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China's Proposed National Carbon Market and Opportunities for Cooperation with Canada

By Roger Song and Ky Kvisle

While there is some uncertainty on how the U.S. climate strategy will evolve under a Trump presidency, a number of new carbon emissions regulations and control strategies continue to be developed throughout the world, notably in China and Canada.

Both China and Canada ratified the Paris Agreement in September and October 2016 respectively, and it was entered into force on November 4, 2016. As one of its key greenhouse gas (GHG) emissions control initiatives, in 2017, China plans to establish a national carbon market (Chinese Carbon Market), according to China's President Xi Jinping.

Once in place, the Chinese Carbon Market will be the largest carbon cap-and-trade scheme in the world, essentially involving all of China's local provincial governments (Local Governments) with oversight and guidance from the Central Government of China (Central Government).

In September 2016, at the Forum on Development of China's Carbon Market (2016 Forum) in Beijing, Deputy Director General of the Department of Climate Change at the National Development and Reform Commission (NDRC), Zhaoli Jiang, outlined the structure, regulatory framework and implementation of the Chinese Carbon Market. Mr. Jiang's presentation was based on NDRC's Tentative Measures for the Administration of Trading of Carbon Emissions Rights (Tentative Measures) and NDRC's draft regulation on the national carbon market (Draft National Regulation), which is currently under review by the State Council of China.

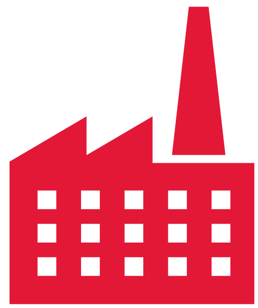
Mr. Jiang indicated at the 2016 Forum that the emission quotas allocated in the Chinese Carbon Market will initially reach three to five billion tonnes of GHG emissions — twice the size of the European Union's emission trading scheme and larger than all existing carbon markets combined, as reported by the International Centre for Trade and Sustainable Development.

This article provides an outline on how the Chinese Carbon Market is expected to be implemented, how it will operate, and considers the potential for collaboration between Canada and China to reduce global GHG emissions on an aggregate basis.

TWO-TIER SYSTEM AND KEY EMISSIONS ENTITIES

Since October 2011, China has launched pilot carbon markets in two provinces (Hubei and Guangdong) and five cities: Beijing, Tianjin, Shanghai, Chongqing and Shenzhen. China is now preparing to roll out carbon markets on a national basis. Under the Draft National Regulation, the Chinese Carbon Market will be a two-tier system where the applicable Central Government department will be responsible for regulating and supervising the Chinese Carbon Market at the national level. The Central Government will determine GHG categories, the scope of industries, and the criteria of the companies or entities that the Chinese Carbon Market will cover. It will also approve, supervise and regulate the carbon exchanges. The Local Governments will have primary responsibility for implementation and monitoring in their jurisdictions.

Only companies or enterprises (Key Emissions Entities) that meet certain criteria published or approved by the Central Government will be subject to the Chinese Carbon Market's emissions regulation.



Under NDRC's circular on ensuring efficient implementation of major works for initiating a national carbon market — issued on January 19, 2016 to its subordinate commissions at the provincial level — the Key Emissions Entities will initially include enterprises that consume a total energy resource of 10,000 tonnes of coal equivalent or more per year between 2013 and 2015 in eight major industries with material GHG emissions. The subject industries will initially include petrochemicals, chemicals, building production and materials, iron and steel, non-ferrous metals, pulp and paper, power, and aviation.

Local Governments will determine what entities in their respective jurisdictions will be designated as the Key Emissions Entities and the Central Government will verify and approve them. Smaller companies or entities that do not meet the criteria for Key Emissions Entities will initially be exempt from regulation under the cap-and-trade system.

The Central Government will determine a national quota for GHGs and will allocate a specific quota to each province, taking into account the situation of the various Key Emissions Entities in each province. The Local Governments will then allocate free emissions quotas to each Key Emissions Entity in their jurisdictions, setting forth the amount of GHGs that a Key Emissions Entity will be entitled to emit without penalty.

CARBON TRADE PRODUCTS

The Draft National Regulation provides that the trading products at the carbon exchanges will include GHG emissions quotas (Emissions Quotas), the Chinese Certified Emissions Reduction (CCER) credits, and futures products relating to the quotas and credits. One Emissions Quota will represent a Key Emission Entity's right to emit a quantity of GHGs equivalent to one tonne of carbon dioxide. Title to the Emissions Quotas will be verified through the national registry of carbon trade and may be traded at the carbon exchanges.

