

# TURNING



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# UP THE HEAT

Climate change is hot: a North American framework for regulating greenhouse gases is now emerging. But its patchwork nature and the prospect of cross-border conflicts are increasing the pressure on Canadian industries and their lawyers to chart the right climate-change course.

By Yves Faguy

**A**fter years of stalling, lawmakers across North America are finally taking climate change seriously. But shifting gears on the fly to a lower-carbon economy is no easy task for governments struggling to come up with coherent laws that won't hamper economic growth — especially in a recession.

From the east coast to the west coast, on Parliament Hill and on Capitol Hill, a patchwork of laws, regulations and market tools aimed at putting a price on carbon is emerging from an unprecedented flurry of legislative activity.

Grappling with all this change is industry, forced to contend with a growing number of competing and possibly inconsistent regulatory environments, making it difficult to understand the financial impact of their emissions. Understandably, most carbon-intensive businesses would prefer continent-wide targets that would at least give them a clearer view of their future obligations. Lawyers are trying their best to help them out.

**Dennis Mahony**  
Torys LLP, Toronto

"Climate change went into a holding pattern around 1998-1999. That's when the government began to realize how incredibly complicated this was."

“There’s a lot of uncertainty,” says Selina Lee-Andersen, an associate in the environmental and energy law groups at Blake, Cassels & Graydon LLP in Vancouver. “In the medium-to-long term, we will have a more coherent system. But for now, we have this patchwork of different systems.”

### Green shoots

Dennis Mahony, co-chair of the climate change and emissions trading group at Torys LLP in Toronto, first joined the firm as a summer student in 1992. That was the year that leaders from around the world converged on Rio de Janeiro for the Earth Summit, which produced the United Nations Framework Convention on Climate Change (and in turn led to the Kyoto Protocol). Over the intervening years, he has closely monitored Canada’s ebbing and flowing interest in climate change.

## Selina Lee-Andersen

Blake Cassels & Graydon LLP, Vancouver

**“In the medium-to-long term, we will have a more coherent system. But for now, we have this patchwork of different systems.”**

Even though the federal government formally signed the Kyoto Protocol in 1998, there really was no legislative activity until three years ago, Mahony says. “Climate change went into a holding pattern somewhere around 1998-1999. That’s when the government began to realize how incredibly complicated this was and how much a federal regulatory regime might impact the provinces in different ways.”

Indeed, debates about climate change policy tend to get heated because every province and state has its own emissions profile, and so each jurisdiction wants to influence the future shape of carbon markets differently, in order to protect its economic interests. Alberta’s emissions profile, for example, is much more carbon-intensive than Quebec’s, which relies on hydro-electricity.



## Going mainstream

*What was once a sub-specialty of environmental law is quickly becoming a whole new area of practice.*

**A**s governments across North America scramble to pass a hodgepodge of climate change laws and regulations, anxious clients are increasingly relying on lawyers for advice on a number of legal issues that deserve particular attention.

According to Dennis Mahony, about two-thirds of Canada’s top 20 largest law firms now have a climate change practice group or some form of climate change expertise with-

in their ranks.

Over the last couple of years, he says, firms have been pouring significant resources into this new area of practice, “because frankly, they see that their clients are interested and are calling and asking a lot of questions. ... [C]limate change is becoming a mainstream practice area.”

“Clients are taking a closer look,” agrees Selina Lee-Andersen. “If you’re a company that produces so many thousand tons of CO<sub>2</sub> every year, that’s a potential cost five years down the line, and it might be time to consider buying offsets to be compliant then.”

According to Jennifer Cleall, achieving compliance with reporting obligations is a big

issue for clients. But she views climate change as a practice area that draws upon the expertise of a diverse group of specialists. “They can’t work alone on these files,” she says of climate change experts. “They must work in multidisciplinary teams.”

Law firms are expected to advise on a range of issues, including the ability to generate and trade carbon credits, ownership of those credits, and how offsets must be treated from a tax perspective. There’s also greater pressure from investors, shareholders and securities regulators about disclosure regarding reporting issuers’ environmental footprint and regulatory risk, says Lee-Andersen.

“There are significant differences between jurisdictions, and the regulatory framework is emerging accordingly,” says Jennifer Cleall, an environmental and climate change associate with Davis LLP in Edmonton. “The government in each province is going to do what makes sense in that province.”

