstop

June 30th 2017

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Honourable Catherine McKenna, P.C., M.P.
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(Sent via email: Carbonpricing-tarificationcarbone@canada.ca)

Re: CAPP Comments on Federal Carbon Pricing Backstop

The Canadian Association of Petroleum Producers (CAPP) represents companies, large and small, that explore for, develop and produce natural gas and crude oil throughout Canada. CAPP's member companies produce about 80 per cent of Canada's natural gas and crude oil. CAPP's associate members provide a wide range of services that support the upstream crude oil and natural gas industry. Together CAPP's members and associate members are an important part of a national industry with revenues from oil and natural gas production of about $120 billion a year.

We appreciate the opportunity to submit comments regarding the technical paper on the *Federal Carbon Pricing Backstop*, as detailed in the technical paper released in May 2017. Given the important role the oil and natural gas industry plays in Canada's economy, it is critical to address climate policy with balanced and pragmatic solutions that allow for growth in investment and jobs while continuing to reduce greenhouse gas (GHG) emissions. CAPP supports a climate policy regime in Canada that maintains a vibrant and competitive oil and natural gas sector while efficiently and effectively managing GHG emissions. To this end, CAPP has developed the following principles to guide climate policy development:

CAPP Climate Principles

Balance: Balanced "3E" policy should deliver Economic growth, Environmental protection, and a secure and reliable Energy supply.

Efficiency: Policy should be designed to drive efficient actions required to achieve emission objectives.

Technology: Policy should stimulate investment in the technologies necessary for significant reductions in GHG emissions in Canada.

Predictability and stability: Predictable policy built on stable principles should support long-term capital investments in the upstream oil and natural gas sector and create jobs for Canadians.

Competitiveness: Policy should maintain competitiveness of Canadian industry, ensure compatibility with major trading and economic partners (particularly with the U.S., our largest trading partner), and compliance should be achievable within the context of growing production.

Distributional fairness: Policy should distribute cost burden equitably among sectors and jurisdictions across the economy.

Harmonization: Policy should be harmonized across jurisdictions within Canada, to an extent that is both reasonable and practical.

Administrative simplicity: Policy should be simple and minimize the administrative burden on industry to the greatest extent possible.

CAPP looks forward to working with government on the development of the federal carbon pricing backstop regulations. We note the proposed policy could have a significant impact on the upstream oil and natural gas sector and we urge government to take the necessary time to consider and develop the regulations. CAPP also wishes to offer a few comments for consideration when designing the federal carbon price. The comments cut across the following dimensions:

- Economic competitiveness of the oil and natural gas sector.
- Federal / provincial overlap.
- Offsets.
- Opt-in for large Final Emitters.
- Revenue recycling.
- Proposed changes to the reporting to the Greenhouse Gas Emissions Reporting Program (GHGRP).
- Tax administration.

Economic Competitiveness of the Oil and Natural Gas Sector

The current oil and natural gas price environment has created substantial challenges for the upstream industry. Oil prices have declined over 70 per cent since 2014, with natural gas prices remaining low for several years. In response, investment in the Canadian upstream industry has declined by 65 per cent since 2014. In this economic environment, it is important to design cost-effective regulations that will help protect the industry's competitiveness while helping to reduce GHG emissions. We urge government to continue to consult with industry when developing these regulations to ensure they are efficient, avoid duplication and do not create unnecessary financial and administrative burden.

CAPP recommends that government takes into account the current economic environment for the oil and natural gas sector and continues to work with industry to develop regulations that help to reduce emissions while still allowing for the continued growth of the Canadian oil and natural gas sector.

Oil and Natural Gas is an Emission-Intense, Trade-Exposed Sector

As the oil and natural gas sector is considered an emission-intensive, trade-exposed sector (EITE), this regulation runs the risk of potentially encouraging carbon leakage. Carbon leakage occurs when industry chooses to move to other jurisdictions with lower environmental regulatory costs; this leads to no global reduction of emissions, but does lead to a loss of jobs and revenue for the government and the Canadian economy. Many jurisdictions across Canada and the world incorporate mechanisms to help manage EITE sectors and prevent carbon leakage. In Alberta, the government has used output-based allocations to help manage competitiveness, and in California the state government provides allocation credits under the cap-and-trade system to help manage the competeveness of the Californian oil and natural gas sector.

