

CANADA'S IMPLEMENTATION OF MARKET MECHANISMS

Existence And Implementation Status Of Domestic Emissions System

Canada's Climate Change Plan, released April 2005 (see <http://www.climatechange.gc.ca/english/newsroom/2005/plan05.asp>), aims to reduce emissions by approximately 270 Mt annually in the 2008-2012 period. Domestic emissions trading will be used by Canadian private sector entities to reach a portion of this overall target. The three significant components of Canada's domestic emissions trading system are the Large Final Emitters System, the Offset System, and the Climate Fund:

1) Large Final Emitters System

(see <http://www.climatechange.gc.ca/english/offsets/lfe.asp>)

- April 2005 Climate Change Plan set out the framework
- Work is underway to translate this broad outline into regulations
- Rules for remittance of compliance units and definition of eligible compliance units are being elaborated, including those pertaining to:
 - domestic offset credits
 - eligible Kyoto units (from CDM, JI, and greened AAUs)
 - Technology Investment units
- Discussions with industry are continuing in order to define the detailed emission intensity standards to be set out in the proposed sector-specific regulations
- Work underway on cross-cutting issues (e.g. implementation of \$15 price assurance)

2) Offset System (see <http://www.climatechange.gc.ca/english/offsets/>)

- An Offset System Overview Paper and Technical Background Document was publicly released on August 11.
- Six quantification protocols are under development currently, with seven more scheduled.
- Formal consultations are currently underway with provinces, territories, and aboriginal governments via the Canadian Environmental Protection Act's National Advisory Committee on the Offset System rules
- Final Offset System rules will go to Cabinet for approval late November/early December
- The Offset System Program Authority is scheduled for establishment in early 2006

3) Climate Fund

- The Fund was established in Budget 2005 with an initial capitalization of \$1 billion Cdn.
- The Fund will act as the Government's purchasing agency for both domestic and international acquisitions of carbon units
- A search for a President and Advisory Board is under way
- Work on defining the criteria for "greening" and "benefit to Canada" is also taking place, with public consultation on the issues in October

Coverage And Projected Reductions In Emissions From Base Year; Allocation Mode

The implementation of the Large Final Emitters System is an initial step in a longer-run transformation of the economy. The development of the proposed LFE regulations is currently underway. The government's aim is to have regulations come into force before January, 2008. The LFE system is based on emission intensity targets. Companies that do better than their target will receive tradeable domestic credits. As these credits will be issued on a net basis, the LFE system is more like a baseline-and-credit system than a cap-and-trade system.

Canada's Offset System is designed to encourage cost-effective domestic reductions or removals of greenhouse gas emissions in activities that are not covered by the proposed LFE regulations. Through the Offset System, individuals, businesses, and organizations will be able to earn offset credits when they implement projects that result in incremental emission reductions or removals beyond what they would have done under normal business activities. Once created, verified offset credits can be sold to the Climate Fund, to Large Final Emitter companies, and, potentially, to other domestic buyers.

Access Of Entities To The International Market, Including Project-Based Mechanisms

Under the proposed LFE system, entities will have several options to meet their legal obligations, including procurement from the international market for Kyoto-compliant project based credits (CDM and JI). They will also have access to AAUs from economies in transition as long as they are "greened". Criteria to define "greening" are currently under development.

Prospects Of Linking With Other Systems And Potential Issues Arising From Linking

Canada recognizes that benefits may accrue from linking our trading system to other systems. Since 2003, we have had an informal dialogue with the European Commission on linking to the EU ETS within the framework of the Kyoto Protocol. Although these discussions have been positive, no decision has yet been made to link to the EU ETS. Additionally, given our high degree of economic integration with the United States, in particular, we recognize that consideration needs to be given to accommodating trading with non-Parties to the Kyoto Protocol. To that end, we have already started an informal dialogue exploring the possibility of linking our domestic system to that of the Northeastern United States (Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont) and New South Wales (Australia), but have yet to make a decision to link. Irrespective of where these informal dialogues ultimately lead, we believe they are a useful opportunity to share information on the development of our respective systems and to uncover the various issues that may arise.

Government Intentions To Participate In The Emissions Trading Market

Budget 2005 established the Climate Fund – a permanent institution to purchase greenhouse gas reduction and removal credits on behalf of the Government of Canada. With an initial capitalization of \$1billion, the Climate Fund will pursue three streams of activities: i) purchases of credits generated by our domestic offsets system; ii) advance purchases of these credits under special conditions; and iii) purchases of international Kyoto units, where doing so is of benefit to Canada. Additionally, all purchases will be undertaken through a competitive process.

We are proceeding this fall with consultations on all aspects of the Climate Fund's mandate. Our first round will focus on further elaborating the criteria surrounding international purchases, bearing in mind that our 2005 Project Green stated that all international purchases have to have *one* of the following characteristics: apply Canadian technology; improve Canada's international competitiveness; expand Canada's trade or otherwise advance our national interest; or advance Canada's international development objectives. Additionally, Project Green stated that any purchases of AAUs would need to be "greened". In our second round of consultations we will focus on elaborating the Climate Fund's competitive procurement process and rules surrounding the selection and administration of domestic projects qualifying for advanced purchases.

In parallel with these consultations, we will be taking the institutional steps required to establish the Climate Fund agency, including the appointment of a President and Advisory Board.

It is our current intention that the Climate Fund will be fully established to begin making arrangements for the acquisition of domestic credits and Kyoto units no later than March 31, 2006.