

BC Forest Industry Working Group on Climate Change

Recommendations to the WCI

on the

“Allocations Discussion Document”

January 31, 2008



The BC Forest Industry Working Group on Climate Change

The BC Forest Industry Working Group on Climate Change (The Working Group) is an industry co-operative made up of representatives of British Columbia's pulp and paper mills, sawmills and the province's two major forestry associations.

As a group, we work to present an understanding of the value of our sector. As one of BC's largest industrial employers and single largest consumer of electricity, our sector is the backbone of many communities and contributes extensively to the provincial economy.

We also work to ensure that forest and related provincial policy is created and implemented in a way that fosters growth and increased competitiveness for our sector and for BC as a whole. We are committed to our industry and believe that it will be a significant contributor to the BC economy for years to come.

Our sector has implemented dramatic improvements over the past decade including sustainable forest management practices, energy reduction initiatives and fuel switching projects. The sector has delivered the strongest greenhouse gas record in the province with total current reductions of about 50% compared to 1990 levels; equivalent to the removal of 2.5 million tonnes of carbon. The sector is currently focusing on opportunities to create new biomass products, generate more carbon-neutral biomass based power and provide solutions to BC's pine beetle epidemic.

Members of the Working Group include:

AbitibiBowater

Canfor Corporation

Canfor Pulp Limited Partnership

Catalyst Paper

Cariboo Pulp

Coast Forest Products Association – representing 22 BC forest products companies

Council of Forest Industries – representing 50 BC forest products companies

Domtar Pulp and Paper Products

Howe Sound Pulp and Paper

Mercer International

Neucel Specialty Cellulose

Pope and Talbot

Tembec Enterprises

Tolko Industries

West Fraser

1 Apportionment of Allowances

Apportionment means the subdivision of the regional cap and trade emissions cap among the participating jurisdictions. The question here is whether each Partner should be authorized to distribute allowances equal to that Partner's share of the regional cap, or, whether a regional entity should distribute allowances on behalf of all the Partners without apportioning the regional cap among them.

- a. Should allowances be distributed centrally, without apportionment to Partners?*
- b. Or, should allowances be apportioned to, and distributed by Partners individually?*
- c. Or, should some combination of centralized distribution and apportionment be pursued?*
- d. ISSUE: The Allocations Subcommittee recognizes that centralized distribution will require more intensive cooperation and a different approach to the exercise of provincial, state and tribal authority. Comments, observations and recommendations are being sought to assist the committee with mechanisms for design and implementation of a regional allocation system.*

1.1 Working Group recommendation on Apportionment

The Working Group feels strongly that **Option b** should be followed. A centralized approach cannot possibly be effective recognizing and understanding local issues and markets by tailoring local solutions. Inconsistency across Partners is ultimately less important than appropriate local distribution by the Partner. Fundamentally, each Partner needs freedom in distributing its allowances based on the uniqueness of its carbon footprint, its geography, its climate, and its economy.

- Each of the WCI Partners have significantly unique characteristics which local governments understand best.
- British Columbia in particular has an unusual carbon footprint because of its high percentage of hydroelectric power generation.
- British Columbia has unique opportunities especially related to energy generation with new hydropower and greater use of carbon neutral biomass fuels.
- British Columbia has committed to carbon neutral power generation by 2016 and as such that component of its carbon footprint will not receive allowances.

As per **issue 1d**, the Working Group believes a centralized approach having to overcome US state and Canadian provincial boundaries across two nations with highly differing Indigenous People's policies **is ultimately unworkable** from a legal, political and social perspective. Carbon allowances should be apportioned to the Partners for their appropriate distribution..

2 Distribution of Allowances

Distribution or allocation of allowances means the process by which emissions allowances are distributed for use by covered sources under an emissions cap and trade system. The question here is to what degree distribution by the Partners should be made uniform, or standardized, among participating jurisdictions.

- a. Assuming allowances are distributed by Partners, should distribution methods be standardized?*
- b. Assuming allowances are distributed by Partners, should distribution methods be left to each jurisdiction to decide?*
- c. Or, should some flexibility be allowed within prescribed limits beyond which all Partners must adopt the same distribution system?*
- d. ISSUE: The Allocations Subcommittee recognizes that there are many more detailed questions concerning the distribution of allowances than are asked here. The subcommittee anticipates seeking comment on these questions at a later time.*
- e. ISSUE: The Allocations Subcommittee recognizes the special challenges associated with the development of a regional system that could successfully merge into a future national program, and the additional complications of developing a single regional program that can accomplish this in two nations. The subcommittee seeks comments on how to ensure that the proposed and potential future programs will function well together.*

2.1 Working Group Recommendation on Distribution

The Working Group believes **Option c should be followed**. Concerns over inconsistency of allocation raised in the previous question can likely be handled with a flexible distribution system with limits. This approach could provide all Partners with a general framework that has limits but provides freedom to customize based on the uniqueness of the Partner.