It was actually the state of California that started the ball rolling in 2006, passing a law implementing a cap-and-trade program on CO<sub>2</sub> emissions. California’s initiative forms the basis of a parallel system being developed by the Western Climate Initiative (WCI), formed by 11 American states and four Canadian provinces (Quebec, Ontario, Manitoba and B.C.). Ontario and Quebec each have passed climate-change legislation to create a provincial cap-and-trade system.

Alberta, not a member of the WCI, took a much different approach when it became the first Canadian province to subject large emitters to a mandatory greenhouse gas (GHG) emissions regime in 2007. It relies instead on an emissions-intensity regime, which aims to reduce over time the ratio of

GHG emitted to a unit of economic output. Saskatchewan introduced similar climate change legislation in May.

Charting yet another course, British Columbia and Quebec both introduced their own versions of a carbon tax last year, a scheme that proponents say is preferable to a cap-and-trade framework because of its simplicity, transparency, and relatively easy implementation.

So what’s with this sudden frenzy? Environmental doomsday scenarios aside, government policy is dictated by the constellation of political forces at play, not least of which is public and international pressure to produce a new global climate treaty to replace the Kyoto Protocol at the upcoming U.N.-sponsored summit in Copenhagen in December.

With only a few short months to go until Copenhagen, neither Canada nor the United States have much to show in terms of curbing global warming. According to a July report commissioned by German insurer Allianz SE, the two countries rank last among G8 members. In spite of talk about a joint North American regime, the Canadian and American plans remain separate works in progress.

### Protectionism concerns

Federal Environment Minister Jim Prentice has said that such decisions “will be made on the basis of Canada’s national interests.” Even so, and by his own admission, Canada has to be mindful what course its major trading partner takes, especially as members of the American political class are eager to voice their support for protectionist measures in the form of “Buy American” provisions.

## Jennifer Cleall

Davis LLP, Edmonton

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## On the lookout

Here are a few things to consider when dealing with carbon-intensive clients.

1. Find out the reporting requirements for a given industry. Does your client meet the reporting thresholds in the various jurisdictions where it operates?
2. Companies must be vigilant about reporting their emissions, says Lee-Andersen. That way, a company can establish a baseline of its GHG emissions, which will be used to measure progress toward meeting its emission reduction goals.
3. Keep an eye on the various timelines. For example, the Western Climate Initiative is aiming for 2012 as the launch of its Regional Cap-and-Trade Program, and will be using 2005 as a baseline. This makes it unlikely that offsets and credits earned in, say, 2003-2004 would be tradeable under the WCI system.
4. Investigate today whether there is a need or opportunities to buy or generate emission credits. Banking them now may help down the line.

# Changement de vitesse

*Un cadre nord-américain pour lutter contre les émissions de gaz à effet de serre émerge. Mais sa nature fragmentée et la possibilité de conflits inter juridictionnels augmentent la pression sur les gouvernements pour qu'ils le dessinent adéquatement.*

**A**près des années de tergiversations, les législateurs nord-américains prennent finalement les changements climatiques au sérieux et agissent. Mais ce changement de vitesse annonce bien des difficultés pour les gouvernements, qui devront présenter des options qui ne nuiront pas au développement économique — particulièrement en temps de récession.

Les entreprises, pour leur part, se voient de plus en plus forcées de faire face à des environnements législatifs parfois contradictoires, ce qui rend la compréhension de l'impact de leurs émissions d'autant plus difficile. « Il y a beaucoup d'incertitude », convient Selina Lee-Andersen, avocate dans le groupe de droit de l'environnement et de l'énergie chez Blakes, Cassels & Graydon, à Vancouver.

C'est particulièrement vrai au Canada, où les débats sur les politiques pour combattre les changements climatiques sont compliqués par le fait que chaque province a son propre profil d'émetteur, et a ainsi la possibilité de légiférer en conséquence. « Le gouvernement dans chaque province va faire ce qui a le plus de sens pour elle », note Jennifer Cleall, avocate spécialisée en environnement et changements climatiques chez Davis LLP, à Edmonton.

