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The Supreme Court of Canada upholds the constitutionality of federal carbon pricing legislation

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Introduction

On March 25, 2021, the Supreme Court of Canada (the SCC) released its much-anticipated decision, upholding the constitutionality of the *Greenhouse Gas Pollution Pricing Act* (the Act), the centrepiece of the federal government's climate change plan, which imposes minimum carbon-pricing standards on the provinces. The majority of judges in the 6-3 split decision emphasized the importance of a national approach to addressing climate change. Three dissenting judges would have found the Act unconstitutional. As Canada's highest appeal court, the SCC majority's decision is the final say on the Act's validity.

This Osler Update discusses the legal and practical implications of the decision on industrial greenhouse gas (GHG) emitters, individual taxpayers and the development of Canada's low-carbon economy, among others. The decision provides much-needed clarity on the federal government's ability to impose increasing carbon prices and the value of emission reduction investments going forward. While conclusive on the Act's general constitutionality, the result of this reference case does not preclude future policy changes or challenges to the Act's application in particular circumstances. Indeed, the SCC noted that its analysis is necessarily short-term because the "Court is not equipped to predict the future consequential impact of legislation."

Background: *Greenhouse Gas Pollution Pricing Act*

The Act implements a carbon pricing regime that is central to the federal government's plan to meet Canada's Paris Agreement commitment to reduce GHG emissions to 30% below 2005 levels by 2030.[1] The Act has two main parts: Part 1 imposes a fuel charge on fuel producers and distributers and Part 2 introduces an output-based pricing system (OBPS) for large industrial emitters. These elements impose minimum requirements on provinces and territories that fail to meet the Act's pricing and emissions reduction benchmarks, either because: they failed to enact carbon pricing laws at all, or their regime falls below federal benchmarks for carbon pricing stringency. Currently, at least one part of the Act applies in New Brunswick, Ontario, Manitoba, Saskatchewan, Alberta, Prince Edward Island, Nunavut and Yukon.[2] The other provincial jurisdictions have implemented their own regimes that meet or exceed the requirements in both parts of the Act.

The SCC's review arises from appeals of three provincial court decisions. The main legal issue in all three was whether the federal government has the authority to impose the regime

established in the Act. In May of 2019, a 3-2 majority at the Saskatchewan Court of Appeal said the Act was a valid use of federal legislative jurisdiction. A 4-1 majority at the Ontario Court of Appeal reached the same conclusion in June of 2019. However, in February of 2020, four of five Alberta Court of Appeal judges found the Act to be unconstitutional on the grounds that it exceeded federal jurisdiction.

At the SCC, Canada and British Columbia argued that the Act is within federal jurisdiction under the national concern branch of the Peace Order and Good Government (POGG) clause of the *Constitution Act, 1867*.[3] They argued that the Act's pith and substance (or its true subject matter) is to establish "minimum national standards integral to the nationwide reduction of GHG emissions." Characterized this way, the Act satisfies the "singleness, distinctiveness and indivisibility" test for a national concern. However, the provinces challenging the Act formulated its function more broadly. Saskatchewan argued the Act's pith and substance is "supervising the provinces by exercising jurisdiction to regulate GHG emissions." Ontario said it is "regulation of activities which create [GHGs]." These characterizations suggest the Act steps into the provinces' preserve of legislative powers under the Constitution.

The Supreme Court of Canada's decision

A 6-3 majority of the SCC held that the Act is constitutional and that Parliament has jurisdiction to enact it as a matter of national concern under POGG. In coming to its conclusions, the majority favoured a modern approach to federalism, which is cooperative and flexible. The majority's reasons applied the "double aspect doctrine" to POGG by balancing federal powers under the "national concern doctrine" with enumerated provincial heads of power. The majority considered the importance of preserving provincial autonomy while favouring a flexible view of federalism and the Constitution that supports "modern cooperative federalism."

The majority noted the Act's pith and substance is not to mitigate climate change generally via regulating specific GHG emitting activities or limiting industry operations, but to mitigate climate change through a specific and narrow pan-Canadian GHG pricing mechanism. The majority explained that the Act's legislative intention corresponds with its practical effect by creating a national standard for GHG pricing.

The majority emphasized the backstop nature of the Act, since it only applies where provinces do not have a sufficiently stringent GHG pricing system. This system gives provinces and territories flexibility to design their own context-specific policies, which may include carbon pricing, so long as they meet the minimum national standards.

The majority also noted that the climate crisis is "an existential threat to human life in Canada and around the world" and thus warrants consideration as a matter of national concern. They explained that the provinces, alone or together, are not able to establish minimum national standards and the success of those standards requires national participation. The majority elaborated that a province's refusal to cooperate could have significant extra-provincial effects. The gravity of the environmental concerns justified the Act's potential interference with a province's preferred balance of economic and environmental considerations.

The SCC also held that the fuel and excess emission charges imposed by the Act are sufficiently connected to the regulatory scheme to be considered constitutionally valid regulatory charges that alter behaviour, rather than being characterized as a tax.

Impacts of the decision on Canadians, government and industry

The SCC's decision will affect individual consumers, industry, the relationships between jurisdictions in Canada, and Canada's position as a global business competitor. While critics will argue that increased emissions costs will push certain investment outside the country, proponents will emphasize the decision's positive implications for environmental, social and corporate governance (ESG) initiatives.

