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GOING GREEN
WILL IT CRIPPLE THE OIL & GAS INDUSTRY?

By John Kiemele

The Green Movement is in its infancy. No one has all the answers, but here's some solid information about carbon trading and what upcoming emissions standards will mean for industry.

In some ways, Going Green will create the perfect storm for a good many segments of Canadian business.

Canada's biggest trading partner, the U.S.A., is in the midst of an economic downturn, the Canadian dollar is the strongest it has been in 30 years, and speculators are driving up the price of oil despite the fact that there are no problems with ongoing crude supply or current U.S. inventory levels.

And to top it off, companies must get ready to Go Green.

This means new industry buzz terms like offsetting carbon emissions, carbon trading and capturing, buying and selling carbon credits, and, of course, lessening the carbon footprints of individuals and business is front and centre on many people's minds. But there is a lot of confusion about what it means to Go Green.

Most of the industrialized world is developing and examining new ways to reduce greenhouse gas emissions. But when it comes to promoting those methods to fight climate change, there is a lot of confusion. Carbon offsetting, or the act of mitigating or offsetting CO2 emissions, essentially allows business to produce carbon emissions in exchange for paying to reduce the equivalent amount of emissions. Global emissions trading began this year.

In March 2008, the Canadian government published details on its Regulatory Framework for Air Emissions. This new legislation is perhaps more crippling for industry than anyone realizes, and it is surprising how little attention is being paid to it as it's going to cost industry every year – this is not a one-shot deal.

Perhaps the reason for the apparent lack of attention is the fact that it's complicated. For the most part, the new details clarify some of the specific provisions of the earlier framework (April 2007), and the key requirements have remained substantially the same.

Who Is Affected?

Typically, companies affected will be industries such as iron ore pelletizing, potash, base metal smelting, chemicals, fertilizer, iron and steel, titanium, oilsands, petroleum refining, natural gas pipelines, upstream oil and gas, lime, pulp and paper, aluminum and alumina, cement and power, among others. As for how big you must be, it is still somewhat unclear. What is known is that there are minimum thresholds of 50,000 tonnes of emissions for chemical, nitrogen-based fertilizer and natural gas pipeline operations.

If you don't comply, it is unclear what may happen. We think you will be hit with a more excessive penalty, or be required to reduce by even further amounts in subsequent years.

For upstream oil and gas, the threshold is 3,000 tonnes per facility, which is a facility generating about 10,000 barrels per day of oil. Electricity generation plants start with a threshold of 10 MW of electricity generation. As for other applicable industries, we must wait and see what the next legislation dictates, and those players should certainly be lobbying the government in the meantime.

What Are the Proposed Targets?

- All existing facilities that fall under the legislative framework will have to cut their emissions by 18% from their 2006 levels by 2010, with 2% continuous improvement each year thereafter. This will supposedly end between 2020 and 2025, where the legislation to reduce intensity is expected to be replaced by legislation to implement hard emission caps.

- Any new facilities (2004 or later operation date) will be allowed a three-year commissioning period, followed by a 2% per year emission intensity reduction target based on a "cleaner fuel."

- The targets will be set at the facility, corporate or sector levels, depending on the sector.

- There will be minimum thresholds to avoid an excessive administrative burden.

- Fixed process emissions, such as processes that generate CO2 emission through methods other than combustion, will have a 0% target, indicating no action will be needed.

- There will be Carbon Capture Standards by 2018 for oilsands upgraders coming into operation in 2012 or later to limit the amount of CO2 emissions that can be pumped into the ground (i.e., into old gas wells).

What Are the Penalties/Costs?

As all existing carbon emitting industrial players will be required to reduce their emissions by 18% as of 2010 versus levels of emission in 2006, the penalty for non-compliance needs to be understood. The alternative to reducing emissions – a $15 per tonne charge on carbon emissions in excess of the threshold. That rises to $20/tonne by 2013. It is important to note, this penalty is not a "do nothing" fallback, as it can only be used for 70% of the regulatory obligation. Anything above that must be either offset with industry offset credits that you will purchase or be reduced through process changes that lower your carbon emissions.

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To put this into perspective, a facility using $1-million of natural gas per year will be consuming about 100,000 gigajoules of gas and emitting about 5,000 tonnes of CO2. To reduce that by 18%, facility owners will be looking at 900 tonnes of reduction in the first year, or face potential penalties and offset credit requirements that will cost at least $15,000 in the first year. That cost will then rise each year thereafter.

Therefore, companies unable to comply or reduce to the targeted levels will have to buy offsets to meet the proposed targets. The cost of offsets is thought to be at minimum $15 per tonne, and if the market is short of credits, the cost will obviously rise. For a larger consumer, such as a nitrogen fertilizer producer with 50,000 tonnes of emissions, a 9,000-tonne reduction will be necessary, costing at least $135,000 in offset credits.

How To Purchase an Offset Credit

Carbon offsets will be available from companies that have reduced emissions by more than the legislative requirements, and be obtained from various brokers. It is, however, not a fluid market and it will be essential that you know what the best offset prices are if you're in the market for offset credits. In any new market there will be parties out there waiting to prey upon captive consumers, so be wary. As part of our services we will be assisting our clients in obtaining the required offsets from the most reliable market players at the lowest available cost.

Some businesses may in fact have credit eligibility from projects undertaken and not even realize it, and may be losing potential offset credit sale revenue.

It may seem as though trading credits is just big business reallocating their pollution, but in fact, emissions credit trading will bring down the overall carbon emissions of the country. If you're not investing in methods to reduce emissions, then you'll be buying credits from those who already have, or from those who have exceeded their requirements. Overall, carbon emissions should decline.

Next Steps

So, what are affected businesses supposed to do to meet the standards?

The first thing to do is to find out if emission credits are needed, then make sure you are able to get the required credits at the absolute lowest price possible. Every business will have to decide whether investments in new technology to reduce emissions makes more sense for the long term than buying offset credits for the short term.

Our view is that manufacturing sectors will take the short--term approach because when times are tough, and the future seems uncertain, acceptable payback periods just keep getting reduced. There is not much of an incentive to spend thousands of dollars on emission reduction technology if your plant's future seems uncertain.

Going Green Good PR Even If Your Business Isn't Legislated To Do So

There will be many operations that voluntarily purchase offset credits to lessen their carbon footprints, either for public relations reasons or due to demands of their major customers. For example, if you are making a product that goes into the manufacture of a popular consumer good that manufacturer may wish to place a green emblem on their product. To do so, they well insist that your company play its part and reduce emissions, even if the legislation does not apply to you.

In these times of green popularity, consumers like to see environmentally friendly products, and carbon offset credits certainly provide a means of promoting the "greenness" of your product.

Final Legislation Expected This Fall

What's next? Draft regulations are expected in fall 2008 and the final regulations are expected in fall 2009. A word to the wise: be prepared and take the time to gather solid information. The perfect storm will pass over businesses that are prepared. □

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