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ONTARIO CHALLENGE TO FEDERAL CARBON PRICING SCHEME REJECTED BY COURT OF APPEAL — WHERE DO WE GO FROM HERE?

By Stanley Berger

On June 28, 2019 the Ontario Court of Appeal rejected the Province of Ontario's constitutional challenge of the Canadian Government's carbon pricing legislation, determining that the law fell within the federal government's constitutional authority to make laws for the peace, order and good government of Canada and did not amount to a tax. http://www.ontariocourts.ca/decisions/2019/2019ONCA0544.pdf.

The majority reasons of the Court summarized its subsequent analysis as follows:

> "[4] The need for a collective approach to a matter of national concern, and the risk of non-participation by one or more provinces, permits Canada to adopt minimum national standards to reduce GHG (greenhouse gas) emissions. The Act does this and no more. It leaves ample scope for provincial legislation in relation to the environment, climate change and GHGs, while narrowly constraining federal jurisdiction to address the risk of provincial inaction."

***Greenhouse Gas Pollution Pricing Act*, Part 5 of the *Budget Implementation Act*, 2018, No. 1, S.C. 2018, c. 12.**

The Court described the challenged federal law as follows:

> "34. The Act puts a price on carbon pollution in order to reduce GHG emissions and to encourage innovation and the use of clean technologies. It does so in two ways. First, it places a regulatory charge on carbon-based fuels. This charge is imposed on certain producers, distributors and importers and will increase annually from 2019 through to 2022. Second, it establishes a regulatory trading system applicable to large industrial emitters of GHGs. This is referred to as an OutputBased Pricing System (the "**OBPS**"). It includes limits on emissions, a "credit" to those who operate within their limit, and a "charge" on those who exceed it. Net revenues from the fuel charge and excess emissions charge are returned to the province of origin, or to other prescribed persons.
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> [35] The Act does not apply in all provinces. Rather, the Act and its regulations serve as the "backstop" contemplated by the Pan-Canadian

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> Framework in those provinces that have not adopted sufficiently "stringent" carbon pricing mechanisms..."

The fuel charge on some 21 fuels that emit GHG's for 2019 would, under the law, be $20 per tonne of CO_2 equivalent emitted by the combustion of each fuel. That rate would increase annually by $10 per tonne, up to $50 per tonne in 2022. The OBPS Pricing system would operate in two ways: First, if a facility's emissions fall below its prescribed limit, the facility will be issued surplus credits called "compliance units". Second, if a facility's emissions exceed its prescribed limit, the facility must pay compensation for its excess emissions. Compensation may be made by remitting compliance units, paying an excess emissions "charge payment" to Canada, or doing a combination of both. The legislation contemplates the possibility of creating an emissions trading system for compliance units.

Ontario's argument against the law

Ontario argued that the these provisions in the legislation were unconstitutional. Parliament was not entitled to regulate all activities that produce GHG emissions and that the jurisdiction Canada asserted under the Act would radically alter the constitutional balance between federal and provincial powers. Ontario's position was that as of 2016, the province had substantially cut annual emissions by 22% below 2005 levels and that going forward, it would reduce its emissions by 30 percent below 2005 levels by 2030, which aligned with Canada's target under the Paris Agreement. It would do so, for example, by updating its Building Code, increasing the renewable content of gasoline, establishing emissions standards for large emitters, and reducing food waste and organic waste.

Upholding the law as a matter of national concern reserved to the federal government

The Court responded by observing that "there is today a greater appreciation that environmental pollution can transcend national and international boundaries and it is no longer thought of as a purely local concern." [at par. 80] Significantly, the Court noted that "the fact that a challenged law is related to Canada's international obligations is pertinent to its importance to Canada as a whole." (par. 106)

Canadian constitutional law precedent requires that for a matter to be of national concern it must be single, distinct and indivisible. This limits national concern to discrete matters with contained boundaries. Treaty or international agreement in relation to the matter under consideration speaks to its singularity and distinctiveness. Carbon pricing, according to the Court met the test of distinctiveness.

> [114] "GHGs are a distinct form of pollution, identified with precision in Schedule 3 to the Act. They have known and chemically distinct scientific characteristics. They combine in the atmosphere to become persistent and indivisible in their contribution to anthropogenic climate change. They have no concern for provincial or national

> boundaries. Emitted anywhere, they cause climate change everywhere, with potentially catastrophic effects on the natural environment and on all forms of life."

