THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

August 11, 2009

Dean Stinson O'Gorman
Manager, Canada's Offset System for Greenhouse Gases
Environment Canada
19th Floor
351 St-Joeseph Blvd.
Gatineau, Quebec K1A 0H3

Dear Mr. Stinson O'Gorman:

Re: Draft Program Rules and Guidance

We are writing on behalf of the Canadian Bar Association's National Environmental, Energy and Resources Law Section and the National Business Law Section (the CBA Sections) to comment on the *Draft Program Rules and Guidance for Project Proponents* (Draft Project Rules) and the *Draft Program Rules for Verification and Guidance for Verification Bodies* (Draft Verification Rules) published in *Canada Gazette Part 1* on June 13, 2009 (collectively the Draft Program Rules). The CBA Sections have particular interest in initiatives regarding the regulation of greenhouse gases (GHG) and the development of a carbon offset market. Our members include many of Canada's foremost climate change legal specialists.

In our view, a robust domestic offset market will not develop until there is sufficient regulatory certainty for potential participants to invest in offset projects with a reasonable chance of return. Although the long anticipated Draft Program Rules are a welcome development, considerably more will be necessary to stimulate a higher volume of market activity. It is by now axiomatic that the implementation of GHG emissions regulation and trading regimes is needed to create high demand for offsets. Canadians have been told by federal governments since at least 2004 that implementation of a domestic legal regime was imminent. Failure to deliver has resulted in a business community especially wary of investing based on federal proposals, no matter how detailed. Finalizing the Draft Program Rules will build real momentum only if followed very shortly by draft GHG emissions trading regulations with a short timeline for implementation. Without that critical extra step, all but the least risk averse investors (or small groups driven by less direct financial considerations) would likely delay any plans for investment.

One of the potential tensions generated by moving forward on a federal regime (and providing the certainty required for the development of a domestic market) is with the equally important need to harmonize with the emerging GHG emissions trading regimes in the provinces, the US

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and other countries. While harmonization from the outset would be ideal, the inevitable result could be years of further delay as we wait for other jurisdictions (like the US) to develop their regimes. Assuming that kind of inaction is unacceptable, the sensible option is to move forward with the implementation and development of a Canadian regime with sufficient flexibility to accommodate necessary harmonization measures in the future. One of the many advantages of that approach is that Canadian businesses (including Canada's investment and trading community) can begin to develop the expertise necessary to participate competitively in what is expected to become a multi trillion dollar global carbon market.

The Draft Program Rules provide helpful guidance by clearly setting out the steps in the project cycle and verification process. Our specific comments on the Draft Program Rules are set out below. The need for program certainty is a central theme.

Legal Nature of Offset Carbon Credits

A key element of any offset framework is the legal nature of the carbon credits. In various parts of the world, carbon offset credits are being created legislatively and contractually under compliance regimes or voluntary protocols. However, most countries, including Canada, have not yet adopted legislation that defines the legal nature of the ownership interest in an offset carbon credit. It is not clear that domestic law is adequate to deal with issues of legal ownership. For example, when will an offset credit be treated as a personal right as opposed to a real property right? In the absence of a legislative framework which defines principles of ownership for emission reductions, there is considerable uncertainty as to how the legal title to these rights can be secured and transferred.

This issue is crucial in the context of sequestration of carbon in trees or soil. Do credits associated with forestry sequestration follow the ownership of timber or land? Are there restrictions under current laws to the transfer of sequestration benefits and carbon rights and how do these relate to contract rights and obligations? The Draft Project Rules require clarification of these important issues and the lack of any legal regime in Canada contributes to risk and uncertainty. A comprehensive and consistent legislative framework is critical to an effective offsets system. Even if new legislation on the legal nature of offset credits is not anticipated, guidance on how offset credits will be considered under existing legislation is critical.

Eligibility

Another area where certainty needs to be established is eligibility dates – when projects may have started and when offset credits may be created. As early as April 2007 in *Turning the Corner*, offset criteria included a start date "on or after January 1, 2000" and a creation date "after January 1, 2008". These dates were restated in the updated *Turning the Corner* document in March 2008 and again in the *Guide for Protocol Developers* of August 2008. The Draft Project Rules revise these dates to only allow projects started on or after January 1, 2006 and only recognize the creation of offsets on or after January 1, 2011. These changes reduce the credibility of the offset system, even in its developmental stage, and fail to recognize current emission reduction initiatives. We suggest that the original dates be recognized to restore credibility to the system and recognize reduction initiatives. Regardless of which eligibility dates are selected, this key element of the program must be confirmed through regulation as soon as possible to establish certainty and allow proponents to proceed with development plans.