Implications for consumers, small business and large industry

The federal government has maintained that the rebate structure associated with the Act, which provides that proceeds generated under the Act are to be distributed to the residents of the province of origin, will negate federal carbon pricing's negative effects on individual taxpayers. Rebates for individual taxpayers will likely rise in step with increases to Part 1's federal fuel charge. However, there has been public criticism of the fuel charge's effectiveness in altering behaviour given that a significant portion of the tax base receives full rebates. These rebates are also criticized for failing to effectively mitigate the fuel charge's impacts on the hardest-hit lower-income Canadians.

Much has been written about the impact of a steadily increasing fuel charge on Canadian business. The fuel charge is currently $30 per tonne and will rise to $40 on April 1, 2021, and $50 on April 1, 2022. From this point onward, the federal Minister of Environment and Climate Change has announced that the government plans to accelerate these increases to reach $170 per tonne by 2030. Some commentators have indicated that a $170 per tonne carbon price could result in a 1.8% decline in national Gross Domestic Product (GDP) and a net loss of 184,000 jobs.[4]

While the exact breadth and scope of the impact of rising fuel charges on Canadian business remains unclear, the SCC's decision upholding the Act provides some much-needed certainty to industry. Operators in low-carbon fuels and renewable sectors — including developers in Canada's growing natural gas, hydrogen, battery storage, wind, solar and biofuels industries — may receive a surge in investment and financing interest based on bolstered financial models for these projects' revenue streams. This is because fuel charge increases can be expected to result in significant upticks to market prices for carbon offset credits, emission performance credits and similar products, which create viable long-term revenue streams for the producers who generate and sell them. Conversely, large industrial carbon emitters, including those in the fossil fuels extraction and petrochemical processing industries, will need to budget for increasingly higher carbon compliance costs to justify their long-term capital projects' viability.

Provincial regulatory patchwork remains a possibility

The SCC's majority decision emphasized that the Act imposes a standardized national pricing floor, while preserving provinces' flexibility to design their own GHG emissions policies, including on carbon pricing. However, that very flexibility also undermines the standardization of carbon regulation across Canada. Many businesses in Canada operate across provincial boundaries. Upholding the Act does not reduce the need for these businesses to expend internal resources to understand, quantify and ensure compliance with disparate provincial regimes.

For provinces with regimes that currently meet the federal pricing and emissions reduction targets, these regimes will continue to be effective, so long as they amend their provincial legislation over time to meet the increasing federal pricing benchmarks. For instance,

Alberta's TIER prices GHG emissions at $40 per tonne and is set to increase to $50 per tonne. Therefore, large carbon emitters in that province will experience no immediate change to their operations or cost of doing business as a result of the SCC's decision. However, the minimum federal benchmarks established by the Act do imply that businesses will not be incentivized to transfer operations from one province to another to arbitrage on carbon compliance costs, at least not below the federal threshold.

Canada's global competitiveness

This decision allows the federal government to continue building on its promise to deliver a unified, long-term Canadian climate change strategy, allowing Canada to join the ranks of other global leaders taking action to address the accelerating threat of climate change. Critics of carbon pricing will argue that the Act's widespread implementation will drive some businesses out of Canada to less climate-conscious jurisdictions, but to others the Act may also increase Canada's attractiveness as a climate-responsible jurisdiction.

ESG factors are gaining momentum as strong drivers of private foreign direct investment and institutional investment, as stakeholders lend their support to more sustainable, less carbon-intensive opportunities.[5] This decision lends further support to the environmental branch of the growing ESG momentum across a wide variety of industries and sectors. Many global corporations and major asset owners have already announced their own commitments to reducing emissions across their operations, and the federal government's ability to implement the Act's carbon pricing regime signals Canada's intention to take concrete action to address climate change. The SCC's decision upholding the Act may remove, or detract from, some climate-motivated opposition to investment in Canadian oil sands or pipeline development.

Political headwinds

The current federal government has put its climate change policy at the centre of its bid for re-election. If it fails to win re-election, the incoming government could revoke or change the Act. For example, the opposition Conservative Party of Canada has said that it is considering other climate-policy alternatives to the Act and its leader has stated that a Conservative government would repeal the Act.

Regardless of the outcome of any potential federal election, the SCC's decision will affect relations and the balance of power between Ottawa and the provinces on the issue of how to address climate change.

For more information on the federal carbon pricing system, as well as other federal and provincial/territorial initiatives to fight climate change, visit Osler's Carbon and Greenhouse Gas Legislation webpage.

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[1] Environment and Climate Change Canada, *United Nations Framework Convention on Climate Change*, online: canada.ca/en/environment-climate-change/corporate/international-affairs/partnerships-organizations/united-nations-framework-climate-change.html.

[2] In Alberta, for example, the provincially enacted Technology Innovation and Emissions

Reduction Regulation (TIER) imposes industrial emissions intensity restrictions, which currently meet the Act's requirements, so that Part 2 of the Act does not apply in Alberta. However, Alberta currently does not have its own fuel charge legislation, so Part 1 of the Act applies in that province.

[3] Where the *Constitution Act, 1867* does not specify whether a particular area of governance is within the jurisdiction of the federal government or the provinces (as is the case with the environment generally and GHG emissions, in particular), POGG's national concern branch empowers the federal government to make laws that inherently concern the entire country.

[4] *Fraser Institute* fraserinstitute.org/sites/default/files/estimated-impacts-of-a-170-dollar-carbon-tax-in-canada.pdf at pgs 4 and 14 (2021).

[5] Robert G. Eccles and Svetlana Klimenko, "The Investor Revolution" (May-June 2019), *Harvard Business Review*, online: hbr.org/2019/05/the-investor-revolution.