The CCER program pertains to voluntary emissions reductions that the Central Government will certify and register with a national system of registration. A Key Emissions Entity will be able to apply CCER credits to offset its actual emissions. The Central Government will develop and issue more detailed rules on the CCER programs in the months to come. Examples of how entities will be able to earn CCER credits include the development and/or implementation of renewableenergy projects and emissions mitigation technologies.

REPORT, VERIFICATION AND CLEARANCE

The Local Governments will have primary responsibility for monitoring and verifying emissions of the Key Emissions Entities in their jurisdictions. Key Emissions Entities will first prepare and submit annual reports of their emissions in the previous accounting year to the Local Governments according to guidelines issued by the Central Government. Local Governments will then verify the reports with the assistance of qualified institutions that are licensed by the Central Government.

If a Key Emissions Entity exceeds its free emissions quota, it will be required to purchase Emissions Quotas from the Chinese Carbon Market or otherwise offset them with CCER credits. In the event that a Key Emissions Entity emits GHGs in a quantity less than the free emission quota allocated to it for the previous accounting year, it may keep the balance for trading at the Chinese Carbon Market or may use those applicable Emissions Quotas against its own emissions in the following accounting year.

LEGAL LIABILITIES

Local Governments will havethe power to impose penalties on Key Emission Entities, carbon verification institutions and their staff, and the carbon exchanges and their staff, for violation of the regulations associated with the Chinese Carbon Market. Potential penalties include fines from RMB$100,000 to RMB$1-million or up to three to five times the market price of the deficient Emission Quota that the Key Emissions Entity would have been required to purchase to ensure compliance. Local Governments may also revoke carbon verification institutions' qualification licences.

TRANSPARENCY

For the Chinese Carbon Market to achieve its desired results, it will need to be seen as legitimate by all participants. As part of its transparency initiative, the Central Government will publish:

- All types of GHGs and industries covered by the Chinese Carbon Market
- The criteria used to determine the status of Key Emissions Entities
- A list of all Key Emissions Entities
- Allocation procedures used to determine free emissions quotas
- Annual quantities of Key Emissions Entities' emissions and surrendered Emissions Quotas
- A list of all qualified institutions involved in carbon verification and monitoring
- A list of all carbon exchanges that are licensed by the Central Government

OPPORTUNITIES FOR COLLABORATION BETWEEN CHINA AND CANADA

While Canada currently does not have any plans to create a nationwide cap-and-trade system similar to the Chinese Carbon Market, a number of provinces including Ontario, Quebec, Alberta, British Columbia and Nova Scotia have either created, or announced intentions to create, forms of cap-and-trade systems. Potential trading of carbon credits between the Chinese Carbon Market and the various cap-and-trade regimes in Canada is not currently contemplated, but given the nature of GHG emissions and the underlying purposes for the creation of such regimes, there may be future opportunities to develop global markets to facilitate global aggregate reductions of GHG emissions.

Article 6 of the Paris Agreement includes provisions on market-based emissions reduction efforts, including the

establishment of a sustainable development mechanism that aims to reduce emission levels in one party, which will benefit from mitigation activities resulting in emission reductions that can also be used by another party to fulfil its nationally determined contribution, thus reducing overall global emissions. Canadian-Chinese cooperation on this basis could help the two countries reduce aggregate GHG emissions between them while also promoting economic development initiatives. Even prior to the development of any global carbon trading mechanisms, there may be opportunity to offset emissions in one country against reductions in the other through that general trade by virtue of financially offsetting any credits that entities or their partners earn in one jurisdiction against any carbon taxes they must pay or carbon credits they must purchase in another jurisdiction. One such example is potential cooperation between companies developing liquefied natural gas export projects in Canada and power producers in China looking to switch their fuel source from coal to cleaner-burning natural gas.

A number of additional business opportunities may arise for a variety of Canadian companies, including those involved in renewable energy or emissions reduction technologies as the development of the Chinese Carbon Market with financial incentives to reduce GHG emissions may lead to an increase in demand for their products. Similarly, financial incentives in China may encourage the development of new technologies that could then be utilized in Canadian jurisdictions to assist in their GHG reduction initiatives.

CONTACT US

Roger Song
403-260-9729
roger.song@blakes.com

Ky Kvisle
403-260-9646
ky.kvisle@blakes.com