

# Response to the Proposed Frame for the Government of Canada's Clean Electricity Regulations

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This document presents feedback from the Canadian Climate Institute on the [proposed frame for the Clean Electricity Regulations](#) (CER, formerly the Clean Electricity Standard) that the federal government published in July 2022. It draws from Canadian Climate Institute publications on this and related topics, including a January [piece in Policy Options](#), our report *The Big Switch: Powering Canada's Net Zero Future*, and its two companion technical reports *Bigger, Cleaner, Smarter: Pathways for aligning Canadian electricity systems with net zero* and *Electric Federalism: Policy for aligning Canadian electricity systems with net zero*.

We provide feedback across six specific topics:

1. Ambiguity around the treatment of existing units
2. Exemptions from financial compliance requirements for emergency use
3. Delivering on Canada's net zero commitment
4. The fate of output-based pricing in the electricity sector
5. Policy durability – making the CER work stand-alone
6. Dealing with affordability and equity concerns

We close with a summary of our recommendations for how the regulation should be designed—and what kinds of larger policy changes should also be pursued—as the government works to elaborate this policy in more detailed proposed regulations.

## 1. Ambiguity around the treatment of existing units

The proposed frame, as it is currently articulated, does not specify whether existing units will be exempt from the Clean Electricity Regulations (CER) until the end of their prescribed lives, or only from the performance standard part of the regulation. The former would be quite problematic, as it would exempt them from any compliance obligations under this policy, and likely put the net zero target out of reach (especially if output-based pricing for the sector remained in place—see #3).

Based on conversations with the department, it appears that the intended design is the latter—that is, for the exemption to only apply to the performance standard part of the regulation, with existing units needing to either procure negative emissions as of 2035 or make financial compliance payments against their emissions. However, the current ambiguity in the text risks shaping incorrect expectations on the part of regulated entities, and it should be publicly clarified as soon as possible.

An additional element needing clarification is how long existing units' "prescribed" lives would extend. This design element appears to have been left intentionally undefined for now. But because it is such a central and critical design feature, it should be clarified as soon as is reasonably possible.

## 2. Exemptions from financial compliance requirements for emergency use

Provisions for allowing emergency use of emissions-generating units are understandable; however, exempting this use from financial compliance obligations (or from a requirement to procure offsetting negative emissions) means that utilities and operators will face a weak financial incentive to secure access to non-emitting emergency generation capacity.

Given that emergency use is likely to be marginal, there is little justification for this exemption, since the costs of this kind of compliance are not likely to be especially high for ratepayers.

## 3. Delivering on Canada's net zero commitment

Given 1) that this regulation is to fall under the Canadian Environmental Protection Act (CEPA), which carries criminal liability for failing to meet its requirements; 2) the imperative to ensure reliable electricity supply; and 3) the fact that emissions sequestration may not necessarily be available to operators to offset emissions from the generation they oversee, it is understandable that financial payment (in line with the full carbon price at the time) would be available as a compliance option. If this were not available, operators who could not secure access to negative emissions (or even just faced a *risk* of not successfully securing access) would be forced to permit brownouts or blackouts in some circumstances, or otherwise risk criminal prosecution.

Including this provision means that there is likely to be some amount of net positive emissions coming from the sector under the regulation, which would be inconsistent with the government's stated commitment of having net zero electricity generation by 2035. Still, there are other means of securing negative emissions, outside of the scope of this regulation, that could allow the government to deliver on its commitment of having net zero electricity generation by 2035.

In particular, the government could commit to using the proceeds from the financial compliance payments on emissions (which should include payment for emergency use; see #2) to secure Greenhouse Gas sequestration on behalf of the sector.<sup>1</sup>

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<sup>1</sup> In any case, clarity is required around how the government would intend to use the revenues it collects, since the proposed frame is currently silent on this.

The most meaningful version of this commitment would be for the government to commit to securing the sequestration even if the financial proceeds from the regulation were insufficient to cover the sequestration's full costs. While this would come at a net cost to government, it would have the significant co-benefit of building Canada's capacity to deliver negative emissions—particularly if the sequestration were restricted to direct air capture or other engineered types of negative emissions, which can deliver sequestration that is more permanent and additional than nature-based types of sequestration, and is also going to be a key technology in efforts to offset unavoidable emissions and deliver the net negative emissions that will eventually be needed to stabilize the global climate.<sup>2</sup>

Absent these kinds of actions or commitments from the government, the regulation would deliver near-zero emissions rather than net zero emissions, and the government would fail to meet its stated commitment. If this were the case, Canada's climate credibility would risk being undermined; and, at a minimum, it would require the federal government to modify or withdraw its net zero commitment.

