Canadian Environmental Law Association
EQUITY. JUSTICE. HEALTH.

# CELA Submission on Cap and Trade Regulation (EBR 012-6837)

*Prepared by:*
Jacqueline Wilson and Barbora Grochalova
April 8, 2016
CELA Publication Number: 1068
ISBN: 978-1-77189-774-7

**Canadian Environmental Law Association**
T 416-960-2284 • F 416-960-9392 • 55 University Avenue, Suite 1500 Toronto, Ontario M5J H7 • cela.ca

## A. Introduction

Please accept the Canadian Environmental Law Association's submission on the proposed Cap and Trade Regulation, EBR 012-6837.

Every decision regarding the design of the cap and trade program should reflect the urgency of greenhouse gas ("GHG") emissions reduction efforts. Instead, many of the design details contained in the draft Regulation skew market signals about the carbon dioxide equivalent ("$CO_2e$") intensity of products and will delay Ontario's transition to a decarbonized economy.

The proposed Ontario Regulation is complex and difficult to understand. There is little transparency around key government decisions on setting the cap or providing free allowances. The Ministry of the Environment and Climate Change ("MOECC") should publish a clear, plain-language guidance document that explains the rationale for each program design element.

## B. Setting the Cap

Ontario's long-term GHG emissions reduction policy is more likely to succeed if the 2020 cap is set below 2020 GHG emissions target levels, leaving room for error and adjustment. There is significant uncertainty about whether reductions achieved by this policy, and other initiatives, will allow Ontario to meet its GHG emissions reduction targets. Ontario should also set the cap below the 2020 target in order to account for the recent Framework Convention on Climate Change agreement to limit global climate change to 1.5°C.[1]

The 2017 cap is set at projected emissions levels for 2017.[2] Setting the cap at "business as usual" GHG levels is a failure to take action on climate change and delays the transition to a decarbonized economy.

The government should also disclose the basis for its decision on the number of emission allowances released each year.[3] The cap only accounts for participants meeting their compliance obligations by submitting emission allowances. Participants may also meet their obligations through offset credits up to eight percent of a participant's attributed GHG emissions[4], through early reduction credits[5], and eventually through emission allowances from other jurisdictions. Facilities emitting less than 25,000 tonnes of $CO_2e$ per year, non-capped sectors, and new facilities for the first two years of operations all fall outside the cap. On an ongoing basis, before the cap is set, the MOECC should publish the calculations and assumptions used to set the cap, and any assumptions should be verified and adjusted over time.

---

[1] *Adoption of the Paris Agreement: Proposal by the President*, UNFCCC, 12 December 2015, Draft decision /CP.21, FCCC/CP/2015/L.9/Rev.1, Annex, art 2(1)(a); see also Kevin Anderson and Alice Bows, *Beyond 'dangerous' climate change: emission scenarios for a new world*, Phil Trans R Soc A (2011) at 20-44

[2] Ontario Regulation proposed to be made under the Proposed *Climate Change Mitigation and Low-Carbon Economy Act, 2016*, ("Cap and Trade Regulation"), s 34

[3] Cap and Trade Regulation, s 34

[4] Cap and Trade Regulation, s 9(2)(1)(ii)

[5] Cap and Trade Regulation, s 9(2)(3), Appendix, A.4.1

**Recommendations**

**Recommendation 1: The 2017 cap should be set below the level of projected growth of GHG emissions in 2017. The level of the cap should reflect the urgency of action on climate change and account for uncertainty, uncapped sectors, and the international commitment to limit global climate change to 1.5°C.**

**Recommendation 2: On an ongoing basis, the MOECC should publish its assumptions and explain its decision on the number of emission allowances to be released each year.**

## C. Coverage of the Cap and Trade Program

### (1) Mandatory Participants

We support the decision to immediately include a significant portion of the economy in the cap and trade program.

Subsection 14(1) outlines which facilities are covered by the cap and trade program. The language in this subsection is obscure and difficult to understand because it is tied to several provisions of Ontario Regulation 452/09: Greenhouse Gas Emissions Reporting ("Reporting Regulation").[6] We understand subsection 14(1) to include facilities emitting over 25,000 tonnes of carbon dioxide equivalent ("$CO_2e$") per year from an activity listed in Table 2 of the Reporting Regulation, persons who import electricity, natural gas distributors, and petroleum product suppliers.[7] It would be much clearer to simply list categories of capped entities in subsection 14(1).[8]

Because of the decision regarding the point of regulation on electricity generation, we seek to ensure that all electricity generation that produces GHG emissions is in fact covered by the cap and trade program. CELA is opposed to exempting electricity from biomass from the cap and trade program. While burning biomass from certain sources may produce fewer GHG emissions as compared to conventional fuels, there is no justification for excluding the resulting carbon dioxide emissions from the cap and trade program.