Le Québec et l'Ontario, par exemple, ont emboîté le pas à la Californie qui en 2006 a annoncé ses intentions de développer un programme de marché du carbone (*cap and trade*). Le Québec et la Colombie-Britannique ont par la suite adopté une taxe sur le carbone. L'Alberta, en revanche, a plutôt misé sur un système basé sur l'intensité des émissions. La Saskatchewan l'a imitée en mai.

Pourquoi soudainement autant d'action? Les pressions publiques et politiques y sont sûrement pour quelque chose. En décembre, au sommet de Copenhague, la communauté internationale doit établir un nouveau protocole pour remplacer celui de Kyoto. Or, les États-Unis et le Canada auront bien peu à montrer à leurs pairs. Selon un rapport publié en juillet par l'assureur allemand Allianz SE, les deux pays arrivent bon derniers parmi les pays du G8 en termes de lutte aux changements climatiques.

## Inquiétudes protectionnistes

Le ministre fédéral de l'Environnement, Jim Prentice, a déclaré que le Canada agirait selon ses meilleurs intérêts. Or, malgré tout, le pays devra rester très conscient de ce qui se passe au sud de ses frontières, particulièrement du projet de loi Waxman-Markey, qui fait son chemin au congrès américain.

Essentiellement, cette initiative législative cherche à réduire les émissions de gaz à effet de serre de 80 % d'ici 2050. Mais son aspect le plus inquiétant pour le Canada est qu'elle cible un certain nombre de secteurs, de l'industrie du ciment à celle de l'acier, entre autres, afin de donner le pouvoir au gouvernement américain d'imposer des tarifs frontaliers aux importations dont la production est jugée trop polluante.

Selon l'avocate de Vancouver Selina Lee-Andersen, ces tarifs sont principalement destinés aux économies émergentes et très polluantes, comme la Chine et l'Inde, « mais ils finiront vraisemblablement par avoir un impact sur les manufacturiers canadiens », dit-elle.

Dennis Mahony, co-président du groupe sur les changements climatiques et le marché des

émissions chez Torys LLP à Toronto, s'est joint à la firme comme étudiant en 1992, à l'époque du Sommet de la Terre à Rio de Janeiro, prélude au protocole de Kyoto. Depuis, le juriste suit de près l'évolution de la lutte du Canada aux changements climatiques. Le pays a longtemps fait du surplace dans le domaine, note-t-il, mais il n'a maintenant d'autre choix que de passer en deuxième vitesse.

« Avec les ajustements frontaliers envisagés sous le projet de loi Waxman-Markey et la perspective d'avoir d'autres pays qui imposent des tarifs frontaliers, les exportateurs canadiens veulent sans doute considérer l'implantation d'une stratégie de réduction des émissions pour demeurer compétitives », renchérit M<sup>e</sup> Lee-Andersen.

Et « dans les cas où des tarifs sur le carbone ne peuvent être évités, les exportateurs auront besoin de bons conseillers légaux pour rester au fait des derniers développements réglementaires et éviter d'être pris en défaut », ajoute l'avocate.

## Questions constitutionnelles

Ultimement, le succès de cette refonte du régime des émissions de GES nécessite une harmonisation des règles à travers le pays. Mais Dennis Mahony craint que cette harmonisation ne mette la table à des affrontements constitutionnels entre Ottawa et les provinces et territoires.

Par exemple, au départ, le gouvernement Harper prônait une approche basée sur les cibles d'intensité. Mais récemment, le ministre Jim Prentice a annoncé qu'il opérerait plutôt pour un système de *cap and trade* — incluant des nouvelles règles visant les sables bitumineux et les raffineries. Ce qui pourrait déplaire à certaines provinces, dont l'Alberta.

« Nous ne sortiront pas de là pour quelques années », note M<sup>e</sup> Mahony. L'important, dit-il, est que le gouvernement perçoive les années à venir comme une période d'expérimentation. « Si on se rend compte que quelque chose ne fonctionne pas, mon espoir est qu'on le répare. C'est un secteur dont l'évolution nécessite une attention constante. » ■

**Yves Faguy** est rédacteur principal au magazine *National*.

Topping the list of concerns is the massive climate change bill now making its way through Congress. The “Waxman-Markey Bill” calls for reducing U.S. greenhouse gas emissions by 80 per cent by 2050. It also includes a cap-and-trade system, and a requirement that utilities get at least 15 per cent of their electricity from renewable fuels. The proposed legislation successfully passed through the House of Representatives in June. But as this issue went to press, it had yet to be adopted by the Senate.