As per **issue e**, it is clear that development of **individual Partner distribution schemes will greatly ease harmonization** issues likely to challenge Canadian provinces involved in the WCI and potential Canadian Federal initiatives. This same issue is likely to repeat for participating US states in the WCI.

3 Allocation Methods

There are multiple ways allowances can be distributed or allocated for use by covered sources. The question here is whether and to what degree allowances should be distributed directly to covered sources free of charge.

- a. Assuming there is centralized distribution or at least partial standardization of decentralized distribution, should some of the allowances be distributed directly to covered entities free-of-charge?*
- b. Assuming there is centralized distribution or at least partial standardization of decentralized distribution, should some or all of the allowances be auctioned or otherwise sold?*
- c. Should the allowance distribution system have the capacity to change over the life of the program through phasing in particular distribution methods or using different distribution bases?*
- d. Should the Partners place restrictions on the use of revenues from auctioned allowances?*

3.1 Working Group Recommendation on Allocation Methods

The Working Group believes that entities currently discharging carbon are **entitled to the free distribution of allowances**. To charge for allowances artificially increases the costs of complying with carbon policies since this is above the cost associated with reductions or the purchase of offsets. Many entities cannot easily pass these costs through to customers.

The Working Group believes that, in strong growth sectors, competition for the purchase of allowances will push their pricing toward the level of market offsets while low growth sectors with fewer interested entrants will enjoy relatively low competition in the auction or sale of allowances. On that presumption, the Working Group believes that there should be **some auctioning and sale of allowances related to a sector's growth**. Most allowances should be distributed free into a given sector while a percentage are withheld for subsequent auction or sale. The percentage of allowances withheld could relate to the predicted or experienced growth in a sector. Failure to provide access to these (potentially) more economic allowances could be a barrier to entry since it represents higher costs for new entrants compared to current players.

The Working Group believes that the **allowance distribution system should be flexible** to reflect potential changes in technologies, delivered carbon reductions, or even identified policy oversights that are causing undue social or economic impacts. However, the degree of flexibility should manifest itself over many years rather than on an annual basis.

The Working Group believes that there should be **restrictions on use of revenue** from the sale or auction of allowances. Such funds should be redirected back into the jurisdiction and sector from where they originated to foster new technologies or other initiatives that help the sector improve its carbon performance.

4 Early Actions

Any cap and trade system implemented by the WCI Partners will take some time to develop, approve and implement. Sources may see a benefit in delaying investments in GHG emission reductions until the program is underway in order to take full advantage of program incentives or credits. WCI Partners wish to recognize early actions through program design and implementation. The question here is how should the cap and trade program either encourage or hold-harmless emission reductions efforts that occur prior to the start of the program. Of course, all qualifying early actions would have to be quantifiable, verifiable, enforceable and permanent.

- a. *The WCI Design Principles state that the program will “provide appropriate recognition and incentives for early emissions reductions.” Should the program accomplish this:*
 - i. *Through the selection of benchmarking and program start dates?*
 - ii. *Through special allocations of allowances?*
 1. *Drawn from within the cap?*
 2. *Drawn from outside the cap?*
 - iii. *Through auctioning of allowances?*
 - iv. *By other means?*

4.1 Working Group Recommendation on Early Action

The Working Group suffered a costly and difficult lesson on the topic of credit for early action. The forest industry in BC has delivered carbon reductions in excess of 2.5 MT CO₂e since 1990 based on federal promises of credit to early movers on the carbon issue. Subsequently, all of those reductions have been surrendered in the development of new federal and provincial policy which recognises 2006 and 2007 baseline years.

The Working Group strongly believes that **credit has to be given for early action.** Failing to bring that surety to the market will result in delay and cancellation of projects until the costs and benefits of carbon are included with the cap and trade program coming into force.

Carbon policies and inception dates must be clearly defined. Allocation of carbon to credit early actors can come **from within or outside the cap.** Ultimately, if early reductions are included in absolute measures then the credit for early action allocation should be within the cap. If a baseline year is established when the carbon cap comes into place forcing early action reductions outside the accounting window, then the early action allocation should be outside of the cap.

The Working Group believes there should be **no auctioning of allowances.** They should be given at no cost to qualifying entities based on absolute reductions and the availability of allowances.