Paragraph 3(4)(3) attributes zero emissions to participants when the participant is not required to have its GHG emissions report verified.[9] Section 26 of the Reporting Regulation exempts all participants from verifying their reports in 2017. 2017 reports under the Reporting Regulation cover 2016 emissions. It should be clarified that "any year" refers to the year when the emissions took place, not the reporting year.

[6] O. Reg. 452/09: Greenhouse Gas Emissions Reporting ("Reporting Regulation")
[7] Reporting Regulation, ss 5, 6, 7.6 and 26
[8] Cap and Trade Regulation, s 14(1)
[9] Cap and Trade Regulation, s 3(4)(3)

**Recommendations**

**Recommendation 3: Subsection 14(1) should be amended to list categories of facilities covered by the cap and trade program.**

**Recommendation 4: The MOECC should further clarify how all electricity generation will be covered by the cap and trade program. All electricity generation facilities emitting above 25,000 tonnes of $CO_2e$ per year, including biomass facilities, should be included.**

**Recommendation 5: "Any year" in paragraph 3(4)(3) should more clearly refer to the year when the emissions took place, not the reporting year, to ensure that all entities exempt from verifying their reports in 2017 under the Reporting Regulation are not deemed to have zero emissions in 2017.**

### (2) New Facilities

New facilities, including both facilities opening in Ontario for the first time in 2017 or later and existing facilities that meet the 25,000 tonnes of $CO_2e$ per year threshold for the first time in 2017 or later, should not be exempt from complying with the cap and trade program for two years.[10] The exemption is contrary to the government's statement that a key purpose of the Act is to "change the behavior of everyone across the Province, including spurring low-carbon innovation".[11] New facilities will be aware of the regulatory environment in Ontario and adjust their business plans accordingly. This transition period may also undermine Ontario's ability to meets its GHG emissions targets because two years of emissions will not be covered by the cap.

**Recommendation**

**Recommendation 6: New facilities should participate in the cap and trade program in the first year that they exceed the 25,000 tonnes of $CO_2e$ per year threshold.**

## D. Compliance Period

Section 2 provides that the compliance periods are January 1, 2017 – December 31, 2020 and each subsequent three year period.[12] Participants will submit their emission allowances and credits for the first time on November 1, 2021.[13]

CELA recommends that a partial true-up of 75% of annual compliance requirements be required each year. It is essential to track the progress of participants to ensure that Ontario is on track to meet its targets and to make any necessary adjustments before 2021.

[10] Cap and Trade Regulation, s 3(4)(1) and Appendix, A.2.8
[11] Bill 172, Climate Change Mitigation and Low-carbon Economy Act, 2016 ("Bill 172"), preamble
[12] Cap and Trade Regulation, s 2
[13] Cap and Trade Regulation, s 5

Regular true-ups would also help participants familiarize themselves with the program and reduces the risk of participants not complying with the program.

**Recommendation**

**Recommendation 7: Section 5 should be amended to require a partial true-up of 75% of each participant's compliance obligation per year, with the final true-up taking place at the end of the compliance period.**

## E. Free Allowances

CELA does not support the free allocation of emission allowances. The MOECC's proposal to make free allowances available to all industrial emitters bears no apparent relationship to leakage concerns and is better understood as a program-wide subsidy for industrial emitters. We renew our request for a clear, transparent explanation for why free allowances are being made available to all industrial emitters. All background studies or evidence relied upon for this decision should be disclosed.

The Appendix to the Regulation which explains the allocation of free allowances is very complex. It should be simplified and explained to the public in plain language.

A list of registrants and a summary of transactions will be posted every year. The MOECC should also disclose the number of free allowances provided to each participant every year. Public acceptance of the program requires transparency about these subsidies to industrial participants. There are no confidentiality concerns that arise, since each facility must already report GHG emissions per year.