Small Facility EITE Protection Mechanism

CAPP notes there are currently many smaller oil and natural gas operations in the country that do not meet the 50,000 tonne threshold, and for these facilities it may be difficult to aggregate up in order to meet the 50,000 tonne threshold needed to be included in the output based allocation (OBA) system. These smaller facilities are still at risk of carbon leakage and will require some form of EITE protection. As the entire oil and natural gas sector is EITE, government must ensure to offer competiveness protection not just to the large final emitters but to all oil and natural gas operations across the country.

CAPP recommends that government works with industry to develop a small facility EITE protection mechanism that provides competiveness protection for the entire sector that will help prevent carbon leakage and reduce emissions.

CAPP recommends that government creates protection mechanisms for EITE sectors to help avoid carbon leakage.

CAPP agrees with the government that there should be a review that will look to examine and address the competitiveness of EITE sectors in the country. CAPP looks forward to working with government on how best to help protect competitiveness and avoid carbon leakage. We urge government to begin this review process well in advance of the proposed government suggested timeline of 2022.

Additional Regulatory Burdens

The price paid for carbon by emitters goes beyond the marginal price of carbon set by governments through a taxation or cap and trade regime. When considering carbon pricing mechanisms – or comparing mechanisms across jurisdictions – it is important to consider all of the costs incurred by emitters to comply with relevant policy instruments, including mitigative regulatory requirements and/or renewable portfolio standards. The carbon pricing mechanisms considered by governments should be inclusive of all policy costs, and set levels that continue to incent environmental change but without damaging the competiveness of Canadian industries.

Industry is committed to a 45% reduction in methane emissions consistent with Federal government announcement made March 10th, 2016 between Canada, the United States and Mexico.

> "The three countries commit to develop and implement federal regulations for both existing and new sources as soon as possible to achieve the target *(ie 40 - 45% emission reduction)*."

Stringent regulation for methane emissions reductions are currently being developed both provincially and federally to achieve the 45% emissions reductions target. This commitment towards regulation will take significant ongoing effort and expense by industry to achieve through regulated Leak Detection and Repair (LDAR) of facilities, retrofitting the fleet of existing equipment and adopting more rigorous standards / new technology for new equipment.

CAPP recommends that the Federal backstop be consistent with the Federal policy direction to deliver methane emission reductions via regulation. Industry believes that the design of a principled, fair and effective carbon policy should exempt methane emissions from carbon pricing. Layering carbon pricing on top of that regulation introduces duplication and has the potential to significantly impact the upstream oil and gas sector's competitiveness.

CAPP recommends that any policy initiatives undertaken by the government should be inclusive of all policy costs and recognize the cumulative burden introduced through a range of new policies and regulations, corporate tax increases and royalty changes. CAPP notes the particular impact the recent methane reduction initiative and the clean fuel standards may have on climate policy in the country and urges government to develop these policies in unison with the federal carbon price in order to avoid duplicative taxation.

Federal / Provincial Overlap

Currently, many provinces have introduced carbon pricing mechanisms that impact the oil and natural gas sector. British Columbia and Alberta have already introduced policies that are leading to emission reductions from the sector and the Atlantic Provinces are currently drafting their own policies that will manage emissions from the Atlantic oil and natural gas sector. A national program consisting of a mosaic of provincial approaches will provide regulatory certainty for those already subject to carbon regulations, while also contributing to achievement of the country's overall GHG emissions reduction objectives.

Currently, the oil and natural gas sector in Canada operates in many different jurisdictions with multiple forms of carbon pricing mechanisms. As mentioned above, CAPP believes that having a mosaic of provincial policies can best serve the country, but determining how the federal policy may impact the provincial policies is key for industry. By providing certainty on key policy aspects, government can help industry better prepare for the implementation of the policy. Key elements needing further clarity are:

Stringency and price: Industry requires set prices and stringencies to properly model economic impacts of carbon policies. Industry requests clarity on how government intends to work with provinces to determine equivalent prices and stringency.

Provincial specific policies: Currently there are many key pieces within provincial climate policies that were not commented on in the federal policy; ensuring these elements established by the provinces are protected is very important to industry. Industry believes that the provinces are best suited to account for their own unique situations and CAPP recommends the federal government allow all aspects of existing provincial policies to continue. This includes the competitiveness protection mechanism that the Alberta government granted to non-large final emitters until 2023. This announcement was introduced to give time to industry to work on emissions reductions and help protect industry's competitiveness as companies work to reduce emissions. CAPP believes strongly that the federal government should look to grant equivalency to all aspects of existing provincial policies.