Additionality

The Draft Project Rules require that, to be eligible for the federal offset program, "a project must achieve incremental greenhouse gas reductions". We agree with the requirement that offset projects must be considered "incremental" or "additional". This concept of additionality is designed to provide assurance that reductions credited as offsets and acquired by regulated entities to satisfy a regulatory requirement result in an overall net reduction of emissions. However, as a policy matter offset credits are also intended to support the development of projects by providing a meaningful financial incentive. We are of the view that the "incremental" requirement should be measured at a fixed date in the development of the project: either the commencement of construction or the approval of the project under the offset program.

For projects determined to be incremental at the relevant time, future reductions would remain additional during the reasonable life of the project, notwithstanding a change in legal requirements. Absent that certainty, project proponents and those financing the projects will find the revenue stream attributable to the generation of offset credits subject to immeasurable risk. As an alternative, these "grandfathering" arrangements could apply in respect of projects commissioned on or after January 2010, to ensure the grandfathering is only available to new projects designed with the federal offset program in place as a financial incentive. A further alternative would have the grandfathering of reductions apply for a maximum period (such as 10 years) following the imposition of a new legal requirement.

Project Registration and Protocol Development

Project participants have been guided by the list of fast track eligible protocols in the draft guidance to protocol developers issued in August 2008 (Draft Protocol Rules). Together, the Draft Protocol Rules and the Draft Project Rules confirm that project registrations will not be received for review until after a protocol has been publicly posted as an offset system quantification protocol. This will result in unnecessary delay. We recommend that Environment Canada consider receiving project applications and base protocols at the same time and process them together. This would allow for harmonization with the CDM process under the Kyoto Protocol.

The Draft Project Rules contain several references to time periods in which project proponents must respond to Environment Canada enquiries. However there are no concomitant time periods within which Environment Canada must make decisions or provide information and guidance to project proponents. This adds to the uncertainty surrounding the development and approval of qualified projects. We recommend that the Draft Project Rules incorporate specific timelines applicable to both project proponents and Environment Canada.

Permanence in the Context of Forestry and Agricultural Sequestration Projects

Sequestration projects carry an inherent risk of carbon reversals. The Draft Project Rules deal with this permanency issue by requiring replacement of credits on a project-by-project basis if the reversal occurs throughout a project's registration period or anytime after its expiration, for a further 25 years. An extended liability period places potential difficulties and concerns on an individual project proponent.

Alternatives include discounting emission removal coefficients and providing for a general buffer/reserve. The latter approach is demonstrated by the Voluntary Carbon Standard and the Climate Action Reserve and could be considered by Environment Canada. A buffer/reserve

requirement would involve qualified sequestration projects contributing a percentage of their credits to a general buffer pool administered by a third party. If a reversal subsequently occurred in s qualified sequestration project, the third party would retire the equivalent number of credits from the buffer pool. The buffer pool would act as an insurance mechanism against carbon reversals with the risk spread across all qualified sequestration projects.

Conclusion

The CBA Sections strongly support the development of rules for an offset credit system..The Draft Program Rules are a step in the right direction. Nevertheless, providing more certainty is necessary to encourage sufficient investment in the creation of offsets to support a robust domestic offset market. The legal nature of offset credits must be clearly articulated, whether through new legislation or guidance under existing laws. The credibility of the offsets regime should not be undermined by changing eligibility rules, nor should Canada adopt an approach to permanence less rigorous in terms of years of protection or more onerous on individual projects. Additionality requirements must address the issue of changing legal requirements. Finally, Canada's offset system should not be impeded by delays in protocol development.

While it should be a central objective of the federal government to harmonize Canada's offsets system with those developed by the provinces and countries like the US, that goal should not result in further delay to the creation of the Canadian offsets regime. It is critical that Canada develop expertise and investment in the offsets market and sufficient certainty can be provided to achieve this, while providing for future harmonization.

The CBA Sections wish to offer their assistance and expertise to the federal government as it establishes this important piece of its climate change regime.

(Original signed by Bruce King)

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