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The Honourable Chrystia Freeland, MP
Deputy Prime Minister and Minister of Finance
Government of Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Re: Clean Electricity Investment Tax Credits

WaterPower Canada is Canada's national association representing the hydropower industry. We represent utilities, equipment manufacturers, constructors, consultants, and associated industry partners. We are pleased to have the opportunity to provide input on the Government of Canada's proposed Investment Tax Credits (ITCs) for clean electricity investment in Canada.

Overall, WaterPower Canada strongly supports the introduction of investment tax credits to encourage the growth of clean electricity. It is essential that the federal government support a meaningful portion of the costs associated with the rapid decarbonization of the grid and electrification of the broader economy, as these costs would otherwise be borne by utilities and passed along to consumers of electricity. Electricity must be kept affordable through this unprecedented electricity transition. ITCs could also help keep Canadian electricity and electricity intensive industry competitive as the US IRA implements a range of similar tax credits.

However, we are deeply concerned that the detailed design of these credits will severely limit their practical availability and are similarly concerned the necessary benefits highlighted above will not be realised. The end of 2034 time horizon, the timelines of the payments, and the numerous conditions tied to the ITCs significantly diminish ITC eligibility and hence limits their ability to encourage large-scale clean electricity options like hydropower and transmission developments.

These projects are further delayed by unduly protracted and complicated federal regulatory processes that remain unresolved.

Our detailed feedback is intended to provide solutions to these issues and to help ensure the implementation of Canada's new investment tax credits are as productive as possible. The comments are organized by subject, with reference to the 2023 Budget.

1. Commitment to Reduce Electricity Rates and to Achieve net-zero electricity sector by 2035.

> *In order to access the tax credit in each province and territory, other requirements will include a commitment by a competent authority that the federal funding will be used to lower electricity bills, and a commitment to achieve a net-zero electricity sector by 2035.*[1]

WaterPower Canada members are concerned these requirements may become obstacles resulting in uneven tax credit availability across the country. The requirement also seems redundant, given the recently released draft Clean Electricity Regulation (CER) will already require rapid progress towards net zero electricity systems.

We are concerned that a program intended to operate as an incentive to spur clean energy development will become bogged down in discussions related to "net zero commitments" and mechanics to implement rate reductions that will only serve to further delay the development of projects that are needed to help achieve Canada's stated net-zero aspirations.

We recommend that progress towards net-zero electricity grids in Canada be addressed through the CER and not as a hurdle in this incentive program.

Canadian electricity markets operate under several different structures, ranging from completely rate regulated integrated markets to deregulated ones, and the development of the competent authorities' roles and mandates in every province could become overly complicated or result in an uneven availability of credits across the country.

Given the urgency to provide clarity to industry, WaterPower Canada recommends the Government of Canada confirm eligibility criteria and mechanisms for industry as quickly as possible, and not delay introduction of the program until discussions about provincial net-zero commitments and uses for the ITCs are concluded.

2. Labour Requirements

WaterPower Canada has already provided detailed commitments on ITC Labour Requirements in correspondence dated September 8, 2023. These are attached to this letter for reference. Following are the key points from our submission:

1. Contractors and unions are parties to collective agreements, not owners, so a determination of prevailing wages will necessarily involve them. The prevailing wage determination can be made directly from the collective agreement; the determination should not require further attestation or follow-up with workers about compliance with the collective agreement.
2. Apprentice requirements are determined by contractors and unions, not owners. Many collective agreements have explicit language on apprentice targets, and the presence of those should determine compliance with the intent of the labour provision. As with wages, apprentice hiring is a matter between contractors and

[1] https://www.budget.canada.ca/2023/pdf/budget-2023-en.pdf, Chapter 3, Page 80.

unions, not owners. More specifically, workers are referred to a job by their union, so an owner/operator should not face sanctions because a union is unable to supply apprentices for a particular job.

3. Timing Issues

> *The Clean Electricity Investment Tax Credit would be available as of the day of Budget 2024 for projects that did not begin construction before the day of Budget 2023. The Clean Electricity Investment Tax Credit would not be available after 2034.*[2]

Large-scale projects have lengthy planning and permitting durations, and limitations in the duration of the credit and when the credit is paid will result in the potential credits offering little or no incentive to the largest projects with significant GHG reduction potential. This risk is heightened, given the complexity of current federal environmental assessment and permitting processes. While the Government of Canada has committed to streamline these processes, it appears unlikely that changes will occur fast enough to enable projects to meet an end of 2034 in-service date.