Timing: As many provinces are currently engaged in the development of provincial policies, CAPP cautions government against moving ahead without providing adequate time for the provinces to implement their individual climate plans. By allowing provincial policies to be created in advance of the federal regulations coming into effect, government can help provide certainty for industry. Additionally, CAPP believes that for facilities that will be covered under the OBA system, there is a large administrative burden that will be incurred by creating accounting and tax programs to manage one year of the carbon levy prior to the implementation of the OBA system in 2019.

Federal / provincial equivalency: CAPP requests clarity on how government intends to determine equivalency of provincial policies and also what will occur if the federal government judges that a provincial policy is not equivalent to the federal standards.

CAPP recommends that government should ensure that all aspects of the existing provincial policies are granted equivalency and are allowed to remain intact.

CAPP also recommends that government provide sufficient time for provinces to implement their individual policies and should also examine the possibility of providing a one-year grace period to facilities that will be included under the OBA system.

Offsets

CAPP would like the opportunity to provide input into the pan-Canadian offsets framework being developed by the Canadian Council of Ministers of the Environment. Outlined below are some general principles and key points CAPP would like to raise for Environment and Climate Change Canada's consideration while considering the role offsets can play in helping Canada achieve climate commitments. For further information on developing an efficient offset market, CAPP recommends that government examine some of the materials put forward by The International Emissions Trading Association (IETA).

General Principles for Offsets

Real: The GHG emission reductions and removals delivered through the offset project must be proven to have taken place.

Measurable: The GHG emission reductions must be quantifiable using recognized measurement tools (including adjustments for uncertainty and leakage) against a credible emissions baseline.

Permanent: In the case where GHG emission reductions carry a risk of being reversed (fire, logging, reservoir leakage, etc.) adequate safeguards and insurances must be in place to minimize the risk and should any reversal occur, a mechanism is in place that guarantees the reductions or removals will be replaced or compensated.

Additional: GHG emission reductions must be additional to what would have happened under a business-as-usual scenario if the project had not been carried out.

Independently audited: All GHG emission reductions should be verified to a reasonable level of assurance by an accredited verification body with the expertise necessary in the country and sector in which the project is located.

Not double counted: There must be no double counting, or double claiming of the environmental benefit, in respect of the GHG emission reductions or removals.

Transparent: There must be sufficient and appropriate public disclosure of GHG related information to allow intended users to make decisions with reasonable confidence.

Conservative: Conservative assumptions, values and procedures must be used to ensure that the GHG emission reductions or removals are not over-estimated.

Key Points for Offsets

Accessibility: Creating a flexible compliance pathway that includes full accessibility for offsets to meet 100 per cent of compliance needs, and ensuring eligible carbon offsets generated by reductions of emissions from any of the seven UNFCCC greenhouse gases can be applied towards carbon pollution obligations, regardless of the source of the obligations. These actions will strengthen the Canadian climate action portfolio, drive emission reductions outside regulated entities, lead to job creation and market diversification, and provide lower cost compliance pathways for corporations (leaving more capital for re-investment in their sector).

Linkages: Allowing linkages to other jurisdictions will allow for the support of reduction projects where the reductions are most efficiently achieved. Although Canada is only a small percentage of the global climate challenge, by linking to other jurisdictions Canada will be able to make a greater impact on global climate solutions, delivering greater reductions, than if we remained isolated in our actions.

Assurance and compliance certainty: It will be important for the government of Canada to provide assurance to offset purchasers that, once they have retired offsets against their compliance obligations, those compliance offsets will not be revoked for any reason. This means there will be a need to develop a mechanism to ensure that if any offsets are revoked (for reasons other than proponent intention or negligence) those lost reductions are replaced. There are many ways this could be achieved and each system manages the replacement separately.

Minimize transaction costs: Creating the conditions for transactional efficiency will result in lower costs and improve access to offsets, promoting their use for compliance with climate change regulations. Improvements to protocol timelines, streamlining protocols, and decreasing the administrative burden associated with verification are vital to ensure the offset system is freely accessed and utilized to its full potential.

Impact on existing carbon trading and offset markets: Generally in market-based systems generating strong demand will increase the market price of the commodity being sought. This is also likely going to be the case when linking the Canadian federal offset program to Western Climate Initiative, Verified Carbon Standard or the Alberta OBA system. This could cause the carbon price for offsets to trade much closer to the economy-wide carbon price than it may currently. The increase in offset carbon value will actually drive more projects to be delivered, especially those with a carbon price below the current trading value of carbon. Ultimately the offset market price would be expected to stabilize just below the tax or levy rate.