## 4. The fate of output-based pricing in the electricity sector

As we discuss in our report *Electric Federalism*, doing away with the current output-based approach to electricity sector carbon pricing and instead applying the full carbon price to electricity and returning all the revenue to ratepayers (to help keep electricity costs low) would allow carbon pricing to work effectively in tandem with a CER. However, the federal government's proposed frame is silent on these potential changes to carbon pricing. This raises the question of what kind of price signal the sector will get between now and 2035, and thereby, how much its emissions will fall by then. If the current output-based approach is maintained, it will provide only a weak incentive for facilities to cut their emissions over the next decade, and will leave the sector poorly positioned to reduce its emissions to net zero. This is especially the case given the fuel-specific benchmarks that the federal policy applies in electricity, which provide a weak abatement incentive to natural gas generation.

While it is admittedly beyond the scope of this regulation, the fate of output-based pricing is a critically important question when assessing both the viability and cost-effectiveness of the sector's pathway to net zero. It also significantly impacts expectations and planning and investment decisions in the sector. Therefore, the government's intentions here should be clarified as soon as possible.

Ideally, output-based pricing would be phased out immediately, and the full carbon arrangement described in the preceding paragraph) and removed from its obligations under the Greenhouse Gas Pollution Pricing Act. This would have the added benefit of making the CER a policy that has meaningful impacts in the near-term, rather than taking more than a decade to have any significant effect on electricity sector emissions.

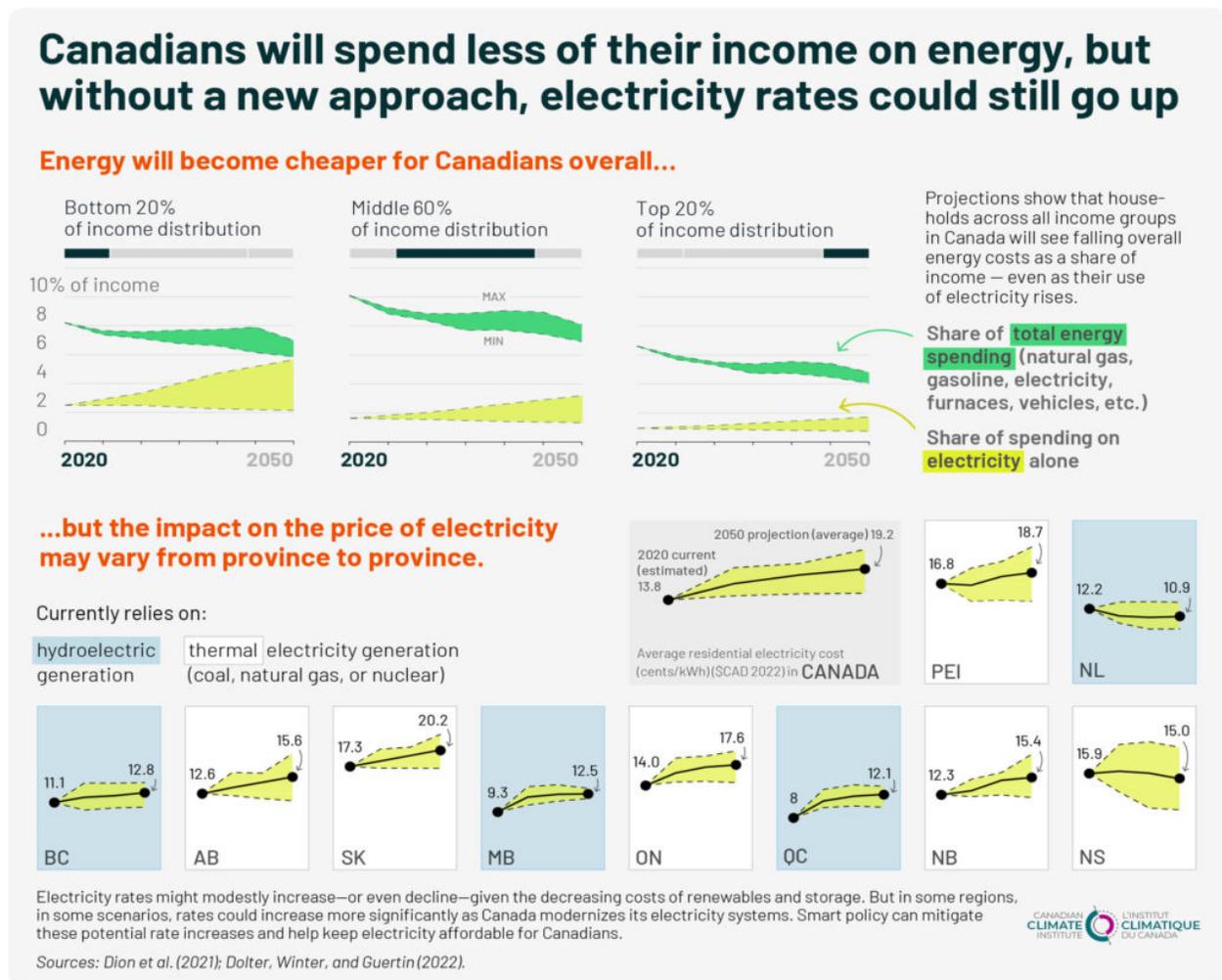
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<sup>2</sup> An additional option that would reduce direct costs to electricity consumers is to earmark the financial compliance revenues for recycling to ratepayers (i.e., instead of using the funds to procure negative emissions) and have the government commit to procuring offsetting negative emissions outside of the scope of this regulation and bearing their full cost using public funds. This would require more significant use of public funds, but could be valuable as a way of reducing direct costs to consumers while still credibly meeting the net zero commitment. And it would also have the significant co-benefit of developing negative emissions capacity and expertise in Canada.