The Regulation provides very limited information about how free allowances are to be allocated. The Minister must disclose:

1- The basis for its determination of which allocation method will be used for each mandatory and voluntary participant;

2- The basis for each fixed process emission benchmark and combustion emission benchmark in Table 1;

3- The basis for each calculation in Tables 2 and 3, including:

   a. How will the result of the calculation of historical emissions levels be used to determine the number of free allowances available to participants?

   b. What period will form the basis of the history-based allocation calculations? There are currently different historical periods being used for different entities, and other base periods have not yet been determined. The Minister's decision about which period will form the basis of the calculations should not allow a

participant to choose its highest emission levels and should be consistent for all participants;

c. The basis for the intensity unit calculation; and

4- The basis for each calculation under the direct allocation method in Table 4, including an explanation for how the result of the calculation will be used to determine the number of free allowances available to participants and why only some participants have a declining cap adjustment factor for combustion emissions.

CELA opposes both the history-based allocation method and the direct allocation method. History-based allocation rewards polluters by giving emitters with higher GHG emissions more free allowances. Direct allocation is not transparent.

All capped entities could be covered by the product output benchmark or energy use-based allocations. We note that only the product output benchmark and energy-use based allocations are generally available for new facilities.[14] The Minister should not consider facility-specific allocations for new facilities.[15]

The assistance factor should not be set at 1 throughout the first compliance period. If the Minister is going to provide free allowances, the proportion of allowances as compared to emissions levels should decline every year and should vary depending on actual, proven leakage risk for emitters, if any.

The cap adjustment factor for fixed process emissions in Table 5 should decline at the same rate as the cap adjustment factor for combustion emissions. The transition to a decarbonized economy is undermined by the cap adjustment factor for fixed process emissions remaining at 1 throughout the first compliance period. The government should also disclose the breakdown between fixed process emissions and combustion emissions under the cap.

Section 12 should be amended to make it mandatory for the Minister to refuse to provide free allowances to any participant who has a continuing shortfall pursuant to subsection 14(8) of Bill 172.

**Recommendations**

**Recommendation 8: The MOECC should justify its decision to make free allowances available to all industrial emitters. All background studies and evidence relied upon to make this decision should be disclosed.**

**Recommendation 9: The MOECC should disclose the number of free allowances provided to each participant every year.**

[14] Cap and Trade Regulation, Appendix, A.2.8
[15] Cap and Trade Regulation, Appendix, A.2.8

**Recommendation 10: The Minister should provide the basis for its determination of which allocation method applies to each participant and the basis for all of its decisions and calculations under each allocation method.**

**Recommendation 11: The MOECC should only use the product output benchmark and the energy-use based allocation methods.**

**Recommendation 12: The assistance factor should decline each year.**

**Recommendation 13: The cap adjustment factor for fixed process emissions should decline at the same rate as the cap adjustment factor for combustion emissions.**

**Recommendation 14: Section 12 should be amended to make it mandatory for the Minister to refuse to provide free allowances to any participant who has a continuing shortfall pursuant to subsection 14(8) of Bill 172.**

### (1) New Facilities

New facilities should not be eligible for free allowances.[16] The allocation of free allowances would not address leakage concerns, or provide transition assistance, and is clearly unjustified.[17]

**Recommendation**

**Recommendation 15: New facilities should not be eligible for free allowances.**

### (2) Voluntary Participants

Voluntary participants should not be eligible for free allowances.[18] The Ministry has not provided any justification for their availability. Eligibility for free allowances should not be an incentive to participate in the cap and trade program. There is a risk that voluntary participants will apply for registration in order to reduce their carbon costs through free allowances.

Paragraph 3(4)(2) provides that zero emissions are attributed to a voluntary participant in its first year registered under the Act.[19] However, there is no corresponding delay for the allocation of free allowances to voluntary participants.[20] It therefore appears possible for zero emissions to be attributed to a voluntary participant, but for the same participant to be provided with free allowances.

[16] Cap and Trade Regulation, Appendix, A.2.8
[17] Cap and Trade Regulation, Appendix to the Draft Cap and Trade Regulation
[18] Cap and Trade Regulation, Appendix, A.2.7
[19] Cap and Trade Regulation, s 3(4)(2)
[20] Cap and Trade Regulation, Appendix, A.2.7

As well, we note that the MOECC has suggested a future amendment to the Reporting Regulation to require voluntary participants to report and verify their emissions. Further clarity on this proposed amendment, and all amendments listed under A.5, is essential.