Opt-in for Large Final Emitters

CAPP was pleased that government is looking to provide some form of protection for large final emitters through the OBA system. The setting of a benchmark can help provide protection and will still continue to create an incentive for larger operations to reduce emissions, but CAPP cautions government that in an OBA system, facilities are compared against each other and there may be a difference in emission intensity and operational performance for smaller facilities that may not allow for fair comparison with larger operations.

CAPP recommends that government works with industry to determine the best way to allow for facilities to opt-in to the OBA system and also examine the possibility of providing other forms of EITE protection for smaller operations.

Revenue Recycling

A key consideration under any market-based carbon pricing system – such as carbon tax or a cap-and-trade regime – is how and where to recycle the revenue. An option available to governments is to recycle some or all of the revenue generated by industry back to that industry to achieve further emissions reductions from the emitting sectors. One of the key purposes for carbon pricing mechanisms is to reduce emissions while not weakening industry's competiveness. By recycling revenue, through a technology fund, corresponding cost decreases from other areas or alternative mechanism, governments create the incentive for companies to reduce emissions while helping to protect their competiveness. This opportunity allows companies to further reduce their emissions and develop and deploy long-term technology advancements that will help to bend the curve and help Canada reach its climate goals.

Currently, many of the provinces use revenue recycling to help reduce emissions and protect industry's competiveness. Industry appreciates government's plan to ensure that revenue raised from the federal carbon price will be returned to the provinces for them to disperse, but urges the federal government to help ensure some form of revenue recycling is returned to industry to help protect competiveness and provide incentive for innovation.

CAPP recommends that government creates a system that returns funds to the provincial governments in an efficient way and encourages the use of revenue recycling within the provinces.

Proposed Changes to Reporting to the Greenhouse Gas Emissions Reporting Program (GHGRP)

On December 10, 2016, the federal government published in the Canadian Gazette its intention to expand the scope of GHGRP to include new emissions and also to lower the reporting threshold for facilities from 50,000 tonnes to 10,000 tonnes. The decrease in threshold will impact a number of facilities in the oil and natural gas sector as the new policy will likely lead to a number of natural gas processing facilities, compressor stations and some conventional oil batteries being included in reporting thresholds. While industry understands the importance of ensuring government is able to collect the appropriate data, CAPP urges government to introduce reporting mechanisms that are efficient, flexible, administratively simple and allow for electronic data upload capability. Government should leverage all the different options available to industry for collecting verifiable emission data. This will ensure companies can maintain focus on achieving emission reductions rather than unnecessarily modifying measurement configurations. CAPP recommends that the federal government look to provincial reporting requirements such as the AER's *Directive 017: Measurement Requirements for Oil and Gas Operations* for further guidance. CAPP notes the proposed changes to fuel gas sampling under the new reporting requirements. Industry already conducts extensive fuel gas sampling and is looking forward to working with government to better understand the rationale for this change and to collaboratively develop fuel gas sampling provisions under the new regulations.

CAPP recommends that government work with industry to ensure an efficient introduction of the new reporting thresholds and encourages government to work with the provinces to create a simple, transparent, flexible and efficient reporting requirement across the country with electronic data upload capability. CAPP encourages ECCC to promote partnerships with provincial emissions reporting to allow for streamlined data submissions.

Tax Administration

In any form of carbon pricing, ensuring there is an efficient and administratively simple form of tax administration is key to providing a system that will minimize the cost for industry. CAPP has helped to provide advice in connection with the creation of many taxation systems in other jurisdictions and looks forward to working with government to provide advice about the creation of a tax system that is efficient and simple to administer. CAPP has submitted comments in a separate letter on the how best to create an efficient tax system.

CAPP recommends that government works with industry to help develop the best possible taxation system to minimize cost and administrative burden, **and recommends** industry consultation on the implementation and administrative phase of the process.

Conclusion

CAPP believes continued collaboration between government and industry is needed to ensure the proper development of the federal carbon price. We appreciate this initial opportunity to engage on this file but we urge government to take appropriate time to fully consult stakeholders to ensure regulations are developed that will achieve GHG emissions goals while maintaining industry competitiveness.

Sincerely,

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The Honourable Jim Carr, P.C., M.P., Minister of Natural Resources
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