The law further met the test of indivisibility:

> "[120] The evidence establishes that a cooperative national carbon pricing system would be undermined by carbon "leakage" in jurisdictions that do not adopt appropriately stringent carbon pricing measures. This is the quintessential case in which the failure of a province to cooperate would undermine the actions of other provinces, and would place unfair burdens on other provinces, potentially subverting a cooperative national scheme."

Finally, the law was reconcilable with the fundamental distribution of legislative power under the Constitution.

Carbon Pricing not a valid federal tax but sufficiently connected to a valid federal regulatory scheme

With respect to the taxation question, the Court agreed with Ontario that the pricing scheme could not be justified under the federal tax authority. However, the Court went on to decide that the carbon pricing was sufficiently connected to the constitutionally valid regulatory scheme even though the charges might not be used to directly defray its costs.

> "[160] Contrary to Ontario's submissions, the fees levied under a regulatory scheme are not required to be cost recovery mechanisms...funds collected under the scheme may be used to alter behaviour.
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> [161] I would also reject Ontario's submission that revenue raised by a regulatory charge must be used to further the purposes of the regulatory scheme. There is no authority for that proposition and indeed there is appellate authority against it.
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> [162] Moreover, even if it is necessary to show that the revenues raised are used for the purposes of the Act, this has been established. The funds are returned to provinces, taxpayers and institutions to reward them for their participation in a program that benefits the provinces and the entire country. This promotes and rewards behaviour modification, encourages shifts to cleaner fuels, and fosters innovation, all of which are purposes identified in the Preamble of the Act.
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> [163] I conclude that the fuel charge and the excess emissions charge under the Act are constitutional regulatory charges.

Where do we go from here?

Interestingly, the reasons of the majority of the Court make no mention of the decision of the Saskatchewan Court of Appeal 2019 SKCA 40 which had arrived at the same conclusion in a challenge to the federal law by the Saskatchewan government.

There was a dissenting opinion which sets the stage for the final battle to be held in the Supreme Court of Canada in the coming year — the reach of federal power over the subject matter of environment, a matter which was not specifically contemplated in the original assignment of federal and provincial legislative responsibilities at the birth of Confederation. The dissenting judge amongst five, Mr. Justice Huscroft, makes reference to the Saskatchewan Court of Appeal decision but takes issue with the characterization of the federal law by the majorities in both the Ontario and Saskatchewan cases. He observes that the majority reasons in both cases conclude that the pith and substance of the federal law is establishing minimum national greenhouse gas emissions pricing standards to reduce greenhouse gas emissions. The flaw in this analysis according Huscroft J.A., is that it describes "the means or technique Parliament has chosen to give effect to the Act's ultimate purpose, rather than a characterization of the Act's dominant feature." (at par. 211) It leaves unanswered the key question...What is it exactly that the Act regulates?" (at par. 212)

> "(213) In my view, the Act should be characterized more simply: it regulates GHG emissions.
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> [227]...Given that GHGs are generated by virtually every activity regulated by provincial legislation, including manufacturing, farming, mining, as well as personal daily activities including home heating and cooling, hot water heating, driving, and so on, federal authority over GHG emissions would constitute a massive shift in lawmaking authority from provincial legislatures to the Parliament of Canada."
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> [230]...carbon pricing is only one approach to addressing GHG emissions — one of many policy options that might be chosen, whether alone or as part of a broader strategy. There are many ways to address climate change and the provinces have ample authority to pursue them, whether alone or in partnership with other provinces...Put another way, nothing stops the provinces from taking steps to reduce their GHG emissions, and hence the emissions of Canada as a whole, and they are in fact doing so."
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> [231] No doubt, action or inaction by one province could undermine the effectiveness of another province's efforts to establish carbon pricing, but this does not speak to provincial inability to address the GHG problem; it is, instead, a reflection of legitimate political disagreement on a matter of policy, and in particular the suitability of carbon pricing as a means of reducing GHG emissions in a particular province."

> [232]...Parliament cannot insist that its preferred means of dealing with a problem be implemented by the provinces when that means encroaches on provincial lawmaking authority."

The Supreme Court of Canada will likely have a third decision by the Alberta Court of Appeal by the time the matter is litigated before the 9 judges. The new Alberta Government has indicated it will launch its own challenge to the federal law shortly. Ontario's Huscroft J.A. dismissed the argument that federal carbon pricing laws were constitutionally valid as climate change constituted an emergency, another area of federal legislative jurisdiction. He wasn't prepared to take this argument seriously because it had been casually thrown in as an afterthought in the final sentence of the federal government's reply factum. (at par. 217) It will be interesting to see if the federal government seeks to develop this argument in the Alberta challenge.