More worrying for Canadian companies, the bill targets a range of sectors from the cement industry to steel producers and could end up giving the U.S. government the power to block the

entry of energy-intensive imports from countries that do not meet its standards. It would do so by requiring the president to impose a “border adjustment” — read tariff — on those goods.

According to Lee-Andersen, these tariffs are “aimed primarily at developing countries, such as India and China,” that export goods with a higher carbon footprint than what the U.S. produces. However, she adds, “they will likely affect Canadian manufacturers as well.”

Critics charge that because Canada was late to take action on climate change policy, we have left ourselves exposed to such punitive tariffs. Instead of taking the lead, Canada will

now have to match American moves to avoid trade disruption.

"This issue has an inevitability that is well beyond Canadian politics," says Mahony. "Canada has to move swiftly to get integrated into that system instead of being on the outside looking in." But Cleall, who helped develop the funding mechanism under Alberta's climate change legislation, disputes the notion that the Canadian federal framework must mirror that of the U.S. "As long as there is some sort of equivalent between them, they can work together."

Regardless of how things pan out, Lee-Andersen says that "the interplay between climate change and trade issues promises to be a hot topic" in the years ahead. Carbon-intensive businesses, unlike governments, would do well to be proactive.

"With the proposed border adjustments under the Waxman-Markey Bill and the prospect of other countries imposing carbon tariffs, Canadian exporters may want to consider implementing a carbon-reduction strategy to stay competitive in their industry," she says. "In cases where carbon tariffs cannot be avoided, exporters will need good legal counsel to stay on top of regulatory developments and avoid being caught off guard."

### It's constitutional

Ultimately, however the success of an emissions regime requires harmonization of mandatory rules across jurisdictions. Only then, for example, can a market for truly fungible GHG credits become viable.

Consider the voluntary market of offset credits, a financial instrument that amounts to paying others to reduce their emissions. Canadian businesses have participated actively on the voluntary markets for years. But there is a legitimate concern for buyers, when it comes to assessing the true value of carbon credits, that these will not be recognized under future mandatory certification standards and therefore will be worthless on the compliance market.

"Everybody thinks, at this point, that there is some value in the credits, and so there is a lot of project development work," says Mahony. "But converting that into credits — well, there is some risk in that." That's why, he says, contracts involving the transfer of carbon credits or offsets now contemplate possible variations in the marketplace.

But more importantly, Mahony worries that the differing approaches among provinces and the federal government in reducing GHG emissions is setting the stage for a constitutional showdown.

Adopting climate change legislation in Canada is messy, not least because jurisdiction for the environment is shared between the federal and provincial governments. The challenge for Ottawa lies in developing policy that balances the needs of the provinces while working to meet Canada's international obligations. So far, Ottawa has indicated that it will explore ways to harmonize federal and provincial carbon trading systems, to ensure efficiency.

But the devil, as with all things constitutional, will be in the details. Initially, Ottawa had in mind an intensity-based approach to reining in GHG emissions. But Minister Prentice has announced that Canada will have to adopt a hard cap-and-trade system that can link to the new U.S. regime — including new rules targeting oil sands producers and refiners.

"It's not just an academic discussion among lawyers," says Mahony. "Climate change legislation has a very real potential impact on provinces that are carbon-intensive versus those that are not." For example, he doesn't see Alberta — which, despite its oil and gas industry, still relies primarily on coal as a thermal source — buying into Canada's new direction.

"We're not going to get this right for several years," says Mahony. "The time period of progress will be measured in years, not months."

Cleall, too, recognizes the difficulty of getting different systems to operate in concert, but remains hopeful that harmonization between the different systems is possible. "Business and industry are really the ones driving the provinces across Canada to have a more level playing field," she says. "They want to have consistency and harmony, so that they have administrative efficiency from one jurisdiction to the next."

The important thing, says Mahony, is that governments embrace the years ahead as a period of experimentation. "If the feedback loop tells government that something isn't working, my hope is that it will adjust to it. This is an area that requires them to carefully watch how things evolve." ■

Yves Faguy is the Senior Editor of *National* magazine.



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