**Recommendation**

**Recommendation 16: Voluntary participants should not be eligible for free allowances. Paragraph 3(4)(2) should be removed. Voluntary participants should be attributed an emission amount according to verified reports of their actual emissions, which are required under subsection 15(1).**

### (3) Early Reduction Credits

It appears possible for participants to benefit from both Early Reduction Credits ("ERCs") and free allowances for the same GHG emissions reduction. The ERC calculation sets a "reference period" of 2009-2011 and a "reduction period" of 2012-2015. To the extent that any free allowance allocation method, particularly history-based allocation or direct allocation, is determined based on historical emissions during the reference period of 2009-2011, the facility may benefit twice for the same reduction by being awarded ERCs for reductions made by 2012-2015, and by being awarded more free allowances based on its higher emissions in 2009-2011. Such double-counting is unacceptable.

**Recommendation**

**Recommendation 17: Early reduction credits and free allowances should not be available for the same GHG emission reduction.**

## F. Penalties

We understand section 13 to calculate the dollar amount owed to the Minister under subsection 14(8) of Bill 172 for a continuing shortfall, which includes a calculation of an amount of allowances equal to three times the shortfall.[21] The value for B should not be the lowest bid price accepted, but instead should be the median price accepted for Auction Class 1 emission allowances at the most recent auction.

**Recommendation**

**Recommendation 18: Section 13, Value B should be the median price accepted for Auction Class 1 emission allowances at the most recent auction.**

[21] Cap and Trade Regulation, s 13, Bill 172, ss 14(7) and (8)

## G. Summary of Recommendations

**Recommendation 1: The 2017 cap should be set below the level of projected growth of GHG emissions in 2017. The level of the cap should reflect the urgency of action on climate change and account for uncertainty, uncapped sectors, and the international commitment to limit global climate change to 1.5°C.**

**Recommendation 2: On an ongoing basis, the MOECC should publish its assumptions and explain its decision on the number of emission allowances to be released each year.**

**Recommendation 3: Subsection 14(1) should be amended to list categories of facilities covered by the cap and trade program.**

**Recommendation 4: The MOECC should further clarify how all electricity generation will be covered by the cap and trade program. All electricity generation facilities emitting above 25,000 tonnes of $CO_2e$ per year, including biomass facilities, should be included.**

**Recommendation 5: "Any year" in paragraph 3(4)(3) should more clearly refer to the year when the emissions took place, not the reporting year, to ensure that all entities exempt from verifying their reports in 2017 under the Reporting Regulation are not deemed to have zero emissions in 2017.**

**Recommendation 6: New facilities should participate in the cap and trade program in the first year that they exceed the 25,000 tonnes of $CO_2e$ per year threshold.**

**Recommendation 7: Section 5 should be amended to require a partial true-up of 75% of each participant's compliance obligation per year, with the final true-up taking place at the end of the compliance period.**

**Recommendation 8: The MOECC should justify its decision to make free allowances available to all industrial emitters. All background studies and evidence relied upon to make this decision should be disclosed.**

**Recommendation 9: The MOECC should disclose the number of free allowances provided to each participant every year.**

**Recommendation 10: The Minister should provide the basis for its determination of which allocation method applies to each participant and the basis for all of its decisions and calculations under each allocation method.**

**Recommendation 11: The MOECC should only use the product output benchmark and the energy-use based allocation methods.**

**Recommendation 12: The assistance factor should decline each year.**

**Recommendation 13: The cap adjustment factor for fixed process emissions should decline at the same rate as the cap adjustment factor for combustion emissions.**

**Recommendation 14: Section 12 should be amended to make it mandatory for the Minister to refuse to provide free allowances to any participant who has a continuing shortfall pursuant to subsection 14(8) of Bill 172.**

**Recommendation 15: New facilities should not be eligible for free allowances.**

**Recommendation 16: Voluntary participants should not be eligible for free allowances. Paragraph 3(4)(2) should be removed. Voluntary participants should be attributed an emission amount according to verified reports of their actual emissions, which are required under subsection 15(1).**

**Recommendation 17: Early reduction credits and free allowances should not be available for the same GHG emission reduction.**

**Recommendation 18: Section 13, Value B should be the median price accepted for Auction Class 1 emission allowances at the most recent auction.**

**Recommendation 19: This Regulation is very complex and difficult to understand. The MOECC should publish a clear guidance document that explains the rationale for each program design element.**