October 16, 2023

To: Hon. Chrystia Freeland, Deputy Prime Minister & Minister of Finance

CC: Hon. Jonathan Wilkinson, Minister of Natural Resources
Hon. Steven Guilbeault, Minister of Environment and Climate Change
Hon. François-Philippe Champagne, Minister of Innovation, Science and Industry
Patrick Charbaneau, Public Sector Pension Investment Board, Canada Growth Fund

Re: Ensuring Carbon Contracts for Difference Won't Undermine Carbon Pricing

Dear Ministers,

We are writing to share our recommendations on the design of carbon contracts for difference (CCfD). We believe that CCfDs have an important role to play in creating certainty around carbon pricing and therefore can help incentivize new low-carbon projects at no additional cost to the government. However, **poorly designed CCfDs risk undermining carbon pricing and resulting in significant fossil fuel subsidies**. In addition, if CCfDs are used for carbon capture and storage in the energy sector, they risk further entrenching carbon lock-in or stranded assets.

Recommendations

- CCfDs should only guarantee the federal benchmark carbon price schedule and not the price of carbon credits. Guaranteeing the price of carbon credits risks undermining carbon pricing by disincentivizing any tightening of the industrial carbon price by provinces and territories, resulting in substantial fossil fuel subsidies (see below). Contracts guaranteeing carbon credits should only be issued by relevant provincial governments, as they exert influence over carbon credit markets.
- The contracts should stipulate that a payout will only happen in the event that both of the following events occur:
    - A policy change from the federal government that reduces the price or scope of the scheduled carbon price, or reduces the enforcement of the benchmark;
    - In response to federal policy changes to the carbon pricing schedule, provincial or territorial governments do not maintain their own carbon pricing regimes in line with the current federal schedule.
- The prices guaranteed by the contracts should be lower than the current scheduled carbon price. This will ensure that companies continue to advocate for maintaining or strengthening the carbon pricing framework, and avoids creating a perverse incentive for companies receiving contracts to lobby for weakening of carbon pricing systems.
- Require that eventual payouts be tied to verified emissions reductions, calculated on a lifecycle basis, rather than to projected or promised emissions reductions.
- Avoid any structure that would create de facto production credits. The contracts should not include any agreements on specific quotas or volumes of credits. Doing so risks generating a payout even if emissions reductions are not actually achieved.

- CCfD should only be available to new projects, since the purpose of CCfDs should be to incentivize additional decarbonization. Companies must prove that these are investments that they wouldn't have otherwise made absent the policy. Companies must also prove that verified emissions reductions are the direct result of the company's investments, and that emissions would not have been reduced otherwise. This includes the provision of baseline emissions data and ongoing emissions-reduction data.
- Restrict CCfD support only to industries aligned with the pathway to a decarbonized economy, as set out by the International Energy Agency in their updated Net-Zero by 2050 analysis (industries such as cement, steel, agriculture, etc). Limiting temperature rise to 1.5°C requires a full transition off fossil fuel consumption, production and export. Therefore, the oil and gas industry must not be eligible for CCfDs. Investments in carbon capture and storage in the energy sector generate significant risk of carbon lock-in or stranded assets. Even absent the oil and gas sector, the demand for CCfD from other sectors would be significant enough to ensure a broad program.
- Given that the policy risk on the carbon price for smaller emitters is likely greater than for the output-based pricing that applies to large emitters, ensure CCfDs can be used to support aggregated low-carbon investments, such as for heat pumps or electrified public transit.
- Include climate criteria into the design of the program. Specifically, require proponents to have climate plans that align with the recommendations from the UN's High-Level Expert Group on the Net-Zero Emissions Commitments of Non-State Entities.
- Limit the use of the Canada Growth Fund (CGF) to backstop CCfDs. The CGF is an important source of concessional finance for unlocking private investment in the energy transition. Tying up significant funds to cover potential contracts could limit the impact of this fund. CGF should look beyond investments targeting existing industrial emitters to reduce their carbon price exposure, and flow capital into new and disruptive investments in electrification and efficiency.

We are especially concerned that CCfD may be used to guarantee the price of carbon credits in addition to or in place of the benchmark carbon price itself. This approach risks undermining carbon pricing, by disincentivizing any tightening of the industrial carbon price by provinces and territories, with the knowledge that the federal government would be on the hook financially. CCfDs on credit prices could result in substantial perverse subsidies from the federal government.

There is a risk of oversupply of credits; this is the product of output-based systems which are overly generous to big polluters. The best way to counter the risk of a credit oversupply is to significantly increase the stringency of output-based pricing systems, which were always intended to be a temporary measure on the path to a harmonized, economy-wide carbon pricing system.

Introducing carbon pricing was meant to internalize the cost of pollution and not to generate sources of revenue for large emitters. **The objective of CCfD should be decreasing political uncertainty around carbon pricing, not guaranteeing companies' profits while removing all of the market risk.**

Sincerely,

Environmental Defence Canada
Climate Action Network Canada
Shift | Action for Pension Wealth and Planet Health
Climate Reality Project Canada
Canadian Environmental Law Association
Équiterre
Stand.earth
Citizens' Climate Lobby Canada
Conservation Council of New Brunswick

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Dr. Jeff Everett, Professor, Schulich School of Business, York University
Dr. Deborah de Lange, Associate Professor, Global Management Studies, Ted Rogers School of Management, Toronto Metropolitan University
Dr. Dianne Saxe, Toronto City Council and last Environmental Commissioner of Ontario
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