A program which requires construction to be started after May 2023 and which expires as of the end of 2034 is of little use to new hydro or transmission projects. While enhancements and life extension projects at existing hydro facilities could fit within this time window, it is very unlikely that new hydro or transmission projects could.

The Government of Canada must recognize that additional large-scale generation and transmission will be required to successfully integrate variable renewables in our electricity system to achieve our net zero aspirations. Additional firm capacity coupled with long-term storage (including pumped storage) and additional transmission capacity will be required to maintain reliable service to customers over periods of peak demand. The Government of Canada must seriously consider approaches that incent these large-scale investments. The terms and conditions associated with the ITCs do not achieve that goal.

Our expectation is that the most critical building period to meet the Clean Electricity Regulation, coal retirements and growing electrification loads will be between 2030 and 2045. Greater certainty for projects coming online after 2034 is needed to encourage their rapid development and to shelter electricity consumers from the associated costs.

The ITC design should also not penalize projects that incur schedule delays during the planning, approval, or project execution processes.

For capital intensive long lead-time projects like hydropower and large-scale transmission, completion by a challenging 2035 deadline is not a meaningful incentive, particularly when suboptimal federal environmental assessment and permitting processes are a significant part of the project timeline.

[2] https://www.budget.canada.ca/2023/pdf/budget-2023-en.pdf, page 79

The final ITC language should confirm that the expiry date of the ITC represents the deadline for incurring eligible costs, not the deadline for payout of the ITC.

Based on our understanding of the portions of the Income Tax Act generally referred to as the 2-year rolling start and long-term project election, if the ITC cannot be claimed after 2034 and the completion date of a project is beyond the end of 2034, then project costs incurred beyond 2032 would be ineligible for the ITC[3]. This would be inconsistent with the Budget statement that the ITC will be available until the end of 2034.

Given the risks inherent in large-scale projects and the need to expedite their construction, we recommend that any project that starts construction prior to the 2034 Clean Electricity ITC deadline be eligible for the ITC in subsequent years beyond 2034. At a minimum, we recommend the Government of Canada confirm that the ITC deadline represents the end date for applicable costs, not the deadline for payout of the ITC.

Significant costs must also be incurred by developers long before a project is approved for construction. We recommend that pre-project costs also be eligible in the year incurred. Pre-project costs include geological, engineering, environment, consultation and indigenous partnership development and regulatory activities.

If credits like the existing Canadian Renewable Conservation Expenses were available for non-taxable entities, this would kick-start project planning. Such an action would help put renewable development on a common footing and would provide cost offsets earlier in the project development process.

4. Definition of Large Hydro

Currently large hydro is undefined as a CCA class. As the components and (per unit of energy) environmental implications are very similar between large and small hydro projects, we recommend that Canada modify CCA class 43.1 to include large-scale hydro projects in a similar fashion to small scale hydro developments but with capacities of 50 MW or greater.

Another alternative would be to have one hydro definition with no distinction between large and small.

5. Transmission and Distribution

Under the proposed program, interprovincial transmission projects would be eligible for ITCs, while the budget committed the federal government to further discussions with provinces about intra-provincial transmission projects. We recommend these discussions be concluded without delay, as often generation projects require new or expanded transmission to deliver their power.

[3] Based on our understanding of the operation of Sections 13(27)(b) and 13(29) of *The Income Tax Act*, a proponent whose project is incomplete could claim the ITC for costs incurred two years earlier.

These generation-related transmission costs can make up a significant portion of the total generation project costs and should clearly be eligible for ITCs.

We also recommend the Government of Canada include transmission and distribution costs incurred to accommodate the growing and shifting loads associated with electrification. It is important that costs for enhanced and smarter transmission and distribution be included within the ITC framework.

6. Investments for Industrial Clean Generation

Given the need for additional clean generation to support industrial applications, including production of steel and aluminum and for mining of critical minerals, we recommend that ITCs be available for any generation and transmission project that supports industrial applications.

7. Investments in Existing Generation

While significant opportunities still exist for greenfield development, these opportunities will take years to develop given the currently regulatory framework. In the near term, however, there are significant opportunities for re-investment in and refurbishment of existing facilities to sustain or enhance generation levels.

Refurbishment should include all sustaining capital expenditures. Without incurring sustaining capital expenditures, hydroelectric generation facilities will not be able to continue to operate at their expected level.