## 5. Dealing with affordability and equity concerns

Both the proposed frame and conversations with the department reveal that there is—rightly—a significant concern around the effect that the CER would have on the affordability of electricity and the impacts that rising electricity costs could have on low-income households.

Designing efficient and cost-effective policy can help address these concerns. At the same time, good design can only mitigate costs up to a certain point, and there is a very real risk of rising electricity rates as a result of efforts to align Canadian electricity systems with net zero, as seen in the figure below. And rising electricity rates would disproportionately impact low-income households.



Source: *Electric Federalism: Policy for aligning Canadian electricity systems with net zero*. Canadian Climate Institute. 2022. <https://climateinstitute.ca/wp-content/uploads/2022/05/Electric-Federalism-May-4-2022.pdf>

Concerns around affordability and equity are one of the key reasons that the Climate Institute recommends in its report *Electric Federalism* that Canadian governments publicly invest in electricity systems and provide targeted supports to low-income ratepayers. And as our forthcoming research paper (embargoed copy attached) proves, public investment in electricity systems disproportionately benefits lower-income households, who tend to spend a greater share of their incomes on electricity.

Concerns about affordability and equity are warranted, but they should not be used to justify less ambitious climate policy. Instead, these impacts should be addressed directly, by bringing in new supports or strengthening existing ones (indeed, provinces commonly provide supports to low-income ratepayers already), or by provinces exploring new rate designs (see attached embargoed paper).

The federal government made a commitment to reach net zero electricity generation by 2035, and presumably it did so with some knowledge of what the costs and impacts could be. Concerns about affordability can and should be addressed directly through other policies and measures, rather than by reducing the stringency of this policy.

Effectively abandoning the net zero commitment in the interest of maintaining affordability for ratepayers is not justifiable when there are other ways of addressing affordability and equity concerns.

## 6. Recommendations

Based on the analysis and feedback outlined above, we make seven recommendations to the federal government regarding the design of its proposed Clean Electricity Regulations:

- 1. Clarify the treatment** that existing units will get under the regulation and clearly define the length of their 'prescribed' lives
- 2. Require financial compliance** for emergency use of emissions-generating facilities
- 3. Make a credible commitment** that the government will procure negative emissions to offset any emissions from the sector post-2035
- 4. Clarify intentions** for the recycling of financial compliance revenues
- 5. Do away with output-based pricing in the sector**, potentially by applying a price schedule under the CER as of 2025 and removing it from obligations under the Greenhouse Gas Pollution Pricing Act
- 6. Ensure that the CER is resilient** to the overturning of the Greenhouse Gas Pollution Pricing Act
- 7. Address affordability and equity** outside the scope of the CER, rather than by servicing these goals in ways that dilute the effectiveness of the CER and potentially abandon delivery on the net zero target