

Canada's Clean Fuel Regulations

Submission to the Senate of Canada's Standing Committee on Energy, the Environment and Natural Resources

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Regarding: Pre-study of Bill C-47 to amend the Canadian Environmental Protection Act to establish the Clean Fuel Regulations' Environmental Economic Instruments Fund

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Chair and committee members, thank you for the invitation to participate on this panel regarding the pre-study of Bill C-47, *Budget Implementation Act, 2023 (No. 1)*. We understand that the purpose of this study is to modify Part 11 of the Canadian Environmental Protection Act, 1999, to establish the Environmental Economic Instruments Fund. In doing so, the Minister of Environment and Climate Change Canada will be able to collect contributions from parties regulated under the Clean Fuel Regulations (CFR).

The Pembina Institute is a non-partisan, national charitable organization that advocates for a science-based approach to climate and clean energy policy development in Canada. We are also part of a coalition of clean fuel industry organizations and environmental non-governmental organizations that has supported the CFR since the Government of Canada first announced its commitment to develop a policy in 2016.

The objective of my remarks today are twofold: first, to communicate our support of the regulations; and second, to provide recommendations on how the federal government may clarify the intent and scope of any eligible fund under the regulations. The final regulations offer limited administrative guidance on the intended use of eligible funds established by different players. There is a risk that funds could, unintentionally, be used for activities beyond the scope of the regulation. This is an opportunity for the federal government to create a properly functioning compliance framework and thus ensure that the regulation delivers the anticipated greenhouse gas emissions reductions of 18 Mt CO₂e per year by 2030.

The impact of a CFR: healthy climate and clean economy

The Clean Fuel Regulations are essential to Canada's climate plan to meet its enhanced Paris Agreement target to reduce emissions by 40-45% from 2005 levels by 2030 and achieve net-zero emissions by 2050. The CFR has proven to be a cost-effective means to incentivizing oil and gas producers and suppliers to reduce the life cycle emissions of fuel production and to attract new investment in the clean fuel technologies needed in Canada's future lower-carbon energy system. When fully implemented, the Clean Fuel Regulations alone are expected to reduce emissions from our atmosphere by 204 Mt CO₂e by 2040. The success of the CFR in achieving the intended objectives depends on an effective compliance framework.

Considerations and recommendations for an effective Environmental Economic Instruments Fund

As per the Clean Fuel Regulations, the Minister of Environment and Climate Change may establish a federal compliance fund (or authorize eligible funds administered by provincial government or Canadian non-profit entities). Primary suppliers can contribute to a compliance fund mechanism for up to 10% of their annual reduction requirement. While this stipulation is commendable as a means of ensuring the purpose of the CFR to reduce carbon emissions from transportation fuels used in Canada, the intent and scope of any eligible fund remains vague. To assist in providing greater clarity, our recommendations to the committee are as follows:

- 1. Provide overarching policy direction for eligible funds:** While the pre-study of Bill C-47 is for an Environmental Economic Instruments Fund, please note that the regulation offers the flexibility for more than one compliance fund to be established (per s. 113(a), 114 and 117). Provincial governments or Canadian non-profits can also apply to create an eligible fund (per s. 114). For these reasons, the federal government should provide greater clarity to ensure that the potential for multiple compliance fund mechanisms do not undermine the environmental integrity of the regulation.
- 2. Establish that the funds be used for near-future emission reductions:** Contributions made to the compliance fund must be used to support projects that will achieve a reduction in CO₂e emissions in the short term. To ensure that funds are used to achieve the objective of emission reduction in the near term, we recommend that:
 - Fund(s) should prioritize investing in projects that deliver quantifiable emission reductions within a one-to-three-year period of receiving funding. Lesser, but still important, priority should be placed on research, development and demonstration projects that may take more than five years to make significant emission reductions but will lead to more technically and economically viable emission reductions down the road.

- Fund(s) should be directed solely to lower carbon emissions associated with transportation fuels used in Canada. The Minister should prioritize investment opportunities for Compliance Category 2 and 3 type projects as they directly reduce emissions from combusted fuels, in the case of CC2, and displace the use of fossil fuels, in the case of CC3.
- Fund(s) should not be used to primarily meet the goals of any regulation other than CFR, such as the Output-Based Pricing System, Technology Innovation and Emissions Reduction Regulation or the like.
- Fund(s) should be efficiently used to incent emission reductions that can demonstrate financial need for support. Due to stacked federal and provincial incentives, projects may be eligible for multiple funding opportunities. This is all the more reason for the federal compliance fund to establish criteria for eligibility to prevent over-compensating some projects at the expense of others and to ensure the most cost-effective means of disbursement. The Senate could undertake a study of this issue, focusing on the economics of several types of emission reduction projects in different Canadian jurisdictions.

3. **Ensure the compliance fund is the last resort to meet compliance.** Because the CFR has been part of the policy landscape since 2016 with extensive consultations over the years, fossil fuel and low-carbon fuel producers have had ample time to prepare for the regulations. Additionally, Canada’s fuel refiners and importers have extensive knowledge of the low-carbon fuel requirements in other jurisdictions, as well as full knowledge of the three primary compliance pathways to meet the compliance requirements in the CFR.

It must be clear that an obligated party purchase all available credits pledged to a market-clearing mechanism; if they are still in a non-compliant position, they become eligible to purchase credits from the compliance fund. The fund represents a ceiling on compliance costs that comes into effect when cheaper options have been exhausted.

Conclusion

I would like to thank the committee for the invitation to speak today. We commend the Government of Canada for operationalizing a key element of the CFR. We hope that the committee consider our recommendations to strengthen the Environmental Economic Instruments Fund and ensure that its intended purpose remains intact and transparent.