WaterPower Canada's recent report on refurbishment and redevelopment[4] indicates that 2,000 to 5,000 MW of incremental generating capacity could be realized from the existing hydropower fleet through refurbishment, but that operators are delaying refurbishment for economic reasons. ITC availability will incent the development of this capacity.

Additional clean production by any grid connected operator – utility, private producer, or industrial – will reduce the need for fossil fuel fired generation. Electricity customers will benefit from this additional supply at a lower cost or development risk than equivalent greenfield projects.

We recommend that any refurbishment cost that is amortized over more than one year be eligible. The amortization of costs will distinguish between regular maintenance and plant reinvestment.

[4] https://waterpowercanada.ca/resources/hydropower-refurbishments-and-redevelopments-in-canada/

8. Partnerships

The overall ITC framework needs to be flexible recognizing that many types of partnerships between entities with differing tax status are used as project development vehicles.

For example, a project may have partners eligible for both the Clean Electricity ITC and the Clean Technology ITC. In this case, the partnership should be entitled to a combination of both ITC's based on the average proportionate interest of the taxable vs. tax-exempt status of the ultimate partner during the year in question.

It is particularly important to recognize and encourage the growing participation with Indigenous communities as partners in energy projects. The ITCs should be inclusive and available to all these types of partnerships.

We also recommend the federal government also consider extending the partnership concept to communities who may be affected by the closure of a fossil fuel operation or industrial process.

9. Treatment of Other Government Assistance

The government announced rules pertaining to the Clean Technology ITC on Aug 4 and the term "government assistance", and the proposed rules say that any federal or provincial support must be subtracted from the costs eligible for ITC treatment.

If the support is in the form of a non-repayable grant, we understand that the ITC should only be available on the net cost of the project because the grant permanently reduces the cost of the project. However, we do not believe this approach makes sense for a low-interest loan or loan-guarantees. Neither of these forms of support reduces the cost of a project unless the government of Canada is reducing the cost of the financing.

These forms of support can be critical for capital intensive and important to the economy projects.

Effectively, this provision reduces the eligible costs by the full approved loan amount regardless of the amount of loan used. The availability of loan funds should not be the determining factor for the ITC. We recommend the ITC eligibility only be reduced by the difference between the interest rate the proponent would have paid and the interest rate on the federal financing. Also, the value of the assistance should be by reference to the drawn amount of low-interest financing.

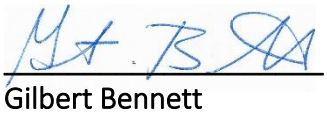
Given that many non-taxable utilities are provincially owned and may have provincial guaranteed financing, we recommend the ITCs focus only on federal loan support and not be limited by provincial funding support.

To summarize, WaterPower Canada's recommendations are:

1. Provide clarity to industry regarding ITC terms and conditions without delay. Negotiations with provinces can take place after terms and conditions are provided to industry.
2. Address Net-Zero industry progress through the Clean Electricity Regulations rather than as a commitment requirement for ITCs.
3. Confirm the basis for prevailing wage and apprentice participation determination is the applicable collective agreement.
4. Extend ITCs to all projects that start before December 31, 2034. This will provide maximum incentives for large-scale clean electricity projects with long development timeliness.
5. At a minimum confirm that ITCs will be available for all expenditures incurred before December 31, 2034, even if they are claimed in years following the deadline based on the operation of the *Income Tax Act*.
6. Provide a credit like the Canadian Renewable Conservation Expenses for non-taxable entities to address pre-project costs.
7. Provide a definition for large hydro (or hydro in general), mirroring the current definition for small hydro.
8. Conclude discussions with provinces to enable ITCs for intra-provincial transmission projects that deliver clean energy to consumers. Enable ITCs for transmission and distribution upgrades to support electrification.
9. Enable ITCs for industrial clean energy projects.
10. Ensure the ITC is available for sustaining capital expenditures for existing facilities.
11. Clarify that refurbishment and redevelopment projects, that are amortized by more than one year will be eligible for ITCs, thus differentiating maintenance and repairs from reinvestment.
12. Ensure that ITCs are available for the variety of partnership arrangements used by project developers, and particularly those than involve indigenous participation.
13. Ensure that ITCs and other forms of federal corporation can co-exist and ensure that ITC eligibility is not affected by provincial support.

We would be pleased to discuss these and related issues at your convenience.

Sincerely,



Gilbert Bennett
President

cc. The Honourable Jonathon Wilkinson, MP, Minister of Energy and Natural Resources